

# ECONOMIC FOCUS

Treasury Division



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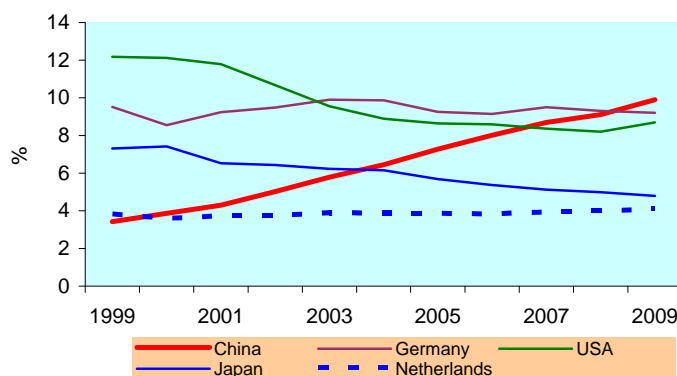
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## Mainland China's Role as the World's Factory is Under Threat

- Mainland China surpassed Germany to become the world's biggest exporter in 2009 on the back of persistent increase in competitiveness and search for new markets. Foreign invested enterprises (FIEs) as a key source of the export sector's technological advancement have played a crucial role for the Mainland's achievement. Presently, at least 70% of the Mainland's hi-tech exports originated from FIEs. Simultaneously, mainland China also succeeded in gaining market shares in developing economies.
- But advanced countries with their dominance in market size would still be the major source of growth for the Mainland's exports for some years to come. In 2009, North America and Europe imported US\$7,651 billion of goods from the world, or 5.7 times the imports of South and Central America, Africa and the Middle East combined.
- However, rapidly rising labour cost on the Mainland has already led some FIEs to move further inland or relocate to other developing countries in a bid to lower operating cost. With the majority of the Mainland's high-tech exports originating from FIEs, mainland China would have to move up market more by itself to remain competitive going forward.

Mainland China surpassed Germany to become the world's biggest exporter in 2009, marking a milestone in the country's recent history in world trade (Exhibit 1). In 2009, the Mainland's exports amounted to US\$1,202 billion, accounting for nearly 10% of the world's total exports, compared with Germany's 9.2% and the US's 8.7%.

**Exhibit 1: Mainland China's share in world exports**



Source: World Trade Organisation; Hang Seng Bank



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## From labour-intensive to more technology-intensive products

Mainland China's emergence as a dominant nation in world trade is the result of persistent increase in competitiveness via moving up markets and exploring new sources of demand. This is evident from the significant change in the country's export structures and market composition in the last decade.

The upgrading of the Mainland's exports was most obvious from the rapid expansion of higher value-added exports such as electronic data processing machines, telecommunication equipment and integrated circuits over the last decade.

Between 2000 and 2009, the growth of mainland China's exports averaged 19.1% per year (Exhibit 2). During this period, higher value-added exports, as represented by machinery and transport equipment, climbed at an annual rate of 24.4%, well above the overall growth rate and the growth rate of lower value-added ones such as textiles and clothing (14.2%) and toys, shoes and plastic articles (10.5%).

**Exhibit 2: Mainland China's exports by commodity**

	Exports (US\$ billion)		Share in mainland China's total exports, %		Annual growth, %
	2000	2009	2000	2009	2000-09
Agricultural products	21.4	42.7	8.8	3.6	8.0
Fuel & mining	7.9	20.4	3.2	1.7	11.1
Manufactured products	219.9	1,138.6	88.2	94.7	20.0
- iron & steel	4.4	23.7	1.8	2.0	20.6
- chemical	12.1	62.0	4.9	5.2	19.9
- machinery & transport eqpt	82.6	590.4	33.1	49.1	24.4
- office & telecom equipment	42.0	343.7	16.9	28.6	26.3
- EDP & office equipment	18.6	147.0	7.5	12.2	25.8
- telecom equipment	19.5	159.1	7.8	13.2	26.3
- IC & electronic parts	3.9	37.6	1.5	3.1	28.8
- transport equipment	9.0	59.0	3.6	4.9	23.2
- vehicles	6.6	28.6	2.6	2.4	17.8
- other machinery	31.6	187.7	12.7	15.6	21.9
- other manufactured goods	120.8	462.5	48.5	38.5	16.1
- textiles & clothing	52.2	172.5	20.9	14.4	14.2
- toys, shoes, plastic articles	20.4	50.2	8.2	4.2	10.5
All	249.2	1,201.7	100.0	100.0	19.1

Sources: China Customs Statistics; Hang Seng Bank

As a result, the share of machinery and transport equipment in the Mainland's total exports rose from one-third in 2000 to almost half (49.1%) in 2009, while that of textiles and clothing plummeted from 21% to 14% in the same period

Today, mainland China is among the world's top exporters in many of the higher value-added products such as electronic data processing machines and office equipment (the largest in the world), and telecommunication products (the world's second after the European Union)<sup>1</sup>.

<sup>1</sup> International Trade Statistics, WTO, 2009



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## High-tech exports are mainly produced by foreign funded enterprises and with a high import content

Foreign investors have played a crucial role in the upgrading of the Mainland's exports. In 2009, 56% of mainland China's exports originated from foreign invested enterprises (FIEs), up from 46% in 1999. More importantly, various studies pointed out that over 40% of FIEs' exports are hi-tech products<sup>2</sup>. If the ratio reflects the true picture, it follows that of the US\$376.9 billion hi-tech products exported by mainland China in 2009, at least 70% were from FIEs (Exhibit 3).

**Exhibit 3: Mainland China's exports of hi-tech products**

	2000 US\$ billion	2009 US\$ billion	Share of total, 2009, %	Annual growth, 2000- 2009, %
High-tech exports	37.0	376.9	31.4	29.4
- biotechnology	0.1	0.3	0	13.0
- life science & technology	1.4	11.0	0.9	25.7
- opto-electronics	1.0	20.9	1.7	40.0
- computer & telecom	27.0	282.5	23.5	29.8
- electronics	5.8	51.1	4.3	27.4
- computer integrated manufacturing	0.5	5.1	0.4	29.4
- materials	0.3	3.0	0.2	29.2
- aerospace	0.7	2.7	0.2	16.2
- other technology	0.2	0.4	0	8.0
Other exports	212.2	824.8	68.6	16.3
All exports	249.2	1201.7	100.0	19.1

Source: China Customs Statistics; Hang Seng Bank

Exports by FIEs also tend to have a high import content. In 2009, mainland China's processing exports, that is, importing all or part of the raw materials, parts and components from abroad and re-exporting the finished products after processing or assembly by enterprises on the Mainland, amounted to US\$587 billion, or 49% of the country's total exports. Of the processing exports, US\$495 billion or 84% were from FIEs. Looking at this from another perspective, it implies that about 73% of exports by the FIEs are processing exports.

## Gaining market shares in developing economies

Another reason for the Mainland's rapid rise to the world's top export position is the country's success in expanding new sources of demand. In the past decade, the Mainland's effort to diversify away from the major markets has been gradually paying off. Exports to the advanced economies accounted for about 62% of the Mainland's total overseas shipment in 1999, but the relative share has declined to 45% by 2009. In contrast, the share of the emerging economies rose from about 13% to 25% during the same period (Exhibit 4).

<sup>2</sup> See for example 「我國出口商品結構及企業競爭力研究」, Finance & Trade Economics (財貿經濟), 12/2009, p.94; or 「中國出口增長之謎」, Finance & Trade Economics (財貿經濟), 12/2008, p.73



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**Exhibit 4: Mainland China's exports by major markets**

	Exports, US\$ billion		Share in mainland China's total exports, %	
	1999	2009	1999	2009
<b>Developed markets</b>				
Japan	32.4	97.9	16.6	8.1
USA	41.9	220.8	21.5	18.4
Europe /1	23.9	159.6	12.3	13.3
Re-exports from Hong Kong SAR /2	22.7	62.3	11.6	5.2
<i>Sub-total</i>	120.9	540.6	62.0	45.0
<b>Emerging markets</b>				
Asean excluding Singapore	7.7	76.2	3.9	6.3
India	1.2	29.7	0.6	2.5
Africa	4.1	47.7	2.1	4.0
South America	5.3	57.1	2.7	4.8
Russia	1.5	17.5	0.8	1.5
Emerging Europe /3	6.3	76.7	3.2	6.4
<i>Sub-total</i>	26.1	304.9	13.4	25.4
<b>Other markets</b>	47.9	356.1	24.6	29.6
<b>All</b>	194.9	1201.7	100.0	100.0

Sources: China Customs Statistics; Hong Kong Trade Statistics; Hang Seng Bank

Notes: 1) covered only UK, Germany, France, Italy and Netherlands

2) estimated from Hong Kong re-exports of Mainland origins to UK, Germany, France, Italy and Netherlands

3) Proxy by EU less UK, Germany, France, Italy and Netherlands

From the perspective of the emerging economies, imports from mainland China have been gaining importance. In 1999, imports from the mainland China only accounted for 2.3% of the total imports of South and Central America, Africa and the Middle East (Exhibit 5). That share rose to 12.2% in 2009. By comparison, the Mainland's share in the total imports of North America and Europe, the country's traditional export markets, rose from 2.0% to 6.6% in the same period.

**Exhibit 5: Mainland China's share in various regions' imports**

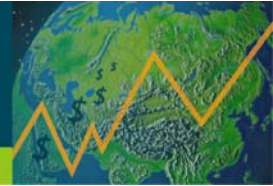
	Mainland China's exports to regions, US\$ billion		Region's total imports, US\$ billion		Mainland China's share in region's total imports, %	
	1999	2009	1999	2009	1999	2009
<b>South &amp; Central America</b>	5	57	335	444	1.5	12.8
Africa	4	48	133	400	3.0	12.0
Middle East	5	58	151	493	3.3	11.8
<i>Sub-total</i>	14	163	619	1,337	2.3	12.2
<b>North America</b>	44	239	1,280	2,177	3.4	11.0
Europe	35	265	2,652	5,474	1.3	4.8
<i>Sub-total</i>	79	504	3,932	7,651	2.0	6.6
<b>Asia &amp; Oceania</b>	102	535	1,352	3,397	7.5	15.7
<b>World total</b>	195	1,202	5,903	12,385	3.3	9.7

Sources: China Customs Statistics; International Trade Statistics, WTO; Hang Seng Bank



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## Can mainland China continue to be the world factory?

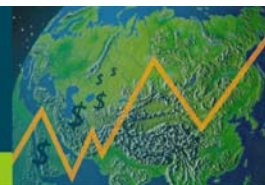
Though the Mainland has been gaining market shares in developing economies, the advanced countries would still be the major source of growth for the Mainland's exports for some years to come. In 2009, North America and Europe imported US\$7,651 billion of goods from the world, or 5.7 times the imports of South and Central America, Africa and the Middle East combined (Exhibit 5 above). In terms of market size, the dominance of advanced economies in world trade is obvious.

But the road ahead for mainland China is becoming tougher. Labour supply is getting tight and labour cost is rising, meaning that the once favourable factor that made mainland China the world's factory is disappearing. It also means that the operating environment for processing exports, which are dominated by FIEs, is deteriorating. While some FIEs will move further inland in a bid to lower operating cost, some will relocate to other developing countries. With the majority of the Mainland's high-tech exports originating from FIEs, the message is that mainland China would have to move up market more by itself to remain competitive in the years ahead, otherwise its role as a dominant exporter may diminish.



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