

Measuring Value[®]

Asian financial integration and co-operation: The power and the path



Introduction

The Asian Financial Forum (AFF) 2013, held in the Hong Kong Convention and Exhibition Centre on 14-15 January, was the largest yet in the history of the Forum. Not only did registrants exceed 2,500, but the geographic reach of participants, keynote speakers, and panelists expanded significantly. The main theme was *Asia: Shaping the Next Global Landscape*, and much of the focus of the Forum was on the integration of Asia, moving beyond previous meetings that were primarily concerned with aspects of the recovery from the global crisis and future models of competitiveness in an emerging new world order.

The Deloitte Workshop was convened on 15 January, the fourth such annual Workshop featured at the AFF in Hong Kong. Against the background of some early but encouraging signs of economic recovery in emerging markets and in North America, and clear progress toward some stability in Europe, a panel of five distinguished experts provided five distinct viewpoints of the role of and prospects of financial markets in the integration of the Asian Region. The panel

included the Hon. Ronald Arculli, GBM, GBS, JP, Senior Partner of King & Wood Mallesons, Independent Non-Executive Director, Former Chairman of the Hong Kong Exchanges and Clearing Limited; Professor Frederick Ma, GBS, JP, Honorary Professor, School of Economics and Finance, The University of Hong Kong, Former Secretary for Financial Services and the Treasury, Hong Kong Special Administrative Region of the People's Republic of China; Mr. Mark McCombe, OBE, Senior Managing Director, Asia-Pacific Chairman, BlackRock; Mr. Anthony Nightingale, CMG, SBS, JP, Non-Executive Director, Jardine Matheson Holdings; Mr. Tse Kwok Leung, Head of Economics Research, Bank of China (Hong Kong) Limited, and was moderated by Dr. Ken DeWoskin, Director, Deloitte China Research and Insight Centre (CRIC), and Mr. Eric Tong, Southern China Leader of Global Financial Services Industry Group, Deloitte China.

The Workshop also continued the tradition of polling the audience, this year with seven key questions related to the Workshop theme. The full results are reported below, after a brief analysis of the findings from the poll.

The panel discussions

After a warm welcoming of the audience and panelists, Mr. Chris Lu, Chief Executive Officer, Deloitte China, offered his review of the success of Asia as an engine of growth in the wake of the global financial crisis. Mr. Chaly Mah, Regional Managing Director, Asia Pacific, Deloitte Touche Tohmatsu Limited and CEO, Deloitte Southeast Asia, provided an overview of the key trends of both growth and integration of the entire region. Noting that growth in Asia had shown a stability not seen in the rest of the world since the global crisis, he went on to describe the importance of new economies entering the picture, including Mongolia and Myanmar. Mr. Mah talked about the key role financial services would play in the process of integration and the critical importance of liberalising the flow of capital to realise the full benefits of integration and enhance the region's growth and competitiveness. He concluded with analysis of possible developments and directions for equity markets and other channels of equity and debt capital in the region.

As the panelists made their presentations, there was a clear consensus on the need to free up flows of capital in the region. Whether looking through the lens of a regulator, an economist, an investor and asset manager, trade and investment associations, large property developers, or large conglomerates, the panel members saw little downside in accelerating the liberalisation of rules that at present are constraining cross-border financial activities. Early steps to take include increasing flexibility through currency swaps, negotiating more harmonised regulations, and permitting the development of more diverse financial instruments. More frequent and sustained discussion and communication, such as that represented by the AFF itself, were seen as important contributions to freeing up capital flows.

Lively debate arose around several key questions. Whereas panelists agreed that more integration of activities in the real economy would precede and drive integration of financial markets, there were diverse views on the sequence and timing, and there were diverse views on the risks of not getting the sequence and timing right.

Activity around free trade agreements had been significant, and signs of regional development of supply chains for manufacturing, to take one example, were unmistakable. But there was also a sense that the foundations for building out more integrating activities in the real economies of Asian countries had not advanced as quickly as one might expect. There was diversity of views on how important accelerated integration of financial markets really was to support the profoundly important integration of activity in the real economies, summed up by one panelist as a "cart and horse" question.

While there was a consensus that regional integration was a good thing, panelists acknowledged the balance points between national interests and regional win-win cooperation were difficult to find, and sometimes politically difficult to implement. In fact, some panelists expressed their concern that we were witnessing occasional cases of increased protectionism, even as the talking points of national leaders were focused on the benefits of integration. Data shows that among both major trading nations in Asia and among the Brazil, Russia, India, China and South Africa (BRICS) nations, significant trade barriers remain in place that impede their gaining the full synergies from what is clearly common cause, given their similar stages of development.

Findings in two issues of Deloitte's Measuring Value specially prepared for the Workshop illustrated that the aggregate value of Asia's capital markets was roughly equivalent to those of North America and Europe, but Asian markets were far more fragmented across national borders, currencies, regulatory regimes, and investing publics. The level of fragmentation in Asian markets has impeded the free market search of capital for the most efficient and productive use in the region as a whole. But on balance, panelists also acknowledge the imperative to approach steps toward liberalisation of things like cross-border capital controls in a well-deliberated and gradual manner, perhaps reflecting the level of caution that persists from the experience of the Asian Financial Crisis of 1997-1998.



Expert panel of the Deloitte Workshop “Asian financial integration and co-operation: The power and the path”

In describing the strength and quality of equity markets and their surrounding financial service “eco-systems”, clear and effective regulation and, of course, high quality issuing companies were identified. There was also discussion of the need for further development of bond markets, as well as world-class banking, legal, auditing, advisory, and consulting services. These are the cornerstones for building platforms to support regional integration of financial services. The importance of diversification in terms of geographic footprint of issuers, as well as specific sector-related attractions of specific markets was also discussed.

Because the panelists brought many different experiences to the conversation, they focused attention of the different roles of governments, businesses, investors, and associations. Panelists shared information on certain concrete steps that associations like Asia-Pacific Economic Cooperation (APEC) and its business council were taking to foster more communication, forward momentum, and consistent, actionable messaging from business to governments and regulators on a regional basis.

Summing up key learnings from the Workshop, there was agreement that fundamental integration of basic business, especially trade in goods and then trade in services, were underway and were

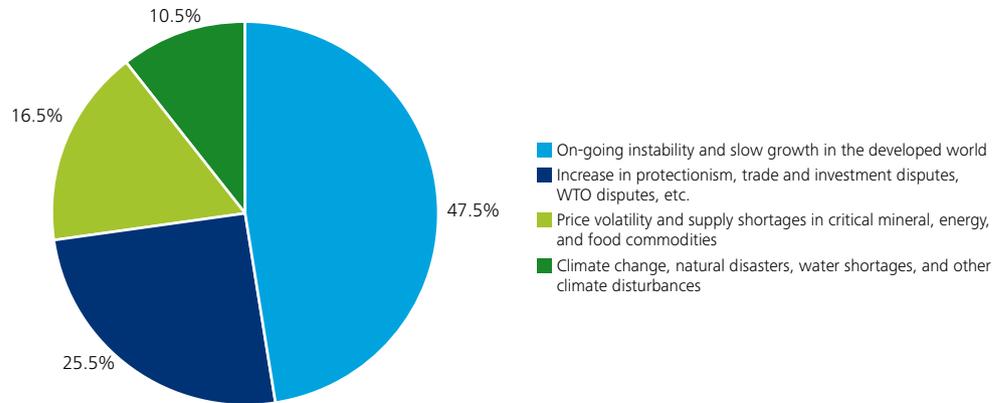
necessary preconditions for meaningful financial integration. It was particularly noted that trade in services regionally had to accelerate as a precursor, and it was noted that this would be a major benefit for Hong Kong. Asia had many forms of diversity, ranging from the many currencies, languages, ethnicities, regulatory strategies to stages of development, and development models, and these were at the heart of both the synergies and the challenges, the opportunities and the risks.

Continuing discussions from previous Workshops, there were audience questions and panelist views on the international role of the RMB. While avoiding a firm prediction on a time frame for free convertibility, the group reviewed some of the important recent steps toward liberalisation, including a broader trading band, greater use of the currency in the essential first use of trade settlement, and several new programmes to facilitate cross-border capital investment in either direction. To the question of if and when the RMB might become a reserve currency, three key points were agreed. First, the world would be well-served to have another reserve currency. Secondly, the RMB was a candidate, but it would have to undergo substantial regulatory liberalisation before it would be firmly on the path to being a reserve currency. And thirdly, this is not something likely to happen in the near future.

The polling questions

As we have done in previous Workshops, this year we asked the audience a series of questions germane to the Workshop topic and used electronic polling devices to collect their feedback. The audience for the Forum and Workshop is uniquely qualified, consisting of hundreds of senior government, business, and academic leaders from Hong Kong, the Mainland, the region, and the world.

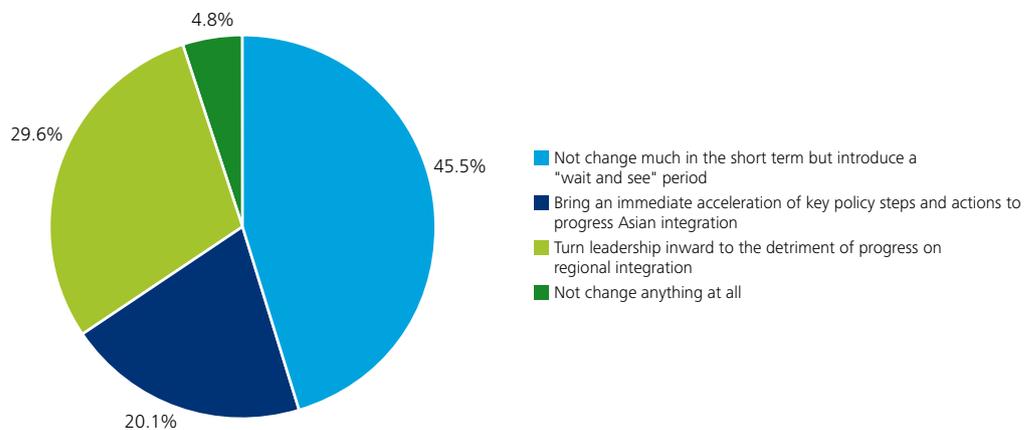
Chart 1: Which is of greatest concern to you in terms of Asia's economic stability in the three to five year period ahead?



1. What was the greatest concern this group had that might impact the rate of growth and development of the Asian region? (Refer to Chart 1)

- Looking ahead in a three to five year time frame, 47.5 percent said that on-going instability and slow growth in the developed world was their greatest concern for Asia.
- 25.5 percent believed that trade friction and protectionism were the biggest challenges.

Chart 2: The recent leadership changes in the Chinese Mainland, Japan, and in many other Asian countries will:



2. Would Asia's new leaders make a difference? (Refer to Chart 2)

- Considering that there are several new leaders of major Asian economies, 45.5 percent believed there would not be immediate change but we are entering a "wait and see" period.
- Another 29.6 percent saw a risk that new leaders would turn inward to the detriment of progress toward resolving regional issues and accelerating integration.
- 20.1 percent saw an acceleration of progress toward integration, and only 4.8 percent believed there would be no change at all.

Chart 3: In the fourth year of proactive promotion of the RMB abroad, the most recent meeting of the London - Hong Kong RMB Forum committed to take further steps to facilitate and promote broader use of the RMB. You expect:

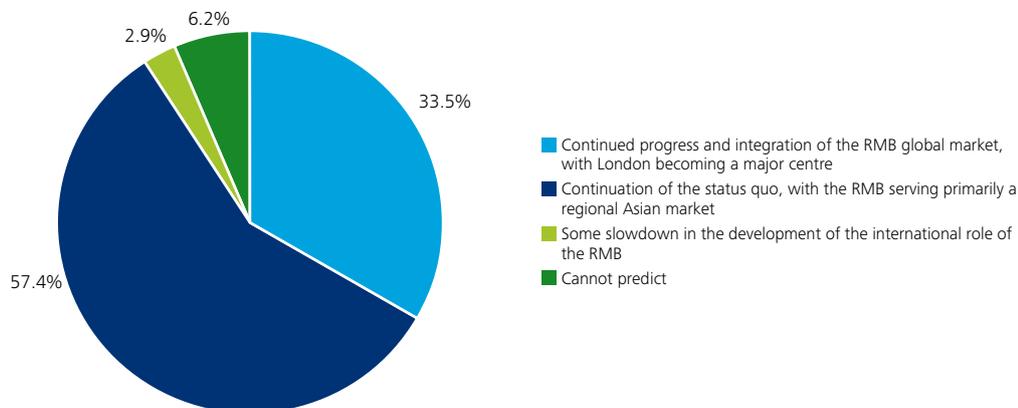
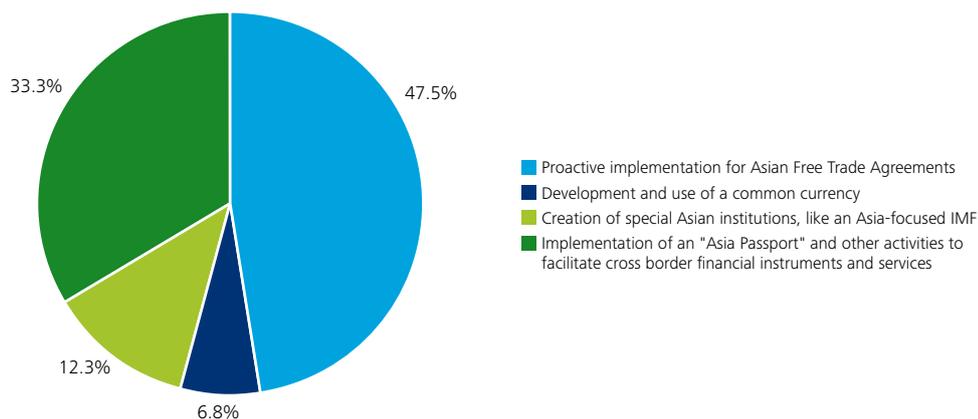


Chart 4: What do you believe will be the most effective mechanism to achieve the benefits of Asian integration and cooperation?



3. What are the key elements to making progress with regional integration? (Refer to Chart 3 and 4)

- The audience focused on specific policy changes and implementation.
- Proactive implementation of the many free trade agreements in place was the choice of nearly half, 47.5 percent, while more concrete steps like the implementation of the “Asia Passport” plan and other steps to facilitate cross-border financial activities was the key for a third of the respondents.
- Only 12.3 percent thought the creation of new Asian institutions, like an Asian International Monetary Fund (IMF) was key, and fewer, only 6.8 percent, thought a common currency for the region was the most important step.
- At the same time, 57.4 percent responding thought the RMB would essentially maintain its status quo, serving primarily as a regional currency, while 33.5 percent believed the RMB would penetrate global markets more deeply and centres like London would become important for RMB activity.

Chart 5: In three to five years, equity markets in Hong Kong and Singapore:

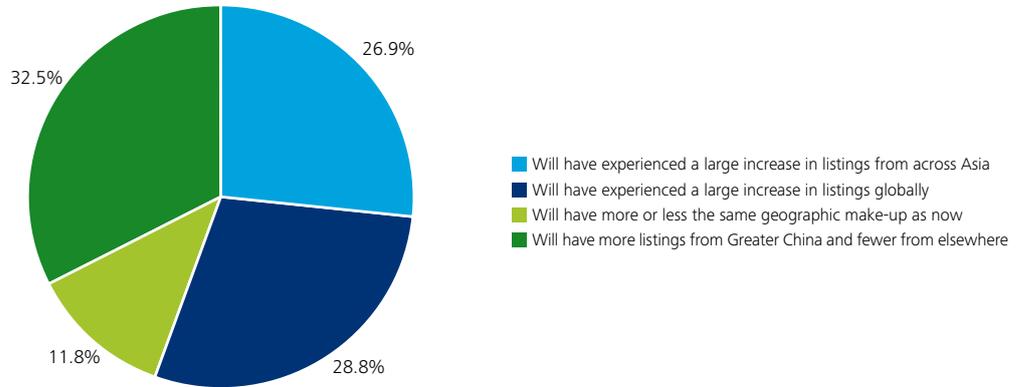
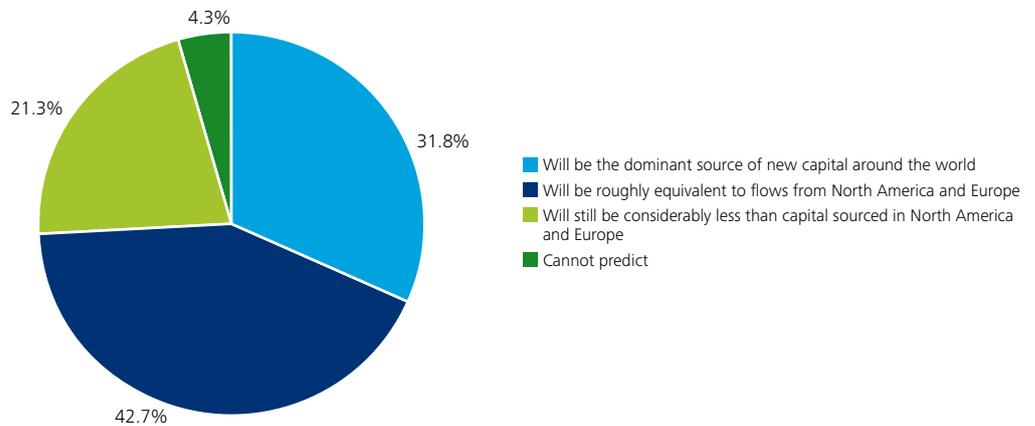


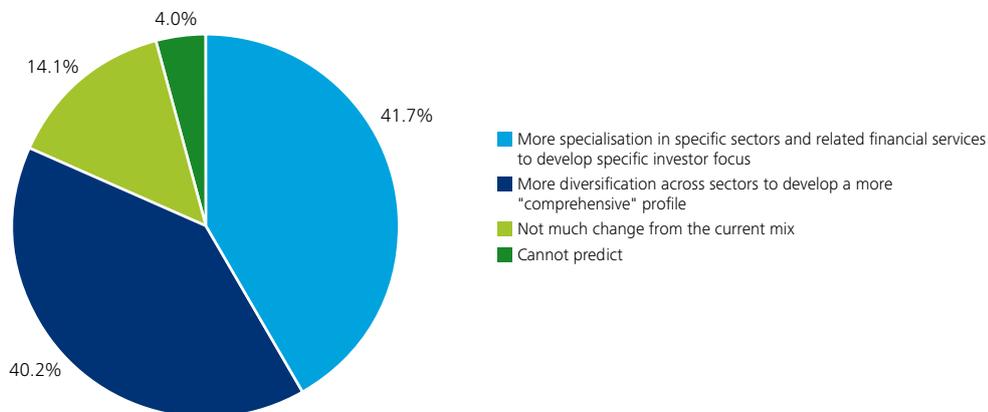
Chart 6: In five years, capital from Asia’s banks, insurers, and investment funds:



4. What will be the role of Asian capital and capital markets in the coming years? (Refer to Chart 5 and 6)

- A large majority, 74.5 percent, believed Asian capital would be the dominant source of investment funds or at least as important as investment funding from developed markets.
- Opinion was divided on the geographic expansion of equity markets in Hong Kong and Singapore.
- Nearly a third of respondents, 32.5 percent, believed that Hong Kong and Singapore would see an increase in listings from the Mainland and fewer from elsewhere.
- But nearly as many, 28.8 percent expected a significant increase in listings from across the globe, and another 26.9 percent expected listings to expand across Asia.
- Only 11.8 percent expected no change in the current geographic make-up of Hong Kong and Singapore listed companies.

Chart 7: In the coming three to five year time frame, the strongest trends in the world's major capital markets, including Asian, will see:



5. What is the sector composition of major equity markets? Are they becoming more focused on specific sectors and developing a specialist profile? Could they trend toward agnostic with respect to sectors and become more generalist? (Refer to Chart 7)

- This question arose from the analysis that panelists discussed of major markets and their degree of concentration in their top three listed company sectors.
- The largest number of respondents, 41.7 percent, believed equity markets would become more specialised, and they would therefore develop listing profiles and support systems with deeper expertise in specific areas of their specialisation.
- But an almost equal number, 40.2 percent, thought the opposite, that markets would become more general and comprehensive.
- Only 14.1 percent thought there would be no change.

So with respect to both the geographic and sector trends in market listings, we can expect change, but we will have to wait and see what direction.

Conclusion

As we enter 2013, financial service leaders in Asia are at the same time celebrating the achievements of Asia's economies since the global financial crisis and expressing some level of concern about the sustainability of Asia's growth and integrative development. Recognising that there is important competitive advantage for the region as a whole in continuing the integration process, the Workshop panelists added depth and texture to our understanding of the role of financial services.

Among the panelists, none thought that progress toward winning the benefits of integration would be easy, but all expressed confidence that the major nations of Asia had the power and the path to get there.

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