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The Outlook of Mainland's Balance of Payments Rebalancing

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After four decades of opening up and reform, the Mainland not only recorded tremendous economic performance and becomes the second largest economy in the world, but its economy is also moving from a relatively closed one in late 1970s to a more open one. The increasing connection between the Mainland's economy and the rest of the world could be shown in its current account and overall balance of payments over the past decade. Going forward, the further opening up of Mainland's financial market and service sector will also bring notable changes to its current account and overall balance of payments.

Current account surplus has narrowed notably since 2015

The Mainland has recorded current account surplus since 1994. The current account surplus held rather steadily at around 2% of its GDP in the beginning of this century, which then increased tremendously to a peak of 9.9% of GDP in 2007 during the early years of China's accession to the WTO when it recorded very rapid exports growth. After reaching its peak in 2007, the Mainland's current account surplus has narrowed substantially to just 0.4% of GDP in 2018. The substantial narrowing of the Mainland's current account surplus was largely due to slowing merchandise trade growth after the global financial crisis and the continuous rapid increase of services imports.

There are four major components in the current account, i.e. goods trade, services trade, primary income and secondary income. The current account of the Mainland was mainly driven by the activity of goods trade throughout its development history, but the impact of services trade has become increasingly more important over the past decade. Primary income mainly comprises of compensation of employees and investment income, while secondary income records current transfers, which includes workers' remittances, donations, official assistance and pensions. The net flows in both primary income and secondary income accounts are relatively small, normally not more than 1% of its GDP.

Similar to the overall trend of its current account, goods trade has recorded surplus for every year since 1994, with its share of GDP held at around 2.5% of GDP in the beginning of this century to its peak of 8.5% of GDP in 2007, which then declined gradually to 2.9% of GDP in 2018. The rapid increase of goods trade surplus in the beginning of the century was the result of sharp increase in goods exports after China's accession to the WTO in late 2001. The goods exports of the Mainland recorded six consecutive years of over 20% growth between 2002 and 2007. By the end of 2008, the Mainland's total goods exports amounted to US$ 1.43 trillion, a 438% increase from its 2001 level. The rapid increase in goods exports also led to a similar increase in trade surplus. Goods trade surplus increased from US$ 22.5 billion in 2001 to US$ 298.1 billion in 2008, which became a major driving force for the current account surplus at that time. However, goods exports slowed substantially after the global financial crisis (particularly after first two years of recovery in 2010 and 2011) to an annual compound average of

3.9% between 2012 and 2018, which was lower than the annual average nominal GDP growth rate of 9.1% during the same period. On the other hand, the Mainland's economy is now moving towards more domestically driven, with consumption the main driver. The growth of goods imports also accelerated to over 15% in both 2017 and 2018, outpacing that of goods exports and resulting in a reduction of goods trade surplus as well.

In relation to services trade, State Administration of Foreign Exchange provided a breakdown for 12 services, i.e. processing service, maintenance and repair services, transportation service, travel service, construction service, insurance and pension services, financial service, intellectual property royalty, telecommunications, computers and information services, other business services, personal, cultural and entertainment services, and government services not mentioned elsewhere. Services trade was not a major item to drive current account performance before 2009, accounting for 0.1% of GDP, when the Mainland's economy was not as open as today, with fewer residents traveled or studied aboard. Among all the services trade, travel service is now the largest component with a deficit of US$ 237 billion in 2018, accounting for over 80% of total services trade deficit. Indeed, travel service deficit has increased continuously since 2009 from US$ 4 billion in 2009 to US$ 237 billion in 2018, even though its annual growth rate has slowed to just 6.6% in the past four years. The rapid increase in travel service deficit was mainly because of the rising economic wellbeing of the Mainland residents, in particular the middle class, as well as the more relaxing visa requirements of many foreign countries. In 2017, there were over 131 million outbound travels made by Mainland visitors, up from just 8 million in 1978. The most popular travel destinations include Hong Kong SAR, Macau SAR, Thailand, Japan, Vietnam, Korea, and the US, etc. Similar to travel service, transportation service is the second largest component of the service trade account. Transportation service registered US$ 66.9 billion deficit in 2018, accounting for another 23% of overall service trade deficit.

Furthermore, the Mainland is now the second largest economy in the world and is moving up the value chain, with innovation and technology the development focus of its economy in the future. Intellectual property royalty is now the third largest component in service trade account. The deficit of intellectual property royalty has been increasing gradually over the past decade from US$ 9.7 billion to US$ 30.2 billion in 2018, account for 10% of service trade deficit. On the other hand, even though the Mainland is moving up the value chain, it still has strong competitive advantage in manufacturing and processing trade. Processing service and other business services are the two components that the Mainland recorded service trade surplus, with the former totaling US$ 17.2 billion and the latter US$ 19.1 billion, accounting for 6% and 7% of service trade balance respectively. However, it should be noted that the amount of processing service surplus had already peaked at US$ 26.3 billion in 2011, likely because of more processing manufacturing activities have been relocated from the Mainland to other lower costing South East Asia countries.

Besides goods and services trade, primary income account recorded 16 out of 19 years of deficits since 2000, indicating that employment and investment income from non-residents continued to outpace that of Mainland's employment and investment income overseas. This might partly because of the relatively smaller stock of Mainland's outward investment as compared to inward investment from overseas. Nevertheless, the net flows in both primary income and secondary income accounts are relatively small, normally not more than 1% of its GDP.

Non-reserve financial account saw more two-way flows

Over the past decade, the Mainland has increasingly opened its economy and financial markets, with qualified foreign institutional investors (QFII) and qualified domestic institutional investors (QDII) in the early days to stock connect, bond connect and mutual recognition of funds more recently. Furthermore, China's economic status in the world has been increasingly recognized, with the RMB being now included in International Monetary Fund's Special Drawing Right currency basket, MSCI including A share in its benchmark emerging market index, Bloomberg Barclays also including China bonds in its benchmark global bond index. All these have shown in the non-reserve financial account from being mainly driven by direct investment during the Mainland's early years of opening up to more and more driven by portfolio investment and other investment (including loans and deposits) currently.

With further opening up of its financial markets, it is no doubt that financial flows in the non-reserve financial account will more likely be affected by the market's view on the Mainland's economic outlook as well as the financial market sentiment. Therefore, the non-reserve financial account recorded two-way flows ranging between -3.9% and 3.6% of GDP from 2012 to 2018, compared with the consistently positive inflows between 0.2% and 5.5% of GDP from 2000 to 2011. In the past, direct investment dominated the non-reserve financial flows of the Mainland, which consistently amounted to 2% to 3% of GDP in the beginning of this century. At that time, the Mainland received much more direct investment from the rest of the world than its investment overseas. However, the situation changed in recent years, as the Mainland enterprises became more active in investment overseas. The net flows of direct investment narrowed from 2.3% of GDP in 2013 to -0.4% in 2016, before recovering somewhat to 0.8% of GDP in 2018.

On the other hand, amid the gradually opening up of the Mainland's financial markets, the net flows of portfolio investment and other investment (including loans and deposits) also showed more two-way movements, with negative flows recorded in 2015 and 2016 when the Mainland's economy faced more intense downward pressure and its financial market recorded huge volatilities at that time. The situation then improved in 2017, but negative flows in other investment were recorded again in 2018, with positive flows in portfolio investment, likely driven by concerns related to the rising trade protectionism, as well as financial market volatilities.

Attracting more financial flows to offset the narrowing current account surplus

As mentioned above, the current account surplus of the Mainland has narrowed notably since 2015. This situation is expected to continue, as China is likely to increase its goods imports in the future. According to the statistics of China's General Administration of Customs, the Mainland recorded US$ 351.8 billion of trade surplus against the rest of the world in 2018, but the Mainland's trade surplus against the US amounted to US$ 323.3 billion. Therefore, even though the Mainland might redirect some trade flows from other countries to offset part of the impact from increasing imports from the US, it is still inevitable that the goods trade surplus is likely to decline further.

In relation to services trade, it is expected that its deficit will remain at a relatively high level or even expand somewhat further. Firstly, the rising of Mainland's middle class is likely to increase the demands for overseas travel and transportation service. Secondly, any possible China and US trade deal will also strength the protection of foreign investors, in particular intellectual property rights. This might result in more demands for intellectual property royalty and other business services from the rest of the world. Both are likely to result in an increase of the Mainland's services imports, leading to a widening of services trade deficit. Amid the further narrowing of goods trade surplus and a widening of services trade deficit, current account surplus is expected to shrink further or even turn into deficit in the years ahead.

On the non-reserve financial account side, the Mainland will continue to open up its economy and financial markets, which is likely to attract more financial flows. On one hand, most of the 11 tasks for financial opening mentioned in Boao Forum in 2018 have been completed. The Mainland will further expand its opening up in the financial sector this year by unifying regulatory rules for domestic and foreign players in the financial sector, and improve connections between onshore and offshore capital markets. More recently, the China Banking and Insurance Regulatory Commission (CBIRC) issued a statement saying that the Mainland will soon announce 12 new opening-up measures. Specifically, the Mainland will remove the ownership limits in Chinese commercial banks for both Chinese and foreign banks in accordance with the principle of equal national treatment. The Mainland will scrap the total asset requirements for foreign banks to set up foreign-funded banks and subsidiaries respectively. The requirement that only or major Chinese shareholders of a Sino-foreign joint-venture bank must be a financial institution will also be lifted. In relation to widen market access to the insurance sector, the Mainland will allow overseas financial institutions to become shareholders of foreign-owned insurance companies. Foreign insurance groups will be permitted to establish insurance companies in the Mainland based on the requirements of Chinese-funded insurance groups. The requirements of 30 years of operation and total asset size for foreign insurance brokerage companies to do business in the Mainland will be abolished. Moreover, the Mainland will relax policies for both Chinese and foreign financial institutions to establish consumer finance companies. The asset requirement for overseas financial institutions to invest into the Mainland's trust companies will also be lifted.

In addition, the National People's Congress just passed the new Foreign Investment Law on 15th March 2019. The new law will come into effect on 1st January 2020, which will replace three laws passed in the 1970s and 1980s. The new law not only mandates the equal treatment of foreign and domestic companies, but also applies the negative list nationwide (The new list is expected to be announced in June). The new law specifies that the state should not expropriate assets from foreign investors except in special circumstances. The law also enables foreign investors to freely remit in yuan or foreign currency their profits, capital gains, proceeds from asset disposal, license fees for intellectual property rights, and compensation, in accordance with laws and regulations. Also, government employees are prohibited from leaking business secrets that they have access to while performing their duties, and violations will have specific punishments under the new law. The new law also strengthens the protection of intellectual property rights, and states that any technological cooperation will be carried out in accordance with business rules on a voluntary basis. It is believed that the new Foreign Investment Law will help level the playing field for foreign investors to operate in the Mainland, and their rights and interests to be much more protected, likely attracting more foreign capital inflows into the Mainland ahead.

Consequently, both the new Foreign Investment Law and the further opening up of the financial markets are likely to attract more direct investment, portfolio as well as other investment (including loans and deposits). Even though such financial flows might be two-way in nature, the continuous opening up of the Mainland's economy and financial markets is likely to attract more inflows than outflows, which will help offset the narrowing of current account surplus, and maintain an overall steady balance of payments.

主要經濟指標 (Key Economic Indicators)

一. 本地生產總值 GDP	**2017**	**2018**	**2018/Q4**	**2019/Q1**
總量(億元) GDP($100 Million)	25,432	26,644	7,743	N.A.
升幅(%) Change(%)	3.8	3.0	1.2	0.5
二. 對外貿易 External Trade			**2019/3**	**2019/1-3**
外貿總值(億元) Total trade($100 Million)				
總出口 Total exports	38,759	41,581	3,436	9,204
進　口 Total imports	43,570	47,214	4,029	10,391
貿易差額 Trade balance	-4,811	-5,633	-592	-1,187
年增長率(%) YOY Growth(%)				
總出口 Total exports	8	7.3	-1.2	-2.4
進　口 Imports	8.7	8.4	-0.1	-3.2
三. 消費物價 Consumer Price				
綜合消費物價升幅(%) Change in Composite CPI(%)	1.5	2.4	2.1	2.2
四. 樓宇買賣 Sale & Purchase of Building Units			**2019/4**	**2019/1-4**
合約宗數(宗) No. of agreements	83,815	79,193	9,911	26,927
年升幅(%) Change(%)	14.8	-5.5	13.4	-9.7
五. 勞動就業 Employment			**2018/12-2019/2**	**2019/1-2019/3**
失業人數(萬人) Unemployed(ten thousands)	11	10.5	10.3	11
失業率(%) Unemployment rate(%)	2.9	2.8	2.8	2.8
就業不足率(%) Underemployment rate(%)	1.1	1.1	1.0	1.0
六. 零售市場 Retail Market			**2019/3**	**2019/1-3**
零售額升幅(%) Change in value of total sales(%)	2.2	8.8	-0.2	-1.2
零售量升幅(%) Change in volume of total sales(%)	1.9	7.6	-0.8	-1.6
七. 訪港遊客 Visitors				
總人數(萬人次) arrivals (ten thousands)	5,847	6,515	586.0	1,823.0
年升幅(%) Change(%)	3.2	11.4	17.3	16.8
八. 金融市場 Financial Market			**2019/2**	**2019/3**
港幣匯價(US$100=HK$) H.K. Dollar Exchange Rate (US$100 = HK$)	781.4	783.6	785	784.9
貨幣供應量升幅(%) change in Money Supply(%)				
M1	9.8	-0.4	-1.8	-2.2
M2	10	4.3	3.2	3.9
M3	10	4.3	3.3	4.0
存款升幅(%) Change in deposits(%)				
總存款 Total deposits	8.7	5.0	4.1	5.0
港元存款 In HK$	11.6	3.6	1.2	3.0
外幣存款 In foreign currency	5.9	6.4	7.2	7.2
放款升幅(%) in loans & advances(%)				
總放款 Total loans & advances	16.1	4.4	3.0	3.1
當地放款 use in HK	15.5	4.0	2.6	2.6
海外放款 use outside HK	17.4	5.3	4.0	4.2
貿易有關放款 Trade financing	8.7	-7.7	-7.4	-6.7
最優惠貸款利率(%) Best lending rate (%)	5.0000	5.1250	5.1250	5.1250
恒生指數 Hang Seng index	29,919	25,846	28,633	29,051