

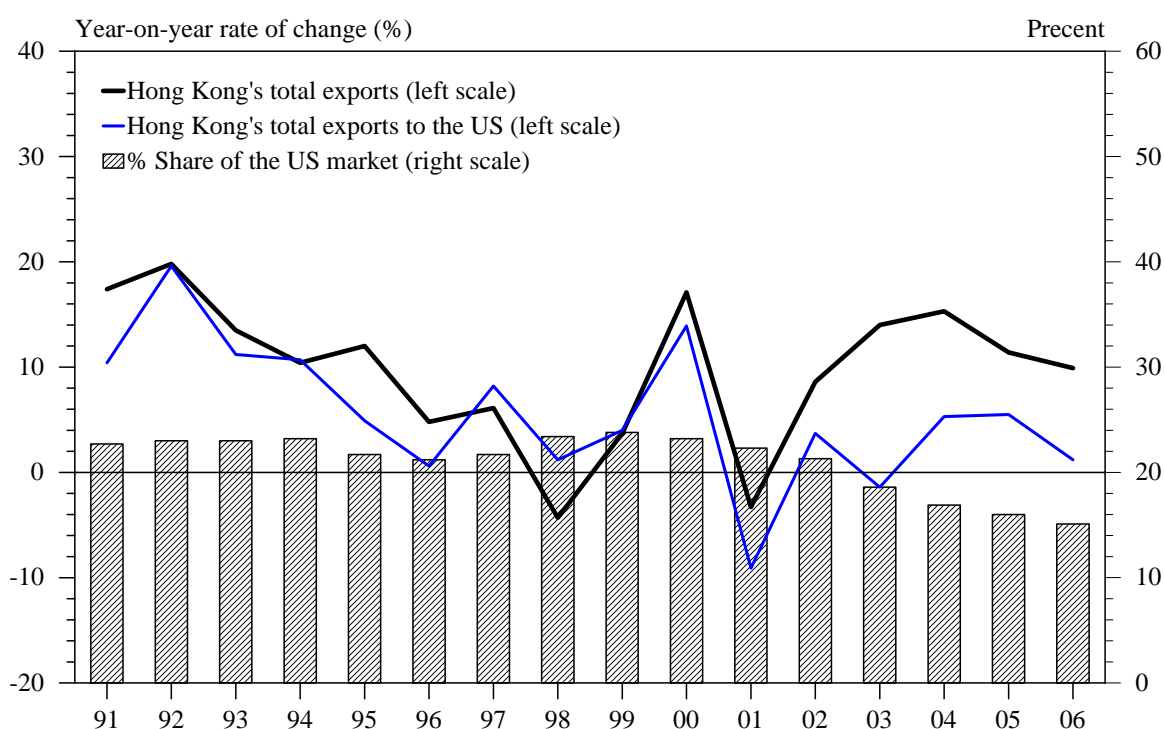
Box 3.1**How would US economic slow-down impact on Hong Kong's exports?**

The US economic slow-down is one of the uncertainties underlying global economic outlook for 2007. Being Hong Kong's second largest export market, a slowing US economy will inevitably dampen Hong Kong's export growth to this market. Nevertheless, the evolving developments in this market over time indicate that the impacts of a slowing US economy on Hong Kong on the trade front may be milder than commonly believed.

Direct impact has fallen over time

First, over the past decade or so, the US market has taken a diminishing share in Hong Kong's exports, from one-quarter in late 1980s to 15% in 2006. After the rapid growth in the early 1990s, the on-going structural shift in Hong Kong's re-exports to offshore trade amidst the expansion and improvement in port infrastructure in South China saw Hong Kong's exports to the US settle to a more modest growth since mid-1990s. The declining share of US in Hong Kong's total exports means that the direct impact of a US economic slow-down on Hong Kong's exports in itself would likely be milder now than before.

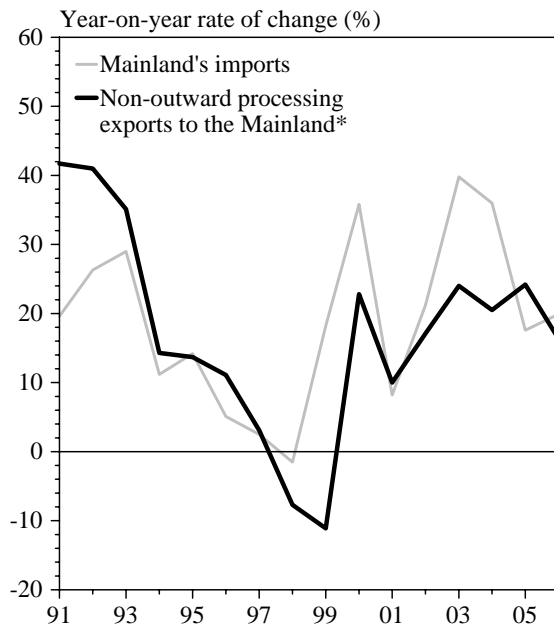
	<u>Total exports to the US in volume terms</u> (% per annum)	<u>US import demand growth</u> (% per annum)
1991-95 (5 years)	11.2	8.5
1996-2000 (5 years)	5.4	10.4
2001-06 (6 years)	0.8	5.8

Diminishing prominence of US in Hong Kong's exports

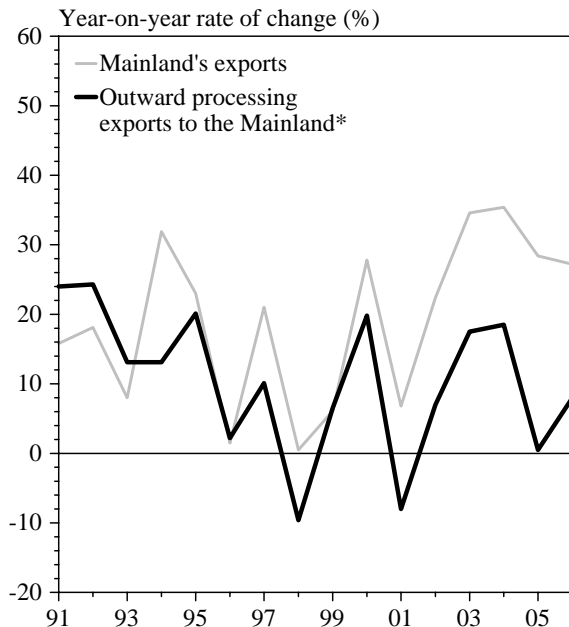
Box 3.1 (cont'd)*The Mainland market now a more important market*

Secondly, compared to US, the Mainland market is a more prominent driver of Hong Kong's export growth. They now account for nearly half of Hong Kong's exports, up from less than 30% in the early 1990s. Excluding outward processing trade, the share is still very prominent, at 30% in 2006, bigger than the combined share of US and EU taken together. The growing integration with the Mainland economy and with the latter's expansion in export capacity and speed-up in trade liberalisation following its WTO accession, coupled with the robust growth in domestic demand, saw a significant increase in Hong Kong's exports to the Mainland, by an average of 17.4% per annum between 2001 and 2006.

Total exports to the Mainland for meeting Mainland's own demand on a distinct surge, particularly after China's accession to WTO in 2001



Total exports to the Mainland for outward processing more related to the Mainland's export performance



Note: (*) Figures for Q1-Q3 2006 only.

Indirect impact through the Mainland likely to be mild

Thirdly, over the past decade, the Mainland's exports to the US demonstrated very robust performance amidst the fluctuation of the US economic cycle. The Mainland's exports to the US surged markedly by an average of 23% per annum between 1996 and 2006, with double-digit growth recorded in all years except 2001. On this, it is noteworthy that the US has become the Mainland's largest export market since 1999. So, conceivably, the distinct slow-down in US demand will also impact on Hong Kong's exports in an indirect way, through reduced exports to the Mainland for export processing. Yet by way of the competitiveness and improved quality of Mainland products, such indirect impact is unlikely to be very large. Also, the diversification of the Mainland's exports to other markets, particularly to the EU in recent years, should help to cushion the impact of a US economic slow-down if other economies can continue to hold up well. As such, the plausibility of Hong Kong's exports being pummeled by a sharp slow-down in the Mainland's exports caused by a US downturn should be rather small, granting a soft landing scenario in US.

Box 3.1 (cont'd)

Sharper-than-expected US economic downturn still a downside risk

As the Mainland economy is now a predominant factor shaping Hong Kong's export growth, and that with the strong competitiveness of the Mainland's exports which is further cushioned by the relative strengthening of other Asian currencies, it can be expected that the impact of a mild growth slow-down in the US alone on Hong Kong's exports should not be too significant. The weakness of the US dollar is also another favourable factor supporting Hong Kong's exports (for details, see **Box 2.1**). However, should the US economy show a sharper-than-expected slow-down, thereby triggering global recession, or should the growth momentum of the Mainland economy lose steam, Hong Kong's exports would likely be more significantly affected.