

Box 1.3**Twenty years after returning to the Motherland : a review**

Since returning to the Motherland, Hong Kong has gone through many significant challenges over the past two decades, including the Asian Financial Crisis, the bursting of the IT bubble, the outbreak of SARS, and the Global Financial Crisis. Each time, the economy was able to recover swiftly and move from strength to strength, making progress in economic development and embodying the successful implementation of “one country, two systems”.

Notable economic growth over the past two decades

Hong Kong economy has grown remarkably since China resumed the exercise of sovereignty over Hong Kong. The size of the economy in 2016 was 1.8 times that of 1997. Real GDP growth averaged 3.2% per annum during the period, exceeding that of advanced economies at 2.0% per annum. Per capita nominal GDP reached US\$43,700 in 2016, surpassing many advanced economies⁽¹⁾.

Sound fundamentals; highly internationalised city

Hong Kong’s friendly business environment is well recognised worldwide. The number of overseas and Mainland companies which chose to locate their regional headquarters or regional offices here increased sizably, up from some 2 500 in 1997 to over 3 700 in 2016. The total position of direct investment liabilities in Hong Kong surged from \$1,914 billion in 1998⁽²⁾ to \$13,845 billion in 2016, or 556% of GDP in 2016, underscoring Hong Kong’s important role as an international business hub.

Hong Kong’s economic development has been underpinned by strong competitive advantages. Its simple and low tax system, free and open trade, rule of law, level playing field, robust regulatory regimes, and fully convertible currency altogether provide an attractive economic environment. In addition, the world-class financial system, superb transport and communications infrastructure, and efficient government are also essential elements of Hong Kong’s success. These competitive strengths have won us successive international accolades from prestigious research institutions worldwide (**Table 1**).

Table 1: Hong Kong ranks among the top in the global league

Economic Freedom	
Heritage Foundation	1st for 23 consecutive years
Fraser Institute	1st every year since the report first came out in 1996
Ease of Doing Business	
The World Bank	4th in 2017; persistently top five in the past ten years
Competitiveness	
International Institute for Management Development	1st in 2016 and 2017; top three in nine out of the past ten years

Hong Kong’s economic fundamentals have also gone from strength to strength, empowering the economy to weather global challenges. Hong Kong’s current account stayed in healthy surplus, averaging 2.6% of GDP in the past five years. Public finance has been sound, with successive years of fiscal surpluses since the fiscal year 2004/05 yielding a huge fiscal reserve of \$953.7 billion, equivalent to 25 months of government expenditure. In terms of international investment position, Hong Kong has all along been a net creditor, with net external financial assets reaching 368% of GDP in 2016. Official foreign currency reserve assets increased from US\$92.8 billion at end-December 1997 to US\$408.0 billion at end-June

(1) According to the IMF’s World Economic Outlook Database in April 2017, the per capita GDPs of Germany, the UK and Japan were US\$41,900, US\$40,100 and US\$38,900 respectively in 2016.

(2) Earliest figure available at 1998.

Box 1.3 (Cont'd)

2017 and are now the seventh largest in the world. The banking sector maintained a strong capital position, sound asset quality and favourable liquidity conditions⁽³⁾. Strong economic fundamentals provided a buffer against external shocks, which helped Hong Kong going through the global financial turmoil. The hard-won reputation as an international financial centre has been firmly built.

Visible gains in jobs, labour income and productivity

Sustained economic growth has brought about continued job creation. Between 1997 and 2016, total employment increased by 624 000 to a record annual high of 3.79 million. Indeed, the labour market held in a state of full employment in recent years, with the unemployment rate hovering at 3.1% – 3.5% since the second half of 2011⁽⁴⁾, lending strength to our private consumption.

The vibrant labour market also gave rise to some visible improvement in labour income. Between 1997 and 2016, average employment earnings of full-time employees (excluding foreign domestic workers) increased by 36.1% in real terms. With the implementation of Statutory Minimum Wage in 2011 and solid labour demand, the lower-paid full-time workers enjoyed a comparatively more notable increase in earnings in recent years, with average employment earnings in the lowest income decile group (excluding foreign domestic workers) up 14.4% in real terms between 2010 and 2016, higher than the overall average of 9.0%.

The increases in labour earnings were supported by remarkable labour productivity growth that averaged 2.2% per annum since 1997, which in turn drove economic growth. Important industries, such as import and export trade, financing and insurance, and wholesale and retail trades, saw spectacular growth in labour productivity⁽⁵⁾. Furthermore, quality talents are vital in driving productivity growth. The share of labour force with tertiary education almost doubled to 38.9% in 2016 as compared to that in 1997. The increasing supply of higher-skilled workers has enabled the economy to climb up the value chain amidst keen global competition.

Closer economic ties to the Mainland

The Mainland's continued economic reforms and opening-up have provided considerable opportunities to Hong Kong. Through realising these opportunities, the economic ties between the two places get ever closer. With a flexible economy, Hong Kong also adapted to the Mainland's economic transformation and played different significant roles in the past two decades. For the trading sector, China's accession to the World Trade Organization (WTO) in 2001 rendered abundant opportunities. Merchandise trade with the Mainland in 2016 was over three times that in 1997. Indeed, in 2016, close to 90% of re-exports routed through Hong Kong involved the Mainland either as a source or as a destination. The continued economic transformation in the Mainland has not only propelled it to become the world's second largest economy, but also created tremendous opportunities for a wide range of services activities in and outside the Mainland. The implementation of the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) in 2003 and its supplements thereafter opened up huge markets, further deepening economic integration between the two places. Under CEPA, the Mainland offers preferential access opportunities for Hong Kong's

(3) According to statistics compiled by the Hong Kong Monetary Authority, the consolidated capital adequacy ratio of locally incorporated authorized institutions was 19.2% at end-2016, well above the international minimum requirement of 8%. Retail banks' classified loan ratio was 0.72% at end-2016, well below the long-run historical average of 2.4% since 2000. The average liquidity coverage ratio of category 1 institutions was 156.3% in the fourth quarter of 2016, well above the 70% statutory minimum requirement applicable for 2016.

(4) The seasonally adjusted unemployment rate was 3.1% in the second quarter of 2017.

(5) Based on sectoral figures which can be dated back to 2000 the earliest, the import and export trade, financing and insurance, and wholesale and retail trades sectors saw spectacular growth in labour productivity at average rates of 5.7%, 4.6% and 4.0% per annum respectively between 2000 and 2016.

Box 1.3 (Cont'd)

products and services, ahead of and beyond its commitments to WTO members. Nowadays, Hong Kong has become an important service hub linking the Mainland and the rest of the world, catalysing the nation's rebalancing of growth towards services and consumption, and benefitting from the process.

China's global financial centre

As an international financial centre, Hong Kong has a long history serving the financial services needs of Mainland enterprises. It has been an important gateway for investment between the Mainland and the rest of the world. Due to its status as a leading equity fund raiser, the number of Mainland enterprises listed in Hong Kong surged from 101 in 1997 to 1 002 in 2016, accounting for over 60% of stock market capitalisation in 2016. Hong Kong has long been the top external direct investor in the Mainland, with Hong Kong's stock of outward direct investment in the Mainland amounting to \$4,702 billion in 2015. In more recent years, Hong Kong serves as an ideal platform for Mainland entities as they "go global". The stock of inward direct investment from the Mainland to Hong Kong amounted to \$3,270 billion in 2015, 16 times that in 1998.

Hong Kong's financial industry also plays an important role as a testing ground for the Mainland's financial market liberalisation and the opening of its capital account. Notable examples in recent years were the Shanghai- and Shenzhen- Hong Kong Stock Connect, the mutual recognition of funds arrangement with the Mainland and the Bond Connect. With continued support from the Central Government, Hong Kong has become the primary offshore RMB business hub, possessing the world's largest pool of offshore RMB funds that engage in a wide and expanding range of businesses. Buttressed by the Mainland's support and its own competitive strengths, Hong Kong's financial services sector has prospered, causing its contribution to the overall economy to leap by 7 percentage points from 1997 to 17.6% of GDP in 2015.

Economic collaboration with other places

As a cosmopolitan city, Hong Kong has been making good progress in advancing cooperation with other economic partners in trade and investment over the past two decades. Apart from CEPA, Hong Kong has signed free trade agreements with other trading partners, including New Zealand, the Member States of the European Free Trade Association and Chile. For years, Hong Kong has also invested heavily in infrastructure to boost connectivity with other parts of the world so as to facilitate people and cargo flows. In 2016, Hong Kong International Airport was the world's busiest cargo gateway and third busiest international passenger airport. The construction of a third runway commenced in August 2016. When completed, Hong Kong's capacity in handling air passengers and cargo flows would be further enhanced.

Tremendous opportunities ahead

The Government will continue to strengthen Hong Kong's role as the principal gateway between the Mainland and the world, being an international financial, transportation and trade centre. Hong Kong will leverage its unique positioning as set out in the Dedicated Chapter on Hong Kong and Macao of the Outline of the National 13th Five-Year Plan. In particular, the development of Guangdong-Hong Kong-Macao Bay Area and the Belt and Road Initiative will certainly provide vast opportunities for Hong Kong in the years to come. The facilitation of factors of production flows in the Bay Area will enhance the complementarity between places in the region and unleash growth potential, while the Belt and Road Initiative will boost demand for high value-added services in Hong Kong as a platform in financing, trading and logistics, and professional services, to name just a few. All in all, given Asia's increasing importance in the world economy amid notable economic growth in the Mainland, Hong Kong's long-term economic outlook is essentially bright. The Government will continue to facilitate economic development, striving for sustainability and thereby creating the necessary resources to improve people's livelihood.