

ASF 2017 - Hong Kong Market Report

HONG KONG ECONOMY

Introduction

Located in the south coast of China, Hong Kong is a special administrative region (SAR) of the People's Republic of China (PRC). With a total land area of only 1,104 square kilometers, the city is a tiny piece compared to the mainland but it certainly carries quite a significant weight in the nation's economic development, particularly in the financial sector amidst its advanced market infrastructure and legal system.

Over the past three decades, HK has played an essential role in bridging China with the international community. It has attracted some of the largest corporations and leading firms in different industries from the mainland to be listed in HK Stock Exchange, one of the key factors behind HK's consistently high ranking in equity fund raising among major global markets. Besides, it has emerged into a major off-shore center for Renminbi (RMB) business in recent years.

Clearly, HK is one of the most powerful international financial centers around the globe, at par with cities such as New York and London. According to statistics, the financial services sector employed over 250,000 people while contributed 18% of the local Gross Domestic Product (GDP) in 2016. It would be difficult to imagine that any major financial institution which has no branch or office in HK. Currently, there are 157 banks, 161 insurance companies, more than 500 brokerage firms, and over 1,000 asset management companies packed in the city and many of them are well-known multi-national corporations.

Economic Performance

Hong Kong economy is enjoying a robust year on the back of continuous recovery in consumption as well as increasing global demand. Its GDP grew by a respectable 4.1% during the first half of 2017. The figure represents an ongoing trend of above average economic expansion since late 2016.

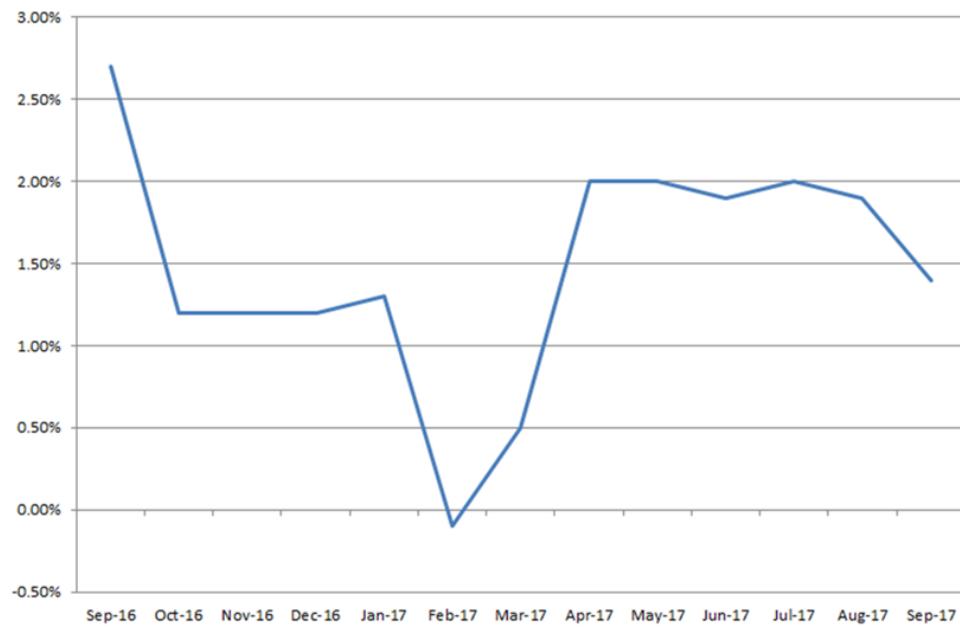
Table 1: Key Economic Indicators

	2014	2015	2016	2017Q2
GDP(yoy,%)	2.8	2.4	2.0	3.8
CPI(yoy, %)	4.4	3.0	2.4	2.0
Unemployment rate(%)	3.3	3.3	3.4	3.2
Foreign reserve (US\$billion)	328.5	358.8	386.2	408.0
Overall Balance of Payments (HK\$billion)	139.09	281.99	8.86	76.11

Source: Census and Statistics Department, the HKSAR Government

Inflation has been largely under control so far this year. According to official statistics, consumer price index was at 1.7% in the third quarter, slightly down from 2.0% recorded in the second quarter while somewhat lower than the 2.4% mark in 2016.

Chart 1: Year-on-year Rates of Change in the Consumer Price Index



Source: Census and Statistics Department, the HKSAR Government

Meanwhile, Hong Kong's labor market has been in a state of full employment since 2015 and this year is no exception. The latest unemployment rate was at 3.1% while the underemployment rate fell to 1.1% during the third quarter this year.

Economic Forecasts

2017 has been a relative "smooth ride" compared to 2016 which saw major surprises such as Brexit as well as the US presidential election. A generally vibrant economic landscape helps HK's economy to expand at a decent rate, exceeding most previous expectations. Many analysts believe that the robust trend would continue for a little while amidst a continuously improving global demand plus surging capital markets. In early November, the HKSAR Government actually revised up the full-year economic growth forecast to 3.7%, making it the fastest growth rate in six years.

SECURITIES MARKETS

Capital Market Data

As of October 2017, a total of 2,082 companies were listed on the Stock Exchange of Hong Kong Limited (SEHK) while there are almost 10,000 other listed securities, including structural products, debt securities, and ETFs. Total market capitalization of SEHK was HK\$32.25 trillion, setting a new record high and equals to an increase of 26.9% over the same period last year.

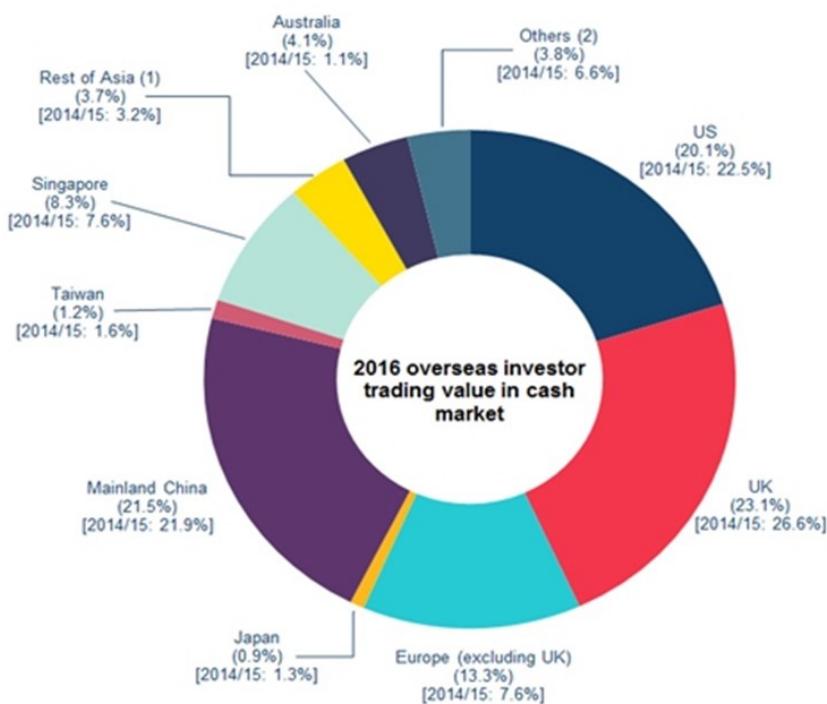
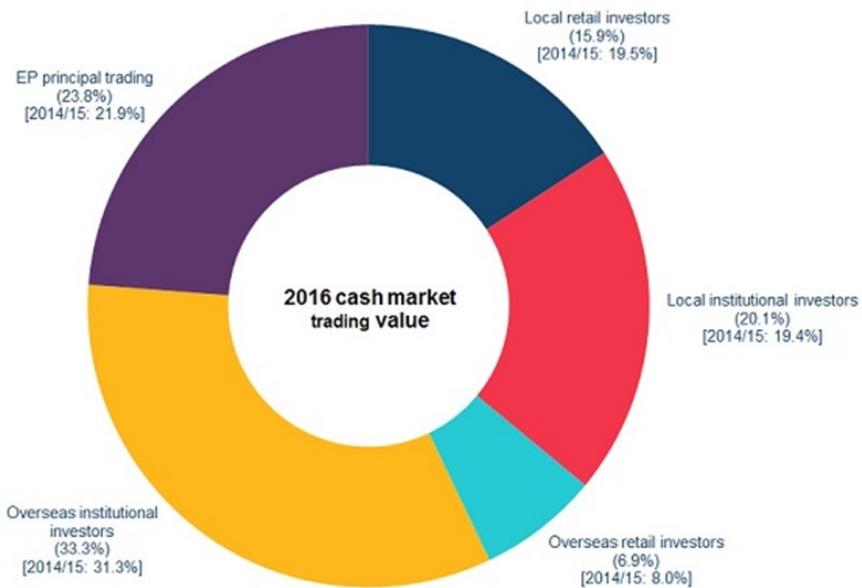
Mainland enterprises continue to play a vital role in the Hong Kong stock market as a total of 1,037 Mainland enterprises (including 250 H-share companies, 158 “Red Chips” companies and 629 private enterprises) are listed in the SEHK at end of October. Altogether, they accounted for 66% of total market capitalization and 78% of the total daily turnover.

Table 2: Key Statistics of Securities Listed on SEHK

	2013	2014	2015	2016	2017(Oct)
Number of listed companies	1,463	1,752	1,866	1,973	2,082
Total market capitalization(HK\$Bil)	24,043	25,072	24,684	24,761	32,253
Number of listed securities	8,522	9,060	9,015	8,591	12,072
Number of equity warrants	8	10	13	9	8
Number of derivatives warrants	4,715	4,938	4,590	3,705	5,509
Number of Callable Bull/Bear Contracts	1,620	1,579	1,630	1,844	3,315
Number of mutual funds	129	134	145	157	148
Number of debt securities	403	640	762	892	994

Source: HKEx

Chart 2: Type of Investors (up to 2016)

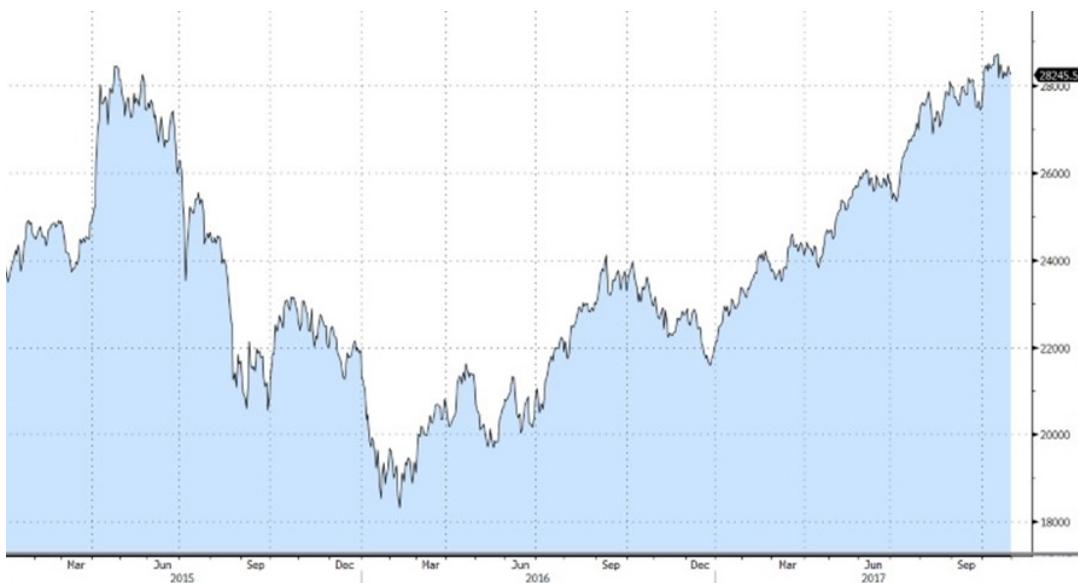


Source: HKEx

Market Performance in 2017

2017 represents one of the best years for many investors and HK is a front-runner in this global bull-run. The Hang Seng Index (HSI), a key benchmark which consists of 50 large-cap stocks and covers more than 50% of the total market capitalization, started at 22,000 points and has been on upward trend for most of the year. In fact, the index has risen for eight months in a row before finally “resting” in September. The bullish sentiment did not stop there and picked up strength soon, pushing the HSI to top the 29,300 level in mid-November, which is a new high after 2007. After all, the index has gained more than 30% so far this year, representing the strongest year since 2009 and outperforms other major indices including the mighty NASDAQ and Dow Jones Industrial Average (DJIA) in the US.

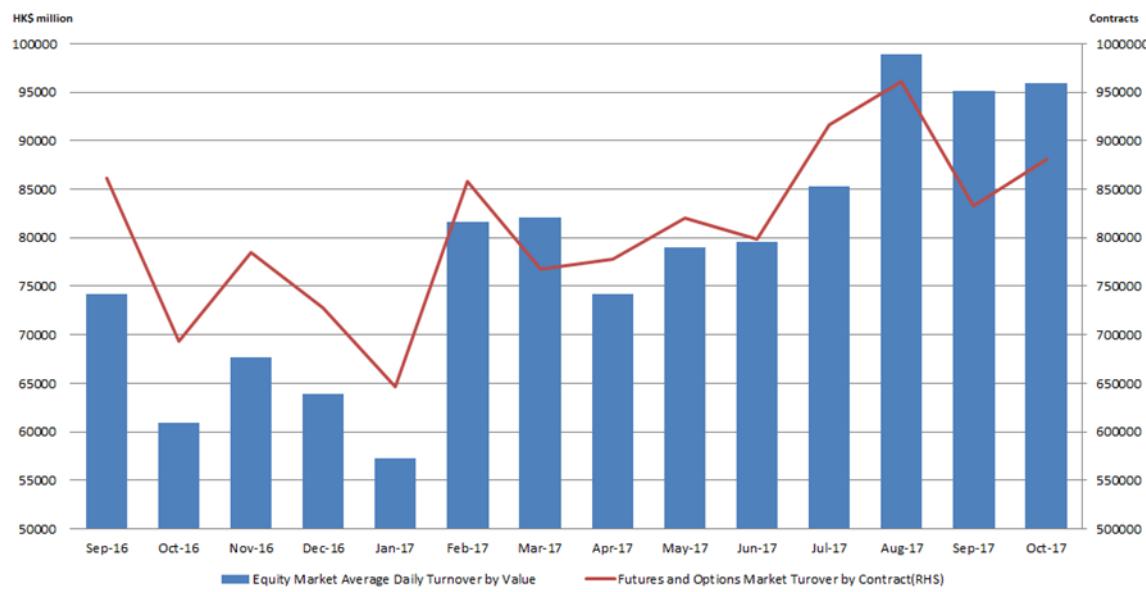
Chart 3: Movements of Hang Seng Index



Source: Bloomberg

In addition, average daily turnover for the first 10 months reached HK\$83.3 billion, 24.1% higher than the HK\$67.1 billion recorded during the same period in 2016. The market reported an average daily turnover of HK\$98.9 billion in August, the highest trading volume in nearly two years.

Chart 4: Trading statistics

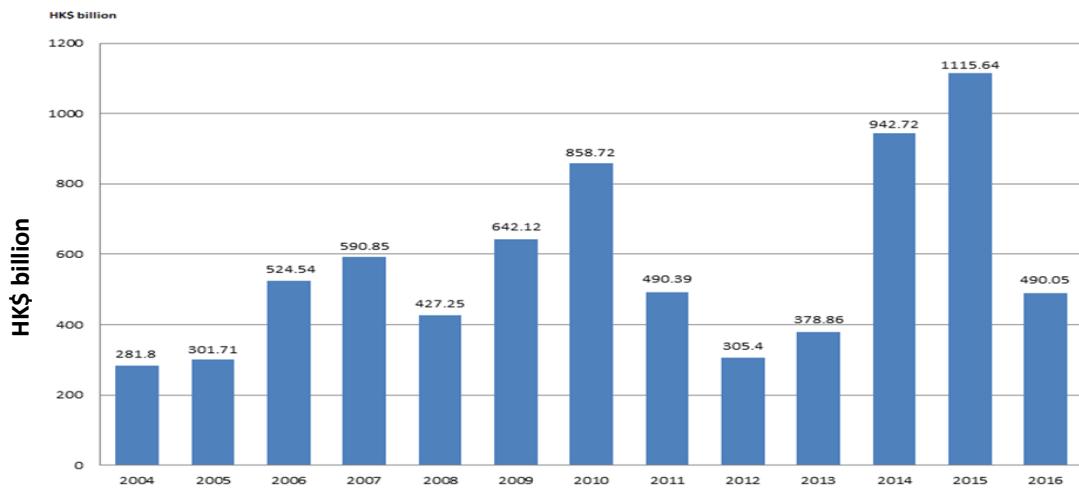


Source: HKEx

Market Fund Raising

According to SEHK statistics, there are a total of 131 newly listed companies hit the market during the period of Jan – Oct, compared to 94 counters reported in the same period in 2016. However, total fund raised by Initial Public Offering (IPO) during the first 10 months fell to HK\$89.2 billion, or decreased by 46.7% yoy amidst lack of mega-size transactions. Meanwhile, total equity raised reached HK\$363.6 billion, reflecting a mild decrease of 5.7% yoy.

Chart 5: Total Fund Raised-Equity Capital Market

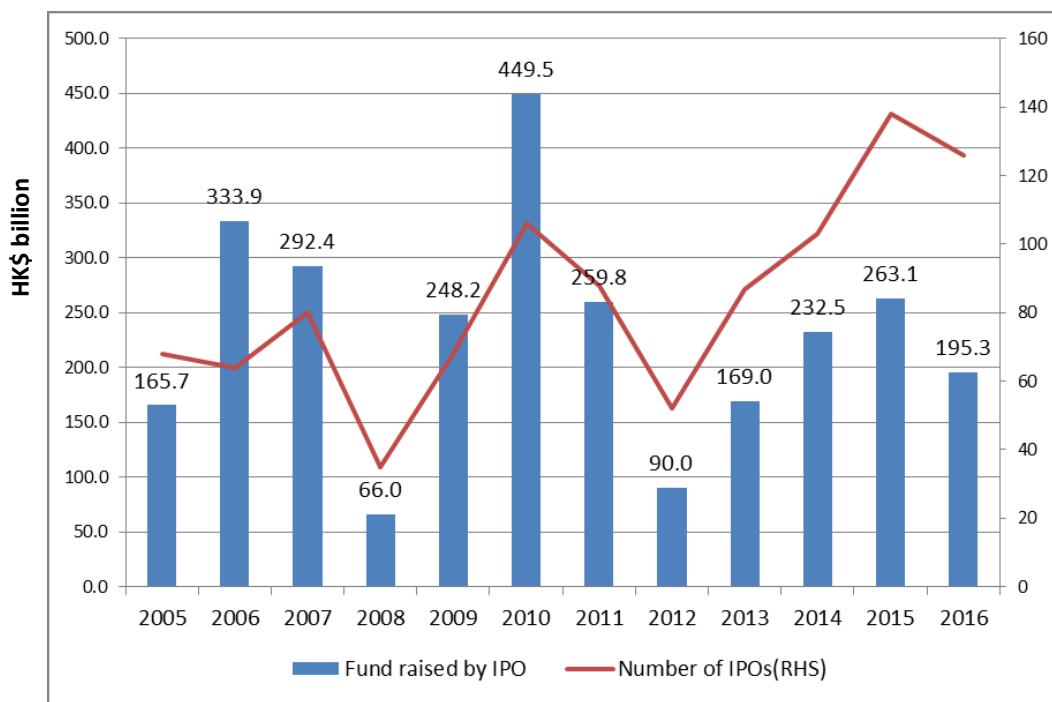


Source: HKEx

Past record shows that fourth quarter usually sees accelerated IPO activities and this year is no exception. A series of newly listed technology or internet related counters stormed the market and made strong debut from late October to mid-November. They were warmly greeted by both institutional and retail investors and many of them saw its share price gained more than 50% in the first trading day.

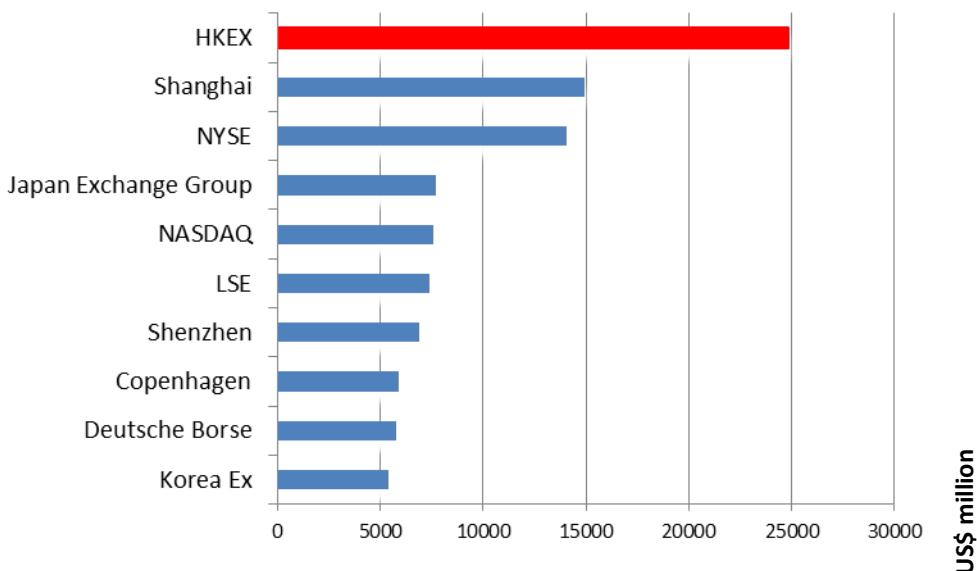
Huge demand from booming economic development in China has put Hong Kong into a great position in terms of equity fund raising. In fact, the city ranked first in IPO activities worldwide in both 2015 and 2016 and consistently cracked into top five for many years. From that perspective, 2017 may consider a minor disappointment (it ranks fifth at the moment, behind New York, Shanghai, Shenzhen, and London) after suffering double-digit drop in total fund raised on the back of the smallest average deal size since 2013.

Chart 6: Number of IPOs and Fund Raised



Source: HKEx

Chart 7: 2016 Global IPO League Table by Equity Funds Raised



Source: HKEX

Futures and Options Market

According to latest statistics, daily turnover for futures in October 2017 recorded 311,379 contracts, up 1.5% month on month. In options, average daily turnover was 569,436 contracts in October, up 8.1% over September. The majority of futures trading were HSII futures while stock options contributed for almost 80% of all options traded at the exchange.

For the first 10 months in 2017, the average daily turnover of all equity index futures actually fell 13.8% yoy while trading volume on stock options surged 36.2% yoy. This is no surprise given the persistent bullish sentiment in the stock market this year.

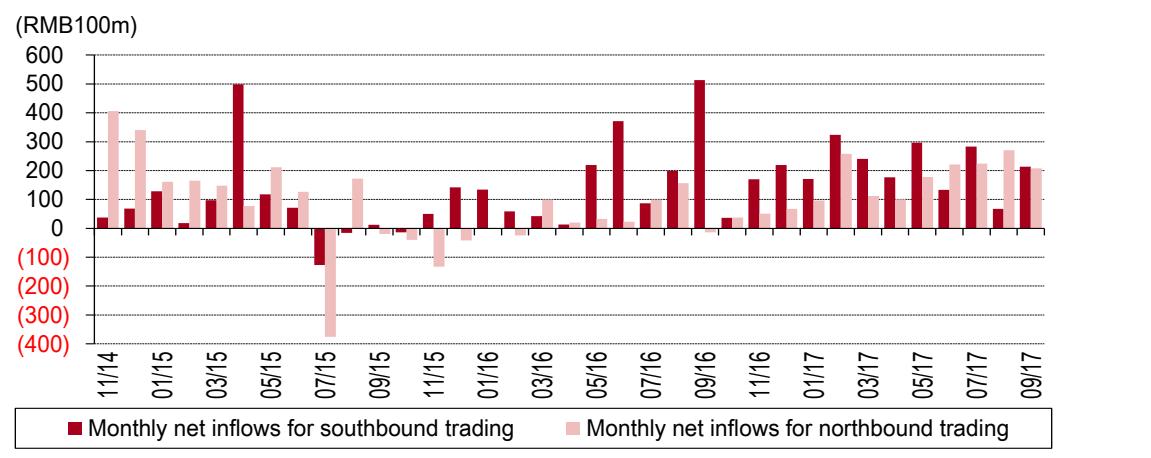
MAJOR MARKET DEVELOPMENTS

Stock Connect

On November 17, 2014, the long awaited Shanghai-Hong Kong Stock Connect was officially launched. It was a milestone for capital markets in both cities as well as a major breakthrough in the process of internationalization of RMB. Two years later, the Shenzhen-Hong Kong Stock Connect commenced trading.

Trade volume in both channels has grown steadily since launch as investors become more familiar with the scheme's rules and regulations. In particular, investors from China have increasingly used Stock Connect as a channel for their asset allocation. According to SEHK, accumulated turnover for the Stock Connect schemes (including both Shanghai and Shenzhen) exceeded HK\$3.3 trillion thus far while Hong Kong has attracted more than HK\$630 billion net inflow. In the first 10 months this year, Mainland investors trading through Stock Connect contributed 7.2% of the Hong Kong market's average daily turnover, compared with an average of 4 per cent in 2016 and 2.4 per cent in 2015. These figures clearly show that the development and execution of the above mentioned schemes are highly successful.

Chart 8: Monthly Net Fund Inflows for Mainland-HK Stock Connect



Source: HKEEx,

Bond Connect

Besides the ongoing Stock Connect, SEHK also launched Bond Connect in early July this year. However, it is designed as north-bound only at the current stage. China is the world's 3rd largest domestic bond market with RMB 72 trillion outstanding as of 3Q2017. 85% of bonds outstanding were issued in the China Interbank Bond Market (CIBM) while only 2% of outstanding bonds are held by foreign investors. Government bonds and policy bank bonds currently account for more than 90 percent of the bonds held by these foreign investors.

The launch of the Bond Connect allows international investors direct access to China's vast onshore bond market. Trading via the Bond Connect is expected to be more active in future, assuming Chinese bonds will be included in major international bond indexes.

Conclusion

As mentioned before, 2017 has been an excellent year for most market participants in Hong Kong but that does not guarantee a rosy picture for 2018 and beyond. Factors such as interest rate hike plus reduction in balance sheet from the Federal Reserve in the US, economic restructuring and deleverage in China, slower growth in corporate earnings etc. may cause some trouble and bring volatility to the market. Nevertheless, HK has a great track record in weathering the storm one way or another given its sophisticated market infrastructure and legal system. After all, the rising power of China and the opportunities generates from there provides the ultimate winning formula for HK in years to come.