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DEPARTMENT OF NATIONAL DEFENCE  
MINISTÈRE DE LA DÉFENSE NATIONALE

IR 37/85 - HONG KONG :  
Brewing Dependency on the  
Chinese Market.

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**INTELLIGENCE  
REPORT**

**BULLETIN DE  
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HONG KONG: Growing Dependency on the Chinese Market

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HONG KONG: Dépendance accrue vis-a-vis le marché chinois

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HONG KONG: Growing Dependency on the Chinese Market

SUMMARY

1. Although Hong Kong faces the threat of rising trade protectionism and weakening demand from Western countries, particularly the USA, the colony's overall exports in 1985 should be stimulated by increasing trade with China. China is emerging as Hong Kong's fastest growing market for domestic exports and particularly for re-exports, which grew by over 45 per cent in the first five months of 1985. This trend should continue, at least for the next several years, as a result of Hong Kong's proximity to the Chinese market and its growing political ties with the mainland. Increased dependency on trade with China is likely, however, to entail more risk for Hong Kong exporters because of the greater uncertainty in doing business with China. While exports to China are unlikely to offset totally the fall in demand from the USA, this trade should allow Hong Kong's overall exports to perform better than those of the majority of the colony's competitors in the East Asian region. While Hong Kong's exports to Canada grew strongly by an average of 20 per cent for the last two years to reach Cdn \$966 million in 1984, lower overall demand is resulting in slower growth this year.

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HONG KONG: Dépendance accrue vis-a-vis le marché chinois

Resumé

1. Malgré la recrudescence du protectionisme et l'affaiblissement de la demande occidentale, en particulier des États-Unis, l'ensemble des exportations de Hong Kong en 1985 devrait être stimulé par amélioration des échanges avec la Chine. Le marché chinois est celui qui se développe le plus rapidement au chapitre des exportations de produits nationaux et surtout des réexportations, lesquelles ont augmenté de plus de 45 p. 100 au cours des cinq premiers mois de 1985. Cette tendance devrait se poursuivre, du moins pour les quelques années à venir, en raison de la proximité des marchés chinois et du resserrement des liens politique entre la colonie et le continent. Cette dépendance n'est cependant pas sans poser des risques accrus pour les exportateurs de Hong Kong étant donné l'incertitude qui caractérise les échanges avec la Chine. Même s'il est peu probable que les exportations vers la Chine compenseront la chute de la demande américaine, elles devraient permettre à la colonie de se tirer mieux d'affaire que la plupart de ses principaux concurrents de l'est asiatique. Si les exportations de Hong Kong vers le Canada ont connu une forte hausse ces deux dernières années (20 p. 100 en moyenne) pour atteindre 9 66 millions de dollars canadiens en 1984, une demande globale plus faible s'est traduite cette année par un ralentissement de la croissance.

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2. The surge in demand for Hong Kong's exports in 1984 contributed to strong export-led growth of close to 10 per cent. Domestic exports grew by 24 per cent (in real terms) to reach US \$17.7 billion, while real growth in re-exports (exports of imported commodities without significant alteration) jumped by 40 per cent to US \$10.7 billion, resulting in overall exports totalling over US \$28 billion or some 90 per cent of the value of GNP. This good export performance was largely the result of the economic recovery in the USA, which accounted for close to 44 per cent of the market share of Hong Kong's domestic exports or some five times higher than the next largest importer. However, despite the fact that the real increase in domestic exports to the USA was close to 21 per cent, demand in this market showed a progressively decelerating trend throughout the year. The decrease in the relative price competitiveness of the Hong Kong dollar and the slowdown in overall USA import demand resulted in a fall in Hong Kong's domestic exports of one per cent by the fourth quarter of 1984.

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3. On the other hand, Hong Kong's domestic exports to China surged throughout the year by 60 per cent (in constant dollar terms) as economic reforms increased China's demand

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for consumer good imports. China's share of Hong Kong's 1984 domestic exports grew from six per cent in 1983 to eight per cent and the mainland emerged as the colony's fastest growing market. China leaped ahead of Britain and West Germany to become Hong Kong's second largest importer, a considerable achievement since the mainland was Hong Kong's 35th largest market less than a decade ago. Growth in Hong Kong's re-exports to China was even more rapid and China's share of the colony's re-exports grew to 34 per cent from 22 per cent in 1983. Re-exports to the mainland jumped by 130 per cent as the colony strengthened its role as the major entrepot for East Asia. China was also the source of a large proportion of Hong Kong's re-exports to other markets.

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4. Expansion in the Chinese market will become increasingly important to Hong Kong's growth over the next several years in order to offset the anticipated decline in demand in the colony's major Western markets. Slower growth in the USA economy and increasing protectionist pressures resulting from the growing USA trade deficit are expected to restrain growth in import demand. While protectionism in the textile sector has always been strong, even more severe restrictions are being discussed. In addition to the recent

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"country of origin" rules, the USA is considering further limiting quota increases and/or introducing import surcharges of 25 per cent. While USA legislation may be less directed at Hong Kong than at countries which restrict USA products, the colony's exports are unlikely to escape from growing restrictions. Even if Hong Kong were able to adjust production to circumvent such restrictions, changes would be difficult to make in the short-term. The situation in Hong Kong's other major markets is little better, where the growth in Hong Kong's domestic exports is being weakened by the strong Hong Kong dollar and declining overall demand. Hong Kong's exports to Canada have grown strongly for the last several years by an average of 20 per cent to reach Cdn \$966 million in 1984. Nonetheless, while Canada's import restrictions did not increase this year, lower overall demand led to slower growth in imports from Hong Kong in the first five months of 1985. If this trend continues, Canada's 1985 trade deficit with Hong Kong could fall from last year's Cdn \$751 million.

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5. Conversely, Hong Kong's trade with China should continue to expand, stimulated by growing economic and political ties. While import growth is expected to slow

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from the 70 per cent increase experienced in the first six months of this year, China's commitment to maintaining its "open door" policy and its considerable import requirements should result in continuing strong import demand. In addition to the comparative advantage Hong Kong enjoys because of its proximity to the mainland, the colony's trade is expected to benefit from the growing interdependence of the two economies. While the long-term benefits of the 1997 repatriation of Hong Kong to China are still uncertain, the recent signing of the Sino-British agreement is helping to stimulate trade opportunities for the colony in the near term.

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6. Since the growing influence of China on Hong Kong's trade is expected mainly to stimulate Hong Kong's re-exports, the structure of the colony's trade could change over the next decade. While the value of Hong Kong's domestic exports has traditionally exceeded that of re-exports, positions could reverse if re-exports continue to outperform domestic exports. In the first five months of 1985, Hong Kong's re-exports jumped by just over 45 per cent to reach US \$5.7 billion, while domestic exports declined by two per cent to US \$6.3 billion. In March of this year, re-exports exceeded exports for the first time in recent

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history. Although domestic exports to China shot ahead in the first five months of 1985 by 84 per cent, re-exports to the mainland increased by 151 per cent. Hong Kong is ideally situated for re-export trade with China, since its position as the world's second largest container port allows the colony to handle seven times more cargo than all China's ports combined. Although the Chinese are currently taking steps to expand and modernize their ports, the major container ports at Shanghai, Canton and Xingang will be unable to compete with Hong Kong in the foreseeable future.

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7. Nonetheless, increased dependency on the Chinese market is likely to entail greater risk for Hong Kong traders because of the increased uncertainty in doing business with China. Periodic policy adjustments are necessary to promote the smooth implementation of China's ambitious economic reforms and these will probably continue to have repercussions on China's external trade. Most recently, China's decentralization policies and a sharp increase in domestic import demand resulted in an unplanned US \$5 billion drop in foreign exchange reserves in the six months ending in March 1985. Consequently, stricter controls over foreign exchange spending are being

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implemented, particularly for "non-essentials" such as consumer goods. Since a large proportion of Hong Kong's exports is in consumer goods, many traders are suffering from the cutback, despite the fact that it is in China's long-term interest to promote strong growth in Hong Kong's exports. (CONFIDENTIAL)

8. Chinese officials have stated, however, that import constraints will be temporary, although China's recent foreign exchange experience and its US \$3.1 billion trade deficit in the first six months of 1985 will make authorities more cautious about encouraging rapid import increases over the next several years. While expansion of Hong Kong's domestic exports to China is unlikely to offset the projected lower USA import demand, growth in the colony's re-export trade with China should help to stimulate an increase in the colony's overall exports. Even if the trend continues and Hong Kong's domestic exports decline this year, growing trade with China should still allow the colony's overall exports to outperform the majority of its East Asian competitors this year. (CONFIDENTIAL)

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