

**Speech by the Financial Secretary
John C. Tsang
at the Evening Banquet of the
20th Annual East Asian Seminar on Economics
(26 June 2009)**

The Potential of Developing a Commodities Market in Hong Kong

Professor (Leonard) Cheng, Professor (Francis) Lui, Distinguished Guests, Ladies and Gentlemen,

I am delighted to join you all this evening.

2. First and foremost, a warm welcome to Asia's world city. Also, congratulations on the 20th Anniversary of the Annual East Asian Seminar on Economics.

3. How time flies!

4. The first time the Hong Kong University of Science and Technology hosted this event was back in 1996 – a year before Hong Kong's reunification with the Mainland of China. Next week, we will be celebrating the 13th birthday of the Hong Kong Special Administrative Region.

5. I am pleased to tell you that our city remains as vibrant and dynamic as it has always been, even though some of us have a little more grey hair these days.

6. Much of our city's continued prosperity is due to the success of the "One Country, Two Systems" formula for our reunification. Under this unique concept, Hong Kong has maintained all the key ingredients that are required of a global financial centre.

7. Our economy thrives on low taxes, free trade and open markets. We have retained our common law legal system, and we have our own freely convertible currency. We have also a robust regulatory system and zero tolerance for corruption.

8. These are just some of the attributes that serve to highlight our potential in developing a successful commodities market in Hong Kong.

9. Today, our financial services industry contributes some 20 per cent of our GDP and employs around 200 000 people across a broad spectrum. Even though we have been battered by the global financial crisis, our stock market remains the 7th largest in the world and 3rd largest in Asia. At end-May, market capitalisation was US\$1.7 trillion. That's not too bad for a city of 7 million people.

10. I will avoid the temptation of reeling off a series of financial facts and figures, and cut to the chase.

11. A key feature of today's global financial centres is the wide range of products and services that they offer. This is crucial to meeting the diverse needs of local and international investors.

12. In Hong Kong, we have broadened the range of listed companies and products over the past decade or so. The first H-share company was listed on the Exchange in 1993. Now there are some 470 Mainland companies listed on our stock market.

13. In recent years, the Hong Kong Exchanges and Clearing Limited (HKEx) has vigorously developed its derivatives market and expanded its product range. Last year, Hong Kong was ranked first in the world in terms of securitized derivatives turnover and for ETF market turnover in the Asia Pacific region.

14. The commodities market is one area which remains relatively less developed here. Given the increasing demand for commodities for both economic and investment purposes in Asia, it is also an area that is certainly full of potential.

15. Indeed, both London and New York – the cities that consistently rank as the top two financial centres in the world – have strong commodities markets.

16. London is the global centre for gold trading, and its London Metals Exchange is a leading market for base metals. London is also home to the world's second largest energy exchange, ICE Europe Limited.

17. New York, on the other hand, has the New York Mercantile Exchange, the world's largest commodity futures exchange, trading mainly in energy products and precious metals.

18. So what about Asia?

19. The successful development of a commodities market in this part of the world could potentially offer global investors, and market participants an alternative platform to conduct their business. Such a platform would be exchange-based, operate in the Asian time zone and more accurately reflect the supply and demand information originating from this region.

20. After all, Asian countries – including our own nation – are today among the world’s largest consumers and producers of different commodities.

21. At present, gold prices are mainly determined in London and New York. The bulk of spot gold trading takes place in the over-the-counter (OTC) market, with London being the largest gold trading centre in the world, followed by New York and Zurich.

22. On the futures side, the gold futures contract traded on the New York Mercantile Exchange is the most actively traded gold futures contract in the world.

23. However, India remains the world’s largest consumer of gold, despite the current high prices. China is the largest gold producer, and its gold consumption is second only to India.

24. Despite the prominence of the Asian market in gold business, Asia has yet to establish a gold trading centre comparable to London and New York. Although a number of Asian exchanges offer trading of spot gold or gold futures, it is dominated by local investors with only limited overseas participation.

25. As a well-recognised international financial centre, Hong Kong has the credentials to become a major gold trading centre in the Asian time zone. We have an active OTC loco-London gold market. A variety of investors participate in it, financial institutions, gold bullion firms, and professional and retail investors. The Chinese Gold and Silver Exchange Society, which was established almost a century ago, has been operating the spot gold market in Hong Kong since the 1950s. This has provided us with a great deal of experience in gold trading. Indeed, Hong Kong is one of the leading centres for the import and export of gold.

26. Allow me to move from one of the most traditional trading commodities to one of the newest – carbon emission trading.

27. Here too, Hong Kong can play an important role.
28. Although the global carbon emission market is fairly young, it is expanding rapidly. The market is predicted to reach US\$2 trillion by 2020.
29. Under the Kyoto Protocol, the Clean Development Mechanism allows emission-reduction projects in developing economies, including the Mainland, India and many other Asian countries. Certified emission reduction, or CER credits, are each equivalent to one tonne of CO₂. These CERs can be traded, sold to, and used by developed countries to meet part of their emission reduction targets.
30. Currently, the most active carbon emission market is in Europe. To capture the growing market demand, an increasing number of exchanges around the world are considering offering carbon emission trading or related derivatives products.
31. Ladies and Gentlemen, to capture the potential of developing our commodities market, Hong Kong has implemented a number of initiatives recently.
32. In 1980, Hong Kong launched its first gold futures contract. The contract was de-listed in 2001, but the HKEx re-launched a gold futures contract in October last year.
33. Last July, a gold Exchange Traded Fund (ETF), was listed on the HKEx. This new financial product offers investors a convenient way to invest in and hold physical gold. The product is also concurrently listed in New York, Tokyo and Singapore. The market's current value is about US\$34 billion, or more than 1 000 tonnes of gold.

34. A world-class precious metals depository has recently been set up at the Hong Kong International Airport – a strategic location for the delivery of gold and other precious metals.

35. The Hong Kong Mercantile Exchange announced its establishment in June last year. Our regulator – the Securities and Futures Commission – is currently processing its license application. Subject to its compliance with the regulatory requirements, we look forward to it coming into operation and launching new commodities products in the market. We welcome such private sector initiatives in promoting the development of a commodities market in Hong Kong.

36. HKMEx announced earlier this week that it was preparing to begin trading in the fourth quarter of this year. Subject to regulatory approval, the first products to be traded on the exchange would include gold and silver, with further products planned for introduction in the months ahead.

37. Meanwhile, the HKEx today published a consultation paper to gauge the market's interest in trading Certified Emission Reduction or CER futures contracts in Hong Kong. The trading of such contracts will capture market players in the Asian time zone and help facilitate the price discovery process of CER credits in the region.

38. Ladies and Gentlemen, I mentioned earlier that Hong Kong will soon celebrate another Anniversary of our reunification. Since 1997, we have naturally become more closely integrated with the Mainland on all fronts, including financial services. Not only are we an established international financial centre, Hong Kong is also our nation's most important city for global finance.

39. Our proximity to the Mainland, open economy and international experience has helped us capitalise on China's rapid economic growth, as well as contribute to our nation's development.

40. We have wide ranging Renminbi banking services, a Renminbi bond market, and we are well placed to capture the potential of the vast Mainland commodities market.

41. Last December, the Central Government announced 14 measures to support Hong Kong's economic stability and development. Four of these measures concern strengthening co-operation between the Mainland and Hong Kong in the financial sector.

42. This includes introducing a pilot programme using Renminbi for cross-boundary trade settlements in Shanghai and four cities in Guangdong province. Hong Kong has completed the necessary technical preparations to become the first offshore Renminbi clearing centre.

43. The measures also include supporting the listing of Mainland enterprises in Hong Kong, and encouraging Mainland entities to make use of Hong Kong as a platform to develop financial businesses.

44. Financial sectors on both sides of the boundary also benefit from a free-trade pact – what we call the Closer Economic Partnership Arrangement, or CEPA.

45. Under CEPA's latest liberalisation measures, bank branches established by a Hong Kong bank in Guangdong Province can set up "cross-location" sub-branches across the boundary.

46. On securities services, qualified Mainland and Hong Kong securities companies can set up joint venture securities investment advisory companies in Guangdong.

47. I am confident that the new measures – together with existing ones – will assist Hong Kong financial institutions to establish a larger presence in the Mainland.

48. Indeed, many of our financial co-operation measures with the Mainland serve as building blocks for further, and more specific joint initiatives, including those involving the commodities market.

49. Ladies and Gentlemen, in today's highly competitive global environment, it is important for Hong Kong to continue to innovate and venture into new business areas. This will help to maintain a leading edge in the financial services sector, and foster our position as an international financial centre.

50. The growing demand for commodities products in Asia and the continued rapid growth of the Mainland economy coupled with Hong Kong's particular background and expertise, presents a unique opportunity for us. We will continue to explore ways to develop a commodities market in our city. I look forward to hearing your views on this topic.

51. Once again, congratulations on your 20th Anniversary. I hope that all our visitors have an enjoyable stay here in Hong Kong, and that you will come back and visit us again soon.

52. Thank you.