Ladies and gentlemen, good morning and welcome to the 2017 HSBC China and RMB Forum.

The title of this year’s Forum is “Innovation and integration: Inside tomorrow’s China”.

It is deliberately forward-looking, because we want to try and give you the best possible sense of where China is going and how it intends to get there.

This is reflected in the calibre of the speakers that we are honoured to have with us today.

I’d like to use my speech today to look at the context around these discussions.

In the twelve months since our last conference, we have witnessed the impact of far-reaching political changes that have over-turned the common perception of the values underpinning the global economy.

The developed world is retreating from globalisation and support for established institutions has eroded quite markedly.

The new US administration is reversing past policies aimed at increasing global economic integration.

And in Europe, the result of the UK referendum and nervousness around forthcoming elections in France and Germany have fostered a sense that the future of the EU itself hangs in the balance now.

This new atmosphere feels very far removed from the spirit of international cooperation and optimism in which China was welcomed into the WTO back in 2001.

However, sixteen years on, China is itself in a very different position.

It has emerged not just as the world’s engine of growth, but as a global leader, an advocate of trade openness and a driving force behind the Paris climate change agreement.

The leadership position that China has assumed – both regionally and globally – is an accurate reflection of its standing in the world.

But this standing also comes with a great duty and a great expectation.

China has set a very high bar, not just in terms of economic growth, but in the pace of reform and the rate at which it has transformed its economy and its society.

The world now looks to China not just for strong and sustainable growth, but for continued rapid progress towards the ambitious goals that China has set for itself - two things that are not always immediately compatible.

So over the next twenty minutes or so, I will directly address what China is doing to reconcile the tensions between those aims.

I want to reflect on China’s new role and why it matters, both globally and domestically.

And I want to explain how stable growth, continuing reform and China’s global economic leadership can work together to benefit its transition to an open and innovation-driven economy.

**Capturing a greater global role**

Let’s start with this new global environment and what it means for China.
Now, 2016 was clearly a transformative year.

After two decades of slowing wage growth and rising income inequality, some Western electorates rejected the old world order, choosing instead the politics of protectionism and economic nationalism.

76 days in to the new US administration, we are still piecing together what this means…

…but what we do know is that the relationship between the United States and the rest of the world seems to have fundamentally changed.

The US withdrawal from the Trans-Pacific Partnership, doubts surrounding the future of the North America Free Trade Agreement, and the rejection of US obligations under the Paris Climate Commitment have all given stark demonstration of the prevailing mood in Washington.

Nothing captured this more clearly than last month’s communiqué from the G20 group of finance ministers, which omitted a commitment to oppose protectionism for the first time in a decade.

As the US has relinquished its position as the driving force behind globalisation, it is China that has taken its place.

In Davos this year - three days before President Trump’s inauguration - I listened to President Xi talk about the importance of defending economic globalisation and advancing it in the world’s interest.

It was a seminal moment that for the first time demonstrated not just China’s active commitment to defending the values behind globalisation, but also that it has a clear vision for the global economy and the institutional framework that supports it.

It placed the Belt and Road initiative and RCEP – the Regional Comprehensive Economic Partnership – into this broader strategic context.

And this speech established China as the single most influential voice in pressing for greater global action in tackling that other global challenge – that of climate change.

China is now very visibly the world leader in promoting economic globalisation and at the same time ecological progress.

And for the first time in the modern era, China’s intellectual influence is starting to match the size and weight of its economy.

This points to a fundamental realignment in both the nature and the institutional framework of globalisation, with potentially far-reaching consequences.

**Strong and stable growth**

However, China’s new global role also carries an increased weight of expectation – and that brings a different kind of challenge.

The world continues to look to China for strong and stable growth despite the challenging global environment. But having called for a new era of global openness, China has therefore raised expectations that it will reform faster than recent conditions have allowed.

For the last two years, this inherent conflict has governed China’s economic policy.

While China remains committed to steady but sustained reform, a combination of currency pressure and external challenges have caused it to slow the pace of change and focus instead on guaranteeing economic stability.

Faster capital outflows, rising debt, and sluggish global demand have all limited Beijing’s room for manoeuvre.

And whilst China’s leaders have made better progress than expected in cutting capacity and reversing deflation, risks remain – not least from sluggish private sector investment and a challenging global environment.
However, while China’s pragmatism around reform has drawn criticism, it has also clearly had the desired effect.

Growth remained stable at 6.7% in 2016.

Temporary capital controls helped to slow outflows, easing worries about a disorderly depreciation of the renminbi.

And early signs suggest that 2017 will offer greater economic support for reform.

Private sector investment has rebounded since the start of the year.

Business profits have started to recover, particularly in the industrial and manufacturing sectors.

External demand is improving and domestic consumption is reviving.

There will still be drags on growth – including likely measures to cool the housing market. And there remain external threats to China’s economy, not least from rising global protectionism and interest rate tightening in the United States.

But the experience of 2016 demonstrates that Beijing retains the policy flexibility to adapt to any given situation.

It has already illustrated that it will do whatever it needs to maintain economic stability – which remains the prudent course of action in a fundamentally uncertain world.

One of those uncertainties concerns the possibility of disrupted trade relations between the United States and China.

Whilst I completely understand the concern about the potential impact of tit-for-tat retaliation between the world’s two biggest trading nations, my personal view is that a full blown trade war remains unlikely, given what’s at stake for both nations.

Both China and the US have benefitted far more from economic cooperation than they ever could from economic conflict.

And while differences clearly remain between the two, I’m sure we all hope that this week’s meeting between Presidents Xi and Trump lays the groundwork for a relationship built on mutual understanding, not mutual suspicion.

**Securing sustainable growth**

But even with these uncertainties, we expect China to achieve its growth target of around 6.5% in 2017.

On the face of it, this target represents a moderation of expectation. But in reality, it takes account of plans to reform faster and more deeply than conditions previously allowed.

Fiscal and monetary measures remain necessary to keep growth stable and create new jobs to compensate for the negative impact of state-owned enterprise reform.

But they also sit alongside new steps to build the capacity to ultimately enable the economy to create its own demand without significant stimulus.

To achieve that, China has to move forward with three aims simultaneously.

The first is to increase the role of the private sector in the economy, which partly relies on reform of China’s remaining SOEs.

Since steps were announced to reform SOEs in 2013, progress has been mixed.

But while it continues to experiment with different ownership models, the message from Beijing is that reform will accelerate markedly in 2017.

In addition to implementing a growing preference for mixed-ownership reform, it will also use growth in the real economy to provide greater competition and encourage reform by necessity rather than compulsion.
New measures to reform the tax system and increase financing for SMEs are therefore critical to creating a supportive business environment, and were at the centre of plans announced at the recent National People’s Congress.

This then needs to be supported by the second area of reform, which is the continued opening up of the capital account and the financial markets to increase outside investment in China and provide better support to the real economy.

The China–Hong Kong Bond Connect announced by Premier Li last month is another potentially important step towards fulfilling the massive potential of China’s onshore bond market.

New rules allowing investors to hedge CNY exposure using onshore foreign exchange derivatives should create greater convergence in the onshore and offshore renminbi exchange rates, and pave the way for China’s bonds to be added to global indices.

And Governor Zhou’s comments the weekend before last indicate that China intends to continue opening its financial sector, while maintaining a close watch on currency outflows.

This also sends an important political message.

China is backing up its rhetoric on openness with clear signs that it intends to resume the course it delayed in response to currency pressure a year ago.

It represents an important move in light of overseas criticism of the pace of progress on opening its capital account.

And it also offers clear reassurance that it remains committed to increasing access for international investors in all areas of its economy.

The third area of reform concerns strategic investment to drive innovation and raise China’s economy up the value chain.

This is critical to improving both the quality and the quantity of Chinese jobs, boosting incomes and increasing consumption, as well as improving the environment by reducing reliance on heavy polluting industry.

Both of these things are integral to making China’s growth more sustainable in the long-term.

The announcement last weekend of the Xiongan New Area - a vast new economic zone explicitly on a scale to rival Pudong and Shenzhen – demonstrates the staggering extent of the government’s investment in domestic economic integration.

The Beijing-Tianjin-Hebei, or Jing-Jin-Ji, project – of which Xiongan forms an integral part – is realigning the regional economy around high-tech industries, high-end services, and high-grade research and development, with environmental as well as economic benefits.

In addition, the Yangtze Economic Belt is accelerating the development of strategic emerging industries, boosting services and modernising the agricultural sector in the extended region around Shanghai.

And the newly announced Greater Bay Area of Hong Kong, Macau and Guangdong will rapidly accelerate the development of the ‘Silicon Delta’, increasing the pace of technological, structural and economic integration throughout the region.

This integration – which HSBC’s own expansion in the Pearl River Delta, announced in 2015, is designed to serve – is vital not just to the economic development of the region, but also to building new financial links between China and the outside world.

It is further opening a gateway for overseas investment to meet Chinese creativity, increasing cross-border financial flows and boosting the supply of finance to the innovation economy.

Fairer procurement, better licensing and more supportive tax measures are all designed to attract foreign hi-tech investment, building on an
average 12% per year increase between 2013 and 2016.

And ‘Going Out’ remains a critical component of Beijing’s strategy to meet domestic demand for new knowledge and new technology.

Despite the increase in protectionism across the world, China’s overseas direct investment increased by 170 billion US dollars in 2016, much of which flowed into advanced sectors in developed economies.

In the past two years alone Chinese companies announced more than 110 billion US dollars of M&A technology deals, and January this year saw significant growth in ODI in advanced manufacturing and information services.

Even taking into account current global sentiment, it seems more likely than not that the flow of Chinese finance to developed markets – including the United States – will not abate.

Taken together, all these initiatives are upgrading the economy, increasing the role of the private sector and the real economy, and providing the quality and quantity of jobs that will help China escape the middle income trap.

**The value of leadership**

This reform programme should be helped, not hindered by China’s active stance on globalisation.

As China’s political influence expands, it should increase its capacity to manage its external environment and its ability to build a more integrated global economy.

Over the last 500 years, the dominance of Western ideas has been driven by its command of the architecture and language of globalisation.

But economically, philosophically and intellectually, the world is now returning to a ‘pre-Columbus’ model of globalisation, driven by Eastern products and Eastern values, with China at its centre. The return to an economic order is dominated by the arc of the Silk Road, from the Middle East at one end to China at the other.

In the medium term, I believe that this means three things.

First, the collapse of the Trans-Pacific Partnership, the new impetus behind RCEP and the sheer expanse of the Belt and Road initiative mean that China is now the lodestar of global economic integration.

Whereas TPP membership was once the standard to which emerging economies aspired, it is the terms of RCEP that will motivate emerging economies towards economic reform, encouraged principally – but not exclusively – by China.

The Belt and Road initiative is creating a network of trade and financial connections not just within Asia, but with the Middle East, sub-Saharan Africa and Europe.

Together, these increase China’s ability to shape the outside world in its interests, and in the medium term help its exporters by offering support to flagging trade.

Second, the combined weight of China’s economic and intellectual influence should give it much greater leverage over global policy.

It should no longer be a given that the established institutions of globalisation remain, in effect, closed to Chinese leadership.

The World Bank and the IMF have historically had Western leaders. But this is becoming increasingly incongruous with the size and impact of China’s economy, and the influence of Chinese ideas on global economic development.

Third, and critically, on a practical level this means that China should be guaranteed a prominent role in any review of the post-crisis rules that govern the global financial system.

After 2008, policymakers advanced a set of proposals that suited a model of banking common in North America and Europe but
which seemed to ignore the unique characteristics of Asian and emerging market banks.

In these nations where there are high savings rates, banks are often deposit-funded, and have little need to issue debt to meet capital requirements, and few options to deploy additional cash if they do so without materially increasing risks.

A louder Chinese voice in these negotiations could not only increase the supply of finance to Asia’s real economy, it could offer a timely boost to China’s financial sector in meeting demand for greater support for entrepreneurs, SMEs and innovators to accelerate China’s own economic transition.

The recent appointment of Norman Chan of the HKMA to the chairmanship of the Financial Stability Board’s premier policy committee is already a welcome step in this regard.

**Conclusion**

Some might see the rise of China on the world stage as a direct challenge to the developed world.

But China’s strategy is to work with the developed world, not against it, and to advance the global interest, not just its own national interest.

Ultimately both China and the world gain more from an integrated global economy than a fragmented one, and President Xi’s Davos speech provided important reassurance that the political will remains to drive this ambition forward.

Integration and economic development are not new aims for China, as existing initiatives like Belt and Road and RCEP demonstrate.

But by placing them in the context of a broader global vision, China has positioned itself at the centre of a coordinated effort to remove barriers and increase connectivity between nations.

In parallel, China’s reform programme has gained added impetus on the back of stable growth delivered by Beijing’s prudent economic management over the last twelve months.

And increased investment in innovation, combined with greater in-flows of foreign investment, should accelerate the development of higher-value industries and, ultimately, a stronger and more sustainable Chinese economy.

We think, at HSBC, that this will continue to provide significant opportunities for those with the means and foresight to capture them.

I hope that today’s Forum gives you the information and the insight that you need to prepare for tomorrow’s China.

Thank you.