

Real GDP is expected to grow by around 5% in 1996. The unemployment rate has stabilised. The cuts in interest rates and the revival of the property market have provided the basis for a pick-up in consumer spending, particularly in the second half of this year. The inflation rate abated further in the March quarter. This was due to slower increase in import prices and moderating growth in services prices.

Economic Activity

The economy of Hong Kong consolidated in 1995, with real GDP slowing to 4.6% growth. This was mainly due to the slowdown in private consumption expenditure from 6.9% in 1994 to 1.1% in 1995. Private spending remained subdued, as retail sales volumes were 0.9% lower in the first two months of 1996 than in the corresponding months last year. Nevertheless, private consumption expenditure is forecast to rise by 4% in real terms this year. This should follow from the revival of share prices through 1995 and the rebound in property prices. The cuts in interest rates in December 1995 and in February 1996 should provide the basis for a pick-up in consumer spending, particularly in the second half of the year. The labour market has also stabilised, with the unemployment rate falling to 3.2% in the March quarter from the recent peak of 3.6%. Real GDP is forecast to grow by around 5% this year (Table 1).

The demand for capital equipment is expected to remain strong in 1996 as the bulk of spending on the airport project shifts from construction to equipment installation. Nevertheless, incremental growth may be smaller, given the increases of 14% and 18.3% in real terms in 1994 and 1995. On the construction sector, private sector building is expected to pick up along with the reviving property market, while public sector construction should remain resilient, underpinned by various large infrastructure projects. Taking these together, investment spending is forecast to maintain a solid growth of 6% in 1996.

External Trade

Growth in external trade moderated since early 1995 (Chart 1). This was mainly attributable to the slowdown in the economies of most of our major trading partners and the strengthening HK dollar as the year progressed. During the year to

Table 1:
GDP by major component

	1995e		1996f	
	change in real terms (%)	contribution to GDP growth (%)	change in real terms (%)	contribution to GDP growth (%)
Private consumption expenditure	1.1	0.7	4	2.4
Government consumption expenditure	4.8	0.4	5	0.4
Gross domestic fixed capital formation	6.1	1.8	6	1.8
<i>Transfer costs of land and buildings</i>	-28.9	-0.4		0.1
<i>Building and construction</i>	1.0	0.1	6½	0.7
<i>Real estate developers' margin</i>	-8.7	-0.4	-6	-0.2
<i>Machinery & equipment</i>	18.3	2.5	8½	1.3
Change in inventories		4.1		-3.7
Net domestic exports ¹		-7.2		-0.2
Net re-exports ²		3.0		2.7
Net services exports		1.9		1.6
Gross Domestic Product (GDP)	4.6	4.6	5	5

e: government revised (May 96) estimates.

f: government budget forecast.

1: Net domestic exports refer to domestic exports net of retained imports.

2: Net re-exports refer to re-exports net of imports for re-exports.

the March quarter, the value of merchandise exports grew by 6%, with a continuing shift from domestic exports towards re-exports (Table 2). Import growth decelerated further to 6%. The deceleration in external trade in the March quarter was concentrated in March, and was influenced by temporary factors such as heightened tensions across the Taiwan Strait and the postponement of imports into China because of tariff cuts effective in April.

Inflation

Inflation, as measured by CPI(A), averaged 6.4% in the March quarter, following successive reductions in the previous quarters (Chart 2). The decline in inflation was in part due to reduced pressures from services prices and in part due to the strengthening HK dollar and moderating inflation in China which helped to restrain import prices.

Inflation is forecast to recede to 7.5% in 1996 from 8.7% in 1995.

Monetary Situation

Growth in total deposits picked up to 2.9% during the March quarter from 2.1% during the December quarter. This was accounted for by the acceleration in HK dollar deposits to 3.8% during the March quarter.

Total loans receded by 1.0% in the March quarter after the 0.3% rebound in the December quarter. This was due to a 4.3% decrease in loans for use outside Hong Kong, which outweighed the 3.4% rise in loans for use in Hong Kong in the quarter. In line with the revival in the residential property market, loans for the purchase of residential property grew by 4.2% in the March quarter. Loans for trade financing (including offshore trade) also accelerated to 3.3%.

Chart 1
Merchandise Trade – Value of Export & Import Growth
(% change over year ago)

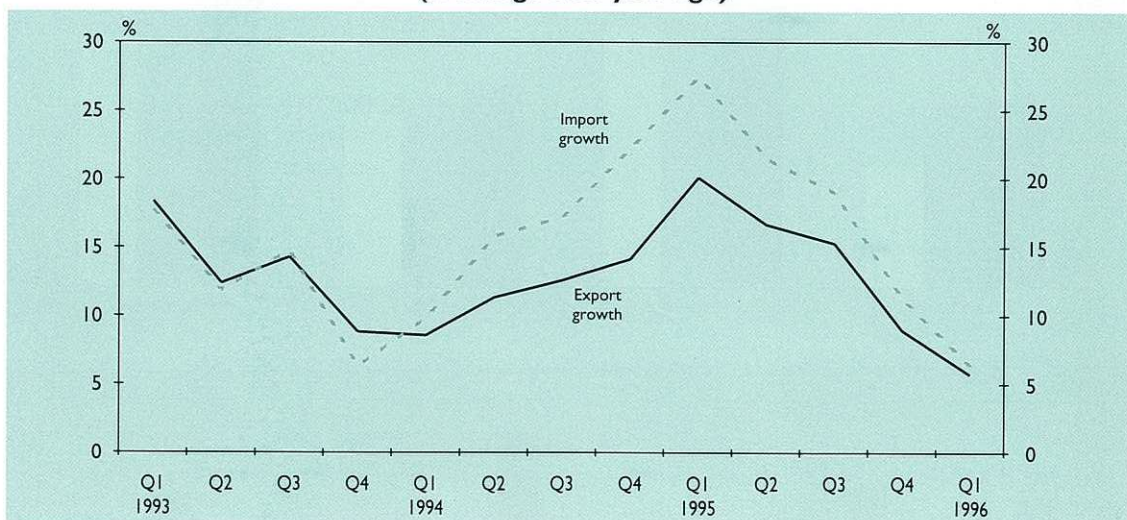


Table 2:
External Trade (% change in value terms over same period a year ago)

	1994	1995	1996 (Jan — Mar)
Total Exports	11.8	14.9	5.7
Domestic exports	-0.4	4.3	-6.0
Re-exports	15.1	17.4	8.2
Imports	16.6	19.2	6.4
Exports of Services	13.1	18.5	n.a.
Imports of Services	15.8	14.8	n.a.

Asset Markets

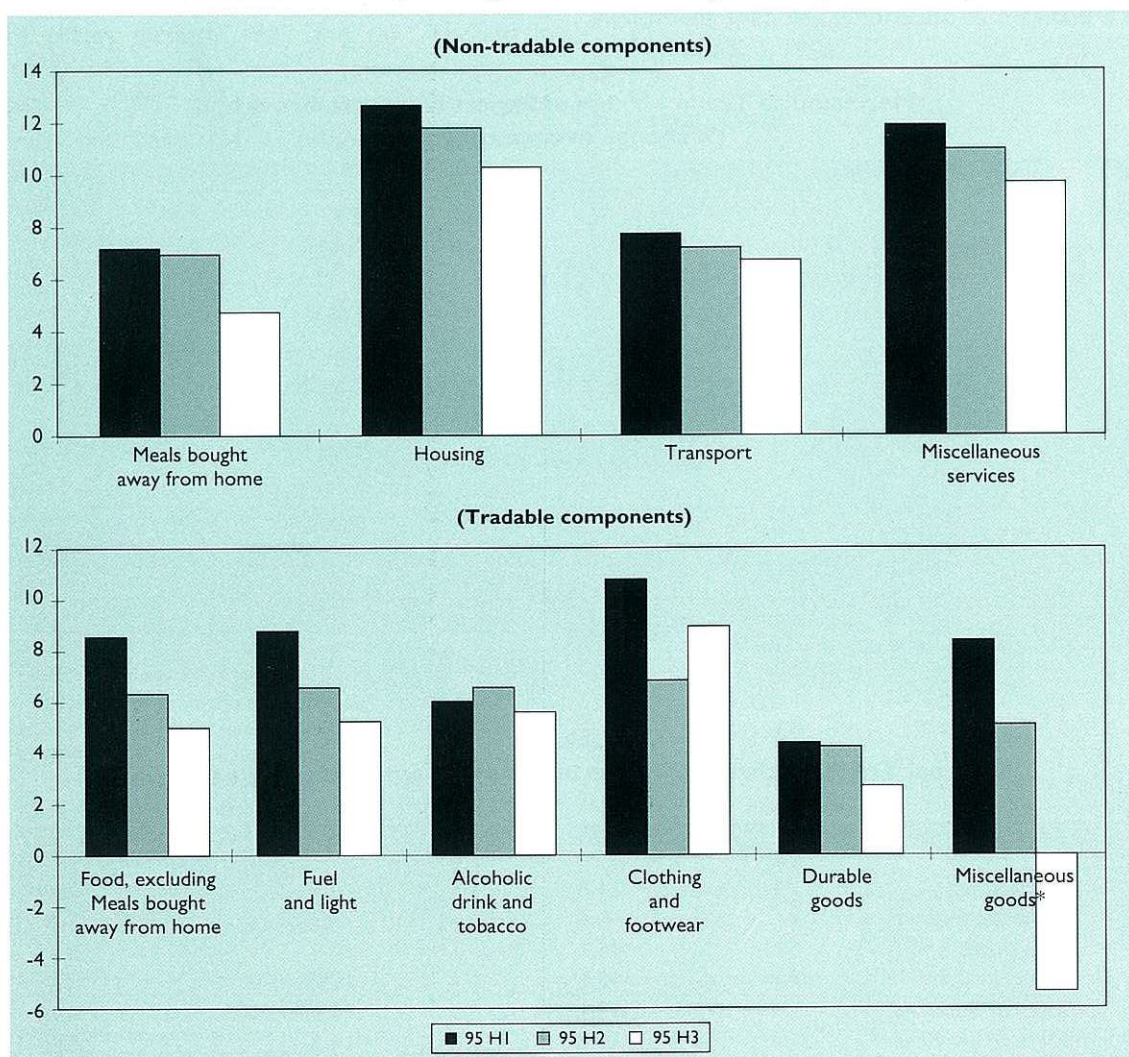
Encouraged by interest rate cuts in December 1995 and February 1996, the Hang Seng Index rose by 10.5% in the first two months of 1996 to 11126, following an increase of 23% in 1995. In March, the market was much more volatile. The hope for a further rate cut during the month evaporated on the back of the stronger-than-expected employment figures in the US, while cross-strait tension also dampened market confidence. Nevertheless, supported by the bullish sentiment in the residential property market and sound corporate earnings, the HSI regained the lost ground in the second half

of March. Prices then eased back and by mid-May the HSI was around 10900.

Residential property prices fell by some 25% between its peak in April 1994 and October 1995. At more affordable levels, buying interest began to emerge. Fuelled by the two cuts in interest rates and the more flexible payment arrangements and attractive mortgage packages offered by developers and banks, there was a moderate revival in the residential property market. Between October 1995 and March 1996, residential property prices rose by about 10%. ☼

– Prepared by the External Department

Chart 2
Consumer Prices (% change over the same period a year earlier)



Box 1: The 1996-97 Budget

With budgeted increases of 16% in revenue and 14% in expenditure, the government budget projects a surplus of HK\$1.6 billion for 1996-97, compared with a deficit of HK\$2.5 billion in 1995-96. This will bring our fiscal reserves to an estimated HK\$150.2 billion as at 31 March 1997. The Corporate Profits Tax rate and the standard rate of Salaries Tax were left unchanged, at 16.5% and 15% respectively, in the 1996-97 Budget.

In order to ensure the continuation of a business-friendly policy, the Financial Secretary announced in the 1996-97 Budget a package of measures to strengthen the service sector and enhance overall competitiveness. A Services Support Fund of HK\$50 million is to be set up for financing projects which will benefit the development of the service industries. The Trade Development Council is to take up an additional role of promoting exports of services, while the Industry Department is to encourage inward investment in the service sector. A Small and Medium Enterprises Committee, comprising both the private sector and the Government, will be established and responsible for the formulation of initiatives to assist these firms to lift productivity, upgrade management systems, obtain finance and improve access to market information.

To maintain our status as an international financial centre, several incentives are introduced. First, income of certain debt instruments¹ will be subject to a concessionary tax rate which is half the normal Profits Tax rate. Second, certain income derived from bona fide offshore funds managed in Hong Kong is exempted from tax. Third, stamp duty for market makers on stock transactions for the purpose of hedging options transactions is waived. Fourth, to develop further our debt market, 10-year Exchange Fund notes are to be issued (thus further extending the benchmark yield curve) and a Mortgage Corporation is proposed. The latter would also serve to strengthen stability in the banking sector by improving liquidity and reducing concentration risk.

¹ These debt instruments must be lodged and cleared with the Central Moneymarkets Unit of the Hong Kong Monetary Authority, carry a suitable rating, have a maturity of not less than five years and a minimum denomination of HK\$500,000.