

EDITORIAL

Recent Trends and Events

Indicators for the second quarter of 2003, released during the course of the summer, show a slowing down of the Hong Kong economy under the impact of the outbreak of severe acute respiratory syndrome (SARS). Fuelled by the strong export performance in Mainland China, Hong Kong's external trade continued to grow. But domestic demand and tourism contracted, as people stayed at home and avoided crowded places. Property prices declined further. Real GDP shrank by 0.5% year-on-year, compared with an increase of 4.5% in the first quarter. The unemployment rate, a lagging indicator, rose to a record high of 8.7% in the May-July period. Nevertheless, it was lower than many had predicted, and a decline in the underemployment rate suggests that the situation may be stabilising.

Following the difficult second quarter, a gradual recovery seems to have set in over the summer. Hong Kong was removed from the World Health Organisation's list of SARS-affected areas on 23 June. Since then, retail sales and tourist arrivals have returned to near pre-SARS levels, helped by a variety of policy initiatives, including the relaxation of restrictions on individual travellers from the Mainland. The new Closer Economic Partnership Arrangement between Hong Kong and the Mainland, combined with growing signs of global recovery, have boosted confidence in the economy. The Government raised its full year growth forecast from 1.5% to 2%. Buoyant trade on the Mainland and the expected global rebound should continue to support the export of goods and services from Hong Kong. The strength and durability of the recovery in domestic demand, however, remains uncertain, given high unemployment and weak property prices.

Signs of recovery, both globally and in Hong Kong, helped boost stock prices in Hong Kong to a nearly 15-month high in early September. The Hong Kong dollar strengthened, with 12-month forward points declining to +48 pips in early September — the lowest level for 12 months. Generally, financial markets remained stable both during the period of economic contraction and during the politically eventful weeks of July, which saw a large but peaceful protest against proposed national security legislation on 1 July, and the resignation of two senior ministers on 16 July.

In This Issue

The feature articles in this issue focus on banking in Hong Kong. Two research articles examine the profitability of the banking sector over the past 10 years and the factors influencing the decline in the ratio between Hong Kong dollar deposits and total deposits; the conclusion of the second article is that the decline was driven by structural and cyclical developments in the economy rather than by any lack of confidence in the Hong Kong dollar.

Two further features look towards the plans for the banking sector in the future. One of them outlines plans for the establishment of a commercial credit reference agency in Hong Kong, which is intended, through greater credit transparency, to make it easier and cheaper for corporate customers to borrow money from banks. The other explores the implications for banks in Hong Kong on the New Capital Accord of the Basel Committee on Banking Supervision, which is scheduled for implementation at end-2006.

With increasing economic integration between the two places, output and price developments in Mainland China have important implications for Hong Kong. A feature article examines inflation dynamics in Mainland China in the past decade or so. The article concludes that the high inflation between 1990-1997 was attributable mainly to increases in international prices and devaluations of the renminbi, while the deflation in more recent years reflected productivity growth and appreciation in the effective exchange rate of the renminbi following the Asian financial crisis.

Earlier this month, the Monetary Authority and the three note-issuing banks of Hong Kong unveiled plans for the issue of a new series of banknotes for Hong Kong. The first of these notes, with denominations of \$100 and \$500, will go into circulation later this year. The other denominations will be released in the second half of 2004. The new notes carry additional security features, as well as new designs. An illustrated article on the \$100 and \$500 notes explains how the security features work.