

**CENTRAL POLICY UNIT
HONG KONG SPECIAL ADMINISTRATIVE REGION**

**CONSULTANCY STUDY ON
SOCIAL, ECONOMIC AND POLITICAL
DEVELOPMENTS
IN THE MAINLAND,
WITH PARTICULAR EMPHASIS ON
REGIONAL DEVELOPMENTS AND
THE GUANGDONG PROVINCE**

FIFTH BI-MONTHLY REPORT

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EXECUTIVE SUMMARY

1. Risks currently faced by China and direction of macroeconomic policies to be adopted in the second half of 2008

Economic growth in the Mainland has slowed down for four consecutive quarters, dragged by both the measures adopted by the Mainland to prevent overheating as well as the lackluster external demand due to the downturn of the global economy. Given the international financial market turmoil as backdrop, with the US sub-prime crisis still unresolved and global economic growth slowing notably, it is China's priority to shield its economy from drastic fluctuations and to maintain steady and fairly robust growth in the second half of the year. On July 25, the Political Bureau of the Central Committee of the Communist Party of China decided to set the policy tone for the second half of the year as: "the most important tasks would be to maintain steady and fairly rapid development, as well as to control excessive inflation; efforts to curb inflation would be particularly prominent." The Mainland is likely to duly relax its tight monetary policy and adopt more aggressive fiscal policy so that it could simultaneously stimulate exports, propel domestic demand and control inflation. The Mainland's ability to maintain steady and fairly rapid development would benefit Hong Kong. In particular, slowing down the appreciation of the Renminbi and relaxation of export tax rebate policy would safeguard the profit margins of Hong Kong exporters based in the Mainland.

2. Lessons China can draw from Vietnam's financial crisis

Since May 2008, Asia's new dragon, Vietnam, has been afflicted with sharp depreciation of its currency, crashing of its stock market and collapse of its property market, alarming the world and triggering serious concerns from neighboring Asian countries. The rapid downturn of the financial conditions in Vietnam was mainly due to risks accumulated throughout the years of excessively rapid economic growth. Despite overheating of the economy and continued influx of hot money, the government had not regulated the economy with effective macroeconomic and financial policies, leading to the outbreak of the current crisis. Similar issues are now daunting the Mainland, including overheating of investments, unabated inflation, and excess liquidity on the domestic front, as well as high prices of food and oil, which is a global phenomenon. Amidst economic globalization and financial integration, the Mainland should learn from the lessons of Vietnam's financial crisis so that similar outbreaks could be prevented. To keep things under

control, the Mainland should (i) take caution when liberalizing its capital account and closely monitor the flow of funds; (ii) prevent the persistent inhibition of the Renminbi value to guard against the flow of hot money which makes China prone to speculative manipulation; (iii) curb the excessive rise in property prices and prevent sharp fluctuations in the stock market; and (iv) continue to rein in excessive inflation.

3. Means by which Hong Kong can take part in the development of the Pan-Beibu Gulf region

Hong Kong enjoys a prominent geographical advantage in the Pan-Beibu Gulf economic cooperation. Located at the junction of northeast and southeast Asia, flow of goods, people, funds and information between the two regions can most naturally be coursed through Hong Kong, giving the city with massive trade and investment opportunities. At the current stage, however, a blueprint of the Pan-Beibu Gulf cooperation is still being fine-tuned. Before the mechanics of the regional cooperation are confirmed and finalized, it would be to Hong Kong's best interest to course its search for opportunities in Pan-Beibu Gulf's development. Spearheading cooperation in the Pan-Beibu Gulf area, Guangxi is Hong Kong's most natural gateway. With the "Development Plan of Guangxi's Beibu Gulf Economic Region" approved early this year, cooperation between Guangxi and Hong Kong are presented with invaluable opportunities. To complement Guangxi's integration into the Pan-Beibu Gulf region, Hong Kong businesses can take part in the developments of the Qinzhou Bonded Port Area, Beibu Gulf logistics industry, Ninghai-Beihai-Qinzhou-Fangchenggang city cluster, Nanning regional financial centre and Guangzhou-Hong Kong tourism industry. In the long run, increased resources invested by the SAR government, such as setting up of economic and trade offices in Vietnam, would help Hong Kong expand its role in the Pan-Beibu Gulf region economic co-operation.

4. New bright spots of the Jiangsu economy and its cooperation with Hong Kong

This year, Jiangsu introduced its "Decision to Speed up the Changes in the Ways of Jiangsu's Economic Development", which requires the province to calibrate its industrial structure, strengthen its creativity and innovativeness, step up energy conservation and pollution control, and introduce institutional and procedural reforms to help speed up the transition of Jiangsu from a major economic province to a powerful economic province. With the more rapid adjustment of its industrial structure, introduction of new manufacturing industries that are led by modern

services, as well as construction of resource-conserving and environmentally friendly society, Jiangsu and Hong Kong will find increasing opportunities for economic and trade cooperation. In particular, recent developments of Jiangsu's coastal cities including Lianyungang, Yancheng and Nantong, which may be integrated into the national-level strategies for economic development, would provide an additional platform on which Jiangsu-Hong Kong cooperation can be further strengthened. With the construction of coastal ports and development of port-related industries sped up, trade flows between Jiangsu, Zhejiang, Shanghai, Beijing-Tianjin-Hebei, the western and central regions, as well as northeastern regions are bound to surge, giving rise to new demand for logistics services. These would provide Hong Kong's logistics companies with bigger room for development. Moreover, as a coastal province, Jiangsu's abundant resources can be leveraged upon for the development of new energy industries, particularly wind energy, which is another investment area that Hong Kong companies can participate.

5. New challenges faced by Guangdong's economy and counter-measures to be undertaken

The growth of Guangdong's economy, which has persistently been kept at high levels, slowed in the first half of 2008, with real GDP growth falling to the lowest level seen since 2003. Some academics thought the possibility of Guangdong's continuous slack should not be dismissed. Constraints to the development of Guangdong's economy include: increasing pressures coming from high prices of oil and other resources, shortage of land supply, difficulties in raising funds due to structural incompatibilities in the supply and demand of resources, enterprises and industries that are incurring serious losses, rapid rise of the property prices in some districts, and problems arising from the widening trade deficit. For the second half of this year, the province will focus its efforts on ten specific areas. Such measures will speed up the relocation of both industries and workers. Hong Kong businesses should be prepared accordingly.

6. Guangdong strengthens promotion of economic and trade cooperation with ASEAN countries

Economic and cultural exchanges between Guangdong and Southeast Asian countries trace back to time immemorial. Further deepening of cooperation between the two sides is being spurred by the division of labour arrangements under the current internationalized industrial setting and Guangdong's inherent need to improve its international competitiveness, which is, in turn, triggered by its

aggressive “going out” policy. Following the smooth implementations of the “Merchandise Trade Agreement” and “Service Trade Agreement” signed under the framework of the China-ASEAN Free Trade Area, Guangdong has been fostering closer cooperation with ASEAN members, attracting investment from Singapore and Brunei into Guangdong’s electronics, information technology, and petrochemical industries on one hand and inviting potential investors from Malaysia, Thailand, Philippines and Indonesia to invest in electrical appliances, textiles and process assemblies, as well as Vietnam, Cambodia, Laos and Myanmar to jointly cultivate resources and undertake subcontracting ventures on the other. Given its strategic location, Guangdong can leverage on the platform provided by the Pan-Pearl River Delta (PRD) regional cooperation to exert its comparative advantages in the areas of manufacturing, industries, technology, human resources, and management. Together with the other Pan-PRD constituents, Guangdong can tap the markets of the 10 ASEAN member countries, the scale of whose economy is comparable to the “9+2” region. As part of the “9+2” set up, Hong Kong will certainly be able to find new opportunities herewith.

7. Zhanjiang to become the star of Guangdong’s new round of development

Zhanjiang is located at the southern tip of China, on the southwestern side of Guangdong. Situated at the junction of Guangdong, Guangxi and Hainan, it is a coastal city endowed with abundant natural resources. As a port city, Zhanjiang’s marine and port-related industries will see continuous expansion. In recent years, Zhanjiang Port has constructed the country’s first 300,000-ton onshore oil terminal and southern China’s first 200,000-ton iron ore terminal. Channels for 30,000-ton class vessels are undergoing construction, boosting Zhanjiang to progress towards becoming a major port of southern China. Port development in Zhanjiang will provide Hong Kong businesses with many new opportunities.

8. Zhaoqing to strengthen integration with the Pearl River Delta region by riding on the strategy of “relocating both industries and labour”

As the mountain region closest to the core Pearl River Delta (PRD) region, Zhaoqing enjoys a unique position in complementing other PRD constituents’ implementation of the strategy of “relocating both industries and labour”. Zhaoqing can also take the opportune time to attract more sophisticated production and peripheral resources, resolving two of its major problems – its relative under-development and the imbalance in development between cities and counties.

This should also support the city in boosting productivity as socio-economic development continues, and enable Zhaoqing to expand the scale of its economy. Although Hong Kong entrepreneurs in Zhaoqing have traditionally focused their investments in labour-intensive industries, Zhaoqing is actually better suited for pursuing development based on non-manufacturing sectors such as logistics, culture+ and tourism, resource development and environment protection, and human resource training. Hong Kong has a long track record in these areas and can complement Zhaoqing's long-term development by providing both financial and technical support.