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# Economic Analysis

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## The Changing Employment Landscape behind Hong Kong's Economic Development

### Remarkable Run

After hitting rock bottom in 2003, the Hong Kong economy rebounded strongly and delivered sustained growth for the remainder of the last decade. Over the seven-year span to 2010, real GDP growth averaged 5.2% per year. In 20 out of the 28 quarters, the economy enjoyed 6% or faster growth. The last time we experienced such a run was the boom period of 1991 to 1997.

However, a comparison of the two boom periods indicates very different growth patterns. In the 1990s, growth was characterized by strong domestic demand. In real terms, private consumption increased by 53%, well ahead of the 39% growth between 2003 and 2010. Furthermore, Government spending jumped by 41% in the 1990-1997[1] period. It rose by only 9% between 2003 and 2010. Investment tells a similar story. Between 1990 and 1997, investment spending increased by 90%. Between 2003 and 2010, the rise was only 24%. The building of the airport and the fast pace of housing construction in the 1990s contributed to the high 1990s figure. Little wonder that there was widespread optimism about Hong Kong's economic future in the 1990s!

The most recent run is characterized by strong growth in services exports, which jumped by 100% from 2003 to 2010, as compared to a 48% increase from 1990 to 1997. The trade in services accounted for 24.8% of GDP in nominal terms in 2010, well ahead of the 6% to 8% share during the 1990s.

Slower population growth in recent years led to a faster increase in real GDP per capita, with the figure rising by 34% in 2003-10 compared to 24% between 1990 and 1997. However, household income presents a reverse image. In real terms, median household income per capita increased by 11.4% from 2003 to 2010, compared to a jump of 20.1% in the 1990s. Employment growth could partially explain the difference. Total employment increased 313,300, or 10.4%, from 2003 to 2010. From 1990 to 1997, 477,800 new jobs were created, representing a 17.4% rise. This is worth exploring further, and digging down to the industry level offers useful additional detail on the relationship between growth and employment.

### Industry Analysis: Relationship between Economic Growth and Employment

Real GDP increased by 40.9% from 2003 to 2010. Import/export trade and finance and insurance were the two major drivers, growing by 69.2% and 112.2%, respectively. Together they accounted for 34.9% of GDP, but 55.3% of growth during the 2003-10 period. Rapid development of the Mainland economy in the past decade provided the major impetus for the local economy, with Mainland exports growing by an average of 21.4% per year between 2004 and 2010. The lion's share of Hong Kong's merchandise trade is Mainland related, and hence benefited from this trend.

Meanwhile, Hong Kong's role as China's international financial centre has flourished. Funds raised in the Hong Kong equity market during the 2004-10 period totalled HKD 1,653bn, a 342.3% increase over the prior seven-year span. Mainland firms accounted for 55% of the total funds raised during the period.

The export sector was also a major engine of job creation, adding 65,300 jobs, or 20.8% of the total between 2003 and 2010. Meanwhile, finance and insurance created only 35,700 jobs in the same period, accounting for 11.4% of the total employment growth. This is noticeably less than the sector's 26.7% share of GDP growth. The capital-intensive nature of the financial services industry partially explains the limited impact on job creation. However, the industry has generated substantial demand in supporting services. Professional, business services and real estate industries created 79,800 jobs between 2003 and 2010, accounting for 25.5% of job growth during the period.

**Growth of Real GDP and employment by industries during 2003-2010**

| | Real GDP(1990=100) | | | Employment | | |
|---|---|---|---|---|---|---|
| | 2010 | 2003-2010 increase | | 2010 | 2003-2010 increase | |
| By industry | % of Total | HKD mn. | % of Total Increase | % of Total | ('000) | % of Total Increase |
| Finance & insurance | 14.6% | 134,382 | 26.7% | 5.6% | 35.7 | 11.4% |
| Exports & Imports | 20.3% | 144,123 | 28.6% | 14.4% | 65.3 | 20.8% |
| Professional, business services & real estate | 10.3% | 33,588 | 6.7% | 12.6% | 79.8 | 25.5% |
| Public administration, social & personal services | 16.5% | 33,282 | 6.6% | 25.7% | 158.1 | 50.5% |
| Wholesale & retail | 4.1% | 27,161 | 5.4% | 9.7% | 10.4 | 3.3% |
| Accommodation & food services | 3.0% | 18,233 | 3.6% | 7.6% | 31.3 | 10.0% |
| Manufacturing | 1.7% | -2,391 | -0.5% | 3.7% | -73.9 | -23.6% |
| Construction | 3.3% | -8,260 | -1.6% | 7.7% | 10.3 | 3.3% |
| Transportation & storage | 5.8% | 30,584 | 6.1% | 8.6% | 9.5 | 3.0% |
| **Total** | **100.0%** | **503,513** | **100.0%** | **100.0%** | **313.3** | **100.0%** |

Source: Census and Statistics Department, BEA estimates

[1] The study focuses on changes during the two seven year spans (1991-1997 & 2004-2010). When annual growth rates are involved, these are the periods used. When examining accumulated changes over the period, it will compare level at 1997 versus that of 1990, and in the same token the changes of level between 2010 and 2003.

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Meanwhile, the largest job generators were the public administration, social and personal services sectors, which added 158,100 jobs. This growth was offset by a loss of 73,900 jobs in the manufacturing sector. However, the economic value added by these sectors accounts for only 6.6% of GDP growth. As a result, the share of the total GDP contributed by this group declined from 20.6% in 2003 to 16.5% in 2010. The declining influence of these sectors is reflected in slow wage growth. Payroll for social and personal services increased 1.9% during 2004-10[2], as compared to 16.3% increase for the overall economy. The dismal performance of the largest employment sector is troubling. It indicates that it takes time for economic benefits of externally driven growth filtering down to the domestic sector.

## Key Challenges: Expand Economic Capacity

China's 12th 5-year plan calls for the country's engine of economic growth to shift away from exports. As Mainland export growth cools, Hong Kong's trade sector will feel the chill. Already, Hong Kong exporters have been squeezed by sluggish demand and rising costs, as Europe and the United States wrestle with deep-set economic woes and as the Rmb rises in value.

Although a rise in demand from Mainland consumers will offset some of the decline from overseas, this new demand may not kick in quickly enough to mitigate the impact on local traders. Signs of weakness are already evident. The increase in the trade sector's economic value added was only 2.3% for the period 2008 to 2010, lagging behind the 4.1% increase for the economy as a whole. Total employment in the sector was 5.1% lower in 2010 than the pre-crisis level in 2008.

On the other hand, factors that underpin the strong growth in the financial sector will continue to favour the industry's development. The 'Going Out' policy under China's 12th 5-year Plan encourages Mainland companies to expand overseas by acquiring expertise and strategic assets such as energy and commodities. Many Mainland companies seeking to expand overseas will use Hong Kong as a financial platform.

Furthermore, the development of Hong Kong as an offshore Rmb centre has gained momentum in the past three years. The scope of Rmb financial services in Hong Kong, including trade settlement, fund transfer, and investment products, has expanded significantly. Rmb deposits stood at Rmb 609bn as of August 2011, accounting for 10.2% of the total deposits in Hong Kong. Total trade settled in Rmb in Hong Kong passed the Rmb 1 trillion mark in the first eight months of this year, accounting for 7.5% of China's total trade.

The latest announcements involving Rmb Foreign Direct Investment and Rmb Qualified Foreign Institutional Investors will provide yet further business opportunities. And as the expansion of Rmb business reaches a critical mass, it will attract Rmb funds from the Mainland and overseas and will create a new engine of growth for the industry. Its significance to the economy as a growth driver will be further enhanced, and may very possibly compensate for the weakness in the import/export sector.

One bright spot in the effort to identify new growth areas in the Hong Kong domestic economy is the surge in spending by visitors from the Mainland. Tourist spending (excluding hotel bills) as a percentage share of consumer expenditure in the domestic market increased from 6.3% in 2003 to 12.5% in 2010. Growth accelerated between 2008 and 2010, with tourist spending accounting for 44.7% of the increase in expenditure in the domestic market during this period. Visitors from the Mainland accounted for 68.7% of total tourist spending in 2010. And this spending is highly targeted: 74% of spending by Mainland visitors goes to shopping. As a result, the retail sector saw sales jump by a stunning annual rate of 25.6% in the first eight months of this year.

However, the lion's share of the earnings goes to overseas producers, as most consumer products sold in Hong Kong are imported. The economic value retained in Hong Kong is limited. Furthermore, there are concerns that the Mainland government may lower the import tariff on luxury imports in future. This could reduce Hong Kong's price advantage and attract some spending back to the Mainland. To offset this risk and retain more of the economic value of visitor spending, greater effort should be made to encourage Mainland visitors to use other local services, such as education, finance and medical services. With more local content, a shift to these services has greater potential to create local employment.

Another area that Hong Kong should address is the rising cost of business premises. As mentioned earlier, an increasing number of Mainland firms are moving to Hong Kong to use our financial services. Foreign firms also set up office in Hong Kong to serve the growing Mainland market. However, office supply has not increased in tandem with the demand. Government estimates that office completion during 2009-2012 averaged only 135,275 sq.m.[3], well below the average of 260,000 sq.m. during 1998-2008. As a result, Hong Kong has overtaken London as the most expensive place to rent office space in the world[4]. This has significantly increased the cost of doing business in Hong Kong, and forced some business operations to relocate to neighbouring cities. Hence, an increase in office supply is urgently needed to allow Hong Kong to continue to serve as a centre for business services.

In conclusion, service exports have fuelled Hong Kong's economic growth in the past seven years. This is a desirable and sustainable growth model for the small and open Hong Kong economy. Looking ahead, we should maintain our software advantage on financial and consumer services and benefit from the growing Mainland demand for our business and consumer services. However, supply side constraints have kept Hong Kong from capturing the full benefit. From office space to healthcare services, capacity has failed to keep up with surging demand. As a result, we have to turn customers away. Employment opportunities are forgone. This makes expanding our economic infrastructure the most urgent task for Hong Kong.

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[2] The 2004 data is earliest data available
[3] Source: Hong Kong Property Review
[4] Source: Jones Lane LaSalle