CHAPTER 3 : THE EXTERNAL SECTOR

Summary

- *Hong Kong's external sector faced stronger headwinds after the first quarter of 2011. This was particularly evident in the flows of merchandise trade. The combined influences of repercussions from the Japan earthquake in March, unsteady recovery in the US, and re-intensification of the European sovereign debt crisis took their toll on the global economy, resulting in an increasingly difficult external trading environment.*

- *The faltering demand in the advanced economies was the main drag on Hong Kong's merchandise exports, as it affected not only Hong Kong's exports to these markets, but also exports of raw materials to other Asian economies that were closely linked to the final consumption in the advanced economies. Although exports of consumer goods to Asia fared better, they were insufficient to make up for the lull in the advanced markets. Total exports of goods had lost steam since the second quarter of 2011, but still attained a modest growth of about 2.9% in real terms for the year as a whole.*

- *Exports of services stayed fairly resilient over the course of 2011, growing by 6.3% in real terms for the year as a whole. Exports of travel services grew notably further on the back of vibrant inbound tourism. Exports of financial and other business services also held firm during most of the year. Yet exports of trade-related services and transportation services decelerated markedly alongside the slowdown in trade flows.*

- *The National 12th Five-Year Plan (the Plan) promulgated in March included a dedicated chapter to Hong Kong and Macao for the first time, symbolising that Hong Kong's development had become a crucial part of the national strategy. Concrete progress was made in 2011 in implementing the Plan. Supplement VIII to the Mainland and Hong Kong Closer Economic Partnership Arrangement was signed in December to intensify the liberalisation of the Mainland market towards Hong Kong's services trade and strengthen co-operation in various areas. More measures to facilitate Hong Kong's development as an offshore renminbi business centre were announced. The development of the Shenzhen Qianhai Modern Service Industry Co-operation Zone proceeded further. Also, Hong Kong enhanced economic linkages with both traditional and new trading partners over the year.*

Visible trade

Total exports of goods

3.1 2011 was a year full of vicissitudes for Hong Kong's merchandise trade, mirroring the rapidly changing global economic environment. *Merchandise exports* (comprising re-exports and domestic exports) grew spectacularly by 17.7% in real terms[(1)] in the first quarter of 2011 over a year earlier, then abruptly relapsed to virtually no growth in the second quarter and further to a decline of 4.0% in the third quarter, before resuming a positive growth of about 1.3% in the fourth quarter. Yet thanks to the distinctive performance in the first quarter, merchandise exports still posted a modest growth of about 2.9% in real terms for 2011 as a whole, following the sharp rebound of 18.1% in 2010. On a seasonally adjusted quarter-to-quarter basis, merchandise exports leaped by 16.3% in the first quarter, then fell by 12.6% and 1.1% respectively in the second and third quarters, and reverted to a growth of about 1.3% in the fourth quarter.

3.2 The global trading environment was rather robust in the early part of 2011, with the advanced economies seemingly recovering at a steady pace and the emerging economies across continents growing strongly. However, the situation deteriorated markedly since the second quarter of the year. The 9.0-magnitude Great East Japan Earthquake on 11 March caused serious, albeit temporary, disruptions to the global supply chains and hence international trade flows. The encouraging signs displayed by the US and EU economies early in the year also proved to be short-lived, as many of them were constrained by the weak fundamentals as well as the needs to pursue austerity measures amid deepening concerns about their fiscal positions. In the US, the political disputes over the national debt limit in July and the unprecedented downgrade of sovereign credit rating by Standard & Poor's in early August led to another round of global financial market gyrations severely denting economic sentiment worldwide. In the eurozone, concerns about the European sovereign debt crisis re-ignited as the risks of contagion beyond the peripheral economies escalated notably since mid-2011, clouding further the global economic outlook. Asia was hardly unscathed. The setbacks in the advanced economies led to region-wide deceleration in industrial activities and intra-regional trade flows, causing many Asian economies to pause their policy tightening or turn to an easing bias in the latter part of the year.

3.3 *Re-exports*[(2)], the mainstay of overall merchandise exports and accounting for about 98.0% of total exports by value, increased by about 3.5% in real terms in 2011, after the substantial growth of 18.1% in 2010. *Domestic exports*, which constitute the remaining 2.0% of total exports, turned to a notable decline of about 22.1% in real terms in 2011, in stark contrast to the 15.5% growth in the previous year.

Table 3.1 : Total exports of goods, re-exports and domestic exports (year-on-year rate of change (%))

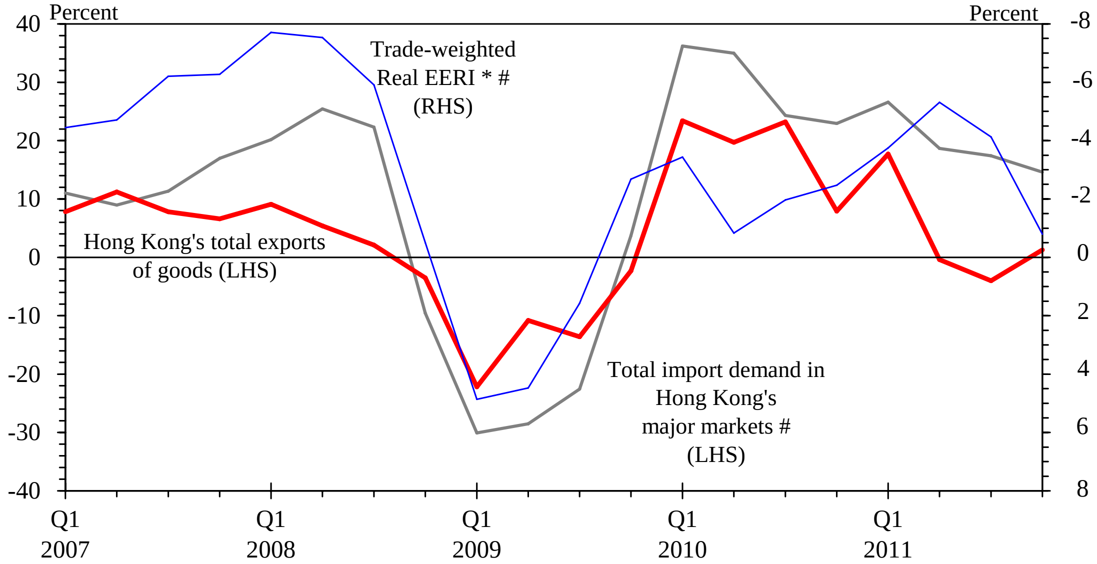
	Total exports of goods			Re-exports			Domestic exports		
	In value terms	In real terms	Change in prices	In value terms	In real terms	Change in prices	In value terms	In real terms	Change in prices
2010 Annual	22.8	18.1	4.7	22.8	18.1	4.6	20.4	15.5	5.5
Q1	26.0	23.4 (6.7)	2.8	26.1	23.5 (6.5)	2.8	23.1	20.2 (17.0)	3.2
Q2	24.3	19.7 (3.6)	4.0	24.4	19.7 (3.7)	3.9	22.4	17.0 (-3.3)	6.1
Q3	27.8	23.2 (1.9)	5.2	27.9	23.4 (2.0)	5.2	20.2	14.9 (-4.4)	5.7
Q4	14.4	7.9 (-4.1)	6.5	14.3	7.9 (-4.3)	6.5	16.7	11.1 (3.2)	6.7
2011 Annual#	10.1	2.9	8.0	10.5	3.5	8.0	-5.5	-22.1	6.4
Q1	24.6	17.7 (16.3)	7.6	24.9	18.2 (16.6)	7.6	11.9	-4.1 (0.4)	6.7
Q2	7.7	-0.4 (-12.6)	8.6	7.9	* (-12.6)	8.7	1.2	-16.0 (-14.7)	6.4
Q3	4.2	-4.0 (-1.1)	8.6	4.6	-3.5 (-0.8)	8.6	-12.3	-30.0 (-20.2)	7.6
Q4#	6.9	1.3 (1.3)	7.5	7.5	2.2 (1.4)	7.5	-19.5	-35.7 (-5.6)	5.7

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

(*) Change within ±0.05%.

(#) Figures on rate of change in real terms and change in prices for the fourth quarter and for 2011 as a whole are estimates based on actual unit value indices up to November 2011. They are subject to revision when the full-year data become available.

Diagram 3.1 : Merchandise exports slackened markedly over the course of 2011 (year-on-year rate of change)



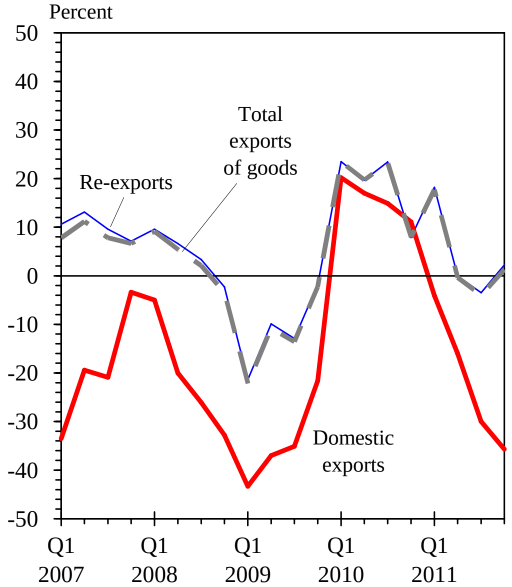
Notes : Total exports of goods as depicted refer to the year-on-year rate of change in real terms, while total import demand in Hong Kong's major markets as depicted refers to the year-on-year rate of change in US dollar terms in the aggregate import demand in Asia, the United States and the European 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 and trade-weighted real EERI for the fourth quarter of 2011 is based on statistics for October and November 2011.

Diagram 3.2 : Both re-exports and domestic exports saw sharp slowdown during 2011

(a) Year-on-year rate of change in real terms



(b) Seasonally adjusted quarter-to-quarter rate of change in real terms

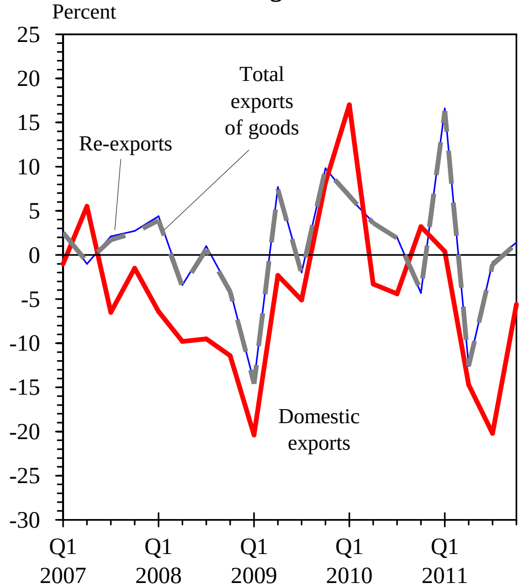
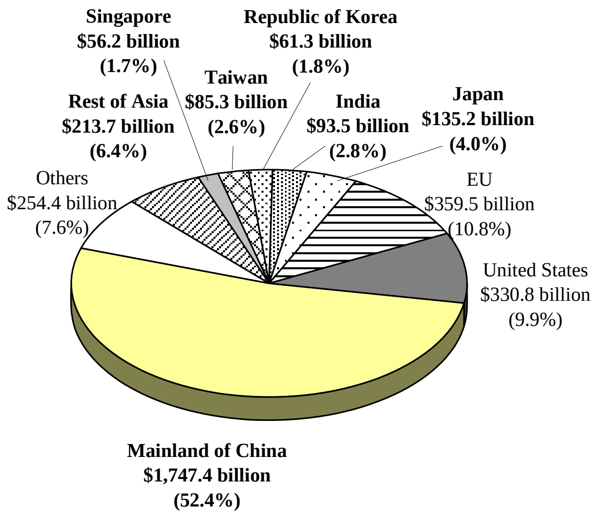


Diagram 3.3: Asian markets continued to feature prominently in Hong Kong's exports



Total exports of goods in 2011 :
$3,337.3 billion

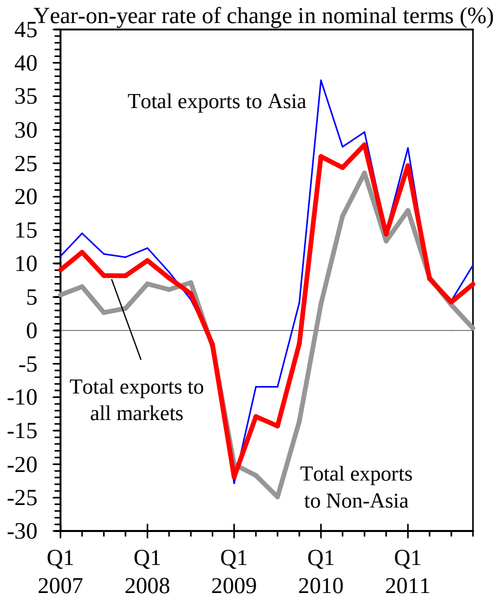


Table 3.2 : Total exports of goods by major markets (year-on-year rate of change in real terms (%))

	2010					2011			
	Annual	Q1	Q2	Q3	Q4	Annual#	Q1	Q2	Q3	Q4#
Mainland of China	20.0	32.1	18.8	26.3	7.0	3.4	20.8	-2.3	-6.9	5.6
United States	14.5	6.7	19.9	19.7	10.4	-9.7	7.0	-12.4	-16.0	-12.8
European Union	6.6	-0.6	10.4	15.8	1.0	-1.8	6.4	-0.9	-3.1	-8.3
Japan	15.5	15.1	26.2	15.4	7.4	-2.0	3.2	-5.7	-2.4	-2.7
India*	37.4	36.0	48.7	45.8	21.4	15.7	38.4	14.8	9.3	3.0
Taiwan	23.0	59.8	28.1	17.6	2.8	16.3	20.5	18.2	19.9	7.2
Republic of Korea	21.1	37.9	24.9	13.1	13.4	5.6	14.8	9.4	2.2	-2.9
Singapore	18.1	16.9	18.6	22.2	14.7	5.6	21.7	9.0	0.1	-5.5

Notes : (#) Figures for the fourth quarter and for 2011 as a whole are estimates based on actual unit value indices up to November 2011. They are subject to revision when the full-year data become available.

(*) The volume figures for exports to India are crude estimates, as a unit value index specifically compiled for exports to India is not available.

3.4 Although the Asian region as a whole stayed fairly resilient during 2011, production activities and trade flows within the region decelerated progressively after the first quarter along with the slackening final demand in the advanced economies. Consequently, Hong Kong's exports of raw materials to the Mainland and other Asian economies also lost steam. Exports of consumer goods to the Asian markets nevertheless held up relatively better, though also with some moderations in the second half of the year. Total exports to the Mainland, having fared strongly in the first quarter, eased back sharply in the second and third quarters before rebounding somewhat in the fourth quarter and recorded a modest growth of about 3.4% in 2011. Total exports to Korea and Singapore likewise decelerated noticeably over the course of 2011 and both only grew by about 5.6% for the year as a whole. Those to Japan fell, initially due to the disruptions caused by the March earthquake, then also the slow economic recovery there. On the other hand, total exports to Taiwan displayed strength during most of the year, conceivably boosted by the surge in trade flows after the signing of the Economic Cooperation Framework Agreement in June 2010. Exports to India, though also moderated during 2011, still posted a notable growth for the year as a whole.

3.5 Exports to the US and the EU showed renewed weaknesses in 2011, especially in the second half of the year. Private demand in the US was constrained by the depressed housing market, on-going deleveraging and persistently high unemployment, resulting in sharp year-on-year declines in exports to the US during most of 2011. Exports to the EU also reverted to decline in the second quarter and worsened notably in the second half of the year, as European consumer and business sentiments weakened progressively alongside the deepening eurozone sovereign debt crisis, which in turn posed a drag on import demand there. As a result, exports to these two major markets fell back towards their troughs in 2009. The US and the EU markets will be the key sources of downside risks to Hong Kong's export performance in the coming year, not only because they will affect Hong Kong through the direct trade channels, but also because their knock-on effects on other Asian economies and indeed the global economy could be severe (for more details, see ***Box 3.1***).

Diagram 3.4 : Exports to the Mainland significantly affected by reduced import intake of raw materials

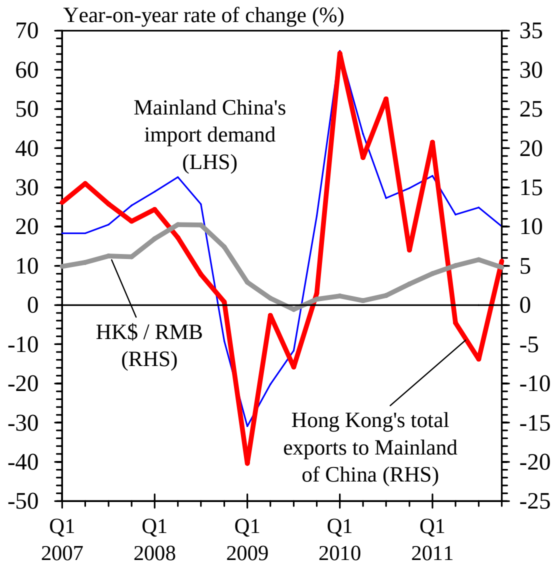
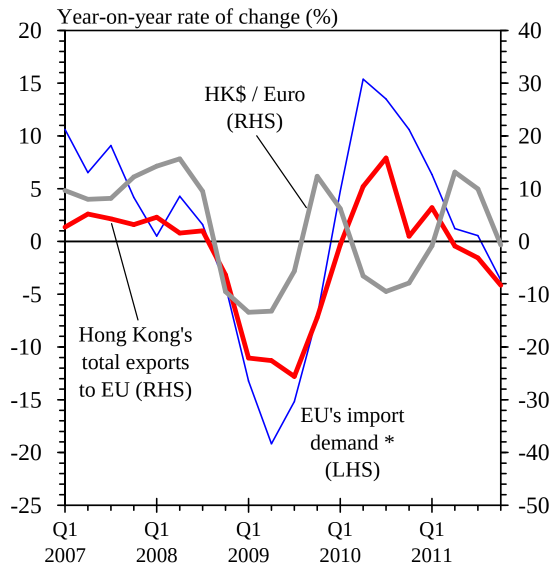


Diagram 3.5 : Exports to the EU slackened visibly during the year



Note: (*) Import demand figure for the fourth quarter of 2011 is based on statistics for Oct-Nov 2011.

Diagram 3.6 : Exports to the US fell markedly in 2011

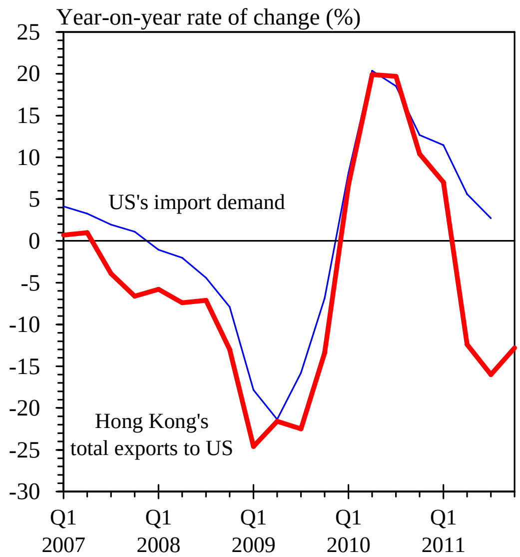
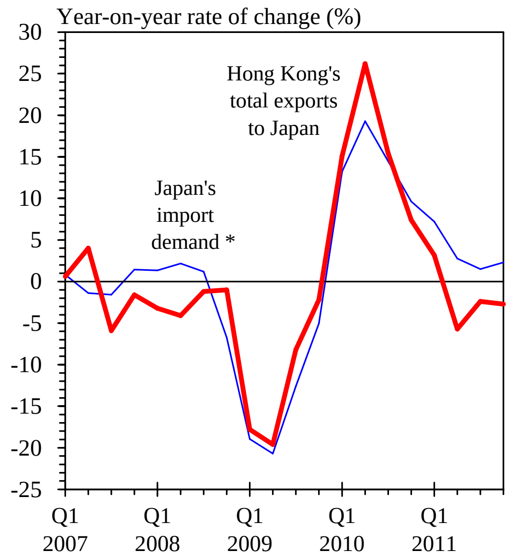


Diagram 3.7 : Exports to Japan also saw a moderate decline



Note: (*) Import demand figure for the fourth quarter of 2011 is based on statistics for Oct-Nov 2011.

Diagram 3.8 : Exports to India, though moderated during 2011, stayed relatively resilient

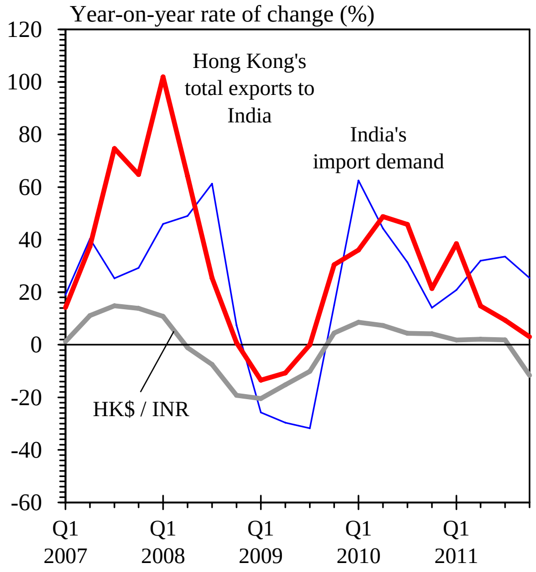


Diagram 3.9 : Exports to Taiwan sustained strong momentum throughout 2011

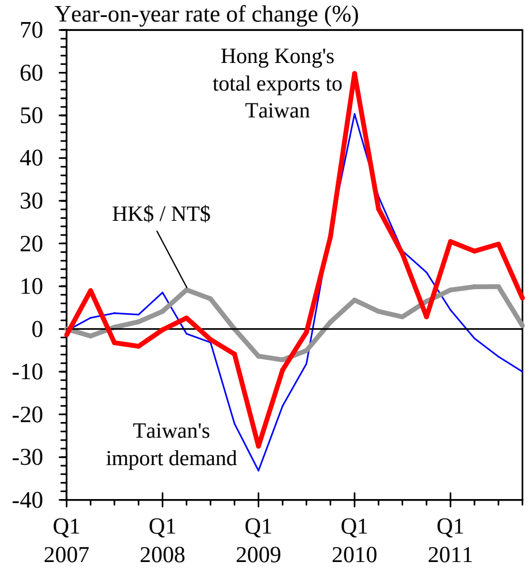
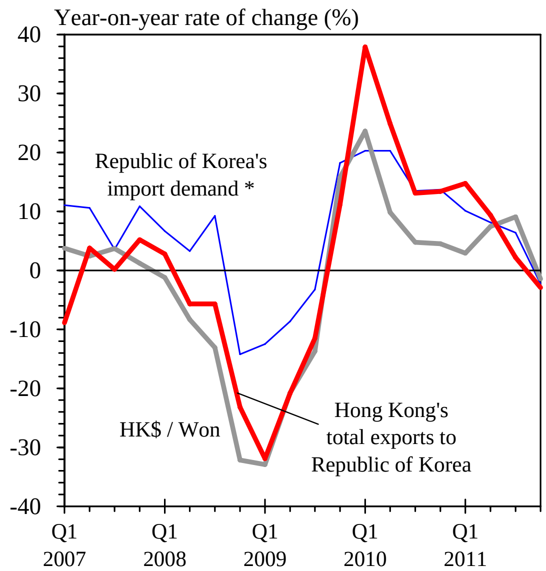
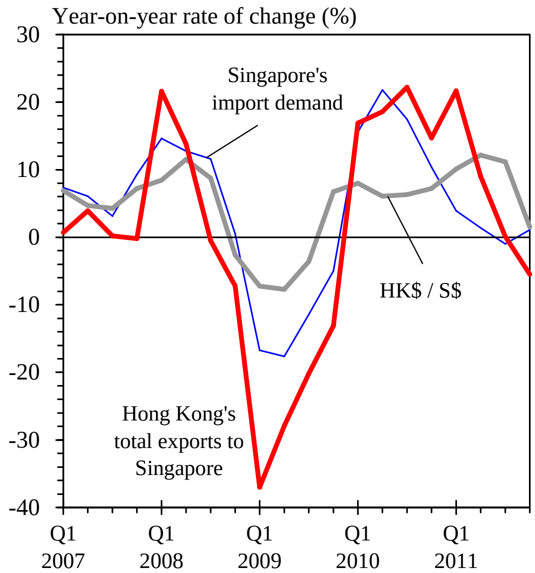


Diagram 3.10 : Exports to the Republic of Korea weakened over the course of 2011



Note: (*) Import demand figure for the fourth quarter of 2011 is based on statistics for Oct-Nov 2011.

Diagram 3.11 : So did exports to Singapore



Box 3.1

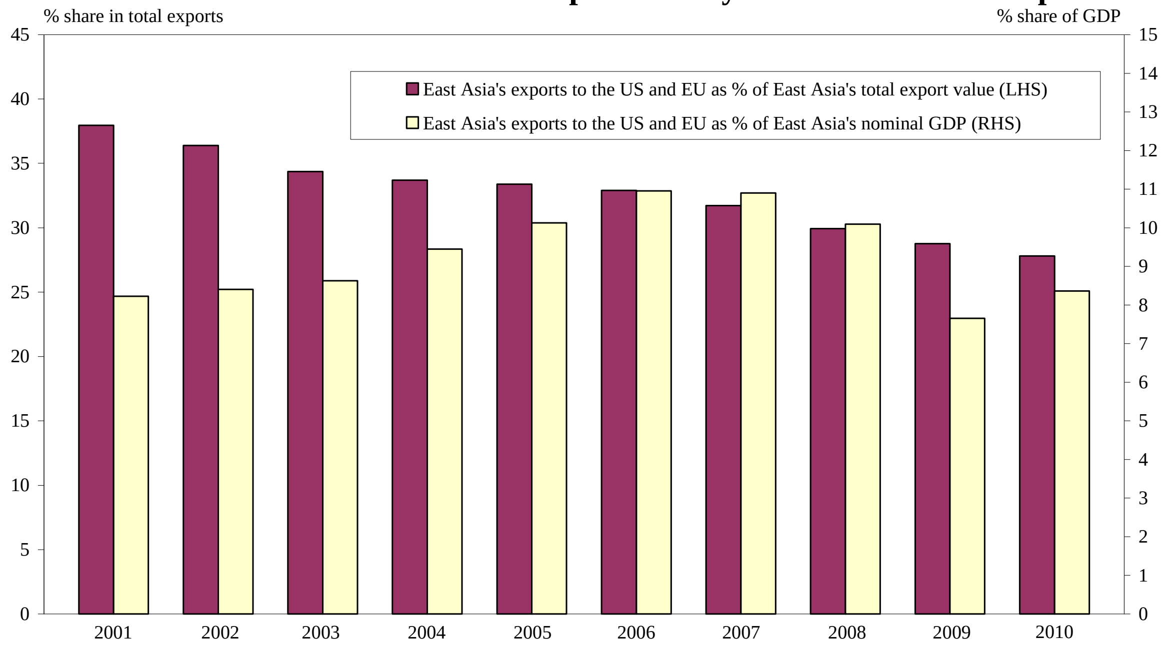
Will the economic slowdown of the US and EU affect East Asia?

When the global financial crisis pulled the advanced economies into deep recession in 2009, East Asia was severely hit despite their sound fundamentals[(1)]. But over the past three years, East Asia recovered well while economic growths in the advanced economies are still noticeably below trend. While this seems to suggest that the business cycle synchronisation between East Asia and the advanced economies had weakened, several pieces of evidences indicate that East Asia is still notably exposed to the vicissitudes of the advanced economies. Given the current escalated downside risks facing the US and EU, it is worthwhile to revisit these linkages to shed some light on the growth prospects of East Asia this year.

Fact 1 : The US and EU are still important export markets of East Asia

Given the enormous scale of their economies, the US and EU are important export markets of East Asia. The US and EU together still accounted for about 28% of East Asia's total export value in 2010, though their combined share was already lower than 10 years ago. As such, East Asia's external trade performances are still directly affected by the import demand in these two economies in a significant way (***Chart 1***).

Chart 1: The US and EU still feature prominently in East Asia's total exports



Fact 2 : East Asia's export dependence on the US and EU markets when measured in terms of GDP remains very large

The large external sector of East Asia means that a sharp swing in their exports could cause notable fluctuations in the GDP growth of East Asia. To further illustrate the economic significance of East Asia's export dependence on the advanced economies, it is worth noting that total exports to the US and EU represented about 8% of East Asia's GDP in 2010. Although this ratio had diminished from about 11% before the global financial crisis, the pressure it could exert on East Asia remains sizeable (***Chart 1***).

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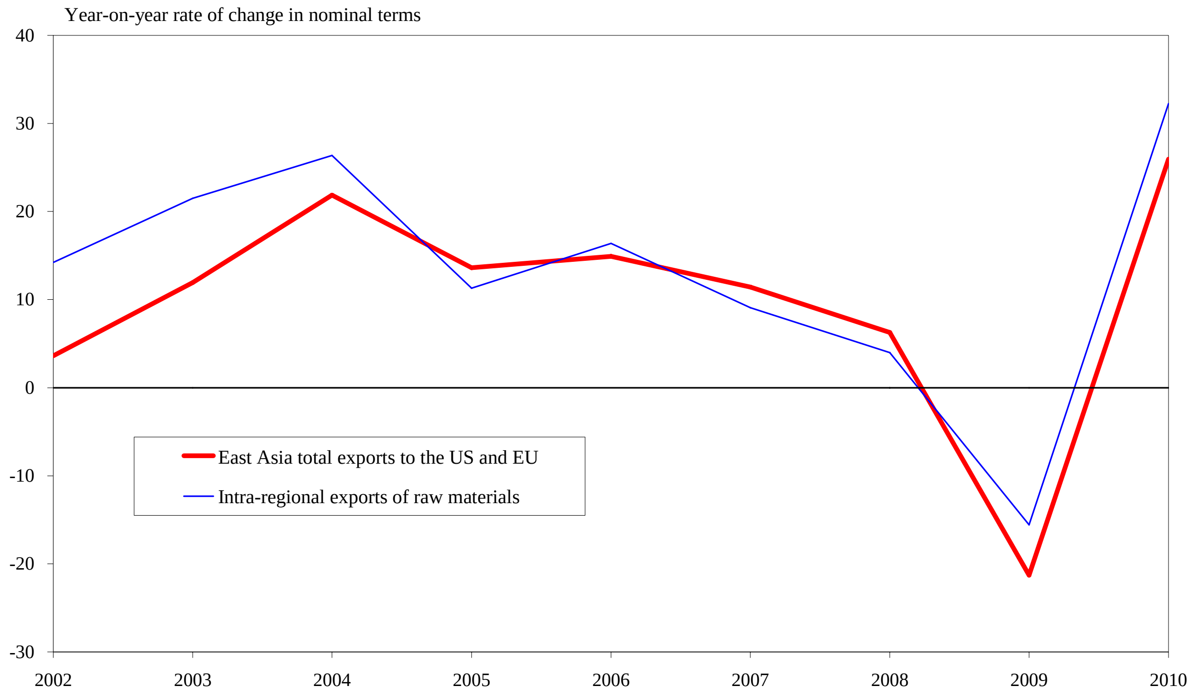
(1) In this Box, East Asia refers to the following 10 economies: the Mainland, Japan, Hong Kong, Taiwan, South Korea, Singapore, Indonesia, Thailand, Malaysia and the Philippines.

Box 3.1 (Cont'd)

Fact 3 : East Asia as intricate production supply chains

While intra-regional exports surged over the past decade and now account for about half of East Asia's total exports, a large part of these intra-regional exports comprise trade in raw materials (roughly about 40% in 2010)(2). This is a manifestation of the intricate production supply network within Asia, propelled by globalisation and trade liberalisation over the past two decades. It is impossible to trace where these raw materials would go after rounds of processing, but the close relationship between growth rates of intra-regional exports of raw materials and East Asia's total exports to the US and EU provided a clue (***Chart 2***). This, together with the fact that the US and EU are the major export destinations of East Asia, suggests that a significant share of intra-regional exports of raw materials is related to East Asia's eventual exports to the US and EU, and in turn the final consumption demand in these two markets. Indeed, when the demand in the advanced economies shrank in 2009, East Asia's exports to the US and EU fell by more than 20% and intra-regional exports of raw materials also fell sharply by around 15%.

Chart 2: Intra-regional exports of raw materials conceivably hinge on eventual exports to the US and EU



As such, the direct and indirect economic influences of the US and EU on East Asia are still substantial. In this connection, if both the US and EU economies sink into a recession, East Asia would still be severely affected. This relationship had become evident again since the second quarter of 2011. When the demand in the US and EU weakened, not only did East Asia's direct exports to these two markets slow, intra-regional trade and industrial production in the region also trended down generally. In short, East Asia is yet to decouple from the advanced economies and remains closely tied to the vicissitudes of the US and EU markets in the near term. The growth rebalancing process towards more domestic demand-led growth in East Asia is likely to be more a long term goal that will take time to accomplish.

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(2) East Asia's exports by end-use figures were crudely estimated based on the UN Comtrade database.

Imports of goods

3.6 *Imports of goods* recorded a moderate growth of about 5.1% in real terms in 2011, following an 18.6% increase in the previous year, largely due to the sharp slowdown in re-export trade. *Retained imports*, which accounted for over one-quarter of total imports, nevertheless leaped by about 9.2% in real terms in 2011, further to the 19.7% growth in 2010. The sharp contrast between the lacklustre external demand and the strong domestic demand led to a notable divergence among import intakes of different end-use categories. In particular, retained imports of consumer goods maintained strong growth throughout the year, reflecting buoyant local consumption and tourist spending. Retained imports of capital goods also grew notably on the back of a resilient domestic economy. Retained imports of foodstuffs recorded a mild growth for the year as a whole. On the other hand, retained imports of raw materials declined sharply, conceivably dragged by dimmer export outlook. Retained imports of fuels also went down after the sharp surge in 2010.

Table 3.3 : Imports of goods and retained imports (year-on-year rate of change (%))

		Imports of goods				Retained imports[(a)]			
		In value terms	In real terms		Change in prices	In value terms	In real terms		Change in prices
2010	Annual	25.0	18.6		6.4	27.3	19.7		8.2
	Q1	34.3	31.4	(6.8)	3.6	56.0	54.2	(7.4)	3.1
	Q2	29.9	22.8	(2.2)	6.6	42.8	32.0	(-1.6)	11.4
	Q3	24.1	17.3	(1.0)	7.2	9.8	2.5	(-1.6)	9.4
	Q4	15.1	7.0	(-2.7)	8.2	13.6	5.0	(1.7)	9.6
2011	Annual[#]	11.9	5.1		8.1	15.9	9.2		8.2
	Q1	20.6	12.9	(12.1)	8.9	9.5	0.5	(0.4)	12.6
	Q2	10.3	3.6	(-6.1)	8.1	16.8	13.4	(13.3)	6.5
	Q3	8.9	1.7	(-0.1)	8.6	22.7	17.0	(1.6)	8.2
	Q4[#]	9.3	3.2	(-1.9)	7.1	14.3	5.8	(-9.5)	5.9

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.

(#) Figures on rate of change in real terms and change in prices for the fourth quarter and for 2011 as a whole are estimates based on actual unit value indices up to November 2011. They are subject to revision when the full-year data become available.

Diagram 3.12 : Imports moderated along with the slowdown in re-exports, but retained imports grew remarkably

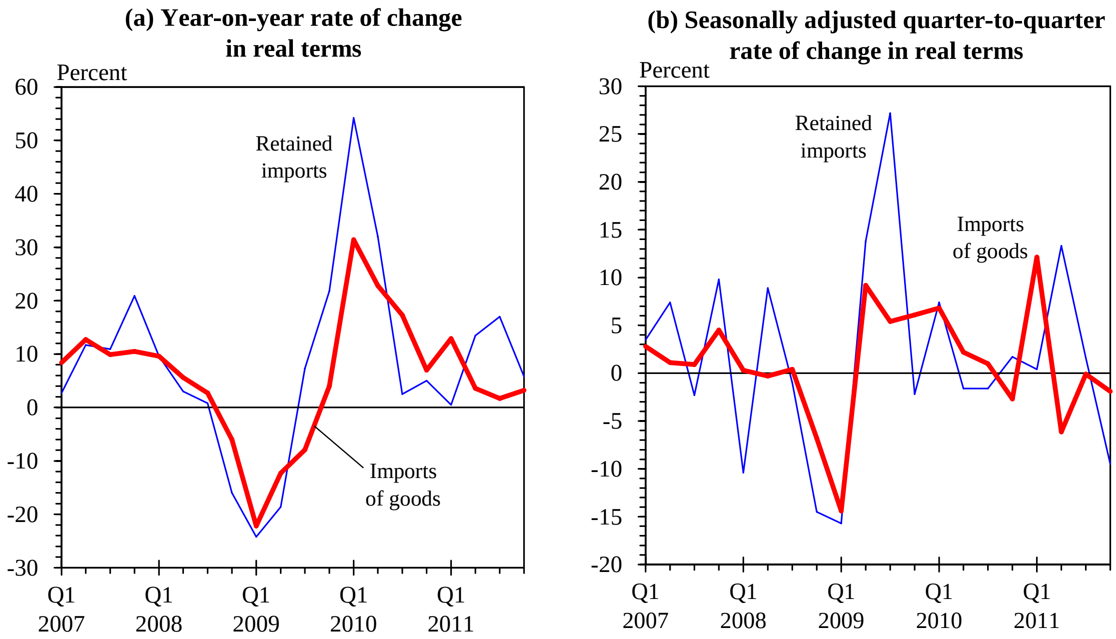

Table 3.4 : Retained imports by end-use category (year-on-year rate of change in real terms (%))

		Consumer goods	Foodstuffs	Capital goods	Raw materials and semi-manufactures	Fuels
2010	Annual	22.5	11.6	15.5	31.3	13.9
	Q1	48.7	28.6	21.2	344.4	-0.2
	Q2	32.9	8.5	24.2	70.8	42.6
	Q3	7.2	2.8	7.2	-18.1	14.6
	Q4	12.6	8.6	12.1	-13.9	1.4
2011	Annual#	24.2	1.9	15.2	-9.3	-11.2
	Q1	20.4	-6.1	2.3	-22.6	4.6
	Q2	34.6	3.8	16.3	9.0	-25.0
	Q3	33.3	12.8	21.9	6.2	-12.6
	Q4#	10.1	-1.4	19.0	-25.4	-7.2

Note : (#) Figures for the fourth quarter and for 2011 as a whole are estimates based on actual unit value indices up to November 2011. They are subject to revision when the full-year data become available.

Invisible trade

Exports of services

3.7 *Exports of services* maintained an appreciable growth at 6.3% in real terms for 2011 as a whole, further to the 14.6% increase in 2010. Exports of travel services remained the bright spot with strong growth throughout the year, thanks to the thriving inbound tourism. Exports of financial and business services were likewise resilient during most of the year, on the back of buoyant cross-border financing, fund raising and other commercial activities. These two components provided a strong cushion against the slack in the trade-related components and helped underpin the still solid performance of exports of services in 2011.

Diagram 3.13 : Exports of services grew rather appreciably for 2011 as a whole

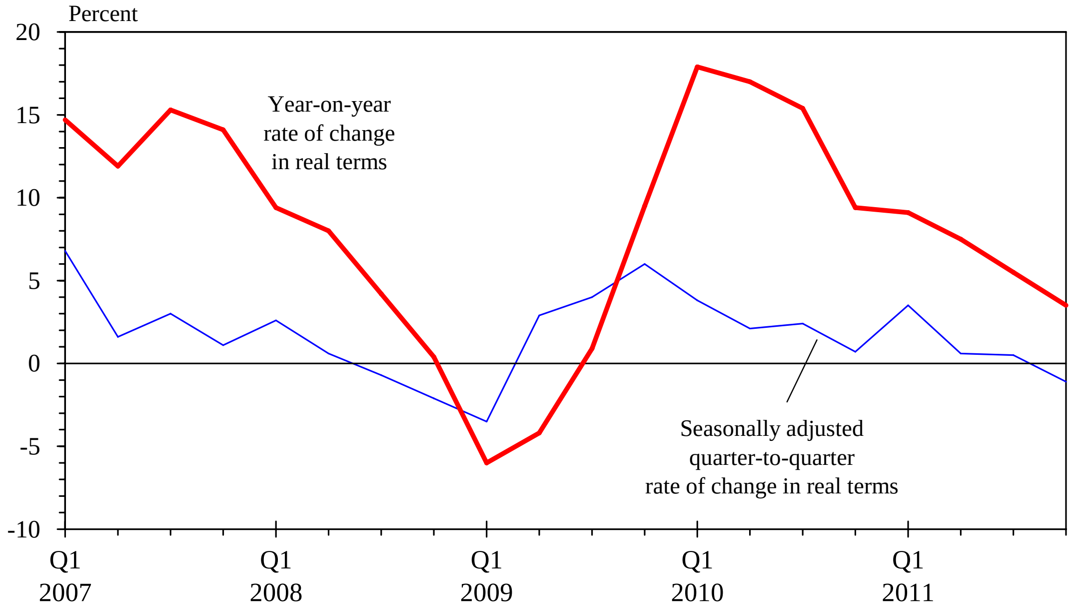

Table 3.5 : Exports of services by major service group (year-on-year rate of change in real terms (%))

		Exports of services		*Of which :* Trade-related services[(a)]	Transportation services	Travel services[(b)]	Financial and business services
2010	Annual	14.6		12.5	8.5	25.8	15.5
	Q1	17.9	(3.8)	18.8	13.0	19.1	21.5
	Q2	17.0	(2.1)	16.2	10.0	37.1	16.2
	Q3	15.4	(2.4)	12.3	8.1	39.6	10.8
	Q4	9.4	(0.7)	6.6	3.6	12.9	13.7
2011	Annual	6.3		N.A.	N.A.	N.A.	N.A.
	Q1	9.1	(3.5)	11.5	0.6	10.6	13.4
	Q2	7.5	(0.6)	3.4	4.8	15.7	9.1
	Q3	5.5	(0.5)	2.4	2.0	9.4	10.4
	Q4	3.5	(-1.1)	N.A.	N.A.	N.A.	N.A.

Notes : (a) Comprising mainly offshore trade.

(b) Comprising mainly inbound tourism receipts.

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

N.A. Not yet available. An advance schedule has been adopted in compiling the figures of exports of services for Q4 2011 and year 2011. Due to insufficient data, breakdown figures of major service groups are not available.

Imports of services

3.8 *Imports of services* grew modestly by 3.0% in real terms in 2011, following a sharp increase of 10.7% in the previous year. Growth in imports of financial and other business services moderated, amid an increasingly difficult external environment. Imports of transportation and trade-related services slowed more conspicuously alongside the slowdown in regional trade flows. Meanwhile, imports of travel services showed only a small growth in 2011.

Diagram 3.14 : Imports of services grew modestly

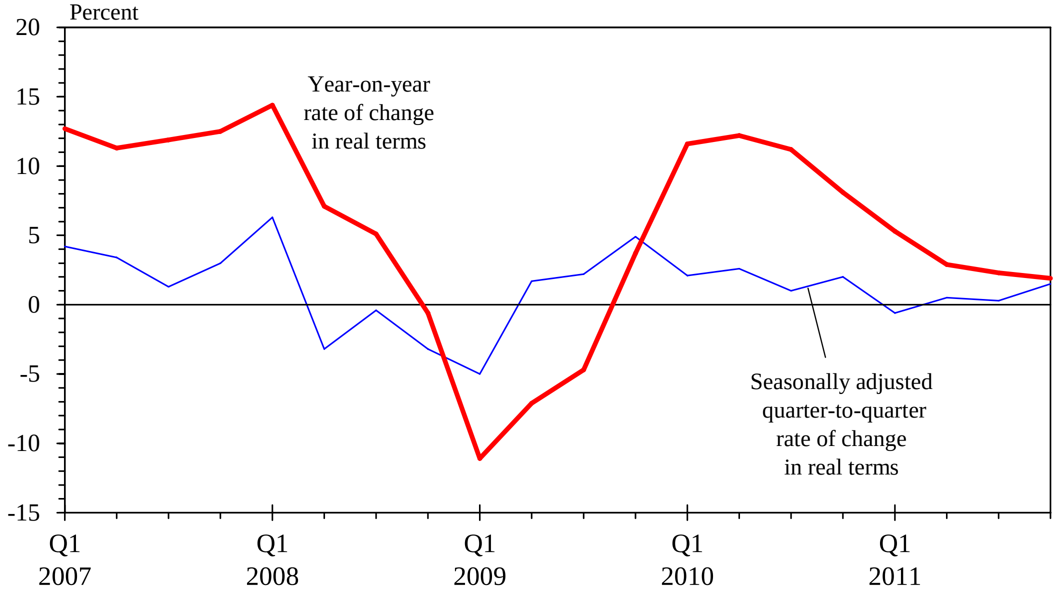

Table 3.6 : Imports of services by major service group (year-on-year rate of change in real terms (%))

		Imports of services		*Of which :* Travel services(+)	Transportation services	Trade-related services	Financial and business services
2010	Annual	10.7		6.4	12.5	14.0	13.4
	Q1	11.6	(2.1)	4.2	13.2	20.4	17.0
	Q2	12.2	(2.6)	5.0	16.1	17.8	17.3
	Q3	11.2	(1.0)	10.2	11.8	13.9	10.9
	Q4	8.1	(2.0)	5.8	8.9	8.1	9.6
2011	Annual	3.0		N.A.	N.A.	N.A.	N.A.
	Q1	5.3	(-0.6)	3.6	3.8	13.1	6.7
	Q2	2.9	(0.5)	3.6	1.3	6.3	3.0
	Q3	2.3	(0.3)	1.6	0.6	0.4	5.5
	Q4	1.9	(1.5)	N.A.	N.A.	N.A.	N.A.

Notes : (+) Comprising mainly outbound travel spending.

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

N.A. Not yet available. An advance schedule has been adopted in compiling the figures of imports of services for Q4 2011 and year 2011. Due to insufficient data, breakdown figures of major service groups are not available.

Visible and invisible trade balance

3.9 Due to the strong headwinds in the external environment and buoyant domestic demand, visible trade deficit widened substantially in 2011. Nevertheless, the invisible trade surplus was still more than enough to offset the visible trade deficit. In 2011, the combined visible and invisible balance posted a surplus of $68.8 billion, or 1.6% of the total value of imports of goods and services, though smaller than the surplus of $94.7 billion or 2.5% in 2010.

Table 3.7 : Visible and invisible trade balance
($ billion at current market prices)

		Total exports		Imports		Trade balance			
		Goods	Services	Goods	Services	Goods	Services	Combined	As % of imports
2010	Annual	3,061	825	3,395	396	-334	428	95	2.5
	Q1	640	190	728	92	-88	99	11	1.3
	Q2	774	185	871	92	-97	93	-4	-0.5
	Q3	838	220	898	104	-60	116	56	5.6
	Q4	809	230	898	109	-89	121	32	3.2
2011	Annual	3,409	941	3,846	435	-437	506	69	1.6
	Q1	796	222	890	103	-94	119	25	2.5
	Q2	835	215	960	103	-126	112	-13	-1.3
	Q3	891	250	991	114	-100	136	36	3.3
	Q4	888	254	1,006	115	-118	139	21	1.8

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

Other developments

3.10 Hong Kong’s role was highlighted in the national development strategy, as a dedicated chapter to Hong Kong and Macao was included for the first time in the National 12th Five-Year Plan (the Plan). In addition to bolstering Hong Kong’s role as an international financial, trade and shipping centre, the Plan also positioned Hong Kong as an offshore renminbi business centre and an international asset management centre. Besides, the Plan also encouraged development in the six industries and deepening of Hong Kong’s economic linkages with the Mainland.

3.11 Concrete progress was made in implementing the Plan. Following Vice-Premier Li Keqiang's visit in August, Supplement VIII to the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) was signed on 13 December 2011. The new supplement provides for 32 services liberalisation and trade and investment facilitation measures, which include 23 liberalisation measures in 16 service sectors, and strengthen co-operation in areas of finance, tourism, innovation and technology etc. Inclusive of the measures in Supplement VIII, the total number of service sectors under CEPA increases to 47. Moreover, the Vice-Premier also announced a series of measures to facilitate Hong Kong's development as an offshore renminbi business centre, including but not limited to the renminbi Qualified Foreign Institutional Investor scheme (RQFII) and the expansion of renminbi-denominated bond issuance in Hong Kong.

3.12 Hong Kong's economic relations with Shenzhen have strengthened, with a view to raising the joint productivity of the twin cities. The formal establishment of the Inter-ministries Joint Conference on the Development of Qianhai Area in Shenzhen in September 2011 indicated that the Qianhai project has now entered the implementation stage. The Qianhai Modern Service Industry Cooperation Zone will help leverage Hong Kong's experience to expedite the development of a modern industry structure in the Mainland while strengthening the competitiveness of Hong Kong's service industries. Furthermore, in the 2011 Hong Kong-Shenzhen Cooperation Meeting, the two Governments signed agreements to enhance collaborations on various aspects, such as legal services and development of the Lok Ma Chau Loop.

3.13 Hong Kong also made notable progress on overseas trade relations with economies worldwide during 2011. Hong Kong and the member states of the European Free Trade Association, namely Iceland, Liechtenstein, Norway and Switzerland, signed a Free Trade Agreement (FTA) in June, marking Hong Kong's first FTA with the European economies. Moreover, agreements for avoidance of double taxation were signed with Portugal, Spain and Czech Republic to foster economic ties with these overseas markets. Separately, the Hong Kong-Guangdong Business Conference held in Poland in November and the business delegation led by the Financial Secretary to South Africa in December boosted links with these emerging economies. The Government has also been actively exploring the possibility of a FTA with Chile, and will start negotiation with Russia about an agreement on investment promotion and protection.

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.