Talking US trade

The view from Hong Kong

Commissioned by:

About this report

This article is based on the responses from 50 Hong Kong executives to a survey conducted for the report, *Terms of trade: Understanding trade dynamics in the US*, written by The Economist Intelligence Unit (EIU) and commissioned by American Express. It examines key aspects of trading with the world's largest economy from the perspective of foreign companies. The EIU surveyed 531 companies that trade with the US in March and April 2016. The survey sample is global, spanning Asia-Pacific (49%), Europe (22%), North America (19%) and South America (9%). Nearly half of those surveyed are C-level executives, and another 40% hold senior executive positions (SVP, VP, director, head of business unit, head of department). The firms in the survey are split almost evenly between those with annual revenue of US$250m-500m and those with US$500m-1bn. Of the 23 sectors covered, the best represented are financial services, manufacturing, consumer goods and services, IT and retail.

The Economist Intelligence Unit (The EIU) is the research and analysis division of The Economist Group, the sister company to The Economist newspaper. Created in 1946, we have 70 years' experience in helping businesses, financial firms and governments to understand how the world is changing and how that creates opportunities to be seized and risks to be managed.

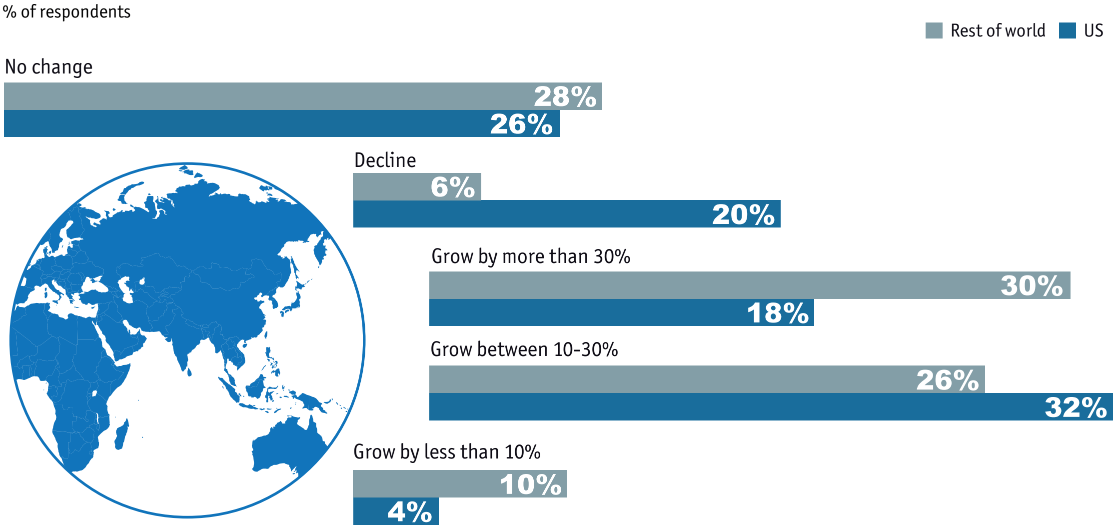
Talking US trade: The view from Hong Kong

At a time of low global growth, slowing volumes of international trade and rising anti-globalisation sentiment in the West, a recent survey of Hong Kong firms by The Economist Intelligence Unit (EIU) shows that the majority remain confident that their trade will grow over the next five years, although there is concern about the prospects for growth in trade with the United States, the city's second-largest trading partner.[1]

Nearly one-third of Hong Kong respondents said they expect trade with the US to grow between 10 and 30% and a further 18% expect it to grow by more than 30%, but one-fifth of them expect a decline in trade, while 26% expect no change. By contrast, just 6% of Hong Kong firms expect trade with the rest of the world to decline and 30% expect it to increase by 30% or more.

Figure 1: Trade growth—Expectations of HK firms for next 5 years

% of respondents



Source: The Economist Intelligence Unit.

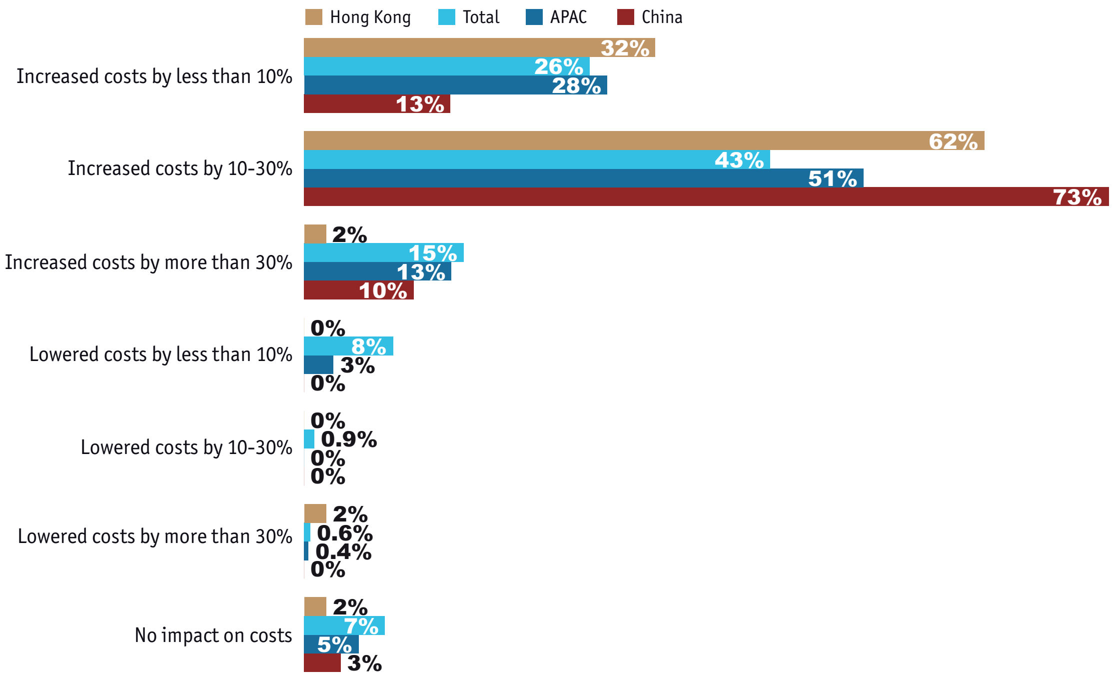
[1] The survey was conducted March-April 2016, before the US presidential election.

Real challenges

Like firms across the globe, Hong Kong firms say that trade-related regulatory and compliance issues increased the cost of trading with the US, with 62% answering that it increased costs "by 10-30%". That is 20 percentage points above the global average and 12 percentage points above the Asia-Pacific average, although it's still below mainland China, where 73% of firms say that regulation and compliance issues increased their costs by that amount.

Figure 2: US trade-related regulatory & compliance costs

% of respondents



Source: The Economist Intelligence Unit.

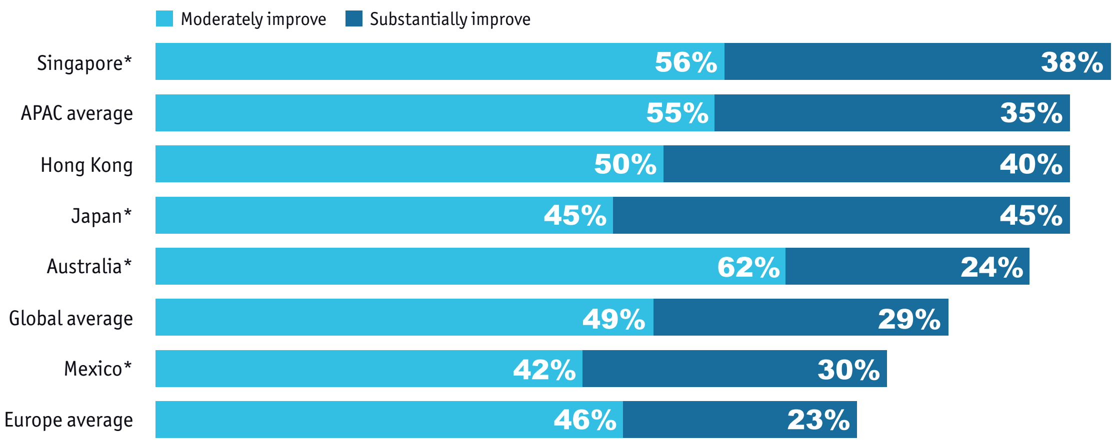
Some of these costs could be reduced in the coming years but some almost certainly will not be. The Customs-Trade Partnership Against Terrorism (C-TPAT), or "known shipper" programme, was part of a raft of post-9/11 initiatives taken by the US government. These increase the cost of trade by requiring additional paperwork and certification of compliance with US security standards, as well as through higher standards for packing shipments. Given the level of fear of terrorist attacks, it's unlikely that any such initiative will be rolled back.

The Trans Pacific Partnership (TPP) was expected to help in this area but prospects for its implementation are increasingly slim. The agreement, which (at the time of writing) includes the US and 11 other countries in the Asia-Pacific region, contains provisions covering the compliance issues that affect Hong Kong firms' profits when they trade with the US. Not being party to the agreement itself, the benefits to Hong Kong would be indirect, but Hong Kong-based firms with regional production networks might see clearer benefits in the form of improved access to the US and other member country markets. This perhaps explains why 90% of survey respondents agree that they will either "substantially" (40%) or "moderately" (50%) benefit from the agreement. But given that US President Elect Donald Trump has vowed to withdraw the US from the TPP on his first day in office, effectively scuttling the pact, it's unlikely that anyone will receive benefits.

However, there is one major international agreement pending that could help in this area, namely the Trade Facilitation Agreement (TFA). Agreed in 2013 at a World Trade Organisation (WTO) ministerial meeting in Bali, Indonesia, the TFA is aimed at streamlining trade by lowering administrative and logistical barriers. Although it has not yet entered into force, if and when it does, the WTO estimates that it will reduce trade costs globally by 14.3%.[2]

Figure 3: How will the TPP improve opportunities for trade with the US?

% of respondents



* TPP members

Source: The Economist Intelligence Unit.

Hoping against hope

Hong Kong-based executives are not alone in their optimism about the potential impact of the TPP and in fact, with the exception of Singapore, they are even more optimistic than executives from the countries we surveyed that are actually TPP members. While this may seem counter-intuitive, Hong Kong's role as a regional financial centre and logistics hub, along with it being the location of the regional headquarters for many multi-national companies (MNCs), means that executives take a broader view of the agreement's impact rather than narrowly focusing on its potential for diverting trade away from Hong Kong.

With the TPP now all but dead, the next best hope for the region in terms of trade liberalisation is the Regional Comprehensive Economic Partnership (RCEP), a 16 member agreement that includes all of ASEAN plus six countries with which ASEAN has existing free trade agreements: China, India, Japan, South Korea, Australia and New Zealand. Long viewed as China's counterweight to the US-led TPP,

[2] https://www.wto.org/english/res_e/booksp_e/wtr15-2d_e.pdf.

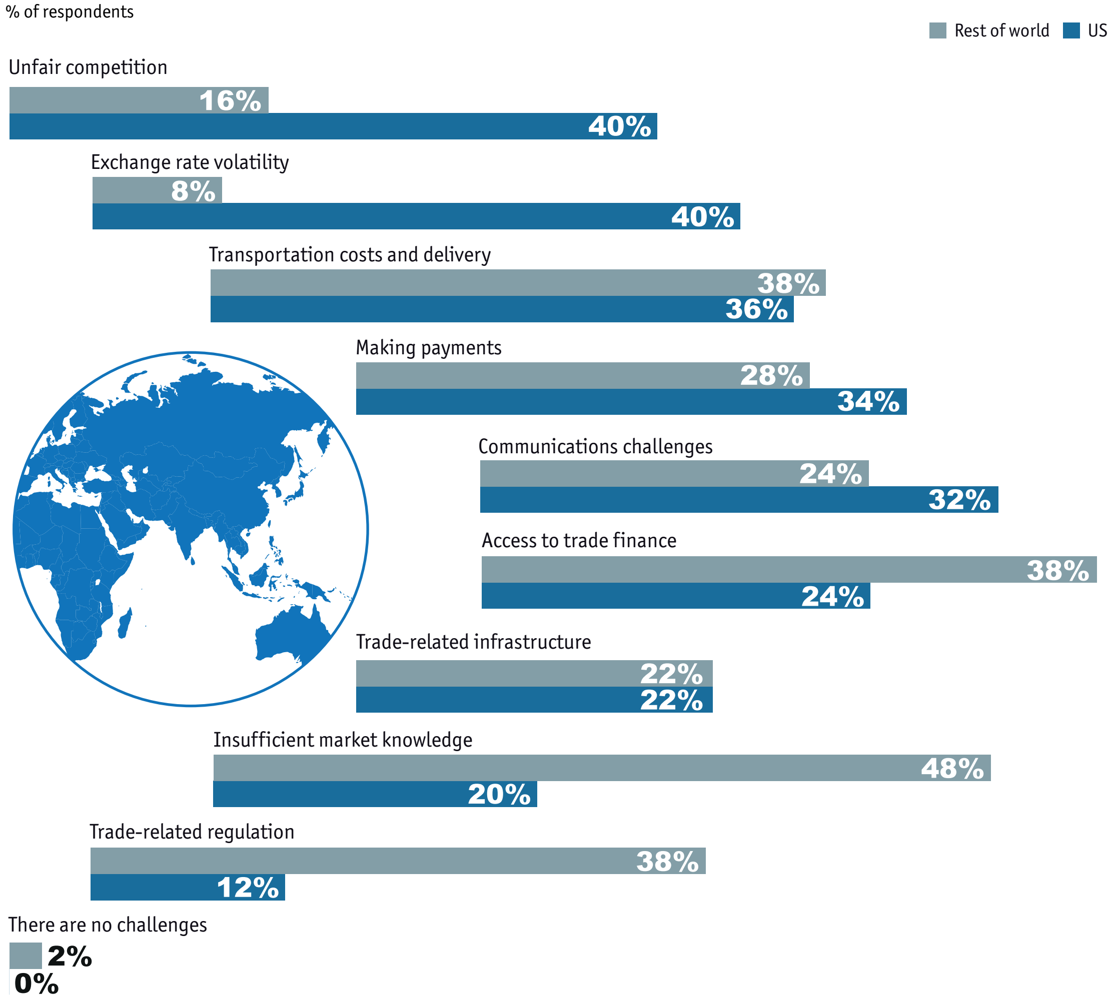
RCEP is now the only viable forum for further liberalising trade in the Asia-Pacific region. Members have set the end of 2017 as a target for concluding negotiations, but the history of trade negotiations shows such targets are more honoured in their breach than observance. Nevertheless, barring some major shock, the negotiations will conclude in the next few years and will likely install China as a major player in writing the rules of trade.

Top concerns

According to the survey results, the top two challenges for Hong Kong firms trading with the US are "exchange rate volatility" and "unfair competition". These responses seem hard to understand, as does "transport costs and delivery", given the fall in oil prices and shipping costs in recent years. "Making payments" also scored highly as a challenge, and this likely reflects the frequent incompatibility of payments systems in the region with those in the US. Bank transfers can be time-consuming and

Figure 4: Trade—Top challenges for HK firms

% of respondents



Source: The Economist Intelligence Unit.

expensive while traditional paper-based trade finance methods have faced the growing risk of fraud.[3] As a result, enterprises may turn to other payments methods, such as credit cards, setting up US subsidiaries to handle cash management or to some of the new digital payment systems promised by the fintech revolution, such as blockchain technology that allows trade information to be securely recorded on a centralised, digital ledger.

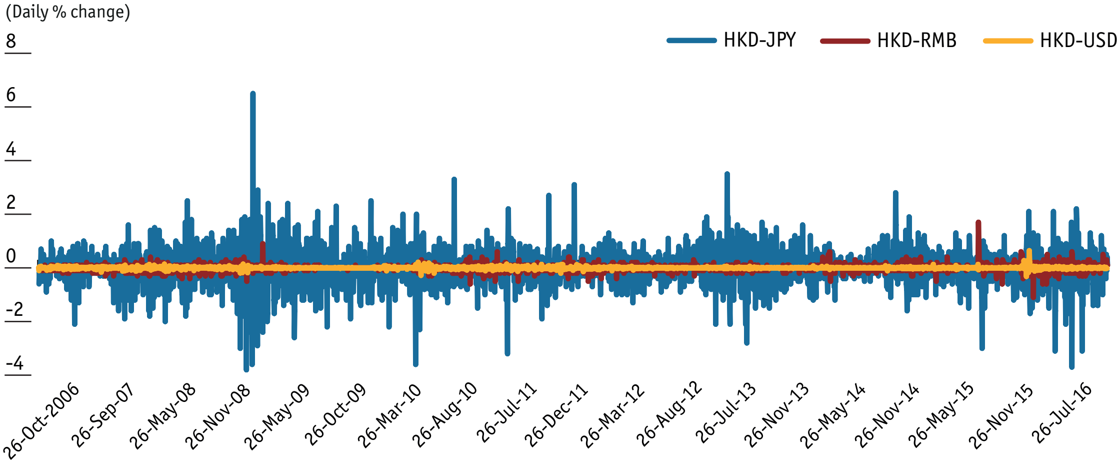
With regard to FX volatility, since 1983 the Hong Kong Monetary Authority (HKMA) has pegged the Hong Kong dollar to its US counterpart via the Linked Exchange Rate System (LERS). The peg, held at HKD $7.8 to USD $1.0 for 22 years, shifted to a band in 2005, which allowed for fluctuations between a HKD $7.75 ceiling and a $7.85 floor. Since then, the Hong Kong dollar has never depreciated or strengthened outside that very narrow range, providing firms that trade a level of currency stability that few other economies enjoy. And while in the last year there have been some swings in value, few economists doubt the ability of the HKMA to maintain the peg, even as US monetary policy tightens.

Yet when it comes to trading with the US, “exchange rate volatility” was cited as a challenge by 40% of respondents, while only 8% cited it as a challenge when trading with the rest of the world. Reality suggests that those figures should be in reverse order. Of Hong Kong’s three largest trading partners, the Hong Kong dollar’s value against the Japanese yen has been the most volatile over the past decade, as shown in Figure 5 below. The Hong Kong dollar’s value against the Chinese yuan has also seen more volatility over the last year as the People’s Bank of China (PBoC) gradually moves away from the crawling peg to the US dollar.

The idea that Hong Kong-based executives face “unfair competition” in the US market is equally as pervasive, having also been cited by 40% of respondents as a challenge, but is perhaps more easily explained. According to data from the World Trade Organisation (WTO), the US is currently the complainant—or plaintiff—in a total of 50 disputes with various countries in Asia-Pacific over unfair trade practices, slightly more than the 44 disputes it has brought against either the European Union (EU) as a whole (19) or individual EU members (25). It is also the respondent—or defendant—in almost

Figure 5: Daily HKD FX volatility

(Daily % change)



Source: Thomson Reuters, The Economist Intelligence Unit.

[3] http://www.bloomberg.com/news/articles/2016-05-22/fraud-in-4-trillion-trade-finance-turns-banks-to-digital-ledger

60 cases brought against it by countries in Asia-Pacific, versus 35 such cases brought by the EU.[4] With trade tensions between Asia-Pacific and the US so high, it makes sense that HK-based respondents feel that they are at a competitive disadvantage in the US, regardless of how the cases are eventually decided. For firms based in Hong Kong, and the wider region more generally, there has to be hope that this isn't a harbinger of more tensions to come.

[4] https://www.wto.org/english/tratop_e/dispu_e/dispu_maps_e.htm

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