

## THE DOMESTIC ENVIRONMENT

The Hong Kong economy has gradually accelerated since the first quarter. While the export performance remained weak, the visible trade deficit continued to narrow with slower import growth. The unemployment rate improved in the September quarter and is expected to ease further along with the moderate recovery in economic activities. Inflation is trending lower. Trade financing loans declined in the September quarter, but other domestic loans expanded healthily. The growth of HK\$M3 remains largely in line with that of nominal GDP.

### Domestic Activity

Real GDP is estimated to have grown by 4.3% in the second quarter of 1996 from a year ago, faster than 3.3% in the first quarter, underpinned by a moderate recovery in consumer spending and continued intense infrastructural developments. However, the rebound of the economy has so far been slow, restrained largely by weak export growth. Reflecting the slower-than-expected export growth in the first half, the Government has revised its official forecast of real GDP growth for 1996 to 4.7%, down from the original projection of 5% (Table 1).

In the coming months, domestic economic activities should quicken further, albeit only moderately. Private consumption expenditure has recovered somewhat from the weak performance in 1995, rising by about 3% in the first half of 1996 from a year ago. Having resumed their uptrend in

the June quarter, retail sales continued to expand steadily in July and August, fuelled by notable improvements in sales of consumer durables and motor vehicles (Chart 1). The moderate revival in consumer spending is likely to continue in the latter part of 1996, as the labour market stabilises and the positive wealth effect stemming from the rises in stock and property prices filters through. Meanwhile, private sector building is expected to grow faster along with the reviving property market, while public sector investment should continue to be buoyant as works on the airport and public housing programmes and various infrastructural projects intensify.

### External Trade

Export performance remained weak, with the growth in the value of exports slowing to 3.1% and 3.5% in the June and September quarters

Table 1:  
GDP forecast by major components

	August 96 forecast		May 96 forecast	
	Change in real terms (%)	Contribution to GDP growth (%)	Change in real terms (%)	Contribution to GDP growth (%)
Private consumption expenditure	4	2.3	4	2.4
Government consumption expenditure	5	0.4	5	0.4
Gross domestic fixed capital formation	9	2.9	8	2.3
Change in inventories		-3.2		-4.3
Net domestic exports of goods <sup>1</sup>		-1.5		0.0
Net re-exports of goods <sup>2</sup>		2.1		2.8
Net exports of services		1.7		1.5
<b>Gross Domestic Product (GDP)</b>	<b>4.7</b>	<b>4.7</b>	<b>5.0</b>	<b>5.0</b>

Note: Components may not add up to total due to rounding.

<sup>1</sup> domestic exports of goods less retained imports

<sup>2</sup> re-exports of goods less imports for re-exports

Chart I  
Real Retail Sales

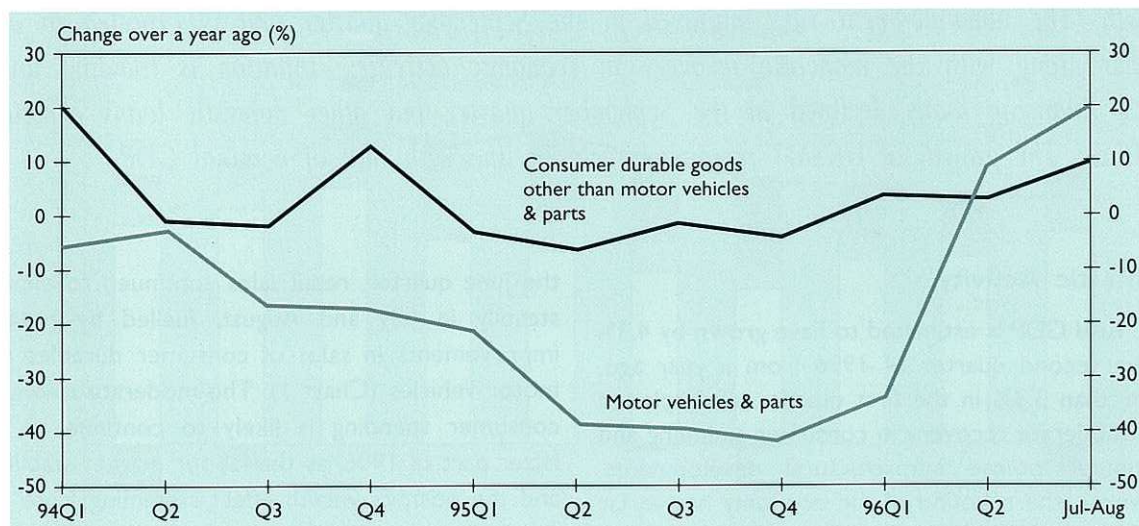


Table 2:  
Retained Imports by End Use

	(% change since a year ago)			
	Consumer goods	Raw Material	Capital Goods	Total *
95 Q1	28.5	32.4	54.4	37.9
95 Q2	14.3	31.8	38.9	25.3
95 Q3	1.4	18.5	46.5	21.1
95 Q4	-4.6	13.7	22.6	10.3
96 Q1	-1.4	1.4	8.8	3.5
96 Q2	-12.7	-14.3	1.7	-7.5
96 Jul-Aug	-8.0	-7.7	-10.0	-8.8

\* including foodstuffs and fuels

respectively, partly due to the appreciation of the US dollar and hence the HK dollar. Domestic exports to the US have been hit by the decrease in clothing exports, as a result of the shift of sourcing by some US buyers and the additional import documentation requirements for textile products from Hong Kong. Increasing direct shipment from China to the US, Japan and Korea has slowed Hong Kong's re-export growth, while the earlier cross-strait tension and Sino-US trade disputes have also hampered China-related re-exports.

Import growth, likewise, remained slow in the September quarter, rising by 1.4% in value terms, after an increase of 0.4% in the June quarter. While partly reflecting the slow-down in re-exports, the

weak import growth was also due to a continued large fall in retained imports of 9% during July and August compared to the same period in 1995. The decline in retained imports was across-the-board (Table 2) and reflects that the build-up of stocks may have begun to slow. As a result of slow import growth, the visible trade deficit narrowed to \$102bn (9.0% of total imports) in the first nine months of 1996, from \$114bn (10.3%) in the same period of 1995.

Exports are expected to pick up in the latter part of the year, on the likely stronger overseas demand stemming from anticipated economic expansion in the OECD countries and within the region. In particular, with the inventory-to-sales

ratio falling to its early-1994 level in the US, it is likely that US import demand would soon revive as stock replenishment continues. At the same time, Hong Kong's exports should also benefit from stronger China exports and the progressive reduction of import tariffs in China.

While the shift from re-exports to transshipment and direct shipment will restrain somewhat the pace of Hong Kong's export growth, the negative impact on the merchandise trade account will be offset by the rise in exports of services associated with increasing offshore trading.

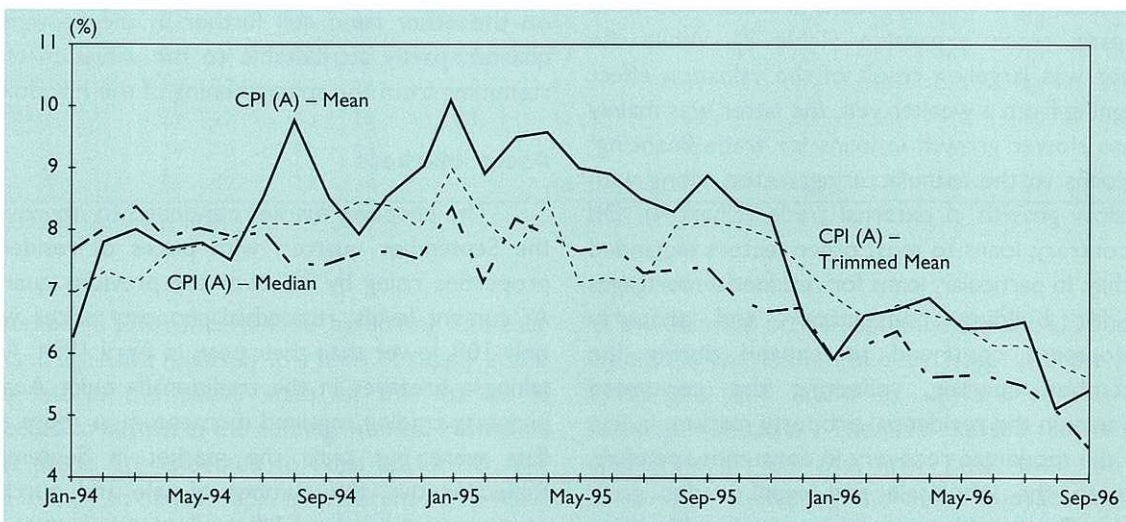
### Labour market

The labour market continued to improve, with the unemployment rate falling further to 2.6% in the September quarter. Total employment remained strong, increasing by 1.5% in the year to the August quarter, while total labour supply grew less rapidly by 0.7%. Jobs in the retail trade and in the building and construction sectors have recorded impressive growth of 5% and 13% respectively in the June quarter.

### Inflation

Consumer price inflation, on the CPI(A) basis, eased further from 6.3% in the first half of 1996 to 5.4% in the September quarter. For the first nine months of the year, inflation averaged 6.0%, compared with the official forecast of 6.8% for the whole year. The median and trimmed mean measures<sup>1</sup> of the CPI(A), which are less volatile in nature, show clearly the underlying downtrend in inflation (Chart 2). The trimmed mean measure also shows that the sharp decline in inflation in August 1996 was exaggerated by falls in prices of fresh vegetables and other fresh sea products. Domestically, a more balanced situation in the local labour market helped restrain inflationary pressures, while the earlier consolidation of rentals during 1995 also contributed. The movement of the private housing component of CPI(A) usually lags behind the rental index, as the latter indicates the most recent rental payment while the former includes both new and existing tenancy agreements (Chart 3). Externally, a stronger US dollar and moderate inflation in Hong Kong's trading partners should continue to help restrain imported inflation.

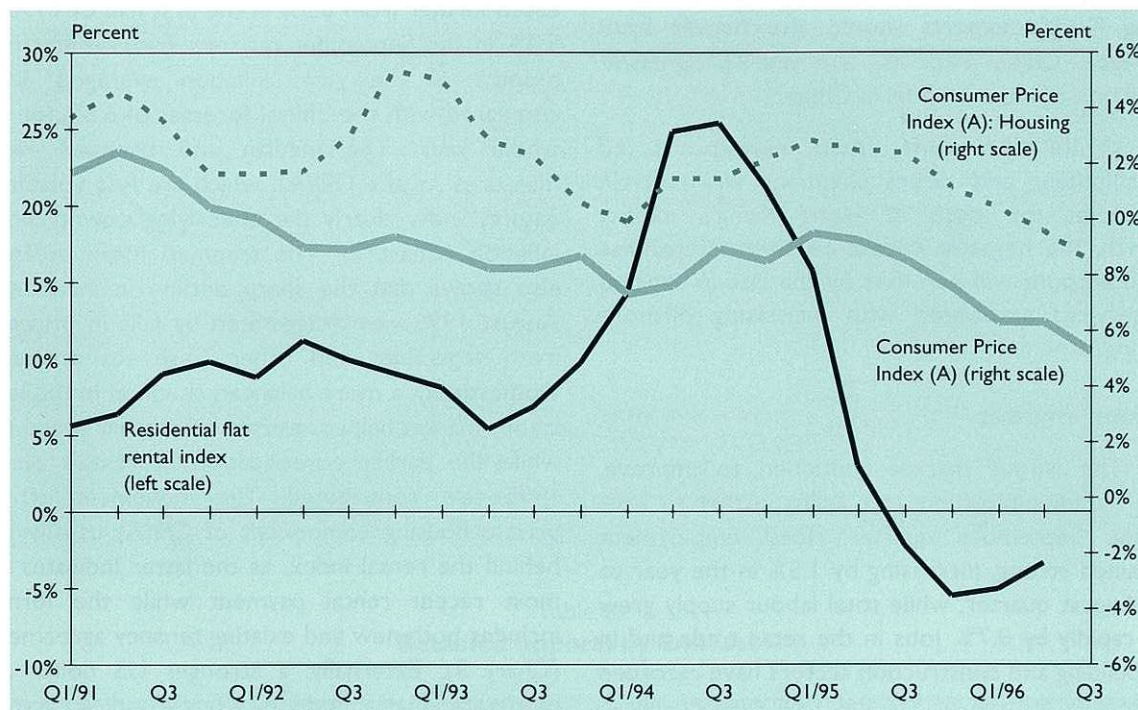
Chart 2  
Inflation – Mean, Median & Trimmed Mean  
(% Change on Year Ago)



\* Base Year 1989/90=100

<sup>1</sup> For the (weighted) median measure of underlying inflation, the percentage changes for all the components in the CPI are ranked and then the percentage change which has goods accounting for almost half the weighting above it and goods accounting for almost half the weighting below it is selected. The "trimmed mean" measure is a concept closely related to the median; those categories of goods whose price increases are in the top or bottom 10% of the distribution are excluded as 'outliers' before the mean is calculated. For a more detailed discussion, see "Analysis of Inflation in Hong Kong" in the August 1996 issue of the Quarterly Bulletin.

Chart 3  
Consumer price index and rental index



### Monetary Situation

Total loans and advances increased more slowly in the September quarter, reflecting both the slackening in offshore loans and a slowdown in domestic credit expansion (Table 3). While the former was largely a result of the valuation effect stemming from a weaker yen, the latter was mainly due to slower growth in loans for trade financing<sup>2</sup> and loans to the manufacturing sector, along with the slow growth in external trade (Chart 4). On the contrary, loans to most other sectors expanded healthily. In particular, loans for residential mortgages and for building, construction and property development continued to expand during the September quarter, reflecting the continued buoyancy in the residential property market. In line with the moderate recovery in consumer spending, loans to the wholesale and retail trades grew further. On the other hand, loans for stockbrokers fell sharply in the September quarter, as the figures of the June quarter were boosted by two new share floatations close to the end of June.

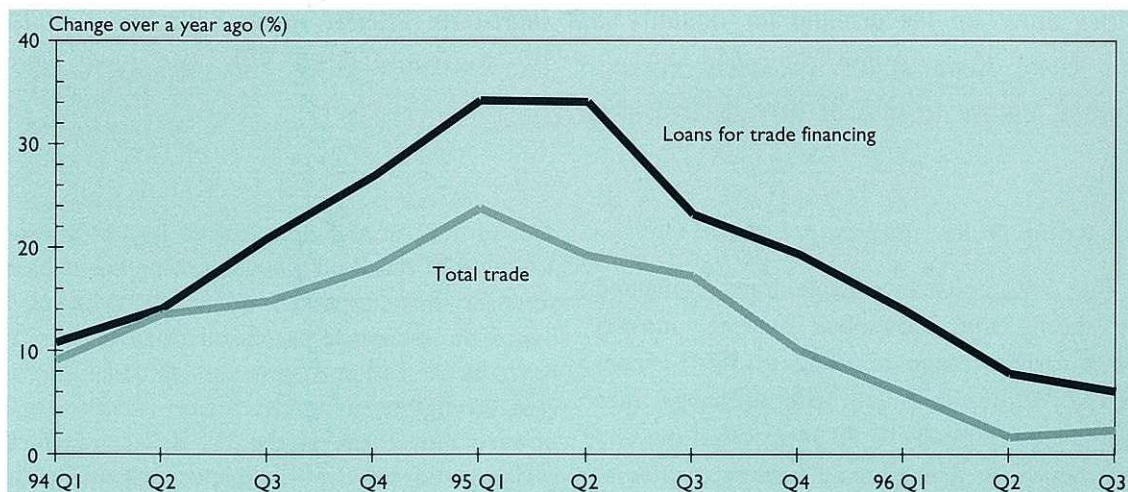
The growth in HK dollar deposits during the year to the September quarter remained largely in line with domestic credit expansion and the growth in nominal GDP. Foreign currency deposits, on the other hand, fell further in the September quarter, partly attributable to the valuation effect stemming from the strengthening of the HK dollar.

### Asset Markets

The property market continued to improve in the September quarter, with prices of residential properties rising by 3% over the previous quarter. At current levels, residential property prices were only 10% lower than their peak in April 1994. After taking a breather in the traditionally quiet August, property trading regained momentum as more new flats were put onto the market in September. Reflecting this, the number of sale and purchase agreements rose by 5.8% in September over the previous month. The growth of residential mortgage loans also accelerated from an annual rate of less than 10% in October 1995, to around 16% in

2 Include loans to finance imports to and exports and re-exports from Hong Kong and loans to finance merchandising trade not touching Hong Kong.

Chart 4  
Loans for Trade Financing and Total Trade



Note: Loans for trade financing includes loans to finance visible trade and merchandising trade not touching H.K.

Table 3:  
Financial Aggregates

Growth during period	Deposits				Domestic Loans					Offshore Loans	Total Loans	HK\$ Loan-to-deposit ratio (%)
	HK\$	US\$	non-US\$ F.C.	Total	Trade financing	Purchase residential property	Other property and construction related lending	Stock-brokers brokers	Others			
(% share of total*)	(56)	(22)	(22)	(100)	(5)	(10)	(8)	(0.4)	(22.6)	(54)	(100)	
1995 Q1	3.7	4.3	8.1	4.8	8.1	1.4	2.1	4.0	3.5	10.7	7.5	108.8
Q2	5.2	-1.9	7.6	3.9	12.2	5.8	1.0	39.6	2.0	14.1	9.8	107.4
Q3	3.6	0.7	0.8	2.3	-2.4	4.3	1.5	-10.6	2.3	-6.7	-3.3	105.8
Q4	2.0	3.2	1.3	2.1	1.0	4.1	-0.4	3.6	2.9	-1.2	0.3	105.6
1996 Q1	3.8	0.3	3.3	2.9	3.1	4.2	6.4	24.1	2.0	-4.2	-1.0	105.9
Q2	2.9	-3.0	0.2	0.9	6.2	5.2	4.8	30.2	5.0	0.0	2.3	108.2
Q3	4.2	0.0	-2.2	1.8	-4.1	3.6	4.7	-20.5	1.7	0.1	0.9	106.2

\* as of end-September 1996

September 1996. Underpinned by strong end-user demand against a relatively low level of supply in the near future, the active state of the market is expected to sustain in the coming months. However, while prices are expected to edge up further, the pace is likely to be less rapid after recent sharp rises.

By late August, the Hang Seng Index was buoyed by strong bank results, rising to about 11,500, before easing on tensions in the Gulf to the 11,000 level in the first week of September. The HSI picked up again in late September, subsequent

to the decision on 24 September by the US Federal Open Market Committee to keep interest rates unchanged, and lately, by upward revisions of earnings forecasts. The HSI closed above the 13,000 level for the first time ever on 14 November. Reflecting the more buoyant market, the turnover increased from a daily average of \$3.8 bn in the June quarter to \$4.6bn in the September quarter, and further to around \$7.0bn-8.0bn in October and November. ☉

— Prepared by the External Department