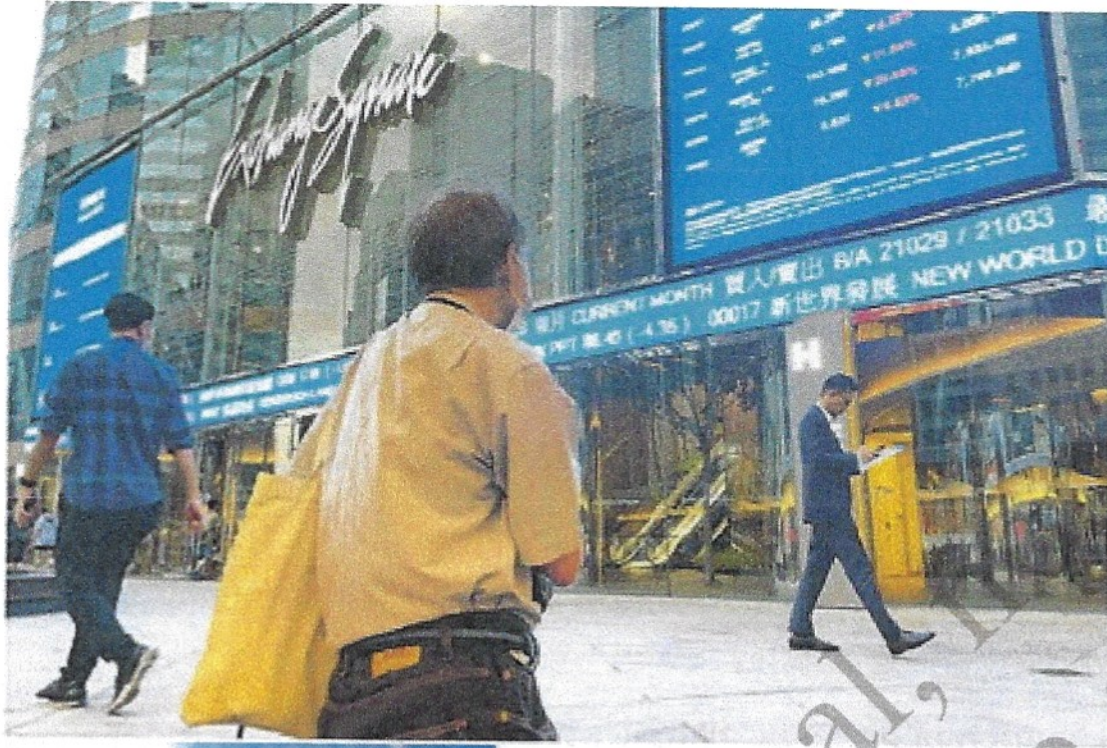


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'The Hong Kong market now is really just a China market.'



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The world's pre-eminent East-meets-West investment hub has become more Chinese. Top left, Hong Kong's stock exchange building; right, CEO Bonnie Chan. CLOCKWISE FROM TOP LEFT: ASSOCIATED PRESS; PAUL YEUNG/ BLOOMBERG NEWS; LIAU CHUNG-REN/ ZUMA PRESS



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How Beijing Took Over Banking Hub

Hong Kong becomes more Chinese as financial institutions retreat

BY REBECCA FENG

HONG KONG—With the golden gongs behind her waiting to be rung, Bonnie Chan, head of Hong Kong's stock exchange, launched into a speech this spring. What she said, extolling Hong Kong's position as an international financial hub, wasn't remarkable. Rather, it was how she said it.

The Harvard-educated Chan spoke in Mandarin. The language was dictated by a 2-to-1 vote over English by the three Chinese asset managers launching new cryptocurrency funds at the exchange that day. The exchange hadn't offered simultaneous translation in English or any other language.

As red-cloth mallets struck the gongs and trading began, the few Westerners in attendance watched silently. Had they understood a word of Chan's speech, a reporter asked? No, they shook their heads in unison.

In ways big and small, Beijing's takeover of Hong Kong's financial sector is looking irreversible. With stunning speed, the world's pre-eminent East-meets-West investment hub has be-

come more Chinese as international financial institutions, corporations, and expatriates retreat.

Foreign banks played major roles in one-fifth of Hong Kong's initial public offerings this year, compared with roughly half just two years ago. Chinese banks have taken the places of Western ones as top earners in the city's debt capital market.

Private bankers are increasingly catering to first-generation Chinese millionaires instead of the rich expatriates who made their fortunes in decades past. Corporate recruiters say conversational Mandarin is essential to get hired.

A spokesman at the Hong Kong exchange said events and listing ceremonies are held in a bilingual format to the extent possible and are tailored to the preferences of individual issuers. He added that Chan, who became CEO in March, often gives speeches in English.

The shift feels dramatic at The Iron Fairies, a cocktail bar a short walk from Hong Kong's stock exchange that for years had been a go-to haunt for Western bankers.

Now it's dominated by Chinese customers, who favor bottles of whiskey and tequila over individual drinks, said Sandeep Sekhri, chief executive of the firm that runs the bar. The in-house jazz band learned a few Mandarin songs at the beginning of the year, including a 1970s mandopop hit called "The Moon Represents My Heart."

With a decline in the oncemassive fees netted from Hong Kong, the likes of Goldman Sachs, Morgan Stanley and UBS have carried out several rounds of layoffs across Asia in their investment banking divisions. Some of the world's biggest international law firms have followed banks in layoffs, as they struggle to compete with Chinese peers, who usually charge lower fees, according to capital markets lawyers.

Longer-term, the shift means Western financial institutions need a new strategy for their China operations. Many have changed their focus from investment banking to wealth management in hopes of still serving Chinese customers. Others have shifted resources to India and the Middle East.

The already fraught U.S.China relationship is set to take another hit. President--elect Donald Trump has spoken about imposing a tariff of 60% or more on goods from China, a move, if realized, could push companies to further diversify their supply chains away from China and dent Chinese growth.

Trump nominated Sen. Marco Rubio of Florida as secretary of state and has asked Rep. Mike Waltz to be his White House national security adviser. Both men are hawkish on China and have urged the U.S. government to adopt harder stances toward Beijing.

Investment banking revenues in the Asia region excluding Japan last year sank to the lowest level since at least 2010 for Goldman Sachs, JPMorgan and Morgan Stanley, according to data from Dealogic. Chinese banks including Citic Securities and China International Capital Corporation have become the region's top earners since around 2022.

International banks have other sources of revenue, such as fees from wealth management and securities trading, but they don't break down their make-up in Asia. Globally, fees from other sources make up the bulk of their revenues.

Wall Street executives have said they are committed to doing business in China. JPMorgan's Chairman and Chief Executive Jamie Dimon, who visited Hong Kong in May as part of celebrations for the bank's centenary there, called for continued engagement with China, which he said has set a new course with more focus on national security, military capacity and internal development.

Privately, many Western bankers and investors rue the changes in dealmaking and in culture, which they say could lead to an erosion of Hong Kong's diversity and result in less transparency and less scrutiny over high-risk financial behavior.

Funneling capital

Chinese banks were often more willing to funnel their own capital into mainland China's overbuilt property market and into financing vehicles for heavily-indebted local governments, some of which are now at risk of default. Many Chinese banks have tightened standards after such high-risk lending backfired.

The head of investment banking at a Wall Street bank, who is from a Western country, said he felt alienated in Hong Kong now, with so much Mandarin spoken and so much competition from Chinese banks. "It's still a world-class city," he said. "But I don't think we can call it a world city anymore."

Nonsense, say Chinese executives, many of whom prefer Chinese banks, which they say treat them better, charge less, and have wider networks in mainland China, though their presence elsewhere is small. Hong Kong is still vital for anyone in China who wants to issue or invest in stocks and bonds outside the mainland—they just don't need Western bankers to be the gatekeepers, they say.

One executive at a Chinese property developer, who was working on a small-scale private debt deal, said some Western banks refused the work due to their bearish view of China's real-estate market. A Chinese bank, the executive said, has assigned multiple senior-level directors and around 20 associates.

"Chinese banks are different," he said. "If the price is right, they will do it."

In a statement, the Hong Kong government spokesman said, "Any suggestion that with more Chinese companies having presence here, Hong Kong is becoming less international and more and more like one of the cities of Mainland China, is completely untrue."

He added that Hong Kong remains an international financial center, being ranked in September again as one of the global top three financial centers in the world, alongside New York and London, under the Global Financial Centres Index.

A number of global banks have recently announced plans to expand in Hong Kong and the city continues to attract overseas capital, such as deepening connections with the Middle East investors and markets, he added.

Change of guard

So far this year, 56 companies have listed on the Hong Kong stock exchange, and 79% of those didn't engage any foreign bank as major sponsors, according to deal prospectuses. That number was around 50% in 2022 and 2021, according to documents compiled by financial data provider Wind.

In 2022, mainland Chinese companies with regional headquarters in Hong Kong outnumbered American ones for the first time in at least three decades, official figures show. The gap widened in 2023. Mainland Chinese companies have also solidified their dominating position in Hong Kong's stock market, taking up 80% of the market's total value by the

end of October, compared with 60% a decade ago. All that activity is helping offset some of the economic losses Hong Kong suffered as a result of the pandemic and departing Western executives. Prices for Hong Kong residential rentals have largely bounced back to prepandemic levels, according to data from the city's Rating and Valuation Department.

But the mood is less exuberant than before, with China's economy struggling. For the city's skyscrapers, rental prices are lower than prepandemic levels—creating more options for Chinese businesses that want to move in.

One Chinese wealth-management firm recently expanded its office size, renting another floor in its building in Hong Kong's Causeway Bay area. The total rental was less than what it paid for the original space in 2019, according to an executive there. Sevva, a bar overlooking HSBC's Hong Kong offices and frequented by the city's Western bankers, closed in April after 16 years. Mainland Chinese restaurant chains, such as Yang Guo Fu, which serves spicy hot pot dishes, have opened.

Some of the shift in Hong Kong reflects the reality that the market for deals is weak, given China's economic problems. New listings on Hong Kong's stock exchange dropped to the lowest total in more than 20 years in 2023. In recent months, momentum picked up a notch after Chinese appliance maker Midea Group's \$4 billion listing fueled optimism among bankers and investors.

Even so, the changes seem more structural than cyclical.

Ceded to the U.K. by China's Qing dynasty in 1842, Hong Kong for decades was the primary gateway where foreign investors could grab a slice of China's market, especially after economic reforms began in the late 1970s.

Western banks earned fat fees helping Chinese companies list on foreign stock exchanges, issue debt, and buy up European and U.S. firms.

The boom continued after Hong Kong was returned to China in 1997. During the 1990s and early 2000s, celebrity chiefs such as Nobu Matsuhisa and Alain Ducasse opened outposts in the city.

That era started to end in 2019, after millions of Hong Kong people took to the streets to protest against a controversial extradition law floated by pro-Beijing legislators. China's central government cracked down, arresting dissidents, restricting press freedom, and imposing a national security law that included heavy punishments for foreign interference. The pandemic further isolated Hong Kong.

Today, the city retains many advantages that made it a key financial center, including—in contrast to mainland China—a freely-traded currency pegged to the dollar, free movement of capital across its borders, and a common law system that tends to be more efficient than the mainland's socialist legal system.

But the things that foreign banks are good at—hooking up large, fast-growing Chinese companies with global investors, especially those from Europe and the U.S.—are no longer priorities for many Chinese clients in Hong Kong. Deals are getting smaller and companies care more about raising money at a low cost than courting global investors, bankers say.

“Hong Kong went from a pan-Asian investment banking center to a China investment banking center. The Hong Kong market now is really just a China market,” said Joseph Gallagher, who spent most of his four decades of investment banking career in Hong Kong and was chairman of Asia Pacific investment banking committee at Credit Suisse until late 2022. In recent years, the majority of bankers in the city have been working on China deals only. That's in part because other Asian markets now justify having their own operations on the ground, he said, and the growth of China requires large, dedicated banking teams.

Unlike Western financial institutions, mainland banks in Hong Kong have an inside track to the kind of business that is becoming more prevalent in China, as government investors and state-owned enterprises play larger parts in the economy.

Chinese banks used their bigger balance sheets to keep financing higher-risk parts of China's economy in recent years, including complex state-owned investment vehicles which cities used to build highways, tourist attractions and other infrastructure that are now sparsely-utilized in heavily-indebted parts of the country. As much as \$800 billion of that

debt is now at a high risk of default. Last week, China's top legislative body signed off on a \$1.4 trillion package to help ease local governments' off-balancesheet debt burden.

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