Global Maritime Weekly Digest

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*The **Global Maritime Weekly Digest**, based at **Southampton SOLENT University**, provides a regular flow of maritime news and analysis, of significance in a global context.*
Topics covered include shipping fleets and management, seaborne trade, ports, shipbuilding, ship recycling, maritime policy and regulations, and seafarers' labour.

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Editorial comments

- Overcapacity in the global **liquefied gas carriers** (LNG) fleet has been evident recently, resulting in a weak freight market and disappointing returns for investors in these highly sophisticated and expensive vessels.
- However, a **favourable long-term outlook** for LNG ships is still a realistic expectation, according to a leading consultancy firm (item 3). Greater fleet growth than implied by ships currently on order may be needed to service expansion of trade and, in particular, new LNG export plants coming on stream.
- Changes in **container ship operating patterns** are being implemented following the opening of the enlarged Panama Canal, as outlined in item 2. Dividing the global fleet into more relevant size groups has become necessary: 'panamax' for container ships previously implied ships with a maximum capacity of about 4-5,000 teu (twenty-foot equivalent units), but now implies a much larger maximum of around 13,500 teu, depending on precise ship dimensions.
- Controversy still surrounds possible maritime changes following the UK's **Brexit** vote to leave the EU. However. much of the analysis and commentary is based on sheer speculation about the unknown outcome of future unpredictable negotiations.
- One attempt to clarify **key aspects for UK seaborne trade, ports and shipping** has been made by consultants who have gathered opinions from senior industry executives as well as offering their own conclusions (item 1). Although industry leaders can point to potential risks related to specified possible changes, it seems clear that nobody really knows what will actually happen.

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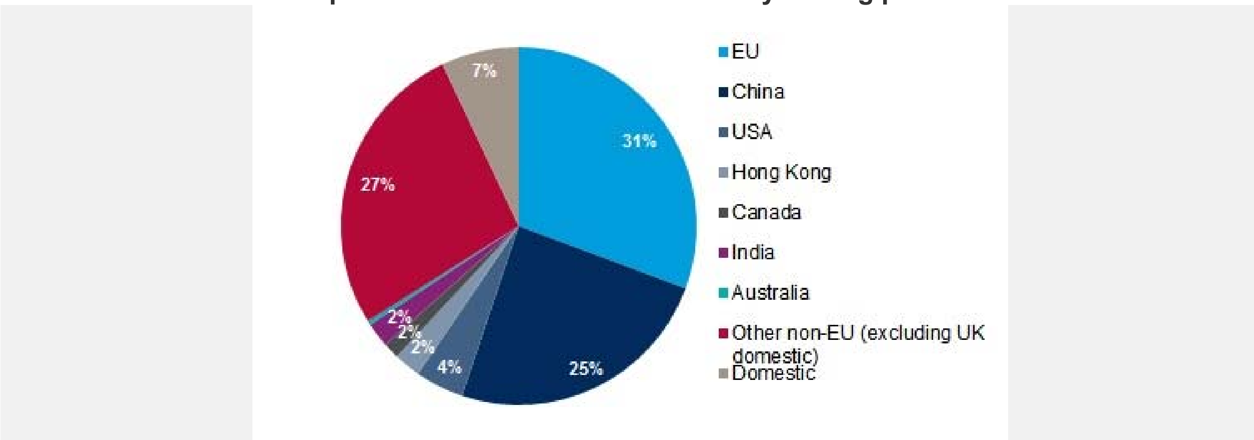
(1) Hellenic Shipping News, 26 July 2016/ Drewry Maritime Research

What Brexit means for UK shipping

The UK's decision last month to leave the European Union will mean both positives and negatives. But there are more "unknowns" than "knowns" for UK maritime trade and ports.
International maritime trade faces new opportunities and challenges, both in the run-up to the UK leaving the European Union (expected in early 2019) and in the long-term. Drewry has gathered industry opinions from shippers, ports and shipping people and attempts to provide here an informed preliminary assessment of the impact of Brexit, looking at 3 big questions.

Will UK maritime traffic rise or fall because of Brexit?
UK container traffic will see more muted growth than expected a few months ago, at least in the short term.
Patrick Walters, Peel Ports' Group Commercial Director, believes that the bigger Brexit-related risk for UK container ports is a short-term negative impact on box volumes caused by economic and political uncertainty and GDP slowdown.
According to the International Monetary Fund, the Brexit vote implies a substantial increase in economic, political, and institutional uncertainty, which is projected to have negative macroeconomic consequences. The IMF has just downgraded 2016 and 2017 GDP growth forecasts for the UK.
And a slowdown in UK GDP will mean a slowdown in UK maritime trade.
But Walters stresses that there will be both positives and negatives in the medium and long term. Positives include opportunities to have new or improved bilateral trade agreements between the UK and countries such as India, the US, Canada (with whom the UK has strong historical ties) and South American countries. It may be easier for the UK government to strike an agreement with India without the need to get consensus approval from the other 27 EU countries, Walters observed.
The UK lo-lo container port sector derives 31% of its total volume from trade with the rest of the EU (see Figure 1), so any new tariffs on trade between the UK and the EU will pose of risk of lower intra-Europe maritime trade volume.

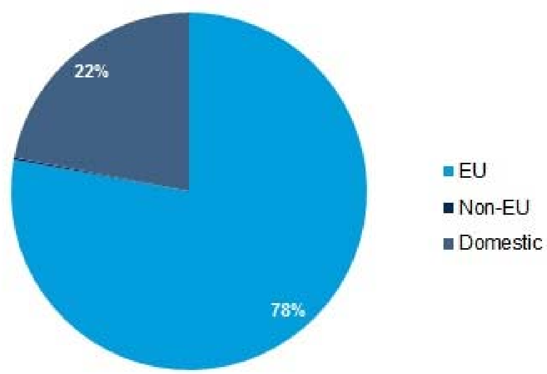
Figure 1
UK port container traffic breakdown by trading partner



Source: UK government 2014 national statistics

Ro-ro maritime trade in the UK (primarily trucks and trailers on cross-Channel and Irish Sea ferries) is much more exposed than container maritime trade to the risk of new intra-Europe tariffs and/or onerous customs export and import procedures (see Figure 2). The 78% percentage for the EU is somewhat inflated, though, because it includes UK traffic via EU ports to and from non-EU areas such as Turkey.

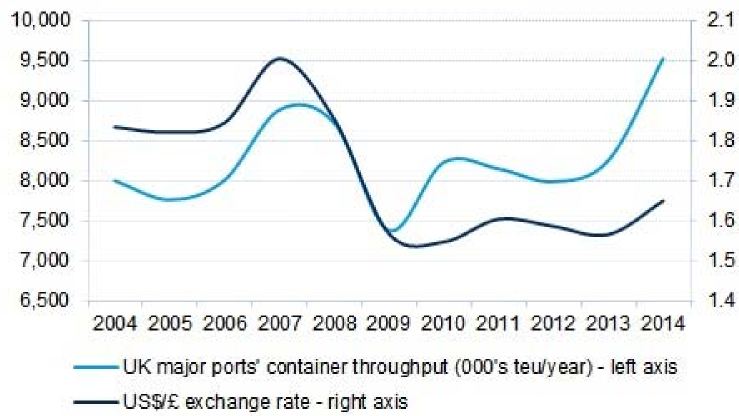
Figure 2
UK port rolll-on/roll-off traffic breakdown by trading partner



Source: UK government 2014 national statistics

The key questions are how much difference tariffs and non-tariff barriers will make and, to the extent that they do, whether or not there will be tariffs on UK/EU trade and more complex customs procedures.
The British Shippers' Council debated the impact of Brexit at a meeting in July and concluded that it is too early to tell what the outcome will be, because it will depend on what new trade agreements are negotiated with both the EU and non-EU trading partners. Drewry agrees. Similarly, the British forwarders' association BIFA said it is too soon to give a sensible prediction whether Brexit will have a positive or negative impact on its members' trade volume with EU countries and non-EU countries.
Some shippers see opportunities for more favourable trade agreements to be concluded on a bilateral basis between the UK and countries in Asia, Oceania and the Americas. Politicians in Australia have already said that they are happy to discuss a bilateral deal (we caution that UK/Australia trade accounts for less than 1% of total UK volume, though).
But how about the depreciation of the UK currency since the Brexit vote? Sterling has lost more than 10% against the US dollar in the past four weeks. Because the UK has a large merchandise trade deficit with the rest of the world and is a large importer of consumer goods, it would be reasonable to expect that more expensive containerised imports will become less appealing to UK consumers.
However, a comparison of the trends in the US$/£ exchange rate and total UK port volume over a 10-year period shows only a weak link between exchange rates and total trade (see Figure 3). This implies that a small change in the unit value of imports and exports has only a limited influence on total UK port volumes.

Figure 3
Development of total UK ports' throughputs and the US$/£ exchange rate, 2004-2014



Sources: Bank of England, Drewry Maritime Research (www.drewry.co.uk)

In Drewry's view, irrespective of the exchange rate and irrespective of whether or not (presumably smallish) import tariffs are introduced, UK consumers will continue to buy large quantities of products made in Asia and will not return to "made in the UK" sourcing – the differential in labour costs with producing countries in Asia remains huge and compelling.
What could happen, though, is a switch between some sourcing countries, particularly if the UK strikes a favourable deal with countries such as India, Bangladesh or South American countries.
Will container lines skip UK ports because of Brexit?
British importers and exporters prefer direct mainline container services calling at their national ports and tend to dislike feeder services. Is there a risk that a politically isolated UK will no longer benefit from direct vessel calls, particularly as there is no longer any large British container carrier based in the UK to champion their cause?
Drewry believes that the container lines will continue to call directly at UK ports. Even if the UK enters a small recession, UK volumes are more than large enough to justify direct calls with mainline vessels, mainly in the South of England ports and it is in the lines' own interest to call there direct. In fact, based on January-May statistics from Container Trade Statistics, the UK imports more containers from Asia than any other North European country, even Germany. Today, 15 of the 17 Asia-North Europe loops call at a British port; we expect this very high proportion to continue.

Will UK trade benefit from moving away from EU rules and regulations?
British shippers are fearful of losing the benefits of free trade and customs harmonisation with the EU single market. They do not want to return to the days of red tape and single administrative documents. Drewry sees a risk of new inefficiencies and costs here, which trade negotiations with the EU will have to tackle. British companies are already lobbying their government to ensure that simplified trade processes are on the agenda.
A return to tariffs for UK merchandise exports and imports, if this is the outcome of trade negotiations with the EU, will be detrimental to UK trade with the EU, and may result in a small reduction in UK-EU maritime volume.
At a meeting of the All-Party Parliamentary Maritime and Ports Group on 19 July, Guy Platten, CEO of the UK Chamber of Shipping, said that the UK maritime sector can make Brexit work, and that although there will be some difficult issues, trade would continue.
The UK Chamber of Shipping believes that nothing has changed at the moment and the UK is still subject to all EU directives relating to the maritime sector. As and when the UK exits, it will then have to be decided which directives are adopted within UK law. The EU ports policy will have to be reviewed.
Platten said that the UK Chamber of Shipping has "a feeling of optimism" for a post Brexit world.
British ship-owners support access to free trade and access to free movement of labour.
But the UK Chamber of Shipping highlighted that, within the UK maritime sector, the UK relies heavily on skilled people from across the globe, and it felt that it is imperative the right to remain is invoked and that future immigration process should not deter European citizens wanting to work within the UK maritime sector.
In Drewry's view, again, the impact will depend on what is negotiated between the UK and the EU. Restrictions on the right of EU workers to work in the UK maritime sector (an international sector by definition) could harm the UK shipping cluster.

Our view
In the short term, a slowdown in UK GDP is expected to result in a slowdown in UK maritime trade growth. It is too early to say what the impact of Brexit on maritime trade will be in the long term, but it is unlikely that Brexit will have a material impact on total UK maritime volume.
There will probably be a change in the mix: depending on the new trade agreements negotiated between the UK and the EU and between the UK and non-EU countries, the UK could switch some of the countries from which to imports and to which it exports.
There is also a risk of harmful UK-EU red tape, tariffs and reduced access to skilled EU shipping workers in post-Brexit and much uncertainty as to what will happen.
Source: Drewry Maritime Research

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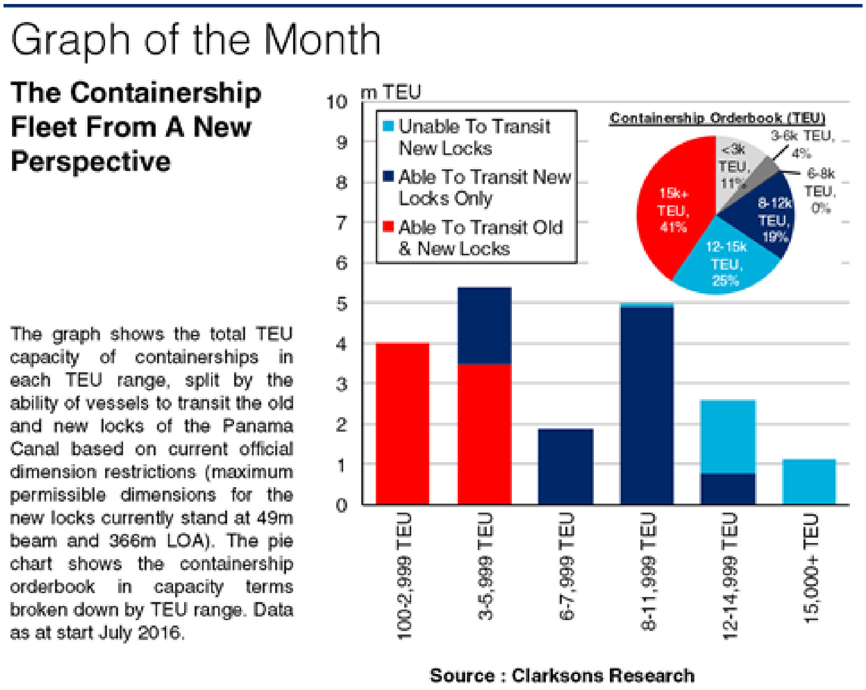
(2) Clarksons Research, 28 July 2016

Panama Unlocks A Fresh Look At The Containership Fleet

The opening of the new, expanded Panama Canal locks in June has ushered in a new era for the containership sector, and is prompting significant changes in asset and deployment trends. With a greater proportion of containership fleet capacity now able to transit the Canal, it is appropriate for the boxship fleet to be considered in a new light, and to be broken down into a new range of more relevant sectors.



Thou Shalt Not Pass

The ability for a containership to transit the Panama Canal has long been a defining vessel characteristic, with the emergence of a distinct 'Panamax' sector above 3,000 TEU, comprising vessels with a maximum beam of 32.3m. However, rapid upsizing has meant that the fleet capacity of ships in sizes Panamax and below has been dwarfed by the growing numbers of 'Post-Panamax' ships in recent years. By the start of July 2016, 63% of boxship capacity was unable to transit the old locks of the Panama Canal.

A New View Emerges

The recent completion of the canal's third set of locks now enables many more boxships to transit, with only 15% of fleet capacity unable to pass through according to current official dimension restrictions. This change has led to the need to segment the boxship fleet in a fresh way, as shown on the graph.
At the start of July, the sub-3,000 TEU sector comprised 4.0m TEU, accounting for 20% of total fleet capacity (with 11% of capacity on order accounted for by this size range). In the 3-7,999 TEU 'Intermediate' sizes, all ships are now able to transit the canal, up from less than 50% previously, and a significant 36% of fleet capacity (but only 4% of the orderbook) falls into these sectors. The 8-11,999 TEU sector, totalling 5.0m TEU (25% of the fleet) comprises 'Neo-Panamaxes' likely to form part of the initial wave of upsizing on routes through the canal. Many ships sized 12-14,999 TEU are also seen as 'Neo-Panamaxes'. While only 59 ships (of up to 13,500 TEU depending on the specific design) of the 192 ships in this sector are able to transit based on official limits, another 39 fall so close to these limits that they are

likely to be able to transit. A further 50 ships in this sector would also be able to pass through if the beam restriction was raised to the already mooted 51m.
Finally, ships sized 15,000+ TEU have notably distinct designs from vessels in the 12-14,999 TEU sector, and are clearly too large to transit the current locks. While there were only 62 ships of this size in the fleet at the start of July (6% of fleet capacity), 40% of capacity on order falls into this size range.

New Sectors Locked In?
So, the recent expansion of the Panama Canal locks and the continued rapid upsizing of the fleet in recent years have both brought about the need for high-level segmentation of the containership fleet to evolve as well. As market dynamics continue to be affected by the recent developments, it's clear that size matters and that the containership industry has reached a significant milestone. While it will remain important to track trends in the 'old Panamax' sector, the new breakdown of the containership fleet should help with keeping track of the fast-moving market developments as they unfold.
Source: Clarkson Research Services Limited

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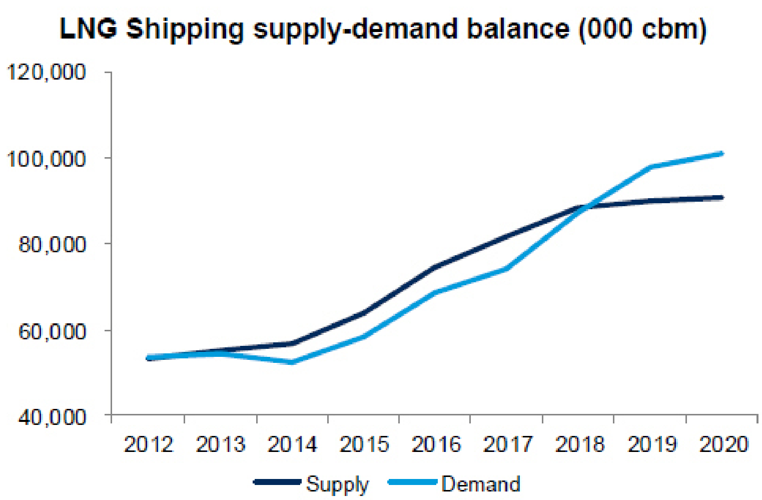
(3) Hellenic Shipping News, 29 July 2016/ Drewry

LNG Market Needs More Vessels than Currently on Order

Despite the current weakness in LNG shipping rates, Drewry maintains its bullish long-term outlook for LNG shipping and believes that the market will require more vessels than listed on the current orderbook, according to the latest edition of the LNG Forecaster report published by global shipping consultancy Drewry.
Spot rates for dual fuel diesel electric LNG vessels have been hovering around $30,000 per day since the second quarter of last year, representing a decline of 80% compared to the last market peak in 2012. Strong fleet growth coupled with weak cargo demand has been the principle cause. The impact of weak rates is clearly visible on falling newbuilding activity as only four LNG vessels had been ordered in the first six months of the year. By comparison, an average of 44 vessels per annum were ordered over the prior five-year period. Continuingly weak ordering is expected to slow fleet growth from 2019, exactly at the time by when almost all of the currently under-construction LNG plants will come online.



Source: Drewry LNG Forecaster

Drewry reiterates that the long-term outlook for LNG shipping is still strong and the limited new ordering is not based on market fundamentals. “The reason for our optimism is that almost 125 million tonnes of capacity is currently being built and there are plans for more. As a majority of the supply from plants under-construction has been contracted on long term agreements, it is likely that LNG will be traded so requiring more vessels”, said Shresth Sharma, Drewry’s lead LNG shipping analyst.
“Despite a widened Panama Canal, new LNG export capacity due to come online by 2020 will require shipowners to order an additional 65 vessels over this period to meet shipping demand,” added Sharma.
Source: Drewry
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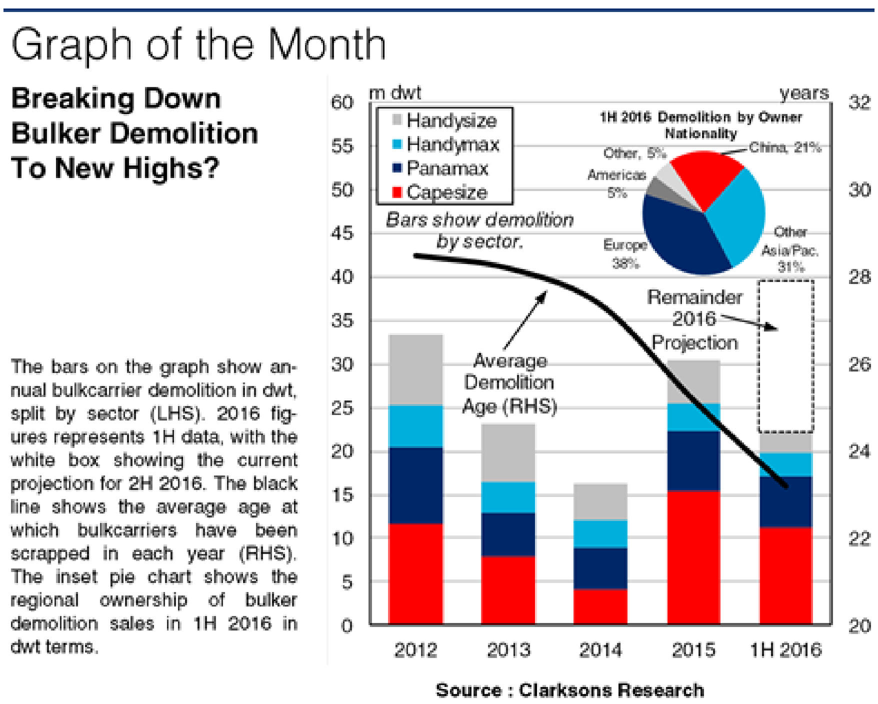
(4) Clarksons Research, 27 July 2016

A Record-Breaking Year For Bulkcarrier Demolition?

Depressed bulkcarrier market conditions have continued to exert severe financial pressure on owners, with bulker earnings averaging a record low of $4,824/day in 1H 2016. This has led to a firm pace of scrapping so far in 2016, and while demolition activity has slowed somewhat in recent months, the current annual bulker demolition record of 33.4m dwt, set in 2012, seems likely to be challenged this year.



A Year Fit For The Scrap Heap
In 1H 2016, 292 bulkcarriers of 22.1m dwt were scrapped, representing a half-yearly record, after 429 ships of 30.5m dwt were recycled in full year 2015. Bulker demolition has also accounted for 77% of all tonnage demolished globally so far this year, up from less than 50% in 2014-15. Meanwhile, the average age at which bulkers have been scrapped has continued to decline, reaching 23 years in 1H 2016, down from 25 years in 2015, and over 28 years in 2012. Now that the half-way mark in 2016 has been passed, what other trends in bulker demolition have been apparent this year?

Big Is Beautiful?
Scrapping of large bulkers has been an evident feature. In 1H 2016, 66 Capesizes of 11.3m dwt and 80 Panamaxes of 5.7m dwt were scrapped, with Capesize and Panamax demolition together accounting for

a significant 77% of total bulker tonnage scrapped. In 2012, demolition was comparatively more balanced between the sectors, and scrapping in the smaller sizes appears to have slowed slightly since then. In 1H 2016, 146 ships of 5.1m dwt in the Handymax and Handysize sectors were scrapped.

East And West

Various trends in ownership of units sold for demolition have also emerged. Chinese owners have accounted for the largest share (21%) of bulker tonnage scrapped this year, selling 4.7m dwt. This is in line with Chinese owners' share of the 'elderly' bulker fleet (ships aged over 20 years) at the start of 2016. European owners accounted for 38% of tonnage scrapped in 1H 2016, far exceeding their 23% start year share of the 'elderly' fleet, with 50 ships of 3.5m dwt sold by Greek owners alone. In contrast, owners in the Americas appeared more cautious, accounting for 5% of demolition in 1H 2016, compared to their 13% share of the 'elderly' bulker fleet.

Hitting The Brakes

Meanwhile, recent months have seen a slower pace of demolition activity. In Q1, 175 ships of 14.1m dwt were scrapped, falling to 117 ships of 8.0m dwt in Q2 (sales in June totalled only 1.5m dwt). However, weak earnings and a challenging demand outlook suggests that bulker scrapping may well remain firm in 2H 2016. Assuming that activity picks up in the short-term, demolition in full year 2016 could reach a record 39.5m dwt.

So, while challenging demand trends appear to have limited the impact of firm demolition on the market balance so far this year, supply growth has been successfully limited to less than 1% so far this year. While 2016 will not be remembered as a year in which many highs were reached in the bulkcarrier sector, demolition at least could be one area where a new record level is being set.

Source: Clarksons

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(5) Hellenic Shipping News, 25 July 2016/ McKinsey

China's One Belt, One Road: Will it reshape global trade?

The future of trade in Asia could depend heavily on what becomes of China's expansive One Belt, One Road initiative, which calls for massive investment in and development of trade routes in the region. In this episode of the McKinsey Podcast, recorded in May, McKinsey senior partners Joe Ngai and Kevin Sneader talk with Cecilia Ma Zecha about One Belt, One Road—what it really means, what it needs to become a reality, and why people should take it seriously.

Podcast transcript

Cecilia Ma Zecha: Hello, and welcome to this edition of the McKinsey Podcast. I'm Cecilia Ma Zecha, an editor with McKinsey Publishing, based in Singapore. Today we're going to be talking about one of the biggest stories in Asian business, China's One Belt, One Road initiative, arguably its most ambitious economic and diplomatic program since the founding of the People's Republic.

To explain One Belt, One Road and what it means to business, I'm joined today by Kevin Sneader, McKinsey's chairman in Asia, and Joe Ngai, managing partner of McKinsey's Hong Kong location. Kevin, let's start from the very beginning, particularly for anyone listening outside of Asia. But frankly, for many of us who live and work in the region, behind the diplomatic language and the policy speak, what exactly is One Belt, One Road?

Kevin Sneader: At one level, One Belt, One Road has the potential to be perhaps the world's largest platform for regional collaboration. What does that actually mean? There are two parts to this, the belt and the road, and it's a little confusing. The belt is the physical road, which takes one from here all the way through Europe to somewhere up north in Scandinavia. That is the physical road. What they call the road is actually the maritime Silk Road, in other words, shipping lanes, essentially from here to Venice.

Therefore it's very ambitious—potentially ambitious—covering about 65 percent of the world's population, about one-third of the world's GDP, and about a quarter of all the goods and services the world moves. That is what's at the core of this—at least a potential trading route. The belt, the physical road, and the maritime Silk Road would re-create the shipping routes that made China one of the world's foremost powers many, many years ago.

Cecilia Ma Zecha: Joe, why is this important now?

Joe Ngai: China is seeing a bit of a slowing down in its growth. A lot of people are saying that that's part of the next growth wave of Chinese exports, which is that it's going to have its influence and its infrastructure build-out in many of these countries, most of them emerging markets, in lots of things that frankly have fueled the very high growth in China over the past decade.

What remains to be seen is if that can be replicated in many of these countries in the next ten years. That is very significant. Because many of these countries are really lacking in this infrastructure. I remember when I take groups of delegates into China; they always marvel at the trains, the railway stations, the airports, and all that, which frankly is a bit of a miraculous creation in the past two decades.

The question is going to be how these are financed: whether there is going to be long-term planning that's required, and whether the local governments and the state governments are able to take the Chinese model and the Chinese infrastructure and figure out how they can have their own version.

Kevin Sneader: Some people have talked about this being the second Marshall Plan. It's worth recalling that the Marshall Plan, which obviously was at the heart of the regeneration of Europe after the Second World War, was one-twelfth the size of what is being contemplated in the One Belt, One Road initiative. So the question is the scale. The ambition is enormous, and the sums of money are equally enormous. That is why I think whether this initiative is successful will have two parts to it. One will be that the funds are indeed available and that governments are willing to deploy them.

The second is that the money can actually be deployed wisely. There is a real risk that this becomes a source of funding that gets misdeployed and doesn't end up contributing to greater trade or greater economic collaboration but just gets wasted on projects that really should never have been funded in the first place.

Cecilia Ma Zecha: It sounds like it's a great concept, but it's really far from becoming a reality. Can you elaborate on some of the challenges, such as funding and financing?

Kevin Sneader: I think the skepticism around whether this could be delivered has been at least partially allayed by looking at what's already been achieved. Maybe let's turn to the funding side and talk about that for a moment. The Asian Infrastructure Investment Bank (AIIB) has come into being.

There were lots of questions around whether that would happen. It's $100 billion, the funding of which China provides somewhere between one-third and one-half, depending on how you look at it. That's happened. Its governance is still being debated. But interestingly the governance model seems to have become a bit more transparent, a bit more recognized by the European powers that are involved than had initially been expected. So you tick one box and say that's progress.

The Silk Road Fund has also come into being. Again, we'll see how that unfolds. But that's somewhere around $40 billion of investment. There were probably some bets around whether that would happen. Then there is the New Development Bank, which is the funding source for the BRICS countries. That has another $100 billion of investment allocated against it. These funding sources theoretically are beginning to move from the drawing board to at least some form of reality. How they operate, how they deploy, is still to be determined. But at least you can start to see how the big hurdle of funding is beginning to manifest itself in terms of tangible sources.

Cecilia Ma Zecha: The investment is a positive sign. But what's the answer to that question: the deployment of these funds, how that will be operated? Joe, what do you think?

Joe Ngai: While we have the AIIB and the Silk Road Fund and the New Development Bank, if you add it all together, it's still a very, very small amount relative to what needs to be funded, which is roughly between $2 trillion and $3 trillion per year.

You think about all the infrastructure across a third of the world's GDP. The question is also going to be, even though you have these new banks and these new funds, whether they are able to change the way investors think about the risk in a lot of these emerging markets.

Whether they will tag along—infrastructure investment in a lot of the emerging markets is notorious for its risk. It's long term, it's political, and there are lots of uncertainties. People are pretty unwilling to do that investment for many, many years.

The fact that now China is putting together these consortiums of banks and funds and are standing behind it is a positive sign. What needs to happen, though, is the rest of the world needs to go along and use that as a way to get past a lot of the things that have inhibited progress in the past, namely getting very familiar with the risks in a lot of these countries.

Kevin Sneader: For this funding to be deployed, a lot of things need to come together. First of all, you need to have transparency, because if private money is going to be associated with this, and that recognizes Joe’s point today, the gap between the public funding and the private funding is what we need to talk about. That’s only going to get deployed if there are clear returns, transparency around the way that money gets allocated, a balanced approach so that the balance between the public funding and the private funding is appropriate, conduct that everybody can recognize as being close to market principles, and a regulatory system that’s able to work across borders. Those requirements are pretty substantial, and it’s fair to say that, at the moment, the rhetoric hasn’t yet delivered.

There’s a lot that’s got to happen before this moves off of the very grand and appropriate drawing board and into practical reality in some countries where it’s proved very difficult to deploy funds.

Joe Ngai: And frankly one of the other transparencies that needs to happen is around China’s intention. Because one of the things that people are going to look at is how much of this is political versus on the business side. For a lot of people, there’s still a little bit of suspicion or skepticism around whether this is part of China’s emergence as the next world power, to which obviously some countries are going to be a little bit less welcoming.

Cecilia Ma Zecha: How are you seeing other Asian countries view One Belt, One Road? You mentioned the risks involved for investors and how other countries have to go along. What are the implications for them? And how are they engaging with China?

Kevin Sneader: The implications are very significant. This week in Hong Kong there was a conference called the One Belt, One Road summit. And I chaired a panel with the delegates to that event from the Association of Southeast Asian Nations (ASEAN). It was quite interesting to look at the divergence, even within ASEAN.

The Indonesians were quite clearly excited about how is this going to play out. How is Chinese infrastructure investment going to make a difference in a place where they need that?

Malaysia is obviously one of the world’s great trading countries, whereas the Philippines is still quite internally focused. One of its challenges is to become a trading country. And so in Malaysia, at least the way that people were responding to the concept was one of, “Well, let’s see the economic output.” But there was enthusiasm.

Cecilia Ma Zecha: What are the other points of contention? How do you see Japan or the United States or other countries outside of Asia dealing with it?

Joe Ngai: If you follow the establishment of AIIB, it has been quite a geopolitical tension there in terms of who gets in first and who gets a say in it. Where is the first rail going to be built because of this? Where is the first funding? I’m not sure whether Japan or some of these other countries are going to be a big beneficiary of One Belt, One Road. It’s to be seen because there are a lot of countries.

The other question that’s out there is that China right now is also facing its own economic transition. We have seen enormous growth before. But it’s actually slowing down now. The capital markets in China are also going through a period where there are a lot of gyrations between the stocks.

You also see in China right now that there’s overcapacity in a lot of sectors. So the question is going to be, given that China is also in a transition economically, how much more attention these new enterprises can deploy overseas while domestically also fighting a few fires on its own turf.

It’s coming at a very interesting time because one can argue that this is part of how you deploy overseas. But it’s not as simple as that. In a lot of our work in different provinces in China, we see challenges internally in many, many places. So that’s going to be another tension: while One Belt, One Road is great, don’t forget that China also faces a lot of domestic challenges. That will need to be sorted out at the same time.

Cecilia Ma Zecha: We’re sitting in Hong Kong, and you’re both based here. Is there a role for Hong Kong to play with this initiative? And is it a significant role?

Kevin Sneader: The prospect of Hong Kong not playing a role is something that I think would be quite disappointing, or at least distressing on many levels, because I think Hong Kong’s role has been the gateway on many levels for China to the rest of the world.

While that role has been shifting, Hong Kong remains a vitally important financial center, an RMB trading center, and a source of advice, perspective, and assistance for Chinese companies and Western companies trying to work with each other. So it would be disappointing if Hong Kong somehow didn't have a very important role to play here.

What was intriguing in listening to the Chinese leadership—we had Chairman Zhang here this week, the number-three leader in China—was the degree to which he went out of his way to reaffirm two things: what he felt were the advantages that Hong Kong enjoyed and what he felt the opportunities were for Hong Kong.

On the advantages: its location. It's very well located when you come to look at the map and figure out the trading routes. That's why Hong Kong is what it is today. Second, there's its open and free culture. This is a city that is the long-standing benchmark for openness—21 years at the top of the open-trade indexes and various others—so it is very much seen as a place where one can do business. Third, it's a place where there is a lot of expertise. He went out of his way to name professional services in advisory, engineering, construction, a lot of talents that have been deployed to build modern China, which again the chairman talked about whether they can be taken elsewhere.

And, finally, culture. It's a can-do culture, entrepreneurship, the kind of initiative taking that's going to be important for this. When he mentioned those, he then said that should translate into a series of opportunities that mirror the four advantages. So the Chinese leadership went a pretty long distance to say, "We see Hong Kong as having a vital role."

But it was also saying, I thought, "We expect you to play a role in this major initiative for China." Whether Hong Kong chooses to play that role or not, that's more complicated. Because ultimately it will hinge on the businesses and the leadership that's here seeing something that they feel they can invest in and see a return and make a contribution around. But I would have thought there's more upside than downside.

Cecilia Ma Zecha: Do you agree?

Joe Ngai: Sure. For Hong Kong professional services, I think that's a real area where there's a lot of upside. When you think about that in the past, as China was building out its infrastructure, a lot of Hong Kong bankers, people from construction, project engineers, all the way to your risk managers and all that. You can imagine that there's a whole generation, really, of professional-services companies that grew up in the last decade because of the growth in China.

The question is whether you can actually take that and go into the One Belt, One Road countries and replicate the same story. There are going to be more challenges because China was something that was very convenient and very natural for Hong Kong given the Chinese language and everything else.

Now you go into countries where the language is going to be a challenge for everyone and where a lot of local traditions and legal systems and all that are going to be very different. We all have to learn. But to be honest, Hong Kong has more advantages than disadvantages. I also can't see any other city that's better positioned than Hong Kong to do a lot of these. As a Hong Kong national, I would say that it's our game to lose, but at the same time, we have to strengthen quite a lot of muscle in order to play this game, too.

Cecilia Ma Zecha: So help people take stock here. If I am a business leader with operations and customers in Asia, what are the key takeaways? And what should I be looking out for in the coming months?

Kevin Sneader: For every skeptic, there are two optimists, and what was striking this week in looking at the gathering of business leaders was the sheer number of people who showed up and the breadth of the countries they represented and the businesses they were part of. While it's going to be very easy to provide long explanations of why this won't work, there are people already looking at what it's going to take to make it work. We saw leading construction companies, leading financial companies, and leading advisory firms all looking to be involved. At this stage, the very practical side of this is, you could choose to sit out all of what we've just discussed. You could do so on the basis of this being a foreign-policy move. The economics are questionable. The geographic coverage is never going to be achieved. The financial returns won't be offered.

You could make all those assumptions and sit out. Or you could say, "If I sit out, I may be missing out on the world's largest trading collaboration for many, many years. Missing out on a set of theoretical opportunities that, if delivered, would amount to an enormous step change in infrastructure investment and the quality of trade." And you would say to yourself, "Do I really want to sit that out? Or is it time to at least understand at a deeper level and invest some time and assets in doing so?"

My sense, based on where we are today, is I’d probably want to do the latter. In other words, participate and at least be part of the conversations, and only after that make the decision to not move forward.
Source: McKinsey

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