

Hong Kong as one of the world's largest net creditors: a study of international investment position statistics

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Hong Kong is one of the world's largest net creditors with net assets worth more than twice the size of its gross domestic output. Main contributing factors are the sharp increases in recent years in net portfolio investment and in other investments, including loans and currency and deposits.

The study also shows the significant accumulation of net assets by Hong Kong residents is generally explained by two factors - the cumulative trade balance, and investment returns, especially Hong Kong's productive investment overseas. This contrasts with Singapore, whose net creditor position is smaller than its cumulative trade surpluses.

I. Introduction

Among the 59 economies publishing their International Investment Position (IIP) statistics², Hong Kong had the largest net external creditor position as a percentage of GDP and the third largest in dollar value, amounting to 259% of GDP, or US\$429 billion at the end of 2004. This unique position has been built up through years of concerted savings and productive investment overseas. Specifically, at the end of 2003, Hong Kong was the fifth largest net portfolio investor among the IIP reporting economies; the world's sixth largest foreign direct investor, holding more direct investment assets abroad than Japan; and the seventh largest recipient of foreign direct investment, next only to China in the region. At the end of 2004, Hong Kong was the world's twelfth largest international banking centre in terms of foreign currency asset holdings; and, in July 2005, had the seventh largest official foreign reserves in the world.

Given the small size of the Hong Kong economy, it may seem puzzling to some that Hong Kong can enjoy such a strong position in the international financial arena alongside other economies such as Switzerland and Japan. Questions that may arise include: to what extent the IIP statistics present a true picture of Hong Kong's financial position? With Hong Kong's financial intermediary role, could a large part of Hong Kong's IIP reflect the financial position of other economies, especially Mainland China? And, how did Hong Kong accumulate such a large net external creditor position?

This paper addresses some of the issues highlighted above. Section II provides an overview of Hong Kong's international investment position. Section III examines each of the underlying components of Hong Kong's IIP to assess the extent to which these statistics reflect Hong Kong's true financial position. Section IV examines the possible factors contributing to Hong Kong's large net creditor position.

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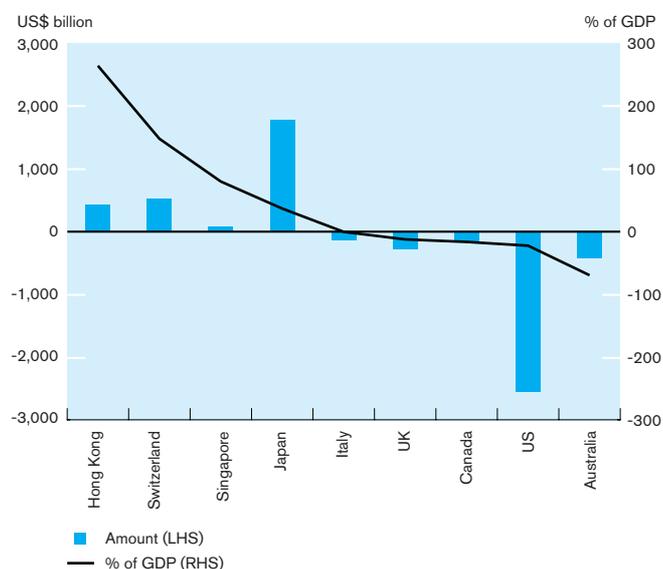
² These include all OECD economies, major offshore financial centres (OFCs) and large emerging markets except China. A full list of the IIP reporting economies is available at <http://dsbb.imf.org/Applications/web/sddsiiipage/>.

II. Overview of Hong Kong's international investment position

Hong Kong's status as a major financial centre is reflected in its international investment position, which is a balance sheet showing the stock of external financial assets and liabilities of an economy at a specific point of time. (Table 1) At the end of 2004, Hong Kong's gross external assets were US\$1,377 billion (equivalent to 831% of GDP) and gross external liabilities were US\$948 billion (equivalent to 572% of GDP). On a net basis, Hong Kong enjoys a sizeable external asset position of US\$429 billion (corresponding to 259% of GDP). Chart 1 shows Hong Kong has the largest net external creditor position in terms of GDP among the nine major economies reporting IIP statistics at the end of 2004. Indeed, Hong Kong has significantly reinforced its leading net creditor position among the major economies over the years as its net IIP increased by US\$206 billion from US\$223 billion (equivalent to 134% of GDP) in 2000.

CHART 1

Net international investment positions at the end of 2004



Sources: C&SD; International Financial Statistics, IMF; relevant National Statistical Bureau; CEIC

TABLE 1

Hong Kong's international investment position

(US\$ billions)	2000	2001	2002	2003	2004
Assets	1,142	1,072	1,030	1,180	1,377
Direct investment abroad	388	353	309	338	404
Portfolio investment	179	206	244	333	399
Financial derivatives	17	18	23	20	22
Other investment	450	384	342	371	429
Reserve assets	108	111	112	118	123
Liabilities	919	805	687	789	948
Direct investment in HK	455	419	336	380	455
Portfolio investment	153	117	94	125	154
Financial derivatives	13	12	21	20	21
Other investment	298	257	236	264	318
Net Assets/(Liabilities)	223	267	343	391	429
(% of GDP)	(134%)	(159%)	(210%)	(248%)	(259%)
Direct investment	-67	-66	-27	-42	-51
Portfolio investment	26	89	150	208	245
Financial derivatives	4	6	2	0	1
Other investment	152	127	106	107	111

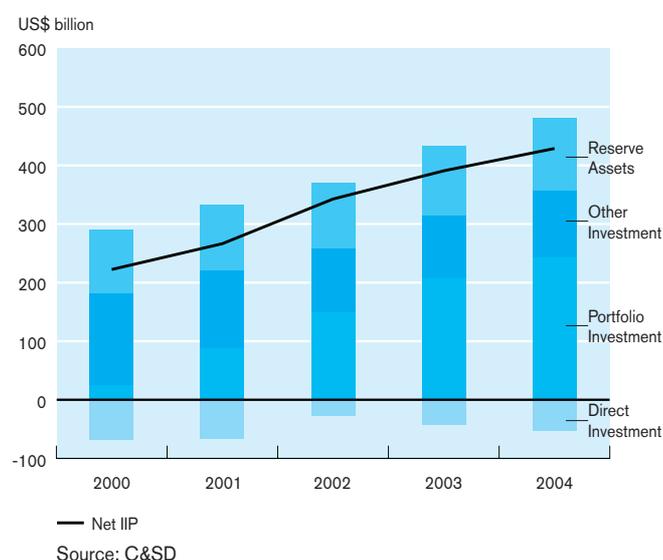
Source: Census & Statistics Department of Hong Kong (C&SD)

The substantial increase in Hong Kong's net creditor position over the years is mainly due to the increase in net portfolio investment from US\$26 billion in 2000 to US\$245 billion in 2004, which raised the share of net portfolio asset in overall net assets from 12% to 57%. (Chart 2) The other two components - net other investment and reserve assets - each accounted for roughly one-third of the total net assets. While Hong Kong has a sizeable US\$404 billion (244% GDP) gross direct investment asset, it hosts an even larger inward direct investment of US\$455 billion (275% of GDP), resulting in a net liability position in direct investment. In comparison, the share of financial derivatives in net IIP is relatively small, at less than 2%, which is similar to most major economies.

As a large net portfolio investor, Hong Kong plays an important role among major financial centres around the world both in terms of equity and debt investment. Table 2 below shows Hong Kong was the fifth largest net foreign portfolio investor in the world at the end of 2003. A further breakdown reveals that Hong Kong is the world's fifth largest

CHART 2

Contribution to Hong Kong's net IIP by component



cross-border short-term debt investor, the seventh largest long-term debt investor and ninth largest equity investor. This may reflect, in part, the importance of Hong Kong as an asset management centre.

TABLE 2

Top 10 net portfolio investors with instrument breakdown in 2003

Equity	Debt		Overall
	Long-term	Short-term	
1 US	1 Japan	1 Ireland	1 Japan
2 Italy	2 Luxembourg	2 Luxembourg	2 Ireland
3 Germany	3 Switzerland	3 Singapore	3 Luxembourg
4 Belgium	4 UK	4 Bermuda	4 Switzerland
5 Canada	5 Ireland	5 Hong Kong	5 Hong Kong
6 Ireland	6 France	6 Guernsey	6 Belgium
7 Sweden	7 Hong Kong	7 Switzerland	7 Norway
8 Norway	8 Bermuda	8 Spain	8 Jersey
9 Hong Kong	9 Belgium	9 Japan	9 Singapore
10 Jersey	10 Jersey	10 Bahamas	10 Guernsey

Source: Co-ordinated Portfolio Investment Survey 2003, IMF

As an important centre for intermediating capital and investment in the region, Hong Kong is also ranked favourably among other major economies in terms of the size of its direct investment positions (Chart 3 & 4). Hong Kong hosts the world's seventh largest stock of inward direct investment and the second largest in Asia after the Mainland. In terms of outward direct investment position, Hong Kong is ranked sixth in the world and is top in Asia, holding even more direct investment assets abroad than Japan. This largely reflects Hong Kong's unique investment hub position³, especially vis-à-vis the Mainland.

CHART 3
Ranking on inward direct investment position for selected economies in 2003

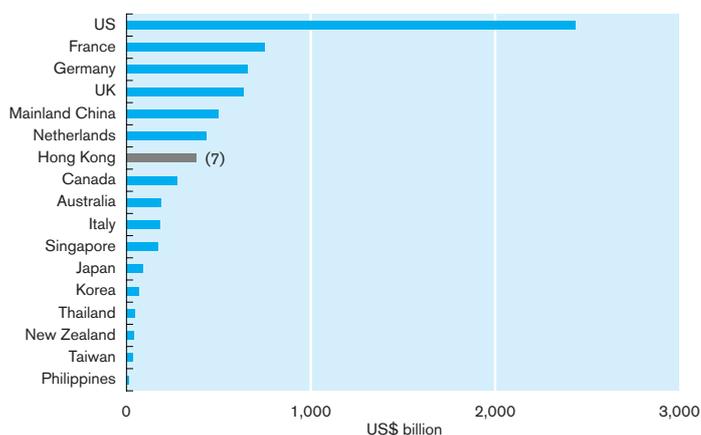
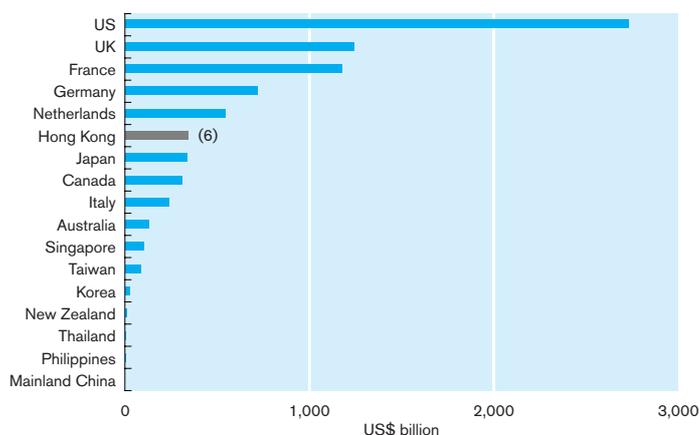


CHART 4
Ranking on outward direct investment position for selected economies in 2003



Source: C&SD

Hong Kong continues to maintain its role as a major international banking centre in channelling funds around the world. In terms of the size of gross external assets, Hong Kong is the world's twelfth largest banking centre. On a net basis, Hong Kong's banking sector has the second largest net foreign currency asset position and fourth largest net external asset position (in all currencies) in the world, highlighting its role in cross-border bank lending. (Table 3)

TABLE 3
Top 5 international banking creditors in 2004

Net foreign currency assets		Net external assets (all currencies)	
1	Japan (US\$798 bn)	1	Japan (US\$919 bn)
2	Hong Kong (US\$190 bn)	2	Germany (US\$604 bn)
3	Luxembourg (US\$97 bn)	3	Luxembourg (US\$273 bn)
4	Switzerland (US\$76 bn)	4	Hong Kong (US\$200 bn)
5	Jersey (US\$55 bn)	5	Belgium (US\$133 bn)

Source: International Banking Statistics, BIS

III. Do IIP statistics truly reflect Hong Kong's international financial position?

To better understand the structure of Hong Kong's IIP, this section looks more deeply at each of the major components of its IIP and considers to what extent these statistics reflect the true international financial position of Hong Kong.

Direct investment

According to the IIP statistics, at the end of 2004, Hong Kong's gross direct investment abroad amounted to US\$404 billion (equivalent to 244% of GDP), while gross direct investment in Hong Kong was US\$455 billion (equivalent to 275% of GDP). This is a recognition of Hong Kong's major hub status for intermediating capital and investment in the region. A distinct feature of Hong Kong's direct investment statistics is that a large part of the

³ It is important to note that Hong Kong's large direct investment positions, to some extent, include financial booking transactions. For example, in 2000 the gross direct investment into Hong Kong was US\$62 billion. This included a financial booking entry worth US\$23 billion relating to asset acquisition by

China Mobile (HK) in which it issued shares to its parent company in the Mainland in exchange for the asset acquired from its parent. Adjusting for this booking entry (not representing real direct investment flows) would reduce the overall direct investment inflow into Hong Kong in 2000 to US\$39 billion.

investment is associated with companies residing in offshore financial centres (OFCs), such as the British Virgin Islands, the Cayman Islands and Bermuda, which are usually not the ultimate source or destination of the investments. These funds are normally channelled to or from places other than the OFCs, like the Mainland or even Hong Kong.

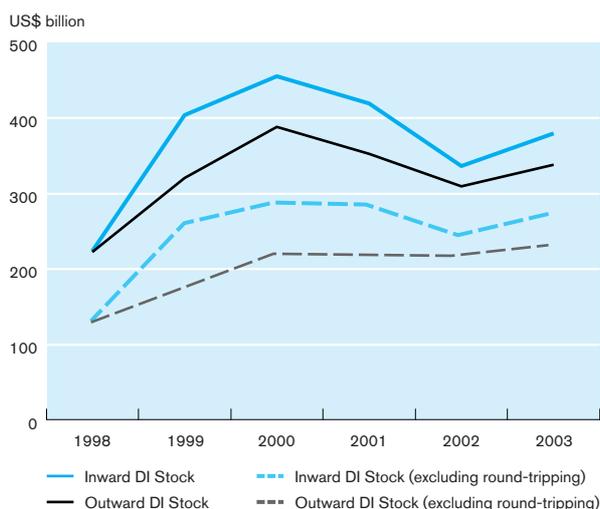
For this reason, an additional set of direct investment statistics that excludes round-tripping investment activities between Hong Kong and OFCs (direct investment in Hong Kong by OFC-resident companies that are beneficially owned by Hong Kong interests, and Hong Kong's direct investment in OFCs that are funded by OFC-resident firms) is produced to facilitate analysis.⁴ Excluding this round-tripping investment, Hong Kong's gross direct investment positions are reduced by about one-third throughout the period from 1998 to 2003. (Chart 5) At the end of 2003, gross foreign direct investment in Hong Kong totalled US\$274 billion (equivalent to 173% of GDP), while Hong Kong's gross direct investment abroad was US\$232 billion (equivalent to 147% of GDP). This still leaves Hong Kong with the world's eighth and

ninth largest stocks of inward and outward direct investment, assuming round-tripping does not exist in other economies (a very conservative assumption). Since the current IIP statistical system defines residence by the immediate rather than the ultimate source and destination of funds, it is not possible to identify round-tripping activities.

Net of round-tripping investments, Mainland China is by far the largest direct investor in Hong Kong and is also the top destination for Hong Kong's direct investment abroad (Charts 6 and 7). Investment from the Mainland in Hong Kong is mainly related to investment holding companies, while Hong Kong's direct investment in the Mainland is focused largely on the communications industry, followed by investment holding companies and manufacturing activities. This underlines Hong Kong's role as a major funding and management centre for direct investment into and out of the Mainland - the world's largest recipient of direct investment flow last year and the most favoured investment destination among the developing economies for almost a decade.

CHART 5

Hong Kong's inward and outward direct investment (DI) positions



Source: C&SD

⁴ Such data are prepared by the Hong Kong Census and Statistics Department through special surveys not required by the normal IIP studies. The surveys cover only round-tripping investment activities between Hong Kong and OFCs, and does not include activities relating to third areas, whether or not through the OFCs, such as investments from Hong Kong via OFCs to the Mainland or vice versa.

CHART 6

Sources of inward DI at the end of 2003

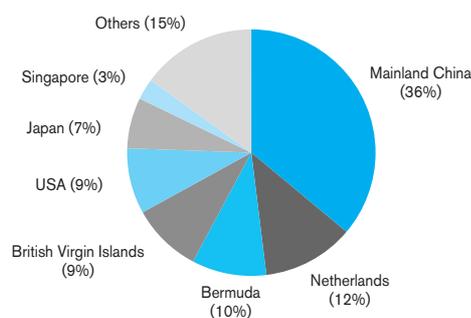
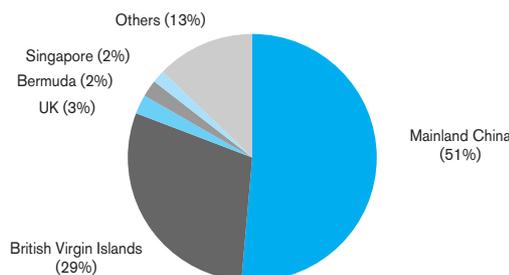


CHART 7

Destinations of outward DI at the end of 2003



Note: Excludes Hong Kong-related round-tripping investment via OFCs. Source: C&SD

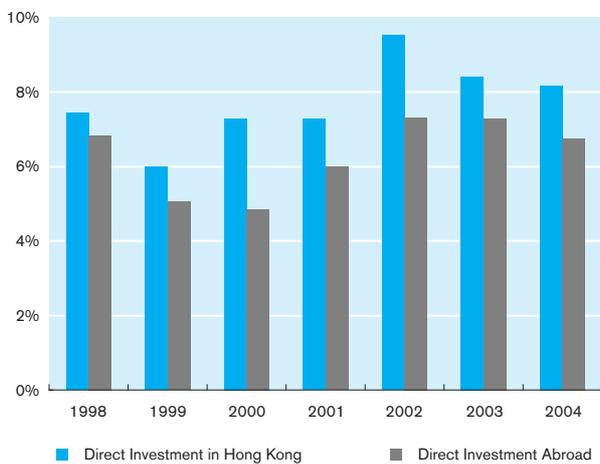
Hong Kong's large stock of direct investment may also be explained, in part, by the attractive rates of return earned on both inward and outward investment. Using a very rough method of calculating rates of return based on data from C&SD (dividing the direct investment income - which includes dividend, reinvested earnings and other branch profits - by stock of direct investment), it can be seen in Chart 8 that the annual rate of return on direct investment in Hong Kong has ranged between 6 and 10% over the past seven years. The annual rate of

return on direct investment abroad has remained fairly stable at around 5-7% during the period. This is supported by data released by the US Bureau of Economic Analysis, which indicate that US company affiliates located in Hong Kong are among the most profitable in the world (Chart 9).

Portfolio investment

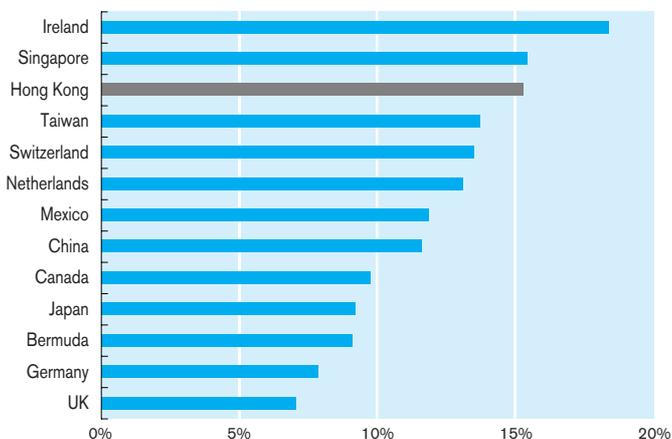
As indicated in the preceding section, net portfolio investment has become an increasingly important factor contributing to Hong Kong's net creditor position over the years. Chart 10 shows the composition of portfolio investment assets held by Hong Kong banks and non-bank entities over the past few years. Banks in Hong Kong are big investors of overseas debt securities (with negligible equity investment). Figures released by the US Treasury Department indicate that Hong Kong alone accounted for 6% of the global net purchase of US agency bonds and 2% of US corporate bonds in 2004. The non-bank entities (largely corporates) in Hong Kong invest largely in overseas equity securities. There was a sharp increase in net acquisition of overseas equity securities by the non-bank sector in 2003 and 2004. This was consistent with the general upward trend in the major

CHART 8
Rate of return on direct investment



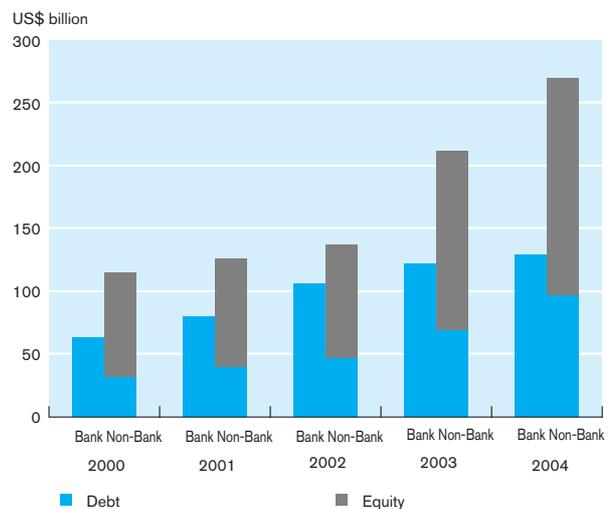
Source: C&SD

CHART 9
Average rate of return from direct investment abroad by US company affiliates in 1994-2004



Note: The rate of return is calculated by dividing direct investment income by direct investment stock abroad.
Source: US Bureau of Economic Analysis

CHART 10
Hong Kong's portfolio investment assets with sector breakdown



Source: C&SD

equity indices during the period, reflecting a recovery in investor sentiment following the bursting of the IT bubble in 2001.

According to the Co-ordinated Portfolio Investment Survey conducted at the end of 2003, the overseas investment portfolio of Hong Kong residents was divided evenly between equity and debt securities (mainly long-term debt). About half of Hong Kong residents' equity investment was in the OFCs, while around 20% was invested in UK equity securities and another 10% in Chinese equity securities.

Investment in the OFCs was mainly associated with shares of holding companies domiciled in the OFCs, but listed elsewhere. It is possible that a substantial number of these OFC-domiciled companies are Hong Kong-listed firms. However, as there are no

statistics on where the shares of these holding companies are listed, it is not possible to differentiate between round-trip portfolio investments and others. As for investment in debt securities, Hong Kong residents mainly invest in US, European and Australian securities (Table 4). Hong Kong accounted for 4% of the total foreign holdings of Australian debt securities at the end of 2003, making it the fourth largest international investor in these securities after the US, the UK and Japan.

Other investment

According to the IIP statistics, Hong Kong has maintained a substantial net asset position in other investment (consisting mainly of loans, and currency and deposits) since 2000 although it has declined

TABLE 4

Hong Kong's gross portfolio investment assets with geographical breakdown in 2003

Investment from HK in:	(in US\$ billions)			(as % of total)		
	Equity	Debt		Equity	Debt	
		Long-term	Short-term		Long-term	Short-term
France	0.6	5.9	0.4	—	4%	1%
Germany	0.4	9.3	0.7	—	6%	2%
Ireland	2.0	1.4	0.1	1%	1%	-
Italy	0.1	1.2	0.1	—	1%	-
Luxembourg	5.2	5.6	0.1	3%	4%	-
Netherlands	0.2	7.2	1.5	—	5%	5%
OFCs*	73.5	10.3	0.2	48%	7%	1%
UK	30.7	15.4	2.4	20%	10%	9%
US	8.0	33.7	5.0	5%	22%	18%
Asia:						
Australia	1.1	17.1	7.5	1%	11%	27%
China	15.7	1.5	2.5	10%	1%	9%
Japan	3.3	6.6	0.6	2%	4%	2%
Korea	1.3	7.4	1.3	1%	5%	5%
Malaysia	0.6	2.8	0.3	—	2%	1%
Singapore	2.4	2.9	0.3	2%	2%	1%
Taiwan	2.3	0.4	0.2	1%	—	1%
Thailand	2.9	0.3	0.3	2%	—	1%
Total	152.8	154.1	28.0	100%	100%	100%

* OFCs include Bermuda, Cayman Islands and British Virgin Islands.

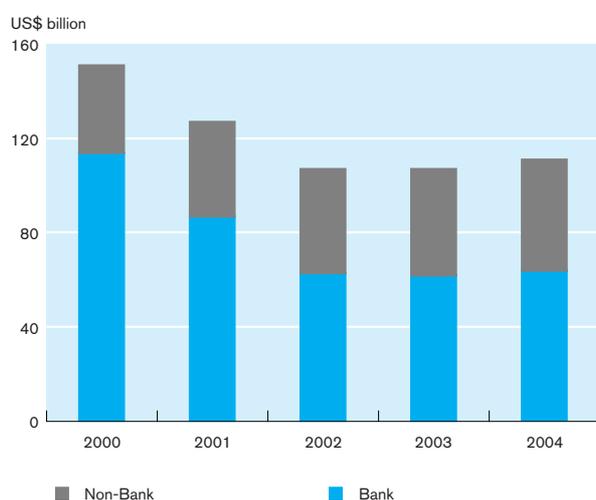
— represents figures less than 0.5% of total

Source: Co-ordinated Portfolio Investment Survey 2003, IMF

somewhat over the years (Chart 11). At the end of 2004, Hong Kong had a net other investment position of US\$111 billion (equivalent to 67% of GDP), which accounted for about 26% of Hong Kong's overall net creditor position. According to the data on external claims and liabilities of the banking sector compiled by the HKMA⁵, the overall net external claim of the banking sector on the rest of the world increased by about 50% between 2000 and the end of March 2005. This was mainly due to a substantial rise in net claims on banks in Singapore and non-bank customers in the US that more than offset the large decline in net claims on non-bank customers in Japan resulting from the retreat of Japanese banks from overseas markets from the mid-1990s. The sharp rise in net claims on banks in Singapore reflected the merger of the Dao Heng Bank, the DBS Kwong On Bank and the Overseas Trust Bank into a new DBS Bank (Hong Kong) Limited in 2003.

CHART 11

Hong Kong's net other investment position with sector breakdown



Note: The above figures assume that trade credits are fully attributable to the non-bank sector.

Source: C&SD

⁵ The major difference between data on external claims and liabilities of the banking sector compiled by the HKMA and the statistics on other investment (OI) of the IIP statement is that figures compiled by the HKMA include loan capital extended to affiliated non-financial institutions by resident banks. Such data are not covered in OI, but under direct investment in the IIP statement.

China factor

In light of the increasing economic and financial integration between Hong Kong and Mainland China, the question arises over whether Hong Kong's net creditor position, as indicated by the IIP statistics, is amplified by capturing some part of the Mainland's own financial position. This is unlikely given that Hong Kong's IIP statistics are compiled in accordance with the "residence" approach and international standards prescribed by the International Monetary Fund (IMF). According to the IMF, a resident unit of Hong Kong is defined as one that engages and intends to continue engaging in economic activities and transactions on a significant scale within the economic territory of Hong Kong. For example, a Mainland-owned company located in Hong Kong that has substantial economic interest in Hong Kong will be classified in the IIP statistics as a Hong Kong resident unit. Therefore, by definition, an economic entity that is classified as a Hong Kong resident unit in Hong Kong's IIP statistics will not appear again as a Mainland resident unit in Mainland China's IIP statistics. This removes the possibility of double counting in the IIP statistics of Hong Kong and the Mainland (which has yet to publish its IIP). Also, in net terms, any investment that routes through Hong Kong-resident entities into or out of the Mainland would be counted in both Hong Kong's inward and outward positions, which would be mutually offsetting and have no impact on Hong Kong's net investment position.

Nevertheless, given the heavy presence of Mainland economic interest in Hong Kong, it is plausible that some part of the foreign assets and/or liabilities captured in Hong Kong's IIP statistics may "ultimately" be owned by, or owed to, Mainland entities. Therefore, in terms of "ultimate ownership", Hong Kong's gross investment positions could be quite different from that reported under the IMF "residence" concept. However, the same would be true for all other IIP reporting economies. From a practical point of view, it is not feasible to compile IIP data using the "ultimate ownership" concept. Some may also assume that a large amount of Mainland

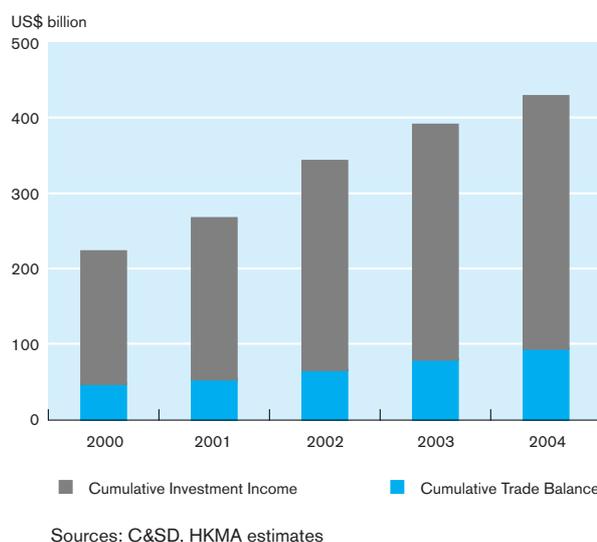
funds have flowed into Hong Kong through unofficial channels (for example, money changers), which would not have been captured by the existing statistical framework. While this claim may sound plausible, it would be very difficult in practice to estimate the size of such unofficial fund flows.

In relation to the question “to what extent Hong Kong’s large overall net creditor position is attributable to the net asset position vis-à-vis the Mainland?”, it is estimated that any such position is likely to be small. In terms of direct investment, while Mainland China is both the largest host of direct investment in Hong Kong and the top destination of Hong Kong’s direct investment abroad, Hong Kong has a net liability position in direct investment that contributes negatively to the overall net creditor position. As for portfolio investment, the Co-ordinated Portfolio Investment Survey at the end of 2003 (Table 4) showed that Hong Kong residents’ gross investment in China’s equities was only US\$15.7 billion, and in debt it was only US\$4 billion. The net position is even smaller or negative. Therefore, the net portfolio investment vis-à-vis the Mainland does not seem to contribute much to the overall net foreign asset position of Hong Kong. In terms of other investment, Hong Kong has a net liability position vis-à-vis Mainland China.

IV. Factors contributing to Hong Kong’s large net creditor position

There are essentially two factors that may explain the large accumulation of net assets by Hong Kong residents - accumulated trade balance and accumulated investment income (including valuation changes). An estimate of the cumulative trade surpluses is obtained by adding the overall goods and services trade balance since 1961, which amounts to around HK\$723 billion (equivalent to US\$94 billion). Given that net labour income flows are relatively insignificant, it is reasonable to infer that investment income accounts for a substantial portion of the remaining US\$335 billion⁶ of Hong Kong’s net asset position. (Chart 12)

CHART 12
Hong Kong’s net asset accumulation



An interesting comparison can be drawn with Singapore, which in many ways is similar to Hong Kong, as it is a small open economy with a substantial net creditor position of US\$85 billion (equivalent to 80% of GDP) at the end of 2004. In Singapore’s case, the cumulative trade account surpluses since 1960 amounted to around US\$203 billion at the end of 2004, which more than accounted for its net creditor position. This implies that while both Hong Kong and Singapore enjoy substantial net creditor positions, Hong Kong’s financial position has been mainly built up through productive investment overseas, whereas Singapore’s financial position may be explained by a high level of savings over the years.

Conclusion

Hong Kong is one of the world’s largest net creditors with net assets worth more than twice the size of its gross output. A major contributing factor to its large

⁶ As there are no data available on Hong Kong’s net IIP in 1961, an estimate is obtained by assuming that the proportion of net IIP to GDP in 1961 is the same as that in 2004 (259% of GDP). This is a conservative estimate and would not undermine our argument. As Hong Kong’s GDP in 1961 was US\$1.3 billion, this would mean that Hong Kong’s net IIP amounted to around US\$3.4 billion. Under such a scenario, cumulative investment income is estimated to be about US\$332 billion at end-2004.

net asset position is the sharp increase in net portfolio investment over the past few years. While banks in Hong Kong invest heavily in overseas debt securities, the non-bank entities (largely corporates) in Hong Kong invest mainly in overseas equity securities. Hong Kong also enjoys a significant net asset position in other investment (consisting primarily of loans and currency and deposits). This clearly reflects Hong Kong's status as an international banking centre.

The significant accumulation of net assets by Hong Kong residents over the years may be largely explained by two factors: (i) cumulative trade balance, and (ii) investment returns (including valuation changes). Based on data on Hong Kong's trade balance dating back to 1961, it is estimated that cumulative trade surpluses account for only around one-quarter of Hong Kong's overall net asset position. This would imply that the remaining portion of the overall net assets can be attributed to productive investment overseas. This stands in contrast to Singapore, which is also a small open economy with a significant net creditor position that is smaller than its cumulative trade surpluses.

In view of the growing integration between Hong Kong and Mainland China, some questions may be raised regarding the extent to which Hong Kong's net creditor position reflects the Mainland's own financial position. From a statistical point of view, it is unlikely that the Mainland's net assets would be double-counted in Hong Kong's IIP statistics due to the adoption of the "residence" approach and international standards prescribed by the IMF. In addition, further analysis of the major components of Hong Kong's net asset position seems to indicate that the proportion vis-à-vis the Mainland is in fact quite small. Nevertheless, the existing statistical framework may not have captured Mainland funds that flowed into Hong Kong through "underground" channels.