The Push for Macau: An Ill-Advised Play

On December 12, 2019, *Reuters* reported that the Central Government has more or less made it a policy goal of transforming Macau's economy – diversifying its heavy exposure to the casino industry and tourism[1]. Furthermore, state-owned banks and enterprises are strongly encouraged to help build new and updated infrastructure in order to implement this project for financial "diversification".

Among a plethora of new policies for the semi-autonomous port, the key highlights included: the establishment of a CNY-denominated stock exchange (presumably onshore CNY)[2]; picking up pace on the setting up of a CNY settlement center; and releasing swaths of land in the mainland for Macau to develop. Notwithstanding the obvious signal these policies send to neighboring Hong Kong and the wider international business community, it is necessary to step back and consider whether these policies are prudent, before jumping onboard the Macau bandwagon.

Macau is not Hong Kong

The CCP's attempt at hedging the chaos from Hong Kong by developing Macau is ill-advised for the time being. And to be fair, Macau will never be Hong Kong. The differences between both special administrative zones are deep-rooted, sometimes going back to their colonial legacies[3].

It is also puzzling as to why the Central Government has not, instead, focused on Shenzhen or Shanghai, where infrastructure is already in place. If the CCP wants to play carrots and sticks with Macau and Hong Kong, the ultimate loser may be the Party itself.

Moreover, the establishment of another exchange seems unnecessary. It is no secret that filing for IPOs have been clogged in both Shanghai and Shenzhen. This is more a problem of regulation and law than it is about the sheer number of exchanges available for mainland companies to go public.

Similarly, the previously mentioned *Reuters* article pointed out that the main purpose for this future Macau exchange is for mainland firms to float bonds. Corporate debt in the People's Republic has always been an issue, even more so in recent years, and giving companies yet another outlet to raise debt-fueled capital simply does not seem like the best thing to do – another exchange means that financial interconnectedness on the mainland will move the risk around, thereby potentially creating more systemic issues.

For its part, the CNY settlement center is not an entirely misguided idea. If China wants to truly internationalize the CNY, more settlement centers are definitely needed. At the same time, it begs the question: why not just allocate more resources to Shanghai, Shenzhen, and even at this point, Hong Kong? These localities are already equipped with CNY settlement capabilities and are in of themselves financial centers. It is puzzling, to say the least, why the CCP is ready to commit such vast resources and time to transforming Macau.

Further to this point, the CCP still believes that most problems of statecraft can be solved if enough capital is allocated to it. Unfortunately, artificially creating a stock exchange in a city in the absence of real demand (in addition to Hong Kong's strong English common law legal structure and simple taxation structure) will likely result in failure – apart from allowing more mainland companies to list and issue debt. For example, one can easily recall that in 2018 CNY-denominated crude oil contracts had been launched in China. The hype around that faded off quick after people realized that the high volumes of trading were pretty much only done by local players[4]. Just because an exchange, a product, or a policy is put in place does not guarantee that it will have international appeal, which is the bedrock for the financial industry. As such, insofar as Hong Kong has not totally collapsed, it will remain the preferred option over Macau for the international community, and most likely for mainland companies as well.

Finally, allocating more land for Macau to develop runs into the same problem that is the real estate industry and the wider construction industry in China. Real estate assets are viewed – dare we say it – as safe as sovereign bonds in the country.

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[1] https://www.reuters.com/article/us-macau-politics-exclusive/exclusive-protest-free-macau-to-win-financial-policy-rewards-from-china-idUSKBN1YG0EJ
[2] It is said that individuals involved with the creation and development of the Shanghai Stock exchange will help set up the stock exchange.
[3] To make a long story short, the British drafted the Basic law in addition to provide a form of election process for the executive and the Legislative council; Portugal kept negotiation to a minimum, handed over Macau and its governance to mainland.
[4] https://www.wsj.com/articles/chinas-oil-futures-give-new-york-and-london-a-run-for-their-money-11553679002

And with tier-1 and tier-2 cities already oversaturated with real estate development, capital is now moving into the lower tiered cities, further inflating the market, and further adding to the growing systemic risk. Of course, the CCP has no easy solution to this issue, not when the construction firms for real estate development are mostly state-owned. In effect, the money has to keep flowing – this is a governance issue. Although, knowing and understanding the dilemma that haunts the Party does not make the Macau land allocation policy a smart one. Besides, the moment the exact pieces of land that will be allocated is announced, the price will skyrocket. And money will soon follow into the real estate assets, inflating their value way beyond what is reasonable. The worst part is Macau's stagnant economy will most likely not improve, not in the absence of any real economic drivers.

When it is all said and done, Macau's economy will become diversified – diversified into yet another tier-2/tier-3 city in the People's Republic sitting on top of a mountain of corporate and local government debt, and with unaffordable housing for its locals.