

Our Connect Story

A New Chapter Begins...



Contents

CEO View	1
Our Connect Story	2
The New Chapter	6
Linking the Connect Story with Our Purpose	11
Concluding Remarks	12

CEO View

What defines Hong Kong?

Connectivity defines Hong Kong. It is the ability to bring together cultures, communities and commerce with a unique East/West flavour, creating a city of unrivalled depth, diversity and opportunity. It's at Hong Kong's core. It's what it does... and it underpins Hong Kong's role as a leading IFC.



And today, Hong Kong's position as a superconnector between East and West is perhaps more needed and vital than it has ever been.

We live in a world of heightened geopolitical tension and polarised debate, but we are also at the start of something very exciting – something we call the Big Bang of Finance; a megatrend being driven by new capital market reforms, innovations and connections that we expect will increase the size of China's financial markets to more than USD100 trillion by 2030.

Our own Connect Story, rooted in Hong Kong's track record of reinvention puts us at the heart of this megatrend.

Now, we are starting a new chapter in our Connect Story, but this one is different from those before.

Past chapters, such as the launch of Stock Connect in 2014 and Bond Connect in 2017, were built around singular initiatives that created new infrastructure to connect China and the world.

In this new chapter, four distinct initiatives – the inclusion of ETFs in Stock Connect, the development of Swap Connect, adding RMB counters to Stock Connect and launching China Treasury Bond Futures – and one potential gamechanger – the inclusion of international companies in Stock Connect – are quickening the pace and stretching the narrative of the Connect Story.

This new chapter means a new dimension for Hong Kong's connectivity between China, Asia and the world, making our markets more relevant.

At HKEX, we are focusing on our unique China expertise and access; diversifying our business to connect capital with ideas; and actively embracing the trends and dynamism that are shaping our industry.

In short, we are building the Marketplace of the Future – a liquid, vibrant market that customers and stakeholders from across the world want to be part of and which will be at the heart of the Connect Story as it plays out over the coming years.

Nicolas Aguzin
HKEX Chief Executive Officer

Our Connect Story

Hong Kong has served as a connector between China and the world for years but the ‘Connect Story’ – connecting China and the world through capital markets – had its genesis in the early 1990s.

At that time, cross-border investment opportunities were far more constrained and Hong Kong’s capital markets were primarily local in scope.

H-shares in Hong Kong – the first step in the Connect Story

But that all changed in 1993 with the launch of the very first H-share, offering investors exposure to Mainland Chinese companies for the first time through a Hong Kong listing. An important cornerstone for Hong Kong’s capital markets, the launch of H-shares made them part of China’s market system, while also being accessible for international capital, and laid the foundations for the Connect programmes to come.

As the Chinese economy grew through the 1990s and into the 2000s, international investors wanted greater exposure to China’s onshore stock market and in 2002 and 2011, new channels – the QFII and RQFII – were set up.

Though these breakthroughs were notable, international investors and institutions demanded a more efficient process, less restrictive rules, more flexibility and a safe, secure channel through which to gain exposure to onshore markets.

Stock & Bond Connect

That came with the start of the next chapter in the Connect Story in 2014, linking onshore markets and international investors, and vice versa.

Starting with the launch of Hong Kong-Shanghai Stock Connect in November 2014 and then expanding to Hong Kong-Shenzhen Stock Connect in December 2016, the Stock Connect programmes opened up onshore markets for international investors and Hong Kong markets for Mainland Chinese investors.

More than that, the innovative, pioneering Stock Connect programmes made China accessible as an asset class, provided new diversification opportunities for the sizeable investor base in Mainland China, facilitated two-way capital flows between China and the world and paved the way for China assets to be included in key global benchmarks.

In 2017, the Connect universe expanded into fixed income with the launch of Bond Connect. First linking the onshore fixed income market via a Northbound channel with Hong Kong, then expanding to include a Southbound channel in 2021, Bond Connect has been a success, growing in both size and scope over the years.

Constant enhancement

But while the Connect Story is one of a steady stream of breakthroughs, it is also one of constant enhancements to widen the array of investment opportunities, improve efficiency and facilitate the two-way flows of capital between China and the world.

In the eight years since the start of Stock Connect, there have been a series of new enhancements, including: Master Special Segregated Accounts for more efficient pre-trading checking and average price execution; the launch of MSCI China A50 Connect Futures, offering investors an effective A-share exposure risk management tool; the addition of more eligible stocks to expand investor choice; the development of Synapse to automate

post-trade processes on Northbound Stock Connect; and the addition of holiday trading on Stock Connect, adding trading days to the calendar. All these have dramatically improved access and efficiency for investors.

And that story extends to Bond Connect which, since its launch in 2017, has implemented real-time delivery-versus-payment (DVP) to reduce settlement risk; introduced block trade allocation to improve trading efficiency and operations and added new platforms to bring in more traders.

Stock and Bond Connect – connectivity timeline



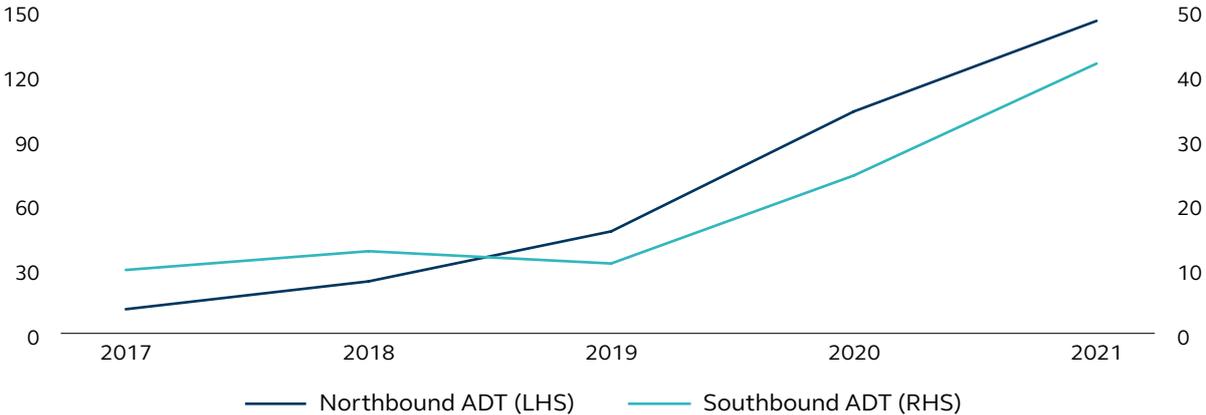
Rising cross-border flows

The combination of new breakthroughs, continuous enhancements and closer connectivity has integrated Mainland China's markets more closely into the global financial system, with Hong Kong acting as the primary gateway.

This has played a key role in driving inclusion of China assets into global benchmark indices, such as the MCSI EM Index and Bloomberg Barclays Global Bond Aggregate. It has also had a significant impact on flows.

Looking at Stock Connect alone, average daily trading volumes on the Northbound and Southbound channels have grown over the years, with Northbound trading alone growing from HKD11.2 billion per day in 2017 to HKD144.9 billion per day in 2021.

Average daily trading value on Stock Connect Northbound (LHS) & Southbound (RHS), HKD billions, 2017 – 2021

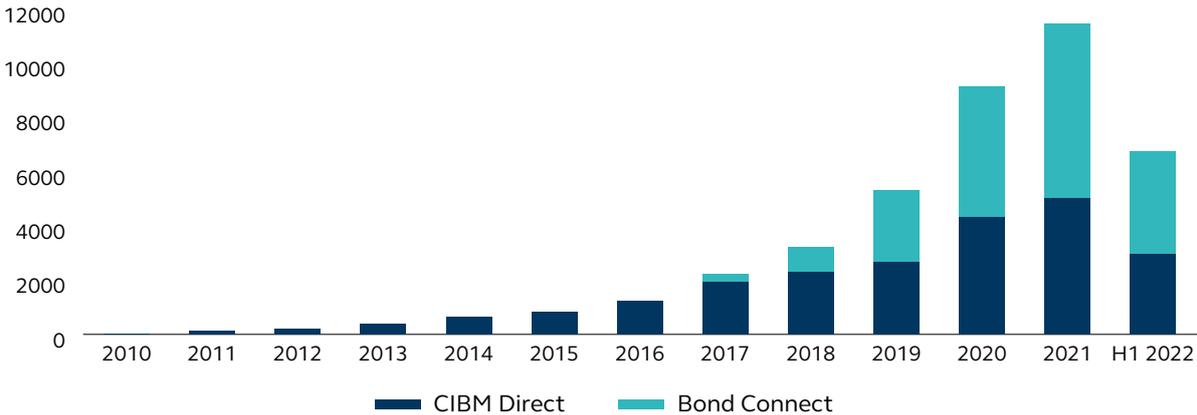


Source: HKEX, August 2022



For Bond Connect it is a similar picture, with registered overseas institutional investors growing from 137 in July 2017 to 3,513 as of May 2022 and average daily trading value growing from RMB2.2 billion in 2017 to reach RMB26.6 billion in 2021.

Trading value on Bond Connect & CIBM Direct, 2010 – H1 2022 (RMB billions)

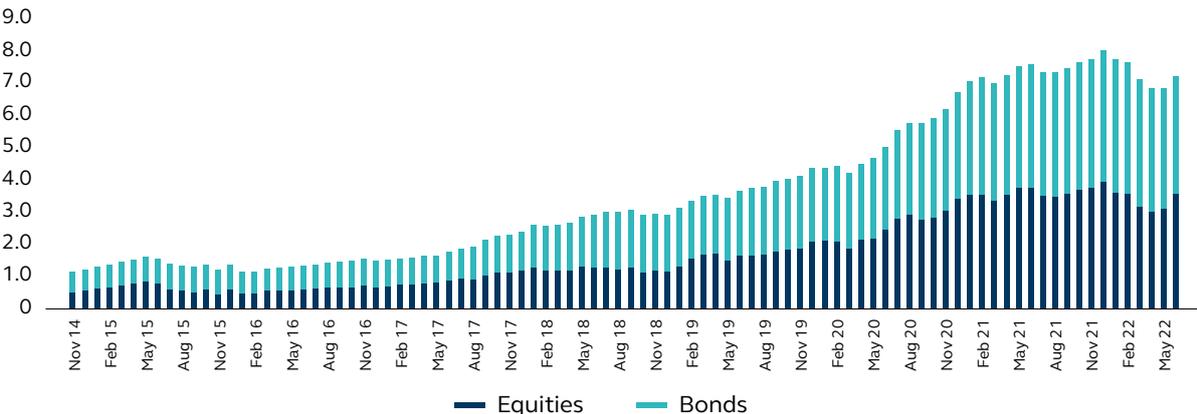


Source: HKEX, August 2022
 Note: CIBM Direct: China Interbank Bond Market Direct

In terms of total investments the impact on cross-border holdings has been definitive.

Since November 2014, international investors have increased their allocations to Mainland China assets, with total holdings across equities and fixed income growing from RMB1.1 trillion in November 2014 to RMB7.2 trillion in June 2022, according to data from the People’s Bank of China.

International investors' holdings of onshore China equities and bonds (RMB trillions), Nov 2014 – Jun 2022



Source: People's Bank of China, June 2022

And it’s a similar picture for onshore investors, who have increased their overseas investments from RMB4.9 trillion in 2014 to an estimated RMB22.8 trillion at the end of 2021, according to estimates by China Merchants Bank.

Where do we go from here?

So what’s next for the Connect Story and where do we go from here?

The New Chapter

A new chapter in the Connect Story has already begun, but this new chapter is different to those of the past.

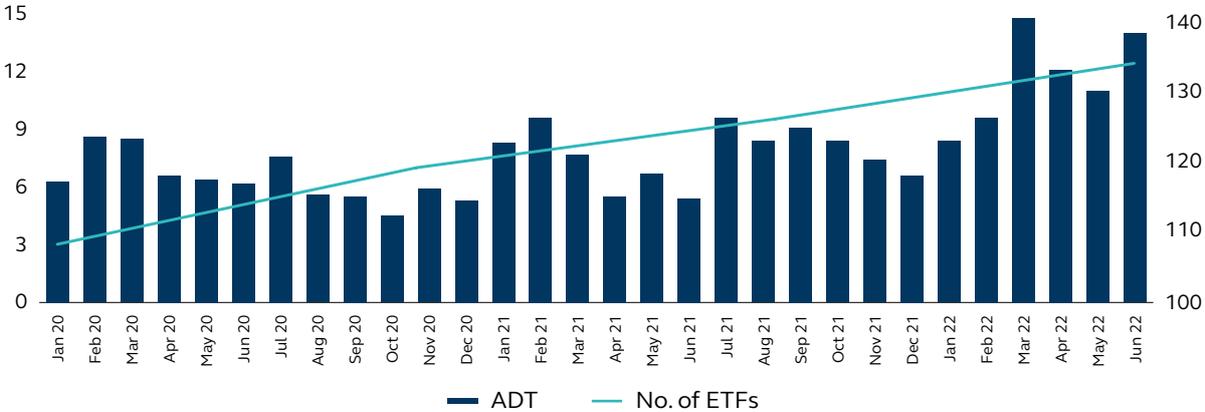
Past chapters, which included the launch of H-shares in 1993 and Bond Connect in 2017, were built around singular breakthroughs. This new chapter, however, features five new initiatives.

The inclusion of ETFs in Stock Connect

On July 4 2022, ETFs were included in Stock Connect allowing Hong Kong and international investors to trade eligible onshore-listed ETFs; while Mainland Chinese investors gained access to a range of Hong Kong-listed ETFs.

83 onshore and four Hong Kong-listed ETFs were included on the Northbound and Southbound Stock Connect, respectively, with Northbound-eligible ETFs covering 73% of the market capitalisation and 58% of the turnover on the Mainland China ETF market. Southbound-eligible ETFs covered 57% of aggregate AUM of ETFs listed in Hong Kong.

Hong Kong ETF market: No. of ETFs (RHS) and ADT (HKD billions, LHS), Jan 2020 – June 2022



Source: HKEX, September 2022

The inclusion is significant because it captures the trend toward passive investing seen around the world, providing international investors with access to thematic and stylistic ETF strategies in the world’s second biggest equity market and boosting liquidity in Hong Kong’s markets via Southbound flows.

Performance since July has been strong, with Southbound volumes reaching HKD8.16 billion in August, compared with HKD4.31 billion in July. Though smaller than volumes seen on the Southbound channel, volume on the Northbound channel reached RMB606 million in August, compared with RMB396 million in July.

Swap Connect

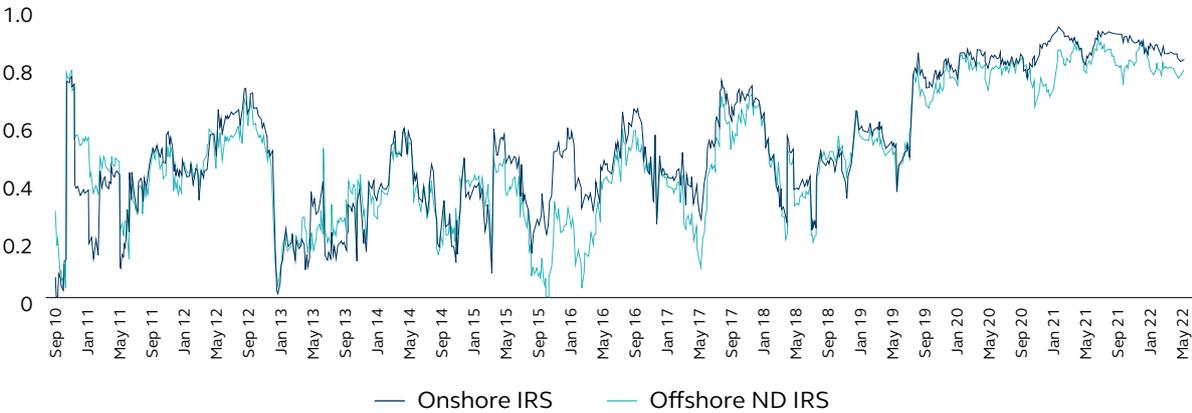
At the same time as the inclusion of ETFs in Stock Connect, HKEX announced plans for Swap Connect - a collaboration between HKEX, China Foreign Exchange Trade System (CFETS) and Shanghai Clearing House (SHCH) that will offer a new mutual access programme between Hong Kong and Mainland China's interbank interest rate swap (IRS) markets.

Swap Connect will be an entirely new Connect channel and the world's first derivatives mutual market access scheme. It will allow international investors to trade and clear onshore RMB IRSs in Mainland China without changing their existing trading and settlement practices. The China onshore IRS market, measured at USD5 trillion, is the second most liquid market in Asia, which reached USD17.7 trillion in 2021, according to CLARUS.

Swap Connect will provide the risk management tools for China's bond markets that are increasingly demanded by the growing pool of international investors trading onshore China fixed income.

Onshore IRS are valuable cost-effective risk management tools to complement existing offshore IRS products, differentiated by their greater correlation to key benchmarks in the onshore fixed income market, lower volatility and tighter bid-ask spreads.

Daily rate change correlation of Onshore IRS and Offshore ND IRS with Chinese Government Bond 5Y, Sep 2010 – May 2022



Source: Bloomberg, June 2022

Three further breakthroughs

Three significant announcements followed in September 2022.

1. Including international companies in Southbound Stock Connect

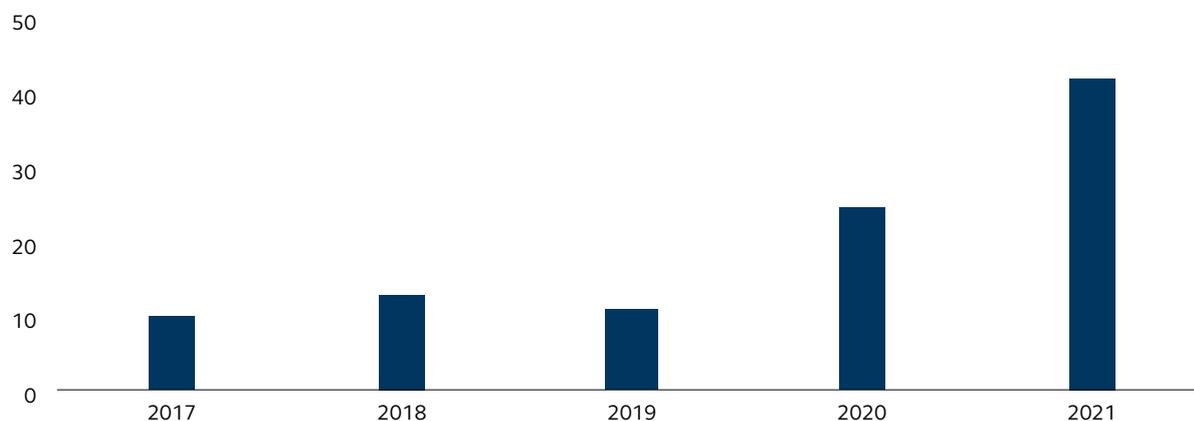
First, the proposed inclusion of international companies in Southbound Stock Connect, in particular, is a potential gamechanger. For the first time ever, it will allow retail investors from Mainland China to buy international stocks in Hong Kong, which has the potential to make Hong Kong's listing platform more attractive to international issuers looking to tap the significant pools of capital on the Mainland.

McKinsey estimates the pool of capital onshore is significant. At the end of 2020, Mainland investors held an estimated RMB205 trillion in financial assets. By 2025, that total is forecast to rise by a CAGR of 10%, to an estimated RMB328 trillion.

Together with the wide range of existing international products at HKEX, such as the suite of MSCI futures products with underlying from many jurisdictions, the addition of international companies will offer investors more diversification opportunities. This supports strong risk management and the broader health of the regional and global financial system.



Average daily turnover on Southbound Stock Connect (HKD billions), 2017 – 2021



Source: HKEX, August 2022

2. Adding RMB counters to Stock Connect

The addition of RMB trading counters to allow Mainland Chinese investors to trade Hong Kong-listed shares in either HKD or RMB will simplify settlement processes – making the market as a whole more accessible and efficient; and potentially bringing more retail investors into Southbound Stock Connect.

The initiative has the potential to also help expand channels for two-way cross-border RMB capital circulation, deepening liquidity in Hong Kong's offshore RMB market and driving the long-term RMB internationalisation process.

At a time when other IFCs are competing for RMB business, the launch of the RMB counter initiative will give Hong Kong a special role in promoting RMB trading to the international market.

3. Launching China treasury bond futures in Hong Kong

Another development – the launch of treasury bond futures – will give international investors additional risk management tools for China’s bond markets. International investors are increasingly active in onshore China fixed income and are demanding a wider range of tools, particularly amid recent market volatility.

Looking at the longer term, as Hong Kong develops its position as Asia’s risk management hub; as it adds more RMB risk management tools; and as derivatives trading is more widely adopted in China, the overall upside for fixed income derivatives in Hong Kong could be significant.

Connecting China and the world and facilitating vital two-way capital flows between East and West

All these initiatives and enhancements are foundational. They bring the China growth story to international investors, help Chinese capital access global opportunities, promote the internationalisation of the RMB and strengthen Hong Kong’s superconnector status.



Linking the Connect Story with Our Purpose



Building the Marketplace of the Future

This new chapter is undoubtedly great news for Hong Kong's markets, opening an opportunity-rich future as a leading IFC and global superconnector.

But, on their own, the breakthroughs described in the new chapter are not enough to realise that future.

At HKEX we are going further to seize the opportunities we see and shape the future we want by creating a business and a market that seamlessly and efficiently connects with clients, offers both traditional and new asset classes and attracts the innovative companies of tomorrow.

In short, we are building the Marketplace of the Future – a liquid, vibrant market that customers and stakeholders from across the world want to be part of.

And it's a vision and a mindset that is rooted in the connectivity that defines Hong Kong.

To achieve that vision, we are focusing on our unique China expertise and access; diversifying our business to connect capital with ideas; and actively embracing the trends and dynamism that are shaping our industry.

And that's how we will realise the opportunities in front of us and connect, promote and progress our markets and the communities they support for the prosperity of all.

Concluding Remarks

Three terms summarise our Connect Story:
**new breakthroughs, continual enhancements
and closer connectivity.**

Can we expect the same in our new chapter?

Almost certainly yes.

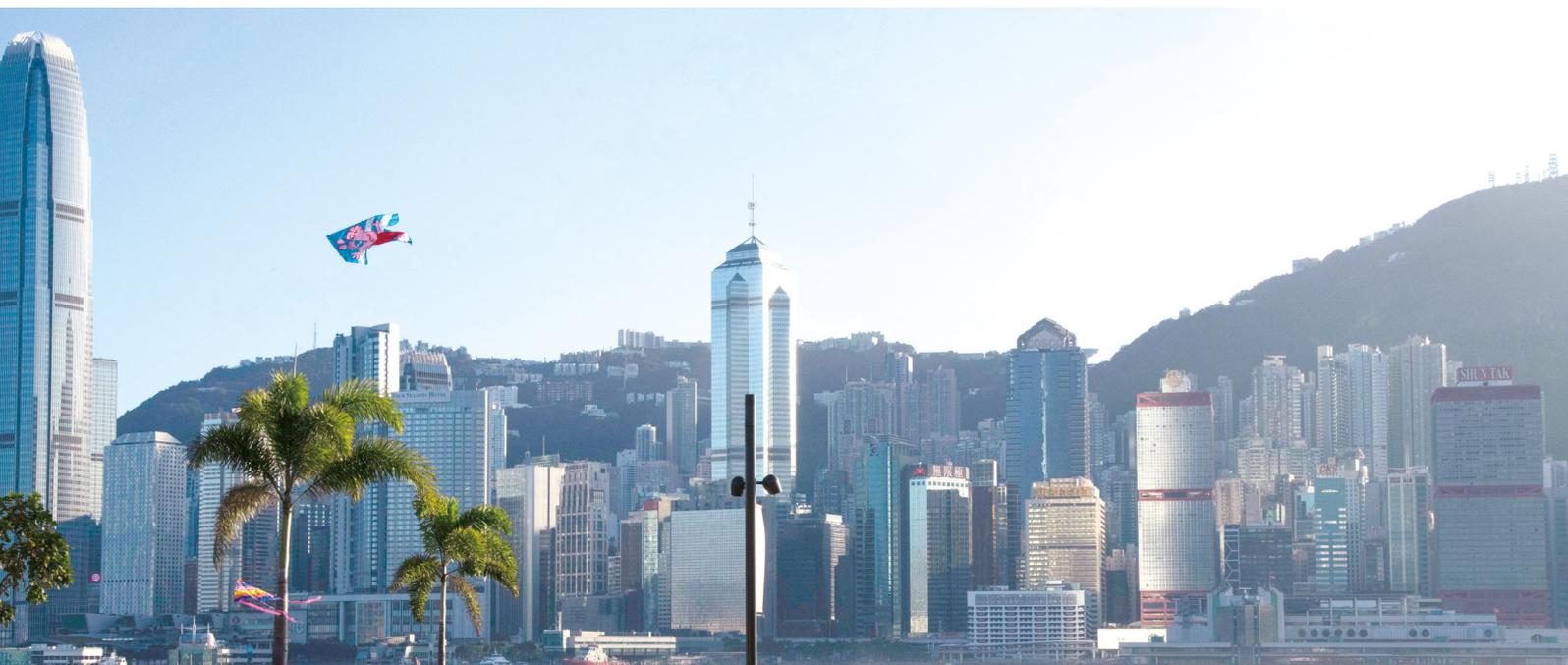
But this new chapter adds more: a bigger range of asset classes, closer connection to investment opportunities in China and deeper linkages to the sizeable pools of capital in onshore markets.

Together they position Hong Kong at the heart of the Big Bang of Finance - a structural change in global finance that we expect will expand the size of China's financial markets to more than USD100 trillion by 2030, driven by reforms to open Mainland China's markets to international capital and a reallocation of the estimated USD30 trillion of domestic wealth in China out of real estate and into financial products.

The opportunities are hard to fully quantify, but they are significant. HKEX has a big role to play, and we are focused on capturing the opportunities by building our vision – the creation of the Marketplace of the Future.

We are doing this by focusing on our unique China expertise and access; diversifying our business to connect capital with ideas; and actively embracing the trends and dynamism that are shaping our industry.

So as we build the Marketplace of the Future and explore the opportunities emerging from our Connect Story, a new and exciting chapter is unfolding for Hong Kong.



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Hong Kong

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