

Hong Kong - growth to moderate in 2007

Key trends

- Hong Kong's economy grew strongly in the first nine-months of 2007 and the monthly data indicates that this trend continued in the December quarter.

Consequently, we are estimating full year growth of 6¾% (7.2% in 2005) - well above long-term trend growth. We also expect GDP to remain fairly strong at 5½% in 2007, as easing exports are offset by strong growth in private consumption.

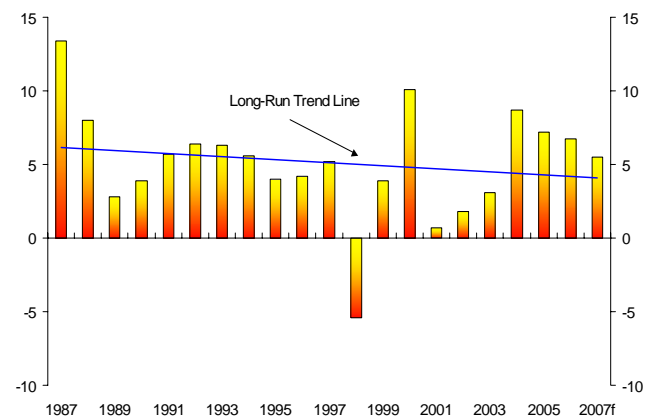
- The monthly trade data shows that the acceleration in export growth continued in the December quarter as Mainland Chinese growth continued unabated.

Re-exports are currently growing at their fastest rate in two years.

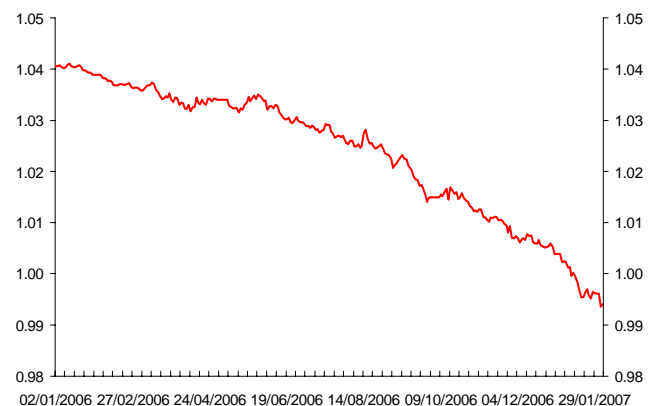
- Private consumption spending is also growing strongly, with very favourable labour market conditions supporting strong domestic demand. Not surprisingly, consumer sentiment is also very upbeat.

- Rising domestic demand, together with the strengthening of Chinese currency against the HK\$ is exerting upward pressure on inflation in Hong Kong. Although economic activity is expected to moderate this year, inflation is forecast to accelerate to 2.6%, from 2% in 2006.

Annual Real GDP Growth (%)



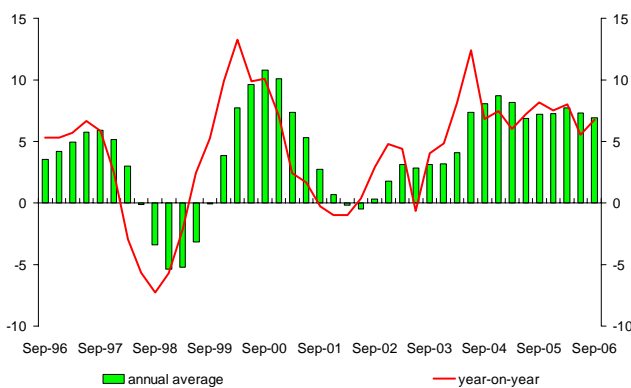
Chinese Yuan against HK\$



Growth to moderate in 2007

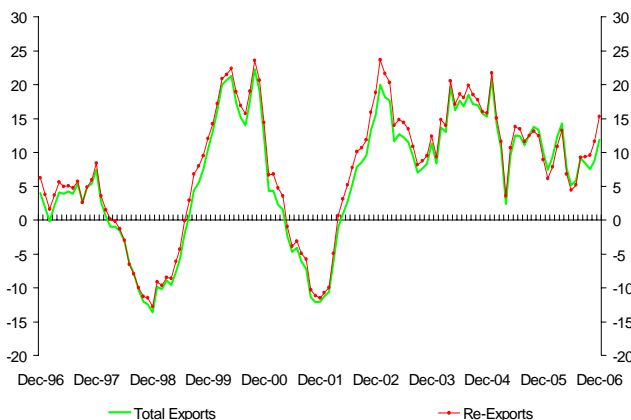
Economic activity in Hong Kong is moderating. Real GDP growth in January-September 2006 eased to 6.8% yoy, down from 7.3% yoy in the same period in 2005 and we estimate full year growth came in at around 6¾% (7.2% in 2005). We expect GDP to remain fairly strong at 5½% in 2007, as easing exports are offset by strong growth in private consumption.

Chart 1: Real GDP Growth (%)



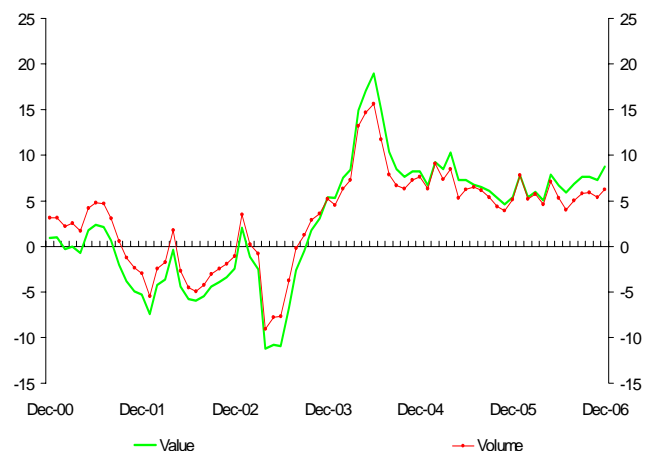
Brisk growth continued in the September quarter, with GDP accelerating to 6.8% yoy (5.5% yoy in June), underpinned by strong growth in Mainland-related exports of goods and financial services (as the Mainland's economy continues to open up) and continued strong domestic demand.

Chart 2: Export Growth (3mma, % yoy)



The monthly trade data shows that the acceleration in export growth continued in the December quarter as Mainland growth continued unabated. Total exports increased by 11.8% yoy in 3-month trend terms in December. Within total exports, re-exports remained the main driver rising by more than 15% yoy - the fastest rate of growth in almost 2 years. Despite a projected easing in global demand this year, we have recently upgraded our forecasts of Chinese economic growth (10% in 2007 and 9% in 2008). Given Hong Kong's entrepot role for the Mainland, this will help export growth remain an important contributor to growth in the territory in 2007.

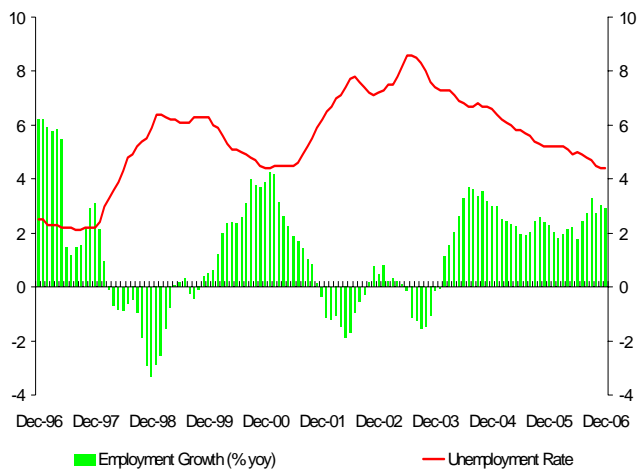
Chart 3: Retail sales (3mma, % yoy)



Private consumption spending is also growing strongly. Retail sales revenue jumped by 11.4% yoy in December, or by almost 9% yoy in 3-month trend terms, continuing the upturn that began in early-2005. Overall retail sales is being supported strong growth in visitor arrivals, which increased by 9.3% yoy in December to a record 2.4 million visitors. Tourists directly contribute more than 20% of retail sales in Hong Kong and outlook for tourist inflows remains positive as appreciation of the Chinese Yuan relative to HK\$ will likely to provide a lift to the mainland tourists' purchasing power in Hong Kong.

Retail sales growth has also been supported by strong domestic demand as labour market conditions remain very favourable. Although the seasonally adjusted unemployment rate remained at 4.4% in December (its lowest level since January 2001), the economy added a further 9,100 jobs during this period, bringing total employment to a record high of 3.52 million.

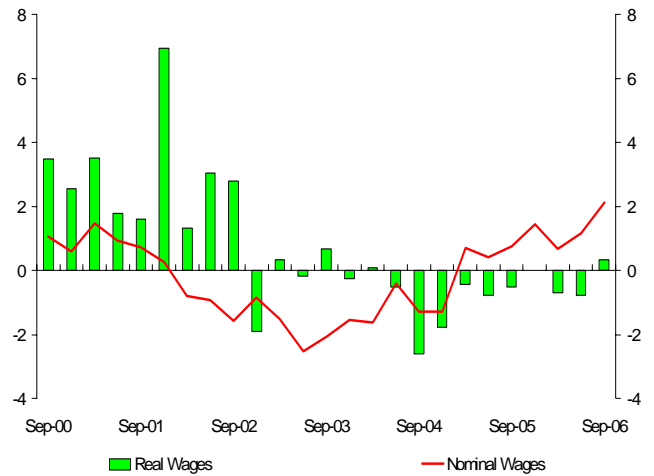
Chart 4: Labour Market Trends (%)



Strong labour demand and falling unemployment have also underpinned a pick in wages growth. Nominal wages grew by 2.1% yoy in the September quarter - its fastest increase since September 1998. At the same time, real wages also grew by 0.3% yoy for the first time since September 2003.

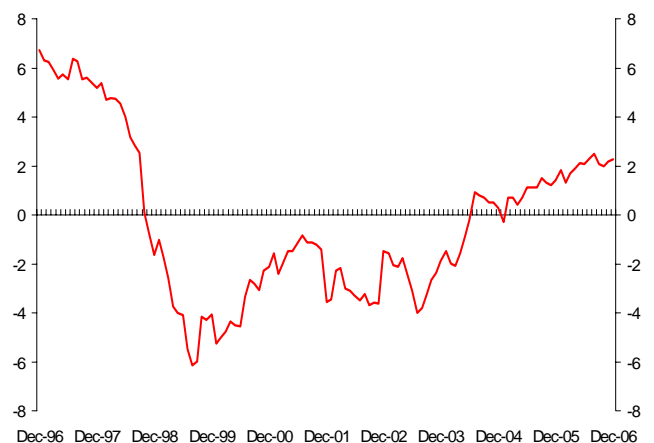
Not surprisingly, consumer sentiment in Hong Kong is very upbeat. Measured by the latest MasterIndex of Consumer Confidence, consumers in Hong Kong are the second most buoyant in the Asian region after Vietnam. The consumer sentiment index for Hong Kong for the first half of 2007 was 88.8, up from 88.5 in the first half of last year, and well ahead of the regional average score of 64.3. Notwithstanding improved labour market conditions and growing wages, the recent reduction in domestic interest rates and the wealth effects created from a strong stock market have also contributed to improved confidence.

Chart 5: Wage Indices (% yoy)



However, rising domestic demand, together with the strengthening of Chinese currency against the HK\$ is also exerting upward pressure on inflation in Hong Kong. Consumer price inflation rose by 2.3% yoy in December, up from 2.2% yoy in November. This brought full year inflation to 2%, up from 0.9% in 2005. Housing, food and clothing prices saw the largest increases in December. Although real GDP growth is expected to moderate somewhat this year, inflation is forecast to accelerate to 2.6%, with higher inflation underpinned by solid income growth and a strengthening Chinese yuan.

Chart 6: Consumer Price Inflation (% yoy)



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