

CHAPTER 2 : THE EXTERNAL SECTOR

Summary

- *The global economic recovery remained uneven in the third quarter of 2014. The US economy showed some visible improvement; the Mainland economy sustained solid growth; and many other Asian economies kept expanding albeit at a moderate pace. In contrast, the rebound of the Japanese economy from a tax-induced slide was somewhat weaker than expected. The eurozone economy also lacked momentum, having nearly stalled in the preceding quarter, being constrained by the internal structural problems and weighed by the geopolitical risks in Ukraine and tensions with Russia. Given the unevenness of the global recovery, monetary policy directions of major central banks in the world tended to diverge, adding uncertainty to the external environment.*
- *In the third quarter, Hong Kong's merchandise exports grew moderately further in real terms⁽¹⁾, with expansions seen across most markets. Exports to some major Asian markets accelerated more visibly.*
- *Exports of services staged a visible rebound in the third quarter after the setback in the second quarter. Exports of trade-related services picked up further, in tandem with the recovery of regional trade flows, while exports of financial and other business services posted appreciable growth alongside the expansion in cross-border financial and fund raising activities. Meanwhile, exports of travel services saw a much narrower decline after the plunge in the preceding quarter. The receding base effect and the somewhat faster growth in visitor arrivals were the key factors contributable to the relative improvement.*
- *The Government strives to enhance Hong Kong's trade and investment relations with its economic partners. The Hong Kong-Korea Mutual Recognition Arrangement (MRA) on the Authorised Economic Operators (AEOs) became operational in late August, enabling local companies to tap into the Mainland and Korean markets. Moreover, a Free Trade Agreement (FTA) between Hong Kong and Chile also came into effect in early October. It expands Hong Kong's existing FTA network to the Americas and covers areas including trade in goods and services, investment, and other related areas.*

Goods trade

Total exports of goods

2.1 The global economy continued to recover at a moderate pace in the third quarter of 2014, with uneven performance across regions. Against this backdrop, Hong Kong's *merchandise exports* (comprising re-exports and domestic exports) sustained moderate year-on-year growth in the third quarter of 2014, at 4.8% in real terms, slightly up from 4.3% in the second quarter. On a seasonally adjusted quarter-to-quarter basis, merchandise exports increased by 2.6% in real terms in the third quarter, after the 3.7% expansion in the preceding quarter.

2.2 The external trading environment was still rather unsteady in the third quarter amid the uneven recovery of the global economy. The divergence in performance was most notable among advanced economies. Having recovered from the weather-induced contraction in the early part of the year, the US economy moved along a moderate expansion path in the third quarter. In the eurozone, economic activities remained sluggish and disinflationary pressure turned more evident, with a range of structural problems having yet to be resolved and with the geopolitical tensions around Ukraine hampering sentiment. In Japan, the economic recovery was somewhat weaker than expected after a tax-induced contraction in the second quarter. In Asia, the Mainland economy sustained relatively solid and robust growth in the third quarter, while the expansion pace of many other Asian economies was rather moderate. Moreover, some major emerging economies, notably Brazil and Russia, remained lacklustre. Apart from geopolitical tensions, the divergence in monetary policy among the major central banks will continue to add headwinds to the global financial and foreign exchange markets as well as the global trading environment. In October 2014, the International Monetary Fund (IMF) cut its global economic growth forecast for 2014 further, to 3.3% from that of 3.4% in July. This marked the third mark-down since the beginning of the year, signifying the disappointing outturn of the global economy so far this year.

2.3 *Re-exports*⁽²⁾, the mainstay of overall merchandise exports and accounting for 98.5% of total exports by value, rose by 4.7% year-on-year in real terms in the third quarter of 2014, up from 4.1% in the preceding quarter. *Domestic exports*, constituting the remaining 1.5% of total exports, posted a more moderate 5.8% year-on-year growth in real terms in the third quarter, following the 11.8% increase in the preceding quarter.

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

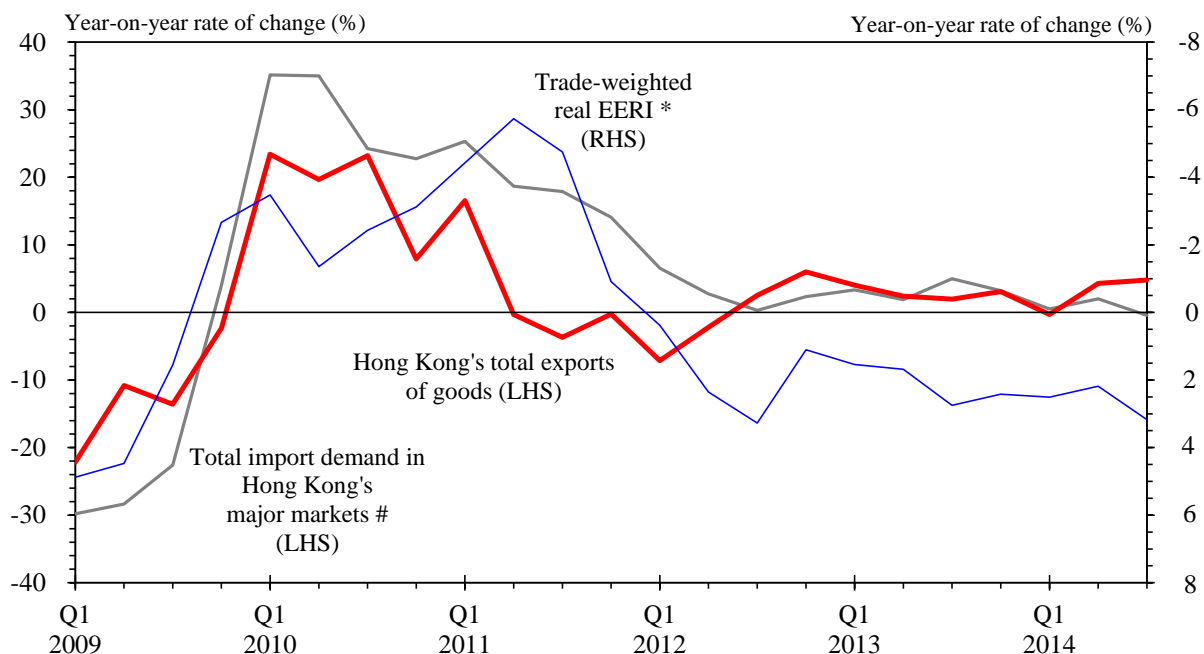
	<u>Total exports of goods</u>			<u>Re-exports</u>			<u>Domestic exports</u>					
	<u>In value terms</u>	<u>In real terms^(a)</u>	<u>Change in prices</u>	<u>In value terms</u>	<u>In real terms^(a)</u>	<u>Change in prices</u>	<u>In value terms</u>	<u>In real terms^(a)</u>	<u>Change in prices</u>			
2013 Annual	3.6	2.8	1.3	3.8	3.0	1.3	-7.6	-9.4	2.2			
H1	3.2	3.2	0.5	3.3	3.4	0.4	-4.6	-7.5	3.2			
H2	4.1	2.5	2.0	4.3	2.8	2.0	-10.3	-11.2	1.2			
Q1	4.0	4.0	(-1.9)	0.6	4.0	4.2	(-1.9)	0.5	-0.9	-4.5	(-1.2)	4.2
Q2	2.4	2.4	(-1.2)	0.4	2.6	2.6	(-1.1)	0.4	-7.9	-10.1	(-5.2)	2.3
Q3	3.3	2.0	(2.2)	1.7	3.6	2.2	(2.3)	1.7	-11.9	-12.9	(-1.0)	1.8
Q4	4.8	3.1	(3.6)	2.4	5.0	3.3	(3.7)	2.4	-8.5	-9.4	(-1.7)	0.6
2014 H1	2.8	2.0	1.8	2.8	1.9	1.8	3.7	7.9	-0.5			
Q1	0.7	-0.3	(-4.9)	1.7	0.7	-0.4	(-5.2)	1.7	-1.1	3.7	(12.4)	-1.2
Q2	4.8	4.3	(3.7)	1.8	4.8	4.1	(3.7)	1.9	8.3	11.8	(2.4)	*
Q3	5.8	4.8	(2.6)	2.2	5.9	4.7	(2.8)	2.2	3.1	5.8	(-6.4)	1.0

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

(*) Change of less than 0.05%.

(a) The growth rates here are not strictly comparable with those in the GDP accounts in Table 1.1, due to differences in coverage and methodology.

Diagram 2.1 : Merchandise exports sustained moderate growth in the third quarter of 2014



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 for the third quarter of 2014 is based on statistics for July and August 2014.

Diagram 2.2 : Both re-exports and domestic exports grew further

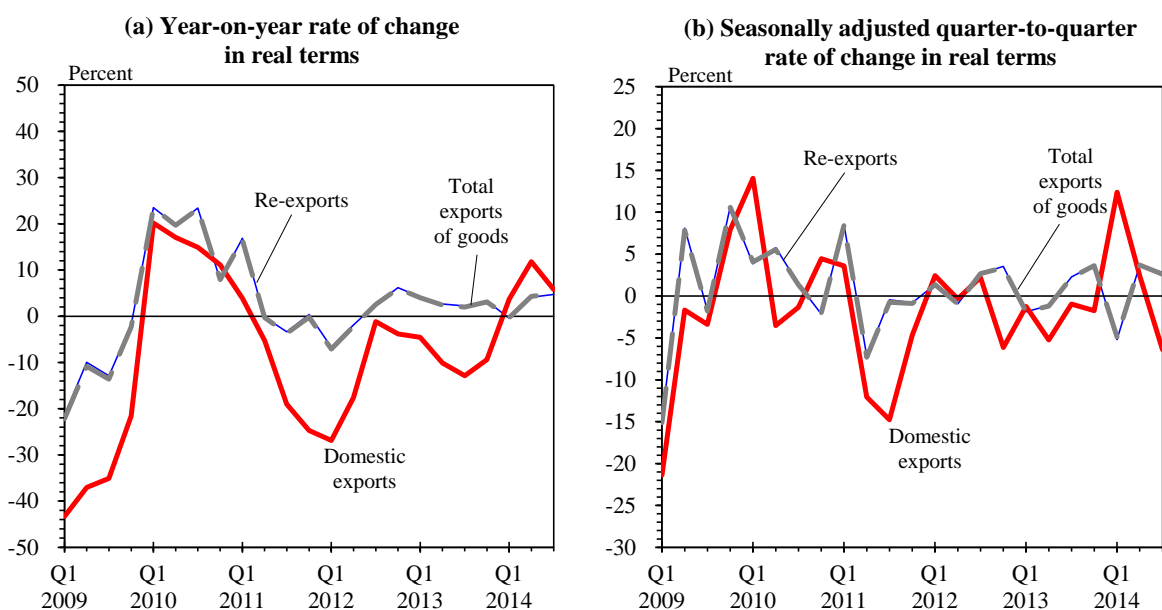


Diagram 2.3 : Asian markets continued to feature prominently in Hong Kong's exports

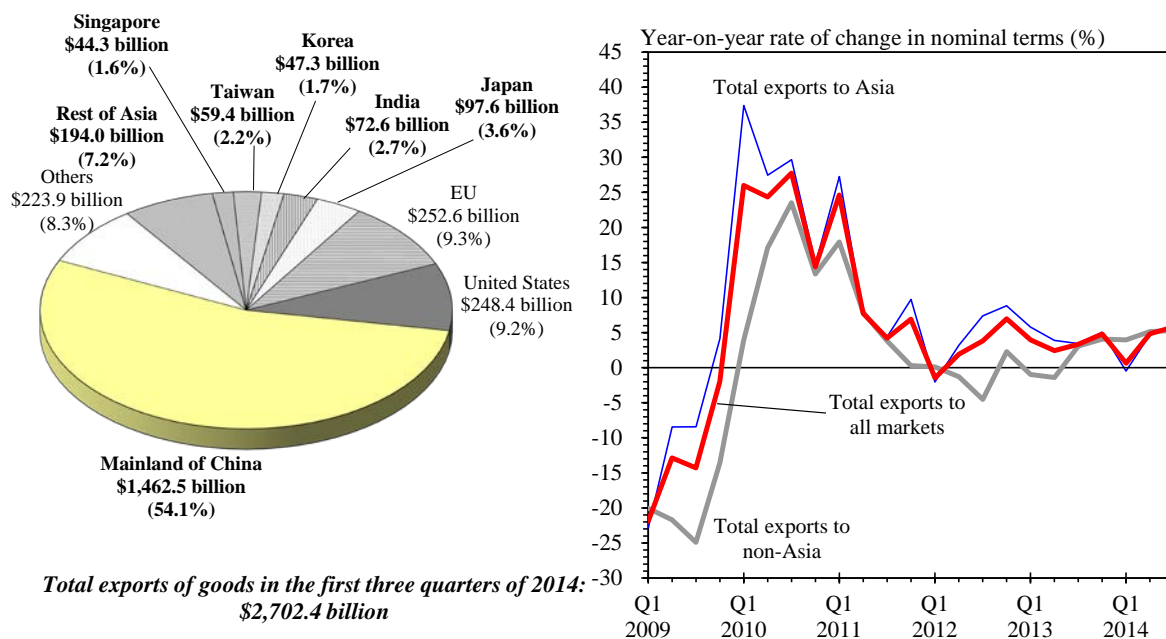


Table 2.2 : Total exports of goods by major market (year-on-year rate of change in real terms (%))

	Annual	2013				2014		
		Q1	Q2	Q3	Q4	Q1	Q2	Q3
Mainland of China	4.9	8.5	6.3	2.8	2.8	-2.9	4.5	3.6
United States	-4.3	-5.0	-8.0	-1.0	-3.6	3.9	3.1	0.4
European Union	-0.6	-5.4	-2.5	2.7	2.4	1.2	4.3	-0.4
Japan	-6.3	-4.9	-5.5	-8.3	-6.2	-2.1	-1.5	-5.1
India	7.7	0.3	8.0	6.7	16.8	7.6	17.4	37.9
Taiwan	-6.1	14.2	-12.1	-7.6	-13.9	-5.9	0.2	13.5
Korea	6.3	0.5	2.0	4.5	18.6	1.8	4.5	7.0
Singapore	2.5	5.2	0.2	-0.9	6.2	6.8	-0.6	2.9
Overall ^(*)	2.8	4.0	2.4	2.0	3.1	-0.3	4.3	4.8

Note : (*) The growth rates here are not strictly comparable with those in the GDP accounts in Table 1.1, due to differences in coverage and methodology.

2.4 Analysed by major markets, Asia was the key growth spot in the third quarter, marked by a visible pick-up in regional intake of raw materials and capital goods upon with the revival in trade and production activities following the slow start earlier this year. Merchandise exports to many Asian markets showed different degrees of improvement, with India recording particularly strong surge of 37.9%. Exports to many ASEAN economies also picked up with notable growth, possibly aided by some recovery in sentiment and inventory replenishment after the weak performance in the second quarter. Exports to the developed economies in Asia, viz. Singapore, Taiwan and Korea, also posted faster growth ranging from 2.9% to 13.5%. Over the same period, exports to the Mainland made solid growth at 3.6%, similarly under the support of somewhat improved export prospect and production activities.

2.5 In stark contrast, exports to the advanced economies remained lacklustre as a whole, though with the mixed performance amongst different markets. Specifically, the US market continued to fare better than those of EU and Japan, reflecting the more advanced stage of economic recovery in the former and the renewed slackening in the latter two. Exports to the US still had some growth, albeit at a dismal 0.4% year-on-year in real terms in the third quarter. Yet, exports to the EU turned back to a decline at 0.4%, reflecting the sluggish demand under the worsening economic conditions and geopolitical tensions in Eastern Europe. Exports to Japan slackened further with enlarged decline of 5.1%, in tandem with the fall-off in import demand and weak yen.

Diagram 2.4 : Exports to the Mainland continued to see moderate growth

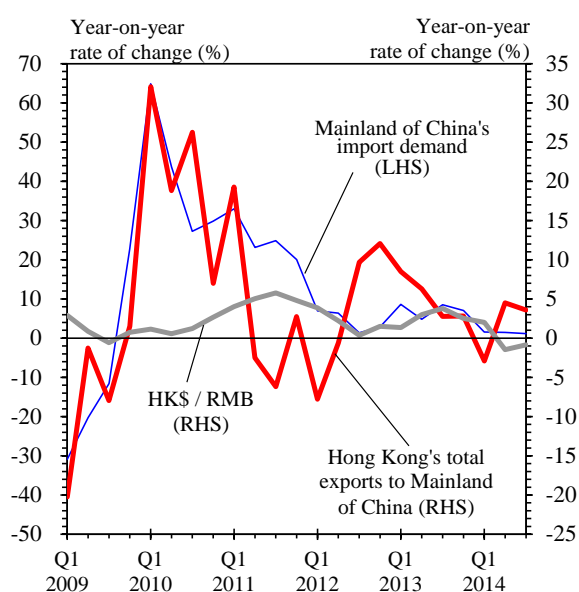
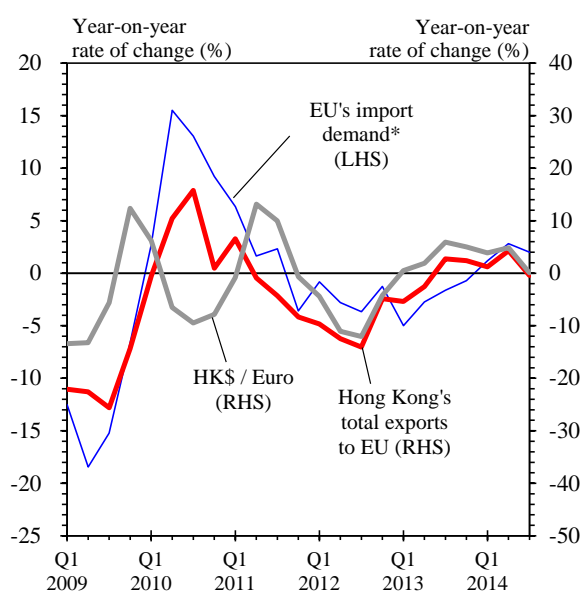


Diagram 2.5 : Exports to the EU related to a decline



Note : (*) Import demand figure for the third quarter of 2014 is based on statistics for July and August 2014.

Diagram 2.6 : Exports to the US expanded only marginally

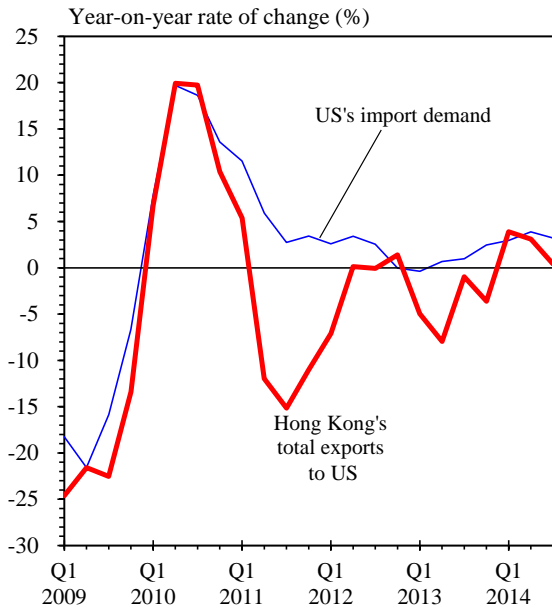


Diagram 2.7 : The decline in exports to Japan enlarged further

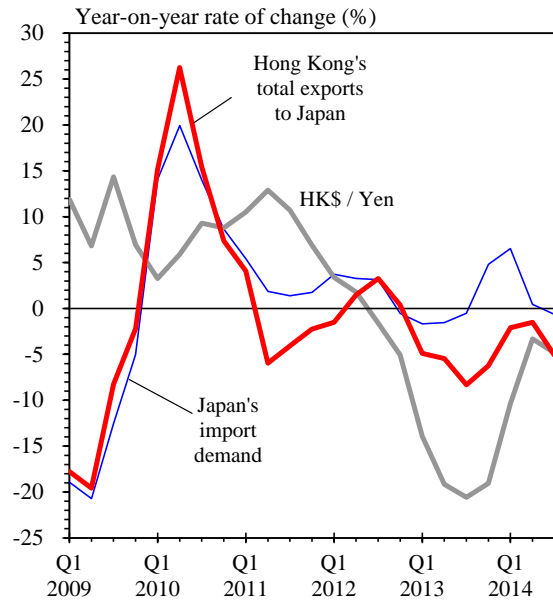


Diagram 2.8 : Exports to India continued to surge

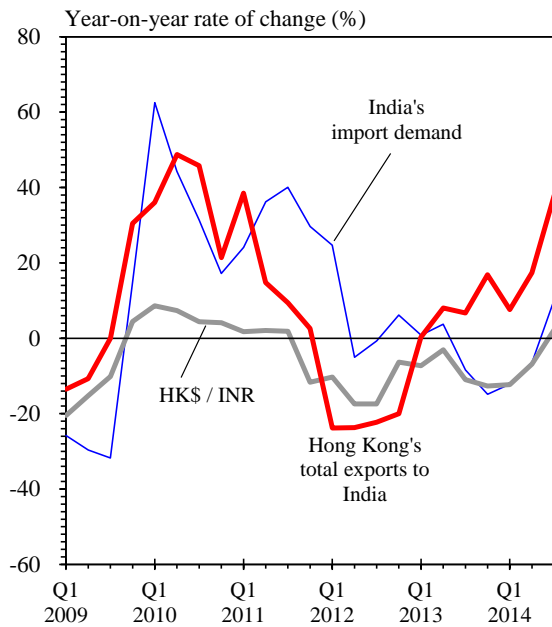


Diagram 2.9 : Exports to Taiwan accelerated visibly

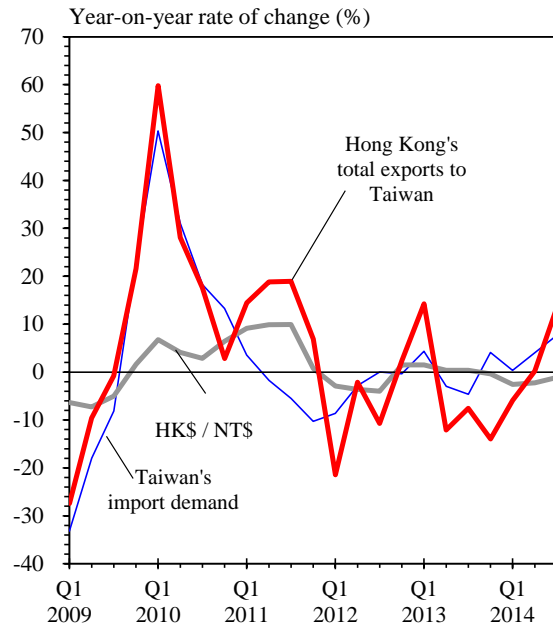


Diagram 2.10 : Exports to Korea likewise grew further

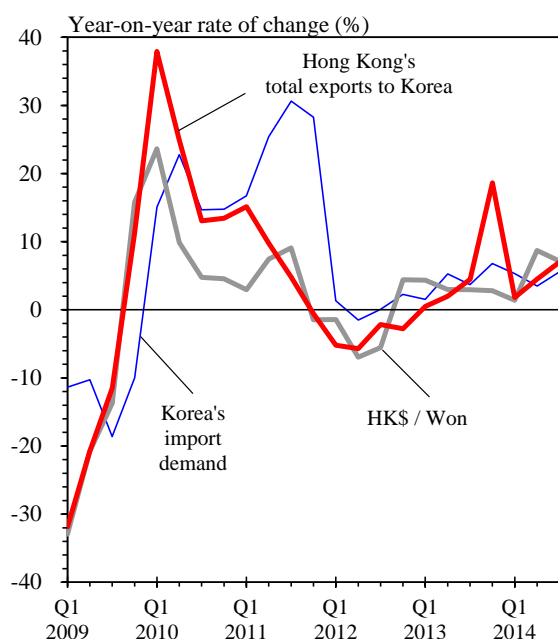
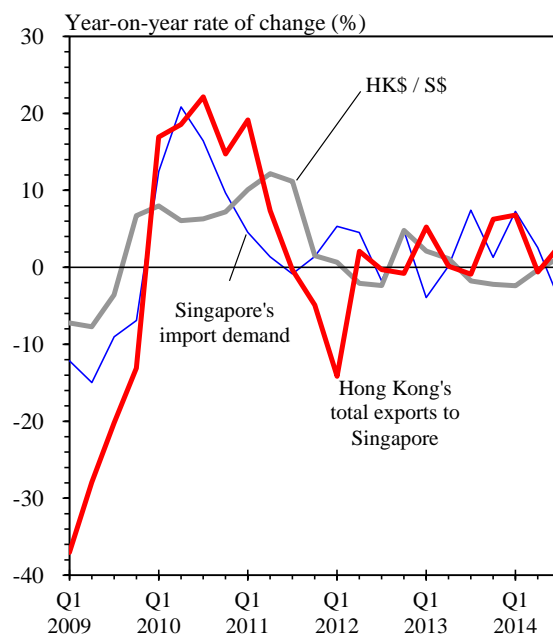


Diagram 2.11 : Exports to Singapore reverted to a moderate growth



Imports of goods

2.6 *Imports of goods* grew by 4.1% year-on-year in real terms in the third quarter of 2014, up from a 3.7% growth in the preceding quarter. Within this, *retained imports*, which accounted for over one-quarter of total imports, rose by 2.3% in real terms in the third quarter over a year earlier, following a 2.6% growth in the preceding quarter. Analysed by end-use category, retained imports of consumer goods and foodstuffs had rather notable growth, in tandem with the rather sanguine consumer sentiment during most of the third quarter, and also in line with the rebound in local consumption market over this period. Retained imports of raw materials and semi-manufactures also maintained strong growth, though partly helped by a low base of comparison last year. However, retained imports of capital goods stayed weak with a further notable decline. Those of fuels fell for the third consecutive quarter, partly due to the continued weak demand for fuel oil associated with cargo transportation.

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

		<u>Imports of goods</u>			<u>Retained imports^(a)</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>
2013	Annual	3.8	3.9	0.9	4.5	6.3	0.6
	H1	4.1	4.5	0.6	7.3	7.6	1.9
	H2	3.5	3.4	1.1	2.1	5.2	-0.6
	Q1	4.9	5.0	(-1.1)	8.1	7.1	(1.0)
	Q2	3.5	4.2	(-0.6)	6.6	8.1	(0.6)
	Q3	2.6	2.8	(1.9)	0.8	4.4	(1.0)
	Q4	4.3	4.0	(3.6)	3.4	5.9	(3.3)
2014	H1	3.3	2.4	2.1	4.7	3.6	2.7
	Q1	2.1	1.1	(-3.2)	5.8	4.8	(1.8)
	Q2	4.5	3.7	(1.6)	3.7	2.6	(-3.5)
	Q3	5.7	4.1	(2.3)	5.0	2.3	(0.9)

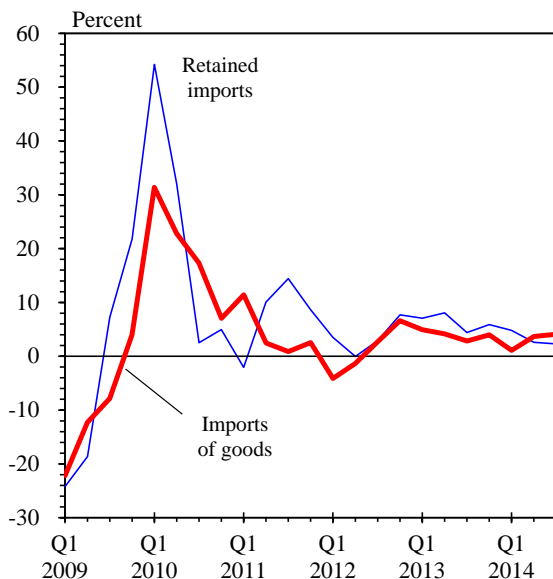
Notes : (a) Based on the results of the Annual Survey of Re-export Trade conducted by the Census and Statistics Department, re-export margins by individual end-use category are estimated and adopted for deriving the value of imports retained for use in Hong Kong.

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

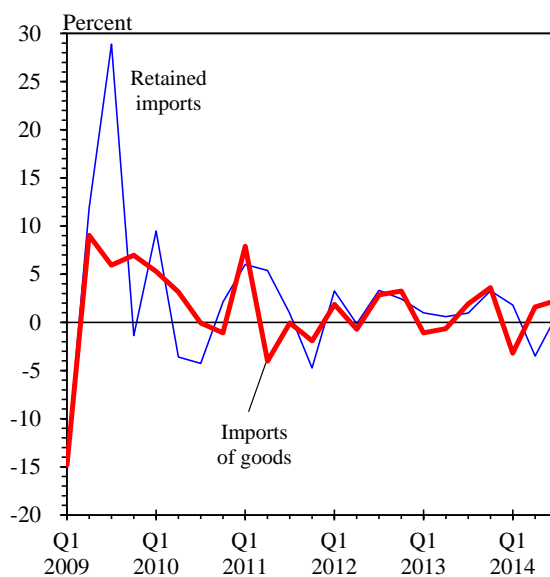
(*) Change of less than 0.05%.

Diagram 2.12 : Both imports and retained imports grew moderately

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



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



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

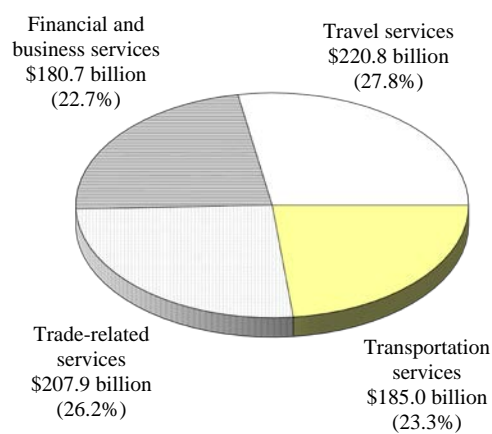
		<u>Consumer goods</u>	<u>Foodstuffs</u>	<u>Capital goods</u>	<u>Raw materials and semi-manufactures</u>	<u>Fuels</u>
2013	Annual	2.9	9.3	22.3	-3.3	0.2
	H1	2.9	6.6	18.7	5.0	0.9
	H2	2.8	11.8	25.1	-11.1	-0.4
	Q1	4.7	12.0	-3.1	12.3	7.6
	Q2	1.3	1.3	38.7	-0.8	-5.4
	Q3	9.5	12.1	16.8	-9.1	-5.9
	Q4	-3.0	11.6	32.7	-13.1	5.2
2014	H1	6.0	7.1	-4.6	8.0	-5.5
	Q1	4.0	1.9	6.1	9.7	-8.5
	Q2	7.9	12.8	-11.5	6.5	-2.3
	Q3	9.9	6.3	-16.0	11.9	-8.1

Services trade

Exports of services

2.7 *Exports of services* staged a visible rebound of 2.0% year-on-year in real terms in the third quarter of 2014, after a 2.0% contraction in the second quarter. The decline in exports of travel services narrowed markedly to a mere 0.8% after a double-digit plunge in the preceding quarter, partly reflecting the waning base effect, and partly helped by somewhat faster growth in visitor arrivals. Other exports of services also improved in general. Specifically, along with the revival in trading and production activities in Asia, exports of trade-related services picked up further to a 2.7% growth. Also, exports of financial and other business services resumed appreciable growth in the third quarter, thanks to more vibrant cross-border financial and fund raising activities. On the other hand, exports of transportation services fared less well and increased marginally over a year earlier.

Diagram 2.13 : Major service groups accounted for similar shares of Hong Kong's services exports, reflecting a diversified base



Exports of services in the first three quarters of 2014: \$794.3 billion

Diagram 2.14 : Exports of services staged a visible rebound

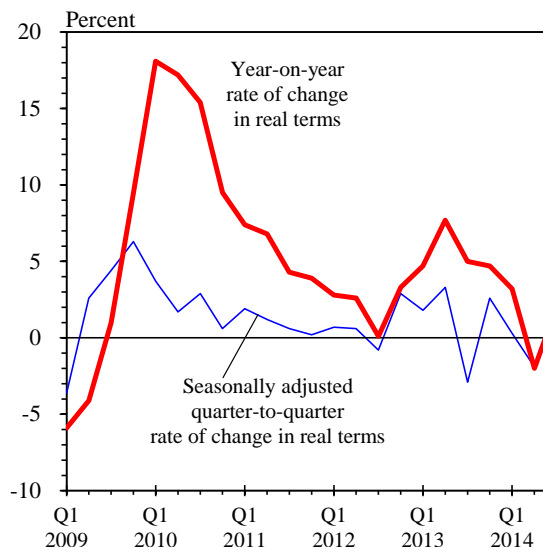


Table 2.5 : Exports of services by major service group (year-on-year rate of change in real terms (%))

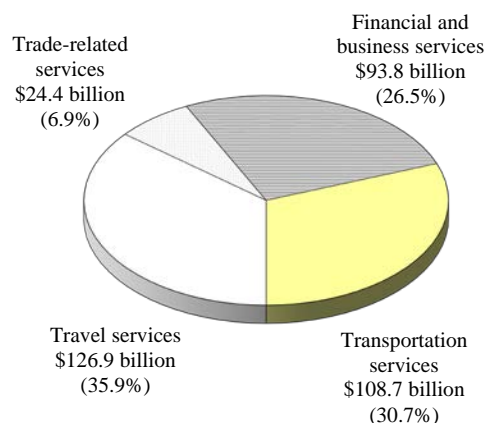
		<i>Of which :</i>				
		Exports of services	Trade-related services ^(a)	Transportation services	Travel services ^(b)	Financial and business services
2013	Annual	5.5	1.2	-1.1	18.2	3.5
	H1	6.2	2.3	-3.6	23.8	2.4
	H2	4.8	0.4	1.4	13.5	4.7
	Q1	4.7 (1.8)	2.8	-3.9	19.0	0.6
	Q2	7.7 (3.3)	1.8	-3.4	28.8	4.6
	Q3	5.0 (-2.9)	0.3	0.5	15.9	4.3
	Q4	4.7 (2.6)	0.5	2.4	11.3	5.0
	2014	H1	0.6	0.7	2.0	-0.7
	Q1	3.2 (0.3)	-0.2	1.1	9.9	0.7
	Q2	-2.0 (-1.9)	1.6	2.7	-10.7	0.8
	Q3	2.0 (1.3)	2.7	0.5	-0.8	6.4

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

Imports of services

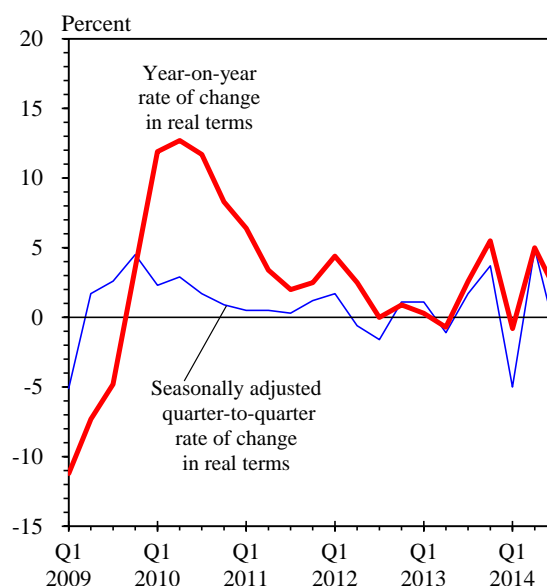
2.8 *Imports of services* grew modestly by 1.8% year-on-year in real terms in the third quarter of 2014, after a 5.0% year-on-year increase in the second quarter. The faster growth in the second quarter was boosted by the increase in outbound tourism due to the timing of the Easter holidays, which fell in mid-April this year but late March last year. In the third quarter, imports of travel services, trade-related services as well as financial and other business services all saw further moderate growth in the range of 1.7% to 3.2%, while those of transportation services were largely flat.

Diagram 2.15 : Travel services had the largest share in imports of services



Imports of services in the first three quarters of 2014:
\$353.8 billion

Diagram 2.16 : Imports of services grew modestly



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

		<i>Of which :</i>					
		<u>Imports of services</u>	<u>Travel services⁽⁺⁾</u>	<u>Transportation services</u>	<u>Trade-related services</u>	<u>Financial and business services</u>	
2013	Annual	2.0	6.3	-1.7	-1.1	1.6	
	H1	-0.2	3.5	-5.2	0.6	1.1	
	H2	4.0	9.0	1.9	-2.3	2.0	
	Q1	0.3 (1.1)	5.8	-6.0	2.3	0.2	
	Q2	-0.7 (-1.1)	1.1	-4.4	-1.2	2.2	
	Q3	2.6 (1.7)	5.5	0.4	-2.4	3.2	
	Q4	5.5 (3.7)	12.6	3.6	-2.2	1.1	
2014	H1	2.0	3.8	0.6	1.7	1.4	
	Q1	-0.8 (-5.0)	-2.8	-0.7	0.8	1.2	
	Q2	5.0 (4.9)	10.7	1.9	2.6	1.6	
	Q3	1.8 (-1.5)	3.2	0.1	1.7	1.7	

Notes : (+) Comprising mainly outbound travel spending.

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

Goods and services balance

2.9 With the services surplus more than outweighing the goods deficit, the overall balance on goods and services showed a surplus of \$37 billion in the third quarter of 2014, equivalent to 2.9% of the total value of imports of goods and services. This was largely the same as the corresponding surplus of \$36 billion or 2.9% in the same quarter of 2013.

**Table 2.7 : Goods and services 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>	
2013	Annual	3,816	1,063	4,395	467	-579	597	18	0.4
	H1	1,801	506	2,124	221	-323	285	-39	-1.7
	H2	2,015	558	2,271	246	-255	312	57	2.3
	Q1	872	256	1,024	114	-152	143	-10	-0.9
	Q2	929	249	1,100	107	-171	142	-29	-2.4
	Q3	1,000	271	1,117	118	-117	153	36	2.9
	Q4	1,015	286	1,153	127	-138	159	21	1.6
2014	H1	1,820	512	2,140	230	-320	282	-37	-1.6
	Q1	871	266	1,029	114	-158	152	-6	-0.5
	Q2	950	246	1,111	116	-162	130	-31	-2.5
	Q3	1,027	282	1,148	124	-122	158	37	2.9

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

Other developments

2.10 As always, the Government strives to foster closer trade and investment relations between Hong Kong and its economic partners. In August, Hong Kong signed a tax information exchange agreement with six Nordic jurisdictions, including Denmark, Sweden, Norway, Iceland, Greenland, and the Faroe Islands. The agreement demonstrated Hong Kong's commitment to promote tax transparency and avoid double taxation with its trading and investment partners. Moreover, Hong Kong and South Africa signed an agreement in October for the avoidance of double taxation and prevention of income tax evasion. The agreement is the 31st of its kind Hong Kong has concluded with its trading partners. It will help to bolster economic and trade connections between the two places and offer added incentives for companies in South Africa to do business and invest in Hong Kong.

2.11 The Hong Kong-Korea Mutual Recognition Arrangement (MRA) on the Authorised Economic Operators (AEOs) became operational in late August, and the recognition arrangement with the Mainland also took effect from 1 September. Local companies accredited by the Customs and Excise Department as AEOs can enjoy customs facilitation, such as reduced examination or prioritised clearance, for goods exported to the Mainland and Korea. Similarly, companies certified by the Mainland and Korea will have their exported goods cleared expeditiously in Hong Kong. The measures will enable local companies to tap into the Mainland and Korean markets and bring

more business opportunities to the import-export and logistics industries, thereby helping to sustain Hong Kong's long-term economic development.

2.12 Moreover, Hong Kong and the Mainland signed a wine customs agreement supplement in mid-September. According to the supplement, registered wine exporters can use a web-based system for the submission of advance consignment information to facilitate clearance on arrival at designated Mainland ports. The supplement can help enhance flexibility in wine trading and strengthen Hong Kong's role as a wine trading and distribution hub in Asia.

2.13 Separately, a Free Trade Agreement (FTA) between Hong Kong and Chile came into effect on 9 October. The agreement expands Hong Kong's existing FTA network from the Asia-Pacific and European regions to the Americas. It covers areas including trade in goods and services, investment, and other related areas. On the issue of trade in goods originating from Hong Kong, Chile will abolish import tariffs on about 88% of its tariff lines, and will phase out the tariffs on another 10% of tariff lines over three years. For trade in services, Hong Kong service providers will enjoy legal certainty in market access and national treatment for a range of services in the Chilean market. On the investment side, Hong Kong investors will have legal certainty on national treatment in respect of their investments in specified non-services sectors in Chile. The two sides will further negotiate a separate agreement on investment after the pact comes into effect. Obviously, traders and investors of both sides can enjoy preferential access to each other's markets.

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. In addition, non-monetary gold is recorded as a separate item in the statistics of merchandise trade and not included in the trade aggregates reported in Chapter 2, but is included in the trade aggregates under GDP in accordance to the international compilation standard.
- (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.