

CHAPTER 2 : THE EXTERNAL SECTOR

Summary

- *The strong momentum in the external sector continued in the second quarter of 2010, thanks mainly to the resurgence in intra-regional trade as well as the further rise-back in demand from the advanced economies in tandem with the sustained global recovery. The sovereign debt problem in Europe, while entailing more downside risks to the global economic outlook later this year, had not caused any significant disruption to global trade flows so far.*
- *Total exports of goods increased markedly further in the second quarter, by 19.7% in real terms over a year earlier. Exports to many major markets continued to record double-digit growth, a reflection of the brisk economic activity in Asia and the sustained moderate recovery in the United States. European markets also staged some rebound, but still lagged significantly behind other markets, and exports to these markets remained distinctly lower than the pre-crisis level.*
- *Exports of services likewise expanded strongly further in the second quarter. Exports of travel services saw a steep gain over a year earlier, boosted mostly by the strong influx of visitors from major sources and also partly by the low base due to human swine flu last year. Exports of trade-related and transportation services were also buoyant, thanks mainly to the robust intra-regional trade flows. Exports of financial and business services picked up notably, despite the intensification of the sovereign debt problem in Europe during the quarter.*
- *On Hong Kong's integration with the Mainland and regional co-operation, Supplement VII to the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) was signed in May 2010. This will improve market access and open new opportunities for Hong Kong's service industries. So far, CEPA has already covered a total of 44 service areas. Also of note was the signing of the Economic Cooperation Framework Agreement (ECFA) between the Mainland and Taiwan in June, which would facilitate trade flows and exchanges between the two places, thereby promoting regional economic co-operation.*

Visible trade

Total exports of goods

2.1 Hong Kong's merchandise exports continued to expand markedly in the second quarter of 2010, in the midst of the strong trade performance of many Asian economies and gradual recovery in demand from the advanced economies. The full impact on global trade flows from the sovereign debt problem in Europe had yet to be seen, with limited impact having emerged so far. Total exports of goods (comprising re-exports and domestic exports) expanded by 19.7% in real terms⁽¹⁾ over a year earlier, after a 23.4% increase in the previous quarter. On a seasonally adjusted quarter-to-quarter basis, total exports of goods increased by 3.9% in real terms in the second quarter, further to the 8.9% growth in the first quarter.

2.2 The sustained global economic recovery provided a favourable environment for the normalisation of trade flows. Asian economies continued to outpace the advanced economies by a large margin in the global recovery process, thanks to continued buoyancy in exports and strong private domestic demand. Against this backdrop, the robust intra-regional trade continued to be the major growth driver of Hong Kong's external trade in the second quarter. The gradual recovery in demand from the United States and to a lesser extent Europe also contributed.

2.3 *Re-exports*⁽²⁾ remained dominant in Hong Kong's overall merchandise exports, accounting for 97.7% of the value of total exports in the second quarter of 2010. Re-exports rose further by 19.7% in real terms in the second quarter over a year earlier, after the 23.5% growth in the first quarter. *Domestic exports*, which constitute the remaining small share of total exports, expanded further by 17.0% over a year earlier, moderating from the 20.2% increase in the previous quarter.

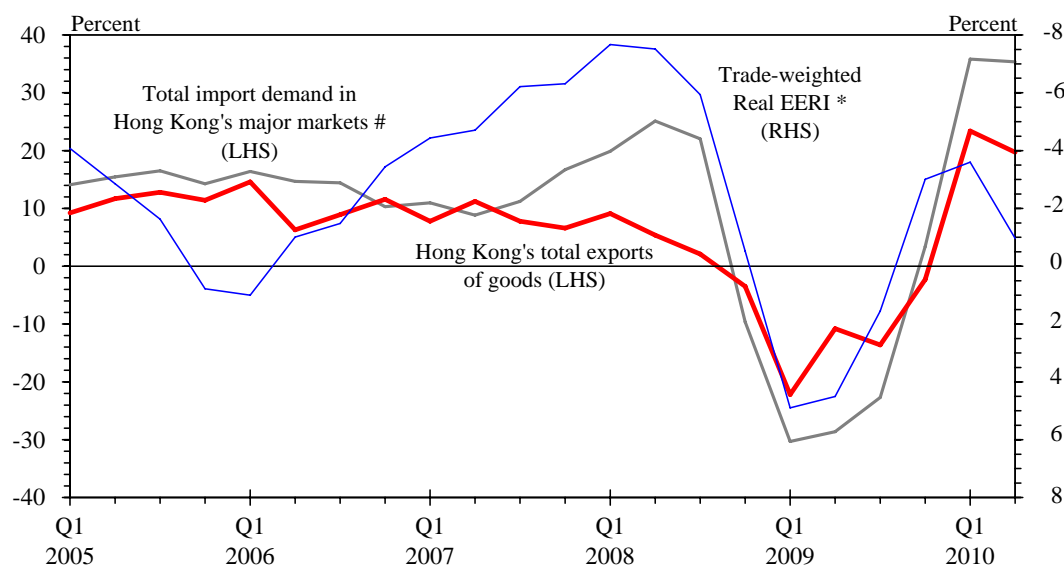
**Table 2.1 : Total exports of goods, re-exports and domestic exports
(year-on-year rate of change (%))**

	<u>Total exports of goods</u>			<u>Re-exports</u>			<u>Domestic exports</u>					
	In value <u>terms</u>	In real <u>terms</u>	Change <u>in prices</u>	In value <u>terms</u>	In real <u>terms</u>	Change <u>in prices</u>	In value <u>terms</u>	In real <u>terms</u>	Change <u>in prices</u>			
2009 Annual	-12.6	-12.0	1.1	-11.8	-11.3	1.2	-36.4	-34.6	-0.2			
H1	-17.2	-16.3	1.6	-16.3	-15.5	1.6	-41.9	-40.1	1.2			
H2	-8.3	-8.1	0.5	-7.6	-7.5	0.6	-30.8	-28.8	-1.7			
Q1	-21.9	-22.2	(-13.1)	2.5	-21.1	-21.4	(-13.0)	2.5	-44.3	-43.3	(-15.8)	2.5
Q2	-12.9	-10.8	(7.7)	0.8	-12.0	-9.9	(8.0)	0.8	-39.6	-37.0	(-4.0)	*
Q3	-14.3	-13.6	(-3.6)	0.2	-13.5	-12.9	(-3.5)	0.3	-38.7	-35.1	(-8.2)	-2.2
Q4	-2.0	-2.3	(9.1)	0.8	-1.4	-1.8	(9.1)	0.9	-21.2	-21.6	(7.1)	-1.2
2010 H1	25.1	21.4	3.4	25.1	21.4	3.4	22.7	18.5	4.7			
Q1	26.0	23.4	(8.9)	2.8	26.1	23.5	(8.5)	2.8	23.1	20.2	(26.7)	3.2
Q2	24.3	19.7	(3.9)	4.0	24.4	19.7	(4.2)	3.9	22.4	17.0	(-5.8)	6.1

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

(*) Change of less than 0.05%.

**Diagram 2.1 : Merchandise exports continued to expand markedly
in the second quarter of 2010
(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 second quarter of 2010 is based on statistics for April and May 2010.

Diagram 2.2 : Both re-exports and domestic exports maintained strong growth momentum

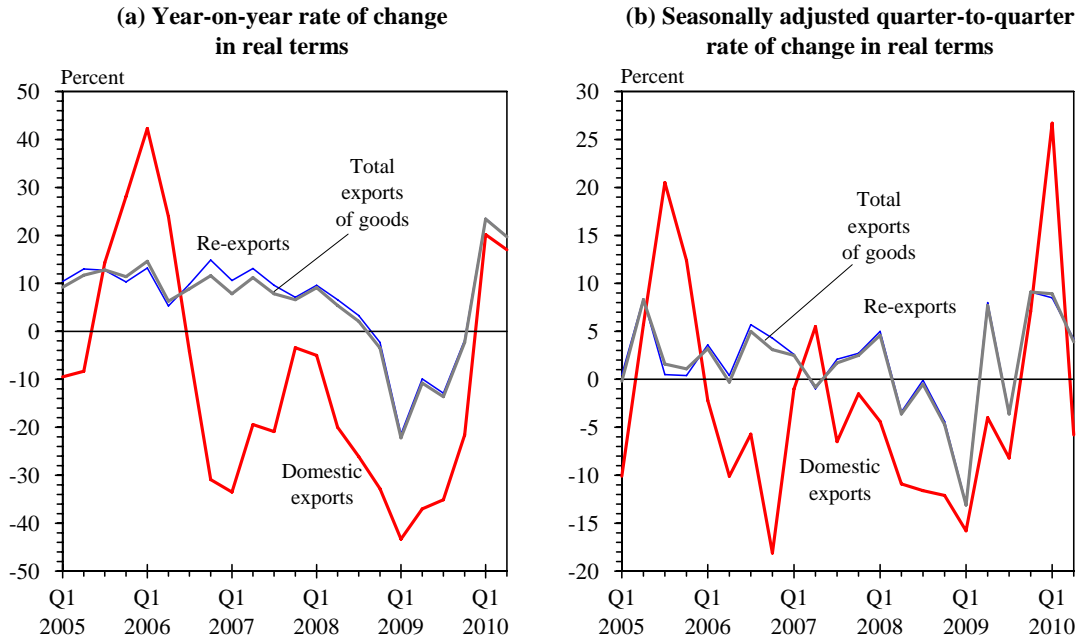
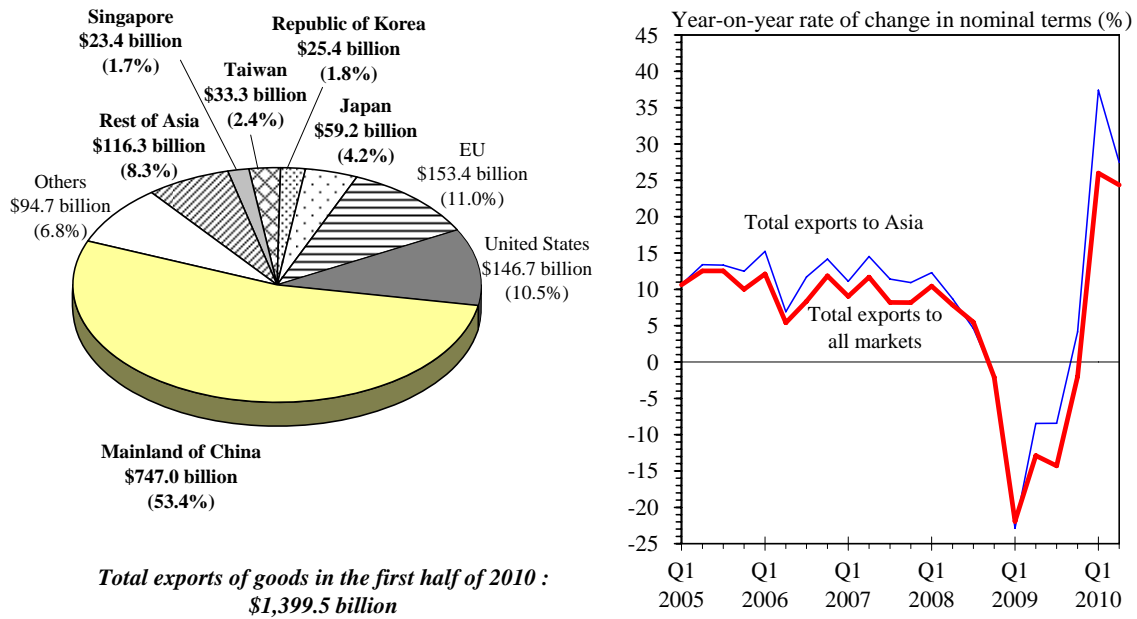


Diagram 2.3 : The Asian markets continued to be the major growth driver of Hong Kong's external trade



**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>
2009	Annual	-6.6	-20.5	-21.2	-11.8	-14.3	-3.8	-25.0
	H1	-10.3	-23.0	-22.3	-18.7	-26.3	-18.1	-32.6
	H2	-3.3	-18.2	-20.2	-5.1	-1.3	10.3	-16.7
	Q1	-20.2	-24.6	-22.1	-17.8	-31.9	-27.4	-37.0
	Q2	-1.3	-21.6	-22.6	-19.6	-20.8	-9.6	-27.9
	Q3	-7.9	-22.5	-25.6	-8.2	-11.5	-0.8	-20.2
	Q4	1.5	-13.4	-14.4	-2.2	11.2	21.6	-13.1
2010	H1	24.4	13.8	5.0	20.7	30.9	41.6	17.8
	Q1	32.1	6.7	-0.6	15.1	37.9	59.8	16.9
	Q2	18.8	19.9	10.4	26.2	24.9	28.1	18.6

2.4 Total exports of goods to many major markets in Asia continued to turn in marked increases in the second quarter over a year earlier. The vigorous performance of the Asian markets provided the major impetus to the strong growth of Hong Kong's exports. Total exports to the Mainland surged further, even against a higher base effect in the second quarter of last year. Total exports to many other destinations in Asia also expanded significantly. In particular, exports to Taiwan, Japan, Korea and Singapore all recorded double-digit growth in the region of 15-30%.

2.5 Meanwhile, demand from advanced economies also recovered further. Total exports to the United States continued to recoup the lost ground and picked up to a double-digit growth over a year earlier, as economic activities there continued to expand and imports grew even faster. Total exports to the European Union also showed some rebound over the exceptionally low base a year earlier, in tandem with a slowly reviving import demand. The sovereign debt problem in Europe, which had prompted many European and other advanced economies to adopt plans to redress fiscal issues, had not caused any significant dampening effect on global trade flows as yet. However, the evolving situation needs to be closely monitored, as its negative impact on global demand may become more evident in the latter half of the year.

Diagram 2.4 : Exports to the Mainland surged further

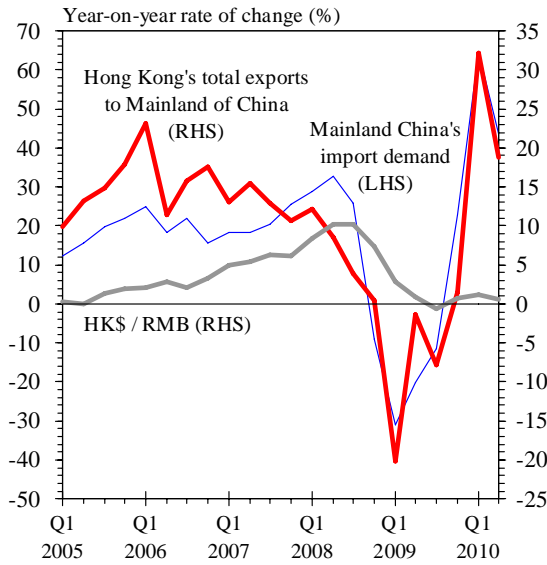


Diagram 2.5 : Exports to EU also showed some growth

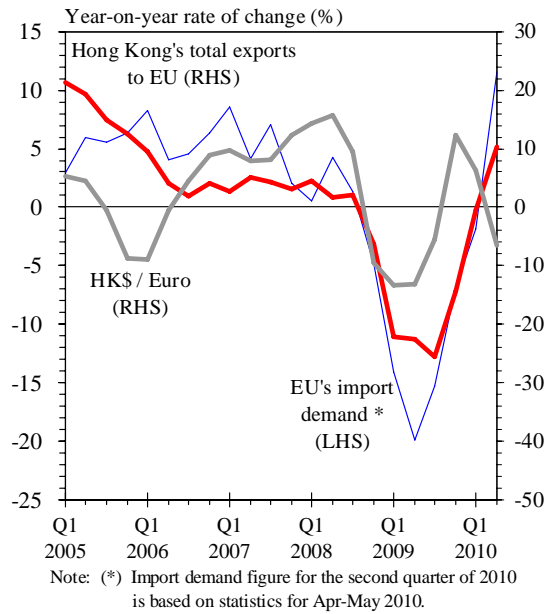


Diagram 2.6 : Exports to US continued to recoup lost ground

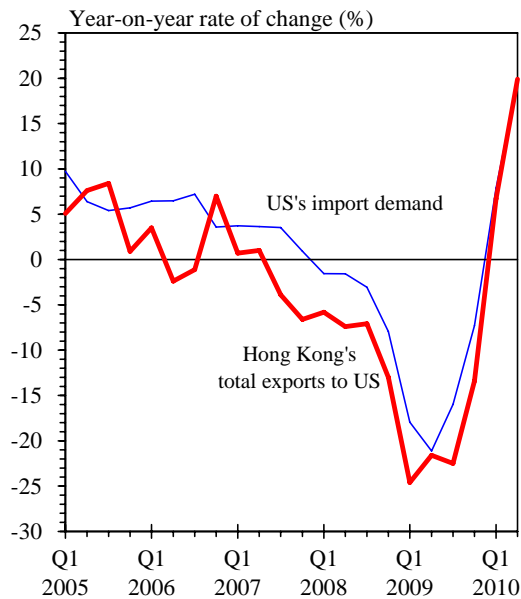


Diagram 2.7 : Exports to Japan expanded significantly

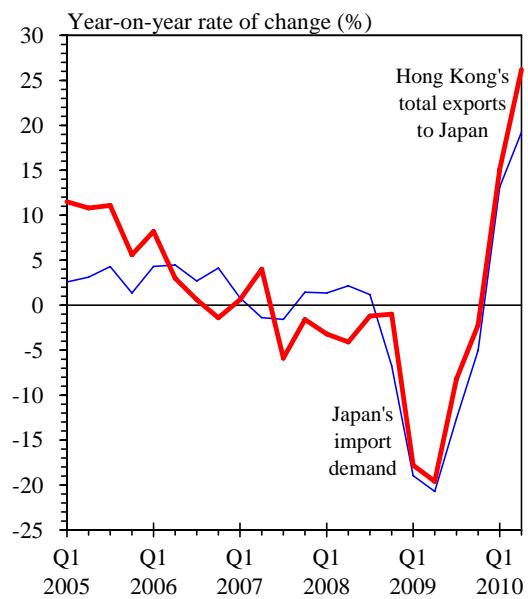


Diagram 2.8 : Exports to Singapore recorded double-digit growth

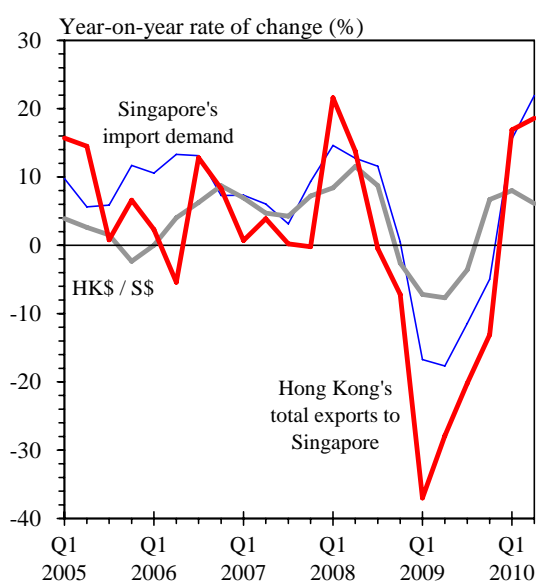
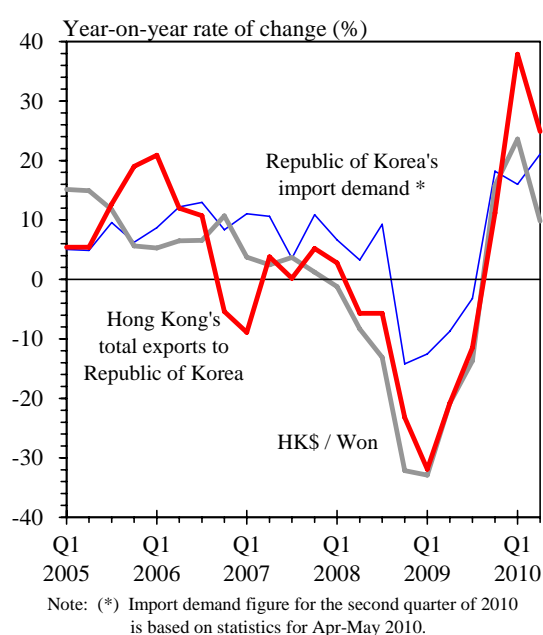


Diagram 2.9 : And so did exports to the Republic of Korea



Imports of goods

2.6 *Imports of goods* continued to grow strongly in the second quarter, by 22.8% in real terms over a year earlier, as compared to the 31.4% expansion in the previous quarter. *Retained imports*, referring to the imports for domestic uses, likewise increased sizably further by 32.0% over a year earlier as compared to the 54.2% increase in the previous quarter. Analysed by end-use category, retained imports of raw materials, consumer goods, and to a lesser extent capital goods all registered substantial increases in the second quarter, which by a varying degree were exaggerated by the very low bases of comparison in the same quarter of last year. Retained imports of fuels reverted to a significant increase over the same period, and retained imports of food also increased notably. On a seasonally adjusted quarter-to-quarter basis, retained imports declined by 9.2% in the second quarter, after the 12.6% increase in the first quarter.

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

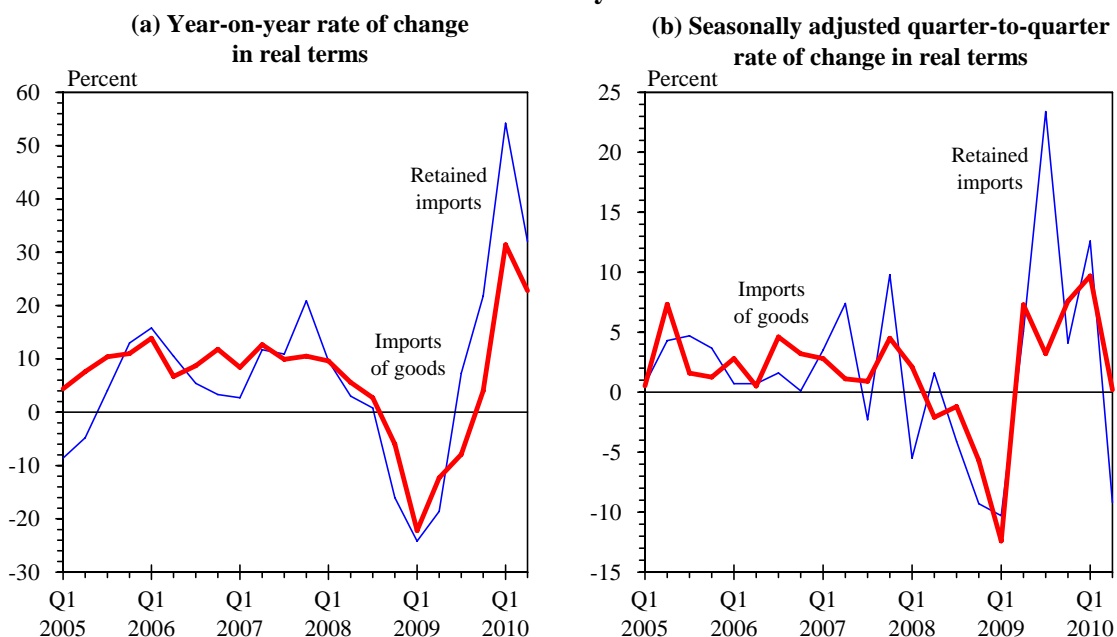
		<u>Imports of goods</u>				<u>Retained imports</u> ^(a)			
		<u>In value terms</u>	<u>In real terms</u>	<u>Change In prices</u>	<u>In value terms</u>	<u>In real terms</u>	<u>Change in prices</u>		
2009	Annual	-11.0	-9.4	-0.1	-10.8	-3.8	-5.8		
	H1	-18.6	-17.0	*	-26.7	-21.3	-6.7		
	H2	-3.8	-2.1	-0.5	5.8	14.2	-5.3		
	Q1	-22.8	-22.2	(-12.4)	1.0	-29.2	-24.2	(-10.3)	-5.8
	Q2	-14.9	-12.3	(7.3)	-0.8	-24.5	-18.6	(5.1)	-7.4
	Q3	-10.4	-7.9	(3.2)	-1.5	-3.3	7.3	(23.4)	-8.2
	Q4	3.4	4.0	(7.6)	0.6	16.3	21.8	(4.1)	-2.1
2010	H1	31.9	26.7		5.2	53.2	42.1		10.5
	Q1	34.3	31.4	(9.7)	3.6	60.5	54.2	(12.6)	6.1
	Q2	29.9	22.8	(0.2)	6.6	47.2	32.0	(-9.2)	14.8

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.

(*) Change of less than 0.05%.

Diagram 2.10 : Both imports and retained imports increased sizably further over a year earlier



**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>
2009	Annual	-8.8	7.0	-4.4	-9.7	23.2
	H1	-26.4	1.5	-10.9	-57.4	24.0
	H2	9.8	12.3	1.6	53.7	22.5
	Q1	-30.7	-3.4	-8.1	-69.5	30.8
	Q2	-22.4	6.3	-13.4	-47.4	17.4
	Q3	0.1	11.1	-3.7	41.1	24.1
	Q4	20.8	13.4	7.6	68.2	21.1
2010	H1	40.1	17.9	22.8	160.1	20.5
	Q1	48.7	28.6	21.2	344.4	-0.2
	Q2	32.9	8.5	24.2	70.8	42.6

Invisible trade

Exports of services

2.7 *Exports of services* remained vibrant in the second quarter, expanding by 16.9% in real terms over a year earlier, and were marginally higher than the previous quarter by 0.8% on a seasonally adjusted basis. Exports of travel services saw the sharpest gain, surging by 34.5%. Even discounting the relatively low base of comparison in the second quarter of 2009 due to concern over human swine flu, the sharp increase still reflected the strong influx of visitors from the Mainland and other major sources over the period. Exports of trade-related services, comprising mainly offshore trade, surged by 18.1% amid buoyant intra-regional trade flows and normalisation of global trade. In tandem with the robust passenger and cargo flows, exports of transportation services were also vibrant, up 11.0%. Exports of financial and business services went up by 12.4% over a year earlier. Exports of business services picked up notably further with reviving commercial activities in the region, but those of financial services grew only moderately as the European sovereign debt problem dampened market sentiment somewhat during the quarter.

Diagram 2.11 : Trade-related and transportation services accounted for nearly 60% of service exports, reflecting Hong Kong's position as a trading hub

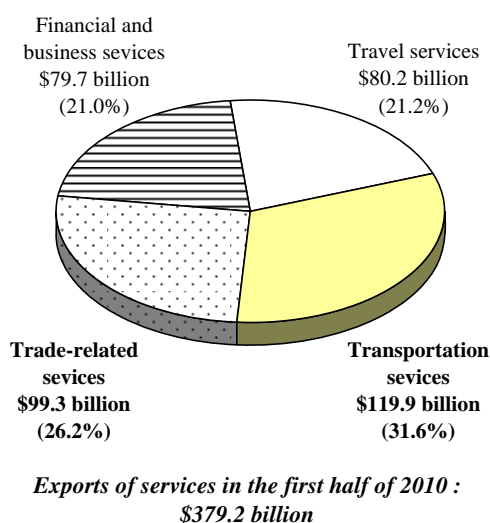


Diagram 2.12 : Exports of services remained vibrant

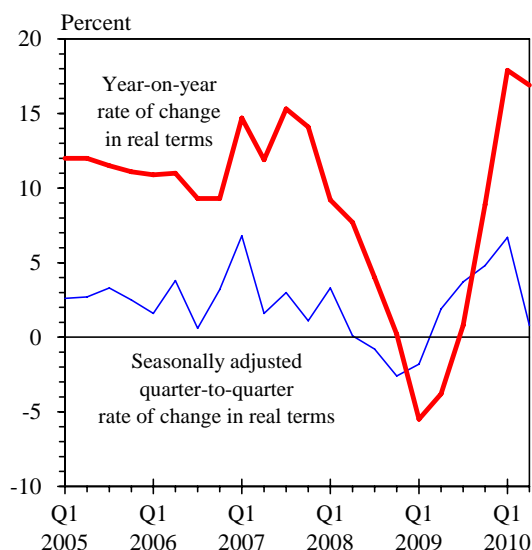


Table 2.5 : Exports of services by major service group (year-on-year rate of change in real terms (%))

Of which :

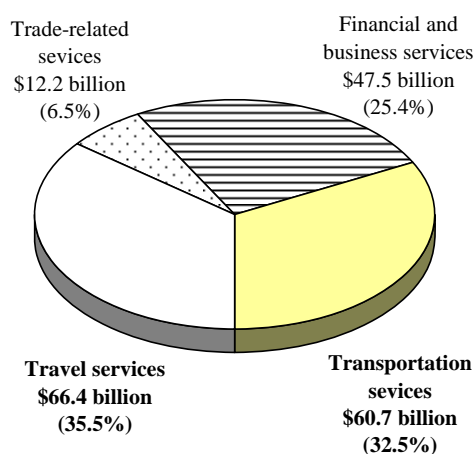
		Exports of services	Trade-related services ^(a)	Transportation services	Travel services ^(b)	Financial and business services
2009	Annual	0.3	-7.4	2.1	7.9	2.5
	H1	-4.7	-13.6	-2.5	6.8	-5.1
	H2	4.8	-2.8	6.7	8.8	10.6
	Q1	-5.5 (-1.8)	-15.0	-5.6	14.4	-7.0
	Q2	-3.8 (1.9)	-12.2	0.4	-1.6	-2.5
	Q3	0.8 (3.7)	-9.0	5.1	1.7	8.5
	Q4	8.9 (4.8)	3.4	8.5	15.3	12.8
	2010	H1	17.4	19.4	13.0	26.3
	Q1	17.9 (6.7)	20.7	15.2	20.0	16.9
	Q2	16.9 (0.8)	18.1	11.0	34.5	12.4

- Notes : (a) Comprising mainly offshore trade.
 (b) Comprising mainly inbound tourism receipts.
 () Seasonally adjusted quarter-to-quarter rate of change.

Imports of services

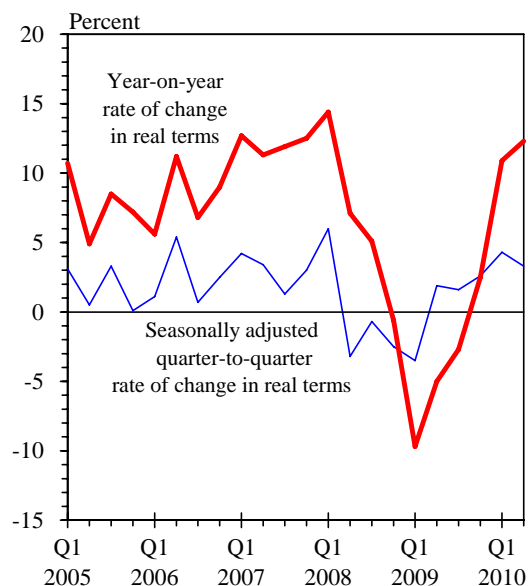
2.8 *Imports of services* rose further by 12.3% in real terms over a year earlier in the second quarter, or 3.3% over the previous quarter on a seasonally adjusted basis. On a year-on-year basis, growth accelerated in imports of travel services and transportation services, to 6.7% and 15.6% respectively, along with strengthening consumer demand for outbound tourism and the continued recovery in global and regional trade flows. Imports of trade-related services also benefited, expanding by 17.5%. Imports of financial and business services were likewise strong, up 15.2% year-on-year.

Diagram 2.13 : Growth in travel and transportation services, which accounted for nearly 70% of Hong Kong's imports of services, accelerated further



*Imports of services in the first half of 2010 :
\$186.8 billion*

Diagram 2.14 : Imports of services leaped further



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

Of which :

		<u>Imports of services</u>		<u>Travel services⁽⁺⁾</u>	<u>Transportation services</u>	<u>Trade-related services</u>	<u>Financial and business services</u>
2009	Annual	-3.7		2.0	-10.4	-7.7	-1.4
	H1	-7.4		0.5	-13.6	-14.0	-8.2
	H2	-0.2		3.5	-7.3	-3.1	5.3
	Q1	-9.7	(-3.5)	-4.0	-16.1	-15.4	-8.2
	Q2	-5.0	(1.9)	5.4	-11.3	-12.6	-8.2
	Q3	-2.7	(1.6)	2.0	-8.9	-9.4	1.9
	Q4	2.5	(2.6)	5.2	-5.4	2.9	8.7
2010	H1	11.6		6.0	14.1	18.8	15.0
	Q1	10.9	(4.3)	5.4	12.3	20.1	14.9
	Q2	12.3	(3.3)	6.7	15.6	17.5	15.2

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 being outweighed by the deficit in the merchandise trade account, the combined visible and invisible trade account recorded a deficit in the second quarter of 2010, at \$5.0 billion, equivalent to 0.5% of the total value of imports of goods and services. In contrast, a surplus of \$25.4 billion was recorded in the same quarter of last year, equivalent to 3.4% of the total value of imports of goods and services. This was the first deficit in the visible and invisible trade account in more than ten years, in large part reflecting the strong growth in imports of goods on the back of the economic recovery, but the deterioration in terms of trade was also relevant.

**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>As % of imports</u>
		<u>Goods</u>	<u>Services</u>	<u>Goods</u>	<u>Services</u>	<u>Goods</u>	<u>Services</u>	<u>Combined</u>	
2009	Annual	2,495	669	2,703	344	-208	325	117	3.8
	H1	1,131	296	1,205	158	-74	138	64	4.7
	H2	1,364	373	1,498	186	-134	187	52	3.1
	Q1	512	152	547	78	-35	74	39	6.2
	Q2	619	145	658	80	-39	65	25	3.4
	Q3	657	178	723	92	-66	86	20	2.5
	Q4	706	195	775	95	-68	101	32	3.7
2010	H1	1,414	379	1,599	187	-185	192	8	0.4
	Q1	640	193	728	93	-88	100	13	1.5
	Q2	774	186	871	94	-97	92	-5	-0.5

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

Other developments

2.10 Supplement VII to the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) was signed on 27 May 2010. The new supplement provides for 35 market liberalisation and trade and investment facilitation measures in 19 sectors, bringing the total number of service sectors covered to 44. The supplement will further liberalise trade in services, as well as broaden the scope of economic cooperation and professional exchanges with the Mainland.

2.11 The Mainland and Taiwan signed the Economic Cooperation Framework Agreement (ECFA) on 29 June 2010. Tariffs on 539 export items from Taiwan to the Mainland and those on 267 export items from the Mainland to Taiwan will be removed in two years. The pact will also give Taiwanese firms access to 11 service sectors in the Mainland, including banking, accounting, insurance and hospitals. This will facilitate trade flows and exchanges between the two economies, thereby promoting regional co-operation. Hong Kong will continue to enhance its competitiveness and to strengthen its exchanges with Taiwan in order to take advantage of the increase in economic activity in the region arising from these developments.

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) 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.