

ASIA'S HEART AND ITS HEAD: HONG KONG SINGAPORE, AND THE SHIFTING PATTERNS OF TRADE

Asia is a large, diverse region, with economies at varying stages of development, making it difficult to get a firm sense of the broad trends important to business. We know that consumer demand is rising and is forecast to continue doing so throughout the region, but not what changes that will bring, particularly in the area of trade flows. After decades of relying on demand in the West to fuel Asia's export-led growth, are more exports going to be sold to regional consumers? And how important will cross-border trade in services become as countries move up the value chain?

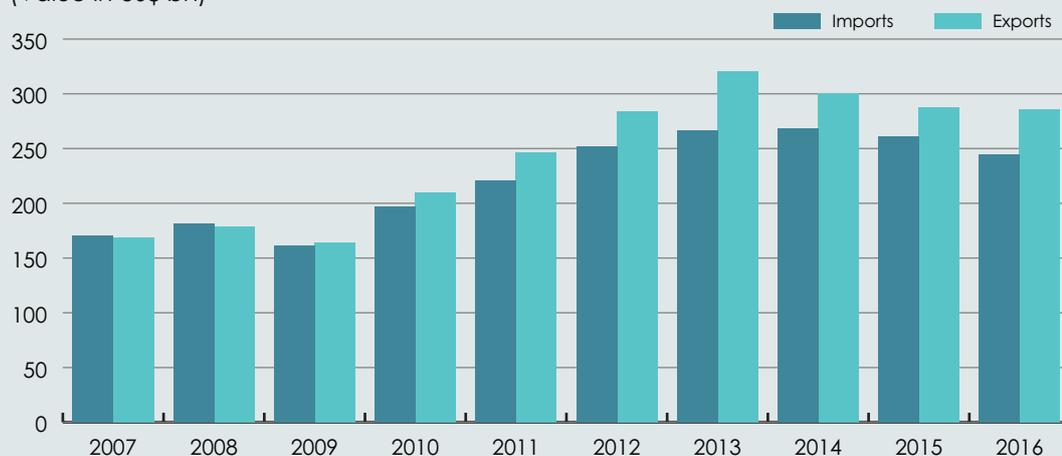
As Asia's two main hubs, Hong Kong and Singapore can help to point to answers.

ASIA'S HEART

While Hong Kong, like most wealth economies in Asia, began as a manufacturer of cheap goods for export to the West, most of that activity migrated over the border to China in the 1990s. Today, it makes almost nothing; manufacturing accounted for just over 1% of GDP in 2015. Instead it provides the services like logistics and financing that enable those goods to flow throughout the region and to the rest of world. In that role, hundreds of billions of dollars-worth of physical goods pass through Hong Kong every year, most destined for China.

For the past two decades, China has been Hong Kong's largest trading partner. That will continue to be true for years to come, but the data suggests that total trade between the two may have peaked around 2014 at just under US \$590bn. As the Chinese economy matures and

Hong Kong's trade with China
(Value in US\$ bn)



Source: The International Trade Centre, The EIU

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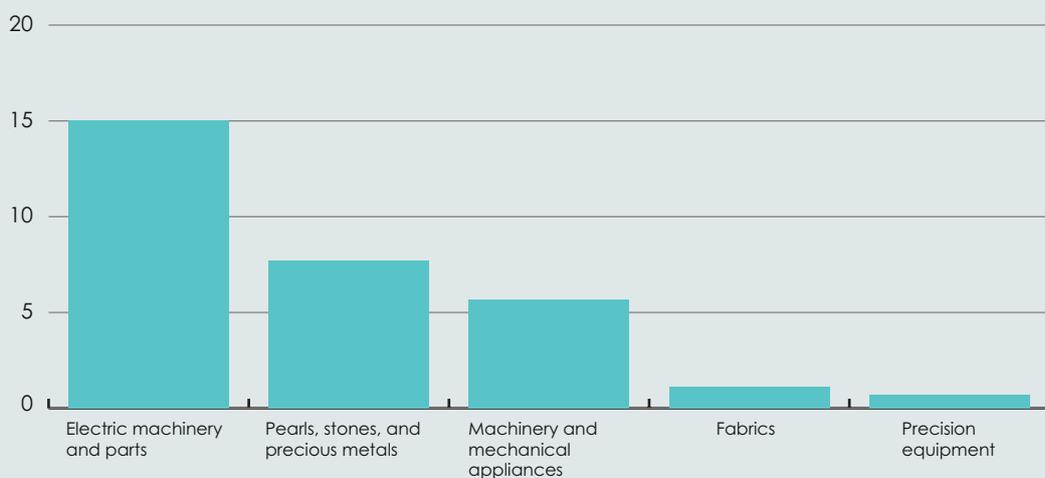


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becomes more service-oriented, the transshipment of Chinese-made goods through Hong Kong is likely to shrink. At the same time, however, the direction of trade will change, with more of the transhipped goods bound for nearby markets rather than North America or Europe.

Hong Kong's main exports to ASEAN, 2016

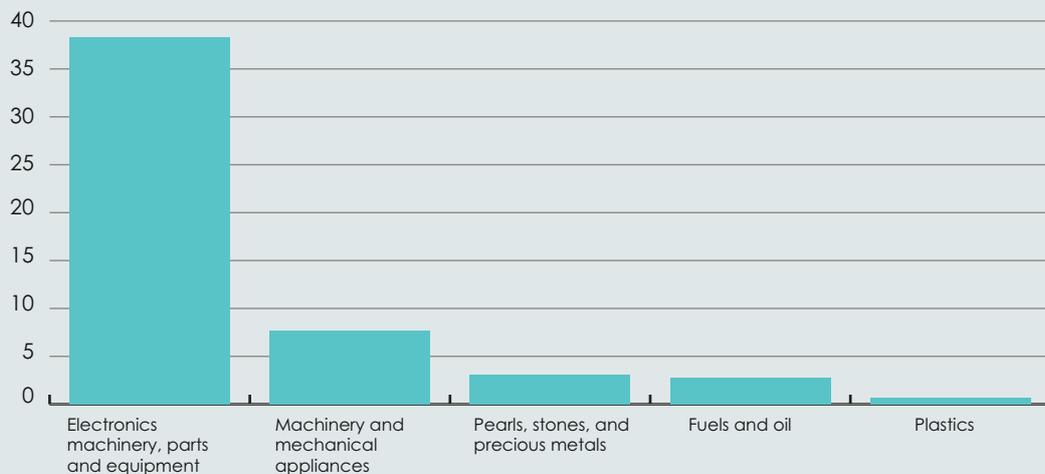
(Value in US\$ bn)



Source: The International Trade Centre, The EU

Hong Kong's main imports from ASEAN, 2016

(Value in US\$ bn)



Source: The International Trade Centre, The EU

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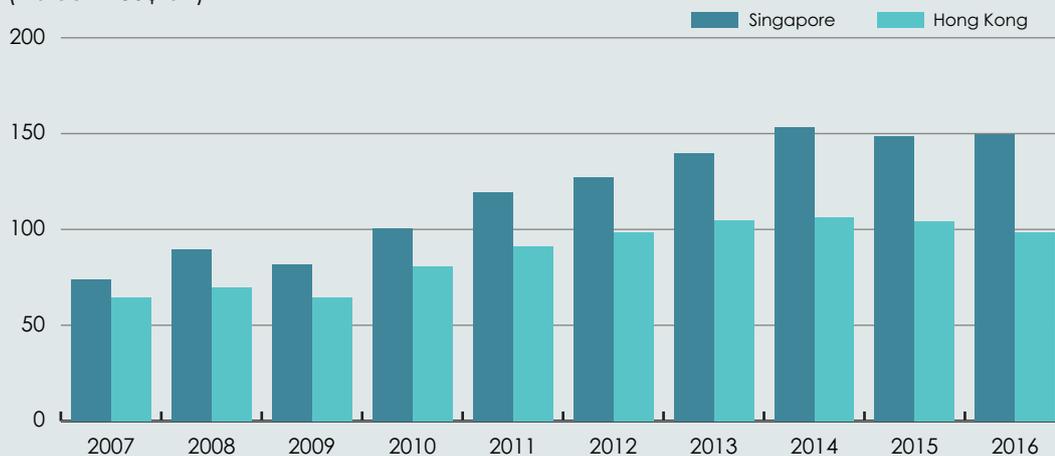
There are already many signs that this shift is underway, albeit occurring more slowly than some anticipated. Hong Kong's exports to ASEAN, for example, stood at a shade under US \$40bn in 2016, stagnant over the previous year but up by 28% from 2012; over the same period, Hong Kong's total exports to the world grew by just 4.8%. Most of the export growth to ASEAN has been in intermediate electric goods or parts for the region's electronics supply chains, but finished consumer goods like cosmetics, food and beverages, footwear are also on the rise.

Meanwhile, Hong Kong's imports from ASEAN, a significant portion of which are destined for the mainland, had been growing strongly until 2016, when they dropped far more sharply than Hong Kong's imports from the rest of the world. With real private consumption in China forecast to increase by \$US 857bn over the next five year, this likely represents a temporary slowdown in the trade relationship between HK, China, and ASEAN.

ASIA'S HEAD

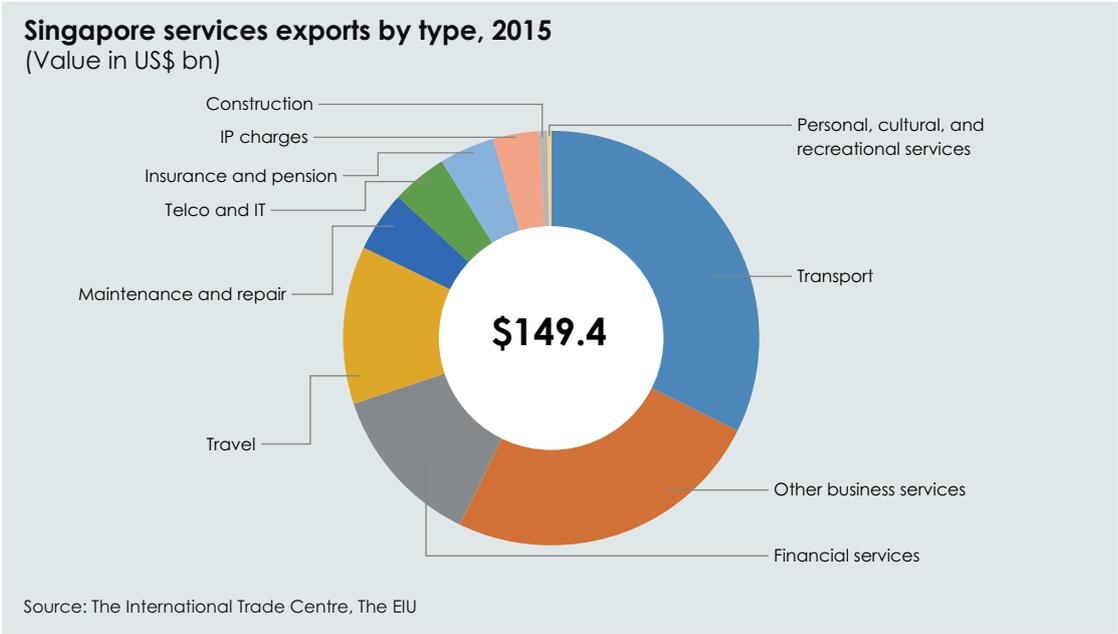
Like Hong Kong, Singapore is a major transshipment hub. And while they both export billions of dollars-worth of services, Singapore is the larger of the two in this regard, with close to US \$150bn in services exports in 2016 versus US \$98bn in Hong Kong. For Singapore, that represents a doubling of services exports since 2007.

Singapore and Hong Kong: Services exports
(Value in US\$ bn)



Source: The International Trade Centre, The EIU

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In terms of the types of services Singapore is exporting, transport is unsurprisingly the largest, accounting for nearly US \$48bn in 2016. Considering its role as a financial services hub, that sector might be expected to be close behind, but business services exports, which includes management consulting, technical support, and R&D, were almost twice as large, coming in at US \$37bn. For all the attention the sector receives in Singapore, as well as in Hong Kong, financial services are the third largest type of services export in both economies and generate nearly identical amounts of export revenue—US \$18.8bn in Singapore in 2016 and US \$18.1 in Hong Kong.

Though not yet as significant, the fastest growing sources of services exports in Singapore—and to a lesser extent, Hong Kong—are telecommunications and information services and charges related to intellectual property use. With cross-border data flows increasing, and intellectual property becoming more important as firms in the region develop IP of their own, this fact shouldn't come as a surprise. Growth rates may not remain so high as the bases becomes bigger, but these two services sectors are sure to provide great opportunities in the years ahead.

LOOKING AHEAD, LOOKING TO ASIA

As economic vibrancy continues to shift from West to East, and consumer demand continues to expand, Hong Kong and Singapore will be ever more vital to the functioning of the regional economy in Asia. No other economies can match their capabilities in facilitating trade in physical

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goods through transport and logistics services and few, if any, are able to provide the same level of financial and telecommunications service.

But the region's success depends on more than demand alone. For trade to grow, Asia needs to become more integrated so that goods, services, people, and data can flow freely across borders. The Regional Comprehensive Economic Partnership (RCEP), a sixteen country free trade agreement (FTA) that includes the ten ASEAN members plus China, India, Japan, South Korea, Australia, and New Zealand, will be a strong step in that direction if and when it's agreed. The Trans-Pacific Partnership, another regional FTA, was believed dead when President Trump withdrew the US in his first days in office but is being revived without the US by its remaining eleven signatories. If it comes into force, it will provide another avenue towards regional integration.

Asian firms both large and small with global ambitions will, in the near-term, still find a great many opportunities in Europe and North America. But current trends point to a time when the opportunities available in Asia outweigh those in the West. That time may be slower in coming than some hoped or expected, but it will come and firms need to be prepared.

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