Asian financial markets: Reform and recovery

Ki-Chi Kwong

Ki-Chi Kwong has served in the government of Hong Kong for the past 27 years, primarily in positions in the economic and financial fields. He currently is chief executive of the Hong Kong Exchanges and Clearing Ltd., a position he has held since March of 2000. Prior to this, he was secretary for Information Technology and Broadcasting from 1998 until 2000, and Secretary of the Treasury from 1995 to 1998. Kwong was born in Hong Kong and has a bachelor of science in physics and mathematics from the University of Hong Kong and a master's degree in economics and politics from the University of Cambridge.

By now the Asian Financial Crisis is a bad memory, though one that is still fresh in everyone's mind, especially in Hong Kong where the once stable economy took a hard hit, said Kwong Ki-Chi, chief executive of the Hong Kong Exchanges and Clearing Ltd.

"The Asian Financial Crisis started around the middle of 1997, shaking the foundation from under the stock and currency markets," said Kwong.

The Hong Kong Special Administrative Region of China was not alone in its misery. On Aug. 28, 1997 the Philippines, Singapore and Hong Kong currencies racked up losses against the U.S. dollar. Tokyo stock prices dropped precipitously and Hong Kong's blue-chip Hang Seng index fell by 759.30 points before recovering a short time later to 14,307.10 points.

Singapore's Straits Times Index tumbled 5.4 percent to its lowest in more than four years. Malaysia's benchmark index was off 2.9 percent, and in South Korea the benchmark stock index fell to its lowest in more than three months. On the same day, Philippine stocks plummeted, taking their biggest one-day dive ever and wiping out $5 billion of market value, an amount equivalent to 7 percent of the economy's annual output.

And the worst was far from over, investors said.

They were right.

On May 27, 1998, another plunge in stock prices hit financial centers around the globe. In Hong Kong, the Hang Seng Index fell 5.3 percent, and Hong Kong Chief Executive Tung Chee Hwa warned that the territory was facing its first negative economic growth in a decade. A month later Tung unveiled a government stimulus package aimed at reviving the economy and stemming a steep slide in property prices.

Ultimately, government intervention restored order in the Hong Kong markets. Since 1999, Hong Kong's financial sector and economy have been recovering, with double digit growth for the last two quarters of 2000.

New Financial Landscape

Reform of Hong Kong's securities and futures markets has been accomplished with the demutualization and merger of:

- the Stock Exchange of Hong Kong and the Hong Kong Financial Exchange;
- the stock, futures and options markets;
- the stock, futures and options clearing houses.
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The new entity is the Hong Kong Exchanges & Clearing Ltd., established on March 6, 2000. The HKEx offers a full spectrum of products and services that include:

- Primary markets
- Secondary markets
- Derivatives
- Post trade services
- Market information.

"In the new financial landscape, alliances and mergers of exchanges are the logical development," said Kwong. "They allow for larger liquidity pools, better prices, lower transaction costs, better risk management, harmonized regulation across markets, and a 24-hour trading market linking the three main time zones.

"Today, because of globalization and information technology, there are more individual investors who are demanding real-time and any-time trading, with low costs and a transparent and level playing field for secondary markets," said Kwong.

China is in the Hong Kong market with "H" shares or "Red Chips." These are shares of 22 large Chinese companies, each with total assets of more than 1 billion ren min bi (RMB). The Hong Kong Exchange represents the biggest foreign exchange market for Chinese State Owned Enterprises (SOEs), where 84 percent of SOE foreign exchange capital from stocks is raised; the balance is raised in the United States and the United Kingdom.

In the initial public offering stage, a fair amount of trading occurs around the world, stimulated by road shows to increase foreign investor interest. But over time, interest wanes and 70 percent to 80 percent of these stocks migrate back to Hong Kong for their secondary market.

Chinese SOEs still have to go back to the U.K. and the U.S. for additional capital.

Best Performer

Hong Kong's Growth Enterprise Market (GEM) bears some similarities to the USNASDAQ. "The GEM is for new companies because they may not have the qualifications for a listing on the big board. There is no requirement for the company's profitability. Thus far, $2 billion has been raised, making the Hong Kong GEM the best performer in Asia."

Established in November 1999, the Hong Kong GEM has quite a bit of liquidity, with a turnover of three times the amount on the main market, said Kwong. Only Korea has more turnovers, about half of which is accomplished through the Internet.

"There is more risk associated with the GEM; in Taiwan, as in Hong Kong, buying these shares is a bit like gambling," said Kwong.

The Shanghai and Shenzhen exchanges are in Hong Kong's back yard. Together these exchanges are slightly larger in size and volume than the Hong Kong Exchange, but Kwong does not consider them to be much competition. "They serve a different market because investments must be made in Chinese RMB, a currency which is not convertible to other countries' currencies. Hong Kong's shares are fully convertible. Also, the goal of the Hong Kong exchanges is the integrity of the markets; we in Hong Kong are honest and open. Shanghai and Shenzhen are not yet up to Hong Kong standards."
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Convertibility is the big issue, said Kwong. "The East Asian crisis has made the Chinese government more cautious, and if your financial markets are still not developed, with full accountability, then they are very risky. The World Trade Organization should provide substantial pressures to correct the situation. I believe that China will continue to go slowly and not allow quick convertibility. Even in Taiwan and Korea, there is only a certain level of convertibility allowed and only recently, up to US$10 billion for qualified financial investors."