

## THE DOMESTIC ENVIRONMENT

*The Hong Kong economy staged a further rebound, underpinned by a gradual pick-up in consumer spending, intense investment expenditure and improved external trade performance. Asset markets were active, with share prices rising to new highs, and prices of residential properties surging to exceed their previous peaks. Reflecting the buoyant asset markets, the growth in HK\$M3 has outpaced that of nominal GDP in recent months. With the continued growth in employment and a less rapid rise in labour supply, the job market improved and the unemployment rate stabilised. Meanwhile, inflation continued to be steady.*

### Domestic Activity

The Hong Kong economy rebounded further, with real GDP growth accelerating to 5.1% in the September quarter of 1996 over a year ago, from 3.3% and 4.6% in the first and second quarters respectively. While a gradual pick-up in consumer spending and continued intense infrastructural developments remained the main impetus to the economic expansion, the current revival was also supported by a recovery in private sector construction. The rebound was, however, restrained somewhat by the weak export performance. With the steady growth trend, the Government has maintained its August revised official forecast of real GDP growth for 1996 at 4.7%.

Domestic economic activities are expected to pick up further. Private consumption expenditure continued to recover in the third quarter, rising by 4.5% from a year ago. Retail sales expanded more rapidly in July-November, after reverting to an uptrend in the June quarter. The recovery was broadly based, with notable improvements particularly in sales of consumer durables and motor vehicles, and is clearly confirmed by the fact that on a deseasonalised basis, retail sales have been gaining momentum (Chart 1). The revival in consumer spending is likely to continue in the coming months, as the job market improves, household incomes increase further, and the positive wealth effect stemming from rising stock and property prices feeds through to consumer markets. Investment spending should also remain strong. While public sector investment is expected to slow along with the peaking of the airport programme and related infrastructural projects, the decline is to be partly offset by an increase in private sector construction. The buoyant residential property market should lead to increased expenditure on private building projects, as suggested by the sharp

rise in consents to commence work in the September quarter (Chart 2). Moreover, greater demand for fitting out and interior decoration work would also stem from the more active property market and rising public housing output.

### External Trade

Exports remained sluggish, rising by 4% in value terms in the December quarter. Export performance had been generally weak in 1996, partly due to the appreciation of the US dollar and hence the HK dollar. Domestic exports to the US were hit by the decrease in clothing exports. The implementation of the North American Free Trade Agreement, the additional import documentation requirements for textile products from Hong Kong, and Sino-US trade disputes on the alleged illegal transshipment of Chinese products to the US have deterred overseas orders and resulted in a diversion of US import orders. For re-exports, the weaker performance in earlier months was attributable to the cross-strait tension, Sino-US dispute on the Special 301 issue and China's cut in value-added tax rebates on exports. Nevertheless, these factors appear to be losing significance, as Hong Kong's re-exports to and from China trended up, in line with a recovery in the total trade of China (Chart 3).

Import growth also quickened somewhat in the December quarter, rising by 4.3% in value terms, after an increase of 1.3% in the September quarter. As a result of faster growth in imports than exports, the visible trade deficit widened slightly to \$36bn (8.9% of total imports) in the December quarter of 1996, from \$33bn (8.6%) in the same period of 1995. For the year as a whole, the visible trade deficit amounted to \$138bn (9% of total imports), compared with \$147bn (9.9% of total imports) in 1995.

Chart 1  
Retail Sales Volume (Deseasonised)

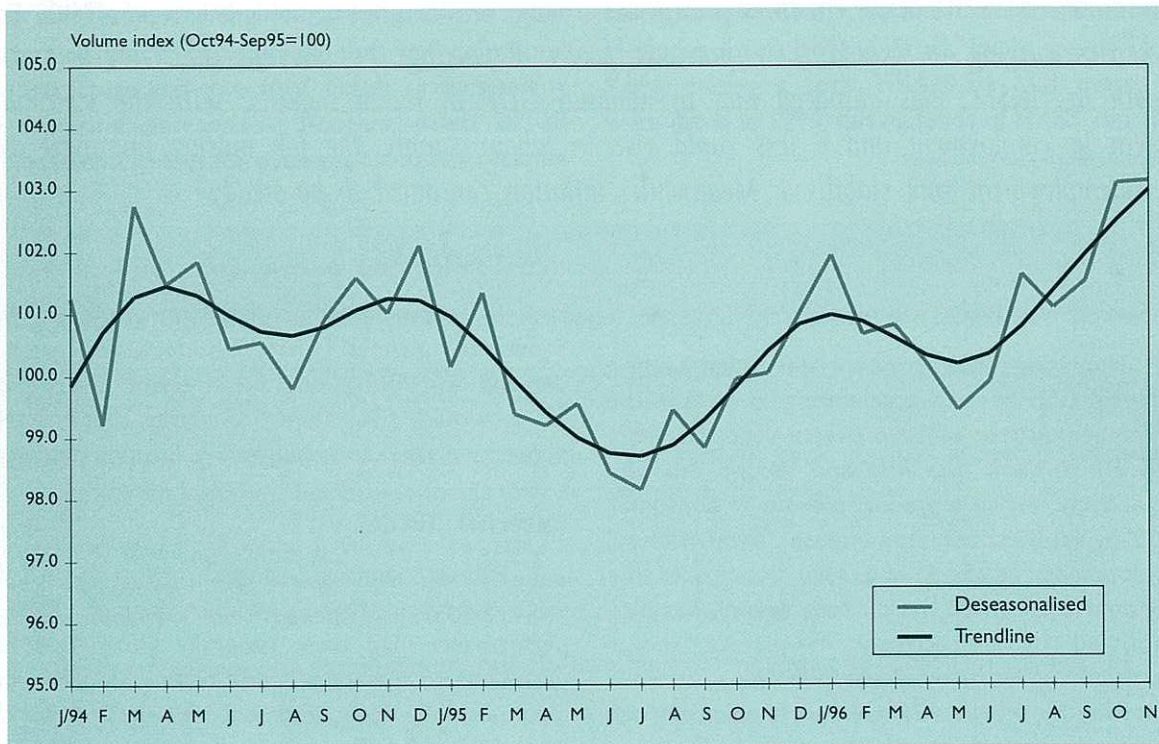


Chart 2  
Private Construction Investment  
and Residential Flats with Consent to Commence Work

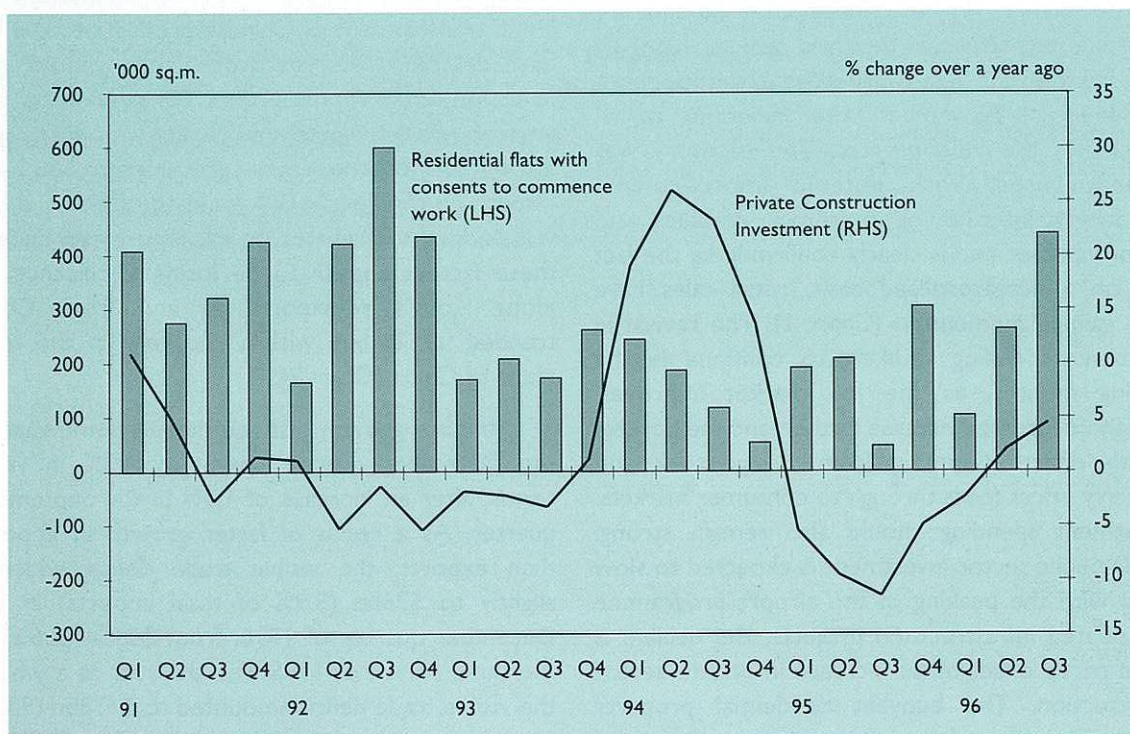
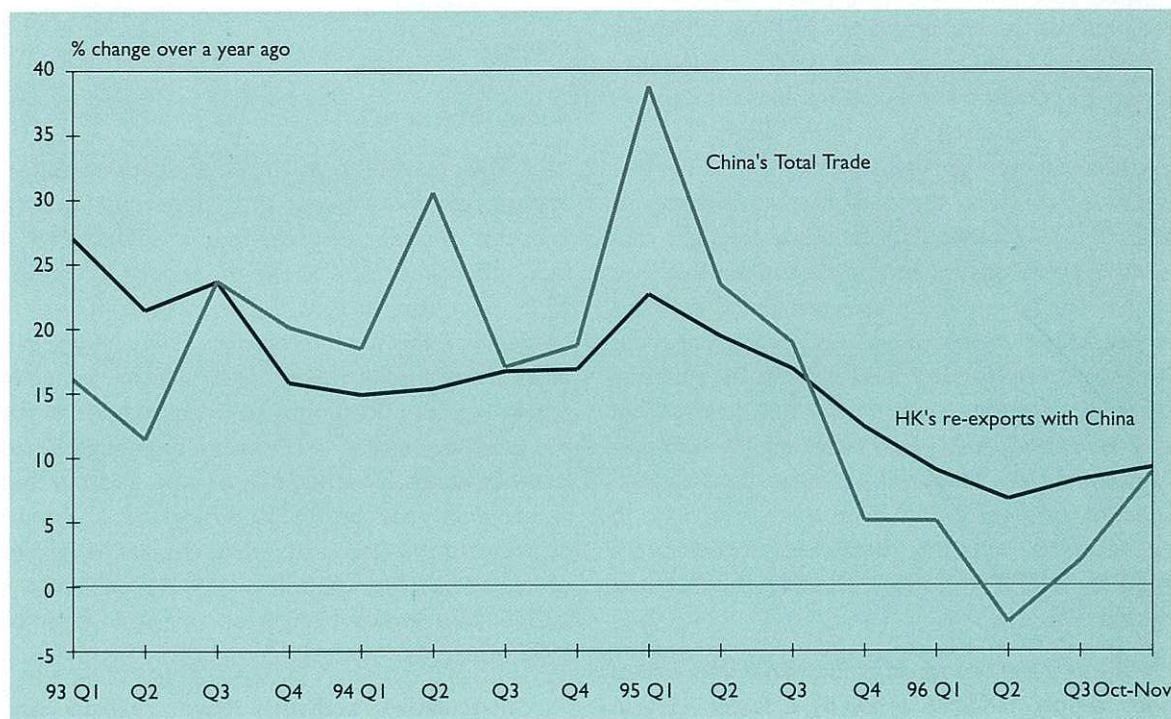


Chart 3  
**HK's Re-exports with China and China Total Trade**



Looking ahead, exports are expected to benefit from China's further liberalization of trade and should grow more buoyantly in the coming months on stronger import demand from the OECD countries and within the region. The conclusion of a new Sino-US textile agreement in early 1997 also augurs well for trade prospects between the two countries, which should benefit Hong Kong. While the expansion of domestic exports would continue to be modest given the on-going relocation of Hong Kong's manufacturing base to mainland China, the negative impact on current account should be partly offset by the rise in associated investment income. Likewise, while the shift from re-exports to transshipment and direct shipment would restrain re-export growth, the drain on the merchandise trade account is to be partly compensated for by rising exports of services generated by increasing offshore trading. The latter, coupled with the robust tourism and the continued increase in exports of financial and other professional and business services, should contribute to a strong growth in overall exports of services.

### Labour Market

The job market continued to be stable, with the unemployment rate edging down to 2.5% in the three months to January 1997, from 2.6% in the September and December quarters of 1996. In the three months ending December 1996, total employment rose by 4.2% over a year earlier, while total labour supply expanded less rapidly by 3.2%. Jobs in the retail trade sector and in the building and construction sector have recorded further impressive year-on-year growth of 5.7% and 16.4% respectively in the September quarter.

### Inflation

In 1996, inflation, as measured by CPI(A), averaged 6.0%, much lower than 8.7% in 1995. While the recent surge in property prices and the stronger domestic demand may intensify inflationary pressures in the coming months, a stronger US dollar and moderate inflation in Hong Kong's trading partners should continue to help restrain inflation.

## Monetary Situation

Along with the gradual acceleration of economic activities, domestic credit grew further strongly in the December quarter of 1996, expanding by 4.5%, up from a 2.0% rise in the September quarter. Excluding trade financing, loans for use in Hong Kong increased at an even faster rate of 4.9%. The slower growth in trade financing was broadly in line with the performance in external trade (Chart 4). Nevertheless, there are signs that the trade performance, and hence the derived loan demand, has been picking up since the December quarter, albeit only moderately. Loans to most other sectors expanded healthily, led by a strong increase in mortgage loans on the active residential property market. Also partly reflecting the booming property market, loans for building, construction and property development grew further strongly in the December quarter. Loans to stockbrokers surged by 61.3% in 1996, reflecting the buoyant stock market.

Given the more rapid credit expansion, broad money supply, HK\$M3, grew by a faster 19% in 1996. The fact that the growth in money supply outpaced that of nominal GDP reflects partly the

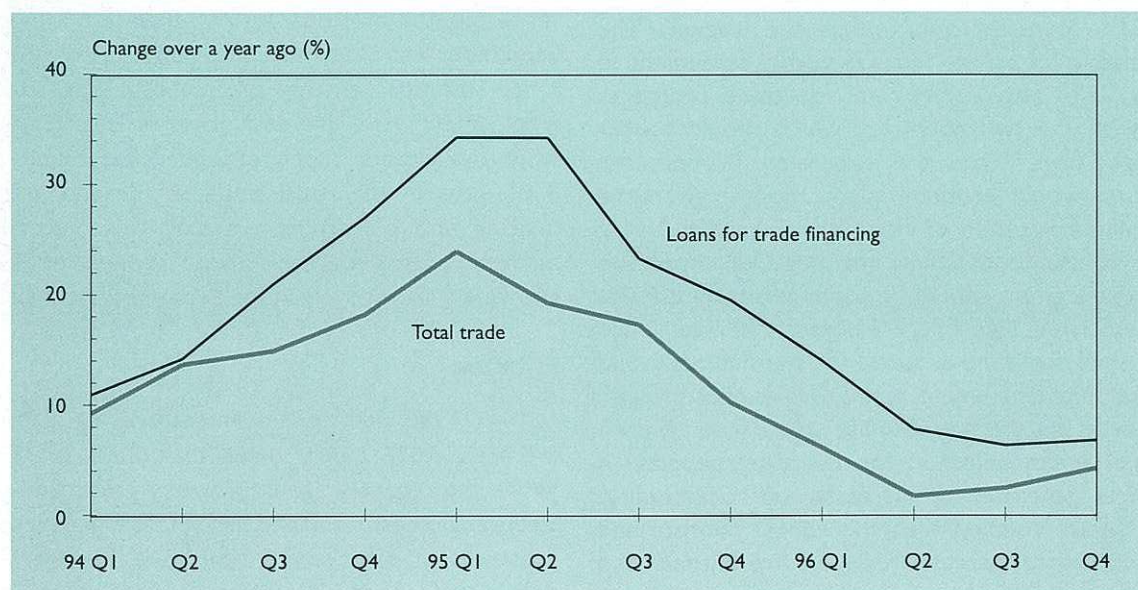
very active asset markets. With stronger transaction demand for money stemming from the buoyant asset markets and consumer spending, the narrow money, HK\$M1, also grew faster by 15.8% during the year.

## Asset Markets

The buoyancy in the residential property market continued into the December quarter. Property prices of selected developments in December were 37% above the trough in October 1995. The top end of the market continued to outperform the small to medium flats and prices of most luxury apartments had already exceeded previous peaks. Response to primary sales of flats has been favourable, with heavy over-subscription in most cases. The number of sale and purchase agreements rose by 87.8% during the December quarter from a year ago, while the annual growth of residential mortgage loans also accelerated to 20.5% in December 1996, from 16.5% in December 1995 (Chart 5).

Speculative activities have revived since February 1996, as evidenced by the rising share of speculative transactions to total transactions<sup>1</sup>, which

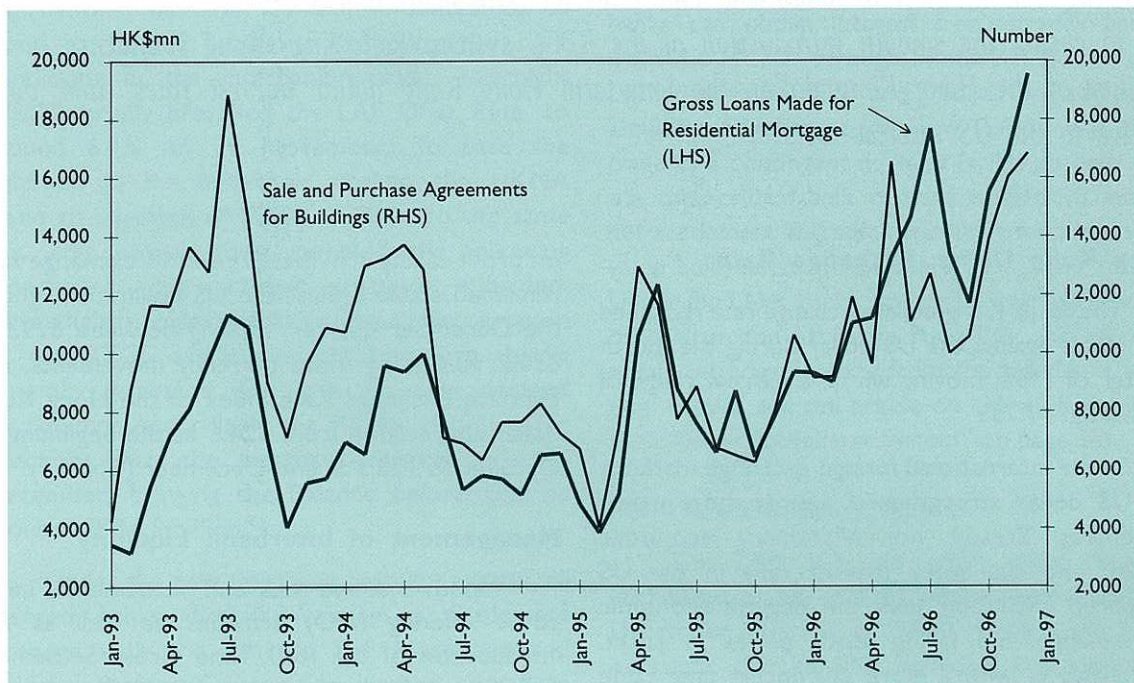
Chart 4  
Loans for Trade Financing and Total Trade



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

<sup>1</sup> Speculative transactions refer to those involving resale either before the property assignment or within two years after the sale and purchase agreement.

Chart 5  
**Sale and Purchase Agreements for Buildings and  
 Gross Loans Made for Residential Mortgage**



increased from 9% in February 1996 to 18% in November. The number of cases using shell companies to acquire properties<sup>2</sup> also rose. In response, the Real Estate Developers Association of Hong Kong (REDA) introduced in mid-January 1997 a number of measures to dampen speculative activities in the property market<sup>3</sup>. To alleviate pressure on property prices, the long-term solution is to make available an adequate supply of land to the market.

Along with surging US stock prices, the local bourse continued to show strong performance in the December quarter of 1996, with the Hang Seng

index reaching a high of 13,531 on 27 November 1996. Stock prices have since then fluctuated around the 13,000 to 13,500 level. On 6 January 1997, the HSI fell by 257 points to 13,198 in a single day, spurred by concerns about interest rate rises and the possible introduction of anti-speculation measures by the Government. However, the market quickly resumed its strength and the HSI rose to an all-time high of 14,000 by mid-January, before retreating to hover around the 13,500 level in early February. ☹

— Prepared by the External Department

2 The number of cases rose from a monthly average of 258 in 1995 to 449 per month during 1996.

3 These measures include:

- To prohibit the resale of uncompleted flats under the consent schemes through companies by way of change of directorship in the period between registration and completion of assignment.
- Flat sale to companies will be limited to the last 15% of each batch of flats under the Consent Scheme put up for sale so as to ensure that genuine end-users' interests are protected.
- To promulgate clearly in sale brochures and newspaper advertisements the total number of flats available for pre-sale in each housing development under the Consent Scheme.
- To ensure that the 10% of flats disposed by private sale will only be sold to genuine end-users and will not become available in the open market for speculation.
- REDA will also encourage its members to adopt the above measures for sale of flats which have already been given consent for pre-sale, and sale of flats which fall outside the Consent Scheme.