CE's speech at opening of Asian Financial Forum (English only)

Following is the speech by the Chief Executive, Mr Donald Tsang, at the opening of the Asian Financial Forum this morning (September 21):

Distinguished guests, ladies and gentlemen,

It is my great pleasure to welcome you all to Hong Kong for the Asian Financial Forum. I am particularly grateful to all our esteemed guests and speakers who have traveled from the Mainland and overseas to be with us today. I am sure your presence will make the Forum a resounding success.

We are hosting this Forum for two reasons:

First of all, the Forum is a major event to help us celebrate the 10th Anniversary of the establishment of the Hong Kong Special Administrative Region. Financial services are absolutely vital to our economy. So, it is only fitting that we stage an international event of this kind to mark this important milestone in our development as China's global financial center, and as Asia's world city.

Secondly, Asian financial markets have endured much, and grown much, over the past decade. As fate would have it, the trigger for the Asian financial crisis occurred just one day after our Reunification celebrations in 1997. Now is an opportune time to examine the lessons learnt in Asia over the past 10 years. And that is why the overarching theme for today's Forum is "Leveraging New Opportunities, Advancing Financial Stability".

Let me start by providing a quick overview of Hong Kong's progress since 1997. Our most important achievement has been the successful implementation of 'One Country, Two Systems'. This was made possible by the wholehearted commitment of Hong Kong people to make it work, and the unswerving support of our sovereign.

All of our core values and core strengths remain intact, as intended. The rule of law upheld by an independent judiciary, a clean and efficient government, a level playing field for business, the free and unfettered flow of information, low taxes, no capital controls, freely convertible currency, highly-educated workforce, and a broad, deep pool of professional talent in key services sectors. Hong Kong has also continued to be rated as the world's freest economy by prestigious think tanks such as the Heritage Foundation and the Fraser Institute.

The past 10 years were not without challenges. The fallout from the Asian financial crisis precipitated a steep drop in asset prices as well as a prolonged - more than five years - period of price deflation. Avian influenza and SARS not only tragically caused the loss of life, they also impacted on economic development. Hong Kong was also affected by the bursting of the dot com bubble and the 9/11 attacks. But we overcame all those challenges. And we emerged stronger, more resilient and more confident as a result. Our economy today is in the best shape it has been for decades, and Hong Kong itself is now much surer of its place in the world, and its special role for China.

Now, let me turn to Asia's progress and challenges. Over the past decade, we have seen two very positive developments in the region. The first is the growing significance of Asia in the world market, particularly the emergence of China and India. The Mainland's major strength over the past two decades has been its prowess in the manufacturing sphere, which has helped lift living standards across the board in our nation. Decades of continued and high growth resulted in the quick accumulation of wealth. Sound fiscal policies and massive capital inflows helped our country to amass considerable foreign assets and reserves. So, the newly rich coupled with the new market infrastructure have created demand for high-end products and more sophisticated services.

Elsewhere in the region, we have seen a similar pattern. In 2005, the savings rates of the nine largest economies in Asia reached at least 20% of their respective GDPs - which is high by international standards. Seven of the world's top 10 foreign exchange holders are Asian economies - China, Japan, Taiwan, Korea, India, Singapore and Hong Kong. Together, these seven economies account for 80%, or US$3,155 billion, of the foreign reserves in the top 10. Of that, China and Japan together account for about US$2,265 billion.

The accumulation of wealth and foreign currency reserves has resulted in a higher degree of Asian participation in global financial markets. For many years, a large proportion of regional savings and reserves were invested in relatively low-yielding assets in developed markets, which were then recycled into the region in the form of foreign investments seeking higher yields.

Now, with such a marked increase in foreign reserves, some economies have created government investment vehicles, Sovereign Wealth Funds, to improve investment returns and manage strategic investment projects. These funds are strong investment forces in their own right. We now also see a rising trend of funds and companies from emerging markets investing in, or holding, major stakes in global conglomerates and financial institutions based in developed economies. Increased Asian participation in the global market is a healthy and encouraging development that I am sure will continue.

The second positive development in Asia over the past decade has been the considerable progress made by many regional economies to strengthen their financial markets and infrastructure. These economies have embraced the need for change and reform. They have also allowed market forces to find their natural level - a strategy that has sometimes caused considerable pain. As a result, renewed economic vigour coupled with tighter, more prudent regulation has led to broader, deeper markets throughout the region. Additional emphasis has also been placed on managing risk and increasing transparency.

Although the region has emerged from the Asian financial crisis more robust and resilient, we cannot overlook the dominance of the banking system and equity markets as the main sources of financing. Our bond markets have yet to flourish. This is despite increasing demands for long-term fixed income products from rapidly expanding retirement funds, insurance funds and other similar products. There is much for the regional economies to do in expanding and deepening their bond market.

My next point concerns the relatively small sizes of the Asian markets by their US or European standards. This makes them more vulnerable to volatile international capital flows. Market integration seems a logical development which will enhance Asian economies' ability to manage and withstand market volatilities such as sudden and massive capital flows driven by large or highly leveraged operators looking for short-term returns. The Asian Bond Fund initiative launched by regional central banks is an important and major step. But, further financial integration will be necessary within Asia to achieve the financial stability that the region deserves from its increasing financial strength.

Looking ahead, there are a number of concerns for all of us: volatile capital flows and their potential to destabilise a market, particularly an emerging market where infrastructure is immature; interest rate uncertainty or adjustments triggering a reassessment of risks, possibly resulting in sudden capital flight; and, the uncertainty caused by the growing prominence of hedge funds and other largely unregulated entities in the financial market.

To address the risks arising from volatile capital flows, regulators should stress test their systems to assess the impact on liquidity and pricing arising from the unwinding of large positions. This should reveal how market stability could be affected and help us prepare for any such shock.

The recent sub-prime mortgage problem and the associated liquidity crunch highlighted the importance of prudent and effective risk management and market transparency. Without the necessary transparency to enable the market to evaluate risks, market operators will tend to assume a worst-case scenario and take unnecessary safeguard action, usually aggravating rather than relieving the stress of the crisis. So, there must be better access to reliable information for risk assessment, stress testing and increased regulatory cooperation across jurisdictions.

As markets grow and products diversify, we will also need the human capital to ensure they work properly. We need people with integrity to manage and regulate risks; who will innovate to create new products and access new markets; and who have the necessary experience and background to manage investment. These people do not grow on trees. We will have to train and nourish them. In this I see a considerable scope for co-operation among governments, regulators, market participants and academia. Only through such concerted efforts can we hope to produce enough talent to service the needs of the industry in Asia.

Ladies and gentlemen, I am sure that our eminent speakers and panelists will provoke a more critical look at the opportunities around Asia today and highlight how we can make the region a more stable market place.

Our speakers may take different perspectives and have different focuses, but we all have the goodwill and common goal to work towards a more prosperous and stable financial market, which is beneficial to our economies' growth and development and the well being of the people in the region.

Thank you.