

Hong Kong remains in good health

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HONG Kong is playing only a small role in the Beijing Olympics. The equestrian events are being held at a scenic spot in the New Territories.

But 11 years after being swallowed up again by China after 99 years in foreign hands, the city still has a critical role in the Middle Kingdom's economy and financial markets and will do so for the foreseeable future.

In 1997 when the Brits were forced to hand back their South China Sea trading outpost, Hong Kong's days as a financial centre appeared to be numbered. Shanghai, then as now in the midst of a breathtaking construction boom, was expected to rapidly take its place.

Hong Kong property prices, long the touchstone of its economic health, plunged. All, it seemed, was lost.

Today, however, as you swing around the freeway across a series of magnificent bridges that take you from thumping Chep Lap Kok airport, even after multiple visits the sight of the main island makes you gasp.

Perhaps never on one lump of rock have so many skyscrapers been squeezed into such a small space. Yet a striking aspect of the spectacular vista is the flock of cranes and new superstructures soaring skywards.

Hong Kong is going through yet another of its regular growth spurts.

Property prices are once again on the up. One banker complained that the rent on his island apartment was about to double.

Since last October, according to UBS, property prices in Hong Kong have risen about 11 per cent on average, and they are still rising.

The island's main playground for bankers and brokers, which once occupied a handful of city blocks universally referred to as Lan Kwai Fong, has burst its seams.

Chi-chi restaurants and bars are now spilling into neighbouring areas and many are packed, even in the middle of the week.

As an open, Western-style economy, Hong Kong's growth will slow with the global trend.

UBS expects its real GDP -- which has been running as high as 7 per cent in recent years, not too far short of China's 10 per cent or so -- to slow from an estimated 5.9 per cent in 2007 to 5.2 per cent in 2008 as net exports weigh on growth.

Still, growth is expected to remain around trend as private consumption maintains its strength from falling real interest rates and increases in real wages.

Like Australia, Hong Kong has fairly full employment. Unemployment is running at about 4 per cent.

Hong Kong's chief executive, the flamboyant Donald Tsang, who has a well-known obsession with keeping koi carp, is seen as a fairly sound economic manager, although he, like his predecessor, has unsurprisingly disappointed the pro-democracy voices.

But, frankly, the Government doesn't really need to do too much.

Hong Kong remains the headquarters of the major global investment banks and myriad professional services firms in the legal and accounting sectors.

The reasons are threefold: first, there is Hong Kong's British/Western legal system; second, there are heavy restrictions on who can buy shares on the Chinese mainland share markets; and a subsidiary reason is Hong Kong's attractiveness as a place to live. Major investment banks, such as UBS and Goldman Sachs, are building ever larger teams in Beijing, headquarters of most of the growing number of Chinese state-owned corporations, such as Chinalco, which has a stake in Rio Tinto and Sinosteel.

The banks, however, have no immediate plans to shift their headquarters from Hong Kong. There are now two share markets on the Chinese mainland: in Shanghai and the industrial city of Shenzhen, about 50km from Hong Kong. Only 30 years ago Shenzhen was a small fishing village, but now it houses about 8million people.

Shares traded on those two markets are widely known as A-shares and the Chinese Government has heavy restriction on trading them. Shares traded in Hong Kong are known as H-shares.

Only 12 months ago the A-share market was roaring, nearing the climax of its first major bubble, which occurred in October in parallel with the world's other stock markets.

Since then the value of the Shanghai and Shenzhen markets has been slashed roughly in half.

The Shanghai Composite was at about 4000 points a year ago, rising as high as 6000 before falling back and closing at 2727 yesterday.

In comparison, Hong Kong's more stable Hang Seng was at 21,000 points 12 months ago, rising as high as 31,000 in October, only to simply return to where it had been.

Figures released yesterday by Thomson Reuters show that the slowdown is continuing.

Chinese A-share initial public offerings declined 32.2 per cent year on year after hitting a record in 2007 with \$US60.7 billion in proceeds from 118 issues.

So far this year, only four A-share initial public offerings have been launched with proceeds above \$US1 billion, compared with the same period in 2007, when a total of six deals were launched beyond the \$US1 billion mark.

A dual-listing trend is replacing a previous system in which New York or the Nasdaq were used together with Hong Kong. This accommodates local Chinese and offshore investors.

For instance, China South Locomotive's A-share tranche raised \$US955.3 million in its initial public offering this week, making it the fifth-largest A-share IPO so far this year.

It is also expected to raise \$US567.6 million in an H-share offer.

Hong Kong has also become the hub of private equity in Asia. Most of the big US and European funds, such as Kohlberg Kravis Roberts, Blackstone and Permira, have their regional offices there.

Global Infrastructure Partners, one of the two consortiums keen to buy the Asciano port and rail group, is also headquartered there.

The buyout maestros are all eyeing Chinese investments and the Chinese Government appears to be increasingly interested in private equity investing in state-owned enterprises, the latest being telecoms equipment giant Huawei Technologies.

Tsang's next big challenge will be to manage the decoupling of the Hong Kong and US dollars. The currency has been pegged to the greenback since 1983 but has recently begun to suffer in comparison with the yuan.

The mainland Government has begun moving to appreciate the yuan against the US dollar, and Hong Kong is expected to follow suit.

What is less clear is when China's mainland stock market will begin to open up to more offshore investment.

As wealth piles up in China, the Government is keen to promote investment as an essential element in its maturing economy, but at present it is taking relatively small steps in that direction.

Meanwhile, the Hong Kong stock market, which holds about \$1 trillion of the \$3 trillion or so value of the country's combined markets, will continue to attract new listings.

Deal flows in China, which are often pumped through the wood-panelled offices of Hong Kong's investment banks, show little sign of abating.

So, as the bankers and lawyers of Hong Kong sip champagne and chow down on crustless chicken sandwiches as they watch the dressage, they will be fairly comfortable with their place in the world.

Reports of the death of Hong Kong's relevance in global markets have been greatly exaggerated.

Source: Michael Sainsbury