



**HONG KONG**  
**NOWADAYS**

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# HONG KONG NOWADAYS

中華人民共和國



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Jamie Berry and Mark Robinson were in Hong Kong last month meeting a broad cross section of the financial community. This edition of Client Insight summarises reflections from an investment perspective, ten years after 1997 and the official handover to China.

Your first clue that life is different in Hong Kong nowadays is clear before you even land: from above, the smoky green islands in limpid water look much the same, but gone is the electrifying landing, the 747's wings seeming almost to brush the laundry hanging from poles outside high rise blocks of flats. The landing now is at the grown up Chep Lap Kok airport, built on a scale which European countries could only dream of. It is a spectacular monument to global aspiration, and your first hint that Hong Kong isn't just a hot and steamy place which got lucky through hard work in the financial services industry, but is now a key gateway to and from China, a country we are all going to hear even more about in the next decade or two.

Despite shocking pollution and smog, even the air somehow seems different. In the old days downtown Central's air was like hot toffee, with a background cacophony of taxis. Of course, it's just as busy, but gleaming Mercedes backed up on the freeway don't seem quite so noisy somehow. And the buildings keep getting taller: IFC2 stands at 88 storeys, and over on Kowloon side a 108 storey building will be ready for occupation by Morgan Stanley next summer. It will be the second tallest building in Asia, and Morgan Stanley will save a fortune in rent by being bold enough to move out of the centre of town.

“...some argue that a

# 特別香港國口



## So, ten years after Prince Charles reclaimed the Union flag and was piped onto HMY Britannia with Chris Patten's pretty daughters, what else has changed?

Walking around Hong Kong it is hard to not to feel that a new type of wealth is influencing the local and wider economy, and that China is the root cause. The most recent Asian economic downturn, which ended in 2003, now seems to be quite distant, with a new wave of optimism pervading through the streets. The influence of Chinese consumerism is most obvious in the squeaky clean covered shopping malls, which are full to capacity with designer label stores; Kowloon, on the mainland side of Hong Kong, now has a Bond Street equivalent all of its own, and if one branch of Prada or Gucci doesn't have what you want, there's another one just around the corner.

Extra wealth is also being expressed in asset prices generally – with interest rates generally sitting at around 4%, investment in property and shares are seen as more lucrative options. Until recently, it was not possible for Chinese investors to buy shares on anything other than their domestic 'A' share market, but the Chinese government has now relaxed this to allow investment in Hong Kong's 'H' shares, which trade at a significant discount to those listed on either the Shanghai or Schenzhen stock exchanges. The granting of licences to Hong-Kong based investment firms, so that they can set up funds which can take in Chinese money, is still in its infancy, but the building blocks of a more progressive government policy on a wider savings market, using Hong Kong as a conduit, are now very much in place. Following very strong rises in both 'A' and 'H' share markets this year, some argue that a correction is well overdue. This may be so, but we would expect any correction to be temporary given the massive amount of money being accumulated and needing a home. It is also worth noting that equities account for less than 20% of Chinese households' savings, compared to around 50% in America, so any setback in markets would not hurt the Chinese consumer nearly as hard as it would in the US.

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It is difficult to comprehend the sheer scale of expansion and progress in China and its impact on cities such as Hong Kong, but taking just one city, Shenzhen, as an example is perhaps a useful starting point. Shenzhen is China's wealthiest city – lying just 25km away from the core urban area of Hong Kong, it has been one of the fastest growing cities in the world over the past 30 years. It attracts Chinese people keen on making quick fortunes or a break for Hong Kong, and gives access to cheap prices and low-cost labour for Hong Kong consumers and companies. Twenty-seven years ago, when it was declared as China's first Special Economic Zone, Shenzhen was a small fishing village on the coast – its coastline now stretches for 250km, equivalent to the distance from the Thames estuary right round to The Wash. In the same period, its population has grown from around 300,000 to around 10 million. If you own an iPod, an HP or Dell computer, a Playstation or a Motorola mobile phone, the chances are that key components were manufactured or assembled by Foxconn – actually a Taiwanese company, but employing over 250,000 people in Shenzhen. Foxconn is not only the largest, but also the fastest growing multinational manufacturing services provider in the world and the largest exporter in Greater China. Not bad progress for a company that started in 1974 with \$7,500 of seed capital and has been growing its revenues at a compound rate of more than 50% ever since.

Of course the huge amount of urbanisation and shift in demographics has come at a big price, the environment being the most obvious casualty. Construction and land reclamation in Hong Kong harbour is still intense, but there are now signs that things have moderated. But there is still much to be done to ensure that the so-called 'great pall of China' does not become so thick that it smothers the creation of wealth beneath it.

Although China's influence in, and over, Hong Kong is clear, its ties with the past are still present, as demonstrated by the fact that its currency is still pegged to the US dollar. This is causing a localised problem of its own, in that Hong Kong's interest rates have been reduced (in line with US policy) at a time when inflation is rising. There is a growing case for the currency peg to be removed and for the Hong Kong dollar's direction to be more closely aligned with that of the Chinese currency, which would be in keeping with the fundamental economic backdrop.

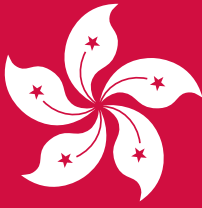
“Hong Kong is the conduit through which to access the opportunities in China...”



**Although it all looks good right now, the last ten years haven't all been easy.**

Not so very long ago the outlook was truly bleak, with the vision of SARS wiping out a generation or two being a real threat. Since 2003, however, Asian economies have generally been trying to get back on their feet after the financial crisis that gripped many economies in 1997. Asia, and in particular China, is still exposed to any global economic slowdown, but is now much less dependent on exports to the US than it once was. Chinese exports to Europe, for example, have now overtaken those to the US and exports to other emerging nations are growing even faster. Add to that the fact that there is a massive increase in domestic demand, no particular real estate bubble and the security of massive reserves, then China looks a much more attractive proposition than many western economies, offering some immunity from the problems that may be brewing elsewhere. What we are now seeing is China changing from being known as the turnkey exporter of the world to being a more self-sufficient nation based upon core facets of growth. For now, Hong Kong is the conduit through which to access the opportunities in China, but this too will undoubtedly change over the next ten years as more barriers come down and more opportunities for investment are exposed.

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