

Box 2.1**ASEAN's Economic Linkages with Hong Kong and Market Potentials**

The Association of Southeast Asian Nations (ASEAN) is composed of ten economies in Southeast Asia, including Indonesia, Thailand, Malaysia, Philippines, Singapore, Brunei, Vietnam, Laos, Cambodia and Myanmar. The former six are older member states (ASEAN-6), representing around 90% of aggregate ASEAN GDP at current prices in 2012 (*see Chart 1a*), while the rest are newer ones. This box article sketches the economic linkages between ASEAN and Hong Kong, and examines its longer-term market potentials.

ASEAN is an important trading and investment partner of Hong Kong. In terms of trade in goods, ASEAN was Hong Kong's second largest trading partner, accounting for about 10% of our total merchandise trade in 2013. As regards services trade, ASEAN was Hong Kong's fourth largest trading partner in 2012, representing 8% of Hong Kong's total trade in services. Besides, there are also extensive investment linkages between Hong Kong and ASEAN. As at the end of 2012, ASEAN was the fifth largest destination of foreign direct investment (FDI) from Hong Kong, cumulating \$207 billion. Reciprocally, the cumulated stock of FDI from ASEAN totalled \$234 billion, which ranked sixth as a source of FDI into Hong Kong. A total of 54 regional headquarters in Hong Kong, 127 regional offices and 319 local offices had been set up by companies from ASEAN as of June 2013.

Buttressed by ASEAN's economic vitality, mutually complementary relations with other Asian economies, and growing trade flows with the Mainland, there should be ample room to further advance Hong Kong-ASEAN economic collaboration. Firstly, the ASEAN economies attained solid growth after recuperating from the Asian financial crisis of 1997, with aggregate GDP at current prices rising to nearly US\$2.4 trillion in 2013, representing 3.3% of world GDP, up from 1.9% ten years ago. Total population in the region exceeded 600 million in 2013, around 9% of the world total. While most members are still developing economies, the share of middle-income class is ever rising amid expanding urbanisation and sustained income growth, implying growing consumer sophistication and rising demand for high-end goods and services.

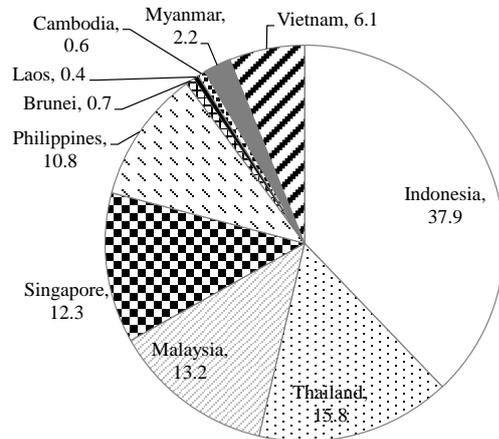
Secondly, the vast differences in endowments and wages provide a strong foundation for geographical division of labour between ASEAN and the rest of Asia and intra-regional trade to grow. In particular, many ASEAN economies are major suppliers of agricultural and mineral resources. Rice exported by Thailand and Vietnam, natural gas by Myanmar, petroleum and palm oil by Malaysia, thermal coal, nickel, copper and many other minerals by Indonesia are some primary examples. Their food and material supplies dovetail well with the economic developments in Hong Kong, the Mainland and the rest of Asia. ASEAN is also an integral part of Asia's supply chain. Indeed, around 70% of Hong Kong's exports to ASEAN in 2013 belonged to capital goods and raw materials, and the final demand for these outputs from these intermediate inputs should come mostly from the advanced markets.

Thirdly, the externally-oriented policies pursued by ASEAN leaders that reduce trade-related costs and liberalise markets also bring support to intra-regional trade growth and create investment opportunities. In particular, ASEAN envisioned the creation of ASEAN Economic Community by 2015 and has signed bilateral Free Trade Agreements (FTAs) with many major economies in Asia, with the ASEAN-China FTA (ACFTA) already in force.

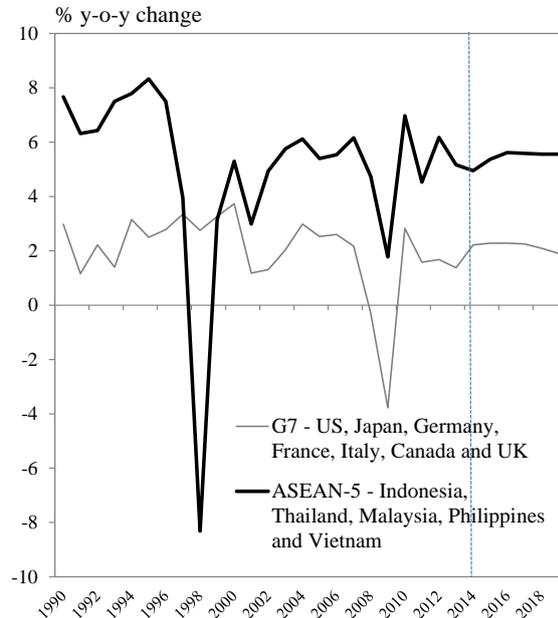
Box 2.1 (Cont'd)

Chart 1 : ASEAN's composition and medium-term growth projection

(a) ASEAN-6 accounted for around 90% of aggregate ASEAN GDP at current price in 2012



(b) IMF forecast major ASEAN economies continue to outpace that of advanced economies in coming years



In terms of economic size, the ACFTA is the world's third largest free trade zone, after North America Free Trade Area and the European Union. The tariff reduction under the FTA launched in 2005 and came fully in force for ASEAN-6 in 2010, bringing the tariffs for a substantial number of products traded between ASEAN-6 and the Mainland to zero. The remaining four newer ASEAN members will achieve similar goals by 2015. Reflecting the complementarity between the two places, and the support of the ACFTA in the more recent years, merchandise trade between the Mainland and ASEAN have grown rapidly, increasing more than fivefold in a decade to reach US\$443 billion in 2013. ASEAN taken as a group was Mainland's fourth largest export destination and the second largest import supplier in 2013, while the Mainland was ASEAN's largest export destination. The deepening economic ties between the two places should bring tremendous business opportunities to Hong Kong as an international trading hub and a gateway to the Mainland.

In the near term, the outlook for ASEAN economies is clouded by the sluggish recovery of the advanced markets and uncertainties surrounding the future path of US monetary policy normalisation. But looking beyond the short-term challenges, the longer-term growth potential remains promising. In fact, the International Monetary Fund (IMF) in April forecast the major ASEAN member economies on average to grow by 5.5% per year between 2015 and 2019, higher than those of the major advanced economies (*see Chart 1b*). Our exports to ASEAN have also grown visibly by 8.4% per year in the past decade, much faster than the growth rates of the US and European markets. To further strengthen the economic links between the two places, Hong Kong and ASEAN launched the formal negotiation for a FTA in July 2014. An FTA would facilitate trade and investment flows between ASEAN and Hong Kong to seize the business opportunities in the expanding ASEAN markets and diversify Hong Kong's market base.