

Hong Kong

- Hong Kong's economy staged a full recovery in 2010 and has surpassed the pre-tsunami level. For 2010 as a whole, GDP grew by 6.8% in real terms, after 2.7% contraction in 2009.
- Consumer prices increased by 2.4% in 2010 and 3.6% year-on-year in January 2011.
- The unemployment rate was 3.8% for November 2010-January 2011, compared to 4.3% in 2010.
- Retail sales have picked up notably. In 2010, the value of total retail sales increased by 18.3%, compared to a 0.6% rise in 2009.
- Total exports increased by 22.8% in 2010 and 27.6% year-on-year in January 2011.
- A total of 36 million visitors, or more than five times the size of local population, came to Hong Kong in 2010, representing a 22% increase from 2009. In 2010, mainland arrivals reached 22.7 million, up 26% from 2009.
- The Supplement VII to CEPA were signed on 27 May 2010, providing 35 market liberalisation and trade and investment facilitation measures in 19 sectors, bringing the total number of liberalised service sectors under CEPA to 44. All these liberalisation measures take effect from January 2011.

Major Economic Indicators

	2008	2009	2010	Forecast/Latest
Population, Mid-year (million)	6.98	7.00	7.07	7.10 ^a
Gross Domestic Product (US\$billion)	215.0	208.0	224.1	238.7-240.9 ^b
Real GDP Growth (%)	+2.3	-2.7	+6.8	+4-5 ^b
GDP Per Capita (US\$)	30,800	29,700	31,700	33,500-33,800 ^b
Inflation (% Change in Composite CPI)	+4.3	+0.5	+2.4	+3.6 ^c
Unemployment Rate (%)	3.6	5.4	4.3	3.8 ^d

^a end-2010; ^b government forecast for 2011; ^c January 2011; ^d November 2010-January 2011

Merchandise Trade Performance

	2009		2010		January 2011	
	US\$billion	Growth %	US\$billion	Growth %	US\$billion	Growth %
Total Exports	316.5	-12.6	388.6	+22.8	36.4	+27.6
Domestic Exports	7.4	-36.4	8.9	+20.4	0.8	+9.1
Re-exports	309.1	-11.8	379.7	+22.8	35.6	+28.1
Imports	345.2	-11.0	431.4	+25.0	38.4	+19.0
Total Trade	661.7	-11.8	820.0	+23.9	74.8	+23.0
Trade Balance	-28.6	N/A	-42.8	N/A	-2.0	N/A

Service Trade Performance

	2008		2009		2010	
	US\$billion	Growth %	US\$billion	Growth %	US\$billion	Growth %
Exports	92.1	+8.7	85.9	-6.7	107.0	+24.6
Imports	47.0	+10.3	43.7	-7.1	50.9	+16.5
Total Trade	139.1	+9.3	129.6	-6.9	157.9	+21.9
Trade Balance	45.1	N/A	42.2	N/A	50.9	N/A



Current Economic Situation

- The world's freest economy
- The world's most services-oriented economy (services sectors accounting for more than 90% of GDP)
- The world's second highest per capita holding of foreign exchange reserves
- The world's ninth largest foreign exchange reserves holding
- The second largest source of foreign direct investment (FDI) in Asia
- The second largest recipient of FDI in Asia

1. Latest Developments

In the wake of the downturn in 2009, Hong Kong's economy in 2010 staged a full recovery at a faster pace than expected and has surpassed the pre-tsunami level. For 2010 as a whole, GDP grew by 6.8 per cent in real terms, after a 2.7% contraction in 2009. The recovery in 2010 was broadly based. Private consumption increased by 5.8% in real terms, following 0.6% in 2009. Fixed investment surged 8.1% after a decline of 3.9% in 2009. As for the external sector, exports of goods and services also surged by 17.3% and 15% respectively in real terms, after declining by 12.7% and growing by 0.3% respectively in 2009. The government forecasts Hong Kong's economy to grow by 4-5% in real terms for 2011.

Retail sales have seen a significant rebound, reflecting a return of consumer confidence and strong inflows of tourists. In 2010, the value of retail sales increased by 18.3%, compared to a 0.6% rise in 2009. The labour market conditions have also improved notably. The unemployment rate has come down to the pre-crisis level in 2008, registering 3.8% for the three-month period ending January 2011, versus 4.3% for 2010. Meanwhile, consumer prices increased 3.6% year-on-year in January 2011, after a 2.4% increase in 2010. Hong Kong is likely to face with higher inflationary pressures, due to the pick-up in import prices amid rising global food and commodity prices, and the gradual building up of domestic price pressures along with the strong pace of economic expansion. The government forecasts the inflation to reach 4.5% in 2011.

In 2010, visitor arrivals reached 36 million, a 22% increase compared to 2009. The Chinese mainland continued to be the primary driver of growth in arrivals to Hong Kong in 2010, with arrivals climbing up by 26% year-on-year to 22.7 million, and accounting for 63% of total arrivals. Total tourism expenditure associated to inbound tourism for 2010 is estimated to reach HK\$213 billion, a leap of 31% compared to 2009, and per capita spending of overnight visitors is estimated to increase by 16% to HK\$6,705 in 2010. As for the flow of goods, please refer to the section on Latest Trade Performance and Issues below.

The four pillar economic sectors of Hong Kong are: trading and logistics (24.1% of GDP in terms of value-added in 2009), tourism (3.3%), financial services (15.2%), and professional services and other producer services (13.1%). On the other hand, the six industries which Hong Kong has clear advantages for further development are cultural and creative, medical services, education services, innovation and technology, testing and certification services and environmental industries. These six industries together accounted for 8% of GDP in terms of value-added in 2009.

2. Budget and Government Initiatives

In the 2011-12 Budget released on 23 February 2011, the Financial Secretary unveiled a raft of measures to alleviate the impact of rising inflation, improve the quality of life in Hong Kong and invest in long-term economic development. New initiatives or measures were announced in education, health care, elderly services, sports development, retirement protection and certain key economic areas such as the four pillar industries and the six industries with clear advantages. For example, the government will earmark \$1 billion for injection into a new fund to promote research and development in public health and medical services, increase the total guarantee commitment under the SME Loan Guarantee Scheme substantially from \$20 billion to \$30 billion to support SMEs, and study the feasibility of operating sustainable Microfinance to help people at the grass-roots level start their own business or take career training courses.

Besides, to enhance Hong Kong's overall competitiveness, the government will step up efforts to build ties with emerging and neighbouring economies.

The Chief Executive delivered the 2010-11 Policy Address - Sharing Prosperity for a Caring Society on 13 October 2010. This Policy Address gives priority to housing, poverty alleviation and livelihood issues. On Hong Kong's economic development, the government will strive to enhance Hong Kong's status as an international centre for financial services, trade, shipping and logistics, and to develop the six new industries where Hong Kong enjoys clear advantages. The government will continue to help Hong Kong's service industries, especially the professional services sector, expand their presence in the mainland market progressively; and work with Guangdong Province to seek to incorporate the most important functions and roles of Hong Kong-Guangdong co-operation into the National 12th Five-Year Plan. Furthermore, the government will continue to strengthen regional co-operation, by encouraging the trades in Hong Kong to seize the opportunities arising from the development of Qianhai and promoting multi-faceted and multi-level exchanges with Taiwan. To support Hong Kong SMEs, the government will explore the establishment of a market-oriented loan guarantee scheme to provide a sustainable platform for obtaining credit and inject an additional \$1 billion into the SME Export Marketing Fund and the SME Development Fund.

The Chief Executive said that the Competition Bill, which was introduced into the Legislative Council in July 2010, aims to prohibit and deter anti-competitive conduct in various sectors and to maintain a level playing field. The government fully understands the concern of SMEs that a competition law may undermine their flexibility in doing business and increase their operating costs. Therefore, exemptions and a mechanism have been included in the bill to help enterprises comply with the law. The government will continue to explain to the business community the content of the bill, and listen carefully to their views.

On top of the provisions granted in earlier phases of the Mainland-Hong Kong Closer Economic Partnership Arrangement (CEPA), the Supplement VII to CEPA were signed on 27 May 2010, providing 35 market liberalisation and trade and investment facilitation measures in 19 sectors, bringing the total number of liberalised service sectors under CEPA to 44. These measures, effective from January 2011, would expedite and facilitate Hong Kong service industries to enter and expand in the mainland market, and foster service industries' integration and professional exchanges of the two sides. Moreover, most of the market liberalisation and facilitation measures cover the four pillar industries and the six economic industries in which Hong Kong has a competitive edge, and as such can help consolidate Hong Kong's status as an international financial, trade, shipping, logistics and high value-added service centre, and lay the foundation for the two sides to jointly develop education, medical services, testing and certification, environmental, innovative technology and cultural industries. CEPA was firstly concluded in June 2003, and supplemented with further liberalisation measures in subsequent years. At present, all products of Hong Kong origin, except for a few prohibited articles, can be imported into the mainland tariff free under CEPA. Details and new developments about CEPA, including our analysis of its impacts on Hong Kong, can be found in <http://cepa.hktdc.com/>.

3. Investment Flows

Hong Kong is a highly attractive market for foreign direct investment. According to the UNCTAD World Investment Report 2010, Hong Kong was the world's fourth largest FDI recipient, attracting US\$48 billion in 2009. This marks the first time that Hong Kong has gained fourth place in the global rankings and represents a jump from its ninth position in 2008. For the 12th consecutive year, Hong Kong continues to be the second largest FDI recipient in Asia, after the Chinese mainland. On the other hand, Hong Kong was the second largest source of FDI in Asia, trailing Japan, with FDI outflows amounting to US\$52 billion in 2009.

According to a recent government survey, Hong Kong's total stock of inward direct investment was estimated at US\$931 billion at the end of 2009, corresponding to 4.4 times of its GDP in that year. One distinct feature of such direct investment was the indirect channelling of capitals from non-operating companies in tax haven economies. Against this background, British Virgin Islands, Bermuda and Cayman Islands accounted for 32.4%, 6.2% and 2.0% of the total stock of inward direct investment in 2009. Excluding tax haven economies, the Chinese mainland was the most

important source of direct investment in Hong Kong (accounting for 36.4% of the total), followed by the Netherlands (6.8%), the US (4.3%) and Japan (2.3%). The majority of the stock of investment was related to service industries including investment holding, real estate, professional and business services; banks and deposit-taking; import/export, wholesale and retail trades; and transportation, storage, postal and courier services.

For more information and assistance in establishing an operation in Hong Kong, contact InvestHK (<http://www.InvestHK.gov.hk>).

Latest Trade Performance

- The world's 11th largest trading economy
- The world's 11th largest exporter of commercial services

Amid the global economic recovery and the vibrant intra-regional trade, Hong Kong's merchandise exports increased sharply, by 22.8% in 2010 and 27.6% year-on-year in January 2011. Hong Kong's major export markets are the Chinese mainland, the EU, the US, ASEAN and Japan, which respectively made up 53%, 11%, 11%, 6% and 4% of Hong Kong's total exports in 2010. During the period, increases in exports to the above markets were 27%, 10%, 16%, 28% and 17%, respectively. Imports also rebounded remarkably by 25% in 2010 and 19% year-on-year in January 2011. A visible trade deficit of US\$2 billion, equivalent to 5.3% of the value of imports of goods, was recorded in January 2011, compared to 9.9% in 2010. Hong Kong's trade performance is in part affected by outward processing activities in Guangdong where the majority of Hong Kong companies have extended their manufacturing base. In 2009, 33.7% of Hong Kong's total exports to the Chinese mainland were related to outward processing activities; the figure was 27.3% for domestic exports and 33.8% for re-exports.

Even though merchandise exports have sustained a rapid growth since 2010, there is no lack of risks and challenges to exporters in the post-tsunami era. First, demand of the developed economies is only expected to expand hesitantly in the short term. Consumers are trading down and saving more in the course of deleveraging. Recent political turmoil around the Middle East is another cause for concern. On the supply side, Hong Kong exporters have to live with a challenging production environment, especially in the PRD. While facing rising labour shortages and surging labour costs, their profit margins are further sliced as the renminbi appreciates against the US dollar. Also, the difficulties and costs of producing may increase when the Chinese government resumes its efforts to promote industry upgrade and hence tightens processing trade policies. To make matters worse, competition from other Asian suppliers is expected to grow.

Economic Relations with the Chinese Mainland

- The most important entrepôt for the Chinese mainland
- The largest foreign investment source of the Chinese mainland
- The key offshore capital-raising centre for Chinese enterprises
- The Chinese mainland as Hong Kong's second largest source of external investment

Hong Kong is so far the most important entrepôt of the Chinese mainland. If re-exports to and from the Chinese mainland are included, about 15% of the mainland's foreign trade was handled via Hong Kong in 2010. The figure will be higher if transshipment of goods to and from the mainland via Hong Kong is also included. According to the HKSAR government statistics, in 2010, 62% of re-exports were of China origin and 53% were destined for the Chinese mainland. According to China's Customs statistics, Hong Kong is the third largest trading partner of the Chinese mainland after the US and Japan, accounting for 7.8% of its total trade in 2010.

Hong Kong is the largest source of overseas direct investment in the Chinese Mainland. By the end of 2009, among all the overseas-funded projects approved in the Chinese Mainland, 45.3% were tied to Hong Kong interests. Utilized capital inflow from Hong Kong amounted to US\$395.7 billion, accounting for 40.7% of the national total.

The Chinese mainland, on the other hand, is one of the leading investors in Hong Kong. According to the HKSAR Census and Statistics Department, the mainland's cumulative direct investment in Hong Kong was US\$339 billion or 36.4% of Hong Kong's total stock of inward direct investment at the end of 2009.

As of January 2011, there were seven licensed banks and six representative offices, incorporated in Chinese mainland, operating in Hong Kong. Big lenders including the Bank of China, Industrial and Commercial Bank of China, Agricultural Bank of China and China Construction Bank have opened their branch operations in Hong Kong. Some other mainland commercial banks such as the Shenzhen Development Bank, China Everbright Bank and Shanghai Pudong Development Bank have representative offices in Hong Kong.

Hong Kong is also a key offshore capital-raising centre for Chinese enterprises. As of December 2010, 592 mainland companies were listed in Hong Kong, comprising H-share, red-chip and private companies with total market capitalization of US\$11.9 trillion, or 57% of the market total. For the past 10 years, mainland companies have raised more than \$1.7 trillion (US\$226 billion) via stock offerings in Hong Kong.

Hong Kong as a Regional Centre

- A popular venue for hosting regional headquarters or representative offices
- A leading telecommunications hub for the Asia-Pacific region
- The world's busiest airport for international cargoes
- The world's third busiest container port
- The largest venture capital centre in Asia
- The third largest stock market in Asia, the seventh largest in the world
- The third largest foreign exchange market in Asia, the sixth in the world

Hong Kong is a popular venue for hosting regional headquarters or representative offices for multinational companies to manage their businesses in the Asia Pacific, particularly the Chinese mainland. Based on a government survey, as of June 2010, there were 3,638 regional headquarters (RHQs) and regional offices (ROs) in Hong Kong representing their parent companies located outside Hong Kong, increased 1.6% from the previous year. Of these companies, 82% were responsible for business in the Chinese mainland, confirming Hong Kong's role as a gateway to the mainland. These companies came from diverse countries and sectors. The US had the largest number of RHQs/ROs in Hong Kong (22%), followed by Japan (17%), the UK (8%) and the mainland (7%). Most of the RHQs/ROs in Hong Kong were in I/E trade, wholesale and retail (45%). Others are in professional, business and education services (15%), manufacturing (14%), finance and banking (12%), and transportation, storage and courier services (9%).

Hong Kong is an important banking and financial centre in the Asia Pacific. As of November 2010, there were 194 authorised institutions and 67 representative offices in Hong Kong, and the total loans provided by the authorised banks to finance international trade, and other loans for use outside Hong Kong totalled US\$34 billion and US\$103 billion respectively. According to the Bank for International Settlements, Hong Kong is the third largest foreign exchange market in Asia and the sixth largest in the world, with the net daily turnover of forex transactions reaching US\$237.6 billion in 2010.

As at end-2010, Hong Kong's stock market ranked the third largest in Asia and the seventh largest in the world in terms of market capitalisation. There were 1,413 companies listed on the stock exchange, including 169 companies on the Growth Enterprise Market (GEM). The total market capitalisation of Hong Kong's stock market reached US\$2.7 trillion. Hong Kong is also the largest venture capital centre in Asia, managing about 24% of the total capital pool in the region as at mid-2009.

Hong Kong is a leading telecommunications hub for the Asia-Pacific region. As at end-2009, there were 3.69 million telephone lines and 286,000 fax lines in Hong Kong. There were 12 million mobile phone subscribers, even outnumbering Hong Kong's total population. The penetration rate of broadband internet exceeded 80% among

household. International Direct Dialling services are available to most countries and regions in the world, with the total international telephone traffic growing at an annualised rate of 7.5% to 10 billion minutes between 2004 and 2009.

Hong Kong is a favourite place in the world to do business and host major conferences. Over 300 international conventions and exhibitions are held in Hong Kong each year. To name a few, in December 2005, Hong Kong hosted the sixth session of the WTO ministerial conference where a Hong Kong declaration was concluded. In December 2008, Hong Kong played host to the first Clinton Global Initiative international meeting outside the US.

Infrastructure Developments

Construction for the Hong Kong-Zhuhai-Macao Bridge (HZMB) started in December 2009 and the whole project is expected to complete in 2016. The bridge consists of three parts, including the main bridge, boundary crossing facilities of Hong Kong, Zhuhai and Macao, and link roads of the three places. The HZMB is of special strategic value in further enhancing the economic development of Hong Kong, Macao and the Western Pearl River Delta region (Western PRD). It will significantly reduce the cost and time for travellers and for the flow of goods between Hong Kong and the Western PRD, accelerate the economic integration of the PRD and its neighbouring provinces, and increase its competitiveness.

Meanwhile, the Hong Kong section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link (XRL) will be 26-km long, running from the terminus in West Kowloon to Shenzhen, Dongguan and Guangzhou with significantly reduced journey time. More importantly, it will become part of the 16,000km national high-speed rail network now being developed in full steam, fostering closer economic ties between Hong Kong and the mainland. Upon completion of the railway, the travelling time from Hong Kong to Beijing and Shanghai will be shortened to about 10 and eight hours respectively. Construction of the project has commenced for completion in 2015.

Besides the cross-boundary endeavours, the government has undertaken other large-scale infrastructure projects for the next few years to improve the local transportation system, promote long-term development of arts and culture, and provide quality living space to citizens. The MTR Corporation Limited has commenced the detailed design of the South Island Line East (SILE) and is proceeding with the environmental impact assessment. The construction for the SILE is expected to commence in 2011 for commissioning in 2015 while the construction work of the West Island Line has commenced for completion in 2014. Further study on the alignment and preliminary design of the Shatin to Central Link (SCL), a strategic railway line that runs through multiple districts in Hong Kong, has been carried out. The construction work is expected to commence in 2012. As for the Kai Tak Development, works of the first stage, including public housing, cruise terminal and associated supporting infrastructure, are in progress. The first berth of the cruise terminal commenced construction for operation in 2013. The second berth is expected to come into operation in 2014.

To enhance the competitiveness of the Hong Kong International Airport (HKIA), the Airport Authority (AA) keeps upgrading the airport's infrastructure to increase its passenger and cargo handling capacities and strengthen transport links between the airport and the Pearl River Delta. In 2008, HKIA and Shenzhen International Airport (SZIA) jointly launched the Hong Kong-Shenzhen Airports Link, a service that enables passengers at HKIA or SZIA to check in and obtain boarding passes for connecting flights at either airport. Besides, AA is formulating the Hong Kong International Airport Master Plan 2030 on airport developments in the next twenty years. A public consultation on the Hong Kong International Airport Master Plan 2030 is expected to begin in the first half of 2011. AA is going to release a consultation paper and a feasibility study report, and invite the public and stakeholders to comment on the strategies and directions of airport development.

Turning to the port, it is projected that the total container throughput will have modest and steady growth over the next few years, and Hong Kong will need the first new container berth by 2015. The HKSAR government has expedited the study on the feasibility of developing Container Terminal 10 at Southwest Tsing Yi. The relevant preliminary feasibility study and environmental impact assessment commenced in March 2009 and are scheduled for completion in 2011.

Research Department