

An Analysis of the Hong Kong Economy after the Financial Crisis

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Abstract This paper analyzes the current economic development and the status of leading industries in Hong Kong. It shows that Hong Kong economy, which is mainly comprised of the service industry in particular, facing with both opportunities and challenges after the financial crisis. Hong Kong economy has a wide range of needs in information technology, electrical and electronic technology, and manufacturing technology. Development in these areas has great significance to ensure sustained development of Hong Kong economy.

Key words Hong Kong economy status; Leading industry; Service industry

1 Introduction

Hong Kong's a small and open economy system and international financial center, its economic development face many new challenges because of the impact of the global financial crisis. Therefore, a comprehensive analysis of the Hong Kong's economic development and their leading industry status becomes an important issue.

2 Overview of Hong Kong Economy

2.1 The services sector is a leading industry in Hong Kong

From Table 1, we can see that the services industry is a leading industry of Hong Kong economy. During the decade from 1997 to 2006, services sector in the Hong Kong economy has gained greater prominence. This change has already been reflected in the share of contribution of the services sector to the local GDP. The contribution of the services sector to GDP increased from 85.9% in 1997 to 91.2% in 2006. Based on the industry definition of Hong Kong Census and Statistics Department, The services sector includes wholesale, retail and import and export trades, restaurants and hotels; transport, storage and communications; financing, insurance, real estate and business services; and community, social and personal services.

Table 1 Gross Domestic Product (GDP) by Economic Activity (at Current Prices)

Economic activity	2004		2005		2006		2007	
	GDP	ratio	GDP	ratio	GDP	ratio	GDP	ratio
Agriculture and fishing	886	0.1	847	0.1	849	0.1	895	0.1
Mining and quarrying	72	*	100	*	93	*	114	*
Manufacturing	44455	3.6	45547	3.4	45761	3.2	39282	2.5
Electricity, gas and water	39726	3.2	39924	3	40364	2.8	39426	2.5
Construction	40376	3.2	38538	2.9	38688	2.7	40154	2.6
Services	1119304	89.9	1207873	90.6	1297545	91.2	1429293	92.3

Note: Data is from Hong Kong Annual Digest of Statistics (2004-2008 Edition) edited by Hong Kong Census and Statistics Department. Data unit is in million terms and ratio unit is %. Besides, * represents the comparison had less than 0.05% is in the total economy

The services sector becomes the principal source of employment. The employment share of the services sector in total employment has increased moderately over the past decade, from 79.8% in 1997 to 86.6% in 2007. In 2007, the services sector as a whole engaged 3.03 million persons out of the 3.5 million overall employments.

The services sector plays a significant role in supporting the growth of our external trade. In 2007, the value of exports of services reached \$652 billion, representing an average annual growth rate of

8.6% over 1997. In 2007, merchant and other trade-related services was the most important major service group, contributing 30.9% to the value of total exports of services. It was followed by transportation services and travel services, contributing 28.6% and 16.5% respectively to the value of total exports of services in 2007. In 1997, the respective percentage shares of these three major service groups in the value of total exports of services were 25.6%, 30.5% and 20.8%.

2.2 The structure of Hong Kong's services industry sector

Among the economic activities in the services sector, wholesale, retail and import and export trades, restaurants and hotels together contributed 27.9% of the GDP in 2006, followed by financing, insurance, real estate and business services (25.0%), community, social and personal services (18.0%) and transport, storage and communications (9.6%). Among them, financial services, trading, tourism and professional services are key industries in the Hong Kong economy. They have been the driving force of Hong Kong's economic growth, providing impetus to growth of other sectors and creating employment.

(1) Import and export trade .The import and export trade is the most important industries in Hong Kong's service industry, has been playing an important role in the development of Hong Kong economy. The import and export trade produced a net output of HK\$305.1 billion in 2006, representing an increase of 39% over 1997. The ratio is the highest among all service industry. In 2007, there were 98 000 import and export trading establishments in Hong Kong, with 520 000 persons. At the same time, import and export trade sector is also directly promoting the development of other industries, such as logistics, transportation, business services and other services.

Hong Kong's import and export trade, including the visible trade and invisible trade two parts. The visible trade refers to the traditional commodity trade. In 2007, the value of Hong Kong imported and exported goods was \$5,556 billion, representing an increase of 9.8% compared to 2006. Hong Kong's total exports of goods (comprising domestic exports and re-exports) in 2007 amounted to \$2,688 billion, or increased by 9.2% when compared with 2006. The value of imports increased by 10.3% to \$2,868 billion in 2007. With the value of total exports being less than that of imports, a merchandise trade deficit of \$180 billion was recorded in 2007. In the import and export trade, the largest proportion of re-exports. This was largely attributable to the relocation of many local manufacturing activities to the mainland of China. Quite a large amount of the goods produced in the mainland of China through the outward processing arrangement were sent back to Hong Kong and re-exported to other countries/territories. During 1997 to 2007, the value of re-exports increased by 107%, while a decline of 48% was observed in the value of domestic exports. In 2007 the re-export trade to the mainland continued to grow rapidly.

The invisible trade services are export and import trade of commercial services and financial services. While these services could be exported or imported by the import/export firms or companies in other sectors, most of the merchant and other trade-related services were exported or imported by import/export firms .In 2007, Hong Kong's exports and imports of services valued at \$652 billion and \$322 billion respectively. Compared to 2006, exports and imports of services increased by 15.4% and 11.7% respectively. Net exports of services in 2007 amounted to \$330 billion, this makes Hong Kong's overall trade surplus of \$150 billion.

(2) Finance. Hong Kong is recognized as an international financial center, many multinational banks and financial institutions gathered here. The financial business is classified in detail, covering all aspects of the financial industry. Hong Kong three-tier system of deposit-taking institutions, namely licensed banks, restricted licensed banks and deposit-taking companies, known collectively as the authorized institutions. At the end of 2007, the number of authorized institutions stood at 200, comprising 142 licensed banks, 29 restricted license banks and 29 deposit-taking companies. 68 of them were incorporated in Hong Kong and 132 were incorporated outside Hong Kong. In addition, there were 79 representative offices of foreign banks coming from 27 economies/regions. As at end December 2007, 152 of the largest 500 banks in the world had a presence in Hong Kong. The value added generated by the banking industry amounted to \$136.5 billion, or 9.6% of Hong Kong's Gross Domestic Product (GDP) in 2006, representing an increase of 41.6% compared with 1997.

The development of the banking sector also promotes the development of other financial industries. In 2007, some 2 940 establishments and about 32 400 persons were engaged in the business. These included stock and share companies; commodity futures, gold bullion and foreign exchange brokers/dealers; stock, bullion and commodity exchanges; fund management companies; investment advisory companies; and firms providing other various financial services. The financial markets and asset management industry generated value added of about \$59.0 billion, contributing to 4.1% of Hong Kong's GDP in 2006.

Hong Kong is also the Securities and Exchange Center and an important place for the mainland enterprises to raise funds. At the end of 2007, 1 048 companies were listed on the Main Board of the Hong Kong Exchanges and Clearing Limited (HKEx), with a total market capitalization of \$20,536 billion. Despite an increase of only 7.5% in the number of listed companies, market capitalization was observed to rise 55.0% over 2006. Since July 1993 when the first Chinese state owned company was listed on the HKEx through issuance of H shares, the role of Hong Kong as a major fund-raising centre for the mainland of China had become increasingly important. By the end of 2007, there were 146 H shares listed on the HKEx, with market capitalization of \$5,080 billion. In addition, there were also 93 "Red Chips" companies and 200 private enterprises listed on HKEx. Hong Kong is one of the most active and liberal debt markets and a leading asset management centre in Asia.

(3) Tourism .In 2007, 51 900 persons were engaged in industries closely related to tourism, such as hotels and travel agents and 315 300 persons in industries partly related to tourism such as restaurants, retailers, transport operators and other service providers serving visitors. In terms of economic contribution, inbound tourism and outbound tourism together generated \$45.3 billion value added and 176 300 job opportunities in 2006, or 3.2% of total GDP and 5.2% of total employment of Hong Kong respectively. The number of incoming visitors in 2007 reached 28.2 million, increased by 11.6% as compared with 25.3 million in 2006 and set the highest record for visitor arrivals in history. The mainland of China remained the major source market of visitors to Hong Kong since 1994. Visitor arrivals from the mainland of China reached 15.5 million in 2007, accounted for 55.0% of the total visitor arrivals, followed by South and Southeast Asia (10.3%) and Taiwan (7.9%). In addition, Hong Kong is Asia's major trade exhibition and business conference center. A total of 218 conventions and 78 exhibitions with international participation were held in Hong Kong in 2006.

(4) Professional service .The professional service is Hong Kong's fourth-largest service industry. The professional services industry generated \$40 billion of value added, or 2.8% of Hong Kong's Gross Domestic Product (GDP), in 2006 and provided job opportunities for about 106 000 persons in 2007. In 2007, there were about 13 500 professional services establishments, including 3 900 accounting, auditing and bookkeeping firms, 1 800 solicitor and barrister firms, 3 300 architectural, surveying and engineering firms and some 4 500 management consultant firms. The business receipts of professional services industry increased by 10.7% in 2007 over a year earlier. The development of professional services industry over the past decade was quite remarkable. Number of establishments and persons engaged increased by 35% and 23% respectively between 1997 and 2007. During the same period, the total number of registered professionals also increased remarkably, with certified public accountants increasing at the fastest rate of 7.3% per year on average.

2.3 Manufacturing company is the support for the Hong Kong service industry

In this paper, the Hong Kong Manufacturing Company refers specifically to the Hong Kong manufacturing companies in the mainland. The rapid expansion of Hong Kong's service industries in the past two decades benefited from the development of the Hong Kong Manufacturing Company and the sub-contracting business model. In the late 80's, under the pressure of high land prices, high rents, high labor costs, a large number of Hong Kong manufacturers shifted their production to the Mainland, where the land and labor costs were relatively low, in particular the Pearl River Delta in Guangdong Province. And because of the changes in the business, many original manufacturing companies become the service company. These companies transferred their manufacturing factories to the Mainland, and kept the headquarters and other high value-added services such as marketing, order processing, material procurement, design, packaging, logistics business in Hong Kong. This business model is known as "shop in front and factory in back" mode. At the same time, in order to adapt to the changes in international markets and increase exports, many traditional trading companies, set up manufacturing factories in mainland, and formed a sub-contracting operation mode. In the sub-contractors mode, products manufactured in the mainland branch companies, headquarters in Hong Kong focused its efforts on trade, market and management. This mode of operation combined the mainland companies' low-cost production advantage and the Hong Kong trading companies' familiar with the international market advantage together, promoted the expeditions of business of Hong Kong trade companies and improved their production efficiency. This production mode provided a strong support to the development of Hong Kong's service industry.

The financial crisis press great operating pressure to the Hong Kong Manufacturing Company. Mostly concentrated in the Pearl River Delta region, the types of these companies are sound equipment, electrical appliances, toys, clothing, footwear and other labor-intensive industries. The development of these enterprises is based on low labor and land inputs, production technology is very low. With the

labor, land costs rising substantially in the Pearl River Delta region, the competitive advantages of the Hong Kong Manufacturing Company decreased a lot in recent years. Under the impact of the financial crisis, there has an obvious drop in experts of these labor-intensive consumer goods. Many Hong Kong Manufacturing Companies face the problem of orders reduction, profit decline, and even bankruptcy.

3 Hong Kong's Economic Problems under the Global Financial Crisis

Table 2 1997-2007 Business Receipts Indices

	1997	2002	2003	2004	2005	2006	2007
Wholesale/Retail	124.4	88.3	85.8	93.8	100	107.4	120.6
Import and export trade	107.2	75.5	80.4	90.5	100	110.2	119.1
Restaurants	104.7	94.9	85.7	94.3	100	109.5	124.2
Hotels	99	73.1	58.8	81.9	100	113.7	131.1
Transport	61.7	68.8	69.1	85	100	110.6	122.6
Storage	157.1	81.1	77.4	90.6	100	110.2	127.8
Communications	127.1	96.6	94.3	95.1	100	100.8	110.8
Banking	84.1	86.4	86.4	90.2	100	119.5	165.3
Financing (except banking)	79.8	56	65.7	87.5	100	147.9	249.7
Insurance	38.2	59.2	70.5	86.2	100	121.3	156.2
Real estate	135.6	71.5	75.9	86.2	100	99.6	139.3
Business services	119.7	87.6	88.1	95.3	100	119.6	135.4
Tourism	91.5	75.5	70	88.5	100	114	135.4
Computer and information services	53.1	63.7	67.3	81.1	100	109.7	117.1

Note: Data is from Hong Kong Annual Digest of Statistics(2008 Edition) edited by Hong Kong Census and Statistics Department.

Table 3 2005-2008 the variation ratio of Business Receipts Indices

	2005	2006	2007	2007 3 quarter	2007 4 quarter	2008 1 quarter	2008 2 quarter
Wholesale/Retail	5.6	7.9	10.4	9	15.5	9.6	14.1
Import and export trade	6.8	7.3	12.8	15.1	17.7	17.5	14.4
Restaurants	10.6	10.2	8	8.2	7.6	13.2	14.6
Hotels	6	9.5	13.4	15.4	14.8	16	15.3
Transport	22.1	13.7	15.2	15.7	16.5	9.9	9.6
Storage	17.8	10.6	10.8	11.7	14.8	15.9	11
Communications	10.4	10.2	16	11.7	10.3	10.7	3.5
Banking	5.1	0.8	10	9.7	16.2	11.2	13.5
Financing (except banking)	10.9	19.5	38.3	47.7	45	6.4	-6.8
Insurance	14.3	47.9	68.8	99.6	82.9	32.8	4.7
Real estate	16	21.3	28.8	42.1	35.4	11.7	8.3
Business services	16	-0.4	39.8	27.7	69.5	14.5	10
Tourism	4.9	19.6	13.2	11.8	14	11.5	10.3
Computer and information services	12.9	14	18.7	18.9	25.4	14.2	14

Note: Data is from Hong Kong Annual Digest of Statistics (2008 Edition) edited by Hong Kong Census and Statistics Department.

Table 2 shows the revenue changes of the Hong Kong's service industry from the 1997 Asian financial crisis. In the 1997 Asian financial crisis and the subsequent 2003 epidemic of SARS, Hong Kong's service industry was particularly hard hit. Until 2006, the industry revenue was generally restored to the level of 97. Finance, insurance, transport, trade and other business incurred the largest loss. In February 2007, the U.S. sub-loan crisis happened, and the Lehman bank filed for bankruptcy in September 2008. The U.S. financial crisis intensified and developed into a global financial crisis. From the second half of 2008, the global financial crisis began to influence Hong Kong economy. This performance is particularly evident in the service industry.

Hong Kong's financial industry has been most affected. From Table 3 it can be seen that Banking and financial services industries are in the most affected after the financial crisis. There is a rapid decline in industry revenue. In the second quarter of 2008, banking industry even has the first negative growth since the past few years. At the end of the third quarter, because a lot of major financial institutions in the United States had been threatened with a bankruptcy, the global financial crisis became even more serious. The panic selling appeared in many countries' stock market, Hong Kong was no exception. Hong Kong's Hang Seng index plummeted by 15% in September, and fell 22% in October. The normal operation of Hong Kong's capital markets has been seriously affected. The growth of other financial related industries, such as insurance, real estate and business services, had a slowed down significantly from the beginning of the second quarter of 2008.

Import and export trade and related industries sectors have been affected in different degrees. The merchandise exports slowed down in the third quarter and only had a small increase. Even so, this was the worst performance since the first quarter of 2002. With the increase of global financial crisis, exports to other markets also had different degrees of slowing down. As a result, the growth of related industries, such as business service, trade service, transportation and storage service also slowed down slightly. Exports of services had maintained a steady increase in the financial crisis, but the growth rate was also smaller than the second quarter. The growth of tourism also had signs of deceleration and affect the growth of related industry, such as transportation, hotels, catering services, the number of visitors from long distance market decrease a lot, particularly the tourists from Europe and the United States.

To face the challenge of financial crisis, the SAR Government has been actively responding well to prevent the spread of financial risks. From the beginning of the sub-loan crisis in the United States, in order to ensure stability of the financial system, the Hong Kong Monetary Authority introduced a number of measures to alleviate the pressure on banks and provide necessary assistance to the banks. Securities and Futures Commission and the Insurance Supervisory Commission also had made action to strengthen the protection of investors and policyholders. At the same time, most Hong Kong's local financial institutions' participation in directly investment to the US sub-loan is limited in small scale. The local banking system remains steadily without be directly effected by the sub-loan crisis.

Benefit from the economic development of the Mainland, Hong Kong's service industries is also faced with new opportunities in the global financial crisis. For example, supported by the growth of trade in the Mainland, offshore trade growth was still significant. Although 2008 is the "Olympic Year", but the mainland tourists to Hong Kong remained a high-speed growth. In the third quarter of 2008, the Mainland tourists to Hong Kong was still higher than last year, an increase of 9.4%. Individual Visit Scheme is one of the bright spots; the visitors in accordance with this scheme had a further rise in the third quarter, the ratio was 14.5%. These factors effectively guaranteed the smooth operation of Hong Kong's service industries. At the same time, the ten naturalization industry plan in the mainland had already been introduced. The mainland accelerated the pace of industrial upgrading and began to support the development of high-tech industry. These policies provide a good environment for the Hong Kong companies in mainland to upgrade their technological level and achieve their own industrial upgrading.

Based on the above analysis, the challenges faced by Hong Kong's economic in the financial crisis can be summarized into the following three aspects: (1) financial sector's profits decline a lot, related sector's services business reduces. (2) The trade and service market in Western countries shrink. (3) Hong Kong Company in mainland operates difficultly. Hong Kong economy is facing the opportunity for: the steady development of the Mainland economy and the acceleration of the industrial upgrading. Therefore, in order to face the challenge of the financial crisis, it is important for Hong Kong service companies to expand business in the Mainland, and to Hong Kong companies in mainland to enhance the productivity.

4 Conclusions

Through the above analysis, this paper can be drawn the following conclusions:

(1) The a major problem of Hong Kong economy is decline in financial sector profits and trade volume with Western developed countries.

(2)The expansion of demand of the Mainland market is the most important opportunity for Hong Kong's economic development.

(3) Hong Kong economy has great demands for information technology, electrical and electronic technologies, manufacturing technology. To ensure sustainable development of Hong Kong economy, it is very important to promote scientific and technological development.

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