Box 1.1

Features of the latest revision to Hong Kong's gross domestic product (GDP) statistics

As part of Census and Statistics Department (C&SD)'s efforts to enhance the quality of GDP statistics once every several years, a technical exercise was recently completed to incorporate the latest international statistical standards in the GDP compilation system of Hong Kong[(1)]. This article highlights one of the key features of the GDP revision exercise, namely the adoption of the change of ownership principle in recording trade in goods and services related to outward processing and merchanting.

Outward processing refers to the arrangement made by a Hong Kong company to send raw materials or semi-manufactures abroad for significant transformation, with the processed goods subsequently returned to Hong Kong for local consumption or re-exporting. Merchanting refers to the purchase of goods by a Hong Kong trader from a non-resident and subsequent resale of the goods to another non-resident without the goods entering or leaving Hong Kong.

Under the old standards, the trade in goods statistics records imports and exports of goods at the time they cross Hong Kong's borders. Hence the materials sent abroad for processing are recorded as exports and the returned goods as imports, even though they are owned by Hong Kong companies all along. On the other hand, goods traded under merchanting are acquired from and then sold to others by Hong Kong traders, but are not recorded in goods trade because they do not physically pass through Hong Kong. Only the difference between the values of goods when sold and when acquired is recorded as the gross margin of merchanting under trade in services.

Under the new standards, the change of ownership principle is adopted in recording trade in goods and services in national accounts. So goods for processing are not recorded as trade in goods because they do not involve actual buying and selling (i.e. no change of ownership), but rather the processing fee is recorded as imports of services to reflect the value of the manufacturing service rendered by the processing economy. In a similar vein, for merchanting the goods acquired are recorded as imports of goods and their subsequent resale as exports of goods since a change of ownership is involved. The gross margin under the old standards would automatically be captured as the net exports of goods. For illustrative examples, please refer to the ***Annex*** in C&SD's ***Special Report*** on the GDP revision exercise.

Since the implementation of the new standards involves only a re-classification of trade components between goods and services, **the overall balance of trade in goods and services remains unchanged.** But the balance of trade in goods would generally change from deficit to surplus, due to the exclusion of trade in goods for processing and the inclusion of the net value of goods under merchanting. In 2011 and the first three quarters of 2012, however, the balance of trade in goods was in deficit under the new standards, albeit at a much smaller magnitude than under the old standards. The small trade in goods deficit in these periods under the new standards was mainly the combined impact of the sluggish

(1) For details of the GDP revision exercise, please refer to C&SD's *Special Report on Gross Domestic Product – September 2012*.

Box 1.1 (Cont'd)

demand from advanced economies for exports and buoyant demand for imports amid strong local consumption and investment as well as inbound tourism (***Chart 1***).

Similarly, the balance of trade in services would tend to change from surplus to deficit in the past years, due to the exclusion of exports of merchanting services and the inclusion of imports of manufacturing services. Yet, in 2009 – 2011, the balance of trade in services saw a surplus each year, as exports of travel and financial services registered significant growth in those years (***Chart 2***). Trade in services continued to record a surplus in the first three quarters of 2012, thanks mainly to the sustained strength of inbound tourism.

Chart 1 : Balance of trade in goods under the old and new standards

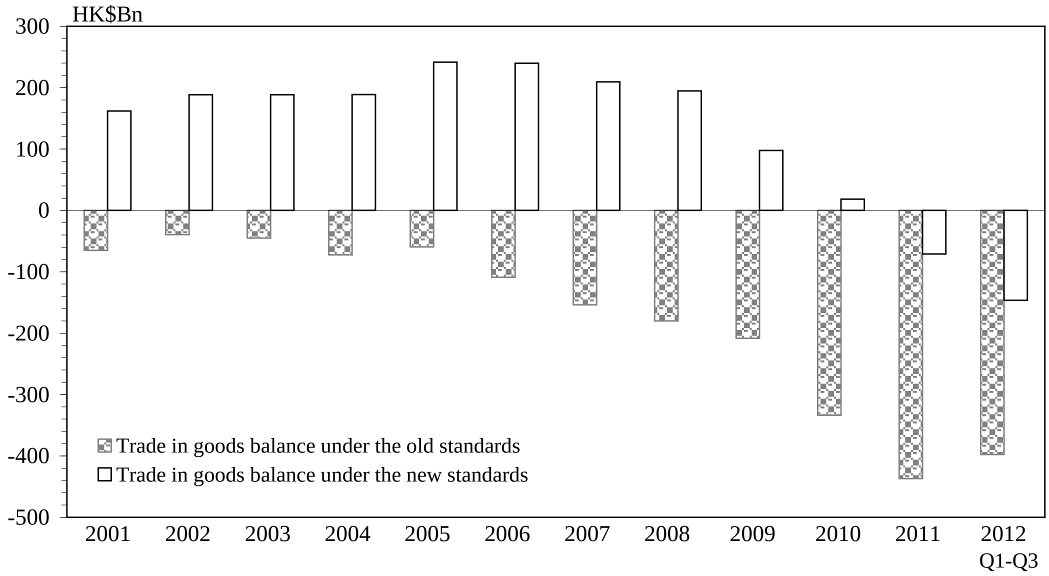
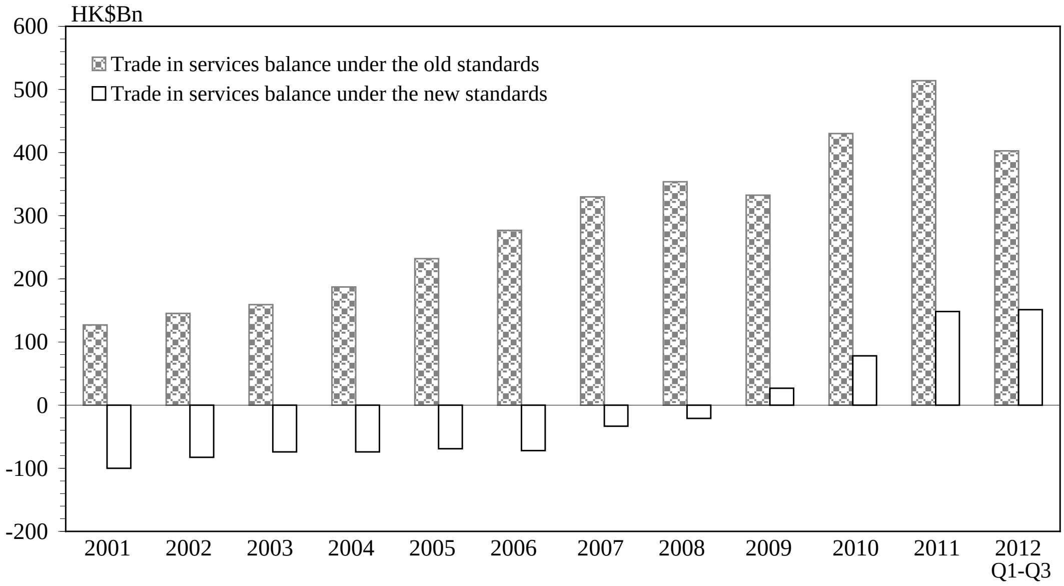


Chart 2 : Balance of trade in services under the old and new standards



Box 1.1 (Cont'd)

The new standards can better reflect the latest trend in globalisation and the genuine trade flows irrespective of the goods' physical movements and locations. This is particularly relevant since outward processing and merchanting activities feature prominently in Hong Kong's trade structure with our traders' extensive trading network of buyers and sellers in the global market. To give a rough idea, in 2011 32% of Hong Kong's total exports to the Mainland were related to outward processing, and the total value of goods sold through merchanting amounted to $3.5 trillion, more than the value of total exports at $3.4 trillion.

The new standards will facilitate macroeconomic analysis in the context of GDP and balance of payments (BoP) frameworks, and complement the conventional monthly external merchandise trade statistics compiled from import/export declarations with detailed breakdown by commodity and trading partner. The new standards were adopted in the BoP statistics starting from September 2012, while for the GDP statistics they are presented in supplementary tables in parallel with the old standards, so as to provide a transition period to allow users more time to adapt to the new trade in goods and services statistics in the GDP framework.

Apart from the adoption of the change of ownership principle in recording goods sent abroad for processing and merchanting, other key revisions to GDP statistics include: (i) capitalisation of research and development (R&D) expenditure to better reflect R&D as an economic asset that provides impetus to economic growth and development, (ii) enhanced estimates of expenditure on life insurance services using the reference rate method, and (iii) recording employee stock options as compensation of employees. As a result of these changes, the level of GDP at current prices is revised upwards by around 2% in recent years, but the revisions to the rates of change in real terms mostly fall within ±0.3 of a percentage point as the revision to the absolute level of GDP is broadly similar from year to year (***Table 1***).

Table 1 : Comparison of GDP real growth rates before and after revision

	Nominal GDP				GDP year-on-year real growth rate		
	Before revision (a)	After revision (b)	Difference (b)-(a)	Revision as % of (a)	Before revision	After revision	Revision
	($Bn)	($Bn)	($Bn)	(%)	(%)	(%)	(% point)
2007	1,615.6	1,650.8	+35.2	+2.2	6.4	6.5	+0.1
2008	1,677.0	1,707.5	+30.5	+1.8	2.3	2.1	-0.2
2009	1,622.5	1,659.2	+36.7	+2.3	-2.6	-2.5	+0.1
2010	1,741.6	1,777.7	+36.2	+2.1	7.1	6.8	-0.3
2011	1,896.7	1,935.2	+38.5	+2.0	5.0	4.9	-0.1
2012							
Q1	470.5	482.8	+12.3	+2.6	0.7	0.7	-
Q2	463.7	473.2 / 474.7	+9.5 / +11.0	+2.0 / +2.4	1.1	1.2	+0.1