

Financial Market Development and Sustainable Growth

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Thank you Minister Li. Ladies and Gentlemen, good morning.

HSBC's economic forecasts for 2050 project a very different world. So-called emerging markets will collectively be bigger than the developed markets. In fact, 19 of the top 30 economies by 2050 will be from what we call today the emerging world. By 2050, China will long since have overtaken the US as the world's largest economy.

HSBC was founded in Hong Kong and Shanghai in 1865 with an unbroken presence since then, and has expanded now to 87 markets. So we are easily convinced that financial market development will continue to contribute to China's future success, just as it has during the remarkable transformation of the past thirty years.

But let's first look at one lesson from the tragic events in Japan. Clearly, in the short-term, there will be a loss of output as well as pressure on the price of oil and gas and other commodities.

In our connected world, these impacts will be felt not only in Japan, but across the global economy through second, third and fourth order effects. However, Japan is well supported by savings rates which remain high by international standards and more importantly well-developed financial and capital markets – not least a mature insurance industry and equity and bond markets. The key point this illustrates and stresses is the critical importance of developed financial markets for the ability of a country to cope both with growth and adversity.

Over the next five minutes, I will try to (quickly) outline three key ways in which financial market development can contribute to sustainable growth.

First, a broader and deeper personal financial services sector can help to distribute the benefits of growth equitably between the people.

McKinsey forecasts that the number of middle-class households in China could quadruple over the next 15 years, to reach nearly 280 million.

As they grow wealthier and older, people will increasingly demand longer-term wealth solutions to fund healthcare, schooling for their children and retirement, including pensions, insurance and asset management products. For example, China's life insurance market is expected to grow at a compound annual growth rate of nearly 25 per cent between now and 2014.

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Also, allowing citizens to invest in foreign assets would be an important step in diversifying investment alternatives. These alternatives would also be enhanced by the stock exchange listing of foreign companies, as contemplated by China with the international board. This would provide diversified investments and therefore reduce risk and improve returns. Currently, Chinese households put over 65% of their savings into bank deposits, which generated an annual real return of only 30 bps over the past 10 years.

Equally, and as mentioned over the last two days, government's actions to reform policies and invest in education, healthcare and social security will be instrumental in increasing the share of consumption in the economy.

As the 12th Five-Year Plan recognises, rural development will also be vital to sustainable growth. Banks can play an important role here, by connecting rural communities to the financial system and to the rest of the economy.

HSBC has built the largest rural network among the international banks, and we are committed to expanding it further.

Second, a reliable and more diverse supply of affordable finance will be essential for investment and innovation in China's seven emerging strategic industries.

We forecast that the global climate business market could be worth two trillion dollars by 2020 and each of the seven strategic industries has a link to this sector – directly so in the case of new energy, clean energy vehicles and energy saving.

China has emerged as a leader, not only as a manufacturer, but as an innovator and developer of new technology in a number of areas, including wind and solar power. In fact, our research suggests that China will exceed its goals for growing the renewable energy sector over the next decade.

However, progress from conception to execution requires a range of funding sources and the efficient allocation of capital. We estimate that, collectively, China's seven strategic industries will require approximately 800 billion US dollars of investment by 2015. This means moving beyond traditional bank lending into more diverse sources of finance, including:

- specialist investment funds to provide equity financing for start-up companies, namely in low-carbon businesses;
- venture capital or private equity for new technology companies expanding globally, for example for electric and hybrid vehicle manufacturers;
- project financing for downstream operators, for example, wind farm projects;
- More broadly, I believe that better access to international and domestic debt capital markets can assist corporations expanding into new sectors. Equity capital markets can also provide a deep capital pool for those with strong track records and convincing investment cases.

So we are encouraged by China's commitment to developing its capital markets further. And we believe that, as the economy enters a new phase, China's corporate bond market would benefit from increased participation from international firms – helping to speed up the development of financing products and securities services as well as continuing direct lending domestically. Similarly, overseas institutional investors could help create market competition and liquidity.

This year marks the 10th anniversary of China's WTO accession with many successes as mentioned yesterday by Minister Chen. Having said that, CBRC data shows that the market share of foreign banks in China has been decreasing over the last 4 years and currently stands at only 1.8% of total banking assets. This compares to 7.7% for India and above 20% for Brazil.

Third, as we enter the next phase of globalisation, China's success will be dependent upon its ability to finance its growing trade and investment flows.

We forecast that China's trade with the rest of the world will be worth 6 trillion US dollars by 2015, implying a compound annual growth rate of 18 per cent. At the same time, China is investing more of its surplus overseas, with over 80 per cent directed to the rest of Asia, Latin America, Africa and other emerging markets.

Our experience elsewhere has shown that relaxing capital controls can help broaden access to the credit and capital that companies need to expand and grow. This is critical but needs to be done with caution as mentioned yesterday by professor Stiglitz.

Cross-border financing and advisory services will also become more important. However, it is perhaps in the internationalisation of the RMB that we have seen the greatest potential. And global banks can play a crucial role in the process. For instance, HSBC has the ability to settle RMB trade in 38 markets. We believe that its international use will be a key driver of future growth – particularly for China's growing flows with emerging markets. In fact, we expect a third of China's foreign trade to be settled in the currency within five years, making it one of the top three global trading currencies.

We have, therefore, also seen rapid growth in Hong Kong in both offshore RMB deposits and bond issuance.

Ladies and gentlemen, in summary, I believe there are three key areas in which financial market development can contribute to sustainable growth:

- (1) Deepening the personal financial services sector to help equitable growth,
- (2) Moving away from a reliance on traditional bank lending towards a more diverse supply of finance to help investment in China's seven emerging strategic industries as well as traditional industries.

- (3) The continuing internationalisation of RMB to facilitate trade growth and the 'going out' policy

To close my remarks, I would like to quote Vice Premier Li who during his visit to the UK in January said: *"China's development will not be possible without the world – and world development needs China."*

I believe financial services are a key part of this interdependency.

Thank you.