CHAPTER 2 : THE EXTERNAL SECTOR

Summary

- *External trade faltered again in the second quarter amid the slack in global demand. Thus far this year, world economic growth has been weaker than expected. Moreover, financial volatility continued unabated, with Greek debt woes deteriorating during the quarter. Against this backdrop, the global manufacturing cycle headed south, putting downward pressure on Asian exports, which in turn significantly curbed Hong Kong's exports to these markets.*

- *Hong Kong's merchandise exports relapsed to show a 3.0% year-on-year decline in real terms[(1)] in the second quarter of 2015, marking the worst performance since the first quarter of 2012. Weakness was evident across major markets, except for the US and some ASEAN markets, which held up further.*

- *Exports of services fared better and posted a modest year-on-year growth of 1.0% in the second quarter, supported by the surge in exports of financial and other business services upon hectic fund-raising and cross-border financial activities. However, the drag from the setback in exports of travel services continued as inbound tourism was still weak, while exports of trade-related services and transportation services remained in the doldrums alongside the subdued regional trade and cargo flows.*

- *Hong Kong's foreign direct investment inflows and outflows both ranked the second among the world economies in 2014, signifying our significant role as an international business hub. Hong Kong continues to strengthen economic collaboration with the Mainland and emerging markets. In the Third Plenary Session of the Hong Kong-Shanghai Economic and Trade Co-operation Conference in April, the two sides reached consensus on co-operation initiatives in a wide range of areas. In June, Invest Hong Kong and the Thailand Board of Investment signed a memorandum of understanding, providing a framework to enhance the close relationship between the two places in promoting both inward and outward investment.*

Goods trade

Total exports of goods

2.1 As with many Asian economies, Hong Kong's goods export performance faltered again in the second quarter of 2015, amid sluggish global demand over the period. *Merchandise exports* (comprising re-exports and domestic exports) relapsed to a decline of 3.0% in real terms in the second quarter over a year earlier, after increasing modestly by 0.7% in the first quarter. On a seasonally adjusted quarter-to-quarter basis, merchandise exports fell further by 1.3% in the second quarter, following the 0.6% decline in the first quarter, signifying the increasingly austere and complicated external landscape.

2.2 The global economy still operated in low gear. The US economy rebounded in the second quarter, but the growth pace remained moderate. The economic recovery of the eurozone still proceeded in a gradual manner, as the deep-seated structural issues remained notable. Emerging market economies continued to face downward pressures of varying extent. Brazil and Russia had both already slipped into economic contraction, while developing Asian economies, including the Mainland, also saw growth slowdown by varying extent. In July, the International Monetary Fund (IMF) revised down its global economic growth forecast for 2015 by two-tenths to 3.3%, marking the slowest annual growth in the post-global financial crisis era.

2.3 The unsteady external environment also impacted on business sentiment and hindered trade activity expansion. Apart from continued financial volatility emanated from divergent monetary policy stance among major central banks and geopolitical tensions in different parts of the world, the Greek debt situation escalated sharply towards the end of the second quarter and added further headwinds. Given the murky economic outlook, manufacturing production in advanced and emerging markets economies alike slackened across-the-board, which weighed heavily on Asian exports, with many of them suffering sharp declines in US dollar terms in the second quarter.

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

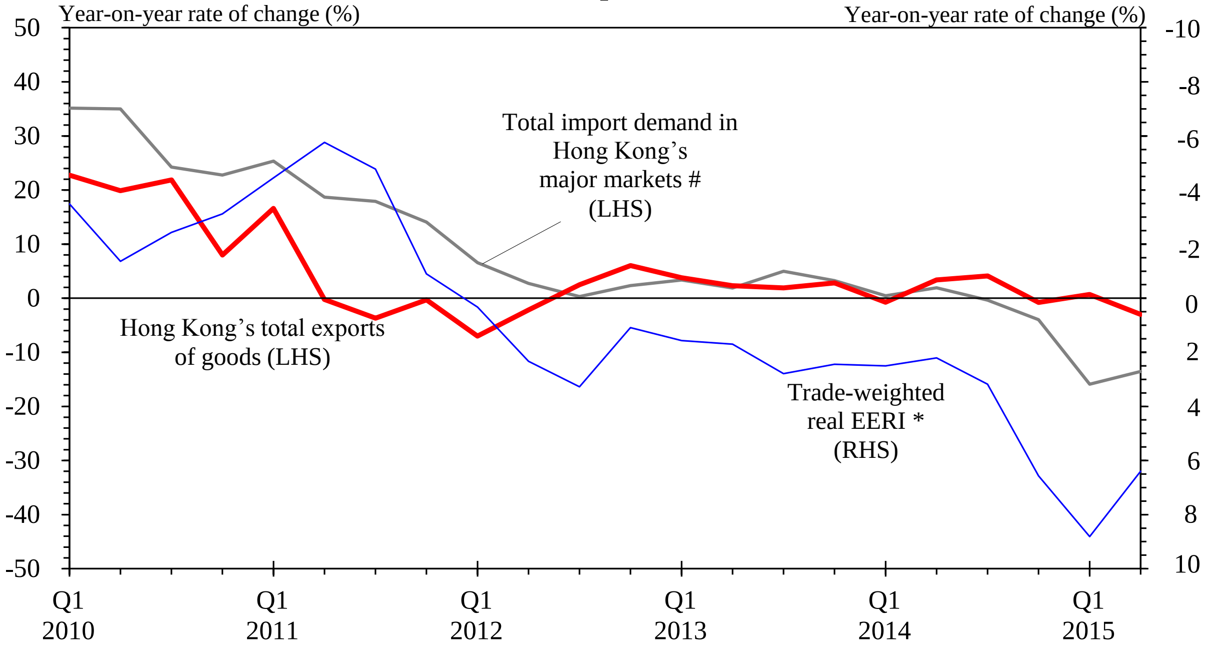
		Total exports of goods				Re-exports				Domestic exports			
		In value terms	In real terms[a]		Change in prices	In value terms	In real terms[a]		Change in prices	In value terms	In real terms[a]		Change in prices
2014	Annual	3.2	1.5		2.0	3.2	1.5		2.0	1.7	2.9		0.2
	Q1	0.7	-0.7	(-4.1)	1.7	0.7	-0.7	(-4.2)	1.7	-1.1	0.6	(4.4)	-0.5
	Q2	4.8	3.4	(3.8)	1.9	4.8	3.3	(3.8)	1.9	8.3	9.6	(3.4)	0.5
	Q3	5.8	4.1	(2.0)	2.2	5.9	4.1	(2.1)	2.2	3.1	3.4	(-4.5)	1.3
	Q4	1.2	-0.8	(-3.2)	2.2	1.3	-0.8	(-3.1)	2.3	-3.7	-2.4	(-5.8)	-0.7
2015	Q1	2.3	0.7	(-0.6)	2.0	2.5	0.8	(-0.6)	2.1	-10.1	-8.7	(-0.1)	-1.5
	Q2	-1.9	-3.0	(-1.3)	1.3	-1.7	-2.8	(-1.2)	1.4	-15.6	-13.8	(-4.2)	-2.7

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

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

2.4 *Re-exports*[(2)], the mainstay of overall merchandise exports and accounting for 98.6% of total exports by value, slackened to a 2.8% decline in real terms in the second quarter of 2015 over a year earlier, after the mild growth of 0.8% in the preceding quarter. *Domestic exports*, constituting the remaining 1.4% of total exports, fell markedly by 13.8% year-on-year in real terms in the second quarter of 2015, further to an 8.7% contraction in the first quarter.

Diagram 2.1 : Merchandise exports slackened again in the second quarter of 2015



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 second quarter of 2015 is based on statistics for April and May 2015.

Diagram 2.2 : Exports in Asian newly industrialised economies all registered notable declines in the second quarter of 2015

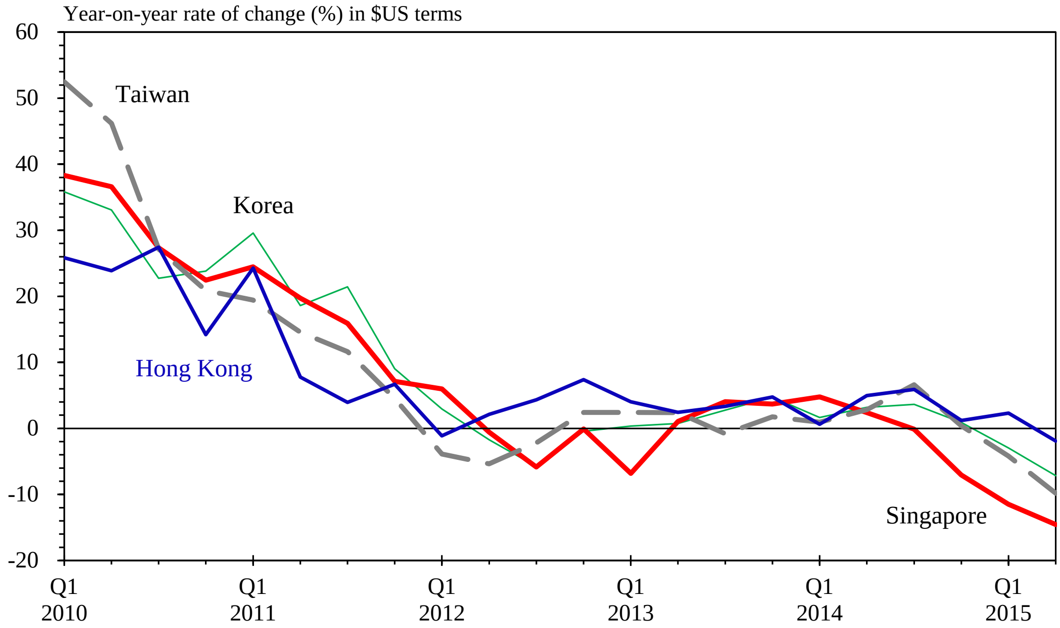
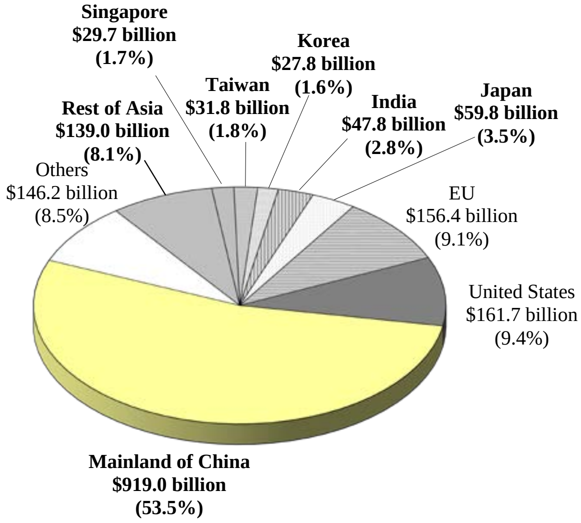


Diagram 2.3 : Exports to the Asian markets faltered in tandem with the slackening regional trade flows



Total exports of goods in the first half of 2015:
$1,719.1 billion

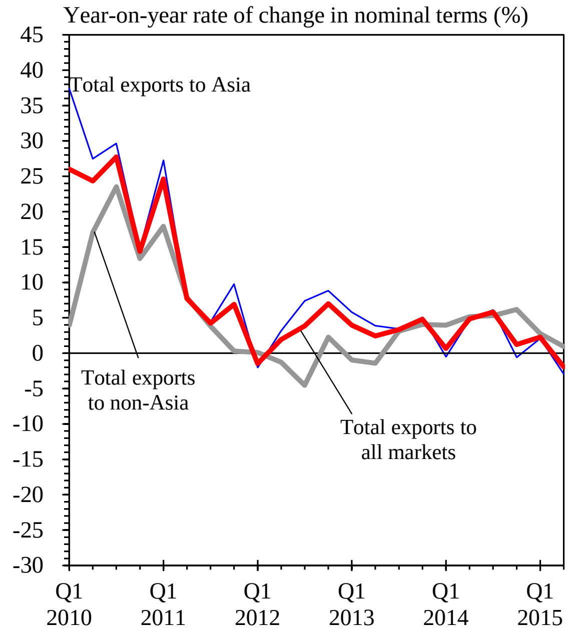


Table 2.2 : Total exports of goods by major market (year-on-year rate of change in real terms (%))

		2014				2015	
	Annual	Q1	Q2	Q3	Q4	Q1	Q2
Mainland of China	-0.7	-3.7	2.8	2.4	-4.3	-0.2	-4.4
United States	2.7	4.2	2.9	0.2	3.8	3.3	3.6
European Union	0.6	1.2	4.4	-0.3	-2.3	-3.5	-6.7
Japan	-4.5	-2.0	-1.8	-5.2	-8.4	-5.8	-4.0
India	16.0	6.8	15.3	35.6	6.1	12.4	-3.1
Taiwan	2.1	-7.9	1.2	13.6	1.7	-12.8	-20.3
Korea	-1.8	0.1	1.3	4.0	-11.5	-5.7	-13.8
Singapore	2.1	7.9	0.3	0.3	0.6	0.4	-3.7
Overall*	1.5	-0.7	3.4	4.1	-0.8	0.7	-3.0

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

2.5 On a year-on-year comparison, merchandise exports to most major markets recorded declines of different degrees in the second quarter. Exports to the EU saw an enlarged decline, as the economic recovery there was too fragile to translate into solid import demand, which in turn was further curtailed by the much weakened euro. Exports to Japan declined further, as consumer spending there had not picked up in any significant way, and the weak yen also discouraged its import demand. Among the advanced economies, the US market was a relative bright spot and held up well with a further growth, largely mirroring the recovery of the US economy and continued improvement of its labour market during the period.

2.6 Merchandise exports to the major Asian markets also registered almost across-the-board declines in the second quarter, dragged mainly by the plunge in import intake of raw materials and semi-manufactures and capital goods, conceivably being significantly curbed by the sluggish global demand and the ensuing slowdown in industrial activity. Exports to Taiwan and Korea saw distinct declines, down by 20.3% and 13.8% respectively in real terms in the second quarter over a year earlier, while exports to Singapore also faltered, down 3.7% year-on-year. In a similar vein, exports to the Mainland fell by 4.4% year-on-year. Exports to India also reverted to a decline, again led by a visible fall in raw materials and semi-manufactures trade, though a high base of comparison a year earlier was also to blame. On the other hand, some ASEAN emerging markets continued to register notable growth and rendered some cushion to Hong Kong’s total exports amid the subdued trading environment.

Diagram 2.4 : Exports to the Mainland weakened in the second quarter

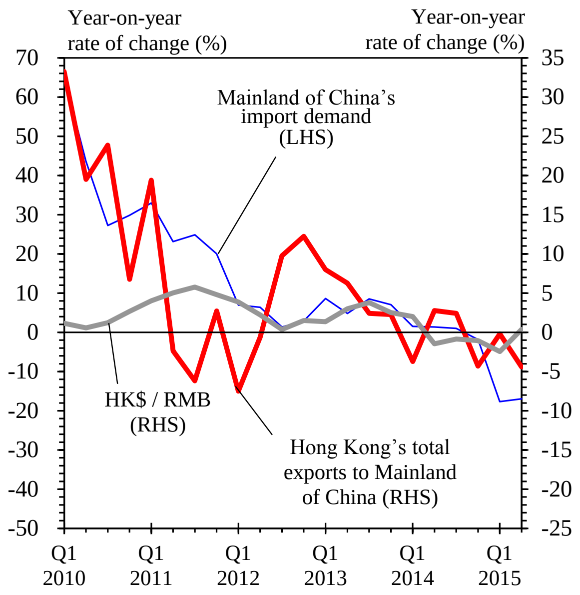


Diagram 2.5 : Exports to the EU showed an enlarged decline

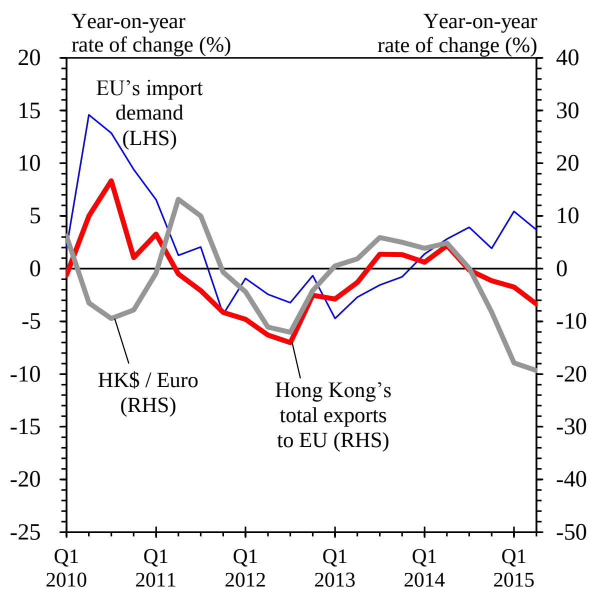


Diagram 2.6 : Exports to the US held up in the second quarter

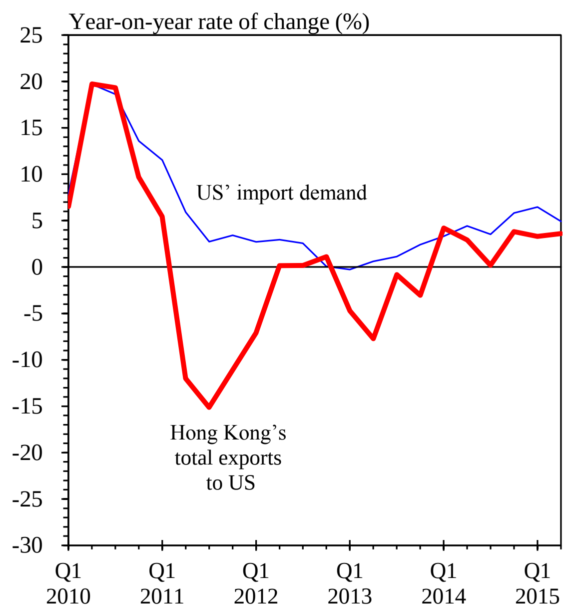


Diagram 2.7 : Exports to Japan remained weak

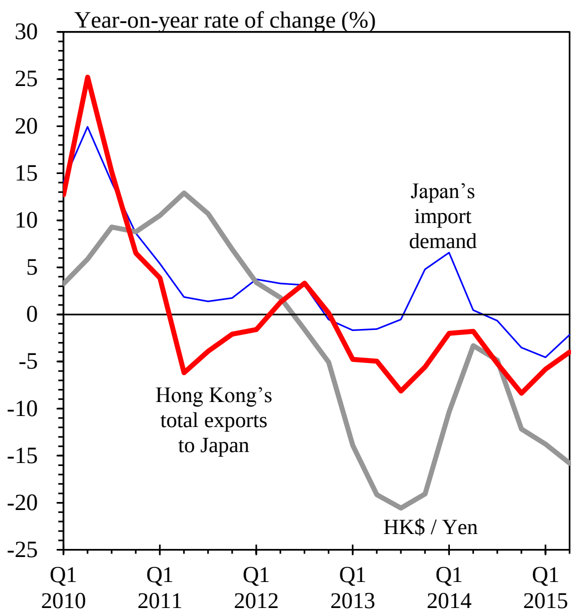


Diagram 2.8 : Exports to India slackened to a decline, partly affected by a high base of comparison

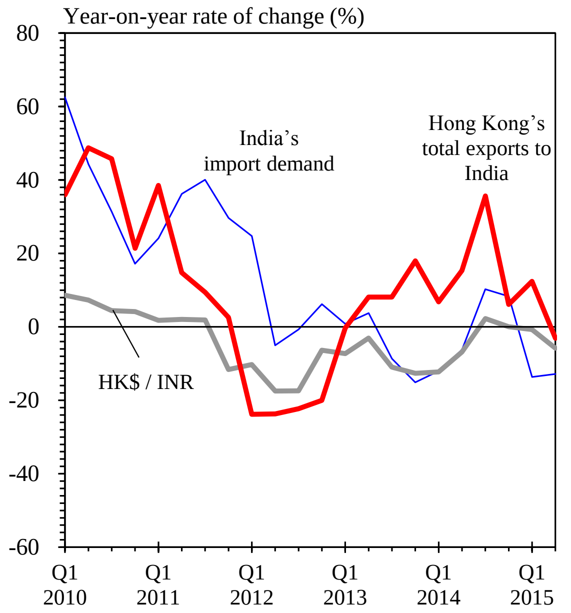


Diagram 2.9 : Exports to Taiwan went sharply lower

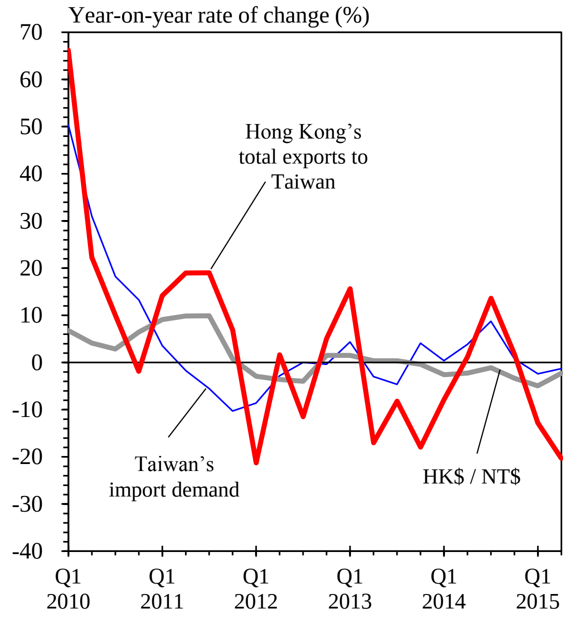


Diagram 2.10 : Exports to Korea plummeted

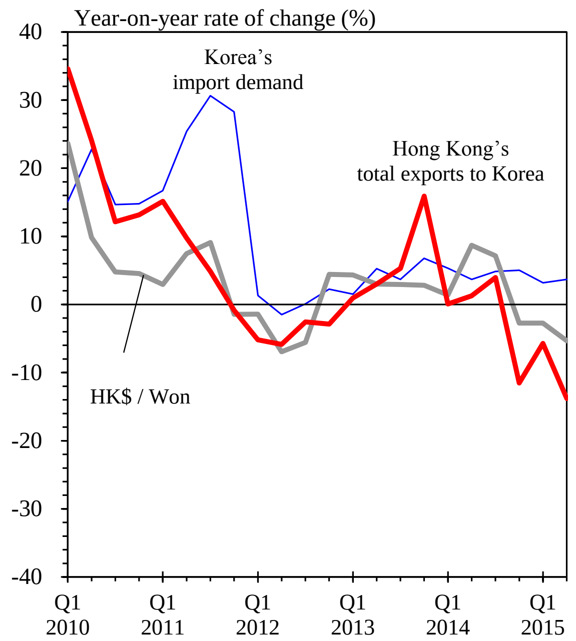
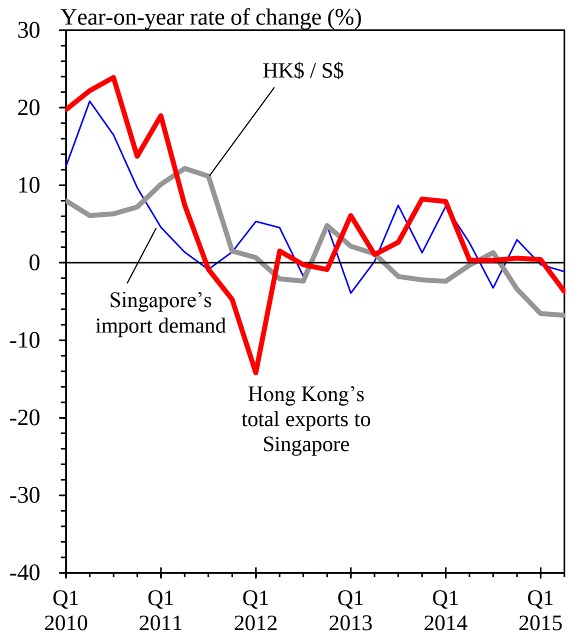


Diagram 2.11 : Exports to Singapore turned more sluggish



Box 2.1

Recent economic performance of the selected member economies in the eurozone

The eurozone came out from recession in mid-2013 and resumed modest growth. The growth momentum early this year seemed to show some pick-up, conceivably helped by better sentiment following the enlarged asset purchase programme rolled out by the European Central Bank. Nevertheless, the economic performance varied considerably among different member economies. To shed light on the recovery progress of the currency bloc from a macroeconomic perspective, this note examines and compares the latest economic situations of the four biggest member economies in the currency bloc, viz. Germany, France, Italy and Spain (referred hereafter as the Big Four)[(1)].

In 2014 when the economy of the eurozone rebounded, over half of the annual growth was contributed by Germany, while that by France and Spain combined was subtle, and Italy was still mired in recession, posing a drag on the region's growth. But the recovery was more broad-based on entering 2015, as Spain outperformed Germany to be the biggest growth driver of the region in the first quarter, and France saw a further pick-up in growth momentum. Meanwhile, Italy also reverted to some positive growth for the first time since 2011. Apart from the Big Four, nearly all other members (except Finland) registered year-on-year increases in GDP, ranging from 0.2 % to 4.9 % over the same period (***Chart 1***).

Along with the gradually recovering economy, deflationary pressures have generally receded. The inflation rate of Germany returned to positive territory in March 2015, followed by France in April. That of Italy also started to see some price increases in May, while Spain came out of an eleven-month deflation in June. Nevertheless, their inflation rates remained very low (i.e. 0.1%, 0.3%, 0.2% and 0.0% in June respectively) (***Chart 2***). It should also be noted that five of the member economies within the eurozone are still in deflation[(2)].

Chart 1 : Growth remained uneven despite recent improvements

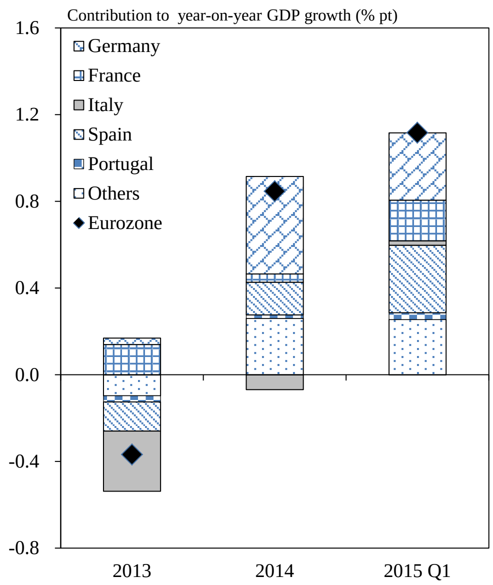
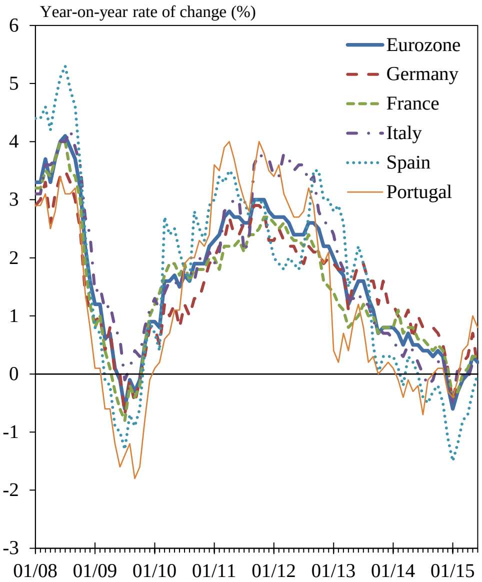


Chart 2 : Inflation rates stayed low despite easing deflationary pressures



Business sentiment has generally stayed positive, though the outlook is now clouded by the uncertainties stemming from the Greece's debt negotiations. The composite PMIs for the Big Four economies all stayed comfortably above the boom-bust line of 50, in particular for Spain which saw a more visible improvement over the period, hinting a further expansion in economic activities in the second quarter (***Chart 3***). Externally, export performance of the Big Four also reverted to some growth in euro terms, partly helped by a rather visible depreciation in euro over the period. But their growth was still rather modest and there were no distinct outperformers (***Chart 4***).

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(1) The four economies contributed to around three-fourth of total GDP of the eurozone in 2014.
(2) The five economies are Greece, Cyprus, Lithuania, Slovenia and Slovakia.

Box 2.1 (Cont'd)

Chart 3 : Business sentiment remained upbeat

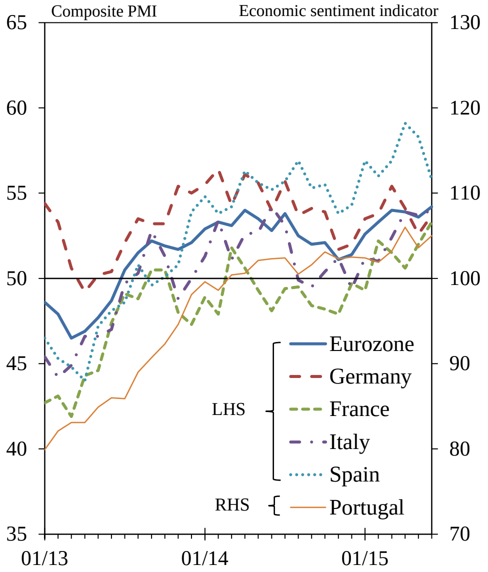
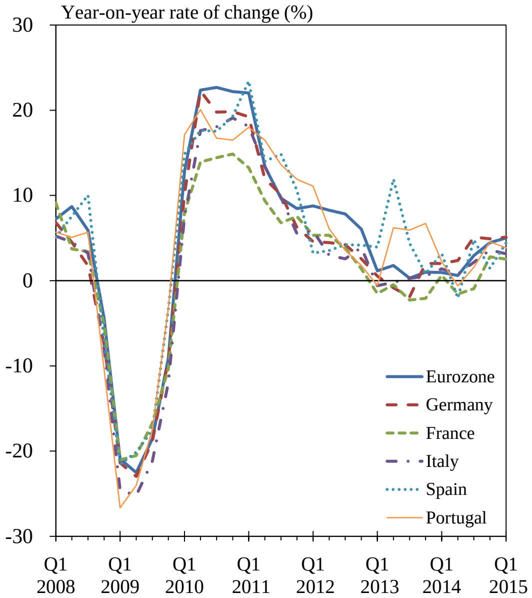


Chart 4 : Exports performance of the member economies were only mediocre



Despite the relative improvement in recent economic performance as seen above, deep-seated structural problems remain prominent. The double-digit unemployment rates in Spain (22.6%), Italy (12.5%) and France (10.2%) are still alarming, despite the visible improvements over the past year or so (***Chart 5***). The government gross debt-to-GDP ratios of these three economies were generally on an upward trend and stayed at dangerously high levels (with Italy surpassing 130% in the first quarter of 2015), which indicated their still rather fragile fiscal positions, and their limited rooms for fiscal policy manoeuvring (***Chart 6***).

Chart 5 : Unemployment rates stayed elevated except for Germany

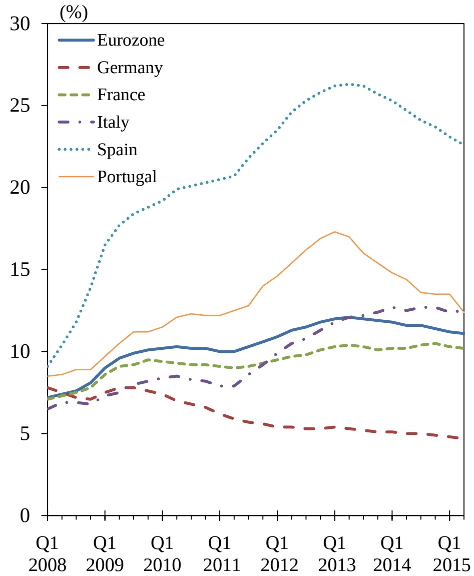
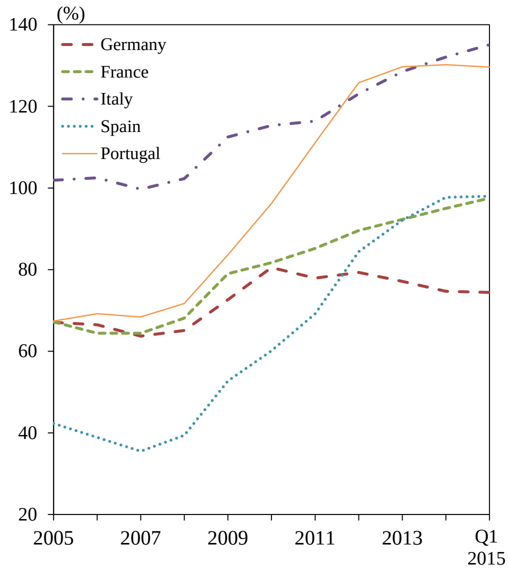


Chart 6 : High government gross debt-to-GDP levels are also worrisome



According to the latest forecast of the IMF in July, the eurozone is expected to grow by 1.5% in 2015, mainly steamed by Spain (3.1%) and Germany (1.6%), while France and Italy would show some slow growth (1.2% and 0.7% respectively). Yet, downside risks are still notable. Whilst the deal reached in mid-July mitigated the immediate threat of a Greek exit from the eurozone, whether the crisis could be fully resolved remains to be seen. The financial market volatility induced by the diverging monetary policies among major central banks, and the geopolitical tensions in Eastern Europe, could also weigh on the growth outlook for the eurozone, which would in turn further impact on our external trade performance. As such, we need to stay alert and closely monitor the developments.

Imports of goods

2.7 In the second quarter of 2015, *imports of goods* declined by 3.1% in real terms over a year earlier, following a 1.1% growth in the preceding quarter. Apart from the contraction in those imports for subsequent re-exporting, retained imports also weakened further to a decline. *Retained imports*, which accounted for over one-quarter of total imports, fell by 3.9% year-on-year in real terms in the second quarter, reverting from the 1.9% growth in the preceding quarter. Analysed by end-use category on a year-on-year comparison, retained imports of consumer goods and foodstuffs both declined in the second quarter, conceivably reflecting partly the weakness in retail and restaurant business caused by the setback in inbound tourism. In tandem with the general sluggishness in regional production activity, retained imports of raw materials and semi-manufactures dived. Retained imports of capital goods still made double-digit growth, a reflection that business investment sentiment held largely sanguine. Retained imports of fuels, after registering marked declines over the past year, grew visibly in the second quarter.

Table 2.3 : 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
2014	Annual	3.9	2.3		1.9	5.1	4.5		1.0
	Q1	2.1	0.7	(-3.1)	2.1	5.1	4.5	(-0.2)	2.5
	Q2	4.5	3.2	(2.4)	2.0	3.0	3.1	(-1.1)	1.7
	Q3	5.7	3.6	(1.8)	2.4	4.3	1.9	(1.1)	2.0
	Q4	3.2	1.7	(-0.4)	1.3	7.7	8.2	(7.1)	-1.6
2015	Q1	1.4	1.1	(-2.0)	0.9	-1.4	1.9	(-5.3)	-2.1
	Q2	-3.2	-3.1	(-2.5)	0.6	-6.9	-3.9	(-5.8)	-1.5

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 2.12 : Imports and retained imports both slackened

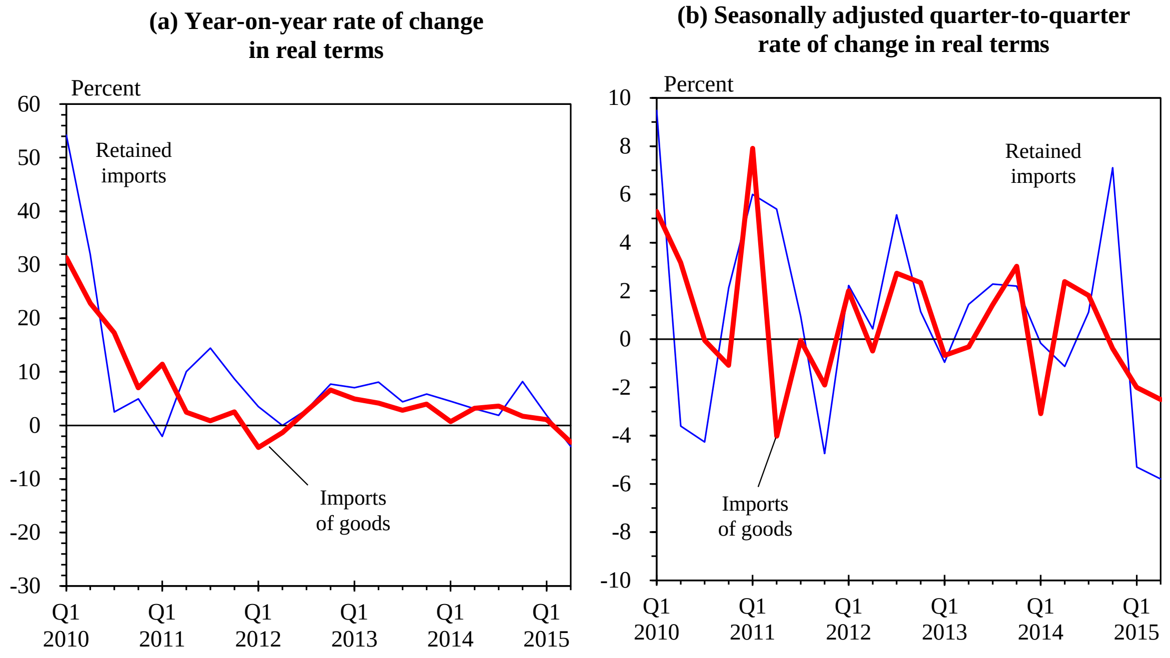


Table 2.4 : Retained imports by end-use category (year-on-year rate of change in real terms (%))

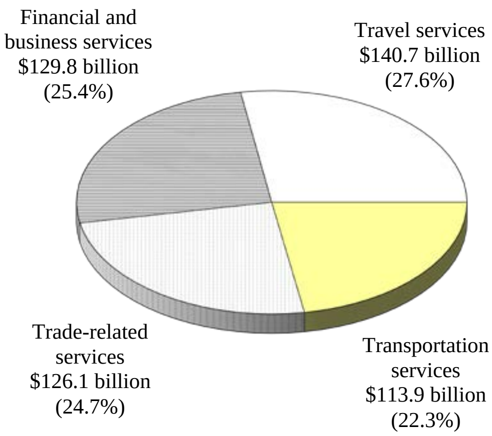
		Consumer goods	Foodstuffs	Capital goods	Raw materials and semi-manufactures	Fuels
2014	Annual	8.2	5.8	-9.9	13.9	-5.9
	Q1	1.8	2.2	-1.6	10.5	-8.8
	Q2	7.6	12.4	-13.2	7.5	-2.6
	Q3	10.9	6.3	-23.5	12.7	-6.6
	Q4	12.4	3.4	-0.4	26.4	-5.2
2015	Q1	-13.0	4.1	44.6	-12.9	22.6
	Q2	-11.2	-11.1	17.0	-14.3	19.7

Services trade

Exports of services

2.8 *Exports of services* fared better than goods exports, posting a modest growth of 1.0% in real terms in the second quarter of 2015 over a year earlier, after staying flat in the preceding quarter. The weakness in exports of travel services posed a continued drag, as visitor arrivals slowed to virtually no growth in the second quarter, while per capita visitor spending remained on a decline. Meanwhile, exports of trade-related services and transportation services also remained in the doldrums, reflecting the subdued regional trade flows under the anaemic external trading environment. Yet, thanks to the hectic fund-raising and cross-border financial activities, exports of financial and other business services grew strongly in the second quarter and more than offset the drag from other services exports weakness, allowing overall services exports to expand modestly.

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 half of 2015: $510.5 billion

Diagram 2.14 : Exports of services picked up slightly in growth in the second quarter

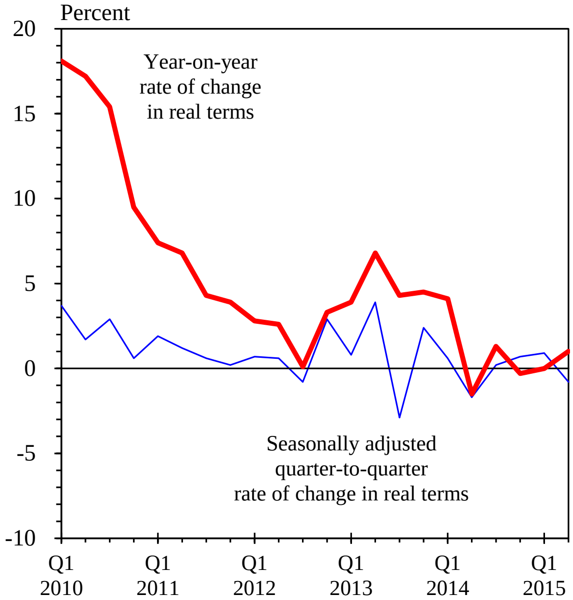


Table 2.5 : Exports of services by major service group (year-on-year rate of change in real terms (%))

		Exports of services	*Of which :* Trade-related services[a]	Transportation services	Travel services[b]	Financial and business services
2014	Annual	0.9	1.3	2.6	-1.5	1.7
	Q1	4.1 (0.6)	-0.2	1.5	11.1	2.5
	Q2	-1.5 (-1.7)	1.5	3.9	-9.6	0.5
	Q3	1.3 (0.2)	2.7	2.9	-3.8	4.2
	Q4	-0.3 (0.7)	0.8	1.9	-2.9	-0.5
2015	Q1	* (0.9)	-1.0	1.0	-4.4	5.4
	Q2	1.0 (-0.8)	-1.8	-1.8	-1.5	11.0

Notes : (a) Comprising mainly offshore trade.

(b) Comprising mainly inbound tourism receipts.

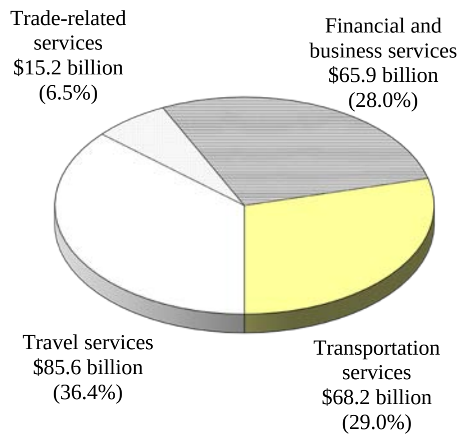
( ) Seasonally adjusted quarter-to-quarter rate of change.

(*) Within ±0.05%.

Imports of services

2.9 *Imports of services* made a solid growth of 4.3% year-on-year in real terms in the second quarter of 2015, after a 6.1% increase in the preceding quarter. Across the service categories, imports of travel services registered further notable year-on-year growth, reflecting keen interests among local residents in overseas travel, conceivably also boosted by the weakening of some major currencies against the US dollar. Imports of financial and other business services expanded moderately. Yet, imports of transportation services reverted to a decline, while imports of trade-related services grew only at a modest pace, in tandem with the subdued regional trade flows.

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



Imports of services in the first half of 2015: $235.0 billion

Diagram 2.16 : Imports of services grew solidly in the second quarter

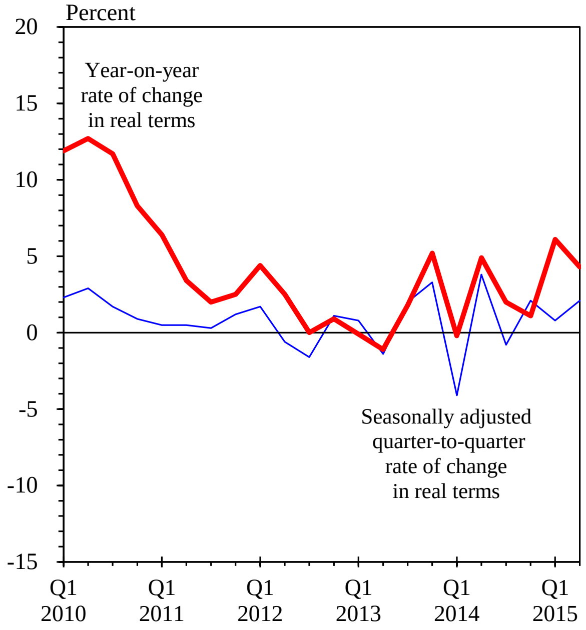


Table 2.6 : Imports of services by major service group (year-on-year rate of change in real terms (%))

		Imports of services		*Of which :* Travel services(+)	Transportation services	Trade-related services	Financial and business services
2014	Annual	1.9		3.7	0.1	1.1	1.6
	Q1	-0.2	(-4.1)	-2.7	-0.8	0.8	2.9
	Q2	4.9	(3.8)	10.5	1.8	2.5	1.7
	Q3	2.0	(-0.8)	4.0	0.4	1.7	1.4
	Q4	1.1	(2.1)	3.3	-0.9	-0.2	0.6
2015	Q1	6.1	(0.8)	12.6	0.5	1.0	5.3
	Q2	4.3	(2.1)	9.3	-2.8	1.2	6.6

Notes : (+) Comprising mainly outbound travel spending.

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

Goods and services balance

2.10 The goods deficit narrowed slightly in the second quarter of 2015 compared with the same period last year, given the fall in goods imports outpaced that of exports. Adding the services surplus, the combined goods and services account registered a deficit of $23 billion in the second quarter, equivalent to 1.9% of total import value, which was also lower than the deficit of $33 billion (2.7% of total import value) in the same period last year.

Table 2.7 : Goods and services balance
($ billion at current market prices)

		Total exports		Imports		Trade balance			
		Goods	Services	Goods	Services	Goods	Services	Combined	As % of imports
2014	Annual	3,877	1,076	4,472	481	-594	595	1	#
	Q1	870	266	1,029	115	-158	151	-7	-0.6
	Q2	949	245	1,111	115	-162	129	-33	-2.7
	Q3	1,027	279	1,148	124	-122	155	33	2.6
	Q4	1,031	287	1,183	127	-152	160	8	0.6
2015	Q1	879	266	1,028	118	-149	148	-1	-0.1
	Q2	916	245	1,067	117	-150	127	-23	-1.9

Notes : Figures may not add up exactly to the total due to rounding.
(#) Within ±0.05%.

Other developments

2.11 Hong Kong strives to enhance economic co-operation with other provinces in the Mainland amid deepening economic integration between the two places. In the Third Plenary Session of the Hong Kong-Shanghai Economic and Trade Co-operation Conference in April, the two sides reached consensus on a wide range of areas, including those in China (Shanghai) Pilot Free Trade Zone co-operation, commerce, trade and investment, finance and tourism. On the areas of commerce, trade and investment in particular, Hong Kong and Shanghai will co-operate more closely to implement the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA), deepen co-operation in service industries, and encourage Shanghai enterprises to “go global” by making use of our professional services.

2.12 At the margins of the Asia-Pacific Economic Co-operation Ministers Responsible for Trade Meeting in May, Hong Kong and Canada announced to the conclusion of the negotiation of an Investment Promotion and Protection

Agreement (IPPA). The signing of the IPPA will help enhance investment flows and further develop the economic and trade relations between the two places. In June, Hong Kong signed a Memorandum of Understanding on Co-operation in Wine-related Businesses between Hong Kong and Romania, which will facilitate co-operation in wine-related trading and investment promotion. In the same month, Invest Hong Kong and the Thailand Board of Investment signed a memorandum of understanding, providing a framework to enhance the close relationship between the two places in promoting both inward and outward investment.

2.13 According to the United Nations Conference on Trade and Development's World Investment Report 2015, Hong Kong's foreign direct investment (FDI) inflows and outflows both ranked the second among the world economies in 2014, signifying our significant role as an international business hub given the institutional strengths and favourable business environment.

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 external trade quantum index series compiled using the chain linking approach, which were first released in March 2015 to replace the previous trade index numbers compiled using the Laspeyres method with a fixed base year. Under the new approach, the series are comparable with the real trade aggregates under GDP (reported in Chapter 1) which are based on the same measures. However, 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.