2018 China Forum: Opening remarks

Speech by Pat Burke and Helen Wong
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Pat Burke:
Good afternoon and welcome to our clients and distinguished guests.

I'm delighted that you are joining us for what I'm confident you'll find to be a very engaging afternoon.

Certainly there's no shortage of China-related topics, and we'll do our best to address as many as we can.

We started organizing these Forums in 2015 for a simple reason:
- The flow of goods, services and investment capital between the United States and China represents one of the most important economic relationships in the world.
- Perhaps THE most important
- Certainly important to many of our clients, here and there
- What's important to our clients is important to HSBC

We meet at Time Warner Center, overlooking Columbus Circle:
- Named of course for Christopher Columbus
- Voyagers across the Atlantic more than 500 years ago inaugurated the migration of Europeans to the Americas
- His statue is on the pedestal in the center of the round-about

Americans have been putting him on a pedestal for decades
- Just to the north-west is Columbus Avenue
- Follow Columbus Ave up-town to Columbia University
- To the east is the corporate headquarters of Columbia Broadcasting System
- On the second Monday of every October, HSBC and every other bank in the US closes for Columbus Day

He has recently become a controversial figure
- Blamed for what the expansion of European civilization meant for the native American civilizations

Controversy overshadows what he originally set out to do
- What the king and queen of Spain paid him to do
- And what he failed to do
- <u>Find a short-cut trade route to China and India</u>

A reminder that the desire for a closer relationship with China has been shaping world history for centuries

HSBC always been at forefront of connecting China and the world
- Not "always" as in "since 1492;" we did not provide financing for the Nina, the Pinta and the Santa Maria
- "Always" as in "since 1865" – the year when our first offices opened in Hong Kong, Shanghai and London
- Also when we began serving clients in San Francisco

I retell this history for a few reasons:
- One: I'm proud of it, and it defines the vision I have for HSBC in the US going forward – as a commercial bridge from America to China as well as to Asia more broadly, and to Latin America, Europe and the Middle East.
- Two: Helen is going to talk about the opening of the Chinese financial markets since Deng Xiaoping, and it's a rare opportunity to talk about American history over centuries and Chinese history over just a few decades.
- Three: it's a reminder that the long-term trends of global trade and commerce transcend the current political moment.

Our strategy in 1865 was more or less than same as today:
- Be on both sides of the busiest trade routes and investment corridors in the world
- Hire the best local people in the markets at each end of those trade routes

- Build a bank that was simultaneously local, foreign and international

It's a strategy that has stood the test of time
- Fueling an expansion that has made us one of the largest financial services organizations in the world
- 3,900 offices in 67 countries and territories

China remains core to who we are
- #1 bank in Hong Kong by market share
- The top international bank in the Pearl River Delta
- The largest foreign bank in mainland China
- The first majority-owned securities JV in the mainland
- Leading international bank in RMB
    - Capabilities in 50+ markets
    - 53% market share as an onshore custodian bank in RQFII offerings
    - First bank to settle RMB transactions on six continents

No other bank can match our ability to serve our clients' cross-border banking needs and facilitate investment flows into and out of mainland China

For HSBC USA, China has always been central to our business
- In 1880 we opened our first branch in NYC
- The business case, as recorded by HSBC's Board, was, and I quote: *"The business between America and China… is assuming large proportions and is likely to be still further developed."*

Talk about foresight!
- We've kept our finger on the pulse of the US-China relationship ever since, through good times and bad
- Last year, our business in serving clients in the U.S.-China corridor grew more than 10%
- That's faster than the GDP growth of either country

There are a variety of explanations for this growth:

Our relentless focus on the needs of clients:
- US-based clients pursuing commercial and investment opportunities abroad, including in China
- China-based clients looking to invest, grow and raise capital in other nations, including the US.

HSBC USA's range of financial services to support clients' cross-border aspirations
- Trade finance, cash management, FX, capital financing, commercial lending, and so on

HSBC's in-country expertise
- In US as well as China, we are a universal bank
- Unique insights from serving the banking needs of consumers, small businesses, corporates of all sizes and institutions

And we're benefitting from our centuries-long presence on both sides of the Pacific, at a moment in history when the economic destinies of these two great nations are becoming ever more intertwined.

You will hear discussion today about the ongoing opening up of China's financial system.
- Certainly it's unfinished business, but it has come a long way
- It has already transformed daily lives of Chinese people

Chinese people can now aspire to a quality of life that we in the West take for granted
- Moving gradually from blue-collar to open-collar (services)
- From rural to urban
- From savers to spenders
- Population is becoming older and richer

Consider these trends:

Starbucks operates more than 3000 stores in China
- Plans to open another 1500 over 4 years
- Not sure if that's more than the number of Starbucks in Manhattan
- But 4500 is a lot of stores selling coffee to a population of traditionally tea drinkers

Tencent's QQ instant messenger has 840M users each month
- Over double the total US population
- The number using WeChat and Weixin is even more – 930M

More broadly, we are seeing incredible growth opportunities coming for China through the Belt and Road Initiative, development the Pearl River Delta and leadership in sustainability and green finance.

These are some of the reasons I'm bullish on the US-China relationship over the long-term

- Big opportunities for American businesses that cater to the Chinese people's desires for the same things Americas want – education, travel, entertainment, health care, cappuccinos
- Opportunities for US firms in engineering, construction, logistics and business services, and the potential to get a piece of the Belt and Road Initiative
- Continued investment by the Chinese in America

Still, we can't avoid the elephant in the room.

- In the short term, much depends on politics and policies

Of course tit-for-tat trade tariffs are troubling

- I'm not going to speculate about exactly what lies ahead
- We believe rules-based trade and the steady lowering of trade barriers is the best path for growth and prosperity
- We know our clients prefer certainty in trade policy
- So we hope for a fair, equitable resolution can be reached soon
- And we are ready to support our clients whatever happens

There is also concern about CFIUS

- The system by which US government reviews Chinese investments on national security grounds
- CFIUS has been taking into consideration a wider array of criteria when assessing security risks
- Proposed legislation, supported by the US administration, would raise the bar higher, expanding the focus to critical infrastructure, materials and technology

My view on CFIUS:

- The current system was established more than 40 year ago
- It's probably time for an update
- The world has changed since Gerald Ford was president
- There are good reasons to do more to protect national security and IP
- Question is: how best to do it
    - Without unduly harming mutually beneficial cross-border investment flows
    - Without crimping innovation

I think government policies that inhibit continued economic integration and bi-lateral investment are on the wrong side of history

- The economies and the people are moving closer together
- Washington and Beijing are moving apart

Earlier this year, we asked business leaders around the world where they are looking to expand over the next 3-5 years

- US was the #1 answer among Chinese business leaders, mentioned by more than 1/3 (Australia 24%, Canada 18%)

We forecast that by 2030, China will be the #1 destination for US services exports, displacing the UK as the largest market.

Those are just a few examples of the strong underlying fundamentals, and some of the reasons I'm optimistic.

Our speakers and panellists will be looking at the US China relationship from many angles, over the long and short terms.

We'll likely hear reasons for excitement, and reasons to worry.

I look forward to a robust, insightful conversation.

I'll let you draw your own conclusions, as I welcome to the stage my co-host, Helen Wong – Chief Executive of Greater China.

She and I share the responsibility for serving HSBC clients in our respective markets, as well as HSBC clients operating and investing in the other's home country.

I am honored to have her as a colleague and pleased to call her a friend.

Please join me in welcoming Helen Wong.

Helen Wong:

Thank you, Pat – and good afternoon to everyone.

I'm delighted to be back in New York.

I was unable to attend the Forum last year, so today I'm extra thrilled to see all the familiar faces and make new acquaintances.

Pat and his team have been hosting the China Forum for a number of years, and I've begun to notice a pattern.

What pattern, you ask?

The Forum is usually held here in the summer – and it seems that every year, in the months leading up to the Forum, something big happens.

It typically concerns US-China trade and investment, and provides everyone at the Forum with plenty to talk about.

Two years ago, the big announcement was China granting the US an investment quota and permitting eligible US firms to invest in mainland Chinese bonds and stocks.

At almost USD40 billion, the US quota was only smaller than that of Hong Kong.[1]

Naturally, it was widely reported in the media. Then last year, MSCI announced that it would include Chinese stocks in its emerging markets index.

The inclusion, which went into effect on June 1 this year, shows that China is becoming accepted into the mainstream of global capital markets.

And it could prompt well over half a trillion US dollars of foreign investment to pour into the Chinese stock market in the next 5-10 years.[2]

I'm sure many of you remember the excitement this created in the investment community.

This year, it's the elephant in the room – tariffs.

We can call this situation by different names but the fact of the matter is the same: it's real.

As everyone here knows, the US imposed tariffs on China. Then China imposed tariffs on the US. Then the US proposed more tariffs on China.

And so the world's two biggest economies are, for now, locked in a face-off over trade.

I'm not here today to speculate on how this situation will develop – clearly, it is very fast-moving.

And it's too early to quantify the impact that this cycle of retaliation and escalation will have on the world economy.

In a couple of months' time, we should have a clearer understanding of the real effects caused by the first round of tariffs – but by then additional rounds may have been imposed and the quantification will have to start over.

Of course, the one thing we know for sure is that this situation is adding to uncertainty for businesses and investors.

Anyone putting capital to work likes to have as few unknowns on the horizon as possible. But friction over trade between two giants of the global economy only makes the future more unpredictable.

I think people would agree on the great importance of free and fair trade between the US and China – and share our hope that an equitable resolution to this situation can be reached as soon as possible.

HSBC's heritage is in supporting international trade and investment. We firmly believe in the power of rules-based trade to increase prosperity and opportunity for everyone.

And whether you're a financial firm in New York, Hong Kong or Shanghai, or a tech company in Silicon Valley or China's Silicon Delta, or a corporate that trades goods and services

[1] https://www.reuters.com/article/china-usa-rqfii-idUSL4N18Z1SN

[2] https://www.scmp.com/business/markets/article/2147014/global-investors-now-precisely-wrong-time-overlook-chinas-market

between the US and China, we all benefit from closer collaboration between the two biggest economies in the world.

Whatever happens, we will continue to help our clients navigate any changes that are impacting their businesses.

And, make no mistake, there continues to be great opportunities for American companies and investors in China.

And that is what today's Forum will focus on.

Let's start with the economy and the growing role of the Chinese consumer.

Mainland China's GDP grew by 6.9% last year. More importantly, its income per capita grew by 9% – which means China's standard of living is growing at a faster rate than its economy.[3]

A higher standard of living translates into greater consumption of goods and services.

As a movie fan, let me share some box-office numbers to illustrate the raw power of Chinese consumers – the rising stars of the global economy.

Last year, the world's highest-grossing film was "Star Wars: The Last Jedi" - but a Chinese film by the name of "Wolf Warrior 2" was also in the top 10.[4]

"The Last Jedi" earned USD600 million or so in the US and Canada combined – and another USD700 million or so in the rest of the world.[5]

"Wolf Warrior 2", meanwhile, earned more than USD850 million in China alone, becoming the biggest commercial success in Chinese cinema history.[6] [7]

Some of you may even recall that, last August, the New York Times ran a front-page story on the film's overwhelming success in China.[8]

To put it in perspective, only one film in history earned more in the US and Canada than "Wolf Warrior 2" did in China – and that was "Star Wars: The Force Awakens".[9]

Since 2010, total cinema ticket sales in China have increased nearly 6-fold to USD8.6 billion, putting China on a path to overtake North America as the largest theatrical film market in the world sometime in the next few years.[10]
As Darth Vader would put it, "The Force is strong with this one."

That "Wolf Warrior 2" smashed box-office records is part of a long-running story featuring the rising stars of the global economy: Chinese consumers.

Our Global Research forecasts that China's GDP will grow by 6.6% this year and 6.8% next year.[11]

And it looks increasingly likely that China will achieve its target of doubling its GDP and income from 2010 levels by 2020.

But even then, the average Chinese will have only about one-third the spending power of the average American.[12] So the Chinese consumer story, like the Star Wars saga, can go on and on…

Consumption and services are two of the long-term drivers of China's economic growth.

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[3] https://www.scmp.com/news/china/economy/article/2129508/chinas-economy-expands-69pc-2017-ending-six-years-slowing-growth

[4] http://www.boxofficemojo.com/yearly/chart/?view2=worldwide&yr=2017&p=.htm

[5] http://www.boxofficemojo.com/movies/?page=main&id=starwars8.htm

[6] http://www.boxofficemojo.com/movies/?page=intl&id=wolfwarrior2.htm

[7] https://variety.com/2017/film/asia/celina-jade-wolf-warrior-2-china-wu-jing-1202631942/

[8] https://www.nytimes.com/2017/08/16/world/asia/china-wolf-warrior-2-film.html

[9] http://www.boxofficemojo.com/alltime/domestic.htm

[10] https://www.hollywoodreporter.com/news/china-box-office-returns-robust-growth-2017-hitting-86b-1070895

[11] https://www.research.hsbc.com/R/10/SD7NgMSjNKxS

[12] https://www.bloomberg.com/graphics/2016-us-vs-china-economy/

China is increasingly a service economy – and nowhere is this more apparent than in China's start-up scene.

Uber, as you all know, is the world's most valuable unicorn, but the second- and third-most valuable unicorns are all born and bred in China.[13]

There's Didi Chuxing, which is China's top ride-hailing app, worth more than USD50 billion.[14]

Then there's Meituan-Dianping, which offers on-demand services such as restaurant-booking, group-buying and food delivery.

Think of it as Yelp and Groupon and Deliveroo rolled into one.

Meituan-Dianping's estimated value is USD30 billion.[15]

As income and consumption rise in China, demand for services will grow – and these and other made-in-China unicorns reflect the country's increasing appetite for services.

Let me now move on to China's capital markets. As I mentioned earlier, on June 1 this year, MSCI began to include Chinese stocks in its emerging markets index.

Next April, Bloomberg is set to add Chinese bonds to its global aggregate index.

Both benchmarks are among the most prominent of their kind, and are tracked globally by assets worth trillions of US dollars.

These index inclusions are the start of what I would call the "mainstreaming" of China's capital markets.

China has the world's second-largest economy, second-biggest stock market and third-biggest bond market, but it accounts for a tiny proportion of international investors' portfolios.

To put it in perspective, China accounts for about 15% of global GDP, but Chinese stocks constitute only about 3% of global equity allocations.[16]

In the fixed income market, global investors own only about 4% of China's government bonds, compared with more than 40% of US and about 10% of Japanese government bonds.[17]

For decades, China has been at the margins of international investment portfolios – but this anomaly is gradually being corrected as access to China's markets increases.

In recent years the game-changers have been the Connect programmes.

The Shanghai-Hong Kong Stock Connect was the first in 2014, followed by the Shenzhen-Hong Kong Stock Connect in 2016 and Bond Connect in 2017.

These Connect schemes allow any investor who can access the market in Hong Kong to trade eligible securities in China and Chinese investors free access to a wide range of shares listed in Hong Kong.

The scale of these portals is also evolving quickly: In April, the quota for the existing Stock Connect investments was quadrupled, and China reaffirmed plans to launch a new stock trading link with London by the end of the year.

Even with these great strides in access to China's onshore capital markets, though, I understand why some global investors remain cautious.

The reality is that investing in Mainland China's markets is still a new discipline for many asset managers. They are still developing the know-how to maximize their success. They are facing a fairly steep learning curve as they become familiar with China's legal framework and financial reporting.

[13] https://www.cbinsights.com/research-unicorn-companies
[14] https://www.cbinsights.com/research-unicorn-companies
[15] https://www.cbinsights.com/research-unicorn-companies
[16] https://www.research.hsbc.com/R/10/6nTkfhVySZdH
[17] https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research-Papers/2017/CCEO_Rpt(CN-bond)-201705_E.pdf?la=en

For US investors, investing in China is simply not the same as investing in, say, Canada or Europe, where the landscape has become more standardized over time.

Of course, this makes it especially important to partner with the right bank.

It should come as no surprise that we feel there are distinct advantages to working with HSBC, a universal bank with a global network and a strong heritage in Mainland China and Hong Kong.

I am confident that the "mainstreaming" of China's capital market is set to disrupt global investment flows, much the way China has rewired global trade over the past 40 years.

Yes, it's been four decades since China, under the leadership of Deng Xiaoping, took the momentous steps to reform its domestic economy and open up to the global economy.

And the process of reform and opening that Deng started is still gaining momentum.

Late last year, China announced that it would remove the limit on foreign ownership of Chinese banks and asset managers, and pledged to further open up the financial sector in next three to five years.

In April, further details were announced. China said it would allow foreign investors to take a stake of up to 51% stake in brokerages, futures companies and fund management firms, with the cap to be removed within three years.

Earlier this month, Tesla announced plans to build a "Gigafactory" in Shanghai. This will be the first wholly foreign owned auto plant in China and makes Tesla Shanghai's biggest foreign manufacturing investor.[18]

Around the same time, German firm BASF revealed that it would be building a USD10 billion chemical plant in Guangdong province. This would be the company's third largest production facility in the world – and would be fully owned by BASF.

HSBC itself has been the beneficiary of China opening up. Last December, for example, we launched HSBC Qianhai Securities – the first Chinese securities joint venture to be majority owned by the foreign partner.

I think you can see that the trend here is clear. And over the next five years, China expects its imports to be worth more than USD8 trillion, while it absorbs more than USD600 billion of foreign investment. [19]

I would urge you all to keep a close eye on the first China International Import Expo in Shanghai this November, which is expected to showcase opportunities for international companies in China.

The trade dispute is real, as I said. But fundamentally, both economies will benefit from greater flows of goods and services, of capital and of talent.

I hope you find today's Forum will reinforce this argument and provide you with some new insights into opportunities in China.

Thank you very much.

[18] https://www.scmp.com/business/companies/article/2154867/teslas-shanghai-plant-announcement-matter-auspicious-timing

[19] http://en.people.cn/n3/2017/0514/c90000-9215214.html