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Competition among Financial Centres in the Asia-Pacific: Prospects, Benefits, and Costs – Stumbling Blocks or Building Blocks Towards a Regional Financial Community?

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International Financial Centres in East Asia and Beyond

a perspective from Hong Kong

by

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East Asia boasts several large and dynamic financial centers

- Hong Kong and Singapore have undergone profound change in recent decades, fast turning into service economies and vibrant international financial centers (IFCs)

- Other cities in the region too have seen their financial districts increase strongly: notably Sidney, Seoul

- And above all Tokyo, which has long had the largest financial sector in the region, in large measure drawing on its huge domestic economy and international trade.

Hong Kong in particular has a hugely strong stock exchange, as does Shanghai …

Leading East Asian Stock Exchanges: Domestic Market Capitalization (Aug 2007, in USD)	
1. Tokyo	$4,518 bn
2. Shanghai	$2,382 bn
3. Hong Kong	$2,276 bn
4. Korea	$1,102 bn
5. Shenzhen	$707 bn
6. Taiwan	$678 bn
7. Singapore	$483 bn

… and both are sizzling:

Leading East Asian Stock Exchanges: Domestic Market Capitalization (in USD)		
	Aug 2007	**September 2007**
1. Tokyo	$4,518 bn	$4,569 bn
2. Shanghai	$2,382 bn	**$2,618 bn**
3. Hong Kong	$2,276 bn	**$2,581 bn**
4. Korea	$1,102 bn	$1,179 bn
5. Shenzhen	$707 bn	755
6. Taiwan	$678 bn	724
7. Singapore	$483 bn	n.a.

Hong Kong's standing on IPOs is similarly impressive

- Overtook NYC for global second place last year, with a massive $44 billion in IPOs

- Bus largely based on two mega-IPOs from Mainland China, in particular ICBC (Industrial and Commercial Bank of China) which raised a record $21.9 in Hong Kong and Shanghai

- This year was supposed to be weaker. But a recent surge in IPO announcements from China suggests the second half of the year will exceed the first half by nearly 40%.

Other East Asian FCs also have extremely bullish

- **An influential study (City of London's) rated Singapore just behind Hong Kong in places 3 and 4 among IFCs globally**

- **Its share in global forex market is well ahead of Hong Kong's and just behind Japan at the top of Asia-Pacific**

- **Also with Japan, by far the largest in OTC derivatives: Japan's global share (April 07) is 3.5% + Singapore's 2.7%; next Australia with 1.2%**

- **Korea on its part has one of the larger stock exchanges in East Asia also one of its largest bond markets**

- **Sydney is extremely strong across the board and fully one of the leaders in the region**

- **Same Mumbai on the other side of the mighty emerging "Chindia"…**

In sum, throughout the region
the financial sector is very strong

Quite naturally many governments in East Asia have made it official policy to strengthen and foster their position as international financial centers

But the sector is special in another way: **its locational structure is *unusual*:**

- Europe and the Americas very long ago had one financial centre take the clear lead in its region: an absolutely dominating lead that after 100s of years remains — despite long periods of war and bad policies in both, plus a bad economy and weak fundamentals for much of London's recent history

- That lead those cities took was no-one's decision or design. It was the result of the ***strong economies of scope and scale that characterize the financial sector*** — with different subsectors creating business for and reinforcing each other, and with core activities being easily delivered across the globe with less tie to location

In Asia this consolidation of FCs and emergence of a dominant player has not happened

- Is it developing now, in Tokyo, Hong Kong or Singapore?

- Do these FCs have areas of relative weakness, alongside their particular strengths?

- What is the distribution of strengths among them, across key areas of finance?

More research is required, and underway at Lingnan University, looking at the spectrum of areas of finance in the region. Let us have a quick look at three sectors:

International Banking;

Foreign Exchange;

and

Bonds.

Bottom line:

- We find that strengths do differ among IFCs in Asia, with regional market leaders growing strongly
- But despite widespread gains in market shares, we also find that their place in markets often is generally dwarfed by the global market leaders

Let's see where and how much:

Cross-border banking: where is the business?

External positions of banks, March 2007 (in bn USD;left column is world rank and % share in world is given in brackets) Source: BIS, *Locational Banking Statistics*, Sep 2007, http://www.bis.org/statistics/bankstats.htm					
ASSETS					
1	UK	5,830.8 (20.5%)	**5**	Japan	1,955.3 (6.9%)
2	Germany	2,948.4 (10.4%)	**12**	Singapore	642.6 (2.3%)
3	USA	2,596.0 (9.1%)	**13**	Hong Kong	619.7 (2.2%)
4	France	2,475.3 (8.7%)	**23**	Australia	167.0 (0.6%)
6	Switzerland	1351.2 (4.7%)			
LIABILITIES					
1	UK	6,145.0 (23.1%)	**11**	Japan	659.4 (2.5%)
2	USA	3,312.8 (12.5%)	**12**	Singapore	646.1 (2.4%)
3	France	2,391.2 (9%)	**15**	Australia	403.2 (1.5%)
4	Germany	1,798.8 (6.8%)	**17**	Hong Kong	346.8 (1.7%)
6	Switzerland	1,235.0 (4.6%)			

Important business but very small relative numbers

- Can partially be explained by the Asian financial crisis (only a decade ago) and Japan's economic and banking slump

- If so, banking sector's catching-up should be strong

- More so given the fundamentals: the economic growth

$\Rightarrow$ All this should mean a **more than proportional current growth in banking activity**

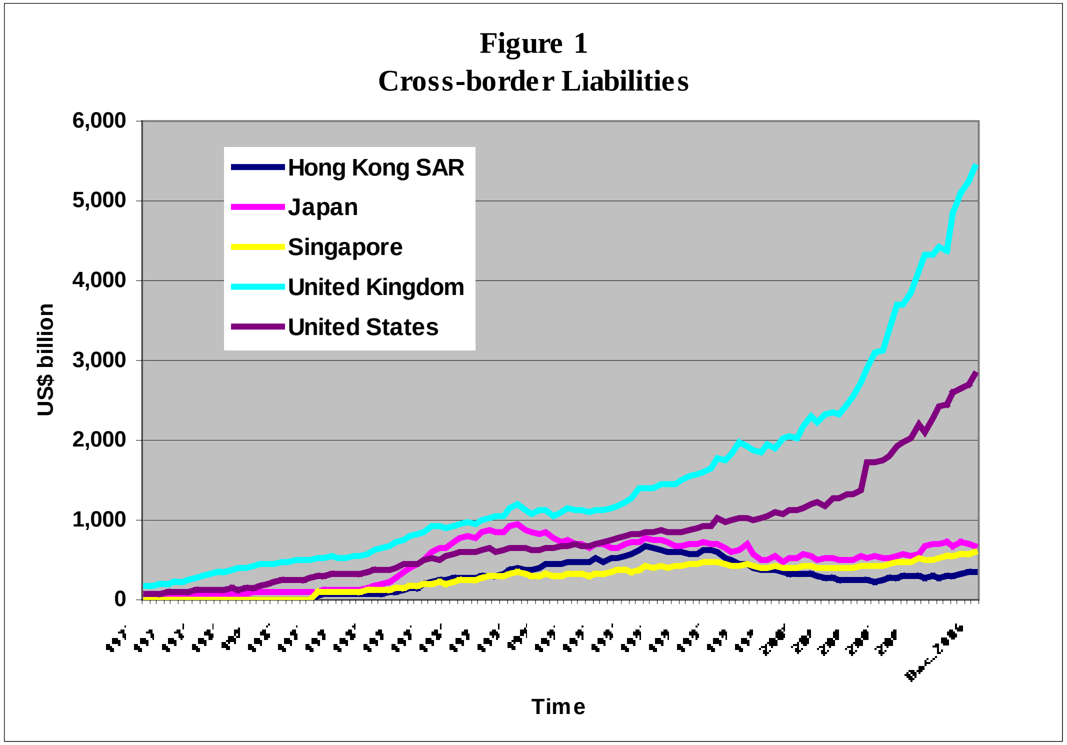
- *So, look at growth*

Latest annual growth rates:

External positions of banks: GROWTH (12/07 on 12/06) in ASSETS			
Hong Kong	21.2	France	14.4
Japan	7.2	Germany	31.0
Singapore	11.5	Switzerland	16.1
Australia	46.5	UK	25.4
Korea		USA	23.9
LIABILITIES			
Hong Kong	15.4	France	18.6
Japan	(-4.7)	Germany	17.0
Singapore	11.3	Switzerland	15.9
Australia	26.4	UK	24.2
Korea	-	USA	27.5

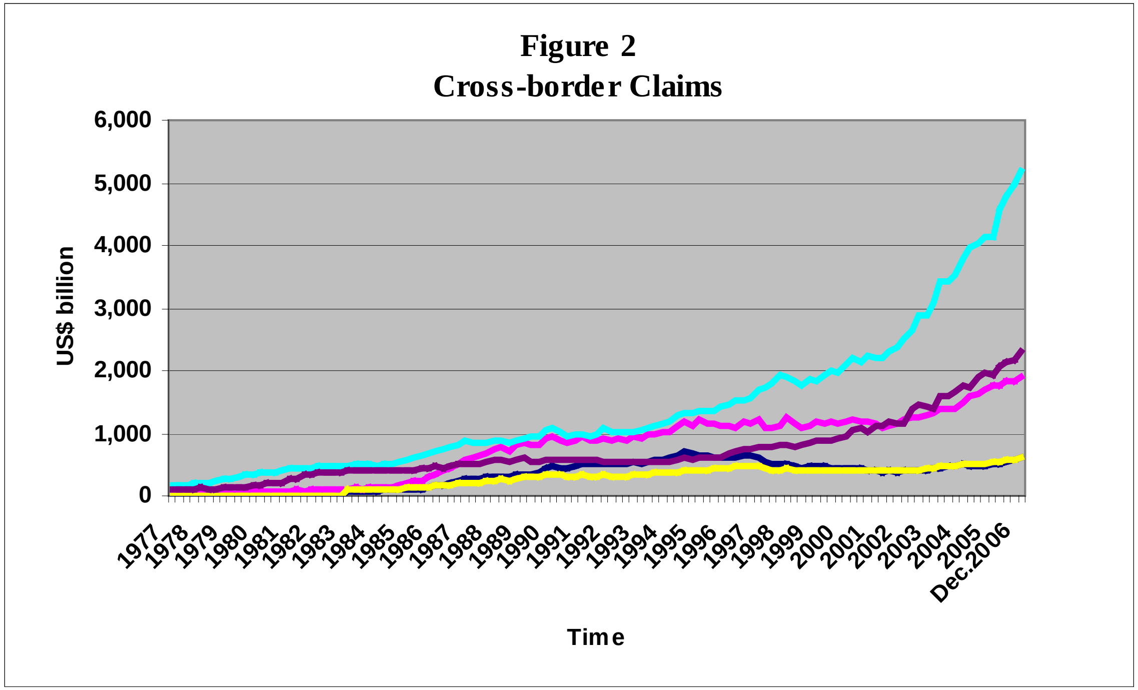
Source: BIS, *Locational Banking Statistics*, Sep 2007, http://www.bis.org/statistics/bankstats.htm

Time paths:



Based on BIS, *Locational Banking Statistics,* http://www.bis.org/statistics/bankstats.htm

and



Based on BIS, *Locational Banking Statistics,* http://www.bis.org/statistics/bankstats.htm

The above is the ***locational statistics perspective,*** our main interest doing IFCs, but not our only interest:

- That is, we were treating a local branch as a local bank: a loan by Citibank in Hong Kong is Hong Kong’s and not in any way New York’s
- There is some sense in which that loan is also New York’s
- That’s certainly true when it comes to exposure of banks: that loan is Citi’s exposure
- But also IFC power and influence partly refer the loan back to HQ

In this regard let us use consolidated statistics, that is, remitting the accounting of loans and deposits back to headquarters. For these, very briefly, the picture is as follows:

Consolidated banks' claims

(in bn USD; world ranks given; March 2007)

1	US	6,429
2	UK	4,244
3	Germany	2,125
4	France	1,702
8	Japan	852
9	Switzerland	804
14	Australia	508
16	Hong Kong	363
23	Singapore	207

Source: BIS, *Locational Banking Statistics*, Sep 2007
http://www.bis.org/statistics/bankstats.htm

Japan partially excepted, the imbalance in the numbers becomes very large, not only relative to the two global leaders but to a country like Switzerland in 9th place.

Number of banks—less imbalance:

Number of banks in major banking centers					
	US	**UK**	**Japan**	**H. Kong**	**Singapore**
1995	9,940	481	150	179	
1998	8,774	468	138	177	154
2002	7,888	390	133	142	120
2005	7,540	347	129	133	111
2006				133	108
2007				137	

Various sources (mostly national monetary authorities). Information reproduced as available.

Perhaps concentration of business among locations relates to concentration among banks.

Or both respond to the same trend, “globalization”.

Among business, concentration is advancing fiercely:

Cumulative distribution of asset holdings among the world’s 1000 largest banks (measured by assets)				
	Top 10	**Top 20**	**Top 50**	**“Bottom” 950**
1995	14	24	45	55
2005	**19**	32	56	44

Source: IFSL, The Banker

With this process, the largest banks in the world have become very large:

10 Largest banks in the world by Tier 1 Capital* (in US$bn, 2006)		
Citigroup	US	79.4
HSBC Holdings	UK	74.4
Bank of America Corp	US	74.0
JP Morgan Chase & Co.	US	72.5
Mitsubishi UFJ Financial Group	Japan	63.9
Crédit Agricole Groupe	France	60.6
Royal Bank of Scotland	UK	48.6
Sumitomo Mitsui Financial Group	Japan	39.6
Mizuho Financial Group	Japan	38.8
Santander Central Hispano	Spain	38.4

*** Core Equity Capital, as defined under Basel I and II. Source: The Banker**

Before leaving banking, a quick look at some key issues on regulation. While purely illustrative here, regulation may partially explain differential performance

Selective Regulatory Indicators, 2006				
	More than one agency grants licenses to banks?	**More than one license required?**	**A single supervisory agency for financial sector?**	**Supervisors legally liable for their actions?**
H. Kong	No	No	No	No
Japan	No	No	Yes [a]	No
Korea	No	Yes	Yes	Yes
Malaysia	No	Yes	No	No
Philippines	No	Yes	No	Yes
Singapore	No	Yes	Yes	No [2]
Thailand	No	Yes	No	Yes
Australia	No	Yes	No	No
N. Zealand	No	No	Yes	No
France	No	No	No	Yes
Germany	No	Yes	Yes	No
Switzrland	No	Yes	No	No
UK	No	No	Yes	No
US	Yes	Yes	No	No

[a] Except for credit cooperatives and government banking institutions; [1] Not permitted; must be locally incorporated;
[2] "Unless acted in bad faith"; [3] Not tracked; * Covers licenses granted, and for

Foreign exchange

- A key sector, extremely dynamic
- Global forex trade grew from US$ 1.88 trillion per day in 2004 to US$ 3.21 trillion per day in April 2007
- Much larger, more liquid, less regulated than other financial markets
- A leading and broad indicator of status as an IFC

- Its volume of business depends on the presence of many banks, openness to international trade and having a large international business base generally.

Geographical distribution of foreign exchange market turnover
Daily averages, in April, in billions of US dollars, shares, and ranks

	2007			2004			1995		
	rank	amount	share	rank	amount	share	rank	amount	share
UK	1	1,359	**34.1**	1	753	31.3	1	464	29.5
USA	2	644	**16.6**	2	461	19.2	2	244	15.5
Switzerland	3	242	**6.1**	8	79	3.3	6	87	5.5
Japan	4	238	**6.0**	3	199	8.3	3	161	10.3
Singapore	5	231	**5.8**	4	125	5.2	4	105	6.7
H. Kong	6	175	**4.4**	6	102	4.2	5	90	5.7
Australia	7	170	**4.2**	7	81	3.4	9	40	2.5
France	8	120	3.0	9	64	2.7	8	58	3.7
Germany	9	99	2.5	5	118	4.9	7	76	4.8
Korea	17	33	0.8	15	20	0.8	-	4[1]	0.2[1]

- **The region's shares are substantive: the four added exceed the US' share;**
- **But they are far smaller than the leading markets'**
- **Is competition as equals in the offing?**

Bonds markets

- East Asia's financial structure traditionally unique: much lower reliance on bonds than other financing, for government and particularly for corporates

- But the picture is changing, *more than is commonly recognized*

Private[1], Public and Total Bonds Outstanding as a % of GDP, 2005							
	Private	**Public**	**Total**		**Private**	**Public**	**Total**
China	10.4	15.2	**25.2**	**Australia**	39.3	12.6	**51.9**
H. Kong	17.8	9.1	**26.9**	**France**	41.4	53.8	**95.2**
Indonesia	2.4	16.6	**19.0**	**Germany**	34.1	41.0	**75.1**
Japan	42.4	150.2	**192.6**	**N. Zealand**	-	22.2	**22.2**
Korea	52.8	25.3	**78.1**	**Switzerland**	32.3	32.3	**64.6**
Malaysia	52.2	38.2	**90.4**	**UK**	15.9	31.1	**47.0**
Singapore	18.8	39.2	**58.0**	**US**	111.8	46.3	**158.1**

[1] Financial institutions and corporations **Source: Beck et al (2000) database, from BIS, World Bank and IMF**

There is in fact *no* lack of recourse to Bonds:

- Japan and not the US or a European country has, by far, the highest bond/GDP ratio, over *twice* more than any other except US

- Korea and Malaysia are among the leaders generally

- They and Singapore have higher total bond ratios than most non-Asian emerging markets (not shown on the table)

➢ ***This depth in Bonds relative to GDP follows huge rates of expansion over the last 10 years:***

Bond finance 1995-2005: totals - shares in GDP				
	1995	**2000**	**2005**	**% Growth ('05 on '95)**
H. Kong	14.1	25.4	27.0	91
Japan	86.8	124.2	192.5	121
Korea	40.0	52.6	78.1	95
Malaysia	65.6	78.4	90.4	38
S'pore	25.5	43.0	58.1	128
Australia	48.4	49.3	51.9	7
France	66.2	80.7	84.8	28
Sweden	100.9	91.5	84.0	(-17)
Switz'lnd	66.7	65.9	64.6	(-3)
UK	47.0	50.7	47.0	0
US	138.9	145.1	158.1	14

All very nice but let's not forget: these are all figures ***relative to GDP***

- Business is not run and scale economies are not won relative to GDP
- Other than Japan and in some measure Korea, the larger mature markets on the table have levels of business of an entirely different order of magnitude

Conclusion – 1

The region's FCs are in very good shape, solid and growing strongly

- Nevertheless the figures we saw make it plain that this growth is mostly of a different order from the global giants
- In the mean time globalization in finance is:
  - making the largest formidable competitors grow further; and
  - making it more possible as time passes to service key global needs from remote locations (*algorithmic* investments). IT finance knows no "time difference" and "personal-contact" factors

The question of “who is winning” in the region must be accompanied by the more important *is it certain that East Asian IFCs’ share in global finance must continue to grow* over the M/T?

Could the *business of the regions’ FCs* increasingly become their *regional business*, related to local needs, leaving the lion’s share of global business to the global leaders?

Of course such regional business will increasiungly be huge. But a different game entirely

- ➲ **One can be very bullish about the region’s long term economic growth, and still wonder whether this exponential growth must translate into *exponential growth as financial service providers***

The stakes and the risks require action: an ambitious policy mix of *competition with cooperation* among the region's FCs

- Vigorous competition the mother of all efficiency
- Cooperation needed to collect scale where possible.

Cooperation where?

- In bonds as heretofore, expanded (Asian Bond Initiative). Other sectors including stock exchanges (NYSE and Euronext redefined *boldness*, as the challenges require)

➢ **Above all, essential to create a common, seamless space for financial business in East Asia**

➢ I argued that East Asia's future high-end financial needs can be serviced from London or New York. That servicing can equally come from **a network of locations in Asia**

A Network-IFC: a common integrated space for financial operators in the region. How?

1. Develop and adopt **common codes and standards** for the sector**;**
2. Create working group with industry participants and regulators to identify core elements for **harmonized regulatory frameworks**;
3. Facilitate regional recourse to **arbitration proceedings;**
4. Establish the fullest **cooperation framework among supervisors** (covering both operational + technical cooperation)**;**

(All above largely non-contentious: most business should support. Then also, liberalize regional trade in the sector …)

5. Seek to negotiate speedily the fullest **freedom of establishment for financial business** throughout the region, in particular among (and starting with) its major centers.

This effectively creates a single economic space in the region for servicing finance

- ✓ The region's operators, both domestic and "guest", gain profitability through larger scale and less duplication. The separate strengths of the region's financial centers are thus added;

- ✓ East Asia's financial industry would gradually morph into complementary IFCs, including more specialized and efficient niches in different locations;

- ✓ *Collectively* they would have, sector by sector, a leading global role — effectively amounting to a global financial centre based not in a city but in a region and network, spread out as much as the region is vast.