An Analysis of Hong Kong Export Performance

Yin-Wong Cheung

University of California

and

Hong Kong Institute for Monetary Research

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Summary

Hong Kong is a very open economy. The strength and the growth of the Hong Kong economy depend heavily on its export activity. Given its current economic difficulties, information on factors affecting Hong Kong's export performance can provide some useful insights on formulating policies to improve the situation. The paper conducts a detailed study on the Hong Kong monthly export performance from 1991 to 2001. First, we estimate the canonical relationship between exports, foreign income, and real exchange rates. The exercise is then extended to investigate the incremental explanatory power of real exchange rate volatility, "third" country competition, domestic wages, and costs of imports from China.

The study has several salient features. First, to address the simultaneity and nonstationarity problems, the cointegration framework and the related error-correction specification are employed to study the basic export demand equation. Second, Hong Kong domestic exports and re-exports are modeled separately because these two export categories evolve quite differently over time. To highlight the variations across destinations, we also compare the performance of aggregate exports and the exports to the U.S. and Japan. Third, it is observed that the general price level, which is routinely used to construct the relative price variable in trade equations, does not correctly reflect the competitiveness of Hong Kong exports. The real exchange rate variables in the current exercise are constructed from destination-and-export-type specific unit value indexes.

In sum, the selected variables explain Hong Kong exports quite well. Most of the significant variables have the expected sign. However, the effects of these economic factors on the volume of exports vary across types and destinations. For instance, effects of real exchange rate volatility, "third" country competition, and domestic wages on aggregate exports are different from those on exports to Japan and the U.S. The use of aggregate export data can give a misleading picture if the focus is on the behavior of a specific category of exports.

Our analyses indicate that, far more than the external factors including foreign income, relative prices, real exchange rate volatility, and costs of importing from China, the lagged exports are the key factors determining Hong Kong exports. The extraordinary export performance of Hong Kong in the past is mainly driven by the internal dynamics of exports themselves rather than external demand conditions. A policy implication of the result is the importance of exploring and expanding the export market. Instead of waiting for external conditions to improve, a fruitful policy would be to explore ways to increase the breadth and depth of the export market and, hence, set the exports on a new dynamic path.