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The Development of Hong Kong Finance

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ABSTRACT. *This report demonstrates the shifting trend and the innovation of Hong Kong industry structure, compares the institutional differences between Chinese mainland and Hong Kong, and analyzes the reason why those differences in financing management exist as well as why Hong Kong's deposit interest rate is 0.*

KEYWORDS: *Development, Hong kong, Finance*

1. Introduction

Hong Kong, as a global city, has been enjoying the freest economy system in the world ever since 1995, which contains a low rate of mandatory taxation, and less strict legal restrictions. Besides, economic activities have made Hong Kong Port the fifth biggest port worldwide (2015), with a cargo volume of 256.6 million tons. And what's more, tourist industry and entertainment industry also promote the development of Hong Kong economy at the same time. However, recently because of the outbreak of COVID-19 and the violence in Hong Kong, its economy has gradually declined. Many believe that it will be eventually marginalized and replaced by mainland cities, losing its status as an international financial center. From fishing to manufacturing center, and to service industry, nowadays Hong Kong's industry structure is very different from Chinese mainland's, where people prefer short-term financing, for example financial instruments like Yu'E Bao, which can bring them stable and considerable returns. While Hong Kong, on the contrary, has no short-term financing products.

2. Ongoing Violence and the Outbreak of Covid-19 Cast a Shadow over Hong Kong Economy

Characterized by free trade, low tax rates and less government intervention, Hong Kong ranks eighth among exporters in the global trading economy. The export trade plays an important role in Hong Kong's trade and economic system. There are more than 100,000 import and export businesses in Hong Kong, and its product trade, offshore trade and carrying trade are well developed, making Hong Kong the main service center for the import and export trade of the goods from Chinese mainland. In addition, Hong Kong is also one of the world's major financial centers. It is one of the most open investment markets in the world and a major fund management center in Asia. International investors can invest freely in debt

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instruments issued in Hong Kong, or choose collective investment. Internationalization, diversified development, high flow of capital and information and transparent legal system are the main reasons why Hong Kong can attract foreign investment.

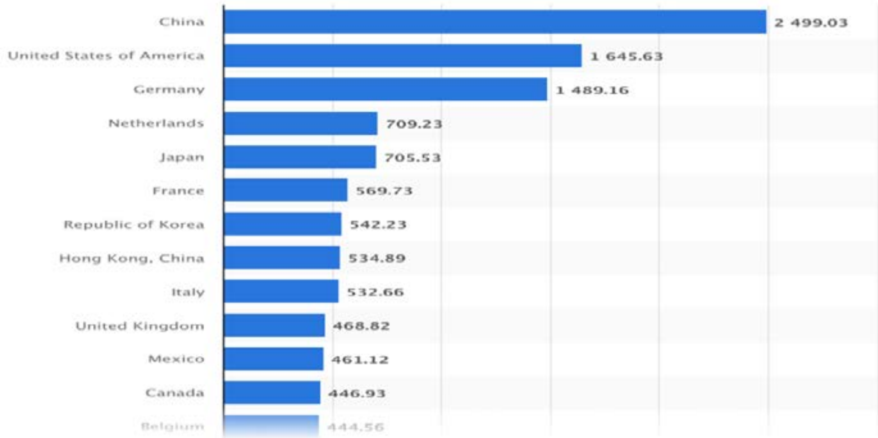

Fig.1 Top 20 Export Sovereign States and Territories in 2019 (in Billion U.s Dollars)

The ongoing local violence and outbreak of COVID-19 have impeded investment and people’s consumption, leading to a wave of failures in Hong Kong’s economy. Hong Kong’s GDP fell more than 8% in the first quarter from the previous quarter, a drop record since statistics began in 1968. On May 28th, 2020, the National Security Law was voted by majority at the third session of the 13th National People’s Congress, which safeguarded China’s sovereignty, security and development interests. If Hong Kong society remains unstable, it will be difficult for it to get developed in the future. In view of the incidents of violence, the outbreak of COVID-19, and the implement of the National Security Law, the foreign investors believe that many uncertainties have occurred in Hong Kong. At present, many enterprises keep their money in Singapore.

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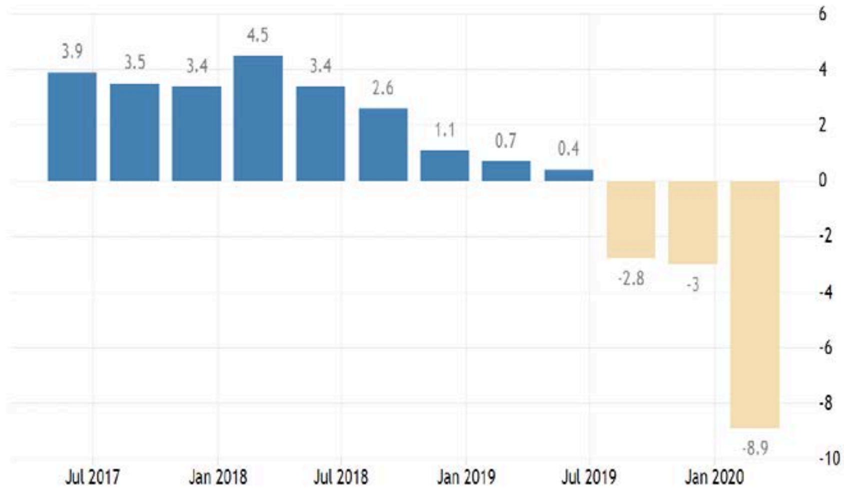

Fig.2 Hong Kong Gdp Annual Growth Rate

The volatility index(VIX), which for a time reached a record high, has now fallen back to about 30. It rose to 82.69 in mid-March, a new high since listing, which means everyone was panicking. While when VIX fell from 82.69 to nearly 30, market sentiment began to cool, although it didn't fully recover. To break even, to maintain liquidity and debt-paying ability are the most important things for every enterprise. As for the real economy, in the midst of ups and downs, many traditional or inflexible industries will be eliminated.

Fig.3 Hong Kong VIX Index

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The debt and credit crises have not yet fully erupted, while the market panic reaches an all-time high level. As long as the real economy is still under influence, measures like closures will last longer and longer, causing more unemployment. In long-term capital investment, now actually many hedge funds are using the same quantitative model to operate. The epidemic is, in fact, a catalyst, and when the catalyst reacts, people start using the same model, and you can see them selling stocks because of higher volatility. When all the people do it together, the market volatility will be increased. And then there will be panic selling in stock market, bond market, and even oil market. Although the current stock market dose not fully reflect all factors, the risks are getting higher and higher whether in China or elsewhere. One of the reasons is that the US and the EU issued quantitative easing policy in 2008, and Japan even earlier. China once provided the market with working capital up to 40 billion Yuan, while this money could not flow into real economy, especially those small and medium-sized enterprises, who couldn't benefit from the money at all. A large amount of money was used to purchase ready-made assets in advancing real estate market and stock market, but the bank rate was nearly 0. Many investors originally planned to deposit in the bank, while at last they turned to some risky bonds with high returns because of bank's low interest rates. In consequence, in the market, including American market, over half of the bonds are in the edge of becoming so-called "junk bonds", which means these bonds are more likely to fail. Under the impact of the epidemic, many companies with low credit ratings find it even harder to borrow money, and the situation is more serious than in the 2008 financial crisis: they are more likely to go into liquidation. This is something the whole world is worried about, and now the US has launched a new quantitative easing policy of unlimited quantity, which will make the leverage more and more powerful, and the crisis will be constantly expanding.

Find opportunities in the crisis, seize them to see new market advantages, and face crisis with global strength. The government of Hong Kong special administrative region again announced preferential policies for small and medium-sized enterprises to provide them with greater financing support and help them cope with economic downturn. This is a kind of strategic changes, namely transformation and upgrading Hong Kong and even the whole world is facing. The small and medium-sized enterprises have a trait of flexibility, especially when they just start up a business, they don't have high overhead expenses. Those companies have never seen so much government support and such a cheap funding. From export credits to BUD special fund for marketing, and even to transformation and upgrading to promote funds in other markets, the government set up over 40 different projects to patronize them. Cash flow is very essential for an investor, which can help to solve living expenses; as for investment, diversification is the most correct choice. Even though the epidemic has hit many traditional industries, including catering and retail, smaller companies have avoided person-to-person contact through e-commerce, electronic technology and electronic payments, and have instead taken advantage of the new environment to start businesses.

3. Hong Kong and Chinese Mainland Are Strongly Associated

The financial status of Hong Kong won't be replaced in a short time. First, it's because Chinese mainland will not fully open its capital market. And known as a world entrepot trade port, Hong Kong has its independent tariff. Second, thanks to the Hong Kong Relations Act signed between Hong Kong and the US, the Hong Kong dollar is freely convertible with the US dollar, while the US has restrictions on its exports to China. Besides, Hong Kong allows borrowers to select their own currency, with simple procedures and low taxes. All these above are very attractive to investors. Last but not least, as a financial center, Hong Kong is bound to appeal to people from all over the world, and its English environment is a significant factor as well.

Shenzhen will build a demonstration zone of socialism with Chinese characteristics, which will finally promote its internationalization to make it a modern and innovative city and a global bench mark city with outstanding innovation power and influence. Shanghai is the economic center of Chinese mainland, and Beijing the political center. If China wants to build another economic center, it will require not only history background and the trust of western countries, but also a new series of improvements on legal system, adjustment on stock market system, open exchange control and tax system, so that it can be possible to establish a new financial center. While neither city, except Hong Kong can serve as a new capital crossroads and buffer zone. Only Hong Kong, this special city, whose sovereignty belongs to China, while political system is capitalism, can perform as a financial center stably.

Backed by a huge market in Chinese mainland, Hong Kong used to be China's only bridge to the outside world, which made Hong Kong a leading transportation hub, trade center and financial center in Asia. Hong Kong is very important to those small and medium-sized enterprises in Chinese mainland. They need to purchase imported raw materials or equipment through Hong Kong due to insufficient foreign exchange quota or export restrictions. Hong Kong's main trading partner is Chinese mainland. Luckin Coffee's fraud caused a sensation, which damaged the credibility of the American Chinese stocks. These stocks ran into short one by one, and some internationally renowned stock writers even declaimed that they would no longer underwrite such stocks. The trade war between China and the US has existed long, and Hong Kong plays a significant role in it because it accumulated a large amount of international capital. With its own talents, capital, customer advantages, as well as its preferential foreign exchange and corporate tax policies, Hong Kong can maintain a certain share in the import and export rate. Hong Kong is of certain importance to the mainland's economy.

4. Future Innovation and Changes in Hong Kong

Hong Kong was born in the "Blue Age" dominated by commerce, in which the approach of trade was equal to wealth. At the same time, it was the "Black Age", which was the age of big industry and manufacturing, where technology, patents and

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economies of scale can bring huge fortune. America used to be the big winner of this era. However, now we've come to a "White Age". The information becomes the king, and the Internet has changed everything. Nowadays this era is underway, Hong Kong can seize the opportunities in the "White Age" to prosper again.

Finance is still a major industry due to Hong Kong's high land price, and Hong Kong can still be positioned as a financial center. The export entrepot gradually becomes less important, and it needs new industry to take its place. Due to China's large population, the consumption market is very huge. The consumption level varies a lot, while the market supply mechanism is not perfect, so e-commerce can stand out to satisfy people's shopping demands and remove the constraints of the blocked commodity sales information. People can compare prices on the Internet, making e-commerce rise rapidly in China. At present, China has completely advanced in smart city and convenient service, improving convenience for its people in many fields like electronic payment and urban service. But Hong Kong has lagged behind in these sectors. In the future, Hong Kong's commitment to science and technology will enhance innovation in all areas. While only by improving service experience can Hong Kong really make its status more stable as an international financial center. For example, it can bring Google, Facebook's regional or Asian headquarters to Hong Kong. Such leading enterprises will attract more talents and investors. However, the drawback of Hong Kong's development of science and technology is that its hinterland is too narrow and its overall scale is relatively small.

Working hard to develop virtual banks can also promote Hong Kong's innovation. Virtual banks can tap into customers neglected by traditional banks by providing differentiated financial products and services, which can not only help financial institutions to make model transformation and upgrading, use technology to replace branch network, improve customer experience, reduce the cost of financial products largely, but also can empower traditional financial institutions and gradually establish a system adapting to Hong Kong market's customer operations, product marketing and risk management. In the future, the manufacturing industry is likely to return to the center of the world, and this wave of reforms will change the world's economic landscaped. Over the past few decades, computer and Internet technology were being developed, but now they have come to a mature stage. All the technological innovations are ultimately geared toward manufacturing, for example one of the biggest possible applications of AI in near future is driverless car. However, technology is not necessarily high technology, while we still need to know current trend. From market trend to changes of science and technology, it will make space for companies to survive.

5. The Reason for Bank's Low Interest Rates and No Financing Products in Hong Kong

The Hong Kong dollar adopts linked exchange rate system, HK $7.75 to HK $7.85 to US $1. The stability of the exchange rate is mainly achieved through arbitrage activities conducted by the three note-issuing banks in Hong Kong (Bank

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of China Hong Kong, Hong Kong and Shanghai Banking Corporation, and Standard Chartered Bank), with an automatic adjustment mechanism. According to the practical application of The Impossible Trinity and the essence of financial freedom, an economic entity cannot possess “stable exchange rate”, “free flow of capital”, “independent monetary policy” at the same time. And a financial product cannot comply with absolute high yield, very high liquidity, completely zero or low risk at the same time, if two in these three is stronger, the other will be weaker. In order to maintain economic stability, the linked rate system was set up to guarantee the stability of currency exchange rate and the free flow of capital. The Hong Kong Monetary Authority cut bank’s capital buffers, releasing a huge amount of Hong Kong dollar cash (US $64 billion). In the mean time the Federal Reserve cut its benchmark interest rate, resulting in low overall interest rates in Hong Kong and thus low survival rates.

In short, Hong Kong’s market is free and flexible. The current and fixed choices are even simpler. The rest are net worth products. People in Hong Kong prefer current deposits, which account for over 50% of their deposits and enjoy an interest rate of nearly 0. The benchmark interest rate in Hong Kong is almost 0, so its money fund marked is not well developed. No banks in Hong Kong have their own financial management products. Usually they only sell such products for insurance companies. For example, Hang Seng Bank sells its Hang Seng life insurance on behalf of Hang Seng Bank, while Bank of China sells its life insurance on behalf of Bank of China. However, there are very few Hong Kong people buying financial management products form banks. Hong Kong’s insurance industry has a long history, which adopts agent system and is highly professional and competitive. Compared with their domestic counterparts, financial products in Hong Kong are generally centralized and standardized, and most of them are long-term products, those short-term ones are usually stocks and funds. In addition, Hong Kong also has an active investment market and various developed financial derivatives.

6. Conclusion

Hong Kong has its advantages in finance, tourism, education, medical treatment and food industry. In the future, Hong Kong will have great potential and development prospects. Hong Kong always possesses a nice financial and commercial background, and it can strengthen its advantages and introspect in time to make correct judgments. Now under the influence of the epidemic, Hong Kong should explore fundamentally sound assets from the aspect of both enterprise and industry, as well as new long-term investment themes and opportunities brought about by the epidemic. In the future, fin-tech will reshape the financial industry, bringing challenges and opportunities to Hong Kong.

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