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512.0-RRE/CHW

Hong Kong, 21st May 2018

Annual Economic report: Hong Kong 2017

Executive Summary

Throughout 2017, the global economic landscape continued to improve. Hong Kong's economy grew by 3.8% in real terms, up from 2.1% growth in 2016. Hong Kong's total exports of goods and exports of services registered a growth of 5.9% and 3.5% respectively in real terms in 2017. Domestic demand remained resilient. Full employment, coupled with the positive wealth effect, drove strong consumer confidence.

Hong Kong is the most important entrepôt of Mainland China. According to the HKSAR government statistics, 58% of re-exports were of China origin and 54% were destined for China in 2017. According to China's Customs statistics, Hong Kong is the third largest trading partner of China after the United States and Japan, accounting for 7% of its total trade in 2017. Mainland China was the largest destination for Hong Kong's outward direct investment and the second largest investor country in Hong Kong.

Hong Kong is also a key offshore capital-raising centre for Chinese enterprises. As of December 2017, 1,051 mainland companies were listed in Hong Kong, comprising H-share, red-chip and private companies, with total market capitalisation of around US$ 2.9 trillion, or 66% of the market total. In April 2018, the People's Bank of China announced that China would quadruple the daily quota on the Shanghai-Hong Kong and Shenzhen-Hong Kong stock connect schemes from 1st May 2018, a move that could increase integration of China's onshore and offshore stock market trading. The daily southbound quota would be increased to RMB 42 billion whereas the daily northbound quota would be increased to RMB 52 billion.

According to the Hong Kong Census and Statistics Department, Switzerland was Hong Kong's 12th largest supplier and 20th largest export market in 2017[1]. According to the Swiss Federal Customs Administration, Swiss exports to Hong Kong totalled CHF 15,747 million (-14%) in 2017. Major Swiss exports included jewellery, precious metal, gold, silver and coins (76% of total, dropped by 19%, CHF 11,953 million in value) as well as watches and clocks (16% of total, increased by 6%, CHF 2,525 million in value). Hong Kong's total exports to Switzerland amounted to CHF 9.227 million (+13%) in 2017. Major total exports included jewellery, precious metal, gold, silver and coins (94% of total, increased by 15%, CHF 8,706 million in value) as well as watches and clocks (3.1% of total, dropped by 23%, CHF 286 million in value).

Hong Kong has signed six free trade agreements, respectively with Mainland China, New Zealand, the Member States of the European Free Trade Association EFTA (including Switzerland), Chile,

[1] Hong Kong official trade figures do not include trade in gold, silver and coins

Macao and the Association of Southeast Asia Nations (ASEAN). Hong Kong is now negotiating free trade agreements respectively with Georgia, Maldives and Australia.

Hong Kong has entered into Comprehensive Double Taxation Agreements / Arrangement (CDTAs) with 39 jurisdictions including Switzerland (which was signed in October 2012). There are 12 countries/territories which are still under negotiation. In addition, it has entered into Tax Information Exchange Agreements with 7 jurisdictions and been negotiating with another 3 jurisdictions.

The HKSAR Government introduced an amendment bill to the Legislative Council in March 2017, which seeks to expand the list of reportable jurisdictions to cover 75 reportable jurisdictions (including Switzerland) for the effective implementation of the arrangement relating to automatic exchange of financial account information (AEOI). The bill, which was passed by the Legislative Council, came into operation in July 2017.

Regarding economic outlook, the HKSAR Government forecast Hong Kong's economy to grow by 3% to 4% in 2018. In fact, the Hong Kong economy turned in a robust growth of 4.7% over a year earlier in the first quarter of 2018, sustaining the full-fledged upturn in 2017. Domestic demand continued to strengthen, thanks to optimistic consumer sentiment on the back of favourable job and income as well as asset market conditions.

Total retail sales increased by 14% for the first quarter of 2018 over the same period in 2017, owing to favourable job and income conditions and buoyant inbound tourism. Products-wise, the value of sales of jewellery, watches and clocks, and valuable gifts increased by 22%. This was followed by sales of clothing and footwear (+17% in value); medicines and cosmetics (+17%) as well as electrical goods and other consumer durable goods (+21%).

As mentioned in the Chief Executive's Policy Address and the Financial Secretary's Budget Speech, the HKSAR Government is keen to push innovation and technology as a new economic driver for Hong Kong. More resources will be allocated to develop biotechnology, artificial intelligence, smart city and financial technology. It will offer business opportunities to Swiss companies which are active in these sectors.

However, there are some downside risks that warrant attention. The US interest rates adjustment has triggered substantial fluctuations in the global financial markets. Furthermore, trade tension between Mainland China and the United States can hit Hong Kong in its entrepôt trade of which its re-exports accounted for about 98.9% of its total exports in 2017. Trading and logistics is one of the four pillar economic sectors of Hong Kong, accounting for 22% of its GDP. The actual impact depends on the scale and enforcement of stiff trade measures of these two countries which are the largest and second largest export markets of Hong Kong. Should it go fiercely and viciously, it would not only disrupt the trade performance of Hong Kong, but it would also cause volatility in its financial market and hence affect investor and consumer confidence. Mainland China and the US issued a joint statement and agreed on substantially reducing the trade imbalance on 19th May 2018. Both countries would continue to engage at high levels and seek to resolve their economic and trade concerns. Although fundamental disputes between Mainland China and the US are not totally over, both sides have made some progress in the latest round of trade talks.

1. Economic problems and issues

1.1 General overview of HK's economy

Throughout 2017, the global economic landscape continued to improve. Hong Kong's economy also grew by 3.8% in real terms, up from 2.1% growth in 2016. As to the external sector, Hong Kong's total exports of goods registered a growth of 5.9% in real terms in 2017, from 1.6% in 2016, while exports of services grew by 3.5% in real terms in 2017, when compared with a decline of 3.4% in 2016. Domestic demand remained resilient. Full employment, coupled with the positive wealth effect, drove strong consumer confidence. In 2017, private consumption expenditure grew by 5.4 per cent in real terms, the fastest since 2011. Investment expenditure also increased by 4.2 per cent in real terms for the year. Unemployment rate was 3.1% while the headline inflation rate was 1.5% for the year. The HKSAR Government forecast Hong Kong's economy to grow by 3-4% in 2018.

However, there are some downside risks. The US interest rates adjustment has triggered substantial fluctuations in the global financial markets. Hong Kong, being a small and open economy, is the most important entrepôt of Mainland China. Trade tension between Mainland China and the United States can hit Hong Kong in its entrepôt trade[2]. Trading and logistics is one of the four pillar economic sectors of Hong Kong, accounting for 22% of its GDP. The actual impact depends on the scale and enforcement of stiff trade measures of these two countries which are the largest and second largest export markets of Hong Kong. Nevertheless, trade tension between the two biggest economies has already caused volatility in global financial markets. Mainland China and the US issued a joint statement and agreed on substantially reducing the trade imbalance on 19th May 2018. Both countries would continue to engage at high levels and seek to resolve their economic and trade concerns. Although fundamental disputes between Mainland China and the US are not totally over, both sides have made some progress in the latest round of trade talks.

1.2 Economic integration with Mainland China

Hong Kong is the most important entrepôt of Mainland China. According to the HKSAR government statistics, 58% of re-exports were of China origin and 54% were destined for China in 2017. According to China's Customs statistics, Hong Kong is the third largest trading partner of China after the US and Japan, accounting for 7% of its total trade in 2017.

In 2016, Mainland China was the largest destination for Hong Kong's outward direct investment (US$ 618 billion or 40% of total) and the second largest investor country (US$ 416 billion or 26% of total) in Hong Kong.

Hong Kong is also a key offshore capital-raising centre for Chinese enterprises. As of December 2017, 1,051 mainland companies were listed in Hong Kong, comprising H-share, red-chip and private companies, with total market capitalisation of around US$2.9 trillion, or 66% of the market total. Since 1993, mainland companies have raised more than US$700 billion via stock offerings in Hong Kong.

Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect were launched in November 2014 and December 2016 respectively. It is a mutual stock market access between Hong Kong and Mainland China, a significant breakthrough in the opening of China's capital markets. It further facilitates two-way investment flows and consolidates Hong Kong's development as the global offshore RMB business hub. In April 2018, the People's Bank of China announced that China would quadruple

[2] In 2017, Hong Kong's domestic exports were confined to about 1.1% of its total exports while re-exports accounted for about 98.9% of its total exports.

the daily quota on the Shanghai-Hong Kong and Shenzhen-Hong Kong stock connect schemes from 1st May 2018, a move that could increase integration of China's onshore and offshore stock market trading. In other words, the daily southbound quota would be increased to RMB 42 billion from the current RMB 10.5 billion. The daily northbound quota would be increased to RMB 52 billion from the current RMB 13 billion.

The China Securities Regulatory Commission and the Hong Kong Securities and Futures Commission approved the mutual recognition scheme which would allow cross-border fund sales between Hong Kong and the mainland. The scheme, which started on 1st July 2015, was the first cross-border fund sales agreement ever signed by Mainland China. This arrangement expands the distribution network of the Hong Kong's fund industry and also attracts more funds to domicile in Hong Kong, which helps to build up Hong Kong's fund manufacturing capabilities and develops it into a full-fledged fund service centre.

In July 2017, the mutual bond market access between Hong Kong and Mainland China (Bond Connect) was launched to promote the development of the bond markets in the two places.

Based on the traditionally close economic and trade relations with Mainland China, the HKSAR Government is positioning Hong Kong as the so called "super connector" within the Belt and Road initiative of the Central Government in Beijing.

The concept of the Greater Bay Area (GBA)[3] dated back to 2011 and was officially endorsed in the annual government report by Premier Li Keqiang in March 2017. A framework agreement was signed by the National Development and Reform Commission and the governments of Guangdong, Hong Kong and Macao in July 2017. The GBA's eleven cities offer a wide spectrum of industries and services such as financial and professional services in Hong Kong, innovation and technology in Shenzhen as well as manufacturing capabilities in Dongguan and other cities across the Pearl River Delta.

Smooth cross-border movements of capital, talents, goods and services are essential for any success in the GBA. However, they fall under different tax, legal, administrative systems and customs jurisdictions. Its potential success rests on the support of the Central Government, co-operation and co-ordination between local governments and efforts of cross-institutions. Local governments need to collaborate on various issues such as free flow of goods, people and capital, regulatory harmonisation, tax initiatives, infrastructural support as well as inter-city positioning and their comparative advantages.

For information on the Closer Economic Partnership Arrangement (CEPA), please refer to 2.2.

1.3 Inbound Tourism

Tourism contributes 4.7% to GDP (in terms of value-added) and employs about 270,000 people (about 7% of total employment). It provides plenty of job opportunities particularly for low-skilled workers.

Inbound tourism turned up in 2017, mainly driven by the strong revival of the Mainland China market. Overall visitor arrivals rebounded by 3.2% to 58.5 million (including one-day tourists), equivalent to 7.9 times the size of Hong Kong population. The growth was recorded after registering annual declines for

[3] The Greater Bay Area (GBA) consists of the special administrative regions of Hong Kong and Macao as well as nine cities of the Pearl River Delta region: Guangzhou, Shenzhen, Zhuhai, Foshan, Jiangmen, Dongguan, Zhongshan, Huizhou and Zhaoqing. With a population of 67.65 million residing across a total area of 56,500 sq km, this region is one of the most developed areas in China.

two consecutive years. Visitors from Mainland China, which accounted for 76% of the total, rose by 3.9% to 44.4 million along with the robust economic growth there.

1.4 Public Finance

The public finance is very strong and healthy. The revised estimates for government revenue and government expenditure are US$ 78.5 billion and US$ 60.8 billion respectively for 2017-18. The government revenue is about 21% or US$ 13.4 billion higher than the original estimate due to much higher-than-expected revenues from land premium and stamp duties. A surplus of US$ 17.7 billion is anticipated for 2017-18. Fiscal reserves stood at US$ 141 billion (equivalent to 28 months of government expenditure) as at March 31, 2018.

The Financial Secretary forecast an annual surplus in the Operating Account for the coming five financial years but a small deficit would surface in the Capital Account in 2021-22. Fiscal reserves are estimated at US$ 157 billion by end-March 2023, representing 36% of GDP or equivalent to 21 months of government expenditure. Taking all these into account, the Government will have an overall surplus in the next five years.

1.5 New fiscal philosophy and a two-tier profits tax system

The Chief Executive has put forward a new fiscal philosophy for the current term government. It envisages that on the premise of ensuring the health of public finance, the Government should adopt forward-looking and strategic financial management principles in optimising the use of surplus to invest for Hong Kong and relieve the burdens of Hong Kong people.

Part of this new fiscal philosophy is the introduction of a two-tier profits tax system which will apply commencing from the year of assessment 2018/19 (i.e. on or after 1st April 2018).

Under the proposal, the first HK$ 2 million (US$ 256,000) of profits will be taxed at half the current tax rate (i.e. 8.25%) whilst the remaining profits will continue to be taxed at the existing 16.5% tax rate for corporations. For unincorporated businesses, the first HK$ 2 million (US$ 256,000) of profits will be taxed at half the current tax rate (i.e. 7.5%) whilst the remaining profits will be taxed at the existing 15% tax rate. As an anti-avoidance measure, a group of “connected entities” can only nominate one entity within the group to enjoy the reduced tax rate.

As global tax rates continue to fall, Hong Kong has to introduce new tax measures to remain competitive and attract foreign investment into Hong Kong while maintaining a simple and low tax regime. The maximum annual tax savings for corporations and unincorporated businesses will be HK$ 165,000 (US$ 21,150) and HK$ 150,000 (US$ 19,230) respectively. While these amounts are not huge for multinational groups, it will nevertheless reduce the tax burden of small and medium-sized enterprises.

1.6 Linked Exchange Rate System

Since 1983 the Hong Kong dollar has been linked to the US dollar at the rate of HK$ 7.8 to one US dollar. The Hong Kong Monetary Authority (HKMA) operates Convertibility Undertakings on both the strong side (at HK$ 7.75 to one US dollar) and the weak side (at HK$7.85 to one US dollar) of the Linked Rate of HK$ 7.80 to one US dollar.

In view of the widening interest rate differential between the HK dollar and US dollar, there have been carry trades involving buying US dollar and selling HK dollar. As such, the HK dollar exchange rate has moved gradually lower since the beginning of 2018. As part of the design of Hong Kong's Linked Exchange Rate System (LERS), the weak-side Convertibility Undertaking was first triggered on 12th April 2018. In line with the LERS mechanism, the HKMA purchased Hong Kong dollars at the rate of HK$ 7.85 to US$1 to maintain the currency peg. Until 16th May 2018, the HKMA has purchased HK$ 62.4 billion in total.

Nevertheless, the outflows of some HK$ 62 billion represent only 6% of the total inflows of HK$ 1 trillion recorded over the past few years. The aggregate balance reduction and fund outflows provide the necessary condition for the normalisation of local interest rates. As at 18th May 2018, the monetary base amounted to about HK$ 1,652 billion whereas foreign currency reserve assets reached to about US$ 433 billion in April 2018. The HKMA is therefore confident that Hong Kong can cope with havoc in the currency market.

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 one of the largest trading economies in the world as well as an international financial centre. 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). Hong Kong also joined the Asian Infrastructure Investment Bank (AIIB) in June 2017.

Hong Kong has signed six free trade agreements, respectively with the Mainland of China (June 2003), New Zealand (March 2010), the Member States of the European Free Trade Association EFTA (including Switzerland) (June 2011), Chile (September 2012), Macao (October 2017) and the Association of Southeast Asia Nations (ASEAN) (November 2017). The one with the EFTA States, entered into force 1st October 2012, is Hong Kong's first free trade agreement with European economies. Hong Kong is now negotiating free trade agreements respectively with Georgia, Maldives and Australia.

Hong Kong has entered into Comprehensive Double Taxation Agreements / Arrangement (CDTAs) with 39 jurisdictions including Switzerland (which entered into force in October 2012). There are 12 countries/territories which are still under negotiation. In addition, it has entered into Tax Information Exchange Agreements with 7 jurisdictions and been negotiating with another 3 jurisdictions.

The HKSAR Government introduced an amendment bill to the Legislative Council in March 2017, which seeks to expand the list of reportable jurisdictions to cover 75 reportable jurisdictions (including Switzerland) for the effective implementation of the arrangement relating to automatic exchange of financial account information (AEOI). The bill, which was passed by the Legislative Council, came into operation in July 2017.

Furthermore, Hong Kong has signed investment promotion and protection agreements with 20 countries including Chile, Canada, Finland, Kuwait, the Netherlands, Australia, Denmark, Sweden, Switzerland, New Zealand, Italy, France, Germany, Belgo-Luxembourg Economic Union, Austria, Japan, Korea, the United Kingdom, Thailand and the ASEAN. It concluded negotiation (pending signing) with Bahrain, Mexico, Myanmar and United Arab Emirates while negotiation with Iran and Russia are in progress.

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 January 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 two sides have broadened and enriched the content of CEPA between 2004 and 2017.

At present, all products of Hong Kong origin, except for a few prohibited articles, can be imported into the mainland tariff free under CEPA. Hong Kong service suppliers enjoy preferential treatment in entering into the mainland market in various service areas. There are also agreements or arrangements on mutual recognition of professional qualification.

In June 2017, the Investment Agreement and the Agreement on Economic and Technical Cooperation (Ecotech Agreement) were signed under the framework of CEPA. The Investment Agreement expands the market access commitments to non-services sectors outside the scope of the Agreement on Trade in Services and introduces obligations on investment protection to both services and non-services sectors. The Ecotech Agreement consolidates and updates the economic and technical cooperation activities between Mainland China and Hong Kong. It includes the cooperation in the economic and trade areas of the Belt and Road Initiative and Sub-regional Cooperation under the systemic framework of CEPA. It is the first investment agreement with the Mainland with pre-establishment national treatment commitments for admission of investments adopting a negative listing approach. The agreement came into force on 1st January 2018.

For more details on CEPA, please consult the website of the Trade and Industry Department of the HKSAR Government (https://www.tid.gov.hk/english/cepa/index.html).

Swiss perspective: CEPA is nationality neutral. Therefore overseas-based and Swiss companies incorporated in Hong Kong can enjoy the full benefits of CEPA.

3. Foreign trade

3.1 Development and general outlook

3.1.1 Trade in goods

Total exports of Hong Kong rose by 8% to about US$ 497 billion in 2017. Major export markets were China (54% of total exports), the US (8.5%), India (4.1%), Japan (3.3%) and Taiwan (2.3%). Major export products were electrical machinery & apparatus (36%), telecom equipment (20%), office machines/computers (10%) and jewellery (5.3%).

Imports increased to about US$ 559 billion (+8.7%) in 2017. Major supplier countries were China (47% of total imports), Taiwan (7.6%), Singapore (6.6%), Japan (5.8%) and Republic of Korea (5.8%). Major import products were electrical machinery & apparatus (36%), telecom equipment (17%), office machines/computers (8.1%) and jewellery (5.8%).

Regulations: Hong Kong is a free port and there is no tariff on general imports except duty on strong 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 dropped to US$ 98 billion (-5.5%) in 2016 (latest available information[4]). Major items included: travel (33% of total exports of services, dropped by 9%), transport (29% of total exports of services, dropped by 5.3%), financial services (18% of total exports of services, dropped by 6.8%), other business services (14% of total exports of services, increased by 2.1%) as well as telecommunication and information services (2.9% of total exports of services, increased by 0.5%).

In 2016, exports of services by main destinations were China (40% of total, decreased by 4.6%), the US (14% of total, dropped by 10%), the UK (8.2% of total, increased by 2.3%), Japan (4.2% of total, decreased by 6%) and Singapore (4% of total, increased by 0.2%).

Import of services amounted to US$ 74.1 billion (+0.7%) in 2016. Major items included: travel (32% of total imports of services, increased by 4.8%), transport (23% of total imports of services, decreased by 2.1%), other business services (16% of total imports of services, increased by 0.5%), manufacturing services (15% of total imports of services, dropped by 2%), financial services (6.3% of total imports of services, dropped by 1.9%), telecommunication and information services (2.6% of total exports of services, increased by 1.9%) as well as charges for the use of intellectual property (2.5% of total imports of services, rose by 1.3%).

In 2016, imports of services by main sources were China (39% of total, dropped by 0.3%), the US (11% of total, increased by 2.8%), Japan (8% of total, grew by 3%), the UK (5.8% of total, decreased by 0.3%) and Singapore (4.2% of total, decreased by 4.4%).

3.2 Bilateral trade

3.2.1 Trade in goods

According to the Hong Kong Census and Statistics Department, Switzerland was Hong Kong's 12th largest supplier and 20th largest export market[5].

According to the Swiss Federal Customs Administration, Swiss exports to Hong Kong totalled CHF 15,747 million (-14%) in 2017. Major Swiss exports included jewellery, precious metal, gold, silver and coins (76% of total, dropped by 19%, CHF 11,953 million in value), watches and clocks (16% of total, increased by 6%, CHF 2,525 million in value), chemical and pharmaceutical products (2.8% of total, increased by 20%, CHF 443 million in value) as well as electrical & non-electrical machinery (2.1% of total, rose by 1.9%, CHF 329 million in value).

Hong Kong's total exports to Switzerland amounted to CHF 9,227 million (+13%) in 2017. Major total exports included jewellery, precious metal, gold, silver and coins (94% of total, increased by 15%, CHF 8,706 million in value), watches and clocks (3.1% of total, dropped by 23%, CHF 286 million in value),

[4] Trade in services figures for 2017 will only be available by Feb. 2019.
[5] Hong Kong official trade figures do not include trade in gold, silver and coins

electrical & non-electrical machinery (1.1% of total, rose by 23%, CHF 103 million in value) as well as works of arts and antiques (0.4% of total, increased by 3.3%, CHF 33 million in value).

As indicated by Appendix 4, there is a huge difference between the two sets of figures: general total (total 2) and economic total (total 1). General total (total 2) includes gold bars and other precious metals, coin, precious stones and gems as well as works of art and antiques whereas economic total (total 1) does not. The above mentioned figures are general total (total 2).

In 2017, Swiss exports to Mainland China (CHF 24,117 million in value) and Hong Kong (CHF 15,747 million in value) accounted for 13.5% of global Swiss exports. On the other hand, Swiss imports from China (CHF 13,099 million) and Hong Kong (CHF 9,227 million). Switzerland got a trade surplus worth CHF 17,538 million.

It is noteworthy that the bilateral trade figures compiled by the Swiss Federal Customs Administration differ greatly from that of the Hong Kong Census and Statistics Department (please refer to Appendix 3). Hong Kong official trade figures do not include trade in gold, silver and coins.

According to the Hong Kong Census and Statistics Department, Swiss products worth US$ 3,510 million were re-exported via Hong Kong to other countries and notably to China (US$ 749 million, dropped by 11%) and Macao (US$ 665 million, dropped by 4.2%) in 2017. Major Swiss products via Hong Kong to China were watches and clocks (US$ 347 million), measuring instruments (US$ 92 million), semi-conductors, electronic valves & tubes (US$ 33 million), silver & platinum (US$ 30 million). Major Swiss products via Hong Kong to Macao were watches and clocks (US$ 569 million), jewellery (US$ 31 million), perfumery, cosmetics or toilet preparations (US$ 14 million) and medicaments (US$ 12 million).

According to the Hong Kong Census and Statistics Department, products of Chinese origin worth US$ 1,324 million were re-exported to Switzerland via Hong Kong in 2017. Major products were watches and clocks (US$ 607 million), telecom equipment (US$ 140 million), jewellery (US$ 64 million), electronic valves & tubes (US$ 56 million) and electrical apparatus (US$ 43 million).

Outlook for Swiss exports to Hong Kong

In early 2018, the HKSAR Government was quite optimistic about the economy of Hong Kong which was projected to grow by 3% to 4% for the year. As a matter of fact, the Hong Kong economy turned in a robust growth of 4.7% over a year earlier in the first quarter of 2018, sustaining the full-fledged upturn in 2017. Domestic demand continued to strengthen, thanks to optimistic consumer sentiment on the back of favourable job and income as well as asset market conditions.

According to the Hong Kong Census and Statistics Department, total retail sales increased by 14% for the first quarter of 2018 over the same period in 2017, owing to favourable job and income conditions and buoyant inbound tourism. Products-wise, the value of sales of jewellery, watches and clocks, and valuable gifts increased by 22%. This was followed by sales of clothing and footwear (+17% in value); medicines and cosmetics (+17%) as well as electrical goods and other consumer durable goods (+21%).

Nevertheless, trade tension between Mainland China and the US is a downside risk that warrants attention. If it goes fiercely and viciously, it will not only disrupt the trade performance of Hong Kong, but it will also cause volatility in its financial market and hence affect investor and consumer confidence. Mainland China and the US issued a joint statement and agreed on substantially reducing the trade imbalance on 19th May 2018. Although fundamental disputes between Mainland China and the US are not totally over, both sides have made some progress in the latest round of trade talks.

As mentioned in the Chief Executive's Policy Address and the Financial Secretary's Budget Speech, the HKSAR Government is keen to push innovation and technology as a new economic driver for Hong Kong. More resources will be allocated to develop biotechnology, artificial intelligence, smart city and financial technology. It will offer business opportunities to Swiss companies which are active in these sectors.

3.2.2 Trade in services

According to the Hong Kong Census and Statistics Department, Hong Kong's exports of services to Switzerland amounted to US$ 1,193 million (1.3% of total exports of services, dropped by 3.1%) in 2016[6]. Switzerland ranked 12th largest market for Hong Kong's exports of services. It consisted of transport (US$ 463 million), other business services (US$ 366 million), financial services (US$ 252 million) as well as telecommunication and information services (US$ 68 million). Figures on travel, construction, insurance and government goods and services were unavailable due to confidentiality of information relating to individual establishments.

Hong Kong's imports of services from Switzerland reached to US$ 444 million (0.6% of total imports of services, increased by 6.2%) in 2016. Switzerland ranked 19th largest supplier in this category. It consisted of travel (US$ 108 million), transport (US$ 85 million), charges for the use of intellectual property (US$ 84 million), financial services (US$ 73 million), other business services (US$ 39 million), insurance services (US$ 32 million) as well as telecommunication and information services (US$ 12 million). Figures on construction as well as government goods and services were unavailable due to confidentiality of information relating to individual establishments.

4. Direct Investments

4.1 Development and general outlook

According to the Hong Kong Census and Statistics Department, at the end of 2016 (latest available information)[7], the stock of Hong Kong's inward direct investments rose by 2.1% to US$ 1,616 billion. Major investor countries were the British Virgin Islands BVI (US$ 553 billion or 34% of total, dropped by 0.4%), China (US$ 416 billion or 26% of total, decreased by 0.7%), Cayman Islands (US$ 124 billion, 7.7% of total, increased by 13%). the Netherlands (US$ 102 billion or 6.3% of total, increased by 2%) and Bermuda (US$ 75 billion or 4.6% of total, rose by 2.7%).

Mainland China was the largest destination for Hong Kong's outward direct investment (US$ 618 billion or 40% of total) in 2016. Guangdong Province remained a popular location for Hong Kong's outward direct investments in China, accounting for 28% (or US$ 171 billion) of Hong Kong's total outward direct investment in China. The British Virgin Islands BVI ranked the second (US$ 597 billion or 39% of total). Cayman Islands ranked the third (US$ 63 billion or 4.1% of total) while Bermuda ranked the fourth (US$ 29 billion, 1.9% of total).

Mainland China and the British Virgin Islands (BVI) were both the major sources as well as the major destinations of Hong Kong's direct investments. The substantial cross-boundary investment between

[6] The trade in services figures for 2017 will only be available by Feb. 2019.
[7] Investment figures for 2017 will only be available by Dec. 2018.

Hong Kong and the Mainland reflected the close economic links between the two places. Moreover, the importance of offshore financial centres such as the BVI, Cayman Islands and Bermuda to Hong Kong's external direct investments was due to their popularity for some Hong Kong enterprises in setting up non-operating companies to channel direct investment funds back to Hong Kong or to other places, and also for some non-resident enterprises in re-directing funds to Hong Kong.

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 Hong Kong Census and Statistics Department, Swiss direct investments in Hong Kong were about US$ 12.7 billion (0.8% of total, increased by 16%) in 2016[8].

The Swiss share in foreign direct investments remains rather stable. It accounted for about 0.6-0.8% (in average) of total foreign direct investments between 2000 and 2016.

As at 1st June 2017, there were 238 Swiss companies operating in Hong Kong: 55 regional headquarters, 84 regional offices and 99 local offices. They are classified in various sectors: banking, beauty products, chemicals & pharmaceuticals, consultants, electronics, food and beverage, freight forwarding, inspection, insurance, machinery/engineering, textiles & garments, watches/jewellery and trading houses, etc.

According to the Hong Kong Census and Statistics Department, ranking of Switzerland as an investor country in 2016 is not available. The Department also added that due to precision consideration, statistics of outward direct investment of Hong Kong to Switzerland for 2016 cannot be provided.

5. Trade, economic and tourist promotion

5.1 Foreign economic promotion instruments

Swiss Business Hub Hong Kong

The Swiss Business Hub (SBH) was officially opened in October 2012, emphasizing the solid economic ties between Switzerland and Hong Kong. Its priority aims in particular to support Swiss SMEs in their entry to the Hong Kong market, nowadays mainly through local distributors. In addition to supporting exports of services and products, the SBH is actively promoting Switzerland as an investment hub in the centre of Europe, a task coordinated together with the SBH in Beijing.

The Swiss Chamber of Commerce in Hong Kong (SwissCham)

It is an organization with the mission to provide business platform and networking for Swiss companies and individuals in Hong Kong. It represents the Swiss business community to both the Swiss and HKSAR governments. For details, please visit its website www.swisschamhk.org.

[8] Bilateral investment figures for 2017 will only be available by Dec. 2018.

Swiss-Chinese Chamber of Commerce/Swiss-Hong Kong Business Association

The Swiss-Chinese Chamber of Commerce and Swiss-Hong Kong Business Association are non-profit associations registered in Switzerland. For details, please visit its website www.sccc.ch.

The Federation of the Swiss Watch Industry

The 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. For details, please visit its website www.fhs.hk.

5.2 Interests for Switzerland as a location for tourism, education and other services, potential for development

Switzerland Tourism ST

Switzerland Tourism organises media trips, travel talks in the media and travel seminars on regular basis. All the above activities help to promote Switzerland in excellent image and top quality branding. ST Hong Kong promotes Switzerland’s tourist industry in Hong Kong, Macao and Southern China.

5.3 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 means to extend marketing and distribution network, and/or to gain access to better technology and designs.

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.

5.4 Interests for Switzerland as a financial location, potential of development and Hong Kong as a premier Offshore Renminbi RMB Centre

Hong Kong was the first offshore market to launch renminbi business back in 2004. Since then, Hong Kong has become the global hub for renminbi trade settlement, financing and asset management, where a wide range of renminbi products and services are available to meet the needs of businesses, financial institutions and investors. Renminbi activities in Hong Kong are supported by the renminbi liquidity pool in Hong Kong, which is the largest outside Mainland China.

Owing to global slackening in offshore RMB activity (partly due to uncertain outlook for the RMB exchange rate), RMB customer deposits and outstanding certificates of deposit in Hong Kong dropped to RMB 618 billion (-1.1% year-on-year but contracted by 47% in three years) at end-2017.

Hong Kong is the global hub for trade settlement in renminbi, serving both local and overseas banks and companies. In 2017, renminbi trade settlement handled by banks in Hong Kong dropped to RMB 3,927 billion (-13.5% year-on-year) due to global slackening in offshore RMB business.

On offshore RMB financing, the outstanding balance of RMB loans dropped to RMB 145 billion (-51% year-on-year) at end-2017. By a similar token, outstanding balance of RMB bonds also fell by 34% year-on-year to RMB 212 billion at end-2017.

Contrary to the overall weakness in offshore RMB activity, cross-border investment flows staged a robust growth in 2017 through Shanghai-Hong Kong Stock Connect launched in November 2014 and Shenzhen-Hong Kong Stock Connect in December 2016. For the southbound investment flow, the daily turnover surged by 138% to hit a record high of HK$ 4.9 billion in 2017, lifting its share in the daily turnover of the local stock market from 4.5% in 2016 to 7.5% in 2017. According to some market analyses, sustained buying sprees from the Mainland have contributed in part to the 36% surge in the Hang Seng Index during 2017. As regards the northbound investment flow, there was likewise a buoyant increase of 103% in the average daily turnover in 2017, reaching a high of RMB 4.8 billion.

In July 2017, northbound trading of Bond Connect was launched, allowing overseas investors to invest in the Mainland interbank bond market. Continuous launch of new initiatives is expected to help entrench the leadership of Hong Kong in offshore RMB business.

Hong Kong is fully aware that its offshore renminbi business is by no means a monopoly. London, Singapore, New York and etc. are keen to develop such business too. There are some unique features which will make Hong Kong a premier offshore renminbi centre above other competitors: policy endorsement from the Beijing Government, the cultural affinities, a well-established financial infrastructure, sound risk management systems, close economic ties with the mainland, advantages of the first-mover, the largest pool of RMB liquidity outside China and last but not least, fire wall protection in term of financial security for the Beijing Government.

On one hand, China makes use of Hong Kong as a good testing ground for the renminbi internationalization. On the other hand, Hong Kong benefits a lot from such experimentation and consolidates its status as an international financial centre. It is indeed a win-win situation for both China and Hong Kong.

Switzerland and Hong Kong agreed to strengthen bilateral cooperation in the area of financial markets and to exchange views on international financial and tax matters. The Swiss State Secretariat for International Financial Matters and the Hong Kong Monetary Authority (HKMA) signed a Memorandum of Understanding (MoU) in January 2018. It serves as the basis for regular financial dialogue and sets out the two parties' willingness to strengthen financial markets cooperation, including in the area of RMB internationalisation, wealth management, infrastructure financing and international financial matters. The Swiss Financial Market Supervisory Authority also signed a MoU with the HKMA to enhance fintech collaboration with a view to facilitating financial innovation in the two places. Another MoU was signed by the Hong Kong Private Wealth Management Association and the Swiss Bankers Association to further collaborate to promote the development of private wealth management in Switzerland and Hong Kong.

Appendices

1. Structure of the economy
2. Essential economic data
3. Trading partners
4. Bilateral trade between Switzerland and Hong Kong
5. Main investor countries