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Hong Kong's Budget Helps Enhance Its Financial Competitiveness

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On 24 February, Financial Secretary Paul Chan presented the Hong Kong Budget for fiscal year 2021/2022. Amid short-term anti-pandemic challenges and long-term development opportunities, how to make good use of Hong Kong's inherent advantages of leveraging the Mainland and the "One Country, Two Systems" as well as the financial development conditions accumulated over the years to further consolidate and improve Hong Kong's status as an international financial centre is a question that Hong Kong must consider. The Budget put a lot of ink in the financial services chapter, and proposed a series of measures for the development of Hong Kong's bond market, stock market, and asset and wealth management market. There is no doubt that these measures would help increase the diversity of Hong Kong's financial ecosystem and further enhance Hong Kong's status as an international financial centre.

1. Promote the diversified development of the bond market

In contrast to the global leading status of Hong Kong's stock market, the development of Hong Kong's bond market has been relatively slow. On the one hand, as the Hong Kong dollar is pegged to the US dollar, issuers of US dollar-denominated bonds would prefer the more mature US bond market. On the other hand, Hong Kong's fiscal balance has been in surplus for an extended period and the government had less incentives to issue bonds. However, in order to promote the development of the local bond market, the Hong Kong government has begun to issue bonds since 2009 to provide liquidity support, pricing reference, and to meet hedging needs, boosting the sustained development of Hong Kong's bond market.

Nowadays, Hong Kong's bond market is the third largest in Asia ex-Japan in terms of issuance in local currency, behind Mainland China and Korea. At the end of 2019, the outstanding size of Hong Kong dollar debt instruments was HKD2.17 trillion, among which 45% were from non-public segment, 45% were from exchange fund, and 5% were government bonds. Although overseas issuers and non-local currency bonds comprised the majority of the Hong Kong bond market while the proportion of government bonds was relatively low, the government's active participation in guiding the bond market development has played an essential role in broadening the depth and breadth of Hong Kong's bond market.

In order to increase the diversity of the local bond market and seize opportunities from the new economy as well as the interconnections with the Mainland, the Hong Kong government has continuously encouraged the diversified development of bond market in recent years. The latest Budget was also proactive regarding the bond market. The Financial Secretary first announced that he would lead a steering group comprising members from the Financial Services and the Treasury Bureau (FSTB), the Hong Kong Monetary Authority (HKMA), the Securities and Futures Commission (SFC), the Insurance Authority (IA), and the Hong Kong Exchanges and Clearing Limited (HKEX), to formulate a roadmap for promoting the diversified development of Hong Kong's bond market and reinforcing its functions, and then introduced a series of supportive measures from the perspectives of green bonds, retail bonds, and the Bond Connect.

The first is to enlarge the volume of green bonds issuance. Green bonds are innovative financial products that not only have financial attributes, but also social attributes that promote sustainability and environmental protection. Compared with ordinary bonds, green bonds have special requirements such as external review and proceeds tracking, therefore it's necessary for the government to provide more information to the market and improve issuance transparency. Although outstanding green bonds accounts for less than 1% of the overall bond market currently, their growth potential is huge. The scale of green bonds arranged and issued in the Hong Kong market has risen from USD300 million in 2015 to USD10.8 billion in 2018, an increase of 35 times in just four years (Figure 1).

It's worth mentioning that the government has successfully offered the second batch of government green bonds totaling USD2.5 billion last December, among which the 30-year tranche is the longest-tenor bond issued by the Government and the longest-tenor USD-denominated government bond in Asia to date, showing proactive stance to developing green finance. The government's promotion in the development of the green bond market will greatly benefit Hong Kong's financial market. First, by issuing green bonds of different maturities, the authorities can construct a government yield curve and set a benchmark for the corporate bond market. Second, developing the green bond market helps to build Hong Kong's status as a regional green and sustainable financial hub. Finally, the issuance of government green bonds not only provides funding for green projects, but also expands the fiscal space of the Hong Kong government.

The Budget this year proposed measures from two perspectives to further support the development of green finance. The first is to enlarge the issuance volume. The borrowing ceiling of the Government Green Bond Programme will be doubled to HKD200 billion, allowing the government to issue green bonds totaling HKD175.5 billion within the next five years. This will provide greater room for piloting the issuance of green bonds that involves more types of currencies, project types and issuance channels, thereby further enriching the green finance ecosystem in Hong Kong. The second is to reduce the cost of green bonds issuance. The Pilot Bond Grant Scheme and the Green Bond Grant Scheme rolled out by the Government previously will be consolidated into a Green and Sustainable Finance Grant Scheme to provide subsidy for eligible bond issuers and loan borrowers to cover their expenses on bond issuance and external review services in the next three years.

Figure 1: Green bonds arranged and issued in Hong Kong

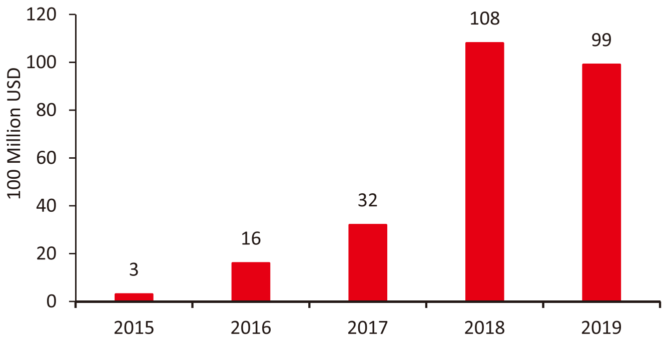
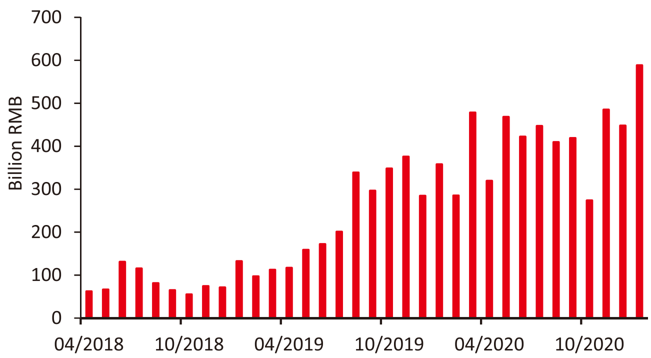


Figure 2: Monthly turnover of Bond Connect



Source: HKMA, CEIC, BOCHK Financial Research Institute

The second is to strive to launch the Southbound Trading of Bond Connect within this year. Since the launch of the Northbound Trading of Bond Connect in July 2017, the scale of northbound trading has increased rapidly. The average daily turnover has tripled in 2019 and continued to grow by 82% in 2020 (Figure 2). However, there has been no clear timetable for the launch of the Southbound Trading which the market has been looking forward to. The Budget clearly stated that the Hong Kong Monetary Authority and the People's Bank of China have set up a working group and will strive to launch the Southbound Trading within this year. After the launch of Southbound Trading, mainland investors will have more international and diversified bond investment options, the capital pool of the Hong Kong market will increase accordingly, bringing more demand for exchange rate and interest rate risk hedging. From this perspective, the Southbound Trading will not only help to deepen the development of Hong Kong's bond market, but also to enhance Hong Kong's role as an international risk management center.

The third is to promote the development of the retail bond market, and provide steady and reliable returns to citizens. The issuance of retail bonds is another important stimulus to promote the diversified development of the local bond market. The Financial Secretary proposed to issue no less than HKD24 billion in Silver Bond and no less than HKD15 billion in inflation-linked bonds (iBond) this year. He also proposed to raise the borrowing limit of the Government Bond Programme from HKD200 billion to HKD300 billion, and lower the eligible age for subscribing Silver Bond from 65 to 60. Silver Bonds and iBond provide investment options with reliable and stable return, and provide citizens with diversified investment choices amid the low interest rate environment.

2. Consolidate the global leading status of the stock market

As we all know, Hong Kong has the world's leading fund-raising equity market. In 7 of the past 10 years, the amount of IPO funds raised in Hong Kong has ranked among the top three in the world, thanks to the Hong Kong Stock Exchange (HKEX)'s institutional innovation and the embrace of new economy. In April 2018, the Hong Kong Stock Exchange revised its listing rules to allow pre-profit biotechnology companies and companies with weighted voting rights structures to be listed, and to establish a new concessionary secondary listing route for Greater China and international companies that wish to secondary list in Hong Kong. There have been 43 companies listed under the new listing rules in Hong Kong since its introduction, including ten China Concept Stock companies returning to Hong Kong for secondary listing and 31 pre-revenue or pre-profit biotechnology companies. These companies have a combined market capitalisation of over HKD11 trillion, accounting for about a quarter of the current total market capitalisation in Hong Kong. Currently, Hong Kong is the largest IPO market for biotech companies in Asia and the second largest in the world. The Budget this year proposed three major moves in promoting the securities market development.

The first is to review the secondary listing rules. In 2020, the United States tightened its listing requirements for mainland companies, encouraging more mainland companies to return to Hong Kong for listing. Nine Chinese companies listed in the United States have completed secondary listings in Hong Kong throughout the year, raising a total of HKD131.3 billion, accounting for 34% of the total funds raised in the Hong Kong market last year. As the most important secondary listing destination for mainland enterprises, Hong Kong has not only shown its status as an international financial centre, but also demonstrated its advantage of leveraging the Mainland and the “one country, two systems” system. In order to attract more companies to return Hong Kong for secondary listing, the Budget proposed to review rules including whether Greater China companies with non-weighted voting rights structures have to be hi-tech companies in order to seek secondary listing in Hong Kong, as well as their corresponding market capitalisation requirements.

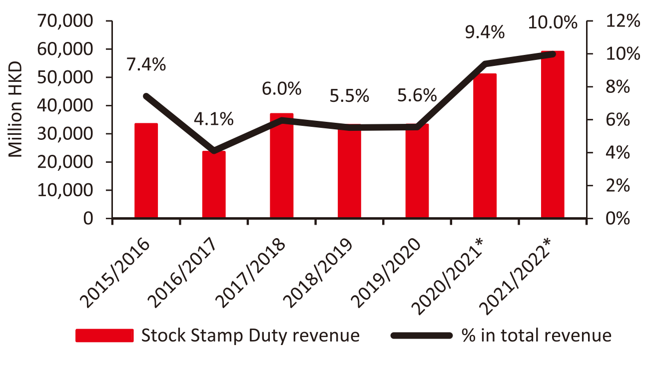
The second is to seek to expand the capacity of Stock Connect. The Budget proposed to progressively include the ETF and other types of assets as well as expansion of the scope of eligible securities into the Stock Connect. With the expansion of fund flows between the Mainland and Hong Kong, there will be growing hedging demand. The HKEX will accelerate the preparatory work for the launch of MSCI China A-Index Futures contract.

The third is to raise the stamp duty rate on stock transfers to 0.13%. This hike exceeded market expectations, leading the Hang Seng Index to fall sharply on 24 February. In our view, increasing the stamp duty rate on stocks is a plan that is suitable for the current situation after weighing the Hong Kong’s current fiscal status and the possible impact on the Hong Kong stock market and international competitiveness. It may have a short-term impact on market sentiment, but will not affect the stability of Hong Kong’s financial system in the medium-to-long term.

It’s quite clear that raising the stamp duty on stocks aims to increase Hong Kong government’s fiscal revenue. A sound fiscal condition is the cornerstone for maintaining the linked exchange rate system and the foundation for stabilizing investors’ confidence in Hong Kong as an international financial centre. In fiscal year 2020/2021, Hong Kong is expected to have a record high fiscal deficit of HKD257.6 billion. Furthermore, as the government expenditures grow faster than revenues, Hong Kong is expected to record consecutive fiscal deficits in the next five years. Therefore, it’s undoubtedly that the public finance needs to expand revenue.

In fact, at the time when the real economy is still in recession and financial activities are relatively strong, raising the stock stamp duty is a policy option with less negative impact on the financial market than raising salaries tax or profits tax. In the past five fiscal years, stock stamp duty accounted for only 5.7% of Hong Kong’s overall fiscal revenue on average, while profits tax accounted for 26% and salaries tax accounted for 10%. According to the government’s forecast, the increase in stock stamp duty rate will lift the stamp duty revenue of fiscal year 2021/2022 by HKD12 billion. Since the government has then announced that the new stamp duty rate will be officially implemented on August 1, 2021, the total revenue contribution will be HKD8 billion in fiscal year 2021/2022. According to our calculations, the proportion of stock stamp duty of the total fiscal revenue will rise to 10% in fiscal year 2021/2022 (Figure 3).

Figure 3: Stock stamp duty as a share of government revenue



Note: * represents forecast number
Source: Financial Services and the Treasury Bureau, 2021/2022 Budget, BOCHK Financial Institute

Figure 4: Stamp duty rates on stocks for major economies

Economy	Tax Rate	Collection target
United States	0%	N.A.
Japan	0%	N.A.
Mainland China	0.10%	Seller
Singapore	0.20%	Buyer
Hong Kong SAR	0.13%	Both seller and buyer
United Kingdom	0.50%	Buyer

Source: Boston Consulting Group, BOCHK Financial Institute

That said, we also need to take into account the negative effects of the tax rate hike, such as the blow to short-term market sentiment, or increased cost of high-frequency trading and hedging transactions, and so on. Compared with other major economies in the world, Hong Kong's stock stamp duty is at an upper-middle level, higher than the zero stamp duty rate of the United States and Japan, and lower than the 0.5% of the United Kingdom (Figure 4). However, the stamp duty on stock transactions is only one of the many factors affecting the overall of stock market activity. We also need to consider the positive factors for the Hong Kong stock market, such as interconnections with the mainland market, the return of China concept stocks for secondary listing in Hong Kong, and the strong Chinese economy attracting a large inflow of international capital.

3. Seize the new opportunities of asset and wealth management

Hong Kong is the largest international asset management center and private wealth management center in Asia, ranking second in the world behind Switzerland. It is also the second largest private equity fund center in Asia, second only to Mainland China. Sixty-four percent of funds invested in Hong Kong's assets and wealth management come from investors outside of Hong Kong. In 2019, under the challenges from local social events and Sino-US trade frictions, the scale of assets managed in Hong Kong increased robustly by 20% year-on-year to HKD28.7 trillion, and net capital inflow reached HKD1.67 trillion. In 2020, facing the threat of the global pandemic, the number of asset management companies in Hong Kong still grew by 3.9% to 1,878.

Since the outbreak of the Covid-19 pandemic, major central banks around the world have lowered their policy rates and implemented new rounds of quantitative easing policies, which have led to a substantial increase in the amount of global funds, and thus a rapid growth of asset management needs. Moreover, while the policy rates in Europe and US have fallen to zero or negative territories, Asian assets become more attractive on the back of the pursuit of yields by global funds. Therefore, Hong Kong should seize new opportunities and utilize its position as Asia's largest asset and wealth management center and its advantages of the interconnections with the Mainland to attract more funds inflows to Hong Kong.

Regarding this, the Budget introduced multiple supportive measures for the asset and wealth management industry. First, the government plans to allow foreign investment funds to re-domicile to Hong Kong, and subsidize 70% of the expenses paid to local professional service providers for open-ended fund companies that are set up or re-domiciled to Hong Kong in the next three years. Second, the government will review the relevant tax arrangements for family offices in Hong Kong. And third, the government will encourage more real estate trust funds (REITs) to be listed in Hong Kong and subsidize 70% of their local professional service fees in the next three years. The three measures above are all aimed to expand the capital pool of Hong Kong's asset and wealth management industry, increasing investing products, and helping Hong Kong's asset and wealth management industry to seize new opportunities and continue to consolidate its leading position.

4. Conclusion

Financial services industry is currently the most competitive industry in Hong Kong. Its real annual growth rate over the past 20 years has reached 6.8%, which is twice as fast as Hong Kong's GDP growth, making it the strongest driving force for the Hong Kong economy. Over the past two years, local social events in Hong Kong, Sino-US trade frictions, the threat of US financial sanctions on Hong Kong and the pandemic have sent the Hong Kong economy into a deep recession. However, while the Hong Kong economy hit its record contraction in 2020, the financial market showed strong resilience. The total transaction volume of the Southbound and Northbound Trading of Stock Connect more than doubled from the year before, and the funds raised through IPO has once again ranked second in the world. The resilience of the financial industry again proves Hong Kong's financial advantages which have accumulated over the years.

Hong Kong's status as an international financial center is the result of historical opportunities brought about by national development, Hong Kong's own institutional advantages, and the result of its continuous advancement and development opportunities over the years. As the pandemic still lingers, geopolitical risks still exist, and the global low interest rate environment continues, strengthening Hong Kong's financial competitiveness requires further improvement of its strengths, remediation of its weaknesses, and seizing new opportunities in the new era. The Budget provides a clear direction for Hong Kong's financial development from multiple perspectives such as consolidating the global leading position of the stock market, promoting the diversified development of the bond market, and seizing new opportunities for asset and wealth management, and thus helps to strengthen the global competitiveness of Hong Kong's financial industry and to create a more favorable conditions for an international financial center comparable to that of New York and London.

主要經濟指標 (Key Economic Indicators)

一. 本地生產總值 GDP	**2019**	**2020**	**2020/Q3**	**2020/Q4**
總量（億元）GDP($100 Million)	27,997	26,277	6,728	7,018
升幅(%) Change(%)	-1.2	-6.1	-3.6	-3.0
二. 對外貿易 External Trade			**2021/1**	**2021/1**
外貿總值（億元）Total trade($100 Million)				
總出口 Total exports	40,961	39,275	3,880	3,880
進　口 Total imports	45,714	42,698	4,132	4,132
貿易差額 Trade balance	-4,753	-3,422	-252	-252
年增長率(%) YOY Growth(%)				
總出口 Total exports	-5.6	-1.5	44.0	44.0
進　口 Imports	-8.1	-3.3	37.7	37.7
三. 消費物價 Consumer Price				
綜合消費物價升幅(%) Change in Composite CPI(%)	2.9	0.3	1.9	1.9
四. 樓宇買賣 Sale & Purchase of Building Units			**2021/2**	**2021/1-2**
合約宗數（宗）No. of agreements	74,804	73,322	7,561	13,773
年升幅(%) Change(%)	-5.5	-2.0	71.3	68.2
五. 勞動就業 Employment			**2020/10-2020/12**	**2020/11-2021/1**
失業人數（萬人）Unemployed(ten thousands)	139	259.1	24.6	25.3
失業率(%) Unemployment rate(%)	2.9	5.5	6.6	7.0
就業不足率(%) Underemployment rate(%)	1.1	3.1	3.4	3.8
六. 零售市場 Retail Market			**2020/12**	**2020/1-12**
零售額升幅(%) Change in value of total sales(%)	-11.1	-24.3	-13.2	-24.3
零售量升幅(%) Change in volume of total sales(%)	-12.3	-25.5	-14.0	-25.5
七. 訪港遊客 Visitors			**2021/1**	**2021/1**
總人數（萬人次）arrivals (ten thousands)	5,590	356.9	0.4	0.4
年升幅(%) Change(%)	-14.2	-93.6	-99.9	-99.9
八. 金融市場 Financial Market			**2020/12**	**2021/1**
港幣匯價(US$100=HK$) H.K. Dollar Exchange Rate (US$100 = HK$)	779.3	775.2	775.2	775.3
貨幣供應量升幅(%) change in Money Supply(%)				
M1	2.6	30.1	30.1	78.4
M2	2.8	5.8	5.8	15.2
M3	2.7	5.8	5.8	15.1
存款升幅(%) Change in deposits(%)				
總存款 Total deposits	2.9	5.4	5.4	15.8
港元存款 In HK$	2.5	6.2	6.2	24.6
外幣存款 In foreign currency	3.2	4.6	4.6	6.8
放款升幅(%) in loans & advances(%)				
總放款 Total loans & advances	6.7	1.2	1.2	12.4
當地放款 use in HK	7.1	1.7	1.7	17.7
海外放款 use outside HK	5.8	0.1	0.1	-0.1
貿易有關放款 Trade financing	-0.7	-6.2	-6.2	-2.2
最優惠貸款利率(%) Best lending rate (%)	5.0000	5.0000	5.0000	5.0000
恒生指數 Hang Seng index	28,189	27,231	27,231	28,284