

CHAPTER 3 : THE EXTERNAL SECTOR

Summary

- *Merchandise exports grew notably further in 2007, although the growth pace moderated somewhat in the second half of the year. The robustness of the Mainland market and the strength of most EU and Asian markets more than offset the impact arising from the lacklustre performance of the US and Japanese markets. The enhanced external price competitiveness brought about by the weakness in the US dollar also helped.*
- *With total exports to the Mainland market continuing to grow sturdily on the back of its strong domestic demand and trade flows, the share of the Mainland market in Hong Kong's total exports increased further to 49% in 2007. Also, the sustained growth momentum of the Asian region also lent support to intra-regional trade during the year. This helped mitigate the dampening effects arising from a slowing US economy and the heightened uncertainty brought about by the global financial market turbulence.*
- *Exports of services were robust throughout 2007, showing double-digit growth over the course of the year. Exports of trade-related services continued to grow sharply upon the vibrant trade flows in the Mainland. The financial market boom during the year led to continued surge in exports of financial services. Exports of travel services also grew markedly, benefiting from the strong performance of inbound tourism.*
- *During 2007, various policy measures were implemented to strengthen Hong Kong's external competitiveness. The Closer Economic Partnership Arrangement (CEPA) and its four supplements will enhance mutual economic co-operation between Hong Kong and the Mainland, and provide impetus for the growth of Hong Kong's service industries. With the implementation of the Supplement IV to CEPA in January 2008, the number of service areas enjoying the liberalised measures has increased to 38. The 2007-08 Policy Address announced ten major infrastructure projects for promoting economic development, among which the four cross-boundary infrastructure projects will enhance the flow of people and goods between the Mainland and Hong Kong. This will strengthen further the role of Hong Kong as an international business, trading and logistics centre.*

Visible trade

Total exports of goods

3.1 Merchandise exports sustained another year of notable growth in 2007. *Total exports of goods* (comprising re-exports and domestic exports) grew by 8.3% in real terms⁽¹⁾ in 2007, after a strong increase of 10.2% in 2006. The global economy remained robust during most part of 2007, but the weakness of the US economy turned more evident in the latter part of the year, being dragged by its protracted housing market downturn and sub-prime mortgage problems, and the financial market turmoil also weakened consumer confidence in the advanced economies. Reflecting this, the growth of total exports slowed modestly to 7.2% year-on-year in the second half of 2007, from an average of 9.6% in the first half. The Mainland's vibrant trade flows remained the key driving force for Hong Kong's exports. The general weakness of the US dollar, sustained steady expansion of the European Union (EU) and strong performance of many other Asian markets also rendered support to the export growth.

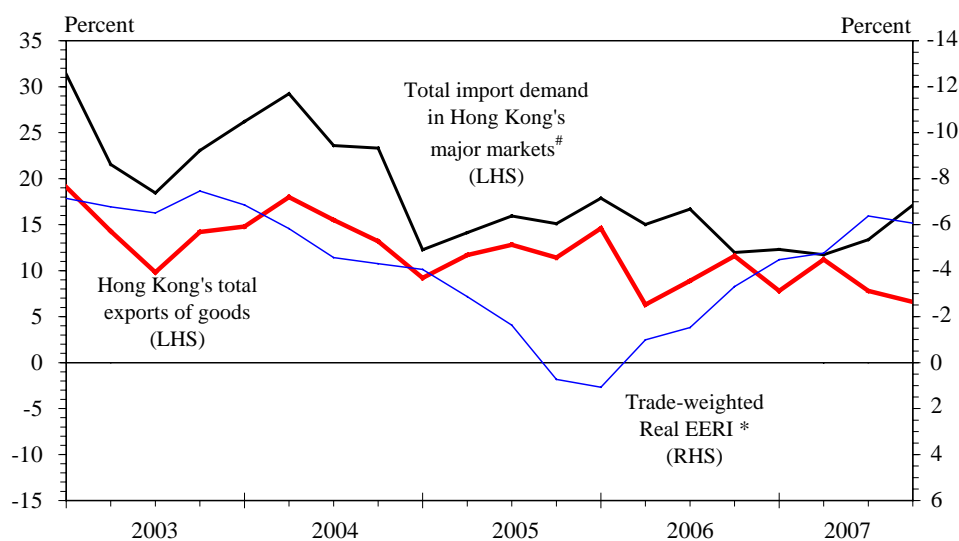
**Table 3.1 : Total exports of goods, re-exports and domestic exports
(year-on-year rate of change (%))**

	<u>Total exports of goods</u>			<u>Re-exports</u>			<u>Domestic exports</u>					
	<u>In value terms</u>	<u>In real terms</u>	<u>Change in prices</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>			
2006 Annual	9.4	10.2	1.0	10.0	10.8	1.1	-1.1	1.1	-2.1			
Q1	12.1	14.6	(3.3)	-0.3	10.7	13.2	(3.7)	-0.2	38.7	42.3	(-0.9)	-2.9
Q2	5.4	6.3	(0.0)	0.6	4.6	5.3	(0.8)	0.9	19.9	23.9	(-10.6)	-3.9
Q3	8.4	8.9	(4.4)	1.4	9.4	9.8	(5.1)	1.5	-6.1	-4.2	(-7.2)	-1.3
Q4	11.9	11.6	(2.9)	1.9	15.3	14.9	(4.2)	2.0	-31.8	-30.9	(-18.9)	-0.8
2007 Annual	9.2	8.3	2.3	10.8	9.9	2.4	-18.9	-19.8				0.8
Q1	9.0	7.8	(0.8)	2.7	11.8	10.6	(0.9)	2.8	-33.4	-33.5	(-0.6)	0.4
Q2	11.7	11.2	(2.7)	2.0	13.5	13.1	(2.4)	2.1	-18.4	-19.4	(8.2)	0.6
Q3	8.2	7.8	(0.9)	2.0	10.0	9.6	(1.3)	2.1	-20.9	-21.0	(-7.9)	0.8
Q4	8.2	6.6	(1.8)	2.7	8.6	7.1	(1.9)	2.8	-0.7	-3.4	(0.0)	1.0

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

3.2 *Re-exports*⁽²⁾ continued to be the key growth driver and outperformed overall export growth, leaped by 9.9% in real terms in 2007, after a 10.8% increase in 2006. Strong growth momentum was maintained, though with some ease-back in the latter part of the year. Re-exports continued to benefit from the Mainland's strong trade flows as well as the robust intra-regional trade. The share of re-exports in total exports increased further to 95.9% in 2007, from 94.5% in 2006. In contrast, *domestic exports* fell distinctly by 19.8% in real terms in 2007, reverted from a modest increase of 1.1% in 2006.

**Diagram 3.1 : Merchandise exports continued to show notable growth in 2007
(year-on-year rate of change)**



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 East 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 fourth quarter of 2007 is based on information available up to November 2007.

Diagram 3.2 : Re-exports remained the key growth driver of total exports

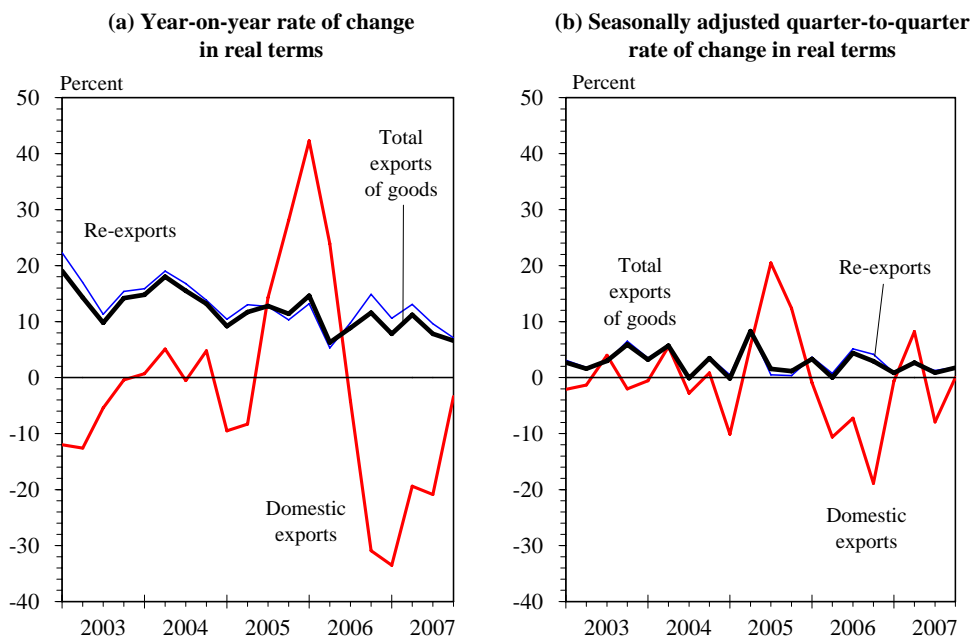
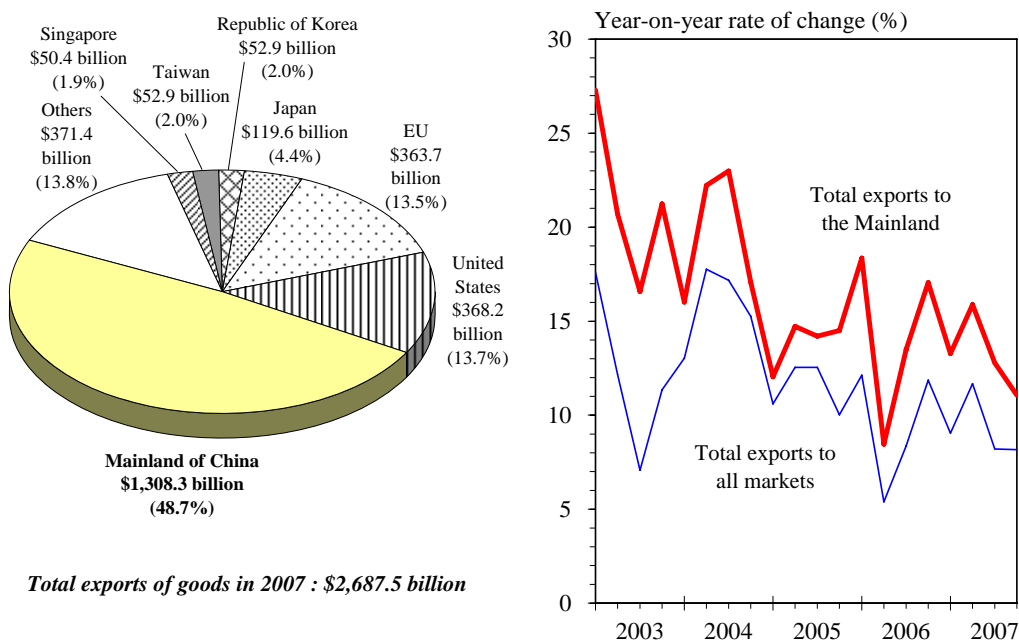


Diagram 3.3 : The Mainland market is the main engine of export growth



**Table 3.2 : Total exports of goods by major market
(year-on-year rate of change in real terms (%))**

		<u>Mainland of China</u>	<u>United States</u>	<u>European Union</u>	<u>Japan</u>	<u>Republic of Korea</u>	<u>Taiwan</u>	<u>Singapore</u>
2006	Annual	16.7	1.7	4.7	2.4	8.8	4.3	4.5
	Q1	23.1	3.5	9.5	8.2	20.9	10.4	2.3
	Q2	11.4	-2.4	4.1	3.0	12.0	-5.3	-5.4
	Q3	15.8	-1.1	1.9	0.6	10.7	8.3	12.8
	Q4	17.5	7.0	4.1	-1.4	-5.4	4.2	8.3
2007	Annual	12.9	-2.5	3.8	-0.8	0.0	-0.2	1.0
	Q1	13.1	0.7	2.7	0.6	-8.9	-1.4	0.7
	Q2	15.5	1.0	5.2	4.0	3.8	9.0	3.9
	Q3	12.9	-3.9	4.3	-5.9	0.2	-3.2	0.2
	Q4	10.7	-6.6	3.2	-1.6	5.2	-4.1	-0.2

3.3 Analysed by market, the strong uptrend of total exports to the Mainland continued and posted double-digit growth for six consecutive years, amidst its strong trade flows and robust domestic demand. Exports to such Asian emerging markets as India, Malaysia, Thailand, Vietnam and Indonesia also saw notable expansion. By comparison, exports to the other major East Asian economies, including Taiwan, Korea and Singapore, were rather lacklustre. Exports to the EU held up firm, especially those to Germany, Netherlands and France, in tandem with the steady expansion of the EU economy. The appreciation of euro should have also rendered some support to exports to the EU.

3.4 On the other hand, exports to the US reverted to a decline in 2007 with the set back concentrated in the second half of the year. This was conceivably due to the softness of the market in the wake of the housing market downfall and the turmoil arising from the sub-prime mortgage problem. Likewise, exports to Japan exhibited mild contraction in 2007 due to its weakness in import demand.

Diagram 3.4 : Exports to the Mainland remained strong

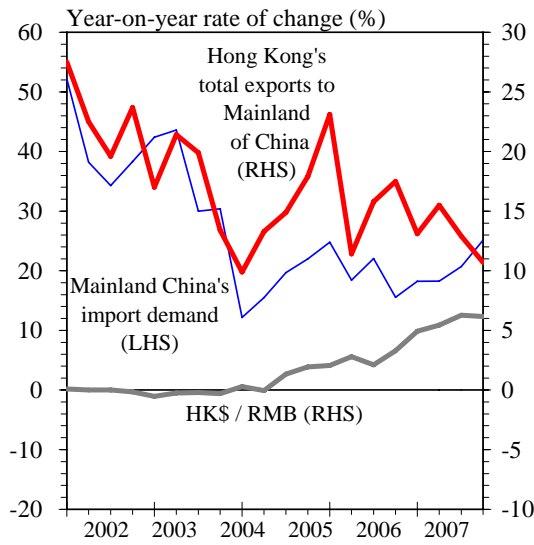
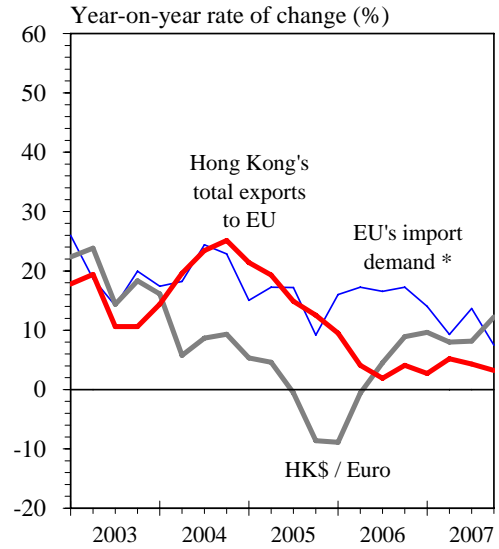


Diagram 3.5 : Exports to EU was helped by steady economic expansion in EU and the euro appreciation



Note: (*) Import demand figure for the fourth quarter of 2007 is based on information available up to November 2007.

Diagram 3.6 : Exports to US slacked further in tandem with its weakening import demand

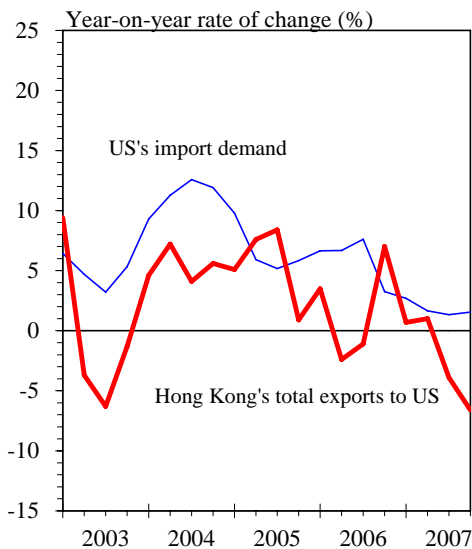
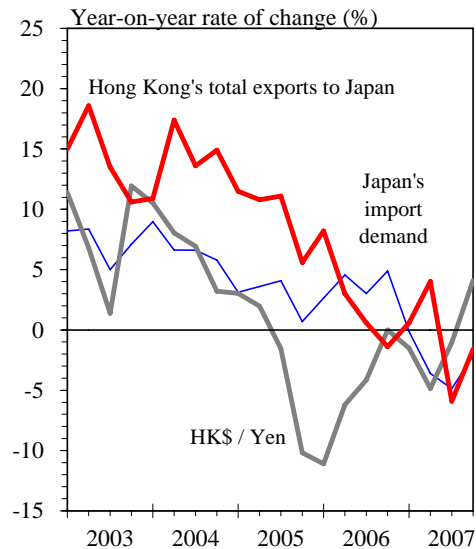
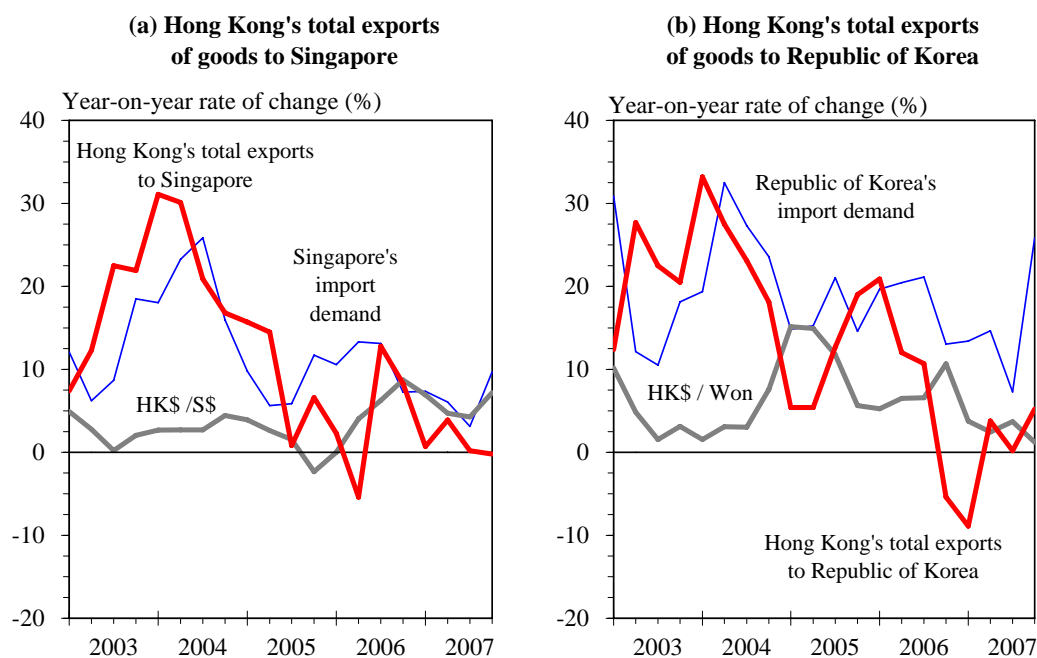


Diagram 3.7 : Exports to Japan reverted to a decline amidst the weak domestic demand



**Diagram 3.8 : Exports to Singapore and Korea moderated,
mainly due to a fall-off on raw materials intake**



Imports of goods

3.5 *Imports of goods* recorded a pronounced growth of 10.4% in real terms in 2007, after a strong increase of 10.2% in 2006. While the surge in intake for subsequent re-exporting continued, *retained imports*, referring to the imports for domestic uses, rose visibly by 11.7% in real terms in 2007, reflecting the prevailing strength of domestic demand on the back of strong consumer and investor confidence. Within this, growth in retained imports of consumer goods and foodstuffs accelerated over the course of 2007, largely tallied with the strong performance of retail sales. Likewise, retained imports of raw materials and semi-manufactures surged during most of the year. Moreover, retained imports of capital goods, which usually exhibit a certain degree of volatility, rose notably further despite the high base of comparison in the previous year.

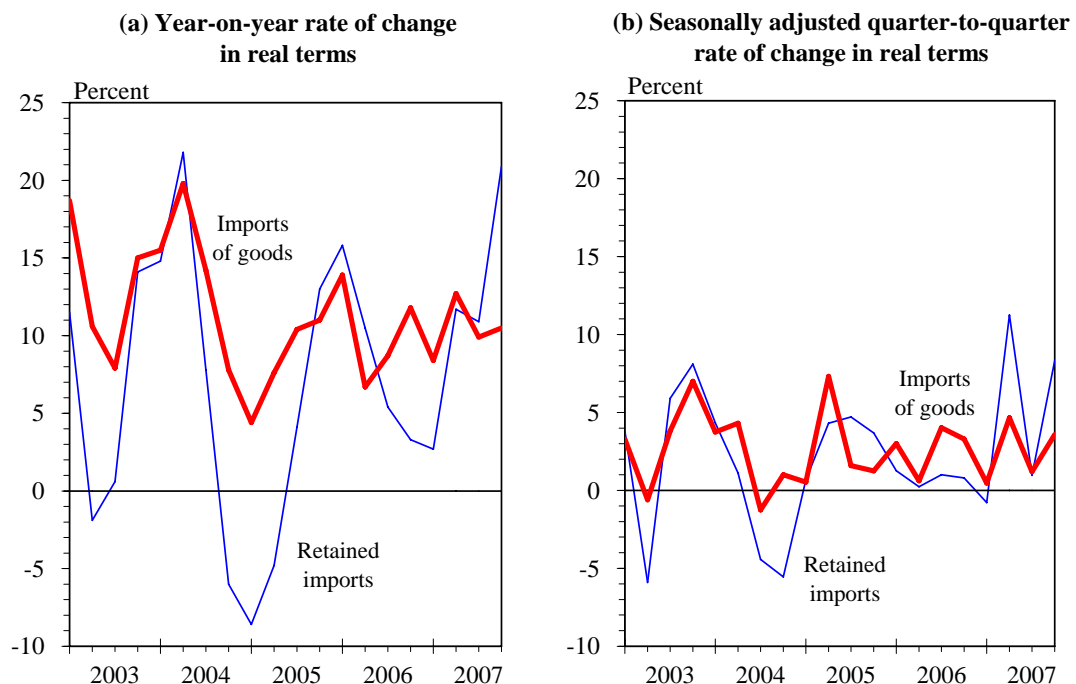
**Table 3.3 : Imports of goods and retained imports
(year-on-year rate of change (%))**

		<u>Imports of goods</u>			<u>Retained imports</u> ^(a)		
		<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>
2006	Annual	11.6	10.2	2.1	14.3	8.4	3.2
	Q1	13.8	13.9	(3.0)	20.8	15.8	(1.3)
	Q2	8.1	6.7	(0.6)	16.7	10.5	(0.2)
	Q3	10.7	8.7	(4.0)	12.7	5.4	(1.0)
	Q4	14.0	11.8	(3.3)	8.2	3.3	(0.8)
2007	Annual	10.3	10.4	2.3	8.8	11.7	1.9
	Q1	9.0	8.4	(0.5)	1.5	2.7	(-0.8)
	Q2	12.6	12.7	(4.7)	10.3	11.7	(11.3)
	Q3	9.1	9.9	(1.2)	6.6	10.9	(1.0)
	Q4	10.5	10.5	(3.6)	16.3	20.9	(8.3)

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 3.9 : Total imports grew briskly



**Table 3.4 : 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>
2006	Annual	14.4	2.0	27.6	-16.8	5.4
	Q1	16.9	4.3	38.4	-6.4	4.0
	Q2	37.3	4.8	19.8	-13.4	-4.9
	Q3	7.8	2.3	32.5	-27.5	3.5
	Q4	0.5	-2.9	22.2	-18.9	19.5
2007	Annual	6.4	6.6	11.1	18.5	8.5
	Q1	-1.0	4.4	6.4	-2.9	8.6
	Q2	2.3	3.5	14.2	16.1	24.4
	Q3	6.6	8.9	1.6	33.7	-0.8
	Q4	17.7	9.7	22.0	29.3	4.7

Invisible trade

Exports of services

3.6 *Exports of services* grew distinctly further, by 11.2% in real terms in 2007, following an already strong growth of 10.1% in 2006. The appreciable growth was across-the-board throughout the four quarters of 2007. Exports of trade-related services, the largest component within exports of services and comprising mainly offshore trade, continued to surge under the support of strong intra-regional trade as well as the Mainland's robust trade flows. Exports of financial services showed a spectacular performance along with the buoyant financial market activities. Exports of travel services also showed rapid growth amidst the rapid expansion of inbound tourism. The weakening of the Hong Kong dollar along with the US dollar rendered further boost to visitor spending. Meanwhile, exports of transportation services, benefited from the vivid trade flows and strong influx of incoming visitors, continued to hold up well.

Diagram 3.10 : Trade-related and transportation services accounting for over 60% of service exports, reflecting the important role of Hong Kong as a trading hub

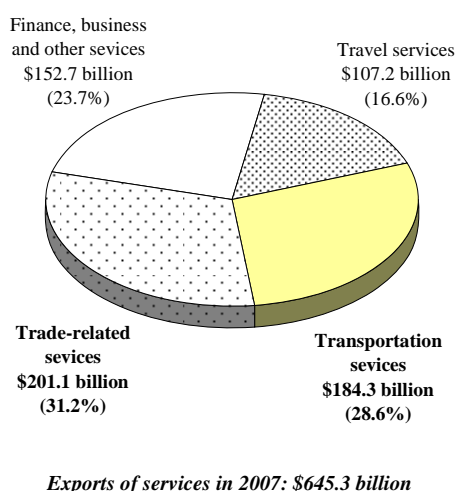


Diagram 3.11 : Notable growth in exports of services accelerated further and across the broad

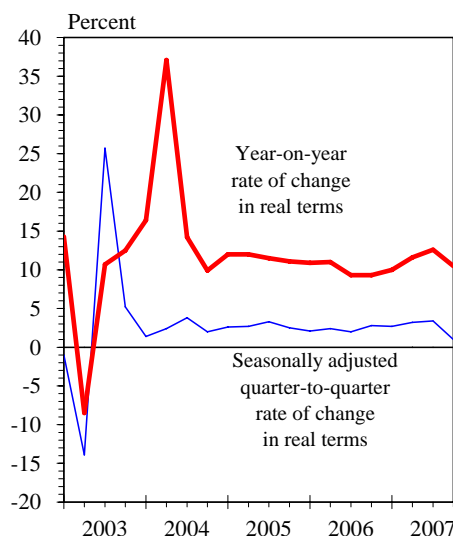


Table 3.5 : Exports of services by major service group (year-on-year rate of change in real terms (%))

Of which :

		Exports of services	Trade-related services ^(a)	Transportation services	Travel services ^(b)	Finance, business and other services
2006	Annual	10.1	8.8	8.0	6.4	18.9
	Q1	10.9 (2.1)	11.1	9.0	8.9	14.4
	Q2	11.0 (2.4)	8.6	9.7	6.0	20.3
	Q3	9.3 (2.0)	9.3	6.4	4.6	18.9
	Q4	9.3 (2.8)	6.8	6.9	6.4	22.3
2007	Annual	11.2	10.2	4.8	13.3	20.6
	Q1	10.0 (2.7)	9.6	3.9	10.9	18.7
	Q2	11.6 (3.2)	11.2	6.3	10.3	21.5
	Q3	12.6 (3.4)	11.4	5.8	14.8	23.5
	Q4	10.5 (1.0)	8.9	3.4	16.9	19.0

Notes : (a) Comprising mainly offshore trade.

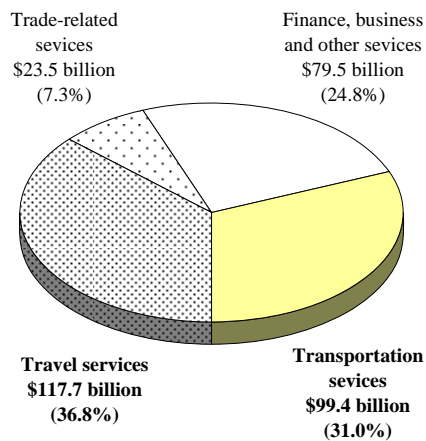
(b) Comprising mainly inbound tourism receipts.

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

Imports of services

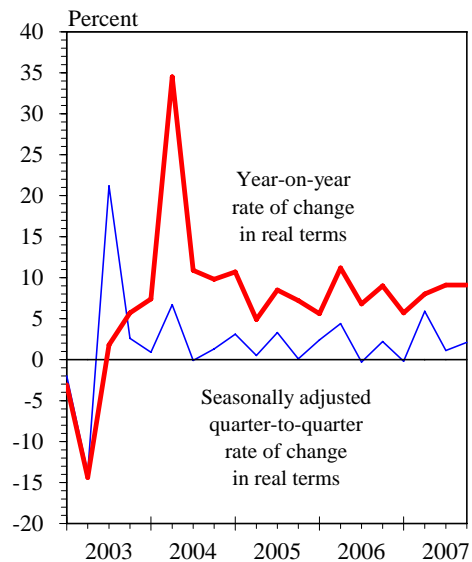
3.7 *Imports of services* rose by 8.1% in real terms in 2007, at the same pace as 2006. Imports of travel services continued on a steady uptrend, reflecting the increase in the number of residents traveling abroad. Imports of transportation services and trade-related services grew strongly on the back of the thriving trade flows. In tandem with the financial market boom and the continued robust business activities, imports of financial, business and other services recorded another year of distinct growth.

Diagram 3.12 : Travel service, transportation services, and services involving finance and business are the main components in imports of services



Imports of services in 2007: \$320.1 billion

Diagram 3.13 : Imports of services rose notably further



**Table 3.6 : 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>Finance, business and other services</u>	
2006	Annual	8.1	4.1	10.4	11.2	10.9	
	Q1	5.6	(2.4)	0.2	10.0	7.7	
	Q2	11.2	(4.4)	9.1	13.3	11.7	
	Q3	6.8	(-0.3)	1.1	9.0	12.2	
	Q4	9.0	(2.2)	6.6	9.6	11.7	
2007	Annual	8.1	4.6	6.3	10.8	15.1	
	Q1	5.7	(-0.2)	1.9	3.0	14.0	
	Q2	8.0	(5.9)	3.9	6.6	15.9	
	Q3	9.1	(1.1)	6.2	6.4	16.7	
	Q4	9.1	(2.1)	6.1	8.9	13.9	

Notes : (+) Comprising mainly outbound travel spending.

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

Visible and invisible trade balance

3.8 With the surplus in the invisible trade account more than offset the deficit in the merchandise trade account, a sizeable surplus of \$171.5 billion was recorded in the combined visible and invisible trade balance in 2007, equivalent to 5.4% of the total value of imports of goods and services. This compared with the corresponding figure of \$168.2 billion (equivalent to 5.9% of the total value of import of goods and services) in 2006. The continued sizeable surplus is a reflection of Hong Kong's strong external competitiveness in the global economy.

**Table 3.7 : Visible and invisible trade balance
(\$Bn at current market prices)**

		<u>Total exports</u>		<u>Imports</u>		<u>Trade balance</u>		
		<u>Goods</u>	<u>Services</u>	<u>Goods</u>	<u>Services</u>	<u>Goods</u>	<u>Services</u>	<u>Combined</u>
2006	Annual	2,467.4	565.1	2,576.3	287.9	-109.0	277.2	168.2
	Q1	538.5	130.3	568.3	65.8	-29.8	64.5	34.7
	Q2	586.7	130.1	622.1	69.3	-35.4	60.8	25.4
	Q3	667.2	148.9	685.8	77.0	-18.6	71.9	53.3
	Q4	674.9	155.8	700.2	75.8	-25.2	80.0	54.7
2007	Annual	2,698.9	645.3	2,852.5	320.1	-153.7	325.2	171.5
	Q1	587.3	147.6	621.5	71.1	-34.2	76.4	42.2
	Q2	656.5	148.3	702.7	76.6	-46.2	71.7	25.5
	Q3	722.1	172.0	749.4	86.5	-27.4	85.5	58.1
	Q4	733.0	177.4	778.8	85.8	-45.9	91.6	45.7

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

Trade policy and other developments

3.9 External trade will continue to play an important role in the Hong Kong economy. In this regard, the Government has made strenuous efforts to open up new business opportunities for Hong Kong's companies in respect of both trade in goods and services.

Enhancing co-operation with the Mainland under CEPA

3.10 In order to enhance opportunities for Hong Kong businesses and reinforce Hong Kong's comparative advantages in better tapping the potential of the Mainland market, the Supplement IV to CEPA was signed on 29 June 2007. It contains 40 liberalisation measures in 28 services areas, including 17 existing services areas⁽³⁾ and 11 new services areas⁽⁴⁾. The new liberalisation measures came into effect starting 1 January 2008.

3.11 As at end-2007, the Trade and Industry Department (TID) and five Government Approved Certificate Organisations issued 29 989 certificates of Hong Kong origin (CEPA) to goods produced in Hong Kong, involving a total of \$11.2 billion worth of goods. TID also issued 1 900 certificates of Hong Kong Service Supplier. The Government will continue to work closely with the Mainland authorities on further liberalisation measures under CEPA for the benefits of the Hong Kong economy.

Strengthening connectivity with the PRD

3.12 The new Shenzhen Bay Bridge was completed and has commenced operation on 1 July 2007. Along with the opening of the new border control point at the new Bridge, the HKSAR and Shenzhen governments signed a Memorandum on co-location arrangement at the Shenzhen Bay Port. The commencement of operation of the new Bridge signifies closer integration and co-operation between Hong Kong and Shenzhen.

3.13 On 10 October 2007, the Policy Address announced four cross-boundary infrastructure projects, including (1) The Guangzhou-Shenzhen-Hong Kong Express Rail Link; (2) The Hong Kong-Zhuhai-Macao Bridge; (3) Hong Kong-Shenzhen Airport Co-operation, for which the feasibility of a rail connection between Hong Kong International Airport and Shenzhen Airport will be studied; and (4) Hong Kong-Shenzhen Joint Development of the Lok Ma Chau Loop. These projects, when completed, will further facilitate the flow of people and goods between Hong Kong and the Mainland and help further strengthen Hong Kong's external competitiveness and its role as an international business, trading and logistics centre, which in turn will generate huge economic benefits to the Hong Kong economy.

Other developments

3.14 It is vital for Hong Kong to foster closer economic ties with the emerging market economies in different parts of the world, which have been assuming an increasingly important role in the global economy. According to the World Bank, emerging market economies accounted for half of the growth in world import demand in 2007. Over the past year, high-level Government delegations visited such emerging market economies as Kuwait, Saudi Arabia, the United Arab Emirates, Slovakia, Hungary, Estonia and Russia, with a view to bringing about more business opportunities for Hong Kong companies.

3.15 Against the background of a series of adjustment in processing trade policy in the Mainland, Hong Kong enterprises with manufacturing operations in the PRD have to seriously consider industrial restructuring, upgrading and relocation. The Government has been working closely with industry and taken a multi-pronged approach to help them better respond to the Mainland's measures, including relaying to the Central Government industry concerns, proposing to the Central Government other flexible measures to match with the policy adjustment, exploring with the provinces and industry alternative operating bases and helping investors obtain first-hand information about the investment

environment. The Government also plans to improve the Small and Medium Enterprises Funding Schemes and help industries to upgrade production facilities and explore new 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.
- (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.
- (3) They are legal, medical and dental, real estate, job intermediary, convention and exhibition, telecommunications, audiovisual, distribution, insurance, banking, securities, tourism, cultural, maritime transport, air transport, road transport, and individually-owned stores.
- (4) They are computer and related services, market research, services related to management consulting, public utility, building-cleansing, photographic, printing, translation and interpretation, environmental services, social services, and sporting services.