As China’s Economy Slows, Hong Kong Seeks To Redefine Its Future

By Drew Bernstein

Hong Kong as China’s Window to the World

For Hong Kong, 2023 was a year for the record books – but not the sort of records that send champagne corks flying.

- The Hang Seng stock index logged its fourth consecutive year of losses, down by nearly 50% from January 2021.
- IPOs on the Hong Kong Stock Exchange dropped to $5.9 billion, a level last seen two decades ago.
- The city slipped to second place on the index of economic freedom, behind arch-rival Singapore, after holding the number one spot for 30 years.

For decades, Hong Kong enjoyed a privileged position as a free-wheeling hotbed of capitalism perched at the edge of the world’s largest socialist economy in transition. The city was where a generation of investment bankers, money managers, and private wealth bankers went to make their fortunes by contributing to China’s meteoric rise. Hong Kong was where China’s blue chips went to list their shares, where Asia’s magnates socked away their wealth, and a sybaritic playground of shopping and dining. Living in Hong Kong allowed you to be in the heady mix of free-flowing capital and gossip about the Goliath just across the border while still enjoying the full comforts and freedoms of an international financial center.

Sliding Down The Global Rankings

As recently as 2019, Hong Kong was the top-ranked stock exchange in the world for IPOs, a title it held for seven years. But in 2023, it dropped to the eighth place, according to Refinitiv, lagging both of India’s stock exchanges and coming in just ahead of relative backwater Abu Dhabi. Even more worrisome, the total market cap of stocks listed in Hong Kong, which is home to tech giants like Tencent and China’s largest banks and consumer companies, dropped to the fourth place below that of India. Just a few years ago, this would have been unthinkable.

The deal drought has been brutal for Hong Kong’s investment bankers, once among the most richly rewarded on the globe. Goldman Sachs and Morgan StanleyMS 0.0% announced several rounds of staff cuts during 2023, while UBS and JP Morgan also trimmed their ranks. In addition to the anemic IPO market, China's M&A volumes dropped to a nine-year low as interest rates soared and the government discouraged splashy foreign acquisitions. International banks now must fight hard for deal slots against domestic Chinese investment banks such as CITIC and CICC, who can leverage deep connections in Beijing to win mandates.

This aerial photo taken on December 19, 2018 shows a general view of the skyline of Hong Kong. ... [+]AFP VIA GETTY IMAGES

Even the more stable world of wealth management experienced a drop in assets managed last year, fueled by sagging equity values and aggressive competition from Singapore. With geopolitical tensions at a slow boil, wealthy Chinese have increasingly adopted a “multi-shoring” strategy to spread their assets into different low-tax jurisdictions rather than place all their golden eggs in Hong Kong’s basket.

Less Special Region

Why has Hong Kong lost its luster as a financial center?

Ever since the handover from the British in 1997, this city of 7.5 million people has enjoyed the status of a Special Administrative Region (SAR) of China. Under the regime of “one country, two systems,” Hong Kong continued to preserve a unique combination of low taxes, predictable laws, and a free-wheeling press. It was easy for ex-pats and locals alike to convince themselves that Hong Kong was a steamy version of London's City, a spicier version of Zurich with neon and dim-sum. As the PRC grew into the world's manufacturing powerhouse, Hong Kong provided a sophisticated, well-regulated portal where global investors could place bets on China's emerging corporate champions while shielded from the vagaries of life on the mainland.

Today, the SAR doesn't feel quite as special. Most of China's IPO action has migrated across the bay to Shenzhen and up to Shanghai, as China's domestic A-share exchanges have ranked #1 for IPO proceeds in 2022 and 2023. Foreign investors and multinational banks are essentially shut out of these deals, which favor companies in sectors that the central government has singled out for strategic importance.

Global institutions have, at least for the moment, lost their appetite for Chinese equities and bonds, spooked by the insolvencies in the real estate sector, capricious changes in regulation to the tech sector, and the increased difficulty of doing fundamental company research in an era heightened security sensitivity. Foreign investors unloaded 90% of the China stocks they had acquired at the start of 2023 and have continued to lighten their exposure in 2024.

People are watching fireworks explode over Victoria Harbour to mark the arrival of the year 2024 in ... [+]NURPHOTO VIA GETTY IMAGES

Charting Hong Kong's Future

Faced with a slew of challenges, Hong Kong's business leaders have put a brave face on the city's prospects by launching a "Hello Hong Kong" campaign to lure finance chiefs and tourists back to reconsider the city's charms. City officials have provided assurances that Hong Kong will preserve its zero capital gains tax and dollar-convertible currency for the "foreseeable future."

Looking forward, Hong Kong promises to have a vital future, but one that is ever more tightly integrated with the Chinese Mainland. Its shining office towers are likely to be increasingly filled with branch offices of Chinese financial institutions. While residency applications by foreign professionals have declined, they have been replaced by applicants from mainland China eager to try their luck in the city under a new talent scheme.

The city has enormous reserves of professional talent able to straddle Chinese business realities and global expectations. This is the primary reason my firm, MarcumAsia, has opened an office in Hong Kong. We couldn't ignore the unique expertise that was available.

The biggest reason to believe that Hong Kong will continue to thrive is that it is simply too valuable an asset for China to neglect. Hong Kong serves as a laboratory where China can experiment with opening its financial infrastructure to the outside world – from the Hong Kong Stock Connect that provides access to domestic equity markets to efforts to make the digital RMB an international reserve currency.

While the most security-sensitive companies will continue listing their shares in Shanghai or Shenzhen, Hong Kong will continue to lure PRC companies seeking to engage with the global markets, access dollar-convertible financing, and lure international talent. To quote Hong Kong's Chief Executive, John Lee Ka-chiu, the city strives to be a "super-connector" and "super value-adder" for domestic companies seeking to go global.

From the outside world's window into China, the new Hong Kong is becoming China's window to the world.