The Asia-Pacific Journal | Japan Focus
Volume 4 | Issue 2 | Article ID 2073 | Feb 16, 2006

Hong Kong, Singapore and the Asia Pacific Economies

Andy Xie

Hong Kong, Singapore and the Asia Pacific Economies

By Andy Xie

[This article shows that Hong Kong and Singapore, the two great Asian city ports, are implementing quite different strategies to regain their competitive prowess in the global economy following setbacks in the 1997 Asian financial crisis, in an era, and at the edge of, a booming Chinese juggernaut. Each confronts a different set of opportunities and possesses a divergent set of institutions and resource endowments. So the strategies they deploy naturally differ. This is an important point in a world where policy options are often regarded as marginal at best, with most constrained by the convergence on free-market reforms allegedly compelled by globalization.

Writing for investors, Xie doesn't discuss the full range of social, cultural and other policies that compose their strategies and options. Nor does he explain the broader context, which is that city-region strategies are a common phenomenon throughout the world. But outside specialist circles, little attention is paid to the disparate niches into which mega-cities are fitting themselves. What makes it possible for each to maintain income levels ten to thirty times those of China and/or their immediate neighbors?

Read this piece and you learn that globalization has not rendered the world flat, as Thomas Friedman has argued in his bestseller "The World is Flat" (a book that was best roasted at the following site). Xie's article is a good example of a growing literature emphasizing the fact that the global economy offers an array of niches for city-regions that have the policymaking smarts to exploit them. Smart city managers don't approach policymaking as a matter of finding the one-size-fits-all package of reforms. Rather, they draw on the area's human and natural resources and other endowments and build on them, fitting the economy into a larger structure of opportunities. Whether they do that equitably, with equality of opportunity, may determine how well the region evolves into a knowledge economy, how effectively it competes, and how well it serves the interests of its people. AD]

In the current emerging market ('EM') boom, Hong Kong and Singapore are not in the limelight. The two city economies became rich by being the gateways to the rest of the world for their large neighbors. However, globalization has allowed their neighbors to bypass them and access the global stage directly. Both are trying to get back into the game but in different ways.

Hong Kong's businesses were previously intermediaries between China and the world. Now Hong Kong's aim is to provide the ground for China and the world to meet directly. While this effort has succeeded in appearing to turn Hong Kong's stock market into China's main board, it is too early to conclude that this business model is sufficiently high margin to support Hong Kong's per capita income at 13 times that of China.

At the same time, Hong Kong has been tightening land supply to support property prices to stimulate consumption. This strategy was effective after the SARS crisis. But, some reversal in property prices is already apparent. The hikes in the Fed funds rate have increased the cost of funds in Hong Kong through the pegged exchange rate. The outlook for Hong Kong's consumption is becoming increasingly uncertain.

Singapore looks to be turning into a private equity fund and is trying to own the growth in neighboring economies. This strategy seems quite successful at the moment with the EM boom creating big paper gains for Singapore's investments. However, past history suggests that EM activity is very cyclical and long-term gains are difficult to achieve. It is too early to judge the success of Singapore's approach. Even if the investments do work out, the returns may not be sufficient to sustain Singapore's per capita income at 27 times that of Indonesia or 14 times that of China.

Singapore is also focusing on China's weaknesses to create economic activities at home. Private wealth management, healthcare, education, and casino operations are some of the areas. I think these activities look promising for creating sufficient jobs for Singapore's small labor force.

Singapore and Hong Kong are taking different approaches to regaining their relevance in globalization. It is too early to say if either approach will be successful. In the background, the enormous wage gaps between the two cities and their neighbors work as a headwind to their economies. Their economic policies need to be very effective for living standards to be maintained.

The Lucky Twins

Hong Kong and Singapore are Asia's lucky cities. Their income levels are considerably higher than those of their large neighbors.

In 2005, Hong Kong's GDP per employee was US$52,000 and Singapore's US$54,000, not far from Japan's US$66,500 and much higher than Korea's US$34,000 and Taiwan's US$30,000. The income levels in China, India and Indonesia are less than 10% of these levels.

The cities of Hong Kong and Singapore have become rich by being the intermediaries between the world and their big neighbors (China in Hong Kong's case and Southeast Asia for Singapore's). To a significant extent, the two cities have gained from inefficiencies in their giant neighbors.

In the EM boom in the 1990s, for example, Hong Kong benefited from international enthusiasm for China by offering its listed companies and properties as plays on China's future. Its property and stock markets boomed. When the bubble burst, Hong Kong continued to benefit with foreign investors the losers.

Singapore benefited from the massive inflow of Indonesian money into its property market. This source of money was partly the regurgitated foreign capital flow into Indonesia. Another gain for Singapore was its ability to provide a base from which multinational companies could operate to manage businesses in Southeast Asia.

Hard Times since 1997

The Asian Financial Crisis in 1997/98 was the turning point for the two cities. Since that time, GDP growth in Hong Kong has averaged 3.6% and in Singapore 3.7%. In nominal terms, Hong Kong's GDP regained its 1997 level only in 2005. Furthermore, its nominal domestic demand last year was still 17.3% less than in 1997. Nominal GDP recovered on the increase in net exports.

Singapore's nominal GDP has performed much better, up 3.6% a year during 1997-2005. The 12% currency depreciation against the dollar helped in boosting Singapore's nominal GDP.

The difference in deflationary pressure between Hong Kong and Singapore is a reflection of the extent of property overvaluation when the EM bubble burst in 1997. Hong Kong's property prices were up by 546% over the previous ten years and Singapore's 253%.

Hong Kong's property prices dropped by 65% and Singapore's by 28% between 1997 and 2003. Even after the adjustment, Hong Kong's property is still twice as expensive as Singapore's on average, while the two have similar income levels.

The Fragile Recovery

Hong Kong and Singapore have experienced a sharp recovery since the end of the SARS crisis in 2003. Hong Kong's property prices have shot up 63% in two years. Its real GDP rose by 15% and nominal GDP by 12% between 1997 and 2005. Singapore's real GDP rose by 15% and nominal GDP by 19% over 1997-2005, while its property prices remained flat during the period.

The rapid recovery after the SARS outbreak has brought hope that the two city economies are back to their old forms. I think this is a wrong perception. Domestic demand remains depressed in both economies. Hong Kong's real domestic demand was only 5.7% higher in 2005 than in 1997, while nominal domestic demand was 13% less.

Singapore's domestic demand rose by 11% in real terms and 12.5% in nominal terms between 1997 and 2005 or one third as much as the increase in GDP. The real reason for the recovery of both is the expansion in the current account surplus. Hong Kong's net exports accounted for 14.5% of GDP in 2005 compared with -1.5% in 1997. Singapore's net exports rose from 12.8% of GDP in 1997 to an estimated 29.5% in 2005. The fragility of the recovery is due to its dependence on the rise in net exports, which is a form of cashing out of past investments. This sort of cashing-out depletes the domestic capital stock and, hence, the growth potential over time.

Capital Exports Become the Key to the Future

Rising exports, or the cashing-out of past investments, is possible when capital is exported in the same amount. There lies the key to the future of both economies, in my view. How much they earn on their exported capital will determine if the two cities can sustain or raise their living standards.

Singapore has executed unprecedented capital redeployment, led by its government, relative to the size of its economy. The efforts have so far been successful. Some of its investments (e.g., the stake in China Construction Bank) have appreciated considerably in the current EM boom. For a small economy like Singapore, the government-led approach is entirely appropriate, as long as it works.

Hong Kong's capital exports are driven by the private sector. Its leading businesses have been buying into some of the same businesses as Singapore. In addition, its population has been buying into Chinese IPOs and properties. Such investments have been profitable so far in the current EM boom.

However, asset markets in emerging economies are highly cyclical. It is too early to judge if the current paper gains will last. As Hong Kong and Singapore invest in their neighbors rather than at home, their living standards depend on the long-term returns on such investments.

Hong Kong's and Singapore's strategy contrasts with that of Korea, which is to build up manufacturing industries that are ahead of China's or India's in terms of quality and branding. Korea's living standards depend on sustaining its edge over China and India in such areas. The success or failure of Korea's strategy depends on Korean businesses. Hong Kong's and Singapore's strategy depends on entities over which they have no control.

Employing People

As Hong Kong and Singapore divert capital to neighboring economies, how to employ the local population becomes an issue. Again, Singapore has a government-led strategy that tries to take advantage of China's weaknesses. The low level of confidence in aspects of China's economy gives Singapore an edge in private banking and healthcare. The possibility of obtaining a Singapore passport increases demand for Singapore-based education. Gaming, as in many other places, is viewed as an easy source of economic activity.

The effects of Singapore's economic adjustment are not apparent yet. Its economic recovery so far is still based on manufacturing, not services. This employment strategy will eventually work, I believe. But, we cannot yet predict the wage level that such activities can support.

Hong Kong has pursued one consistent policy in recent years to boost consumption, i.e., pushing up property prices by decreasing land supply. This policy was effective from mid-2003 to 2005 as the low Fed funds rate and strong global demand once more triggered property speculation.

However, pushing up property prices is proving to be much more difficult than previously. First, Hong Kong's nominal and real wages have stagnated since 1997 compared with the double-digit annual growth rate in the preceding ten years. The diminution in income prospects, mainly because of competition from China, is likely to continue in the next ten years.

Second, the expatriate population – a major force in the high-rent market – has declined as foreign businesses send more of their employees directly to Chinese cities. For example, since 1997 the number of Japanese nationals has fallen by 39%, British by 22%, Canadian by 20%, and American and Australian by 16%. The diversion of the expatriate population to Chinese cities is a secular trend.

This is why Hong Kong's property market is softening even though the Fed funds rate at 4.5% is still relatively low by historical standards. I believe it will become harder and harder for Hong Kong to keep its property prices up.

The other relevant change in Hong Kong is the opening to mainland tourists. This change has been quite important in creating jobs for unskilled labor. Even though the initial effect of 'opening up the floodgate' has worn off, it is likely to remain a major factor in Hong Kong's labor market. However, this business is unlikely to support high-wage jobs.

The bottom line is, will Hong Kong and Singapore be able to justify wages that are 10 or 20 times those of their immediate neighbors in the era of globalization? If not, steady deflationary pressure will constrain wage growth, which suggests poor earnings growth for the companies operating in these economies.

Andy Xie is Morgan Stanley's Hong Kong-based analyst.

This is a slightly abbreviated version of an article that appeared in Morgan Stanley's Global Economic Forum on February 13, 2006. Posted at Japan Focus on February 19, 2006.