

## Norman T L Chan: Hong Kong's role in China's reform and opening

Speech by Mr Norman T L Chan, Chief Executive of Hong Kong Monetary Authority, at the 4th Annual China Bankers Forum 2010: "Global banking – restructuring and reform", Shanghai, 17 September 2010.

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I am very pleased to be invited to attend the Annual China Bankers Forum 2010 today.

The concepts of economic globalisation and financial globalisation have been around for decades. Yet, without the reform and opening up of China in the last 30 years and the rapid development of China's economy which forms a major part of the global economy, globalisation would merely be a concept without important implications. Nowadays, the scale of the economy of China has exceeded US\$5 trillion and China has surpassed Japan as the world's second largest economy. However, when the reform and opening up policies were initiated in 1979, how many of us could ever forecast that China would be able to develop from a poor country to its current state? In 1979, the GDP of China was US\$260 billion, with per-capita income of US\$270; many of the daily consumables were in significant shortage and had to be allocated by the rationing system. At present, per-capita income of China is US\$3,700, which is 14 times the level in 1979; and per-capita income in large cities, such as Shanghai, Shenzhen and Beijing, even reaches as high as US\$10,000. China can now be regarded as having entered a "moderately affluent" stage.

Some said that the development in the last three decades was a miracle and was almost incredible. Instead, I would describe it as a "world-shaking" development. Having encountered enormous difficulties and challenges at every single stage of reform and opening up, China, as the country with largest population in the world, managed to carry out an unprecedented transformation from a planned economy to a market economy. As there was no precedent to learn from, China could only rely on its own efforts and took one step at a time.

Hong Kong has played an extremely important and irreplaceable role during the process of China's reform and opening up. At the initial stage of opening up, China focused on attracting foreign investors to set up manufacturing factories. Hong Kong manufacturers were the first to move their operations to Mainland China. In the past 30 years, Hong Kong has always been the largest source of direct investment in the Mainland. In 2009, Hong Kong invested US\$46 billion in China, accounting for one half of the total foreign investment in the country. In the course of investing in China, not only has Hong Kong injected capital but, more importantly, it has introduced skills in production and management. In the past decade, the Mainland projects in which Hong Kong invested have gone through some significant changes. The focus has been shifted from investment in the manufacturing industry to a range of diversified and multi-dimensional investments that include investment in all kinds of service industries. With regard to trades, Hong Kong continues to serve as the major channel for the rest of the world to access Mainland China. Notwithstanding the decrease in the proportion of China's exports of goods going through Hong Kong, our role as the intermediate hub for trading has never been diminished. Nowadays, the offshore trade conducted through Hong Kong and the re-export trade of Hong Kong still accounts for 30% of China's total trade volume.

And what kind of role has Hong Kong been playing in the reform and modernisation of the banking system in China? Can you recall the difficult times in the 1990s? In 1994, China implemented the significant reform of the exchange rate system and introduced the unification of the official and swap exchange rates. At the same time, transformation of state-owned banks into commercial banks started. Due to various reasons related to the history and the system of Mainland banks, the bad debt ratio of the banking system was very high. The International Monetary Fund once estimated that the total bad debt in China's banking

system reached RMB2.3 trillion, accounting for 23% of the total loans of the banking system and 19% of the GDP. At that time, many people were not optimistic about the prospect of China because they thought the reform of the banking system would unlikely be able to succeed. If the reform failed, not only would economic growth slow down, the entire system of reform and opening up may also collapse. Nonetheless, China managed to stand firm and implemented the system reform step by step. The critical stages of the reform included the transformation of the top four state-owned banks into joint-stock commercial banks and the subsequent listing of these banks to raise and replenish capital and to elevate the reform of governance, accountability, risk management, staff employment and transparency of the banks to a new height. It was not at all easy to overcome such a hurdle. In 2005 and 2006, the Bank of China, the China Construction Bank and the Industrial and Commercial Bank of China were successfully listed in Hong Kong, raising a total share capital of US\$36 billion. During this period, the stock markets in the Mainland witnessed a relatively difficult time. The listing of domestic enterprises was subject to more restrictions. And at this critical moment, Hong Kong fulfilled this historical mission for our nation by playing an irreplaceable role in and making significant contribution to the reform of the banking system in China. We can imagine that, should the listing of the Bank of China, the China Construction Bank and the Industrial and Commercial Bank of China be delayed, no one knows to what extent would the progress of the reform of China's banking system be affected with the outbreak of the global economic crisis in 2008. In July this year, the Agricultural Bank of China was also successfully listed in Shanghai and Hong Kong simultaneously. Although the market sentiment had turned cautious, the Agricultural Bank successfully raised US\$12 billion in Hong Kong. The total proceeds raised from the offering of its A and H shares exceeded those of the Industrial and Commercial Bank of China, making it the world's largest IPO. In the past 20 years, the Hong Kong stock market has raised over US\$300 billion for enterprises on the Mainland.

The reform and modernisation of the financial system in China is an important cornerstone for the continuous, rapid and stable economic development of our nation. The reform of the financial system involves the gradual relaxation of restrictions on capital accounts, the gradual move towards free convertibility of RMB and the adoption of the same practices by the Mainland and international capital markets. However, moving too fast or moving in the wrong direction in the course of reform may bring high risk and great damage to China. Therefore, China has to implement the reform gradually and take one step at a time. In the future reform of the financial system of China, Hong Kong will shoulder important missions in a number of aspects.

First, Hong Kong banks that establish branches in the Mainland and invest in the financial institutions in the Mainland will not only bring in capital but also transfer the advanced management skills and experience of Hong Kong, which are conducive to enhancing the awareness and standard of governance and risk management of banks in China. In addition, Hong Kong will contribute to the improvement of the regulatory standard of Mainland financial institutions through regulatory co-operation, technological exchanges and staff visits between the regulatory bodies in Hong Kong and on the Mainland.

Secondly, with the expansion and diversification of international trade and investment activities in China, Mainland financial institutions (particularly banks) have to expand and engage in cross-border and overseas businesses. However, banks on the Mainland have to be cautious when "going global" because the operating environment, legal and regulatory requirements and staff employment system of the Mainland market are very much different from those of the overseas markets. Therefore, Hong Kong acts as a suitable "window" or "springboard". Many Mainland banks, such as the Bank of China, have a long history in Hong Kong and have accumulated much operating experience. These banks are generally trusted and welcomed by the Hong Kong people due to their pragmatic ways of doing business. In 1996, the total asset of Mainland banks in Hong Kong was HK\$870 billion, accounting for 11% of the total assets of banks in Hong Kong. In 2009, the total asset of Mainland banks in

Hong Kong increased to HK\$2 trillion, accounting for 19% of the total assets of banks in Hong Kong. More and more Mainland banks plan to expand their business or establish their branches in Hong Kong as they recognise that there is no other place like Hong Kong that offers a suitable and world-class operating, regulatory, legal and professional environment and serves as the springboard and bridge for Mainland banks and financial institutions to “go global”. This is also why the majority of overseas direct investment from China is made through Hong Kong. In the past decade, overseas direct investment from China has been on the rise and reached US\$56 billion in 2008, of which 70% was invested in Hong Kong or in other countries through Hong Kong.

Thirdly, Hong Kong may play a role in promoting RMB as an international currency as well as in promoting the circulation of RMB outside the Mainland. Since there have been many discussions and coverage of this topic recently, I am not going to elaborate here. Nevertheless I would like to emphasise that Hong Kong is an international financial centre and with the implementation of the “one country two system” policy, Hong Kong is closely linked to the Mainland in history, culture, and the flow of people, goods, capital and information, distinguishing us from all other places outside China. Hong Kong also enjoys the advantage of being a “first mover”. We began to develop personal RMB business in 2004 and started to develop RMB bond market in 2007. During this period, Hong Kong has established a highly efficient and secure RMB settlement platform and payment system. It explains why the offshore RMB business in Hong Kong has grown by leaps and bounds within just a year after the introduction of the cross-border RMB trade settlement in July last year. RMB services for all types of enterprises as well as personal financial and wealth management RMB products, including insurances, investment products and funds, have been launched one after another and have been welcomed by the public and investors. Hong Kong can play a part in expanding and deepening RMB offshore business by serving as the “window”, “testing ground” and “firewall” for RMB’s internationalisation and make important contribution to the gradual relaxation of restrictions on capital accounts in China and the gradual move towards free convertibility of RMB.

I would like to emphasise that China has made remarkable achievements with its reform and opening up in the past 30 years and Hong Kong has made major and irreplaceable contributions in numerous aspects in the process. After we have reviewed the past, we will have to look forward to the future. I believe that under the principle of “one country two system”, Hong Kong will continue to contribute to the continuous development of China, the modernisation of its financial system, and its linking to the international markets, helping to develop China as a fully “moderately affluent” community.

Thank you very much.