

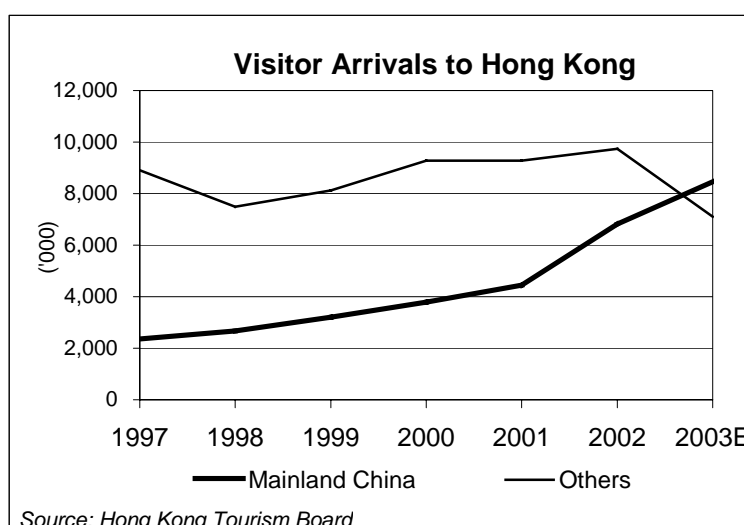
Hong Kong: China's Consumption City

Introduction

Hong Kong was blessed with a bumper harvest of positive economic news in the third quarter. Sentiment has received a marked boost, in particular due to the surge of Mainland tourists under the new 'individual visit' policy. It is not just the numbers. Because they live within a few hours from Hong Kong, Mainland visitors could become frequent travelers, and their expenditure patterns could expand to consumer services other than conventional tourist items. This will create more onshore activities and employment opportunities in the local economy. Meanwhile, the critical mass of visitors to the territory could also be used as a platform to leverage its image as a desirable destination and build up the reputation of Hong Kong brand name products.

Growth Potential

In the first eight months, Mainland visitors increased by 18.6%, accounting for 54.9% of total tourist arrivals. The dominance of the Mainland segment has been reinforced by the new 'individual visit' scheme — residents of eight Guangdong cities, Beijing and Shanghai are now allowed to travel to Hong Kong on an individual basis, rather than having to join a group tour. By mid 2004, the policy will extend to the entire province of Guangdong, and the number of eligible Mainlanders will reach 100 million.



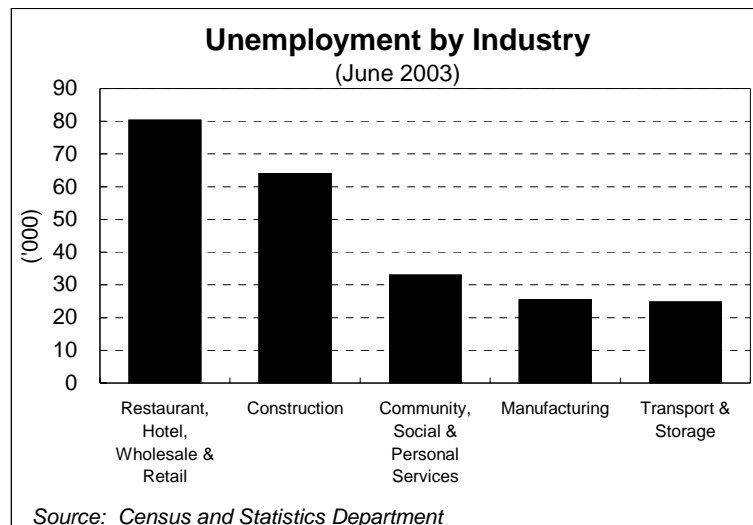
Fully 41% of all Mainland tourists traveling overseas visited Hong Kong in 2002. The reasons for the strong interest in Hong Kong include ethnic affiliation, geographical proximity, close family ties and, most important of all, the high quality of goods and services. According to a survey conducted by the Chinese University, over 80% of Mainland tourist respondents thought highly of the product quality, selection, and customer service in Hong Kong. Our glamorous city life and the close link with the homeland provide a fertile ground for boosting consumption in Hong Kong by our Mainland brethren.

Mainland tourists are significant, not only due to the growth in numbers, but also in the deeper business potential. Firstly, the consumption pattern of Mainland tourists is markedly different from that of visitors from elsewhere. Mainland tourists spend their money on a range of services that go far beyond the general tourist spending categories. Survey results and news reports indicate that they have an appetite for medical services, education, financial products, property purchases, etc.

Moreover, they have a high potential of turning into frequent visitors. A recent survey showed that 90% of Mainland respondents would like to visit Hong Kong again within the next six months. This development could be the mirror image of the growing trend we have experienced over the past decade, of Hong Kong people going north to spend. Hong Kong residents made a total of 55.6 million trips to the Mainland in 2002, up 60% from 1997. 94% of the trips were to Guangdong Province; a third of these were same-day visits. For everything from property investment to golf games, Hong Kong consumers have integrated Guangdong into their spending map. We believe that similar behavior will emerge from Mainland visitors, as far as the travel policy allows. It is not inconceivable that more and more Mainland visitors will make short trips just to visit friends, attend a concert or a football game in the future.

Employment Implications

The rapid growth in Mainland tourist arrivals will help to ease the high unemployment rate in the territory. In the past, up to 90% of tourist spending has gone to shopping, dining and hotel services. These labour intensive sectors create 6.0 employment positions per million-dollar GDP value added, compared to the 2.7 positions for other industries. However, weak domestic demand had pushed the combined unemployment rate in these three sectors to a high of 12.4% in June 2003, accounting for 23.1% of total unemployment. Tourist spending is vital for a turnaround in these trouble spots. The share of revenue received from visitors for these three sectors grew to 27.0% in 2002, from 17.8% in 1998. The growing number of Mainland tourists will further feed this trend, and bring in badly needed onshore activities and hence job opportunities.



Opportunities to Build Up the Hong Kong Brand

Furthermore, the increasing number of Mainland visitors creates a platform for Hong Kong to leverage its image as a desirable destination and build up the reputation of Hong Kong brand name products. The Mainland's huge population had made it the darling of international marketers. While the brand awareness of Hong Kong products and services are weak, the general image is positive. According to a study¹ by the Trade Development Council, Mainlanders give Hong Kong products high rankings in terms of creativity, good taste, trendiness and suitability against our international competitors. To seize the growing business opportunities, brand building targeting the Mainland market is the next logical move. Hong Kong can leverage its commanding share of the Mainland outbound travel market. The evident desirability of the Hong Kong image can be a very effective marketing tool. While American brands have successfully spread the western lifestyle worldwide on the platform of Hollywood productions, Hong Kong could ride on the tourist influx to stamp its name on the biggest consumer market in the 21st century.

Hong Kong as a Consumption City of China

Hong Kong has a long history of success in moving up the merchandise supply chain, from manufacturing in the past to trading, logistics and other business services now. However, perhaps due to complacency from our success in producer services, relatively less attention has been paid to the development of consumer services industries. The integration of the consumption industry on both sides of the Shenzhen River has changed the landscape, at which Hong Kong people head north for low-priced goods and services and Mainland tourists travel in the opposite direction for the high quality and prestige of products available here. While the former activity appears to have reached its zenith, the latter is just in the bud. This can be seen from the fact that the number of Hong Kong travelers going north is seven times as many as the number of visitors from the Mainland, although our population is outnumbered by that of Guangdong alone by a factor of 13. The enormous room for growth means that spending by Mainlanders will become more of a driver behind domestic consumption and overall economic growth in Hong Kong.

In order to fully capitalize on the opportunities presented to us, more effort is required to foster this growing market. Reports of dishonest retailers ripping off tourists have damaged Hong Kong's reputation. Regulations need to be tightened to remove the weeds. Meanwhile, with Mainlanders making up over half of the tourist arrivals, Mandarin and simplified characters should be widely used, not just at tourist attractions but in all public places. Last but not least, policymakers should aim to bring out the full potential of this market force. As we have seen, Mainland consumers have interest in many kinds of services, including education and medical services, and can become frequent visitors. Since travel restrictions have been the main obstacle preventing that from happening, a multiple visit permit together with a longer period of stay would be crucial for realizing the potential gains. Much discussion and lobbying of the central government on the subject are in order.

¹ Source: "Building on a Brand for the Emerging Middle-Class in China" by HK Trade Development Council (May 2003)