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Economic report: Hong Kong 2008 Update

1. Appreciation of the economic problems and issues

1.1 General overview of HK's economy: The economy of Hong Kong expanded by 5.8% in the first half of 2008, after growing by 6.3% in 2007. However, the global downturn triggered by the financial crisis has started to affect the Hong Kong economy. As a matter of fact, the economy grew moderately by 4.2% in the second quarter of 2008 whereas the first quarter recorded a robust 7.3% growth.

Domestic demand has slowed down after a long period of strong performance. Following a 7.8% growth in 2007, private consumption increased by 5.4% in real terms in the first half of 2008. Fixed investment grew by 4.2% in 2007 and also slowed down to a moderate growth of 1.8% in the first half of 2008.

The unemployment rate was 3.4% in July-September 2008, down from 4.8% in 2006 and 4.0% in 2007. Nevertheless, it is very likely to rise in the near term as some sectors such as retails, logistics and food & beverage sectors as well as many small and medium-sized enterprises (SMEs) are bound to be affected by a contraction in business triggered by the global financial crisis.

As for the external sector, growth of exports of goods and services slowed down to 6.2% and 8.7% respectively in real terms in the first half of 2008, after 7.0% and 12.5% respectively in 2007. The government forecast a GDP growth of 4-5% in real terms for 2008 in the latest forecast exercise in August 2008.

In the first nine months of 2008, visitor arrivals reached 21.7 million, up 6.9% year-on-year. Mainland visitors, account for 57% of total tourist arrivals, reached 12.5 million (+11%).

1.2 Policy Address 2008-09: In his Policy Address delivered on 15 October 2008, the Chief Executive Donald Tsang admitted new challenges ahead, including the global financial crisis and environmental pollution. According to the Chief Executive, the Hong Kong government would use the economic crisis as an opportunity to reinforce the position of Hong Kong as a global financial centre, which includes enhanced banking supervision, tightened regulation of fund managers and increased efforts to broaden the scope of stock exchange listings. To further economic and trade development, the government will put forward the large-scale infrastructure projects; step up cooperation with Guangdong, with a focus on service industries; reinforce Hong Kong's intermediary role in technological cooperation between the mainland and the rest of the world; foster closer links with Taiwan in areas such as trade, investment and tourism; promote the development of creative industries and wine trading and distribution businesses; and examine the feasibility of increasing the exhibition area in Hong Kong.

Critics were rather disappointed at a lack of new major initiative to boost economic growth or bolster confidence. Lawmakers criticised that the direction of the economy was over reliable on the financial sector but did not touch other core industries such as tourism and logistics nor introduced any concrete policy to help SMEs.

1.3 Economic integration with Mainland China: Hong Kong's trade with China is to a large extent related to outward processing activities. More than 80% of Hong Kong manufacturers have established production facilities in China. Hong Kong's domestic exports are confined to about 4% of its total exports while re-exports account for about 96% of its total exports. Hong Kong is the most important entrepôt for China. If re-exports to and from China are included, about 17% of China's foreign trade was handled via Hong Kong.

Hong Kong is the largest source of overseas direct investment in China. By the end of 2007, among all the overseas-funded projects registered in China, 45% were tied to Hong Kong interests. The stock of utilized capital inflow from Hong Kong amounted to USD 308 billion, accounting for 40% of the national total. On the other hand, China is the biggest investor in Hong Kong. According to the HK Census and Statistics Department, China's cumulative direct investment in Hong Kong was USD 260 billion or 35% of Hong Kong's total stock of inward direct investment at the end of 2006. It is estimated that there are over 2,000 mainland-backed enterprises registered in Hong Kong, with total asset exceeding USD 220 billion.

Hong Kong is a key offshore capital-raising centre for Chinese enterprises. As of September 2008, total market capitalization of Mainland companies listed in Hong Kong reached USD 808 billion or 51% of the market total. In the past 10 years, mainland companies have raised more than USD 130 billion in Hong Kong.

For information on the Closer Economic Partnership Arrangement (CEPA) and Pan-Pearl River Delta (PPRD) Cooperation, please refer to 2.2 and 2.3

1.4 Big challenges of the HK enterprises in the Pearl River Delta PRD: According to the Hong Kong Trade Development Council (HKTDC), there are about 57,500 HK-funded factories in the PRD. In a move to upgrade the processing trade and to contain the production activities of "high energy consumption, high pollution and resource consumption" industries, China has strengthened its control of the processing trade and adjusted relevant regulations since the second half of 2006. Furthermore, the labour contract law, which took effect in January 2008 in China, has increased overall labour costs of HK-funded companies by about 20%. Many enterprises have experienced labour disputes with their employees since the enforcement of the new law.

In the first half of 2008, rising costs in raw materials, fuels and power pushed up production costs. The pace of RMB appreciation added the woes to the Hong Kong producers in the PRD. The RMB appreciated against the US dollar by 6.1% (year-on-year) in Dec. 2007. But it accelerated to 10.6% in June 2008, year-on-year. While most Hong Kong manufacturers in the PRD receive US dollar payments for their exports, the RMB appreciation means higher production costs and lower profit margins.

Amid the global financial crisis, they receive fewer orders and suffer from tighter credit. An industry source suggested that about 20,000 HK-owned businesses in the mainland will collapse if conditions do not improve significantly.

The Chinese government has recently announced to raise the VAT rebate rates for certain exports, which to some extent may help ease the pain of Hong Kong manufacturers in China.

In October 2008, the Hong Kong Government introduced some immediate measures in terms of providing export credit insurance to the SMEs by the Hong Kong Export Credit Insurance Corporation ECIC. It provides cover for the payment risks arising from the buyers' failure to take delivery of goods which are usually not covered by other insurance companies in the market. The ECIC will not increase premiums for its insurance facilities while the processing time will be shortened.

The Hong Kong Monetary issued a circular and urged all authorised banking institutions to adopt a supportive attitude towards their SME customers which would be in the best long-term interests of the economy and the banking industry.

The Hong Kong Government provides a series of enhancement measures in the SME Funding Schemes. Under the SME Loan Guarantee Scheme, the sub-ceilings for the Business Installations and Equipment Loans and Working Capital Loans (WCL) will be removed, while the overall maximum amount of guarantee for each SME is maintained at about US$ 770,000 million. In addition, the maximum guarantee period for WCL will be extended from two years to five years. Each SME will also be allowed to recycle the guarantee once after it has fully paid up the loan backed by the guarantee, which means each SME will be able to obtain a maximum amount of guarantee US$ 1.5 million in its lifetime. Moreover, the indicative ceiling of guarantee exposure for each participating lending institution (PLI) will be increased from US$ 160 million to US$ 190 million in order to provide more "quota" for the PLIs in granting loans.

1.5 Public Finance: The government finance improved dramatically and the budgetary surplus reached US$ 15.8 billion in 2007/08, which was an all-time high surplus. The fiscal windfall is largely due to good land sales, high stamp duty receipts from stock market transfers and rising revenues generating from profits and salary taxes. The revenues of the government have always fluctuated sharply since the above mentioned revenues are volatile income and subject to the economic cycle. Given a huge drop in both land sales and stamp duty receipts from stock market transfer in the first half of the financial year 2008/2009[1], the government's deficit reached US$ 6.2 billion, with financial experts estimating that it might reach between US$ 6.4 billion to US$ 8.9 billion for the full year amid the economic slowdown. Nevertheless, the public finance is still very strong in short and medium term as the fiscal reserves stood at US$ 57 billion as at September 30, 2008.

1.6 New measures to support the banking system: Previously about US$ 12,800 (HK$100,000) per depositor were protected under a bank-funded scheme. A local bank suffered a significant run on deposits in September 2008 due to rumours. The Hong Kong Government announced new measures in October 2008 to strengthen the confidence in the banking system. Following similar moves from a few countries, the Hong Kong government will use the Exchange Fund, the reserve backing Hong Kong dollars, to provide full deposit protection. The protection applies to all Hong Kong dollar and foreign currency deposits held in authorised institutions, including branches of overseas institutions.

In addition, the government will establish a Contingent Bank Capital Facility (CBCF) for the purpose of making available additional capital to locally incorporated licensed banks, on request and subject to supervisory scrutiny should this become necessary.

Both measures take immediate effect and will remain in force until the end of 2010. According to the Hong Kong Monetary Authority, these measures are precautionary and pre-emptive, which are designed to strengthen the confidence in the local banking system. The average capital adequacy ratio of Hong Kong banks is 14 per cent, well above the 8 per cent international standard. Nevertheless, full deposit protection may generate moral hazards and give incentives for banks to take more risks. Therefore, it has to go through a comprehensive review in end 2010.

1.7 US Dollar peg: The Linked Exchange Rate System (HK$7.8: US$1) has been introduced to stabilize the then volatile economy and financial market since 17th October 1983. The Hong Kong Government has reaffirmed its commitment to maintain the dollar peg amid the turbulent situation in the global financial market. The government claims that the dollar peg system has been running effectively in both good and bad times.

1.8 Mini-bonds saga: About 44,000 Hong Kong investors bought US$ 2 billion mini-bonds issued or guaranteed by Lehman Brothers. Investors suffered considerable losses from the bankruptcy of Lehman Brothers. They rallied and complained against potential mis-selling and misrepresentation. The Hong Kong Monetary Authority and the Securities and Futures Commission came under fire in the Legislative Council for failing to monitor and supervise banks selling complex and high-risk investment products. The problem may turn into a political issue if it is not settled properly.

1.9 Implementation of infrastructure projects to boost economy: In the Policy Address 2007-08, the Chief Executive announced the implementation of ten major infrastructure projects[2]. A rough estimate of the added value to the economy brought about by these projects, from commissioning to a mature stage, will be more than US$ 13 billion annually. In addition, some 250,000 additional jobs will be created. At the time of an economic downturn, the government will expedite the implementation of infrastructure projects to boost the economy and create employment opportunities. While ten major

[1] April-September 2008

[2] South Island Line, the Sha Tin to Central Link, the Tuen Mun Western Bypass and Tuen Mun-Chek Lap Kok Link, the Guangzhou-Shenzhen-Hong Kong Express Rail Link, Hong Kong-Zhuhai-Macao Bridge, Hong Kong-Shenzhen Airport Co-operation, Hong Kong-Shenzhen Joint Development of the Lok Ma Chau Loop, West Kowloon Cultural District, Kai Tak Development Plan and New Development Areas (NDAs)

infrastructure projects involve a lot of statutory procedures and preparatory planning, the government will kick start some projects of smaller scale in various districts. About 85 projects (each will cost between US$ 1.9 million and 2.7 million) can start immediately and hence create more jobs.

2. International and regional economic agreements

2.1 HK’s policy and priorities

Hong Kong is a free port which thrives on free trade. Its open door policy has enabled the city to become the world's 12th largest trading economy and an international financial and commercial centre serving the Asia-Pacific region and China. The cornerstone of this approach is a strong and credible multilateral trading system.

Hong Kong is a founding member of the World Trade Organization (WTO). Hong Kong became a member of the Asia-Pacific Economic Cooperation (APEC) and the Pacific Economic Cooperation Council (PECC) in 1991. Hong Kong belongs, in its own right, to the Asian Development Bank (ADB) and the World Customs Organization (WCO). Since April 1994, Hong Kong has been an observer in the Trade Committee of the Organization for Economic Cooperation and Development (OECD).

2.2 Closer Economic Partnership Arrangement (CEPA)

The Closer Economic Partnership Arrangement (CEPA) is the first ever regional trade agreement signed between China and Hong Kong. It was signed in 2003 and came into effect from Jan. 2004. It covered 3 broad areas, namely 1) trade in goods, 2) trade in services and 3) trade and investment facilitation. As a living agreement, the scope of market access and liberalization measures have been expanded progressively under CEPA II – IV in subsequent years.

China and Hong Kong signed CEPA V covering further services liberalization measures on 29th July 2008. With the approval of the Central People's Government (CPG), Hong Kong and Guangdong will also implement a package of liberalisation and facilitation measures on an early and pilot basis to enhance mutual economic and trade co-operation.

<u>Further liberalization measures under CEPA V</u>

Under CEPA V, the Mainland will introduce 29 liberalisation measures covering 17 services sectors, including existing sectors such as conventions and exhibitions, banking, construction and related engineering services, social services, tourism, accounting, medical and dental services as well as two new sectors, namely services incidental to mining, and related scientific and technical consulting services. The total number of service sectors covered by CEPA will be expanded from 38 to 40.

<u>Deepening Economic and Trade Co-operation with Guangdong Province</u>

As a further step to deepen Hong Kong-Guangdong economic and trade co-operation, the Governments of Guangdong and Hong Kong will implement a total of 25 liberalisation and facilitation measures for early implementation in Guangdong, covering accounting, construction as well as related engineering, medical and dental, placement and supply services of personnel, environment, social services, tourism, education, maritime transport, road transport and individually-owned stores. Out of these total 25 liberalisation measures, 17 are covered under CEPA. 8 other measures in the area of tourism, education, environment, advertising and distribution services are not included under CEPA.

<u>Economic Benefits</u>

According to a study of the HKSAR Government released in June 2007, CEPA created more than 38,500 jobs and the CEPA-induced capital investment reached about US$ 1 billion in 2004-2007.

Out of 15.5 million Chinese tourists to Hong Kong in 2007, 8.6 million Chinese tourists travelled under the individual visit scheme (IVS) which was introduced in CEPA. It is arguable that many Chinese tourists would still have travelled to Hong Kong even without the IVS. Nevertheless, the IVS facilitates people’s flow, promotes cross-boundary understanding and tighten business contact between the mainland and Hong Kong. These benefits are intangible and difficult to measure and quantify.

CEPA offers a good platform for Hong Kong products and services to have an effective access to China even though they have to face intensifying competition from Chinese companies and multinational competitors.

It has also helped to rebuild confidence in the economy after a prolonged period of economic slowdown caused by the Asian financial crisis and aggravated by the SARS outbreak. Although the strong rebound in consumption, investment and overall economic growth in the past few years may not be entirely attributable to CEPA, CEPA is undoubtedly an important confidence booster that has helped to kick-start the recovery.

The mainland has undergone rapid economic development over the past two decades. The secondary industry has thrived and has outstripped development in the tertiary industry. To achieve more balanced growth and to take the economic development to a higher level, the Chinese Government has acknowledged the need to strive for quality growth supported by an efficient services sector. The significant part of CEPA to the mainland lies with the intangible benefits, that is, the transfer of quality capital and management and professional skills to the mainland for its long term economic development.

Under CEPA V and the Guangdong pilot measures, it will offer new business opportunities on the mainland for Hong Kong businesses and service suppliers. Town planners, architects, surveyors, social workers, language teachers, human resources specialists and doctors are major beneficiaries of the 11 supplementary agreements signed between Hong Kong and Guangdong on how to implement CEPA V.

According to the Ministry of Commerce in the Mainland, Guangdong is chosen as a pilot province for some additional liberalisation measures because of the geographic proximity and the strong economic ties between Hong Kong and Guangdong. This is a firm step forward for Hong Kong-Guangdong economic co-operation under the new concept of a "special co-operation sphere", as championed by the new Guangdong party chief Wang Yang. Wang Yang has been advocating "liberalised thinking" in Guangdong's growth model and rekindled special interest in Hong Kong's experience and potential. The Guangdong provincial government is fully aware of the needs to accelerate the development of service industries and to develop high-end manufacturing industries.

Premier Wen Jiabao assured Hong Kong in October 2008 that Beijing would make efforts to help Hong Kong to ride out the global financial crisis. One of the measures is to extend the individual visit scheme (IVS) which will enable more individual travellers to visit Hong Kong. It will certainly help inbound tourism covering retail trade, hotel industry as well as food & beverage sector. He also pledged to provide support for HK-owned SMEs in China. It is hopeful that Beijing may introduce some measures or adjust some policies to help Hong Kong companies to offset the negative developments.

<u>Outlook for Switzerland</u>

According to the information in our possession, some Swiss companies in Hong Kong take advantage of CEPA and have been qualified as Hong Kong Service Suppliers under CEPA and operating their business in China.

A Swiss company, qualified as a Hong Kong Service Supplier under CEPA, mentioned that CEPA as a whole was “useful, positive and beneficial” to their business in China. However, CEPA was an agreement signed between the Central Government and HKSAR Government and its implementation depended on the co-operation of various provinces, municipalities, cities and local authorities. According to their experience, they had to encounter problems such as bureaucracy, different legal system, sophisticated tax regime, unpredictable modification and different interpretation of rules and regulations at the early stage of their entry to China. After some years of practical experience and more openness of China in general, their operation is now much smoother than before.

2.3 Pan-Pearl River Delta (PPRD) Cooperation

The "Pan-Pearl River Delta (PPRD)[3] Regional Co-operation Framework Agreement" was signed in 2004. The PPRD regional governments agreed to strengthen cooperation in 10 areas – infrastructure, investment, business and trade, tourism, agriculture, labour, education and culture, information and technology, environmental protection, health and prevention of infectious disease.

During the 4th PPRD Regional Co-operation and Development Forum in June 2007, according to the HKSAR Government, Hong Kong would continue to capitalise on its niche in financial services to facilitate PPRD enterprises to raise capital and go global through Hong Kong. Moreover, the HKSAR Government would establish an information exchange platform between relevant sectors in Hong Kong and the PPRD provinces and regions in order to facilitate industrial upgrading, restructuring and relocation. Moreover, Hong Kong could serve as a bridge connecting the PPRD Region with ASEAN countries as far as trade and investment are concerned.

The 5th PPRD Regional Co-operation and Development Forum, supposedly to take place in June 2008, was postponed due to the earthquake in Sichuan.

3. Foreign trade
3.1 Development and general outlook
3.1.1 Trade in goods

According to the HKTDC, Hong Kong is the world's 12th largest trading economy. Total exports of Hong Kong increased by 9.2% and reached US$345 billion in 2007. Domestic exports dropped to US$ 14 billion (-19%) whereas re-exports grew to US$ 331 billion (+11%). Major export markets were China (49% of total exports), the US (14%), Japan (4.4%), Germany (3%) and UK (2.8%). Major export products were electrical machinery and apparatus (24%), telecom equipment (16%), office machines and computers (9.7%), clothing (8.3%) and textiles (3.9%).

Total exports moderated to 7.8% year-on-year growth in the first nine months of 2008. Major export markets were China, the EU, the US and Japan, which respectively made up 49%, 14%, 13% and 4% of Hong Kong's total exports.

Imports rose to US$ 368 billion (+10%) in 2007, following a 12% increase in 2006. Major supplier countries were China (46% of total imports), Japan (10%), Taiwan (7.2%), Singapore (6.8%) and the US (4.8%). Major import products were electrical machinery and apparatus (26%), telecom equipment (13%), office machines and computers (8.7%), clothing (5.2%) and textiles (3.7%).

Imports rose by 9.1% in January-September 2008. A trade deficit reached US$21.4 billion as compared to US$23.1 billion in 2007. Major suppliers were China (46% of total imports), Japan (9.9%), the EU (7.6%) and Taiwan (6.5%).

Regulations: Hong Kong is a free port and there is no tariff on general imports except duty on liquors, tobacco, hydrocarbon oil and methyl alcohol.

There are no regulatory measures impinging on international trade other than those required to discharge international obligations or to protect health, environment and access to hi-technology.

3.1.2 Trade in services

Exports of services amounted to US$ 83 billion (+15%) in 2007, following a strong increase of 14% in 2006. It included: trade-related services (31% of total exports of services, increased by 13%), transportation services (29% of total exports of services, increased by 6.9%), travel services (17% of total exports of services, increased by 19%), financial services (15% of total exports of services, increased by 39%), other services (8% of total exports of services, increased by 12%) and insurance services (0.6% of total exports of services, increased by 23%).

[3] The PPRD region, also known as "9+2", comprises nine provinces/regions including Fujian, Jiangxi, Hunan, Guangdong, Guangxi, Hainan, Sichuan, Guizhou and Yunnan, as well as Hong Kong and Macao Special Administrative Regions.

In 2006 (latest available information), exports of services by main destinations were China (US$ 17.6 billion, 25% of total, grew by 7.1%), the US (US$ 15.3 billion, 22% of total, grew by 19%), the UK (US$ 5.7 billion, 8% of total, grew by 32%), Japan (US$ 5.1 billion, 7.2% of total, grew by 15%) and Taiwan (US$ 4.7 billion, 6.5% of total, grew by 2.8%).

Import of services amounted to US$ 41 billion (+12%) in 2007. It included: travel services (37% of total imports of services, increased by 8%), transportation services (31% of total imports of services, increased by 10%), other services (17% of total imports of services, increased by 14%), trade-related services (7% of total imports of services, increased by 12%), financial services (6% of total imports of services, increased by 36%) and insurance services (2% of total imports of services, increased by 19%).

In 2006 (latest available information), imports of services by main sources were China (US$ 9.8 billion, 27% of total, grew by 7%), the US (US$ 5.5 billion, 15% of total, grew by 8%), Japan (US$ 3.1 billion, 9% of total, grew by 7%), the UK (US$ 2.9 billion, 8% of total, grew by 10%) and Australia (US$ 2.1 billion, 6% of total, grew by 2%).

3.2 Bilateral trade
3.2.1 Trade in goods

According to the HKTDC, Switzerland was the 17th largest trading partner of Hong Kong in 2007. Switzerland was Hong Kong's 12th largest supplier and 24th largest export market. In Jan-Sept 2008, Switzerland rose to the 14th largest trading partner of Hong Kong, ranked as the 12th largest supplier and 17th largest export market.

According to the Swiss Federal Customs Administration, Swiss exports to Hong Kong totalled CHF 5.3 billion (+13%) in 2007. Major Swiss exports included watches and clocks (46% of total, increased by 25%, CHF 2.4 billion in value), jewellery & precious metal (29% of total, increased by 1%, CHF 1.5 billion in value), machinery (8.3% of total, increased by 4.5%, CHF 440 million in value) and chemical and pharmaceutical products (8.2% of total, increased by 13%, CHF 438 million in value).

In 2007, Swiss exports to mainland China (CHF 5.4 billion in value) and Hong Kong (CHF 5.3 billion in value) accounted for 5.2% of global Swiss exports, bringing China (incl. Hong Kong) to the position of Switzerland's most important market and trade partner in Asia, ahead of Japan (3.3%). On the other hand, Swiss imports from China (CHF 4.8 billion) and Hong Kong (CHF 1.2 billion) totalled CHF 6 billion. Switzerland got a trade surplus worth CHF 4.7 billion.

Swiss exports to Hong Kong increased to CHF 4.5 billion (+15%) in the first three quarters of 2008. Major products included watches and clocks (45% of total, increased by 19%, CHF 2 billion in value), jewellery & precious metal (32% of total, increased by 17%, CHF 1.4 billion in value), machinery (6.6% of total, dropped by 6.6%, CHF 296 million in value) and chemical and pharmaceutical products (7.7% of total, increased by 9.5%, CHF 346 million in value).

In Jan-Sept. 2008, China (including Hong Kong) maintained the status as the biggest market for Swiss products in Asia (5.5% of global Swiss exports), whereas China and Hong Kong accounted for 2.8% and 2.7% respectively.

Hong Kong's total exports to Switzerland dropped to CHF 1.2 billion (-18%) in 2007. Major total exports included jewellery & precious metal (53% of total, decreased by 31%, CHF 626 million in value), watches and clocks (22% of total, increased by 7.5%, CHF 260 million in value), machinery (12% of total, decreased by 22%, CHF 143 million in value) and textiles and garments (4.8% of total, grew by 16%, CHF 56 million in value).

The first three quarters of 2008 saw a solid growth of Hong Kong exports to Switzerland by 39% and reached CHF 1.1 billion. Major products included jewellery & precious metal (62% of total, increased by 70%, CHF 703 million in value), watches and clocks (19% of total, increased by 14%, CHF 218 million in value), machinery (9% of total, increased by 4%, CHF 104 million in value) and textiles and garments (3.3% of total, dropped by 13%, CHF 38 million in value).

According to the Hong Kong Census and Statistics Department (HKCSD), Swiss exports to Hong Kong totalled USD 4,563 million (+27%) in 2007 of which goods worth US$ 1,563 million were re-exported to other countries and notably to China. Swiss goods worth US$ 700 million (grew by 15%) were re-exported to China via Hong Kong in 2007. Major products were watches and clocks (US$ 229 million), silver and platinum (US$ 70 million), textile machinery (US$ 32 million), colouring matter (US$ 28 million) and measuring instruments (US$ 26 million).

In Jan-Sept. 2008, Swiss products worth US$ 1,363 million were re-exported via Hong Kong to other countries. During this period, Swiss goods worth US$ 604 million (grew by 19%) were re-exported to China via Hong Kong. Major products were watches and clocks (US$ 213 million), medicaments (US$ 57 million), silver and platinum (US$ 35 million), measuring instruments (US$ 24 million), machine tools (US$ 22 million), colouring matter (US$ 20 million) and textile machinery (US$ 16 million).

There has been a notable growth for Swiss products entering China via Hong Kong in recent years, from US$ 518 million in 2005, US$ 610 million in 2006, US$ 700 million in 2007 and US$ 604 million in Jan-Sept. 2008. In this regard, Swiss exporters and manufacturers may make use of Hong Kong as a known entrepôt and trade hub (which has a huge cluster of traders who are experienced in the market of China) to do business with China.

On the other hand, Hong Kong exports to Switzerland totalled US$ 1,813 million in 2007. Among them, products of Chinese origin worth US$ 1,095 million (grew by 12%) were re-exported to Switzerland via Hong Kong. Major products were watches and clocks (US$ 489 million), clothing (US$ 143 million), electrical machinery (US$ 93 million), jewellery (US$ 69 million) and telecom equipment (US$ 38 million).

In Jan-Sept. 2008, products of Chinese origin worth US$ 1,060 million (grew by 32%) were re-exported to Switzerland via Hong Kong. Major products were watches and clocks (US$ 424 million), silver and platinum (US$ 159 million), jewellery (US$ 62 million) and apparel (US$ 41 million).

Outlook for Swiss exports to Hong Kong

Renowned brands and luxury items from all over the world are well presented in Hong Kong. According to the Nielsen Global Luxury Brands Study released in March 2008, Hong Kong consumers are the most brand conscious in the Asia Pacific region with 40% consumers claiming to buy luxury products and designer brands, significantly exceeding the regional average of 15%. Their survey also revealed that over US$ 770 per capita was spent on luxury products in Nov. 07 – Jan. 08.

Swiss products, such as watches, jewellery, clothing, footwear, leather goods and skin care products, enjoy an excellent reputation in the market. They are not only appealing to local consumers, but also winning popularity among tourists, in particular from China (tourists from China reached 15.5 million or 55% of total visitor arrivals in 2007). Hong Kong is a window of the world to Chinese tourists who have high consuming power. According to an established watch and jewellery retailer group in Hong Kong, Chinese tourists account for about 70% of sales of Swiss hi-end watches in their shops.

However, the first ten months of 2008 saw sharp corrections in both the stock markets of China and Hong Kong[4]. Furthermore, the property price in Hong Kong has dropped around 10-20% while that in China has also undergone downward adjustments. The negative wealth effects on local consumers and Chinese visitors and dimmer global economic prospects are likely to dent consumer sentiment. According to an industry source, retail sales dropped substantially by 20-30% (year-on-year basis) in October 2008. Shoe and fashion stores suffered the most. It was the worst month in retail sales since the outbreak of the Severe Acute Respiratory Syndrome (SARS) in 2003. Sales are expected to fall by 5-8% in the lead-up to Christmas.

Therefore, despite sustained growth of Swiss exports to Hong Kong in the first three quarters of 2008, the trend will look less rosy in the following quarters. The repercussions of the global financial crisis

[4] Hang Seng Index in Hong Kong rose to 31,638, an all-time high record, in October 2007 but closed at 13,968 on 31st October 2008. SSE Composite Index in Shanghai reached 6,124 in October 2007 and dropped to 1,728 on 31st October 2008

have yet to fully play out. The adverse impacts on the local economy and Swiss exports to Hong Kong are the issues to watch out.

3.2.2 Trade in services

According to the HKCSD, Hong Kong's exports of services to Switzerland amounted to US$ 717 million (1% of total exports of services, increased by 14%) in 2006 (latest available information). Switzerland ranked 14th largest market for Hong Kong's exports of services. It consisted of transportation services (US$ 234 million), travel services (US$ 30 million), insurance services (US$ 2.6 million), financial services (US$ 99 million), trade-related services (US$ 190 million) and other services (US$ 158 million).

Hong Kong's imports of services from Switzerland reached to US$ 271 million (0.7% of total imports of services, increased by 12%) in 2006. Switzerland ranked 20th largest supplier in this category. It consisted of transportation services (US$ 52 million), travel services (US$ 43 million), insurance services (US$ 30 million), financial services (US$ 23 million), trade-related services (US$ 3.7 million) and other services (US$ 119 million).

Hong Kong wants to position itself as an international trade, logistic and financial centre. Demand for logistic services and financial services[5] are expected to increase whereas Switzerland is known for its excellence in service industries, particularly in financial services.

4. Direct Investments
4.1 Development and general outlook

According to the HKCSD, at the end of 2006, the stock of Hong Kong's inward direct investments was up by 42% to US$ 740 billion. Major investor countries were China (US$ 260 billion or 35% of total, grew by 60%), British Virgin Islands BVI (US$ 250 billion or 34% of total, grew by 53%), the Netherlands (US$ 50 billion or 6.8% of total, grew by 19%), Bermuda (US$ 45 billion or 6.1% of total, grew by 29%) and the US (US$ 36 billion, 4.8% of total, increased by 38%).

China featured highly both as a destination for Hong Kong's outward direct investment (US$ 271 billion or 40% of total, ranked 2nd after BVI) and as a source of HK's inward direct investment (as mentioned earlier). The substantial cross-boundary investment between China and Hong Kong reflected the close economic links between the two places.

The ratios of inward and outward direct investments were 391% and 357% of GDP respectively in 2006. It reflected Hong Kong as a highly externally oriented economy and an important business centre in the region with substantial cross-boundary investment. The highly ranked BVI and Bermuda reflected a common practice of Hong Kong and foreign enterprises in setting up non-operating companies in these offshore financial centres (known as tax haven economies) for channelling direct investment funds back to Hong Kong.

According to the International Monetary Fund (IMF), inward portfolio investments to Hong Kong reached US$ 592 billion (+35%) in 2006. Major investor countries were China (106 billion or 18% of total, grew by 159%), Cayman Islands (US$ 76 billion or 13% of total, grew by 38%), the UK (US$ 72 billion or 12% of total, grew by 2.9%), Bermuda (US$ 70 billion or 12% of total, grew by 56%) and the US (US$ 65 billion or 11% of total, grew by 12%).

In Hong Kong, there is neither restriction on inward and outward investments nor nationality restrictions on corporate or sectorial ownership.

4.2 Bilateral investment flows

According to the HKCSD, Swiss direct investments in Hong Kong rose to US$ 4.1 billion (0.6% of total, grew by 28%) and ranked the 11th largest investor country in 2006. Swiss portfolio investments in

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[5] Financial services cover investment banking services, deposit services, security and commodity brokerage services, portfolio management services, trust services, financial consultancy services, foreign exchange services and etc..

Hong Kong reached US$ 1.3 billion (0.2% of total, insignificant change in the stock) and ranked 23rd investor country in 2006, according to the IMF.

As at 1st June 2008, 53 Swiss companies have set up their regional headquarters in Hong Kong. 63 Swiss companies have set up their regional offices whereas 63 Swiss companies have set up their local offices in Hong Kong. They are classified in various sectors: banking, beauty products, chemicals & pharmaceuticals, consultants, electronics, foodstuffs, freight forwarding, inspection, insurance, machinery/engineering, textiles & garments, watches/jewellery and trading houses, etc..

According to the HKCSD, the outward direct investments from Hong Kong to Switzerland for 2002, 2003 and 2004 were US$ 1.49 billion (ranked 14th), US$ 780 million (ranked 17th) and US$ 564 million (ranked 18th) respectively. The HKCSD compiles for top 20 recipient countries only. As Switzerland dropped out of this category in 2005 and 2006, the corresponding figure is no longer available.

5. Trade, economic and tourist promotion
5.1 Foreign economic promotion instruments

The Consulate General of Switzerland, the Federation Horlogère, Switzerland Tourism, the Swiss Chamber of Commerce in Hong Kong and the Swiss-Chinese Chamber of Commerce are the organisations to promote Swiss economic interests in Hong Kong.

The Swiss Chamber of Commerce in Hong Kong

It is an organization with the mission to provide business platform and networking for Swiss companies and individuals in Hong Kong. It acts as an access to Greater China and Asia Pacific Region. It has consensus voice of the Swiss business community's view towards the HKSAR Government and the Swiss Government.

Its membership is open to Swiss companies as well as companies, individuals and young professionals that have strong ties with Switzerland.

It publishes quarterly issues of "The Bridge" and an annual membership directory in co-operation with the Swiss business communities in Beijing, Guangzhou, Shanghai and Switzerland to meet the challenges of rapid economic development in China.

It jointly organizes luncheons with the Swiss Association of Hong Kong and business chambers with guest speakers to serve as a valuable occasion to exchange ideas and information.

Since a prime business concern of their members lies in the protection of environment, one of its current objectives is to contribute in finding solutions in issues related to environmental matters and particularly to the air pollution in the PRD.

The Consulate General has a close co-operation with the Swiss Chamber of Commerce in Hong Kong such as collaboration in projects and participation at its Committee meetings to exchange views with representatives of various business sectors.

The Consulate General often refers Swiss companies interested in the market of Hong Kong or/and China to the expertise and advice of its members.

Swiss-Chinese Chamber of Commerce

Swiss-Chinese Chamber of Commerce is a non-profit association registered in Switzerland. Over 700 corporate and individual members, among them the leading banks, trading companies, insurances and industrial firms have joined the association. The purpose of the Chamber is to promote and support the global success of the Swiss business community in China.

Switzerland Tourism

According to Switzerland Tourism, Hong Kong visitors staying overnight increased by 3.1% to reach 54,770 in 2007. Their length of stay in Switzerland was 1.9 day, same as that in 2006. The first eight months of 2008 saw a slight increase in Hong Kong visitors staying overnight by 0.3%.

Switzerland Tourism organised 8 media trips, 2 agent educational trips and 13 promotional activities in Jan-Oct 2008. All the above activities helped to promote Switzerland in excellent image and top quality branding.

Fédération Horlogère

The Bienne based Federation of the Swiss Watch Industry (FH) is a private, professional and non-profit association which defends the watch industry's interests and contributes to its development. Its Hong Kong office has regular contacts with watch importers and manufacturers and represents their interests on various matters. One of its activities is the protection of its members' intellectual property rights in Asia (copies, abuses of "Swiss made", trademark infringements, etc.). In Hong Kong and Asia, the Federation launched a watch collector's club called "The Art of Time Club" as well as a website on the watch industry (www.fhs.hk).

5.2 Interests for Switzerland as a location for investment, potential for development

Some Hong Kong companies have acquired Swiss watchmakers and producers of watch movements as a means to extend marketing and distribution network, and/or to gain access to better technology and designs. A noteworthy acquisition was the acquisition of Saia-Burgess by Johnson Electric, a Hong Kong company and one of the biggest manufacturers of micro motors in the world.

Apart from acquisitions, Switzerland as a location of research and development centres or international headquarters may be of interests to a limited number but well-established companies in Hong Kong.

5.3 Interests for Switzerland as a financial location, potential for development

A delegation of the Swiss Bankers Association visited Hong Kong to promote Swiss banking on annual basis in November 2007. The Consulate General of Switzerland organised their meetings with media, Swiss banks, the Hong Kong Monetary Authority and the Securities and Future Commission. The delegation will launch another lobbying trip to Hong Kong and meet the regulators and relevant parties in November 2008.

5.4 Interests for Switzerland as a renowned fabric supplier

The Consulate General of Switzerland worked jointly with Swiss and Hong Kong partners to organize a gala dinner with fashion show in January 2008. Two high-end fashion brand names, one from Switzerland and another from Hong Kong, using mostly Swiss fabrics, presented their spring/summer 2008 collections at a five-star hotel. More than 310 guests from local and overseas, including some 50 Consul Generals and their partners attended. As Swiss watch industry, insurance and financial services are already well known and well presented in Hong Kong, it is hoped that with the gala dinner and fashion show, Swiss textiles can be introduced to the territory.

Both Swiss and Hong Kong participants were pleased with the outcome. More than 40 media from Switzerland, France, China and Hong Kong came for the show and produced extensive and positive media coverage.

6. Useful internet links

HK Government agencies:
HKSAR Government (http://www.gov.hk/)
Commerce and Economic Development Bureau (http://www.cedb.gov.hk/)
Trade and Industry Department (http://www.tid.gov.hk)
Census & Statistics Department (http://www.censtatd.gov.hk/)

Invest HK (http://www.investhk.gov.hk/)
Customs and Excise Department (http://www.customs.gov.hk)
HK Monetary Authority (http://www.info.gov.hk/hkma)
Office of the Commissioner of Insurance (http://www.oci.gov.hk/)
Intellectual Property Department (http://www.ipd.gov.hk/)

Swiss Government agencies and export promotion bodies
State Secretariat for Economic Affairs (http://www.seco.admin.ch/)
OSEC Business Network Switzerland (http://www.osec.ch/)

Statutory trade promotion bodies:
Hong Kong Trade Development Council (http://www.tdctrade.com)

Chambers and Associations:
Swiss Chamber of Commerce in HK (http://www.swisschamhk.org)
Swiss Association of Hong Kong (http://www.swiss-hk.com)
Federation of the Swiss Watch Industry, HK Office (http://www.fhs.hk)
HK General Chamber of Commerce (http://www.chamber.org.hk)
Federation of HK Industries (http://www.industryhk.org)
Chinese General Chamber of Commerce (http://www.cgcc.org.hk)
Chinese Manufacturers' Association (http://www.cma.org.hk)

Newspapers:
South China Morning Post (http://www.scmp.com)
The Standard (http://www.thestandard.com.hk)
Asian Wall Street Journal (http://www.wsj-asia.com)

Trade exhibitions calendar: (http://www.tdctrade.com/exh-con)

Appendices

1. Structure of the Economy
2. Essential Economic Data
3a Trading Partners 2007
3b Trading Partners Jan-Sept. 2008
4 Bilateral Trade Switzerland – Hong Kong
5. Main Investor Countries

Appendix 1 **Structure of Economy**

	1995	2006	2007	% Change 1995 / 2006
Spreading GDP (%)				
Primary Sector	0.2%	0.1%	N.A.	-50%
Secondary Sector	16%	8.7%	N.A.	-46%
Tertiary Sector	83.8%	91.2%	N.A.	+9%
- Part of Public Services	N.A.*	N.A.*	N.A.	N.A.*
Spreading Employment				
Primary Sector	0.6%	0.3%	0.2%	-50%
Secondary Sector	27.1%	13.4%	13.2%	-51%
Tertiary Sector	72.3%	86.3%	86.6%	+19%
- Part of Public Services	N.A.*	N.A.*		N.A.*

*N.A. Not available

Source: Hong Kong Census and Statistics Department

Appendix 2

Essential Economic Data

	2002	2003	2004	2005	2006	2007	2008
GDP (USD billion)	159.9	158.5	165.8	177.3	189.2	206.7	221(a)
GDP per capita (USD)	23,466	23,150	24,100	26,000	27,600	29,800	31,500(a)
GDP growth (%)	1.9	3.2	8.6	7.1	7.0	6.3	5.8(b)
Inflation (%)	-3.0	-2.6	-0.4	1.0	2.0	2.0	4.6(c)
Unemployment rate (%)	7.3	7.9	6.9	5.6	4.8	4.0	3.4(d)
Fiscal balance (% of GDP)	-4.8	-3.3	-0.3	1.0	4.0	7.2	-
Current account balance (% of GDP)	7.9	10.4	9.5	11.4	10.8	11.2	-
Total external debt (% of GDP)	-	-	1	0.9	-	-	-
Debt-service ratio (% of exports)	2.1	1.8	-	-	-	-	-
Reserves (in months of imports)	22.6	23.3	21.1	19.8	18.6	19.6	-

(a) government forecast for 2008
(b) Jan-June 2008
(c) Jan-Sept. 2008
(d) July-Sept. 2008

Sources: HKSAR Government, IMF

Appendix 3a

Trading Partners 2007

	Exports to country/region	Exports (USD millions)	Share (%)	Growth* (%)
1	China	167,735	49	+13
2	USA	47,205	14	-0.8
3	Japan	15,329	4.4	-0.7
4	Germany	10,400	3	+7.2
5	UK	9,598	2.8	+1.7
6	Taiwan	6,786	2	+1.6
7	Korea Rep	6,786	2	+2
8	Singapore	6,468	1.9	+3.8
9	Netherlands	5,695	1.7	+8.2
10	France	4,561	1.3	+6.7
	EU	46,633	14	+5.6
24	**Switzerland**	**1,813**	**0.5**	**+13**
	Total	344,553	100	+9.2
	Imports from country/region	**Imports (USD millions)**	**Share (%)**	**Growth* (%)**
1	China	170,468	46	+12
2	Japan	36,837	10	+7.2
3	Taiwan	26,295	7.2	+5.2
4	Singapore	24,971	6.8	+18
5	USA	17,791	4.8	+12
6	Korea Rep	15,307	4.2	-0.2
7	Malaysia	8,054	2.2	+4.1
8	Thailand	7,356	2	+8.1
9	Germany	6,160	1.7	+8.1
10	Philippines	6,127	1.7	+17
	EU	26,229	7.1	+8.1
12	**Switzerland**	**4,563**	**1.2**	**+27**
	Total	367,694	100	+10

* year-on-year basis

Sources : Hong Kong Census & Statistics Department, Hong Kong Trade Development Council

Appendix 3b

Trading Partners Jan-Sept. 2008

	Exports to country/region	Exports (USD millions)	Share (%)	Growth* (%)
1	China	131,140	49	7.3
2	USA	34,327	13	-0.6
3	Japan	11,414	4.2	0.3
4	Germany	8,919	3.3	18
5	UK	7,115	2.6	3.4
6	Singapore	5,389	2	15
7	Taiwan	5,243	1.9	4.9
8	India	5,209	1.9	69
9	Korea Rep	4,979	1.8	-0.8
10	Netherlands	4,297	1.6	3.5
	EU	36,801	14	8.8
17	**Switzerland**	**2,093**	**0.8**	**58**
	Total	270,623	100	7.8
	Imports from country/region	**Imports (USD millions)**	**Share (%)**	**Growth* (%)**
1	China	134,230	46	8.5
2	Japan	29,027	9.9	7.5
3	Taiwan	19,056	6.5	-0.6
4	Singapore	18,830	6.4	3.6
5	USA	14,760	5.1	14
6	Korea Rep	11,883	4.1	8.2
7	Thailand	6,262	2.1	17
8	Malaysia	6,244	2.1	6.9
9	India	5,969	2	31
10	Germany	5,210	1.8	16
	EU	22,292	7.6	16
12	**Switzerland**	**4,036**	**1.4**	**24**
	Total	292,068	100	9.1

* year-on-year basis

Sources : Hong Kong Census & Statistics Department, Hong Kong Trade Development Council

Appendix 4 Bilateral Trade Table

Bilateral trade Switzerland – Hong Kong

	Exports (CHF million)	% Change	Imports (CHF million)	% Change	Trade Balance	Total Imp./Exp.	% Change
1990	2'265	4.3%	902	-17.3%	1'363	3'166.8	-
1995	2'843	-10.0%	642	-4.3%	2'201	3'485.3	10%
2000	3'842	31.9%	895	36.3%	2'947	4'736.1	32.7%
2001	4'039	5.1%	679	-24.1%	3'360	4'718.6	-0.4%
2002	4'479	10.9%	824	21.3%	3'655	5'304.0	12.4%
2003	4'002	-10.7%	648	-21.3%	3'353	4'650.9	-12.3%
2004	4'073	1.8%	822	26.6%	3'251	4'894.2	5.2%
2005[6]	4'012	-5.3 %	1'674	52.4%	2'338	5'686.0	16.2%
2006	4'694	17.0%	1'457	-13.0%	3'237	6'151.0	8.2%
2007	5'296	12.8%	1'185	-18.6%	4'111	6'481	5.4%
Jan-Sept. 2008	**4'480**	**15.4%**	**1'142**	**39%**	**3'338**	**5'622**	**19.6%**

Major products

Exports	Jan-Sept. 2007 % of total	Jan-Sept. 2007 CHF million	**Jan-Sept. 2008 % of total**	**Jan-Sept. 2008 CHF million**	**Jan-Sept. 2008 % Change Jan-Sept. 2007/2008**
1. Watches and clocks	44	1'689	**45**	**2'009**	**19**
2. Jewellery and precious stones	31	1'222	**32**	**1'434**	**17**
3. Machinery	8.2	317	**6.6**	**296**	**-6.6**
4. Chemical products	8.1	316	**7.7**	**346**	**9.5**

Imports	Jan-Sept. 2007 % of total	Jan-Sept. 2007 CHF million	**Jan-Sept. 2008 % of total**	**Jan-Sept. 2008 CHF million**	**Jan-Sept. 2008 % Change Jan-Sept. 2007/2008**
1. Jewellery and precious stones	51	414	**62**	**703**	**70**
2. Watches and clocks	23	191	**19**	**218**	**14**
3. Machinery	12	100	**9**	**104**	**4**
4. Textiles and garments	5.4	44	**3.3**	**38**	**-13**

Appendix 5

Major investor countries/regions 2006

Rank	Country/Region	Direct investments (USD billion)	Share (%)	Growth (%)	Change of inflow (USD billion)
1	China	260	35%	60%	4.6
2	British Virgin Islands	250	34%	53%	4.1
3	Netherlands	50	6.8%	19%	1.4
4	Bermuda	45	6.1%	29%	-1.6
5	USA	36	4.8%	38%	10
6	Japan	19	2.6%	12%	0.5
7	UK	14	1.9%	27%	0.2
8	Cayman Islands	13	1.8%	51%	0.8
9	Singapore	11	1.5%	0%	-0.4
10	Taiwan	4.3	0.6%	13%	0.7
	EU	72	9.7%	18%	-0.8
11	**Switzerland**	**4.1**	**0.6%**	**28%**	**1.1**
	Total	740	100 %	42%	11

Rank	Country/Region	Portfolio investments (USD billion)	Share (%)	Growth (%)	Change of inflow (USD billion)
1	China	106	18%	159%	N.A.
2	Cayman Islands	76	13%	38%	N.A.
3	UK	72	12%	2.9%	N.A.
4	Bermuda	70	12%	56%	N.A.
5	USA	65	11%	12%	N.A.
6	Australia	43	7%	34%	N.A.
7	Luxembourg	21	4%	31%	N.A.
8	Japan	19	3%	12%	N.A.
9	Republic of Korea	14	2%	17%	N.A.
10	Germany	11	2%	10%	N.A.
23	**Switzerland**	**1.3**	**0.2%**	**0%**	N.A.
	Total	592	100%	35%	N.A.

*N.A. Not available

Sources : Hong Kong Census & Statistics Department, IMF