

New Development Pattern of “Dual Circulation” in Mainland China and Hong Kong’s Role

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Mainland China has been actively planning to accelerate the construction of a new development pattern, which takes domestic market as the mainstay while letting domestic and foreign markets boost each other. Overall, this “Dual Circulation” has two connotations. The first is to develop a “Domestic Circulation” economy and solidify the basis of domestic demand. The second is to advance the “International Circulation” with a high level of openness. This is a great development transformation of Mainland China at the historical juncture, and matters for Hong Kong’s future. In the post-pandemic era, Hong Kong needs to seize the new opportunities brought by “Dual Circulation”, to focus on business opportunities in the Mainland market, and to play an essential role in it.

1. Three pillars in “Dual Circulation”: domestic demand, technology, and openness

Firstly, constructing the new development pattern of “Dual Circulation” is a proactive choice by China’s high-quality economic development. On the internal side, since the Reform and Opening-up, China’s development model of “putting both ends of production in the international markets, with large scales of imports and exports” has achieved great success. However, this model is plagued by problems, as it is not only adverse to the industrial upgrading, but also can easily lead to frictions with other countries. As China’s development phase has transformed from high-speed growth into high-quality development, the exports-oriented model can no more meet the new requirements. Therefore, the driver of economic growth has been increasingly transforming from external demand into domestic demand. The innovation is the key in this process. This means that the previous models, motives, methods, and paths of economic development must be adjusted or transformed accordingly. From the recent stance of the “14th Five-Year Plan”, China’s economic development will probably turn to focus on constructing the “Dual Circulation”, which will bring great and far-reaching influence.

On the external side, the great circulation of global economy is facing uncertain and unstable risks currently, with the industrial chain and supply chain being restructured. Over the past two years, the unilateralism and protectionism has been rising, the process of globalization has encountered headwinds. The United States has not only provoked trade war, tech war, but also even used administrative measures such as sanctions towards China, pushing up the risks of US-China decoupling. Recently, the global economy has retreated deeply because of the Covid-19 pandemic, and the pace of recovery has been also sluggish with a severe contraction in global demand. Currently, the number of confirmed cases of Covid-19 is still rising at a fast speed. The World Health Organization (WHO) has recently warned that despite the advent of vaccines, the pandemic

might last for two years. According to the latest reading of the World Trade Organization (WTO)'s Goods Trade Barometer, an L-shaped recovery of global trade is still a possible prospect.

Facing with the new challenges and opportunities brought by the profound changes in both the domestic and external environment, to construct the new development pattern of “Dual Circulation” will take the smooth circulation of domestic economy as a main focus, and “Domestic Circulation” is the key. Its path would roughly be: first, to take the satisfaction of domestic demand as the starting point as well as the foothold of development, to advance the demand-side structural reform and improve the domestic demand system to realize domestic demand expansion and consumption upgrade. Second, to take scientific and technological innovation as a measure to advance connotative growth and improve the level of modernization of industrial value chain and supply chain, and to accelerate the construction of a relatively independent and complete industrial system, therefore reducing the technology reliance on Western countries. Third, through a higher level of opening-up, to connect the “Domestic Circulation” and “International Circulation”, and reshape the new advantages of China in participating in international competition and cooperation. Overall, domestic demand, innovation and openness will be the three pillars of the “Dual Circulation”. The Yangtze River Delta region and the Guangdong-Hong Kong-Macao Greater Bay Area will serve as pioneers of the “Dual Circulation”. These great changes will bring precious historic opportunities as they did in 40 years ago, in which Hong Kong can play a more important role and gain greater room for development.

2. Expand domestic demand to support the “Domestic Circulation”

Domestic demand is the biggest pillar for the construction of “Dual Circulation”. Under the new development pattern, the Mainland will first improve its domestic demand system, letting domestic demand to dominate and support “Domestic Circulation”. On the one hand, domestic demand expansion and consumption upgrade rely on full and high-quality employment of residents, which increases the disposable income. This requires the expansion of the middle-income group, as well as income rises for farmers. China has a population of 400 million in the middle-income group, and strives to double it to 800 million in about 10 years, letting them truly become the majority of the society. At present, there are still 600 million people in China with monthly income less than RMB1,000, which mainly concentrated in the rural areas. Therefore, it is a must to expand the channels of employment and profit-gaining for farmers. Of the RMB41.16 trillion in the total retail sales of consumer goods in China in 2019, rural consumption only accounts for 1/7, or about RMB6 trillion. From a long-term perspective, rural area is a huge market. Meanwhile, the individual income tax rate also need to be cut for increasing residents' real income.

On the other hand, the expansion of domestic demand under the “Domestic Circulation” is different from that in the era of globalization, as it stresses on the strengthening of endogenous cyclic momentum. Its main features include: first, the emphasis that production, distribution, circulation and consumption rely more on the domestic market, and the improvement of adaptability of supply system to domestic demand, therefore to form a higher-level dynamic balance in which demand drives supply and supply creates demand. Second, it emphasizes the financial support to the real economy, forming a virtuous circle of “security in six areas” and “stability in six fronts”, and let finance to play a greater role in guiding the transformation of consumer behavior and consumption pattern transformations. Third, it emphasizes on forming a virtuous circle of following three

items: increases in operating income and growth of profits, improving expectations on the growth of employment and income, and the consumption growth and upgrade. Then the phenomenon of consumption growth below expectations, while households deposit increased more than RMB8 trillion in the first half year will be avoided.

Under the leading policy of “Domestic Circulation”, it’s expected that the momentum of China’s economic growth will further shift from external-demand-driven to domestic-demand-driven, with a rapid expansion of domestic demand and continuous consumption upgrade. The total retail sales of consumer goods in China in 2019 is about USD5.968 trillion, which is equivalent to around 95.7% of the total consumption in the US. It’s expected that the scale of consumer market in China this year will surpass that in the US. In 2019, China’s GDP per capita has reached USD10,000, and there is still a gap of more than USD30,000 with most advanced economies, indicating a bright future for the consumer industry. In the meantime, the industry chain and supply chain will accelerate the adjustment from the international division of labor to the domestic division of labor, the domestic technology ecosystem will replace the technology ecosystem of the US, Europe and Japan. For example, China’s chip self-sufficiency rate in 2019 is 30%, and it is required to reach 70% by 2025. Large-scale industry substitution will generate massive business opportunities. A considerable part of foreign trade sales will turn to domestic trade sales. Foreign trade and foreign investment directly and indirectly drive the employment of 200 million people, accounting for about 1/4 of the total employment. In 2019, there were 406,000 private enterprises with import and export activities. In addition, China’s reliance on foreign markets will further decline, the international balance of payments will tend to balance, and the internationalization process of the renminbi will accelerate.

Hong Kong can play an active role in assisting the Mainland to expand domestic demand and support the “Domestic Circulation”. On the one hand, tens of thousands of factories in the Mainland, especially in the Greater Bay Area, have always been export-oriented in the past. In recent years, they have turned their attention to the Mainland, learning strategies for domestic sales and establishing domestic sales channels. In the future, Hong Kong can help the Mainland further expand domestic demand and seize this most potential market by expanding the domestic sales of Hong Kong enterprises’ superior products, expanding import distribution business, and promoting the improvement of consumer protection in the Mainland. Fundamentally, the competition between China and the United States will be the competition of the ultra-large domestic demand market. The one with larger market will become the winner. Hong Kong assists the Mainland to promote the “Domestic Circulation”, which will not only greatly expand its development space, but also make itself invincible.

3. Innovations Drive and Lead The “Domestic Circulation”

Innovation is the second pillar in constructing the “Dual Circulation”. At present, China has shortcomings in core technologies and is therefore relied heavily on other countries. For instance, China’s chip imports amounted to USD304 billion in 2019. However, core technologies cannot be bought and must be self-reliant. In the future, China will strengthen its independent innovation in science and technology, and let innovation drive and lead the “Dual Circulation”. On the one hand, we need to strive to improve our capabilities of independent innovation, and to achieve breakthroughs in key core technologies as soon as possible. We need to increase investment on the basis that Research and Development (R&D) investment accounted for 2.23% of GDP in 2019, and pool

superior resources to overcome difficulties. Not only should we have the ability to manufacture more high-tech and high-value-added new products, but also, we need to cultivate the capacity to manufacture machines and equipment that can produce more new products. On the other hand, led by innovation in the integrated circuit industry and the software industry, we need to knock through the blocking points of “Domestic Circulation” and promote the realization of the “Domestic Circulation” in the field of network information technology. For this purpose, the State Council has recently issued the “Several Policies to Promote the High-quality Development of the Integrated Circuit Industry and Software Industry in the New Era” to vigorously support the development of chip-related industries. Meanwhile, we need to drive innovation to catalyze new development momentum, to increase investment in “new infrastructure”, to facilitate digital industrialization and industrial digitization, to promote the development of strategic emerging industries such as digital economy, artificial intelligence, life and health, and new materials, and to build a complete industry chain of “Beidou Navigation” in order to add new growth points and growth poles for economic development.

The innovation-driven “Domestic Circulation” will have three impacts: first, technological innovation will bring new momentum to the “Domestic Circulation”. By creating new supply to generate new demand, integrated circuits, artificial intelligence, Internet of Things and so on will be new investment hotspots and will also nurture new business opportunities. The second is to build a complete industrial system. This needs to improve the level of modernization of the industrial chain and supply chain, to support and cultivate a group of independent brands and enterprises with core technologies, to form a domestic technology ecosystem, to promote the real economy to become bigger, stronger and better, and to promote the new economy to step up to a new level. The third is to guide the modernization of corporate and industry governance with national and international standards. In short, thanks to the innovation-driven pattern, the Mainland economy is expected to achieve high-quality development, the industrial structure can move towards the mid-to-high end, and the economic growth can maintain at a medium-to-high speed for a long time.

Over the years, the Hong Kong SAR government has been committed to strengthening cooperation in the innovation and technology areas with the Mainland. Hong Kong has the world’s top fundamental scientific research capabilities, and its original innovation capability ranks among the best in the Asia-Pacific region. Its top five universities are among the top 100 universities in the world, with cutting-edge expertise in biomedicine, neuroscience, genomics, vaccine technology, stem cell technology, artificial intelligence, computing science and information technology, smart cities, etc., owning great advantages in the development of the Internet of Things, big data analysis, cloud computing, information and risk management, network security, etc., which can support the in-depth development of industrial innovation in the Mainland. Hong Kong also has a high-end technological innovation support system, including a highly-degree open and internationalized scientific research system, a high-level protection of intellectual property rights, a world-class financial service industry, and a world-class business environment, making Hong Kong a region that is easy to gather international high-end innovation factors, especially high-quality innovative talents, to serve the development of the technological innovation industry in the Mainland. The Mainland has a huge market as well as the capabilities to transform scientific research results into practical applications and advanced manufacturing. The two sides can form a strong complementary and cooperative relationship. Hong Kong will play a unique role in cooperating with the Mainland, especially the Greater Bay Area, in the innovation-driven “Domestic Circulation”.

4. Achieve a Higher Level of “Dual Circulation” Interaction

Openness is the third pillar in constructing the “Dual Circulation”. Although the new development pattern takes the “Domestic Circulation” as a mainstay, it does not exclude the general direction of improving openness. In the future, the Mainland market will continue to open up and promote the international economic circulation with a higher level of openness. The first is to open the markets to expand imports, providing broader market opportunities for other countries, and to build the domestic market into a huge gravitational field that attracts international commodities and factors resources. The second is to further unleash the leading role of the 18 free trade zones and 1 free trade port in the Mainland in advancing the “International Circulation”. The third is to incorporate foreign capital into the “International Circulation” system, and while speeding up the introduction of capital to supplement the chain, expand the chain, and strengthen the chain, it also connects the international market through foreign capital. The fourth is to deepen the financial opening, to expand the “Stock Connect” mechanism and strengthen the role of the capital markets in linking the “Dual Circulation”. In short, advancing the “International Circulation” can not only reshape China’s new advantages in participating in international competition and cooperation, but also help China to promote advanced science and technology to the international market, and promote the upgrading of more national standards to international standards.

As the most free and open economy in the world, Hong Kong can play a key role and actively participate in a higher level of “Dual Circulation” interaction. For example, for the construction of 18 free trade zones and 1 free trade port in the Mainland, Hong Kong can provide its free port development experience of over a century, and provide concrete and feasible policy recommendations in terms of the free trade, free enterprise management, free currency circulation, free movement of people, free flow of information, legal system construction and world-class business construction, and assist them in achieving their goals as soon as possible. Take another example, as financial opening is of high importance, Hong Kong as one of the three leading international financial centres in the world, can put an emphasis on strengthening cooperation with the Mainland in areas such as innovative finance, silk road finance, people’s livelihood finance, and green finance to promote the deep integration of innovative technology and innovative finance, and accelerate the development of IPO, wealth management and the offshore renminbi market. While promoting a broader financial opening in the Mainland, Hong Kong can further enhance its status as an international financial centre.

Of course, Hong Kong also faces many difficulties and challenges during the transformation of the economic development model in the Mainland, including business models, technological innovation methods, housing development, and even ideological concepts, all of which need to be adjusted and improved. The most important thing is to better integrate Hong Kong into the overall national development, to further deepen the economic and trade cooperation with the Mainland, to support and cooperate with the nation in building a new “Dual Circulation” development pattern, especially to play an even bigger role in the Guangdong-Hong Kong-Macao Greater Bay Area and the “Belt and Road” construction. Only by this way can Hong Kong, amid the great changes over a century, truly escape its difficulties and rebuild its glory.

主要經濟指標 (Key Economic Indicators)

一. 本地生產總值 GDP	2018	2019	2020/Q1	2020/Q2
總量 (億元) GDP(\$100 Million)	27,355	27,030	6,616	6,379
升幅 (%) Change(%)	2.9	-1.2	-9.1	-9.0
二. 對外貿易 External Trade			2020/7	2020/1-7
外貿總值 (億元) Total trade(\$100 Million)				
總出口 Total exports	41,581	40,961	3,285	20,905
進口 Total imports	47,214	45,714	3,583	22,958
貿易差額 Trade balance	-5,633	-4,753	-298	-2,053
年增長率 (%) YOY Growth(%)				
總出口 Total exports	7.3	-5.6	-3.0	-6.3
進口 Imports	8.4	-8.1	-3.4	-8.5
三. 消費物價 Consumer Price				
綜合消費物價升幅 (%) Change in Composite CPI(%)	2.4	2.9	-2.3	1.1
四. 樓宇買賣 Sale & Purchase of Building Units			2020/8	2020/1-8
合約宗數 (宗) No. of agreements	79,193	74,804	5,390	45,715
年升幅 (%) Change(%)	-5.5	-5.5	4.5	-16.9
五. 勞動就業 Employment			2020/4-2020/6	2020/5-2020/7
失業人數 (萬人) Unemployed(ten thousands)	10.5	12.4	24.1	24.3
失業率 (%) Unemployment rate(%)	2.8	3.3	6.2	6.1
就業不足率 (%) Underemployment rate(%)	1.1	1.2	3.7	3.5
六. 零售市場 Retail Market			2020/7	2020/1-7
零售額升幅 (%) Change in value of total sales(%)	8.8	-11.1	-23.1	-32.1
零售量升幅 (%) Change in volume of total sales(%)	7.6	-12.3	-23.9	-33.5
七. 訪港遊客 Visitors				
總人數 (萬人次) arrivals (ten thousands)	6,515	5,590	2.1	353.7
年升幅 (%) Change(%)	11.4	-14.2	-99.6	-91.2
八. 金融市場 Financial Market			2020/6	2020/7
港幣匯價 (US\$100=HK\$)				
H.K. Dollar Exchange Rate (US\$100 = HK\$)	783.6	779.3	775.1	775.2
貨幣供應量升幅 (%) change in Money Supply(%)				
M1	-0.4	2.6	16.9	28.3
M2	4.3	2.8	3.9	6.7
M3	4.3	2.7	3.8	6.6
存款升幅 (%) Change in deposits(%)				
總存款 Total deposits	5.0	2.9	3.5	6.3
港元存款 In HK\$	3.6	2.5	1.5	5.8
外幣存款 In foreign currency	6.4	3.2	5.5	6.8
放款升幅 (%) in loans & advances(%)				
總放款 Total loans & advances	4.4	6.7	5.5	7.4
當地放款 use in HK	4.0	7.1	5.1	7.8
海外放款 use outside HK	5.3	5.8	6.5	6.4
貿易有關放款 Trade financing	-7.7	-0.7	-5.7	-4.0
最優惠貸款利率 (%) Best lending rate (%)	5.1250	5.0000	5.0000	5.0000
恆生指數 Hang Seng index	25,846	28,189	24,427	24,595