

Monetary conditions continued to tighten, with further adjustment in the money market and corrections in the asset markets. Inflation was contained as the growth in food prices moderated during the December quarter. Inflation of non-tradables levelled off while inflation of other traded goods rose. The improvement in export performance since August 1994 continued into the December quarter and the early part of 1995.

Monetary situation

The monetary situation continued to tighten as interest rates went up in late November 1994 and early February 1995. Adjustment in the money market, prompted by the series of interest rate rises, continued with the public shifting its portfolio from equities and property to bank deposits in the face of higher interest rates.

Following the increases in US interest rates, the Hong Kong Association of Banks (HKAB) raised the ceilings applying to some bank deposit interest rates by 75 basis points on 21 November and by 50 basis points on 6 February. Major banks also raised their best lending rates (BLR) in November and February by the same amounts. This brought the BLR above the inflation rate (at 8.1% as measured by the CPI(A)) for the first time since October 1990.

Domestic credit expansion remained moderate. HK dollar loans grew by 2.5% during the December quarter, similar to the growth recorded in the previous quarter but substantially lower than that in the first two quarters of 1994.

With interest rates on an upward trend, the value of retail sales showed signs of slowing down. Equity and property transactions remained dampened. As a result, the transaction demand for money was well contained. There was a fall in demand deposits during the December quarter, which was offset by an increase in currency due partly to the holiday season demand. Narrow money, HK\$M1, declined marginally during the quarter.

Reflecting the moderation in credit expansion, the growth of broad money supply, HK\$M3, slowed down to 3.4% during the December quarter compared to 4.6% in the September quarter. Higher interest rates continued to induce

the public to switch to time deposits. The deregulation on 1 October 1994 of HKAB's Interest Rate Rules on time deposits fixed for more than one month and the further deregulation of deposits fixed for more than seven days on 3 January 1995 also added incentive for the public to switch to time deposits.¹ At the end of the quarter, time deposits made up 58% of HK\$M3, the highest level in recent years (Chart 1).

Asset markets

Asset markets underwent further corrections in the December quarter as interest rates were raised further.

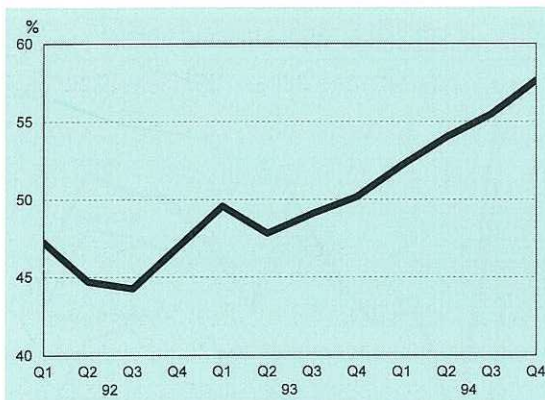
The Hang Seng Index (HSI) stayed above the 9000 level between October and mid-November. However, the interest rate rise in late November triggered off another round of selling of local equity. Rumours about the declining health of Mr. Deng Xiaoping further exacerbated the bearish market sentiment. The HSI touched the year low of 7708 on 12 December before a mild rebound took place to close the year at 8191. Altogether, the HSI fell by 14% during the December quarter. Correspondingly, the public's response to initial public offers was weak, and four out of a total of 14 offers were undersubscribed during the quarter.

In January 1995, the Mexican peso crisis together with expectations of further rises in US interest rates and the slump in the Japanese stockmarket following the earthquake triggered off further selling by fund managers. The HSI touched 6968 on 23 January. The market improved after Chinese New Year and the HSI hovered around the 8000 level in early February.

The correction in the property market continued. Spurred by price cutting and the offer of better payment terms by major developers, property

¹ The timetable for the deregulation of time deposits is given on p12 of the November 1994 issue of the Quarterly Bulletin.

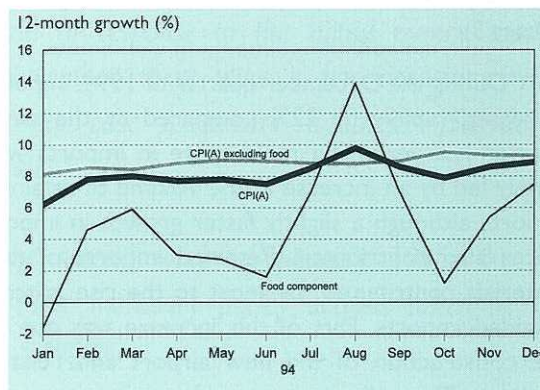
Chart 1
HK\$ time deposits as proportion of HK\$M3



* Time deposits with licensed banks, RLBs and DTCs (adjusted to include swap deposits)

Source: HKMA

Chart 2
Inflation



Source: Census & Statistics Dept.

transactions recovered mildly between August and October. However, the interest rate rise in November and the weak performance in the stock market subdued demand thereafter. This was reflected in the slow growth of 1.4% in total outstanding residential mortgage loans (excluding loans under the Home Ownership Scheme and Private Sector Participation Scheme) recorded during the December quarter. Transaction volumes in both primary and secondary markets remained low. The average monthly value of sale and purchase agreements for building units registered at Land Registries was HK\$26 bn during the quarter. Although the figure was slightly above the value of HK\$23 bn recorded in the previous quarter, it was around half the average value for the first six months of 1994. Buyers at large have adopted a wait-and-see strategy in anticipation of further price and interest rate movements.

Inflation

Slower growth in food prices helped contain inflation. The inflation rate moderated slightly during the December quarter as a result. The annual growth of CPI(A) in 1994 was 8.1%, down from 8.5% in 1993. The growth in food prices moderated from the rapid surge in August, inflation of non-tradables levelled off, while inflation of other traded goods rose.

The rapid rise in fresh food prices in August caused by the summer flooding in southern China tapered off in the subsequent months (Chart 2). The growth in the prices of non-tradable items

such as housing rental, transport and miscellaneous services stayed at a high level but showed no signs of increasing. Prices of other tradables accelerated due, in part, to appreciation of currencies such as the Yen vis-a-vis the HK dollar. As a result, prices of clothing, footwear and some other goods increased by 15% and 9% during the 12 months to October, contributing to the slight rise in the core inflation, as measured by the CPI(A) excluding food. On the other hand, consumer durable goods were less affected by the appreciation and their prices grew by only 2% to 3% during 1994. The manufacturers of such products might have more flexibility in squeezing their profit margins to maintain price competitiveness.

Trade Performance

The improvement in export performance since August continued into the December quarter. However, faster growth in imports than in exports led to a deterioration in the visible trade balance.

Compared to the same quarter last year, re-exports grew by 17% in the December quarter, up from 15.5% in the September quarter. There was a similar improvement in domestic exports. During the December quarter, domestic exports rose by 4% compared to the same quarter in 1993, up from -8%, -1% and 2% respectively in the first three quarters of 1994.

The strong export performance was underpinned by first, a stronger import demand from the US and Japan; and second, the relative

price competitiveness of Hong Kong's products. The effective trade-weighted exchange rate of the HK dollar depreciated by around 5% during 1994. (Chart 3).

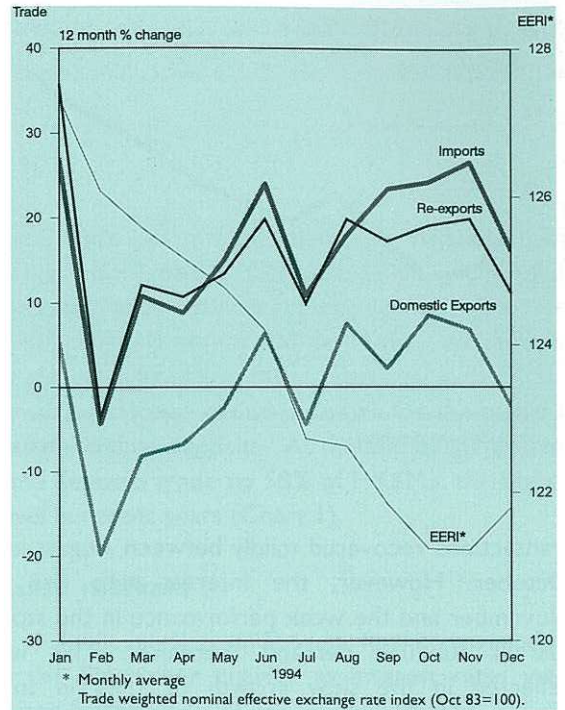
During the December quarter of 1994, imports increased rapidly by 22% compared to the same quarter last year. The rapid surge in imports was mainly led by an increase in the volume of retained imports although a slightly faster growth in import prices also contributed. Retained imports of raw materials contributed the most to the rise in total retained imports. Part of this increase was due to the construction of the new airport and related projects. The other part was due to recovery in export demand as Hong Kong's export markets revived.

Labour market

The labour market remained tight in the December quarter. The unemployment rate during the three months to November slipped to 2.1%, down slightly from 2.3% during the three months to September. Ⓜ

— Prepared by the External Department

Chart 3
Exchange Rate and Trade



Source: C&SD and HKMA