THE YEAR 2000 IN REVIEW

Hong Kong made good progress in its economic recovery during the year 2000. The latest economic forecast expected a GDP growth of 10% in real terms for 2000. Labour market conditions continued to improve with the sustained pick-up in overall economic activity. The unemployment rate showed a further decline to 4.5% in December 2000. By the end of the year, deflation improved with the Composite Consumer Price Index falling 1.8% as compared with the correspondence period last year.

The Hong Kong stock and futures markets experienced a volatile year during 2000. Driven by the global technology stock boom and the expected admission of China into the World Trade Organisation, the Hang Seng Index surged to a record high of 18,301 in March. However, the market was subsequently deflated by negative factors including rising oil prices, Middle East violence, disappointing corporate earnings and finally global disillusionment with technology stocks. The Hang Seng Index ended the year at 15,095, 11% below the 1999 closing. The average daily turnover of the stock market (Main Board and GEM) during the year was HK$12.7 billion. With a total market capitalisation of HK$4,862 billion (Main Board and GEM) as at the end of 2000, Hong Kong was the 11th largest stock exchange in the world and the second in Asia.

One of the key achievements of 2000 was the demutualisation and merger of the stock and futures exchanges and their clearing houses. The new integrated exchange, Hong Kong Exchanges and Clearing Limited (HKEx), was established on 6 March 2000. It was subsequently listed on its own marketplace on 27 June 2000. To avoid potential conflicts of interest, arrangements were made for HKEx to be regulated as a listed issuer directly by the Securities and Futures Commission (SFC). HKEx shares attract wide interest from retail and institutional investors. HKEx’s year-end closing price of HK$17.9 was more than four times its valuation during the demutualisation and merger. The total market capitalisation of HKEx was HK$18.6 billion and its P/E ratio (based on 1999 earnings) was 35.8 times. During the year, HKEx went through an organisational restructuring to streamline and integrate its business and support functions. The initial integration phase, involving most of the operations, was completed by the end of 2000.

During the year, the HKEx signed a Memorandum of Understanding with the Australian Stock Exchange to exchange market surveillance information and began the Global Equity Market partnership talks with nine leading equity Exchanges. The Pilot Programme with NASDAQ for the trading of US securities in Hong Kong marked the first step in the potential development of a global market.

Stock market

Main Board - primary market

In the primary market, 43 companies were newly listed on the Main Board during the year. They raised HK$117.3 billion in total. As at the end of the December 2000, there were 736 companies listed on the Main Board with a total market capitalisation of HK$4,795 billion.

Following the formation of HKEx, the stock and futures exchanges transferred some of their regulatory functions to the SFC. The SFC assumed primary responsibility for routine inspection of the businesses of exchange participants, monitoring of their compliance with conduct rules and liquid capital requirements and appropriate actions to ensure that they have proper systems of management and control. HKEx continues to monitor and enforce compliance with the rules relating to trading, clearing and risk management.
Recognising the trend of market globalisation and the wide acceptance of International Accounting Standards (IAS), HKEx proposed rule amendments to allow the Main Board’s listed issuers and listing applicants to adopt IAS. In addition, it also proposed to allow overseas-incorporated listed issuers and listing applicants which have or are to have a secondary listing on the Exchange to adopt US Generally Accepted Accounting Principles (GAAP).

**Main Board - secondary market**

The secondary market was volatile in 2000. The Hang Seng index surged to a record high of 18,301 in March due to the global Internet fever. Over-shadowed by rising oil price, Middle East violence, disappointing corporate earnings and disillusionment with technology stocks, the Hang Seng Index dived to its year-lowest of 13722.7 at the end of May. The end of rising US interest rates and optimistic views on the US economy pushed the index back to the 17,000 points level in July. However the sentiment did not last long and the Hang Seng Index and All Ordinaries Index closed the year at 15,095 and 6,107 respectively, representing a decrease of 11% and 14.4% during the year. The Hang Seng China Enterprise Index and Hang Seng China-Affiliated Corporations Index, which track H-share and red-chip companies respectively, declined 17.7% and 16.7% during the year. The Hang Seng MidCap 50 index declined 33.9%. All sectors except two of the All Ordinaries Index recorded declines in 2000, with Consolidated Enterprises down 26%, Industrials down 29.9%, Properties down 11.7%, Hotels down 17.2%, Finance up 7.2% and Utilities up 14.9%.

In May, the Stock Exchange of Hong Kong (SEHK) introduced the Pilot Programme for trading US securities. Accordingly, NASDAQ and the SEHK signed an agreement on exchange of regulatory information. Seven large established securities listed on NASDAQ were quoted on the SEHK initially. Regulation of the Pilot Programme’s issuers lies with the primary exchange/market and they are admitted to the SEHK for trading only. These Pilot Programme shares are traded and settled in Hong Kong dollars, via the Hong Kong trading and clearing system, following the standard Hong Kong T+2 settlement period.

Trading activity in equities recorded a year total of HK$2,860 billion which represented 93.9% of the total trading turnover. Of this total, HK$272 million was contributed by trading in NASDAQ PP stocks.

The Stock Exchange of Hong Kong successfully launched AMS/3, the Third Generation Automatic Order Matching and Execution System, in the last quarter of the year. The AMS/3 trading system introduced newly three major features: multi-workstation system (MWS), open gateway (OG) and order routing system. The Broker Supplied Systems (BSS) and the MWS were introduced in November and December respectively. In the final phase scheduled to be launched in early 2001, the Order Routing System will enable investors to trade Hong Kong stocks from anywhere in the world using computers or mobile phones through the Internet.

Effective from 7 April 2000, stamp duty on securities trading in Hong Kong was reduced from HK$1.25 to HK$1.125 for every HK$1,000, payable by both the buyer and the seller. In May, to reduce the transaction costs for securities trading in Hong Kong, HKEx endorsed a proposal to remove the rules for stock and futures transactions with effect from April 1, 2002.

To provide individual investors with an additional electronic mechanism for submitting applications for initial public offerings, the Internet Initial Public Offering (iIPO) service was introduced in 2000. Investors are now able to access the iIPO service directly over the Internet without using a Central Clearing & Settlement System (CCASS) terminal.
During the year, CCASS was enhanced to support the clearing and settlement of securities transactions denominated in foreign currencies so as to facilitate trading of foreign stocks in Hong Kong. The US dollar was the first foreign currency in which securities and clearing services were provided.

Internet access to CCASS for Investor Participants as an alternative to access through the CCASS phone system was launched in October. Investor Participants are given Internet access to affirm Investor Settlement Instructions, check account details and apply for shares through HKEx’s iIPO service. Other services are underway to allow on-line viewing and downloading of account statements and giving dividend election and voting instructions.

**Growth Enterprise Market (GEM)**

The Growth Enterprise Market (GEM) commenced operations on 15 November 1999 to provide capital formation facilities for growth companies that are not qualified to list on the Main Board. 47 companies were newly listed during the year. In total, they raised HK$14.8 billion of new capital. GEM’s average daily turnover value in 2000 was HK$341 million. As of the end of 2000, 54 companies were listed on the GEM with a total market value of HK$67.3 billion.

During the year, the GEM was recognised by the US Securities and Exchange Commission as a designated offshore securities market. As a result, all GEM-listed shares may generally be resold without restriction to US and non-US persons in and outside the United States.

A full review was carried out during the year to gather market feedback on certain proposed changes to the GEM Listing Rules. Key areas of review include the moratorium period for the initial management shareholders, the prohibition on share issues within six months of listing, the minimum track record period, and the limit on the shares over which companies may grant share options.

The SEHK launched the Growth Enterprise Index on 20 March to provide investors a benchmark for the market. The Growth Enterprise Index is a market value-weighted index which includes all the ordinary shares listed on GEM. The base value of the index was 1,000 with the base date on 17 March 2000. The GEM Index closed the year at 309, a decline of 69.1% from the base date.

**Warrant market**

The warrant market was more energetic during 2000. Forty-five equity warrants and 280 derivative warrants were newly listed on the Exchange in 2000. The total number of warrants listed on the Exchange rose to 291 as at the end of 2000, compared to 192 in 1999. The turnover of warrants for 2000 increased to HK$167.4 billion, representing an increase of 28.6% compared with 1999’s HK$130.2 billion.

**Debt securities market**

Twenty new debt securities listed in Hong Kong in 2000, compared with 87 in 1999. The total number of debt securities expanded to 240 at the end of December 2000. Trading remained inactive with a year total of HK$58.7 million.
Unit trusts and mutual funds

There were 21 unit trusts listed on the Exchange as at the end of December 2000, compared to 23 and 27 in 1999 and 1998 respectively. As a result of the successful launch of the Tracker Fund of Hong Kong (TraHK) in the end of 1999, the total trading turnover of unit trusts listed on the Exchange increased substantially to HK$20 billion in 2000 compared to HK$12.5 billion in 1999 and HK$8.8 million in 1998.

Derivatives market

The total number of contracts traded in the HKEx derivatives market increased 8.6% to 9,260,570 in 2000. The average daily volume recorded 45,713 contracts. The growth was primarily contributed by the improved performance of the stock options market, which offset the decline in index options and futures.

Turnover volumes of Hang Seng Index futures and options in 2000 were 4,023,138 contracts and 544,047 contracts, the two products recording a decline of 21.6% and 23.8% respectively. Other stock index futures and options and Rolling Forex also experienced a substantial decline in their trading activities during the year. The good performers for 2000 were the two HIBOR contracts and the 18 stock options classes.

With the addition of stock options on TraHK, the total number of stock option classes traded in Hong Kong increased to 18 at the end of 2000. Turnover volume of stock options grew strongly in 2000, with the average daily turnover reaching 16,958 contracts, almost double the figure for 1999 (8,899 contracts). The total premium for the whole year was 13.9 billion. For stock options trading, agency trading and principal trading contributed 13.8% and 24.6% of total contract volume respectively in 2000, market makers contributed the rest of 61.6%. The derivatives market became fully electronic following the migration of Hang Seng Index (HSI) futures and options trading to the new electronic platform HKATS in June 2000.

The Hong Kong Futures Exchange (HKFE) also obtained the approval of the US Commodity Futures Trading Commission to place HKATS terminals and automated order-routing systems connected to HKATS in the US. This would help expand the trading network of its product to the US market.

During the year two new products were launched - Hong Kong interbank offered rate (HIBOR) Futures Strips and Mini-Hang Seng Index (Mini-HSI) Futures. The HIBOR Futures Strips enable market participants to trade consecutive series of HIBOR futures contract in a single transaction. The Mini-HSI Futures are fungible with the HSI Futures, allowing market participants to offset positions between the contracts. The contract multiplier and the margin of the Mini HSI Futures are one-fifth of those for HSI Futures. The trading hours and the contract months are the same as for HSI futures.

The MSCI China Free Index was licensed for use by the HKEx Derivatives Market. HKEx products based on the MSCI China Free Index would be introduced in 2001 subject to the approval by the SFC.