

CHAPTER 2 : THE EXTERNAL SECTOR

Summary

- *The global recession deepened in the first quarter of 2009, putting a severe drag on world trade. With external demand plunging on a global wide basis, the performance of Hong Kong's external sector worsened markedly in the quarter.*
- *Merchandise exports fell sharply in the first quarter, also as part of a region-wide phenomenon. In fact, many export-dependent Asian economies saw even sharper declines in exports than Hong Kong. Total exports of goods to the advanced economies, which were mired in recession, continued to plunge. As many Asian economies were severely hit amid the global financial crisis, Hong Kong's exports to Asia also plummeted markedly.*
- *Exports of services likewise contracted notably in the first quarter. Exports of financial services were lacklustre given the strains in the financial markets worldwide. Exports of trade-related services and transportation services plummeted along with the plunge in regional trade flows. Yet, exports of travel services continued to rise in tandem with the growth in Mainland visitors.*
- *In the midst of the severe global economic downturn, there has been an increasing concern about rising protectionist sentiment. Leaders of the Group of Twenty reiterated after their meeting in early April to resist protectionism and to promote global trade and investment.*
- *In April, the Central Government announced a pilot program for the usage of the renminbi for cross-border trade settlements in Hong Kong and five other Mainland cities. The program, when implemented, will allow Hong Kong traders to enjoy greater flexibility, thereby allowing them to reduce transaction costs and better manage exchange rate risks. This will also enhance the diversity of renminbi assets in the Hong Kong banking system, increase the local capital liquidity of renminbi, and bolster the renminbi clearing platform in Hong Kong.*

Visible trade

Total exports of goods

2.1 With the global financial crisis evolving into one of the most severe global economic contractions in modern history, external demand fell sharply in the first quarter of 2009. Merchandise exports (comprising re-exports and domestic exports) declined substantially in the first quarter, by 22.2% in real terms⁽¹⁾ over a year earlier, after a 3.5% decrease in the preceding quarter. The decline in export value in the first quarter was the largest since the second quarter of 1954.

2.2 The sharp decline in merchandise exports experienced by Hong Kong in the first quarter was indeed part of a region-wide phenomenon. Exports of many other Asian economies all plunged by 20-40% over the same period, as the deepening global economic downturn weighed heavily on world trade. In view of the worsening external environment, in April the International Monetary Fund⁽²⁾ significantly revised downward the forecast growth rate of the global economy in 2009 to -1.3%, from the earlier forecast of 0.5% in January. This will be the most severe contraction of global economic activity in more than 60 years. Separately, in March the World Trade Organisation forecast global trade to plunge by 9% in volume terms in 2009. In the midst of the severe global economic downturn, there has been an increasing concern about rising protectionist sentiment. Leaders of the Group of Twenty reiterated after their meeting in early April to resist protectionism and to promote global trade and investment.

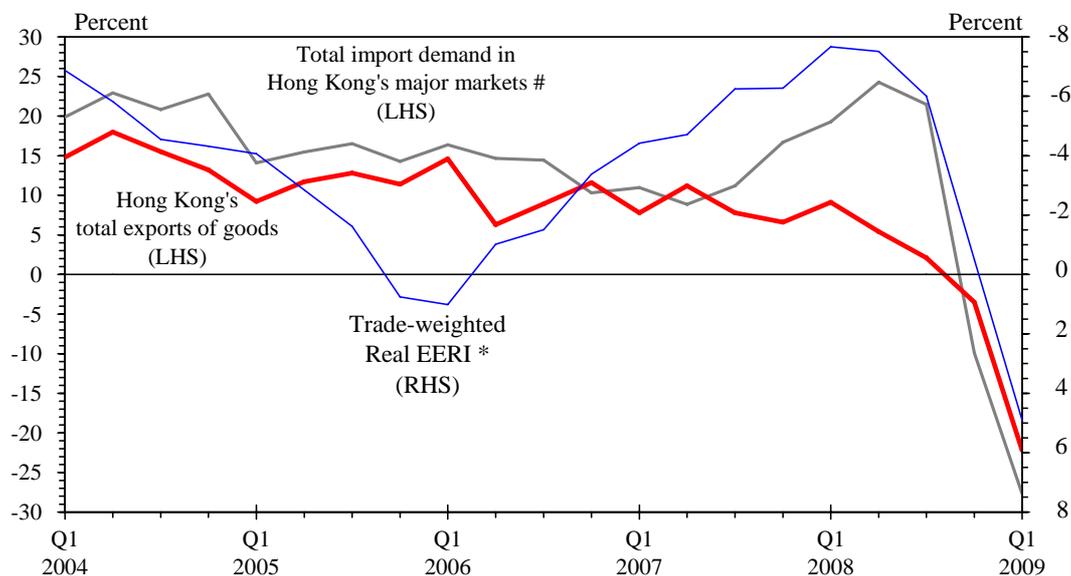
**Table 2.1 : Total exports of goods, re-exports and domestic exports
(year-on-year rate of change (%))**

	<u>Total exports of goods</u>			<u>Re-exports</u>			<u>Domestic exports</u>		
	<u>In value terms</u>	<u>In real terms</u>	<u>Change in prices</u>	<u>In value terms</u>	<u>In real terms</u>	<u>Change in prices</u>	<u>In value terms</u>	<u>In real terms</u>	<u>Change in prices</u>
2008 Annual	5.1	2.9	3.8	6.0	4.0	3.8	-16.8	-22.0	5.1
Q1	10.5	9.1 (1.2)	2.6	10.9	9.6 (1.6)	2.6	0.3	-5.0 (-7.3)	3.3
Q2	7.8	5.4 (0.2)	3.9	8.8	6.6 (0.5)	3.9	-14.3	-20.0 (-9.5)	5.0
Q3	5.5	2.1 (-1.5)	4.8	6.5	3.3 (-1.1)	4.7	-17.8	-26.1 (-12.9)	6.4
Q4	-2.1	-3.5 (-3.7)	4.1	-0.9	-2.3 (-3.5)	4.0	-31.1	-32.8 (-8.2)	6.2
2009 Q1	-21.9	-22.2 (-17.1)	2.5	-21.1	-21.4 (-17.1)	2.5	-44.3	-43.3 (-19.4)	2.5

Note : Figures in brackets are the seasonally adjusted quarter-to-quarter rates of change.

2.3 *Re-exports*⁽³⁾ remained the backbone of the overall merchandise exports in the first quarter, accounting for 97.5% of the total value. There was a notable decrease of 21.4% in real terms in the first quarter of 2009, after a 2.3% decline in the fourth quarter of 2008. *Domestic exports*, which only constitute a small share of total exports, continued to shrink markedly by 43.3% in real terms in the first quarter of 2009, after falling by 32.8% in the fourth quarter of 2008.

Diagram 2.1 : Merchandise exports fell sharply in the first quarter of 2009 (year-on-year rate of change)



Notes : Total exports of goods as depicted refer to the year-on-year rate of change in real terms, while total import demand in Hong Kong's major markets as depicted refers to the year-on-year rate of change in US dollar terms in the aggregate import demand in East Asia, the United States and the European Union taken together.

(*) The real EERI in this graph is inverted in scale for easier comprehension. A positive change denotes real appreciation of the Hong Kong dollar.

(#) Import demand figure for the first quarter of 2009 is based on information available up to February 2009.

Diagram 2.2 : Both re-exports and domestic exports declined

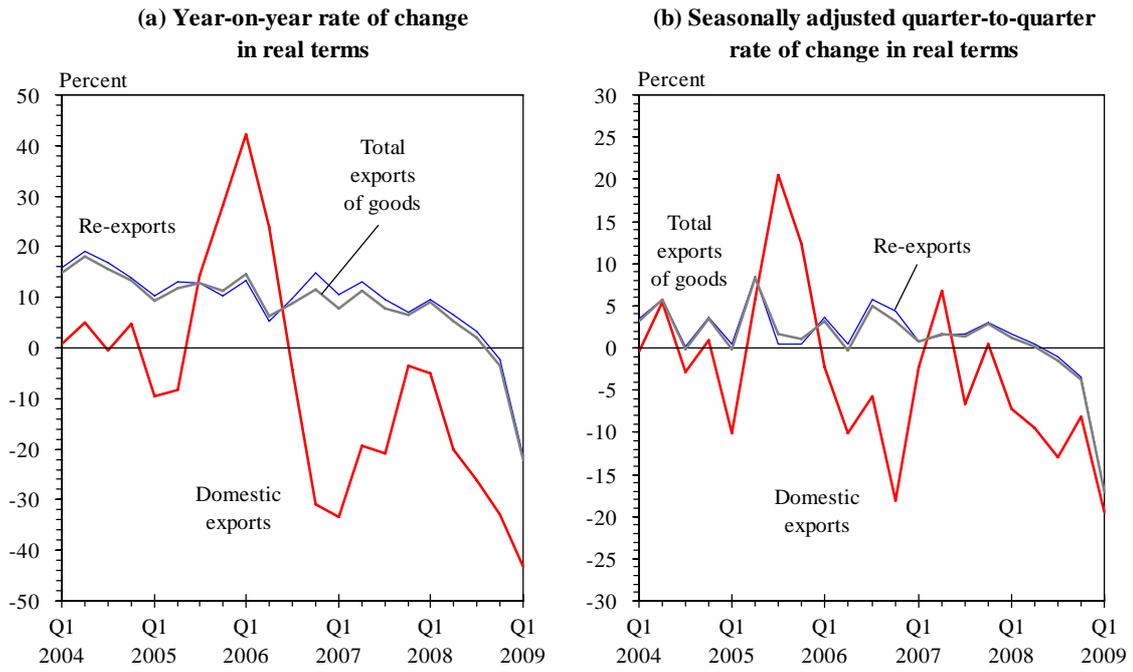
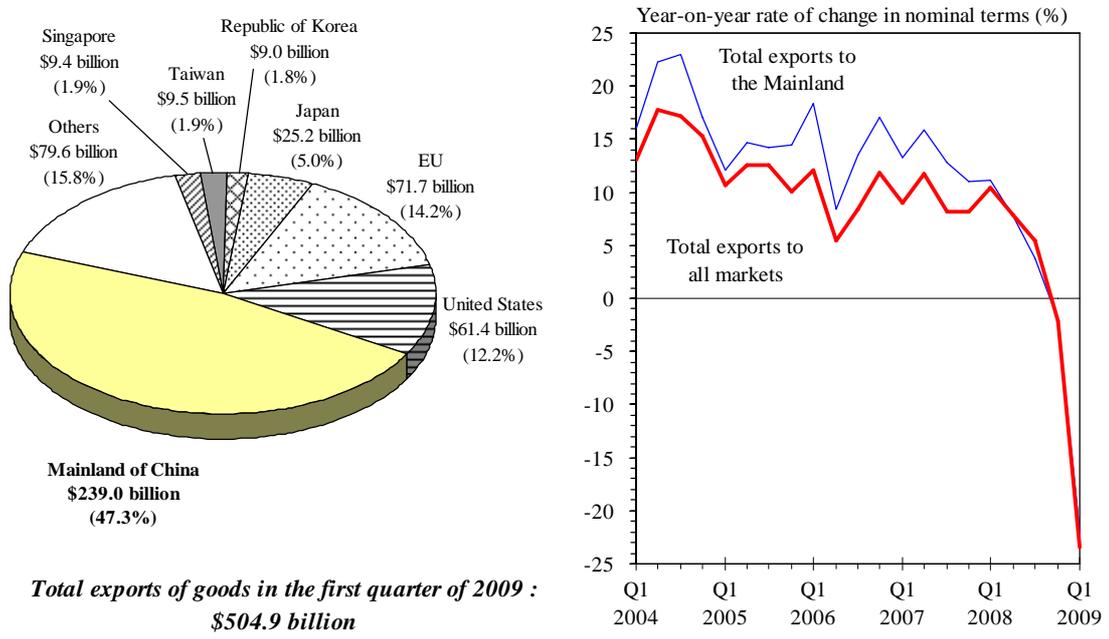


Diagram 2.3 : Exports to the Mainland, Hong Kong's largest market, were also hard hit by the global economic crisis



Box 2.1

Current global economic situation

The dramatic eruption of the financial tsunami in September last year has led to a severe slump in activity in the advanced economies. In a globalised world, emerging economies in Asia and elsewhere have also been seriously hit through both financial and trade channels. At present, the global financial system remains under severe stress. In April, the IMF projected world output to contract by 1.3% in 2009, before recovering slowly in 2010 by 1.9%. The turnaround from the current global synchronised recession, the worst since World War II, will depend on the strong policy actions by the world's major economies to stabilise the financial sector and to support demand with monetary and fiscal easing.

Economic situation in the advanced economies

The US economy has been in deep recession since the latter half of 2008. The economy contracted markedly further at an annual rate of 6.1% in the first quarter of 2009, after a 6.3% contraction in the preceding quarter. Since the recession officially began in December 2007, the cumulative job losses amounted to 6.3 million in April 2009. Consumption spending and hence import demand remained weak. Nevertheless, the US housing market, the downturn of which triggered the subprime mortgage crisis, showed some early signs of stabilization. The fall in housing prices slowed in the more recent months, although home sales and housing starts remained sluggish.

The advanced economies in Western Europe were likewise in a dire state, with severe contraction in industrial production, rising unemployment, and in some economies falling property prices. Business and consumer sentiments in the euro area had been at record lows. The advanced economies in Asia, including Japan (*Table 1*), Hong Kong, Singapore, South Korea and Taiwan, also deteriorated markedly since the latter half of 2008. The performance of the economies in Asia, developed and developing alike, was adversely affected the drastic decline in world trade as a result of the global synchronised recession.

Table 1: Economic performance of selected advanced economies

(Year-on-year growth rate of real GDP (%))

	<u>2008</u>				<u>2009</u>	<u>Forecast by IMF*</u>		
	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>
US	2.5 (0.2)	2.1 (0.7)	0.7 (-0.1)	-0.8 (-1.6)	-2.6 (-1.6)	1.1	-2.8	0.0
Euro area	2.1 (0.7)	1.4 (-0.3)	0.6 (-0.3)	-1.5 (-1.6)	n.a. (n.a.)	0.7	-4.2	-0.4
Japan	1.5 (0.3)	0.7 (-1.2)	-0.2 (-0.4)	-4.3 (-3.2)	n.a. (n.a.)	-0.6	-6.2	0.5

Notes: () Figures in brackets refer to seasonally adjusted quarterly growth rates.

(*) World Economic Outlook, April 2009, IMF

(n.a.) Not yet available.

Box 2.1 (Cont'd)

Economic situation in the export-dependent Asian economies

With the shrinking demand in the advanced economies severely affecting global trade, there had been serious disruptions to production activities in Asia, which constitute important parts of the global supply chains. Declines in industrial production were first spotted in some of the Asian economies stepping into the second half of last year, followed by more severe and widespread contractions in Asian exports. The sharp declines in Asian exports continued in the first quarter of 2009, putting a severe drag on the overall performance of Asian economies. While the more advanced economies in Asia generally entered into recession, the emerging market economies in Asia also saw notable deceleration in growth.

Table 2: Asian economies severely affected by shrinking external demand

	Year-on-year growth rate of real GDP (%)					Year-on-year growth rate of exports in US\$ terms (%)		
	2008				2009	2008		2009
	Q1	Q2	Q3	Q4	Q1	Q3	Q4	Q1
Mainland	10.6	10.1	9.0	6.8	6.1	23.1	4.4	-19.7
Hong Kong	7.3	4.1	1.5	-2.6	-7.8	5.6	-1.8	-21.5
Japan	1.5	0.7	-0.2	-4.3	n.a.	12.9	-9.9	-40.6
Singapore ⁺	6.7	2.5	0.0	-4.2	-11.5	-0.7	-19.6	-30.6
Korea	5.5	4.3	3.1	-3.4	-4.3	27.0	-9.9	-24.9
Taiwan	6.2	4.6	-1.0	-8.4	n.a.	8.0	-24.7	-36.6
Indonesia	6.2	6.4	6.4	5.2	n.a.	27.9	-5.6	-33.9*
Malaysia	7.4	6.7	4.7	0.1	n.a.	21.3	-12.6	-29.9*
Thailand	6.0	5.3	3.9	-4.3	n.a.	28.4	-8.5	-19.2*
Philippines	4.7	4.4	5.0	4.5	n.a.	4.1	-22.3	-39.9*

Notes: (+) Non-oil exports.

(n.a.) Not yet available.

(*) Figures for January and February combined.

The Mainland's external trade also fell markedly, due to the shrinkage in global demand for manufactured goods. In particular, Guangdong's exports, which have been closely tied to Hong Kong's trading and other business activities, also went down notably. Nevertheless, domestic demand in the Mainland remained fairly robust in the first quarter. The growth momentum in retail sales and fixed investment went very much unabated. The industrial value-added also managed to post some re-acceleration in March as compared to the growth rate in January and February combined. Bank loans and money supply M2 also registered notable increases in March. All these tend to reflect the good progress made by the stimulus measures, including the RMB 4 trillion package announced last November, by the Central Government. If the Mainland recovers to faster growth in the coming quarters, as widely expected by many private sector analysts, this will provide some support to the Hong Kong economy as well as to the economic stability of the region.

**Table 2.2 : Total exports of goods by major market
(year-on-year rate of change in real terms (%))**

		<u>Mainland of China</u>	<u>United States</u>	<u>European Union</u>	<u>Japan</u>	<u>Republic of Korea</u>	<u>Taiwan</u>	<u>Singapore</u>
2008	Annual	5.9	-8.5	0.2	-2.4	-8.2	-1.6	6.2
	Q1	12.2	-5.8	4.6	-3.2	2.8	-0.2	21.6
	Q2	8.6	-7.4	1.6	-4.1	-5.7	2.6	13.8
	Q3	3.9	-7.1	2.0	-1.2	-5.7	-2.5	-0.5
	Q4	0.4	-13.0	-6.3	-1.0	-23.2	-5.9	-7.2
2009	Q1	-20.2	-24.6	-22.1	-17.8	-31.9	-27.4	-37.0

2.4 Hong Kong's exports to the major markets declined distinctly. As the advanced economies were mired in deep recession, their import demand all went sharply down. In consequence, total exports to the United States, the European Union and Japan declined distinctly across the board in the first quarter of 2009.

2.5 Economies in Asia were not immune to the global crisis. With a high degree of external orientation and as the key production centre targeting at the markets in the advanced economies, Asian economies had generally experienced a rapid deterioration since the latter part of last year. Furthermore, the strength of the US dollar was not conducive to the competitiveness of Hong Kong's exports. Against this background, total exports to the Mainland (the largest market for Hong Kong's total exports of goods), Singapore, South Korea and Taiwan all saw double-digit declines in the first quarter. Likewise, exports to most of the emerging economies in the region fell significantly.

Diagram 2.4 : Exports to the Mainland falling since late 2008 as world trade faltered

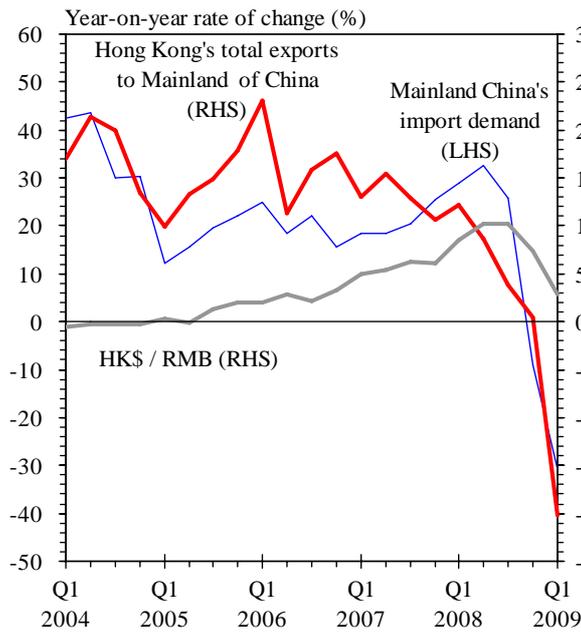


Diagram 2.5 : Exports to EU significantly affected by the deep economic recession in EU

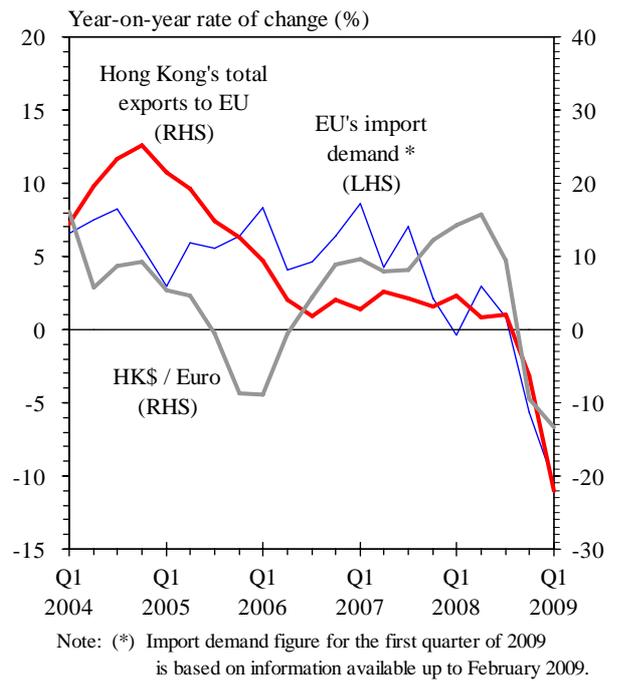


Diagram 2.6 : Exports to US plummeting along with its weak import demand

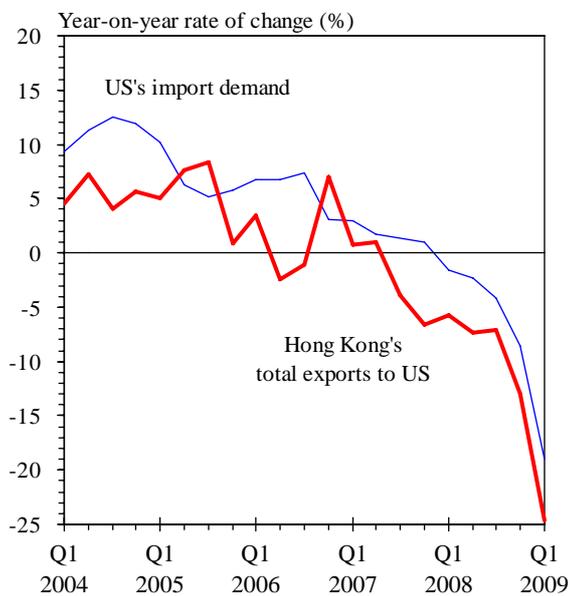


Diagram 2.7 : Exports to Japan likewise sharply down

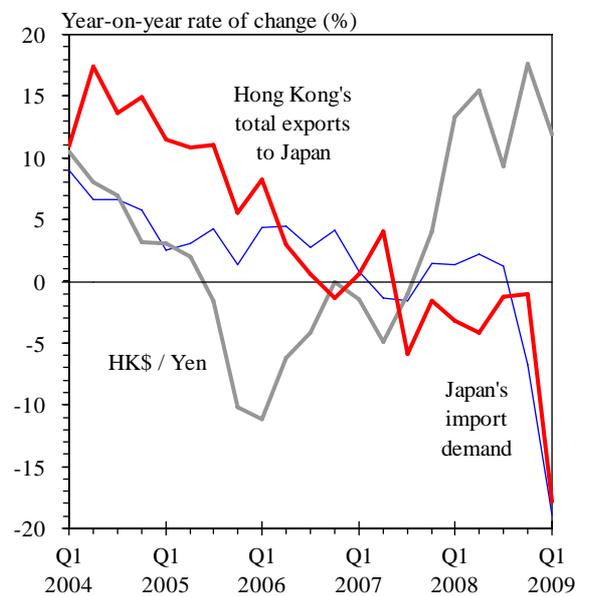


Diagram 2.8 : Exports to Singapore plunging...

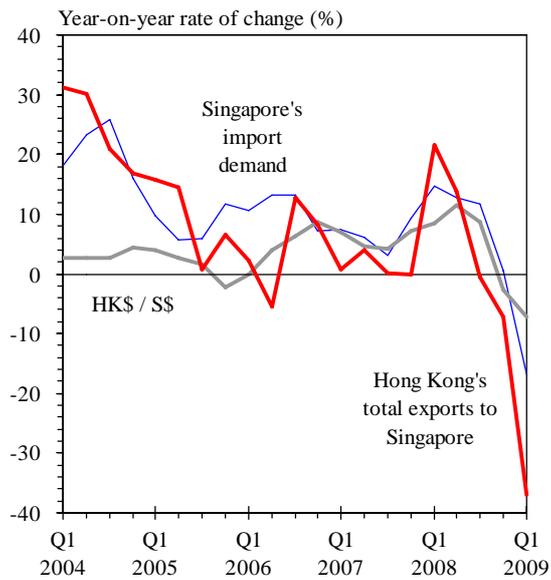
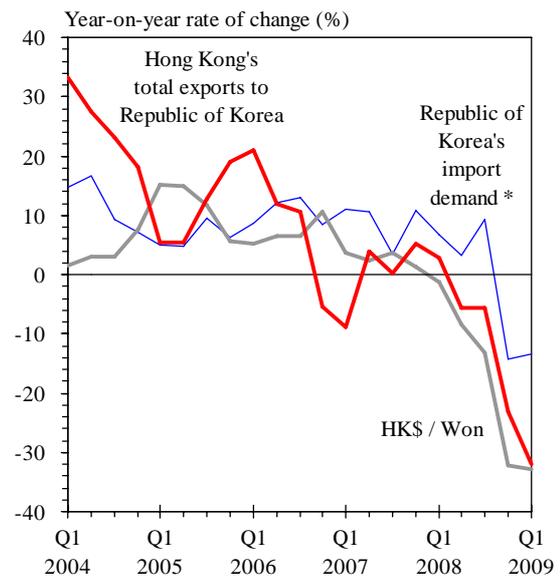


Diagram 2.9 : ...and so did exports to Republic of Korea



Note: (*) Import demand figure for the first quarter of 2009 is based on information available up to February 2009.

Imports of goods

2.6 *Imports of goods* contracted markedly by 22.2% in real terms in the first quarter, after a decrease of 6.0% in the fourth quarter of 2008. *Retained imports*, referring to the imports for domestic uses, likewise slumped by 24.2% in real terms in the first quarter, reflecting the weakening domestic demand. Retained imports of all end-use categories, except fuels, fell in the first quarter, with raw materials and semi-manufactures, and consumer goods showing sharp declines.

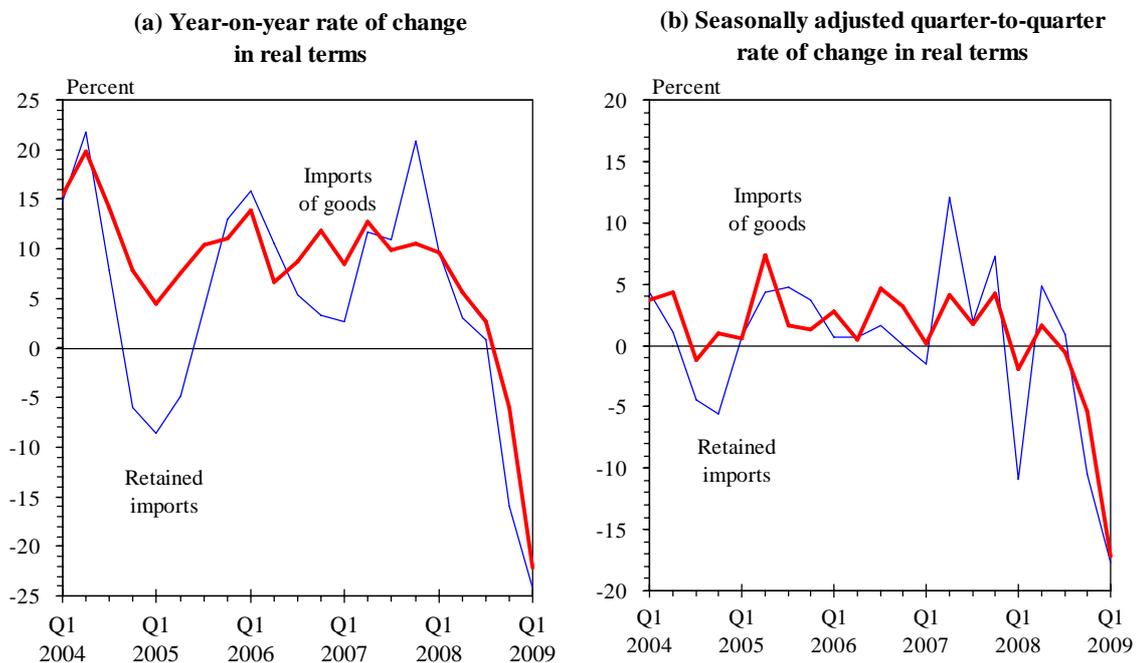
**Table 2.3 : Imports of goods and retained imports
(year-on-year rate of change (%))**

		<u>Imports of goods</u>			<u>Retained imports</u> ^(a)				
		<u>In value terms</u>	<u>In real terms</u>	<u>Change in prices</u>	<u>In value terms</u>	<u>In real terms</u>	<u>Change in prices</u>		
2008	Annual	5.5	2.6	4.4	3.9	-1.4	6.2		
	Q1	11.6	9.6	(-1.9)	3.6	13.7	9.6	(-10.9)	6.5
	Q2	9.1	5.6	(1.6)	4.9	10.1	3.0	(4.9)	7.6
	Q3	7.0	2.7	(-0.6)	5.6	8.5	0.8	(0.9)	8.5
	Q4	-4.2	-6.0	(-5.4)	3.6	-13.7	-16.0	(-10.5)	2.2
2009	Q1	-22.8	-22.2	(-17.2)	1.0	-27.5	-24.2	(-17.7)	-3.6

Notes : (a) Based on the results of the Annual Survey of Re-export Trade conducted by the Census and Statistics Department, re-export margins by individual end-use category are estimated and adopted for deriving the value of imports retained for use in Hong Kong.

() Seasonally adjusted quarter-to-quarter rate of change.

Diagram 2.10 : Total imports plunged



**Table 2.4 : Retained imports by end-use category
(year-on-year rate of change in real terms (%))**

		<u>Consumer goods</u>	<u>Foodstuffs</u>	<u>Capital goods</u>	<u>Raw materials and semi-manufactures</u>	<u>Fuels</u>
2008	Annual	12.4	13.3	7.5	-29.9	-3.9
	Q1	30.3	12.7	14.5	-11.7	-11.3
	Q2	16.2	19.0	11.2	-20.8	-7.0
	Q3	9.8	9.0	20.0	-35.4	0.9
	Q4	-3.3	12.6	-11.1	-47.9	1.9
2009	Q1	-30.7	-3.4	-8.1	-69.5	30.8

Invisible trade

Exports of services

2.7 *Exports of services* were likewise affected by the deteriorating external environment. In the first quarter of 2009, exports of services registered a notable decrease of 8.2% in real terms, after a marginal increase of 0.4% in the final quarter of 2008. As fund-raising and other financial market activities remained subdued, exports of financial services slowed distinctly in the first quarter. Reflecting the setback in regional trade flows, exports of trade-related services (mainly offshore trade) and transportation services shrank notably over the period. With the global economic downturn and negative wealth effect weighing on the demand for travel, visitor arrivals from most sources saw double-digit declines. Yet, the solid increase in visitor arrivals from the Mainland provided a complete offset and led to some increase in exports of travel services in the quarter.

Diagram 2.11 : Trade-related and transportation services accounting for over 55% of service exports, reflecting the important role of Hong Kong as a trading hub

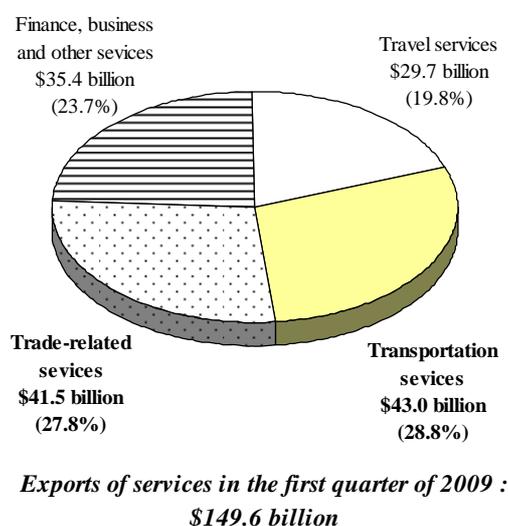


Diagram 2.12 : Exports of services likewise declined in tandem with global recession

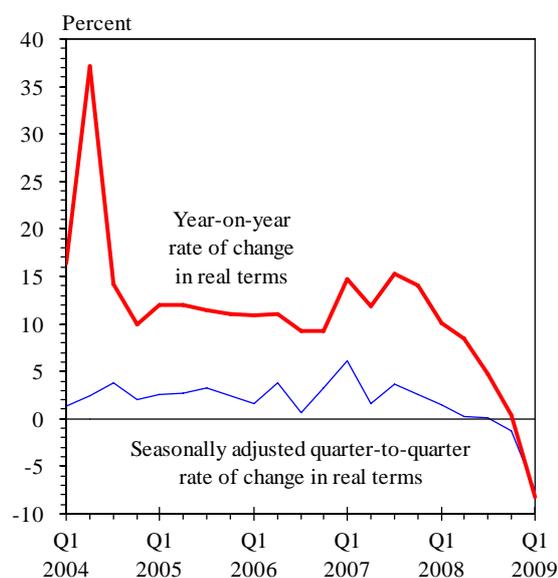


Table 2.5 : Exports of services by major service group (year-on-year rate of change in real terms (%))

Of which :

		<i>Of which :</i>					Finance, business and other services
		Exports of services	Trade-related services ^(a)	Transportation services	Travel services ^(b)		
2008	Annual	5.7	5.8	2.2	6.2	9.6	
	Q1	10.1	9.6	5.2	7.3	17.7	
	Q2	8.4	9.9	4.1	7.7	13.7	
	Q3	4.8	6.0	1.2	7.3	6.2	
	Q4	0.4	0.3	-1.4	3.0	0.7	
2009	Q1	-8.2	-12.5	-10.8	3.9	-8.6	

Notes : (a) Comprising mainly offshore trade.

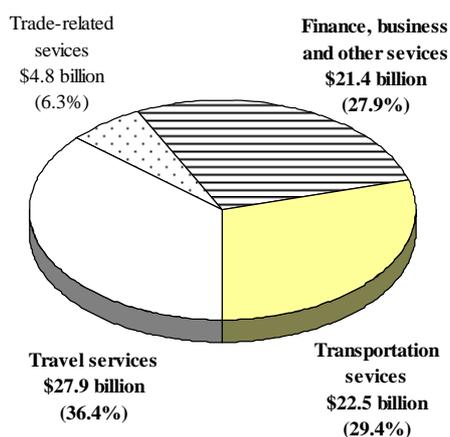
(b) Comprising mainly inbound tourism receipts.

() Seasonally adjusted quarter-to-quarter rate of change.

Imports of services

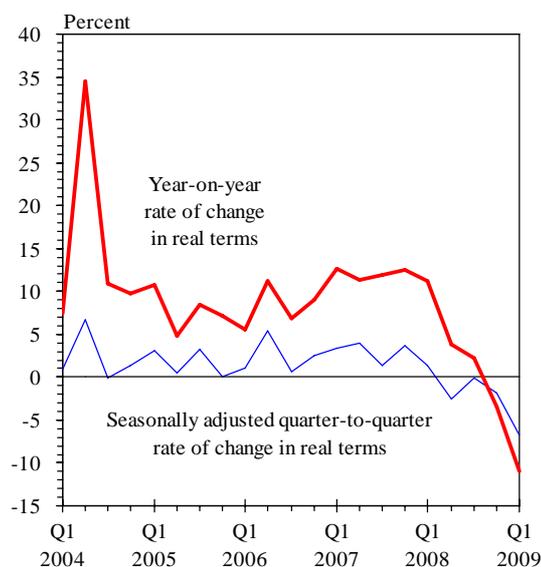
2.8 *Imports of services* fell even more in the first quarter of 2009, by 10.9% in real terms over a year earlier. The decrease was across all sectors. Imports of travel services continued the downtrend since the final quarter of 2008, along with weaker consumer sentiment, and so did imports of transportation services. Meanwhile, financial market and other commercial activities turned more sluggish in the midst of the global financial crisis, leading to a decline in imports of financial, business and other services in the first quarter. As for the imports of trade-related services, a marked deterioration was also seen in the first quarter, due to receding trade flows in the Asian region.

Diagram 2.13 : Travel service, transportation services, and services involving finance and business were the main components in imports of services



Imports of services in the first quarter of 2009 : \$76.6 billion

Diagram 2.14 : Imports of services also went sharply down



**Table 2.6 : Imports of services by major service group
(year-on-year rate of change in real terms (%))**

		<i>Of which :</i>				Finance, business and other services
		<u>Imports of services</u>	<u>Travel services⁽⁺⁾</u>	<u>Transportation services</u>	<u>Trade-related services</u>	<u>services</u>
2008	Annual	3.3	2.2	1.8	6.3	5.9
	Q1	11.2	(1.3)	13.1	10.2	10.1
	Q2	3.8	(-2.6)	-1.3	5.5	7.5
	Q3	2.2	(-0.1)	1.4	0.8	4.2
	Q4	-3.4	(-1.8)	-3.7	-8.1	1.9
2009	Q1	-10.9	(-6.8)	-6.6	-16.5	-9.9

Notes : (+) Comprising mainly outbound travel spending.

() Seasonally adjusted quarter-to-quarter rate of change.

Visible and invisible trade balance

2.9 With the surplus in the invisible trade account more than offsetting the deficit in the merchandise trade account, a sizeable surplus of \$38.2 billion was recorded in the combined visible and invisible trade balance in the first quarter of 2009, equivalent to 6.1% of the total value of imports of goods and services. This compared with the corresponding figures of \$38.3 billion and 4.9% in the same quarter last year. The continued strong external balance position is a reflection of Hong Kong's strength and resilience in meeting the challenges posed by the global crisis.

**Table 2.7 : Visible and invisible trade balance
(\$ billion at current market prices)**

		<u>Total exports</u>		<u>Imports</u>		<u>Trade balance</u>		
		<u>Goods</u>	<u>Services</u>	<u>Goods</u>	<u>Services</u>	<u>Goods</u>	<u>Services</u>	<u>Combined</u>
2008	Annual	2,844.0	718.8	3,024.1	357.0	-180.1	361.8	181.7
	Q1	650.6	174.0	696.7	89.6	-46.1	84.4	38.3
	Q2	708.7	166.9	770.8	87.1	-62.0	79.8	17.8
	Q3	764.3	193.6	805.6	95.5	-41.4	98.1	56.8
	Q4	720.3	184.3	751.0	84.8	-30.6	99.4	68.8
2009	Q1	512.3	149.6	547.1	76.6	-34.8	73.0	38.2

Note : Figures may not add up exactly to the total due to rounding.

Other developments

2.10 Hong Kong, Guangdong and Macau are working together to expedite the implementation of the “Outline of the Plan for the Reform and Development of the Pearl River Delta” released by the National Development and Reform Commission in early January this year. In February, the three sides formed key co-operation areas including finance, service industry, tourism, infrastructure, transport and town planning, innovation and technology, environmental protection, restructure and upgrading of enterprises, as well as education and training.

2.11 The Government will continue to strengthen infrastructure links with the Mainland to further enhance Hong Kong’s position as a financial, trading and services centre. Several major cross-boundary infrastructure projects are being expedited. Specifically regarding the Hong Kong-Zhuhai-Macau Bridge (HZMB), the three governments signed the contract for the preliminary design and investigation of the structure’s main body in March. Consensus on the sharing of the total construction cost by the three sides was also reached. The construction of the project is expected to start no later than 2010.

2.12 In April, the Central Government announced a pilot program for the usage of the renminbi for cross-border trade settlements in Hong Kong and five other Mainland cities. The program, when implemented, will allow Hong Kong traders to enjoy greater flexibility, thereby enabling them to reduce transaction costs and better manage exchange rate risks. The scheme will also enhance the diversity of renminbi assets in the Hong Kong banking system, increase the local capital liquidity of renminbi, bolster the renminbi clearing platform, and pave the way to further promote renminbi businesses in Hong Kong.

2.13 The Government will also continue to strengthen Hong Kong-Taiwan exchanges proactively, and support the full implementation of the “Three Direct Links” across the Taiwan Strait, as Hong Kong will benefit from the increasing trade flows and economic interactions among the Mainland, Taiwan and Hong Kong. Since January 2009, new measures had been implemented to facilitate Taiwan visitors with greater convenience and flexibility in visiting Hong Kong.

Notes :

- (1) Changes in merchandise exports and imports in real terms are derived by discounting the effect of price changes from changes in the value of the trade aggregates. Estimates of price changes for the trade aggregates are based on changes in unit values, which do not take into account changes in the composition or quality of the goods traded, except for some selected commodities for which specific price indices are available. The real growth figures reported here are based on the constant price measures adopted for compiling the external trade quantum index numbers. They are not strictly comparable with the real trade aggregates under GDP (reported in Chapter 1) which are based on the chain volume measures using the preceding-year prices as weights for aggregating the components.
- (2) In April, the International Monetary Fund (IMF) forecast the world economy to contract by 1.3% in 2009, before growing by 1.9% in 2010. Separately, the IMF estimated that write-downs on US-originated assets by all holders until 2010 would reach US\$4.1 trillion, up from US\$2.2 trillion estimated in January 2009.
- (3) Re-exports are those goods which have previously been imported into Hong Kong and are subsequently exported without having undergone in Hong Kong any manufacturing processes which change permanently the shape, nature, form or utility of the goods.