

## EDITORIAL

### Recent trends and events

Economic recovery in Hong Kong continued to broaden in the second half of 2004, helped by generally supportive regional and global conditions, although there was some moderation in the pace of growth. Real GDP grew by 7.2% year on year. Exports remained strong, inbound tourism continued to increase, and domestic demand expanded. The unemployment rate continued to fall, but the pace of improvement moderated, largely owing to an increasing number of people returning to the job market: it declined from 6.8% in the middle of the year to 6.7% in the three months to October. Consumer prices remained stable.

The financial markets in Hong Kong continued to be stable despite the volatility in world currencies. Through the Linked Exchange Rate system, the Hong Kong dollar depreciated in effective terms alongside the US dollar. At the same time, there were further inflows of funds into the Hong Kong dollar, driven by the continued weakening of the US dollar, upward pressure on the renminbi, and the domestic recovery. The Hong Kong dollar exchange rate began to strengthen in October, and the Aggregate Balance rose to HK\$14 billion in November, from around HK\$3 billion in mid-September. Short-term interest rates have, in consequence, fallen to near zero, despite successive increases in the US rates. The Hang Seng index reached 14,339 on 2 December, its highest level in 45 months.

On 11 October the remaining three denominations (\$20, \$50 and \$1000) in the new series of Hong Kong banknotes went into circulation. Hong Kong's new Commercial Credit Reference Agency began operation on 1 November with the purpose of collating information about the credit history of small and medium enterprises and making this information available to banks and deposit-taking companies. The Clearing and Settlement Systems Ordinance, which establishes a statutory regime for the Monetary Authority to oversee important clearing and settlement systems, came into effect on 4 November.

The International Monetary Fund's annual Article IV Consultation for Hong Kong took place between 26 October and 2 November. In its Concluding Statement, the IMF mission expressed support for the Government's efforts to ensure credible and lasting fiscal consolidation. The mission also expressed support for Hong Kong's Linked Exchange Rate system and observed that the HKMA's response to strong-side pressures on the Hong Kong dollar had enhanced the resilience of the system.

## In this issue

This issue of the Quarterly Bulletin contains the regular Half-Yearly Monetary and Financial Stability Report, which analyses in detail the recent external and domestic influences on Hong Kong's monetary and financial systems. A feature article on intra-regional trade and the role of Mainland China examines trends in Asian exports and considers the implications of slower economic growth on the Mainland. A report on a survey of the turnover of the foreign exchange and derivatives market in Hong Kong shows considerable growth since the last survey in 2001. A further article examines the impact of negative equity on the probability of default on mortgage loans, taking into account experience in Hong Kong in recent years, and finds a positive correlation between residential mortgage default risk and the loan-to-value ratio.