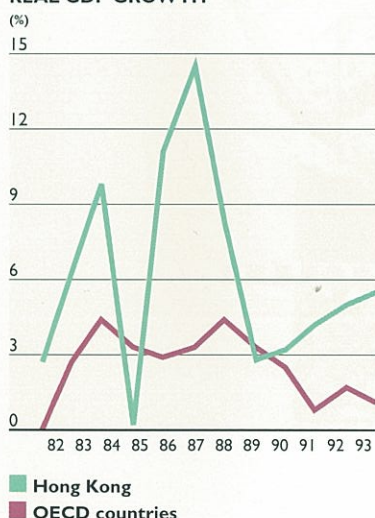


Hong Kong's economy continued to perform strongly in 1993, with GDP rising by 5.5%, slightly faster than the growth rate of 5.3% recorded in 1992. Robust regional growth, notably in China, stimulated the demand for trade, financial and other business services in Hong Kong. Coupled with an increase in

REAL GDP GROWTH



domestic building and construction activity, this helped to offset the impact of the weak economic growth in OECD countries. Hong Kong's per capita GDP reached US\$18,500 in 1993, the third highest in Asia after Japan and Brunei.

OVERVIEW

The strong growth was based on a stable exchange rate, large capital inflows and booming financial markets. The HK dollar exchange rate closed the year at 7.726 to the US dollar, largely as a result of capital inflows. These funds were mainly attracted into the stock market, causing the Hang Seng Index to rise by 116% during the year. Hong Kong's stock market, with a market capitalisation of US\$385bn, is already the sixth largest in the world.

Capital inflows, particularly strong during the last quarter, also pushed up the growth of money supply to reach 25.2% for HK\$M3 by the end of the year, considerably higher than the increase of 13.7% in 1992.

Inflation slowed somewhat during 1993, but remained high: CPI(A) increased by 8.5% in 1993, compared with 9.4% in the previous year. Under the influence of a stable exchange rate, inflation in the tradable goods sector was in fact very low. The inflationary pressure came largely from a substantial demand for services and manifested itself prominently in higher housing costs due to rising property prices. The rent and rates component of CPI(A), accounting for 19.2% in weight, rose by 12.6%, contributing 2.4pp alone to inflation. In

1993, property prices on average increased broadly in the range of 12% to 23%, adding considerably to asset price inflation. Some of the major banks responded to these price trends very prudently by cutting back their loan to valuation ratio for residential properties from 70% to 60%, and then to 50% for those of higher prices. Mortgage loans (including loans under the Home Ownership Scheme and Private Sector Participation Scheme) grew by 19.5%, compared with 13.6% in 1992. The Monetary Authority continued to advise banks to be cautious in their property lending.

DOMESTIC DEMAND

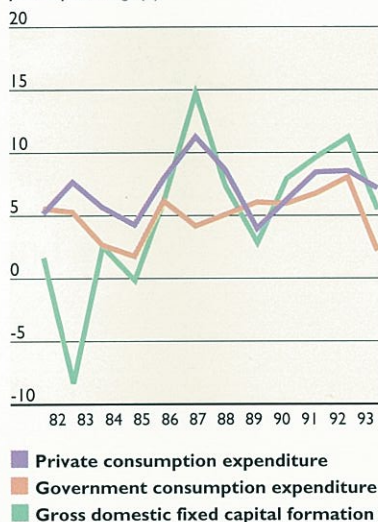
Both private consumption expenditure and domestic fixed capital formation showed robust increases in 1993, of 7.2% and 5.5% in real terms respectively. The faster growth in private consumption expenditure relative to the growth in GDP was supported in part by earnings from investment and other factor income derived from abroad, particularly China. The wealth effect arising from increases in equity and property prices may also have contributed to higher consumption.

After a strong growth of 22.1% in 1992, spending on machinery and equipment rose by 6.1% in 1993, adding substantially to domestic productive capacity. Investment in building and construction accelerated in 1993; the appreciable growth of 14.3% was underpinned mainly by major infrastructural projects in the public



COMPONENTS OF GDP

year-on-year change (%)



sector, including works related to the new airport at Chek Lap Kok.

Government consumption expenditure in national accounts terms grew at a modest 2.2%, which helped to alleviate the overall domestic demand pressure generated by the other consumption and investment needs.

On the fiscal side, total government expenditure (+19.9%) grew slower than total revenue (+23.8%), achieving a surplus of 1.8% of GDP as against a budgeted small deficit for the fiscal year 1993/94, thereby helping to contain the demand driven inflationary pressure.

EXTERNAL SECTOR

While the Hong Kong economy has continued to be export-led, the composition of exports has undergone significant structural changes in the past few years in two main aspects.

First, with a decline in exports of locally produced goods, an increasing proportion of export earnings is derived from the value added on re-exports, which include, for example, product design and packaging as well as trading and marketing services. In these areas Hong Kong has a strong competitive edge.

During 1993, domestic exports fell by 5.1%, due partly to the slackening of economic activity in some major markets and the longer-term trend of

relocation of manufacturing activity to southern China. On the other hand, re-exports registered a substantial growth of 19.8% in 1993. China remains Hong Kong's largest trading partner (with a share of 32% for exports) and the main source of supply of re-exports (with a share of 33%).

Total imports increased by 12.8% in 1993, compared with 22.3% in 1992. The slower growth was mainly due to the slow growth of retained imports of 4% in 1993, which was offset by the robust performance of re-exports.

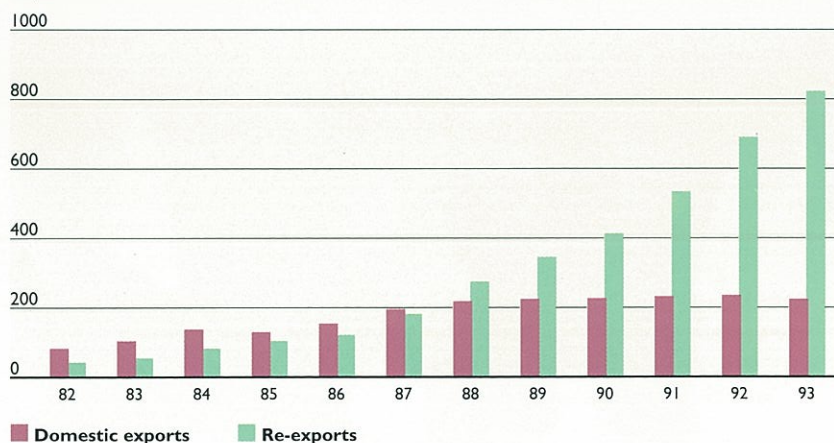
The domestic exports versus retained imports deficit widened to HK\$175bn, while the re-exports versus imports for re-exports surplus rose to HK\$146bn, reflecting the growing role of the re-export trade to Hong Kong.

Secondly, reflecting Hong Kong's role as a service centre in the region, exports of services, such as transportation, tourism and financial services, have assumed a growing importance. The value of exports of services has grown to account for 42% of the total domestic exports of goods and services, compared with only 26% a decade ago.

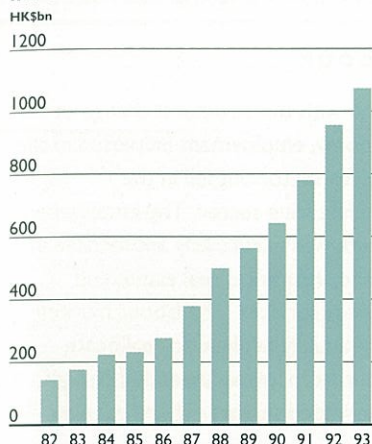
In 1993, exports of services grew by 8.1%, faster than the increase in imports of services at 7%. This resulted in a surplus of HK\$61bn on the invisible trade balance which more than offset the visible trade deficit of HK\$29bn.

DOMESTIC EXPORTS AND RE-EXPORTS

HK\$bn



IMPORTS



There was thus a small surplus of HK\$32bn on the combined visible and invisible trade account, which was equivalent to 2.7% of total imports of goods and services. With a small surplus on the visible and invisible trade account, and sustained capital inflows, the total foreign currency reserves of the Exchange Fund increased by HK\$60bn during the year to HK\$335bn at the end of 1993, equivalent to more than eight months of retained imports.

MONETARY SITUATION

The HK dollar exchange rate stayed on the strong side of the linked rate, influenced significantly by the inflow of funds into the buoyant stock market. It remained generally stable during the year within a narrow range of 7.72 to 7.78.

Under the linked exchange rate system, the overall exchange value of the HK dollar in 1993 reflected the mixed performance of the US dollar exchange rate against other major currencies. The effective exchange rate index of the HK dollar strengthened from 114.2 at end-1992 to 115.3 in early February. It then moved around 112 in the second and third quarters, before firming up during the fourth quarter to close the year at 114.3.

In line with US dollar interest rates, local interest rates remained generally low in 1993. Influenced by shares subscription activities, interbank rates

firmed up slightly on several occasions during the year. At end-1993, three-month HIBOR was 3.63%, 31bp above the corresponding Euro-dollar rate. Throughout the year, deposit rates governed by HKAB remained unchanged, with the savings and the three-month deposit rates standing at 1.5% and 2.75% respectively. BLR stood unchanged at 6.5%.

HK dollar money supply registered notable growth of 26.9% and 25.2% for HK\$M2 and HK\$M3 respectively in 1993. This growth, higher than the corresponding growth rate of nominal GDP, was influenced by a substantial inflow of funds during the fourth quarter of the year. Strong economic activity caused loans for use in Hong Kong to increase by 18% in 1993.

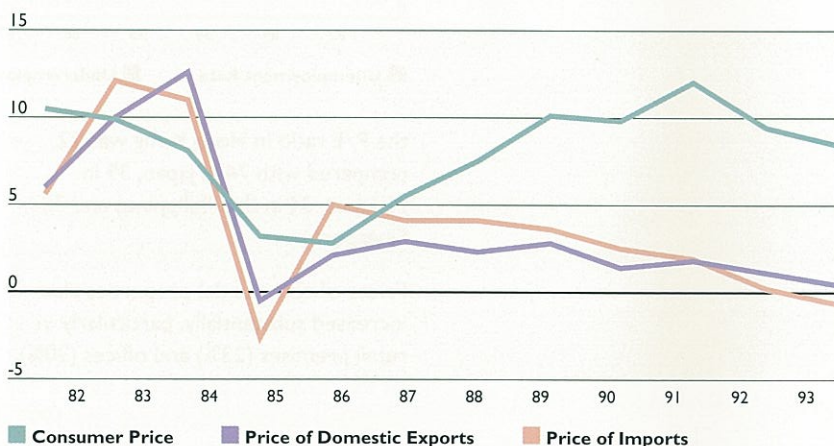
Reflecting these trends, the banking sector had a good year. Developments in the banking sector are described later in this report.

PRICES

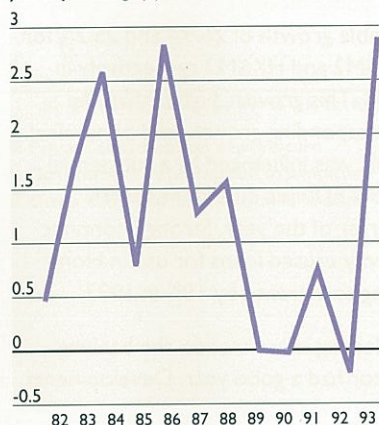
Despite slightly higher growth in the economy, inflationary pressure moderated in 1993. CPI(A) increased by 8.5%, compared with 9.4% in 1992 and 12% in 1991. The declining trend was due to a number of factors. First, the link to the US dollar, which is a low inflation currency, effectively restrained price increases in the tradable goods sector; the prices of domestic exports rose by only 0.3% in 1993. Secondly,

CONSUMER PRICE, DOMESTIC EXPORT PRICE AND IMPORT PRICE

year-on-year change (%)



TOTAL LABOUR FORCE
year-on-year change (%)



Hong Kong benefited from stable import prices, as weak domestic demand in some industrialised countries kept their inflation rates in check; the depreciation of the renminbi against the HK dollar was another contributive factor. Thirdly, on the supply side, the labour force expanded by 2.9% in 1993, partly due to a return of emigrants.

Improved earnings, a high savings ratio, together with a strong inflow of overseas funds led to substantial increases in asset prices in Hong Kong during 1993. The local stock market was very buoyant, with the Hang Seng Index rising by 116% during the year to a record high of 11,888 at end-December. Underpinning this gain was a favourable assessment of the economic prospects of Hong Kong and China by overseas fund managers, and an upward re-rating of the relative share of Hong Kong stocks in their portfolios. The strong increase in share prices was also supported by the fact that the P/E ratio was still low compared with other regional stock markets (in December,

prices picked up again as from the second quarter of the year. In view of this, banks were generally cautious in extending residential mortgage loans and some banks began to lower their loan to valuation ratios from 70% to 50% for higher priced properties.

LABOUR

In line with the structural change of the economy, employment increased in the services sector but fell in the manufacturing sector. The employment growth was particularly appreciable in finance, insurance, real estate and business services. The labour market has gradually evolved to reallocate labour from low value-added to high value-added sectors. There has also been an influx of returning migrants which helped relieve the pressure on the tight labour market, which was at virtually full employment with the unemployment and underemployment rates at the low levels of 2.1% and 1.6% respectively in 1993.

UNEMPLOYMENT RATE AND UNDEREMPLOYMENT RATE
percent



the P/E ratio in Hong Kong was 22, compared with 74 in Japan, 39 in Malaysia, 34 in the Philippines and 33 in Singapore).

Prices of commercial properties also increased substantially, particularly in retail premises (23%) and offices (20%). As for residential properties, after a period of consolidation since end-1992,

OUTLOOK

The US economy appears to be on a cyclical upturn while Japan and Germany are trying to pull themselves out of recession. For OECD countries as a whole, the latest forecast projects an improvement in GNP growth, from 1.1% in 1993 to 2.1% in 1994. The improved economic performance in

these major markets should strengthen the growth impetus for Hong Kong.

China has continued on its fast growth track, with GDP increasing at an annual rate of 13.4% in 1993. In order to avoid overheating, official forecasts have aimed at an inflation rate of below 10% and a growth rate of around 9% in 1994. Recent reforms in the foreign exchange system, including the unification of the currency, and major reforms to the fiscal and financial systems, have strengthened the incentive to export, and this should have a beneficial impact on Hong Kong's re-export trade.

Developments in China-US trade relations are of real importance for Hong Kong's economy. The growth prospect of Hong Kong will in particular be affected by the result of the annual review of China's Most Favoured Nation status by the US around mid-1994.

The considerable demand for services from China and other regional

economies will continue to underpin the evolution of Hong Kong into a major services centre. It will, however, continue to exert pressures on domestic resources, particularly on labour and land supply. Domestic demand is also likely to remain firm in 1994, contributed in part by an acceleration in infrastructural works. Thus, the inflation rate is unlikely to come down sharply in the near term. Nevertheless, the increase in the size of the labour force in 1993, due to reverse migrant flows, is expected to continue in 1994. This suggests that the labour supply may be more flexible than expected. The projected rate of increase for CPI(A) is 8.5%.

On the whole, the continued strong fiscal position, stable exchange rate and increases in private sector productivity will facilitate Hong Kong in its structural change and maintain its growth momentum in 1994. An overall real growth rate of 5.5% for GDP is expected.