Building China into a Financial Powerhouse and the Role of Hong Kong

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Abstract: *Recently, the China Finance 40 Forum (CF40) held a luncheon on the theme of Building China into a Financial Powerhouse and the Role of Hong Kong. Laura Cha, Academic Advisor for CF40 and then Chair of the Hong Kong Stock Exchange, stated that Hong Kong would fully leverage its advantages as a financial sector and contribute significantly to China's financial development by focusing on core financial elements that are essential for building a financial powerhouse.*

Stephen Roach, a senior fellow at the Yale Law School Paul Tsai China Center, expressed his deep concerns about Hong Kong's future development. He noted that Hong Kong's rise had significantly benefited from the mainland's economic miracle. However, facing the economic transformation of the Chinese mainland and geopolitical pressures, Hong Kong's development prospects are encountering unprecedented uncertainty, suggesting that Hong Kong's golden age may be a thing of the past. Mrs. Cha agreed with some of Mr. Roach's views but did not believe that Hong Kong's prosperity was about to end. The factors that made Hong Kong a premier international financial center have not changed, and Hong Kong's strengths and resilience remain intact, offering a promising development outlook.

The attendees proposed policies for consolidating and enhancing Hong Kong's position as an international financial center: First, Hong Kong should continue to maintain its international features and play its role as a global hub. Second, Hong Kong should actively develop wealth management and asset management services. Third, Hong Kong could also support mainland's business and talents for their development abroad. Fourth, Hong Kong should implement various measures to enhance capital market efficiency and address liquidity issues.

I. Hong Kong's Role in Assisting China to Grow into a Financial Powerhouse

The Central Financial Work Conference 2023 set an ambitious goal of accelerating the building of China into a financial powerhouse, based on a robust economic foundation and a series of core financial elements, including a strong currency, a strong central bank, robust financial institutions, a major international financial center, effective financial regulation, and a talented financial workforce. Laura Cha highlighted that Hong Kong would fully capitalize on its financial advantages to assist in the nation's financial development.

As a critical offshore Renminbi (RMB) center, Hong Kong plays a vital role in the RMB's internationalization by continually enriching RMB-related products to meet the diverse investment needs of international investors. This year marks the tenth anniversary of the Shanghai-Hong Kong Stock Connect, which has progressively included ETFs and bonds in addition to stocks, enhancing inter-connectivity between Mainland and Hong Kong markets. This trading model helps to increase the scale of RMB cross-border settlements and is highly secure, ensuring capital controls to prevent capital outflow risks.

II. Hong Kong's Challenges and Opportunities

Roach expressed profound concerns about the future development of Hong Kong. He noted that Hong Kong's rise was greatly aided by the economic growth miracle of mainland China. However, amid the economic transformation in the Chinese mainland and geopolitical pressures, Hong Kong is facing unprecedented uncertainties, and its golden age may never return. From 1980 to 2011, the average GDP growth rates of the mainland and Hong Kong were respectively 10.0% and 5.1%. However, from 2012 to 2023, these figures dropped to 6.3% and 1.4%, declining by 3.7 and 3.8 percentage points respectively. Forecasts from the International Monetary Fund (IMF) show that China's average GDP growth rate will further decrease to 3.8% over the next five years. Given the close ties between the Chinese mainland and Hong Kong, it is difficult for Hong Kong to achieve sustainable economic recovery without external stimuli.

On the other hand, as the competition between the US and China escalates, geopolitical pressures are posing threats to Hong Kong's long-term development. The US is pressuring Asian allies to choose sides between the US and China, which could damage Hong Kong's normal economic and trade relations with these countries, with foreign trade being a crucial pillar of Hong Kong's economy. Additionally, such risks could also weaken international investors' confidence in Hong Kong's market, leading to capital outflows and the loss of international talent. Compared to challenges faced in the past, the current situation is more severe.

Mrs. Cha agreed with some of Roach's views, stating that Hong Kong's prosperity heavily depends on the mainland’s economic growth, and it is currently being tested by geopolitical tensions. However, she did not believe that Hong Kong's prosperity was about to end. The factors that made Hong Kong a distinguished international financial center—robust rule of law, clean government, efficient tax system, regulations and rules that meet international standards, and well-established financial infrastructure—remain unchanged. Despite becoming a victim in Western narratives after the 2019 extradition bill controversy, Hong Kong's strengths and resilience has remained intact, with promising development prospects.

From the perspective of the mainland economy, although it is facing challenges such as downward pressure on the real estate market, local government debt risks, insufficient demand, and a slowing growth rate of the working-age population, the fundamentals supporting medium-high growth in the economy are still stable. As the economy shifts towards high-quality development, emerging industries such as new energy vehicles, artificial intelligence, and bio-medicine have become new drivers of economic growth, and Hong Kong is poised to seize new opportunities in science and innovation to foster economic recovery.

From an international and local political perspective, although Hong Kong cannot change the external environment, it can boost international investors' confidence within its capabilities. Mrs. Cha mentioned that this requires the wisdom of local decision-makers and the joint efforts of all sectors. The Hong Kong government should continue to promote Hong Kong's story abroad, dispel misconceptions from Western countries about Hong Kong and its political system as much as possible, and take actions to maintain Hong Kong's status as an international financial center.

III. Policy Recommendations for Enhancing Hong Kong's Status as an International Financial Center

First, Hong Kong should continue to maintain its international features and play a pivotal role as a global hub. Historically, Hong Kong has risen and developed relying on the economic growth of the Chinese mainland, a unique advantage granted by its strategy of "backed by the motherland, connected to the world." However, given the current international situation and challenges, while maintaining close economic ties with the mainland, Hong Kong should also actively expand its connections with other regions of the world, seeking new growth points and partners. Mrs. Cha expressed that the more international Hong Kong becomes, the more valuable it is to the country. Hong Kong should strengthen exchanges and cooperation with regions such as Southeast Asia and the Middle East, especially the latter, which holds potential investors and sources of capital crucial for Hong Kong's capital markets. Furthermore, Hong Kong should expand international agreements and deepen institutional cooperation in financial regulation, international taxation, and other areas to further enhance its international attractiveness and competitiveness.

Second, Hong Kong should actively develop its wealth and asset management businesses. Several participants noted that Hong Kong has played a significant role in attracting foreign investment in the past, and with the growing scale of wealth and heightened awareness of wealth management among mainland residents, Hong Kong has tremendous potential to connect the mainland with international markets in wealth and asset management. It was suggested that the "cross-border wealth management connect" between the mainland and Hong Kong should be further expanded to introduce more financial tools and investment channels, facilitating more diversified asset allocation for residents of both areas and bringing more development opportunities to the industry.

Third, Hong Kong can also help the overseas development of mainland businesses and talent. Experts predict that, given the current geopolitical situation, China's future Gross National Product (GNP) and Gross Domestic Product (GDP) may diverge significantly, mainly reflected by the rapid growth in China's foreign direct investment and accelerated "going global" of businesses, with domestic talents also turning to overseas markets for employment. In response to this trend, Hong Kong's role should not be limited to connecting the mainland market but should also expand its service range to support overseas enterprises and talents. Hong Kong should seize this opportunity to reposition itself, closely linking its economic development with China's GNP growth and exploring new avenues for growth.

Fourth, Hong Kong should take various measures to improve the efficiency of the capital market and address issues of insufficient liquidity. Mrs. Cha mentioned that, facing a sluggish market, Hong Kong is making efforts to improve market efficiency by shortening the IPO settlement cycle, adding listing channels for tech companies, and simplifying listing process. Additionally, to address liquidity issues, the stamp duty on Hong Kong stocks is recommended to be reduced to 0.1%. However, in simplifying the listing process, Hong Kong faces the challenge of balancing the interests of large and small enterprises, and the Hong Kong Securities and Futures Commission is cautious about this, fearing that simplifying procedures may lower listing standards.

Furthermore, Hong Kong's stock transaction tax rate is significantly higher than that of major global markets, severely affecting the attractiveness of the Hong Kong market. Therefore, Hong Kong should continue to seek innovative solutions to optimize market efficiency and solve liquidity issues.