

Hong Kong Association of Banks

Hong Kong, a personal view

Speech by Sir John Bond
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Let me start by thanking the Association for inviting me here tonight. I have spent more of my career here than anywhere else and it is always a pleasure to spend time with my peers.

HSBC was born in Hong Kong, made in Hong Kong, and any success we have achieved comes as a result of the lessons and practices that we learnt in Hong Kong.

HSBC was founded here in 1865, when Hong Kong had a population of 100,000, with an authorised capital of HK\$5 million. Of the ten banks operating in Hong Kong that year, only five remained by 1866. So our birthplace taught us the virtue of a conservative balance sheet right from the start.

Our original prospectus described us as a local bank founded on Scottish principles, which is perhaps why we are known for our thrifty ways. Actually, I think we learned more about thrift from Chinese people than anybody else.

At HSBC, we believe that a company's character — by which we mean how companies behave and the value systems they have — is the overriding factor that distinguishes successful companies from unsuccessful ones. This is more true in the 21st century than ever before. In an interconnected world, where news travels almost instantly around the globe via the internet and the newswires — and in a world where people can send money into cyberspace at the press of a button — reputation is paramount. A great brand engenders trust. Conversely, transgressions are also ever more visible, so reputational risk is more important than ever before. So we are very grateful that our reputation was forged in Hong Kong.

On a very sad note, we needed all our strength of character to deal with the appalling and

tragic events in Turkey last Thursday. We have been doing everything in our power to support the bereaved families and our injured colleagues; our crisis team arrived on Thursday night and our courageous Turkish colleagues opened for business the following day. We have been heartened by the messages from our colleagues and friends in Hong Kong.

A colleague of mine once told me that if HSBC has been successful, it is not because we are smart, but because we have smart customers. And it is those smart customers in Hong Kong who gave us our start in life and have helped make us the second-largest financial institution in the world and the eighth-largest company in the world, although size is unimportant to us, we prefer quality to quantity. The challenge for me and my colleagues today is never to forget the lessons that we learned here.

We all know that Hong Kong has been through a difficult period recently. It has experienced a five-year period of price declines and a rise in unemployment. There has been a major decline in asset prices, both property and the stock market. And it has faced intense competitive pressure on its cost structure. Territories are no more immune from these cost pressures than are individual companies.

The good news is that there are now plenty of signs that we are coming to the end of the period of cost adjustment. The worst is definitely behind us.

Let me tell you why I believe this.

If you measure the Real Effective Exchange Rate against the basket of major currencies with which Hong Kong trades, then the index shows a 23 per cent devaluation between June 1998 and October 2003. This is all the more

smart customers

impressive when you consider that the Hong Kong dollar is linked to the US dollar in nominal terms.

Hong Kong's trade account has turned from deficit to surplus since 1999 with exports of services averaging growth of 10 per cent a year. This is a strong indication of Hong Kong's external competitive position in services.

Hong Kong is also competitive today in terms of labour. Basic labour costs may still be high compared to the mainland in some areas. But this is work carried out by people who take care of services delivered in Hong Kong, which are not moveable. The tradeable service sector is now highly competitive after years of cost adjustment. I am delighted to see the much-needed decline in the level of unemployment.

For instance, HSBC had found over the last few years that hiring graduates in Hong Kong to work on our information technology had become uncompetitive. However, I am happy to say that now Hong Kong is competitive again, we are starting to recruit here straightaway.

And, of course, Hong Kong received a massive shot in the arm last week with the announcement that renminbi banking services will be licensed next year.

I hope that the ability for Hong Kong banks to take renminbi deposits will enable them ultimately to provide local currency funds for businesses financed in mainland China. And this will further cement Hong Kong's position as a finance base for the mainland.

HSBC economists have estimated that the relaxation in restrictions on mainland visitors, and increased money allowances put in place before this announcement, would boost GDP by 2.5 per cent next year and 4.0 per cent by 2006, when 13 million mainland visitors are forecast.

But while I am very confident about Hong Kong's future, we need to understand that it would be wholly unrealistic to expect the future to be like the past.

Over the past 30 or 40 years, Hong Kong has been through an unprecedented period of wealth creation. GDP per capita has grown from HK\$3,000 in 1963 to HK\$185,000 in 2002.

Now that Hong Kong is one of the world's most affluent communities, it is clear that this type of growth cannot be repeated. It is natural for economic growth, in what is now a mature economy, to be lower than in a developing economy.

The success of banks in Hong Kong over the past 25 years has been heavily dependent on the domestic market, in particular on property financing in the form of development finance and ultimately mortgage finance to the end-buyers.

Indeed the Government has depended on property with land sales for around a quarter of its revenues; it is clear that it will have to address this structural change by reducing expenditure like the private sector now that it has already increased tax rates. Certainly, any further "tax creep" might start to undermine the ability of Hong Kong to present itself as the world-class city that it is.

In future, property in Hong Kong will have to find a value based on its economic use, which will be linked more directly to growth in the GDP and the income of the population.

As the domestic demand for financial services matures, it is likely that growth in financial services in Hong Kong in the future will come more from looking after international customers and international business.

Pressure on the tax base is an issue that we see in some other developed countries around the world. Where you have low birth rates, higher longevity and a shrinking workforce, we see a real possibility that in some countries, private-sector taxpayers are likely to become a voting minority. This is likely to have unforeseen and not necessarily benign consequences. When a majority of the electorate has the power to vote for increased spending, but little of the responsibility of paying for it, social costs will inevitably rise.

massive shot in the arm

When I think about the future of Hong Kong, my mind doesn't do the conventional analysis with Singapore or Shanghai; it tends to stray to Switzerland, which coincidentally has the same population as Hong Kong. Both places service a major hinterland and enjoy a standard of living that exceeds substantially that of their hinterland. Of course you have to give Hong Kong the edge here as a sovereign part of the world's fastest-growing economy.

Half of Switzerland's money supply is in international currencies; a similar situation obtains in Hong Kong.

Both economies are services economy: Hong Kong at about 85 per cent, Switzerland 65 per cent. Like Hong Kong, Switzerland enjoys a high reputation as a low-tax, attractive place to live and to use as a business base to travel the region.

The international financial services provided by Swiss banks have long overtaken their domestic services. And Swiss banks have established universally-recognised brands. There is no earthly reason why Hong Kong banks should not do the same.

I don't want to push the comparison too far. But I think sometimes a different perspective throws new light on a subject. And I certainly think that we should look long and hard at why economies like Switzerland have been so successful for so long, and see if we can learn and apply the same lessons here.

Switzerland acts as a magnet for capital because it has a number of regulatory and fiscal advantages over many of its neighbours. It is important to recognise that Switzerland's different and differentiating regulatory system may be a competitive advantage.

For perfectly understandable reasons — namely, the egregious excesses that have taken place in some Western markets — there has been a substantial expansion in regulation in the Western world.

But by-and-large, the burden of regulation doesn't differentiate between good and bad companies; we all have the same load to bear. There is a perfectly respectable argument that the level of regulation should be directly

proportional to the standards of behaviour of a company and to the standards of its financial strength.

In many places we are seeing the bearhug of regulation — some of it absolutely essential for institutions that have transgressed — but some of it clearly affecting perfectly good companies in terms of cost and time — there is a real opportunity for Hong Kong to learn from Switzerland's example: to have lighter touch regulation and not copy everything that is done elsewhere.

This certainly allows Switzerland to play to its strengths; it would do the same for Hong Kong. You can already see that Singapore is attracting private banking business from other financial centres on just this basis.

I would certainly think that Hong Kong could also learn from the "brand" that is Swiss and Switzerland. Whether you think of private banking, watches or chocolate, Switzerland is able to differentiate itself on the basis of quality, precision and service levels. And it is your brand that allows you to be a premium player, not just another commodity.

One of the best ways you can increase per capita income in a wealthy country is by attracting as residents foreign high net-worth individuals, something Switzerland has been conspicuously successful at, with over 20 per cent of Switzerland's population being foreign. So I believe that it was an excellent move for Hong Kong to allow residency based on an individual's investible funds; the economic benefits of attracting wealthy, talented people are overwhelming.

Of course, both economies face some of the same challenges, because they are global in nature. For the past 25 years capital has been free to move around the world in an unfettered and unprecedented way. Today we are seeing the next phase where many types of work can now be done anywhere in the world. This is facilitated by the revolutions in telecommunications and technologies like the internet and image technology.

Today talented people can choose where they want to work in the world; alternatively

lighter touch regulation

companies can choose where they want the work to be done. So many kinds of work — particularly in services — are being redistributed on a global scale to the most effective labour force. This implies that service sector costs for these types of work will be constrained in higher-cost locations. This is something Hong Kong has had to face over the last five years. And it will continue to be an issue for both Hong Kong, Switzerland and, indeed, every developed economy.

All of which means that governments around the world, including ours in Hong Kong, need employment strategies that focus on the jobs which can't be moved. At HSBC, we estimate that something like two-thirds of all jobs in the service sector of a developed economy are geographically fixed. They're in tourism, hotels, restaurants, hospitals, airports, the customer-facing parts of banks, education, public administration and so on. These jobs will become more important. And they will impact on Hong Kong's position as an international financial services centre.

Hong Kong has already built a marvellous foundation for a world-class financial centre. It has all the essential ingredients: a good legal system; a sound judiciary; world-class standards of regulation; reasonable taxation; high standards of accountancy; it is an attractive place to live.

Here I would like to pay tribute to the HKMA, which has steered Hong Kong through a difficult period with consummate skill and earned world-wide respect for itself and Hong Kong's financial system.

The next phase of development is to attract wealth from around the world in the forms of funds management, private banking, all forms of investment savings. Without these international sources of funds and the skills to look after them, we are all essentially domestic retail bankers. And, after all, the bulk of the world's savings are made in the Asian timezones. It is out of these savings that investible funds for deep, liquid, capital markets will emerge that will enable us to become one of the world's leading capital markets centres, where all sorts of fixed-

income securities and equities are issued to meet the investment needs from wealthy individuals, and institutions which look after people's pensions and capital. It is highly likely that Asia's savings will be re-cycled in Asia in the decades ahead, they should not need to be re-distributed through New York or London.

Hong Kong has all the advantages I have just outlined. And we have great customers to help us. We should never forget that Hong Kong has created world-class companies, in the sky, at sea, some of the world's top operators of ports, of mobile phones, in logistics, in financial services and many other sectors. Their competitiveness improves ours. I cannot think of any other community of 7 million people which has given birth to so many companies, of the calibre of Cathay Pacific, Hutchison, World-wide Shipping, Li & Fung, or domestically MTR and the Wharf Company — there are many others I could mention.

And we also have the advantage of being at the epicentre of a global shift as the centre of economic gravity moves towards Asia and developing markets. At HSBC, we believe that 50 per cent of the increase in world demand to 2050 will come from developing economies; from China, India, Brazil, Russia, Mexico.

The ability to change is the hallmark of all successful societies. Institutions or countries that don't change, fade away or stagnate as the world changes. Therefore we should always expect the future to be different from the past, and be prepared to adapt.

But if there is one thing that Hong Kong has proved it can do, that is change. From entrepot to manufacturing, from manufacturing to services; Hong Kong's history is one of constant change.

So look at what Hong Kong has achieved in the past, and, with this in mind, I cannot see anywhere else in the world better equipped to address an exciting future as Asia, and China in particular, flex their economic muscles with Hong Kong at their heart.

world-class companies