

# THE ECONOMY

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## 1. GDP GROWTH AND PRICE LEVEL

- ◆ GDP grew at an average rate of 3.3% in real terms per annum during the past 10 years. Per capita GDP rose by 1.6% in money terms per annum over the same period, reaching US\$23,300 (HK\$181,500) in 2003.
- ◆ The Hong Kong economy went through a sharp gyration during the course of 2003. Continuing the revival impetus in late 2002, the economy grew quite strongly at the beginning of 2003, with GDP leaping by 4.5% in real terms in the first quarter of 2003 over a year earlier. The growth was abruptly derailed by the spread of Severe Acute Respiratory Syndrome (SARS) in the second quarter and GDP relapsed to a 0.5% decline over year earlier. Yet overall economic activity staged a speedy and broad-based recovery in the third quarter after the waning of SARS, and the upswing spilled well into the fourth quarter upon a further lift in local sentiment. Reflecting this, GDP bounced up strongly to a 4.0% growth in the third quarter and further to a 5.0% growth in the fourth quarter. Thus, even with the profound setback caused by SARS during the year, the Hong Kong economy still attained an appreciable growth of 3.3% in real terms for 2003 as a whole, which was better than that of 2.3% in 2002. On a seasonally adjusted quarter-to-quarter comparison, GDP fell by 0.5% and 2.6% respectively in the first and second quarters of 2003, yet rebounded sharply to increases by 6.6% in the third quarter and 1.5% in the fourth quarter.
- ◆ In the external sector, inbound tourism and the travel-related sectors were badly shattered by the spread of SARS in the second quarter of 2003, yet bounced back swiftly in the third quarter and distinctly more in the fourth quarter. The remarkable turnaround was driven by a strong pick-up in visitor arrivals from the mainland of China (the Mainland), especially after the launch of the Individual Visit Scheme in late July. As to merchandise exports and offshore trade, they both displayed highly robust growth throughout 2003, bolstered by continued hectic growth in the Mainland economy, a visible pick-up in the global economy following the end of the war on Iraq, as well as a surge in intra-regional trade. Enhanced competitiveness of Hong Kong's exports, underpinned by distinct weakening in the US dollar and further domestic cost adjustments, as well as deriving from increasing competitiveness of Mainland products in the world market, rendered an additional boost to the export performance.
- ◆ Consumer spending was likewise severely hit by SARS in the second quarter of 2003, but was progressively resurrected in the third and fourth quarters. Consumer sentiment appeared especially upbeat towards the end of the year, boosted by the rally in the local stock market, a more active property market, and steady improvement in the overall employment situation. Investment spending on machinery and equipment bounced back to a notable growth in the latter part of 2003, on the back of improved economic conditions and brighter business

outlook especially after the signing of the Closer Economic Partnership Arrangement (CEPA) between Hong Kong and the Mainland. Building and construction output however was weak all through.

- ◆ On consumer prices, the decline in the Composite Consumer Price Index continued in 2003, as local prices were kept down by the slack demand and profit margin squeeze especially during the course of the SARS threat, as well as by lower wages and rentals. The rates concession and waiver of water and sewage charges as the Government's relief measures also dragged down the CPI in the latter period. Also relevant to the narrowed decline was firmer prices of retained imports amidst a weaker US dollar and uptrend in world commodity prices. For 2003 as a whole, the Composite CPI fell by 2.6%, modestly smaller than the 3.0% decline in 2002. Yet the GDP deflator, as a broad measure of overall price change in the economy, had a more pronounced decline, by 5.1% in 2003, as against a 3.0% decrease in 2002. This was due in large part to a continued drag from deterioration in the terms of trade upon further weakening in the US dollar, aside from downward price pressure in the domestic sector especially amidst the SARS impact.
- ◆ Looking ahead, with the generally upbeat external and local economic environment, GDP is forecast to pick up notably further, to a 6% growth in real terms in 2004. As to consumer prices, the decline in consumer prices seems likely to taper quite distinctly further during 2004, with the Composite CPI forecast to decline by an average of 1%. GDP deflator is also forecast to have a smaller decline of 3% in 2004.

## **2. CAPITAL INVESTMENT**

- ◆ Overall investment spending, as represented by gross domestic fixed capital formation, declined only marginally by 0.1% in real terms in 2003, visibly improved from the 4.3% dip in 2002.
- ◆ There was renewed interest in acquisition of machinery and equipment during the year, except for a temporary relapse in the second quarter. For 2003 as a whole, expenditure on machinery, equipment and computer software had an increase of 6.1%, in stark contrast to the 9.1% decrease in 2002.
- ◆ On the other hand, building and construction output in overall terms remained subdued throughout the year. Expenditure on building and construction fell back by 6.9% in 2003, after a small increase by 1.2% in 2002. The slump was mostly due to a distinct fall-off in private sector building work, despite a rise in consents for new building projects during the year. The increase in private sector civil engineering work during the year rendered only a marginal offset. Public sector expenditure on building and construction was also slack in the first half of the year, upon the winding down of work on the KCR West Rail and Ma On Shan Extension. Nevertheless, it regained some momentum in the second half of the year, upon commencement of several new infrastructural projects including the

### **3. EXTERNAL TRADE**

- ◆ During the past 10 years, the value of Hong Kong's total merchandise trade with East Asia expanded by 86%. The value of Hong Kong's total merchandise trade with the United States and the European Union also rose over the same period, by 32% and 37% respectively.
- ◆ Total exports of goods (comprising re-exports and domestic exports) picked up distinctly further to a 14.0% surge in real terms in 2003, further up from the already notable growth of 8.6% in 2002.
- ◆ Total exports of goods to East Asia as a whole were buoyant throughout 2003. The strong growth impetus was again led by vibrant exports to the Mainland, which maintained highly robust growth all through the year. Exports to Japan, the Republic of Korea, Singapore, Taiwan and Indonesia registered double-digit growth of various magnitudes. On the other hand, exports to Malaysia and Thailand eased back in growth, after the sharp increases in the preceding year. Exports to North America were also robust early in the year, but the growth momentum ran out of steam after the first quarter, along with a distinct deceleration in US import intake in around the middle of the year. Conceivably, there was some cut-back in orders at a time when the war tension in Iraq loomed high. In addition, the increasing tendency for finished products to be shipped out directly from the Shenzhen ports after outward processing in South China also weighed down Hong Kong's exports to this region. Total exports of goods to the European Union also surged in the year. Enhanced price attractiveness of Hong Kong's exports brought about by the strength of the euro seemed to have outweighed the sluggishness in domestic demand in this region.
- ◆ Imports of goods were likewise robust, leaping by 12.8% in real terms in 2003, distinctly up from the 7.8% increase in 2002. This was attributable to the continued strength in re-export trade throughout the year. The revival in import intake for local use in the second half of 2003 rendered further support. As to the imports for local use, retained imports tumbled in the second quarter upon the profound impact of SARS. Then, along with the progressive picked up in domestic demand, they recovered notably in the second half of the year. For 2003 as a whole, retained imports attained a 5.8% growth, up from the 1.8% increase in 2002.

- ◆ On invisible trade, the strong growth momentum in exports of services in the first quarter of 2003 was dented severely by the spread of SARS in Hong Kong in the second quarter. Yet with a swift rebound in the third quarter and a further pick-up in the fourth quarter, exports of services still attained appreciable growth at 5.5% in real terms in 2003, albeit milder than the 12.2% surge in 2002.
- ◆ Imports of services were likewise severely affected by SARS in the second quarter of 2003. Even with the subsequent rebound, imports of services still fell by 4.4% in real terms in 2003, following a meagre 0.2% rise in 2002. Within the total, both imports of travel services and imports of transportation services were hit by SARS in the second quarter of 2003. Yet, they improved progressively in the second half of the year along with the dissipation of the adverse impact of SARS. On the other hand, imports of trade-related services were not affected much by SARS and tied in well with the strong uptrend in external trade throughout the year. Imports of financial, business and other services also turned up to increase.
- ◆ On the trade balance, the visible trade deficit reckoned on a GDP basis widened in absolute terms, to \$45.0 billion or 2.5% of the value of imports of goods in 2003, from \$39.4 billion or 2.5% in 2002. Taking exports and imports of services together, the invisible trade surplus reckoned on a GDP basis rose further to \$161.1 billion or 85.1% of the value of imports of services in 2003, from \$144.5 billion or 74.7% in 2002. This more than offset the enlarged visible trade deficit to yield a combined surplus of \$116.1 billion in 2003, equivalent to 5.9% of the total value of imports of goods and services in that year, as compared to \$105.1 billion or 5.9% in 2002.

#### **4. MAJOR FINANCIAL CENTRE**

- ◆ Hong Kong's external banking transactions volume (in terms of authorised institutions' gross external position) was the 12th largest in the world as at end September 2003.
- ◆ Hong Kong was the world's 7<sup>th</sup> largest foreign exchange market according to a triennial global survey, which was co-ordinated by the Bank for International Settlements in 2001.
- ◆ Hong Kong was the 7<sup>th</sup> largest stock market in terms of market capitalisation as at end February 2004.
- ◆ Hong Kong has 279 foreign-owned licensed banks, restricted licence banks, deposit-taking companies and representative offices from 37 countries as at end March 2004. 75 of the world's top 100 banks have presence in Hong Kong.
- ◆ Hong Kong is probably one of the four largest gold markets in the world.

- ◆ Trading in Exchange Fund Bills and Notes was active with an average daily turnover of \$15.3 billion for the period from October 2003 to March 2004.
- ◆ By end March 2004, 174 institutions joined Central Moneymarkets Unit (CMU), a debt securities clearing and custodian system operated by the Hong Kong Monetary Authority (HKMA), as members and 1,346 issues of debt securities issued by the public and private sectors, with a total value of over HK\$339 billion equivalent lodged into the service.
- ◆ In December 1994, CMU hooked up with the Euroclear and Clearstream, so that overseas investors can trade Hong Kong dollar debt instruments through the international network of these two international clearing companies. The one-way linkage between CMU and Austraclear, Australia commenced operation on 1 December 1997. Bilateral linkages with the Reserve Bank of New Zealand and Korea Securities Depository commenced in April 1998 and September 1999 respectively. Besides helping market development, these bilateral linkages will also help reduce settlement risk by facilitating cross-border delivery versus payment arrangements.
- ◆ With a view to promoting the access of retail investors to investment opportunities on Exchange Fund Notes (EFNs), HKMA has listed all outstanding EFNs on the SEHK in August 1999. This has enhanced the secondary market liquidity and expanded the investor base of EFNs to the retail level.
- ◆ The CMU was linked to the HK dollar RTGS system in December 1996 and the US dollar RTGS system in December 2000 to provide real time Delivery versus Payment (DvP) capability for HK dollar and US dollar denominated debt securities, as well as intraday and overnight repo facilities for the HK dollar and US dollar payment systems in Hong Kong. The CMU was also linked to the EURO RTGS system in April 2003 providing similar services to Members.
- ◆ In order to develop the international business of the CMU, the one-way inbound links from Euroclear to CMU, and from Clearstream to CMU were extended to two-way links in November 2002 & January 2003 respectively. These real-time links enable investors in Hong Kong and other parts of Asia to hold and settle Euroclear and Clearstream debt securities directly via their CMU members in a secure, DvP environment.
- ◆ The HKMA and the China Government Securities Depository Trust and Clearing Company Limited (CDC) have agreed in principle to establish a link between the CMU and the Government Securities Book-entry System (GSBS) operated by the CDC. This link will enable investors in Mainland China to hold and settle HK securities lodged in the CMU.
- ◆ In order to facilitate the efficient settlement of US dollar transactions in Hong Kong and the region and to eliminate the settlement risks that may arise when a transaction is spread across different time zones, the HKMA has developed a US

dollar clearing system in Hong Kong which has been in operation by December 2000. Leveraging on the technology used for the Hong Kong dollar RTGS system, the US dollar clearing system is built on the same infrastructure and offers a range of advanced and sophisticated clearing functions. The key functions including the real time gross settlement for US dollar payments, delivery versus payment (DvP) facility for US dollar denominated shares, payment versus payment (PvP) between the US dollar and the HK dollar foreign exchange transactions, and US dollar cheques. The system also maintains a seamless interface with the CMU to cater for the DvP of US dollar denominated debt securities and repo facilities.

- ◆ The US dollar clearing system has operated smoothly since its implementation in December 2000. At the end of 2003, there were 67 direct participants and 160 indirect participants. Among the indirect participants, 113 were outside Hong Kong. Turnover has been growing steadily. In 2003, the system handled on average 4,000 transactions daily with a value of US\$5 billion, about one-third of which was related to the PvP transactions.
- ◆ With a view to further enhancing settlement efficiency and reducing settlement risk of euros in Asian time, the HKMA introduced the euro RTGS system in April 2003 and has appointed Standard Chartered Bank as the Settlement Institution for a franchise period of 5 years starting from March 2003. Similar to the technology used for the Hong Kong dollar and US dollar RTGS systems, the euro RTGS system offers the key functions including the real-time gross settlement for euro payments and PvP settlement for EUR/USD and EUR/HKD foreign exchange transactions. The system also maintains a seamless interface with the CMU to cater for the DvP settlement of euro denominated debt securities and repo facilities. Since its inception, the system has been operated smoothly.
- ◆ The development of foreign currencies clearing systems is not only important in building Hong Kong's infrastructure as an international financial centre, but also it can provide a range of opportunities for the further development of the foreign currencies denominated debt and stock markets in Hong Kong, and linkages with other payment systems in the region.
- ◆ With the support of the HKMA, the Guangzhou Branch and the Shenzhen Sub-Branch of the People's Bank of China (PBoC), joint Hong Kong dollar cheque clearing services between Hong Kong and Guangdong were fully implemented in June 2002. Hong Kong dollar cheques drawn on banks in Hong Kong and presented in Guangdong, and vice versa, take only two working days to clear. The service has proved to be popular among the cross border traders and investors. In 2003, about 250,000 cheques totalling HK\$22 billion were cleared through these joint clearing facilities.
- ◆ As part of the on-going efforts to develop cross border infrastructure to enhance co-operation between Hong Kong and Shenzhen, PBoC Shenzhen and the HKMA arrived at a scheme for Shenzhen Financial Electronic Settlement Center (SFESC) to develop cross border links between the Hong Kong dollar and US

dollar RTGS systems between Shenzhen and Hong Kong. The HKD and USD RTGS links were fully implemented in November 2003, further expediting cross border Hong Kong dollar and US dollar payments by allowing banks in Hong Kong and Shenzhen to make HKD and USD RTGS payments to each other.

- ◆ The HKMA has completed a comprehensive review of retail payment services in Hong Kong (“the Review”), which was conducted by an internal task force of the HKMA set up in August 2000. The Review examined issues such as efficiency, pricing and costs, degree of market access, level of competition and risks associated with the various means of retail payment. It also considered what should be the appropriate regulatory approach for oversight of retail payment services in Hong Kong.
- ◆ The Review has concluded that Hong Kong’s retail payment systems generally function well. They are considered to be efficient and effective, and there exists a wide range of payment instruments. The payment system providers are generally innovative. With Hong Kong’s open regime for operation of and participation in retail payment systems, market forces function well to meet the market needs.

## **5. MAJOR BUSINESS CENTRE**

- ◆ The number of companies registered under the Companies Ordinance up to 31 March 2004 totalled 500,919 of which 15,535 were new companies registered in 2004. Among all registered companies in the territory, 7,241 are public companies and 493,678 private companies.
- ◆ The number of new overseas companies establishing a place of business in Hong Kong under Part XI of the Companies Ordinance during January to March 2004 was 180, bringing the total number of such companies to 7,057 as at end of March 2004. The greatest numbers according to origin are British Virgin Islands (2,524), USA (729), Bermuda (639), Cayman Islands (593) and the UK (396).
- ◆ Hong Kong’s tax system is one of the simplest in the world with its tax rates among the lowest in the world –
  - Profits Tax – in 2004-05, 17.5% for corporations and 16% for unincorporated businesses. No tax is levied on profits arising from the sale of capital assets or on offshore trading profits.
  - Salaries Tax – in 2004-05, 16% maximum average rate of tax charged on salaries income only, rather than on total income from all sources (as in many other places). Only slightly over one third of the working population need to pay any tax on their salaries.
- ◆ Business at the Hong Kong International Airport continues to grow at a healthy pace. In the rolling 12-month period to February 2001, passenger throughput

reached a total of 33.5 million in total, an increase of 9.2% over the same period in the previous year. Cargo volume rose by 10.6% to 2.24 million tonnes while aircraft movements also went up by 9.7% to 184,800.

- ◆ With the rebounds in inbound tourism and local consumer spending in the latter part of 2003, the seasonally adjusted unemployment rate decreased from 8.3% in the third quarter of 2003 to 7.3% in the fourth quarter of 2003. The underemployment rate also decreased from 3.6% to 3.3% during the same period. For the period December 2003 – February 2004, the provisional seasonally adjusted unemployment rate and underemployment rate were 7.2% and 3.3% respectively.

## **6. MAJOR CONTAINER PORT AND SHIPPING CENTRE**

- ◆ The total container throughput of Hong Kong was 20.4 million Twenty foot Equivalent Units (TEUs) in 2003, making it the world's busiest container port. This represents an increase of 7% over the year 2002.
- ◆ Being a major centre for shipowning and ship management, the number of vessels on the Hong Kong Shipping Register stood at 898 with a total gross tonnage of 21.6 million as at February 2004, a growth of 30.3% over the same period of 2003.

## **7. TOURISM**

- ◆ Tourism is one of the major economic pillars of Hong Kong. In 2002, the total tourism expenditure associated to inbound tourism amounted to HK\$77.4 billion, an increase of 25.3% compared to 2001.
- ◆ The tourism industry was negatively affected by Severe Acute Respiratory Syndrome (SARS) in the second quarter of 2003 but the sector staged a strong rebound after the crisis. As a result, the overall visitor arrivals for 2003 were 15.5 million, only a moderate fall of 6%. In particular, Mainland visitor arrivals totalled 8.47 million for 2003, up 24.1% year-on-year.
- ◆ We have a good start in 2004 with 4.94 million arrivals in the first quarter of the year, an increase of 14.7% year-on-year.
- ◆ The hotel industry also suffered during SARS crisis but when visitor arrivals rebounded, the hotel occupancy improved to over 85% between August and December 2003. For the full year of 2003, the overall occupancy was 70%. The total number of rooms of hotels and tourist guesthouses available as at end 2003 stood at about 43,000.

## **8. VISIBLE TRADE WITH THE MAINLAND**



- ◆ During the past 10 years, Hong Kong's visible trade with the Mainland expanded by 106% in value terms.
- ◆ The Mainland remained the largest single market for Hong Kong's total exports of goods, taking up 43% of the total value in 2003. After a 15.5% surge in 2002, total exports of goods to the Mainland leaped further by 23.1% in real terms in 2003, marking the fastest growth pace since 1993. Hong Kong's exports to the Mainland were buoyant throughout the year. This was underpinned by surging intake of finished goods for meeting its own demand all through the year, in turn stimulated partly by the tariff cuts and trade liberalisation measures after China's WTO accession. The impact of SARS on the Mainland's imports was apparently only temporary and mild. At the same time, intake of materials and machinery for production use was also boosted by the Mainland's continued strong industrial output for both its domestic and export markets.

## 9. HONG KONG AS INVESTMENT SOURCE AND RECIPIENT

### Outward direct investment

- ◆ The total position of outward direct investment (DI) in Hong Kong, valued at market price, amounted to \$2,412.9 billion at end-2002.
- ◆ Analysed by recipient country/territory, the British Virgin Islands and the mainland of China were the major destinations of outward DI, accounting for 47.6% and 34.9% respectively of the total outward DI position at end-2002. Outward DI to Bermuda and Panama took up another 3.2% and 1.6% respectively.
- ◆ Of the outward DI to offshore financial centres such as the British Virgin Islands, Panama and Bermuda, a significant proportion was related to the setting up of non-operating companies by Hong Kong enterprises for channelling DI funds back to Hong Kong and other destinations.
- ◆ Analysed by the economic activity of the Hong Kong Enterprise Groups\*, 58.9% of the position of outward DI was originated from companies engaged in investment holding, real estate and various business services at end-2002. This was followed by those engaged in the wholesale, retail and import/export trades, at 9.1%, and manufacturing, at 5.6%. *(Note\*: A Hong Kong Enterprise Group consists of a Hong Kong parent company, its Hong Kong subsidiaries, associates and branches. It also includes any Hong Kong subsidiaries and associates of the Hong Kong subsidiaries, and any Hong Kong subsidiaries of the Hong Kong associates.)*
- ◆ Guangdong Province remained a popular location for outward DI to the mainland of China, accounting for 47.3% of the total position of outward DI to the Mainland. The most common activities undertaken by direct investment enterprises in the Mainland were communications; manufacturing; and investment holding, real estate and various business services.

## **Inward direct investment**

- ◆ The stock of inward DI in Hong Kong stood at \$2,622.3 billion at market value at end-2002, amounting to 2.08 times of GDP in that year, and representing a decrease of 19.8% from that of \$3,269.7 billion at end-2001. The decline in the stock of inward DI was mainly due to changes in market value of the Hong Kong affiliates of foreign enterprises.
- ◆ Analysed by the immediate source of investment, the British Virgin Islands was the largest investor country, accounting for 29.7% of the total stock of inward DI in Hong Kong at end-2002. This was followed by the mainland of China (22.7%), Bermuda (10.4%) and the Netherlands (7.8%). Altogether, these four investor countries accounted for 70.6% of the total inward DI stock at end-2002. The prominence of the British Virgin Islands and Bermuda in Hong Kong's stock of inward DI reflects in part a common practice of Hong Kong enterprises in setting up non-operating companies in the tax haven economies for channelling investment funds back to Hong Kong.
- ◆ Analysed by economic activity, investment holding, real estate and various business services was the most popular sector for inward DI, with a 52.1% share of the total stock at end-2002. This was followed by wholesale, retail and import/export trades (with a share of 13.0%), banks and deposit-taking companies (12.4%), and financial institutions other than banks and deposit-taking companies (3.5%). They together accounted for 81% of the total stock of inward DI at end-2002.
- ◆ Recent example of inward direct investment in Hong Kong –
  - ☆ **Kingdee International Software Group Co Ltd**, China's top enterprise software applications provider, recently expanded its Asia Pacific headquarters in Hong Kong. The Shenzhen based firm plans to use Hong Kong as its springboard for a major push into the global enterprise software arena and to expand into overseas markets.

Kingdee has been operating in Hong Kong since 2001 to provide enterprise software and professional services to both local and multinational companies in Hong Kong, the Mainland and key markets in Asia Pacific. Kingdee is the first Mainland Chinese software company to list on Hong Kong's Growth Enterprise Market (GEM).

- ☆ **OppenheimerFunds, Inc.**, one of the largest and best known asset management companies in the US, recently established its first overseas office in Hong Kong. The company will use Hong Kong as its regional headquarters to develop business in Hong Kong and other markets in the Asia Pacific region.

OppenheimerFunds, Inc, together with its subsidiaries, manages more than US\$150 billion in assets. The assets are managed under more than 65 US domestic and offshore mutual funds held in over 7 million shareholder accounts.

## 10. REGIONAL HEADQUARTERS AND OFFICES IN HK

- ◆ A total of 3,207 overseas companies incorporated outside Hong Kong have established their regional headquarters (RHQs) or regional offices (ROs) in Hong Kong as at 2 June 2003. Of these, 966 are RHQs and 2,241 are ROs, according to the *2003 Annual Survey of Regional Offices Representing Overseas Companies in Hong Kong* conducted by the Census and Statistics Department.
- ◆ The United States had the largest number of regional headquarters in Hong Kong (242), followed by Japan (168) and the United Kingdom (86). The United Kingdom tops the list of ROs (498), followed by Japan (442) and the United Kingdom (196). The major lines of business of the RHQs included the wholesale, retail and import/export trades, business services, finance and banking, manufacturing, and transport and related services.
- ◆ The top five important factors attracting companies to establish their RHQs or ROs in Hong Kong are:
  - Low and simple tax system;
  - Free flow of information;
  - Political stability and security;
  - Corruption free government; and
  - Rule of law and independent judiciary.
- ◆ According to the "World Investment Report 2003" released by the United Nations Conference on Trade and Development, Hong Kong is the best-performing host economy for foreign direct investment in Asia.
- ◆ Invest Hong Kong, a Government department established on 1 July 2000,

provides investors with services to enable them to make informed investment decisions and to set up RHQs and ROs in Hong Kong.