Matthews Asia Perspective
Decoding Hong Kong’s Protests

In this Q&A, Matthews Asia Chief Investment Officer Robert Horrocks, PhD, shares his views on the current strife in Hong Kong and how Matthews Asia is approaching the market volatility in China and the macroeconomic environment.

What do the current Hong Kong protests and escalation mean for the “one country, two system” structure that’s currently in place?

In some ways, the protests are all about the one country, two system structure that’s currently in place. When Hong Kong was returned to Chinese governance from British governance in 1997, the “basic law”—which provides autonomy and political, democratic voting and legal right—took effect. The basic law from Beijing provides Hong Kong a high level of autonomy and freedom, for Hong Kong to maintain its legal systems, freedom to protest and strike and express its own views. One of the main drivers of the protests is the belief by those protesting that some of these freedoms and autonomy have been eroded, and that China has not yet lived up to the promises of the “basic law” that over time, it would provide for universal suffrage in Hong Kong.

How do you think the protests will play out?

It can be helpful to think about the four key constituencies involved in the protests and how they might think about them:

The protesters: “What do they want?” This is a hard question to answer in many respects because there doesn’t seem to be a centralized leadership. Among the issues at stake were the extradition bill, which has since been shelved. Also common among the protesters is an interest in universal suffrage in Hong Kong under the terms of the basic law.

The Hong Kong government: “What does it seek?” They seek a peaceful resolution that doesn’t include the Chinese government directly or any intervention from the Chinese military or troops, because being able to manage the protests on their own would help justify its position and its worth to China.

China: “What does it want?” China wants to demonstrate that it is able to deal with these situations calmly and appropriately, that it knows how to be stewards of a world-class financial center, because that is precisely what it hopes Shanghai to be. At the same time, China does not want to encourage any direct attacks on its authority.

The general citizenship of Hong Kong: They’re mostly aligned to the protesters in terms of political demands but prefer to see less disruption. One of the reasons that the earlier 2014 protest movement in Hong Kong had fizzled out a bit is because people got tired of the disruption.
With the protests playing out on a global stage, how likely is Beijing to intervene?

With the global media providing regular coverage of events, I think it all points to the continued need for patience on the side of Beijing. I think China’s preferred approach to the protests is to be hands-off, and have Hong Kong deal with the situation. China is opening up its equity markets to foreign investors and it wants to be seen as a stable, attractive destination for capital, and it wants to promote its currency as a source of global reserves. China wants to generate trust and confidence in the legal system and the market institutions within domestic China, among other goals. And China’s economic diplomacy is becoming an important part of its position in the world, so on many fronts, China has incentives to employ a patient and tolerant approach. However, there is always the possibility that should the protests escalate further that China feels like it may have no choice but to intervene. The incentive to act most squarely is on the shoulders of the Hong Kong government. It has the most pressure to act quickly because its leaders need to be seen as effective. They need to show that they can maintain Hong Kong properly and maintain general order. And they also need to demonstrate that they don’t require the intervention of Chinese authorities. That responsibility ultimately falls on the chief executive of the Hong Kong region, Carrie Lam.

What are the implications for Hong Kong’s legal system?

The legal system that Hong Kong ultimately employs will have an impact on its future. If you look across the world, the most vibrant capital markets, including equity, bond and future markets, tend to be those that have a common-law type of system. In a common-law system, the market decides what works and what doesn’t, while the legal system provides some basic ground rules. The other type of framework we tend to see worldwide is a civil law type of system, where the legal framework is a bit more prescriptive and top-down. Examples of the civil law type of system include Germany, Japan, Taiwan, South Korea and China. These countries tend to be more manufacturing powerhouses. For China to achieve its growth objectives and attract more international capital, it will need to liberalize its financial markets and part of that means letting its legal system evolve. China would like to turn Shanghai into a global financial center and so it has written some of the securities law for Shanghai with more of a common-law flavor. The key question is does China understand how far it has to go to reform the legal system in Shanghai to generate the vibrant markets that it would like to see. There’s clearly a balancing act for China. China understands that the world is watching how it behaves in Hong Kong, which could play a factor into how China proceeds in terms of its response to the protests.

How are these protests different from the ones we saw in Hong Kong in 2014, the so-called umbrella movement?

The umbrella movement was more about inequality within Hong Kong itself. The current protests seem more squarely aimed at the relationship between Hong Kong and China. In the current protests we seem to see more emphasis on things such as the extradition bill and maintaining the current structures in place in Hong Kong. The second thing I might note is that the leadership of the current protests seems more decentralized, less clear who the leaders are, or if there are even any clear leaders behind the movement. This makes it more difficult to negotiate with protesters because there’s not a central point person. Another difference is that in the 2014 protests, the protest activities were limited to certain areas that were well-defined and could be avoided if you’re going about your daily routines, whereas the current protests are springing up in a much broader range of places. And I think the tone seems different. The protests in 2014 seemed a bit more conciliatory, whereas the current protests have been more confrontational.

With the backdrop of the U.S.–China trade war, what are some of the economic risks for Hong Kong if the protests continue to escalate?

The current protests are a different type of risk than the trade war. In the context of the trade war, investors are looking at things such as disruptions to supply chains. Global manufacturers may be asking questions such as, where to locate their next factory for example, in China or Vietnam? The impact, while not huge, is on decisions about where to invest. With the Hong Kong protests, you see more of a disruption to the local economy, including the potential for decreased tourism and a decrease in consumer spending. And around the edges we might see a little bit of capital shifting from Hong Kong to Singapore as a safe haven. It’s important to note that this is not about capital flight from China but money leaving Hong Kong. Hong Kong still plays a big role in trade
finance, it still plays a big role in cross-border capital flows. For example, we don’t expect that the protests would have that much impact on the success of the Hong Kong Stock Exchange Connect Program.

**Amid U.S.-China trade tensions and protests in Hong Kong, volatility has impacted Chinese equity prices. How is Matthews Asia approaching the current macroeconomic environment?**

At Matthews Asia, we are looking to identify investment opportunities that may arise from short-term market dislocations. Dampened sentiment can lead to buying opportunities. As always we’re looking for quality companies with solid management teams that can capture the attractive growth potential of the region. I fully understand that many investors, looking at the disruption, would like to stand on the sidelines, but as long-term Asia investors, we like to buy when sentiment is weak because we are more focused on how companies will perform over a full economic cycle. Chinese equity valuations relative to the U.S. currently seem to be at the bottom of their historical range. So we find this an exciting time to invest in the region.

We continue to monitor risks, including geopolitical risks, while staying focused on the opportunities on the ground. The protests in Hong Kong have been one out of many factors that have been weighing on markets. Other factors seem to be improving a bit and we remain optimistic about China’s long-term growth potential.