

# Hong Kong, China

Coming out of contraction the economy grew robustly in 2010, driven by recovery in goods and services trade that spurred growth in consumer spending and investment. Inflation rose from low levels, and is forecast to speed up in 2011. Economic growth will moderate this year and next. Low interest rates and abundant liquidity have contributed to a property-price spurt that the authorities are trying to damp with macroprudential measures and increased supply of land for housing.

## Economic performance

This services-driven economy made a solid comeback in 2010 as it recovered from contraction in 2009. GDP picked up by 6.8%. From the demand side, consumption, investment, and net exports all contributed to growth (Figure 3.10.1).

Private consumption grew by 5.8% and was responsible for more than half the GDP growth. Consumption spending was supported by a pickup in employment and buoyant stock and property markets. Retail sales were boosted by a 22% jump in visitor arrivals to 36 million.

Government consumption made a small contribution to the expansion. Budget spending in FY2010 (ending 31 March 2011) came in below allocation, while revenue burgeoned alongside the recovery in economic activity and asset prices. The budget was in surplus to the tune of an estimated 4% of GDP.

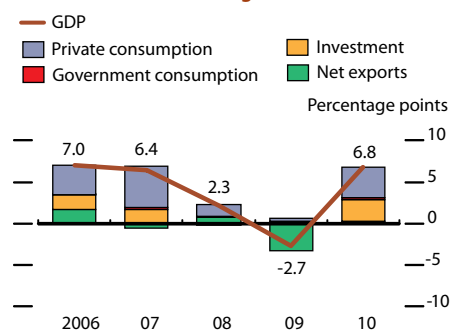
After 2 weak years, fixed investment rebounded by 8.1% in 2010, accounting for about one-quarter of GDP growth. Private investment in machinery, equipment, and computer software was strong, especially in the first half (reflecting the low base). Several large-scale projects boosted public construction, including the Guangzhou–Shenzhen–Hong Kong express rail and the Hong Kong–Zhuhai–Macao bridge.

With the revival of global trade, exports of goods bounced back to record 17.3% growth in real terms, from a double-digit contraction a year earlier. Exports to the People's Republic of China (PRC) and other major Asian markets (Japan; the Republic of Korea; Singapore; and Taipei, China) saw growth of 15%–23%. Exports to the United States and Europe also rose, but failed to scale 2008's precrisis peak. Imports of goods in real terms rose by 18.1%, reflecting growth in private consumption and the pickup in investment.

Services exports grew by 15.0% in real terms in 2010 as financial and professional services, trade services, transport, and tourism all benefited from the recovery in global trade and deepening integration with the rapidly growing PRC.

The important financial and insurance subsector grew by 7.5%

3.10.1 Contributions to growth (demand)



Source: Census and Statistics Department. <http://www.censtatd.gov.hk> (accessed 14 March 2011).

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in 2010. Equity capital raised through initial public offerings rose to HK\$449.5 billion (US\$57.9 billion), making Hong Kong, China the world's biggest center for such capital raising last year. The subsector is benefiting from wider external use of the yuan. The number of authorized financial institutions participating in yuan business increased from 61 to 115 and their total deposits increased almost fivefold.

A resumption of employment gains in 2010 (after net job losses in 2009) lowered the seasonally adjusted unemployment rate to 4.0% in the fourth quarter (Figure 3.10.2). But real earnings grew by just 0.1% during the year.

Inflation quickened over the year to 3.1% in December 2010 owing to rising domestic demand, a softer US dollar, higher prices for imported food, and rising housing costs (Figure 3.10.3). It averaged 2.4% for the year.

Very low interest rates and abundant liquidity, coupled with strong underlying demand for housing, propelled prices of all categories of property in 2010. Residential property prices rose by 20.4% in the 12 months to December 2010, following a gain of 28.5% a year earlier. A housing affordability index shows that houses became more expensive in relation to incomes (Figure 3.10.4).

Concerned that the sharp runup in prices was spilling over from the high-end property sector to the broader residential market, the authorities directed banks to lower their loan-to-value ratios and raised stamp duty on high-end housing. As prices continued to trend up, the government in November 2010 imposed a special stamp duty on residential property resold within 24 months of acquisition. To add to the supply of housing in the medium term, it increased the land available for residential construction. By year-end, these measures appeared to damp speculation, as reflected in fewer transactions.

In the external accounts, a sharply wider merchandise trade deficit and lower surplus in the income account offset a larger services trade surplus in 2010. The current account surplus declined to US\$14.8 billion (6.6% of GDP).

## Economic prospects

In light of projected slower global trade and moderating PRC growth, Hong Kong, China will see its expansion ease this year and next.

Private consumption is expected to remain healthy in 2011, based on growth in employment and incomes, and be the main contributor to growth in the economy. Retail sales in volume terms rose by 23.6% in the first month of 2011 (Figure 3.10.5) aided by inbound tourism.

Business investment will likely expand moderately this year, supported by low interest rates. Major public infrastructure projects begun in the past 2 years will continue contributing to growth in the forecast period.

Slower growth in world trade and the ending of the low-base effect on 2010's outturn are expected to bring down growth in merchandise exports to about 7.5% in nominal terms in 2011 from 22.4% in 2010. Robust growth is foreseen for services exports, particularly to the PRC.

The budget for FY2011 includes an increase in spending of nearly 25%, and projects a small budget deficit. Spending on capital works is budgeted to rise to US\$7.5 billion this year and will likely exceed this amount in

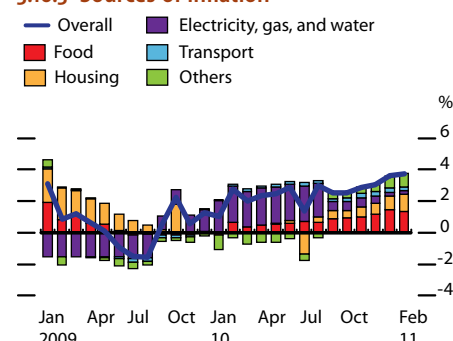
### 3.10.2 Unemployment and earnings



Source: Census and Statistics Department. <http://www.censtatd.gov.hk/> (accessed 28 March 2011).

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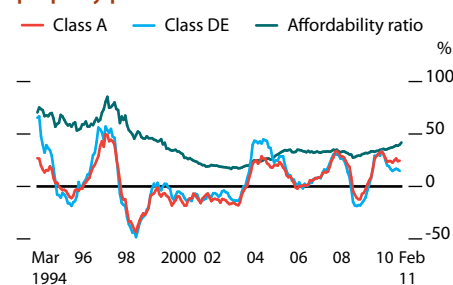
### 3.10.3 Sources of inflation



Source: CEIC Data Company (accessed 28 March 2011).

[Click here for figure data](#)

### 3.10.4 Affordability ratio and growth of property prices



Notes: Class A refers to residential properties less than 40 square meters in size. Class DE refers to residential properties above 100 square meters. Affordability ratio refers to the ratio of mortgage payments (for a 45 square meter apartment) to the median income of all households.

Source: CEIC Data Company (accessed 28 March 2011).

[Click here for figure data](#)

2012. Major infrastructure projects to begin in 2011 include extensions of mass transit rail lines.

On the balance of these factors, GDP growth is forecast at 5.0% in 2011, easing to 4.7% in 2012, as the economy is expected to stabilize around its longer-term growth trend. Current account surpluses equivalent to 7.2%–7.5% of GDP are projected for the forecast period.

Inflation this year will be well above the average rate of just over 2% of the past 5 years. Hong Kong, China imports most of its food from the PRC, where food prices have been rising. Further, the yuan has steadily climbed against the Hong Kong dollar (Figure 3.10.6), raising the cost of all purchases from the mainland. Higher global fuel and food prices, rising housing costs, and a likely increase in wages add to inflation pressures. Inflation was 3.7% in February 2011 and is forecast to average 4.5% for the year.

In 2012, inflation is seen easing to 3.3% as global food prices decelerate and the housing market stabilizes, the latter aided by the policies introduced in 2010.

## Development challenges

The Hong Kong dollar's link to the US dollar through a currency board framework constrains the authorities from using interest rates as a tool to curb property booms. Monetary policy is tied to that of the US Federal Reserve, which is not expected to tighten much during the next 2 years. The government is therefore relying on macroprudential measures to rein in speculation and to ensure prudent mortgage lending by banks, while it increases the supply of land for housing.

Acknowledging the risk of a property bubble, the financial secretary said in March 2011 that the government stands ready to take further action to calm the housing market.

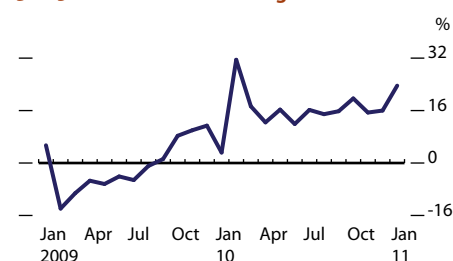
As for inflation more broadly, the FY2011 budget provides several one-time measures aimed at helping the population cope with rising costs of living. They include a subsidy for each residential electricity account capped at HK\$1,800, waived rates (property taxes) up to HK\$6,000, and 2 months' rent exemption for public housing tenants. The government also proposes to give a HK\$6,000 cash payment to permanent residents aged 18 and above, and an income tax rebate up to a maximum of HK\$6,000. These two measures will, however, add to domestic demand and, potentially, inflation.

### 3.10.1 Selected economic indicators (%)

	2011	2012
GDP growth	5.0	4.7
Inflation	4.5	3.3
Current account balance (share of GDP)	7.2	7.5

Source: ADB estimates.

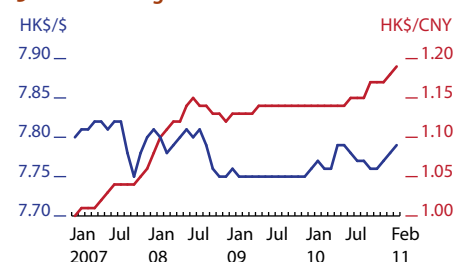
### 3.10.5 Retail sales volume growth



Source: Census and Statistics Department. <http://www.censtatd.gov.hk> (accessed 14 March 2011).

[Click here for figure data](#)

### 3.10.6 Exchange rates



Source: Census and Statistics Department. <http://www.censtatd.gov.hk> (accessed 14 March 2011).

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