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HK, China's 'financier' par excellence

Victor Zheng and **Roger Luk** say the rise of China and emerging economies will make Hong Kong's role as a 'connector' irrelevant, and it's time for the city to redefine its niche

The report "The World in 2050", published earlier this year by PricewaterhouseCoopers, predicts that China and the emerging economies will overtake the US and developed economies as the global growth engine. Hong Kong will have entered its second 50 years of post-reunification, and this shift will call for an innovative role, given that its traditional role as a "connector" between the East and the West is fading.

The report forecasts that the emerging and developed economies together would still account for 70 per cent of the global gross domestic product by 2050, but they will swap positions. The "E7" (China, India, Russia, Brazil, Indonesia, Mexico and Turkey) would contribute 50 per cent; the G7 (the US, Japan, Canada, Germany, the UK, France and Italy) only 20 per cent.

If the forecast is correct, it would mean Hong Kong's traditional connector role is at risk. As China pushes ahead with the Belt and Road Initiative, Hong Kong should reposition itself to provide support.

Absent financial disruptions like the 1997 Asian crisis and the 2008 global crisis, emerging economies will catch up and overtake developed economies. Among the top 10, China would remain the leader and India would overtake the US to second place.

Among the top five, Indonesia would replace Japan in fourth place, and Brazil would take Germany's fifth place. Growth in the G7 nations would be less than 2 per cent a year, with Germany, Italy and Japan's growth dropping to around 1 per cent. Thus, a post-Brexit European Union would fall behind the UK.

The report reflects a new landscape in trade and a new order in finance after the 2008 global financial crisis. Developed economies are endeavouring to reverse prolonged low savings rates and high spending habits, and thus a structural trade deficit.

Meanwhile, smart production is improving the cost/price structure and paving the way for production to return home, thus reducing imports. As export growth slackens, emerging economies are restructuring by encouraging investment and consumption to fill the growth gap.

Hong Kong's evolution reflects its traditional 'connector' role giving way to that of a 'financier'

China would gain most from this shift. As external demand slackens, it is shifting to domestic demand to keep its growth momentum. However, the law of diminishing returns dictates capital investment; it also takes time to raise private consumption levels. In the interim, China has launched its belt and road plan, primarily with two goals in mind: to explore new markets and help internationalise the renminbi.

This latter goal offers a chance for Hong Kong to consolidate its position as a "super financier" as China will become a capital and equipment exporter.

The turning point was the 2005 currency reform when the renminbi was de-pegged from the US dollar and China's financial market was partly opened. Now, through the Belt and Road Initiative, China's market will expand and the renminbi will become a viable alternative to the dollar and euro in trade settlement and foreign reserves.

Hong Kong started as a free port for Chinese trade, where Chinese and Western currencies were freely circulated and exchanged. Subsequently, the Hong Kong dollar allied with the Chinese currency and global trader currencies (the British pound and US dollar) until the renminbi de-pegging. Hong Kong's role as a gateway to China has evolved with time for the past 176 years. It started as an entrepot and settlement centre, and became an exchange and remittance centre in the post-war years. Nowadays, it is an offshore renminbi hub. This evolution reflects its traditional "connector" role giving way to that of a "financier".

The Beijing-based Asian Infrastructure Investment Bank uses the renminbi as its base currency. As an offshore renminbi hub, Hong Kong should ride on its comparative advantages and push itself as a financial platform for Greater China.

As the forecasts in "The World in 2050" report show, there is no room for complacency. Gone are the days of being a "super connector". It's time to be a "super financier".

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Shenzhen city, as seen from Hong Kong. Hong Kong started as a free port for Chinese trade. Photo: EPA