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To: Members of the Executive Board
From: The Secretary
Subject: United Kingdom - Hong Kong - Recent Economic Developments

This paper provides background information to the staff report on the 1992 Article IV consultation discussions with respect to Hong Kong, which was circulated as SM/93/5 on January 13, 1993.

Mr. Miranda (ext. 36522) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

UNITED KINGDOM - HONG KONG

Recent Economic Developments

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Approved by the Central Asia Department

January 19, 1993

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Hong Kong

Basic Data

Area: 1,073 sq. kilometers
 Population (mid-1991): 5.75 million
 GDP per capita (1991): US\$14,369

	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>
<u>GDP</u> (HK\$ bn., current prices)	367.6	433.7	499.2	559.6	643.7	341.0 <u>1/</u>
<u>Population growth</u> (percent)	1.0	0.8	1.0	0.3	0.9	1.0
<u>Annual percentage changes</u>						
Real GDP	14.5	8.3	2.8	3.2	4.2	4.7 <u>2/</u>
GDP deflator	7.6	8.9	11.9	8.6	10.4	11.5 <u>2/</u>
Hong Kong dollar M3	21.8	18.9	15.0	14.8	15.6	13.1 <u>3/</u>
Budget revenues <u>4/</u>	25.3	19.4	13.4	8.6	26.9	13.0
Budget expenditures <u>4/</u>	13.3	11.2	32.7	19.9	7.8	33.8
Total exports <u>5/</u>	36.7	30.4	15.7	12.2	19.7	21.9 <u>6/</u>
Domestic exports <u>5/</u>	26.8	11.5	3.0	0.8	2.3	2.0 <u>6/</u>
Re-exports <u>5/</u>	49.2	50.7	25.8	19.5	29.2	30.7 <u>6/</u>
Total imports <u>5/</u>	37.0	32.0	12.8	14.2	21.2	22.8 <u>6/</u>
Real effective exchange rate	-5.9	-2.9	6.5	5.7	7.2	3.2 <u>6/</u>
<u>Ratios to GDP</u>						
Gross domestic investment	24.9	26.7	27.0	27.3	27.6	28.3 <u>1/</u>
Balance of trade <u>5/</u>	--	-1.3	1.5	-0.5	-2.0	-7.8 <u>1/</u>
Balance of goods and nonfactor services <u>5/</u>	6.7	5.6	8.5	5.5	3.8	-0.9 <u>1/</u>
Budget revenue <u>4/,7/</u>	16.6	16.8	16.5	16.0	17.6	17.2
Budget expenditure <u>4/,7/</u>	13.2	12.4	14.3	15.3	14.3	16.5
Budget surplus/deficit <u>4/,7/</u>	3.4	4.3	2.2	0.7	3.3	0.7
<u>Balance of payments</u> (US\$ bn.) <u>5/</u>						
Exports of goods	48.5	63.1	73.1	82.1	98.6	86.0 <u>8/</u>
Domestic exports	25.0	27.9	28.7	29.0	29.7	22.0 <u>8/</u>
Re-exports	23.4	35.3	44.4	53.1	68.8	64.0 <u>8/</u>
Exports of nonfactor services	9.1	10.9	12.6	14.2	16.4	9.1 <u>1/</u>
Imports of goods	48.4	63.9	72.2	82.5	100.3	89.1 <u>8/</u>
Imports of services	5.9	7.1	8.1	9.9	11.6	6.1 <u>1/</u>
Balance on goods and nonfactor services	3.2	3.1	5.4	4.0	3.1	-0.4 <u>1/</u>

Sources: Hong Kong authorities; and Fund staff estimates.

- 1/ First half of year.
2/ January-June over corresponding year-earlier period.
3/ Year-on-year growth rate for November.
4/ Consolidated account. Fiscal year begins April 1. Data for 1992 are based on official projections.
5/ Balance of payments data.
6/ January-September over corresponding year-earlier period.
7/ Fiscal year receipts and expenditures divided by calendar year GDP.
8/ January-September 1992.

UNITED KINGDOM - HONG KONG

(List of Abbreviations)

ACP	Airport Core Program
BCCHK	Bank of Credit and Commerce Hong Kong
BCCI	Bank of Credit and Commerce International
BLR	Best Lending Rate
HIBOR	Hong Kong Interbank Offered Rate
HKAB	Hong Kong Association of Banks
HKMA	Hong Kong Monetary Authority
HSBC	Hongkong and Shanghai Banking Corporation
LAF	Liquidity Adjustment Facility (or discount window)
LIBOR	London Interbank Offered Rate
MFN	Most-favored-nation (status)
OCB	Office of the Commissioner of Banking
OEF	Office of the Exchange Fund
PADS	Port and Airport Development Strategy
SAR	Special Administrative Region
SCB	Standard Chartered Bank

I. Output and Prices ^{1/}

1. Overview

The Hong Kong economy began to recover in the second half of 1990 from a cyclical slowdown that began in late 1988 and was exacerbated by the effects of the events in China in June 1989. The upswing continued in 1991, supported by a substantial boost to confidence from the Sino-British agreement on the new airport as well as the recovery of the Chinese economy. The strengthening in economic activity was led by a continued pickup of domestic demand, particularly private consumption and investment. Exports also rose substantially. The recovery in activity, however, led to a sharp acceleration in imports, which were buoyed by the rapid increase in domestic demand and the real effective appreciation of the Hong Kong dollar resulting from Hong Kong's relatively rapid rate of inflation. As a result, the trade balance widened considerably, while the balance on nonfactor services declined slightly. Overall, there was a substantial withdrawal of external stimulus in 1991. The recovery of domestic demand and export performance were sustained into 1992, with real GDP increasing by 4 3/4 percent and exports expanding at a greater than 20 percent pace in real terms (year on year) in the first half of the year (Table 1 and Chart 1).

Despite the pickup in economic activity, inflation moderated somewhat in 1992, falling from a peak of 12 percent in 1991 to an average of 9 1/2 percent (year on year) in the first 11 months of 1992. Part of this decline was attributable to special factors, including the reversal of indirect tax increases, a good harvest in China that kept food prices down, and relatively stable world fuel prices. At the same time, resource constraints eased somewhat: compared with the extremely tight situation in 1989-90, labor market conditions eased in 1991 and the first half of 1992, as the unemployment rate rose to 1 3/4 percent in 1991 and further to 2 percent in the first half of 1992.

2. Developments in domestic demand

Real private consumption expenditures rose rapidly in 1991, growing by 7 3/4 percent compared with 6 1/4 percent in 1990 and 4 percent in 1989. This pace of expansion was sustained into the first half of 1992. The acceleration of private consumption growth reflected, in part, a recovery of consumer confidence, in light of favorable developments on both the political and economic fronts in China. Positive wealth effects from a rapid rise in equity and property prices also buoyed consumption. In addition, negative real interest rates helped to spur a sharp rise in

^{1/} It should be noted that the term "country" used in this report does not in all cases refer to a territorial entity that is a state as understood by international law and practice. The term also covers some territorial entities that are not states but for which statistical data are maintained and provided internationally on a separate and independent basis.

Table 1. Hong Kong: Gross Domestic Product by Expenditure
at Constant 1980 Market Prices, 1987-92

	1987	1988	1989	1990	1991	<u>1992</u> Jan.-June 1/
	(Percentage change)					
Consumption	10.6	8.4	4.2	6.2	7.6	8.5
Private	11.3	8.7	4.0	6.2	7.7	7.8
Government	4.2	5.1	6.1	6.1	6.9	15.2
Gross fixed capital formation	14.8	7.4	2.9	8.0	9.2	8.1
Private	15.7	8.3	1.6	...	...	...
Government	9.0	0.4	13.3	...	...	...
Final domestic demand	11.8	8.1	3.8	6.7	8.1	8.4
Private	12.5	8.6	3.4	...	...	...
Government	5.8	3.5	8.5	...	...	...
Change in stocks	43.9	29.4	-71.0	31.9	-5.2	-11.9
Total domestic demand	<u>12.5</u>	<u>8.7</u>	<u>1.2</u>	<u>7.0</u>	<u>7.9</u>	<u>7.6</u>
Net exports of goods and nonfactor services	<u>60.3</u>	<u>1.3</u>	<u>30.3</u>	<u>-46.3</u>	<u>-94.1</u>	<u>-52.0</u>
Exports of goods and nonfactor services	30.5	24.3	9.4	8.9	15.6	20.5
Exports of goods	32.9	26.4	10.2	9.2	16.6	21.2
Domestic exports	23.1	9.0	0.1	-0.5	0.4	1.4
Re-exports	45.9	45.7	18.6	16.0	26.3	31.0
Exports of nonfactor services	18.3	12.4	4.3	7.2	8.7	15.5
Imports of goods and nonfactor services	29.3	25.4	8.5	11.6	18.0	21.6
Imports of goods	31.6	26.6	8.9	11.4	19.0	23.0
Imports of nonfactor services	14.5	16.5	5.9	12.5	10.6	9.9
Gross domestic product	<u>14.5</u>	<u>8.3</u>	<u>2.8</u>	<u>3.2</u>	<u>4.2</u>	<u>4.7</u>
Contribution to growth:						
Change in stocks	1.0	0.8	-2.3	0.3	-0.1	-0.5
Net exports of goods and nonfactor services	2.6	0.1	1.7	-3.3	-3.4	-3.4
	(In millions of Hong Kong dollars)					
Memorandum items:						
Consumption	150,169	162,762	169,622	180,169	193,919 2/	100,843
Private	136,280	148,162	154,131	163,738	176,361 2/	90,640
Government	13,889	14,600	15,491	16,431	17,558 2/	10,203
Gross fixed capital formation	58,443	62,753	64,559	69,710	76,092 2/	39,258
Private	51,447	55,727	56,596	...	...	...
Government	6,996	7,026	7,963	...	...	...
Final domestic demand	208,612	225,515	234,181	249,879	270,011 2/	140,101
Private	187,727	203,889	210,727	...	...	...
Government	20,885	21,626	23,454	...	...	...
Change in stocks	6,324	8,183	2,375	3,132	2,969 2/	4,486
Total domestic demand	<u>214,936</u>	<u>233,698</u>	<u>236,556</u>	<u>253,011</u>	<u>272,980 2/</u>	<u>144,587</u>
Net exports of goods and nonfactor services	<u>13,547</u>	<u>13,717</u>	<u>17,878</u>	<u>9,592</u>	<u>567 2/</u>	<u>-12,598</u>
Gross domestic product	<u>228,483</u>	<u>247,415</u>	<u>254,434</u>	<u>262,603</u>	<u>273,547 2/</u>	<u>131,989</u>

Source: Data provided by the Census and Statistics Department.

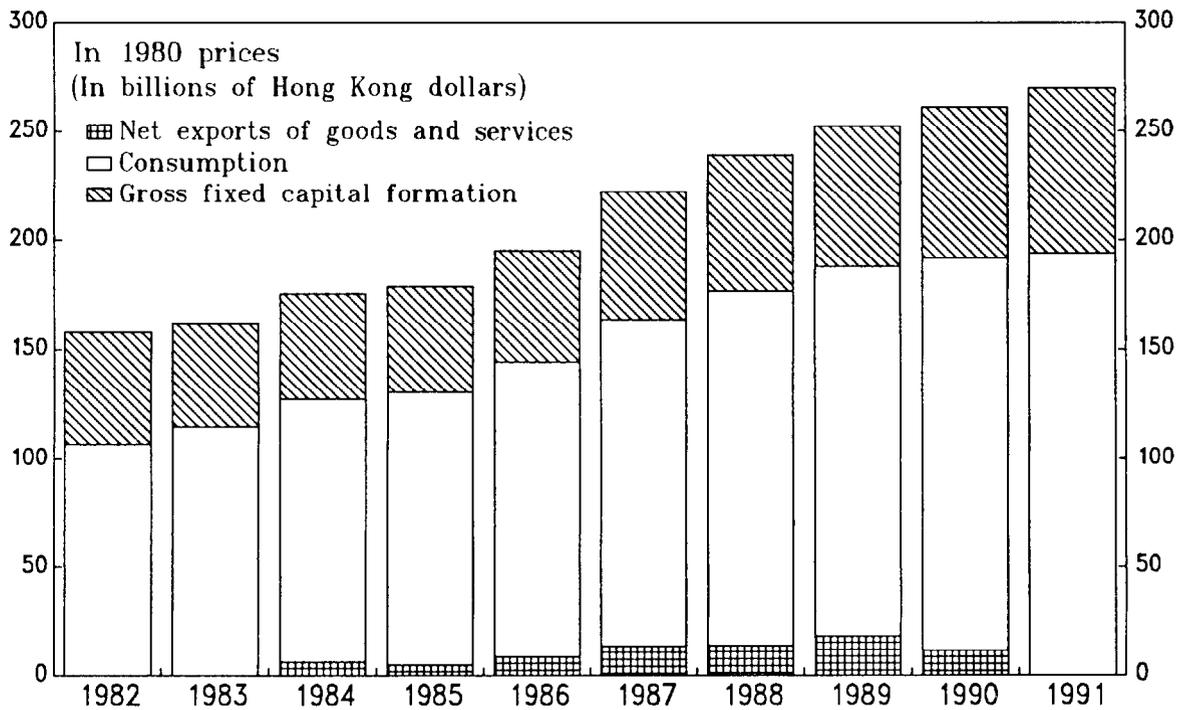
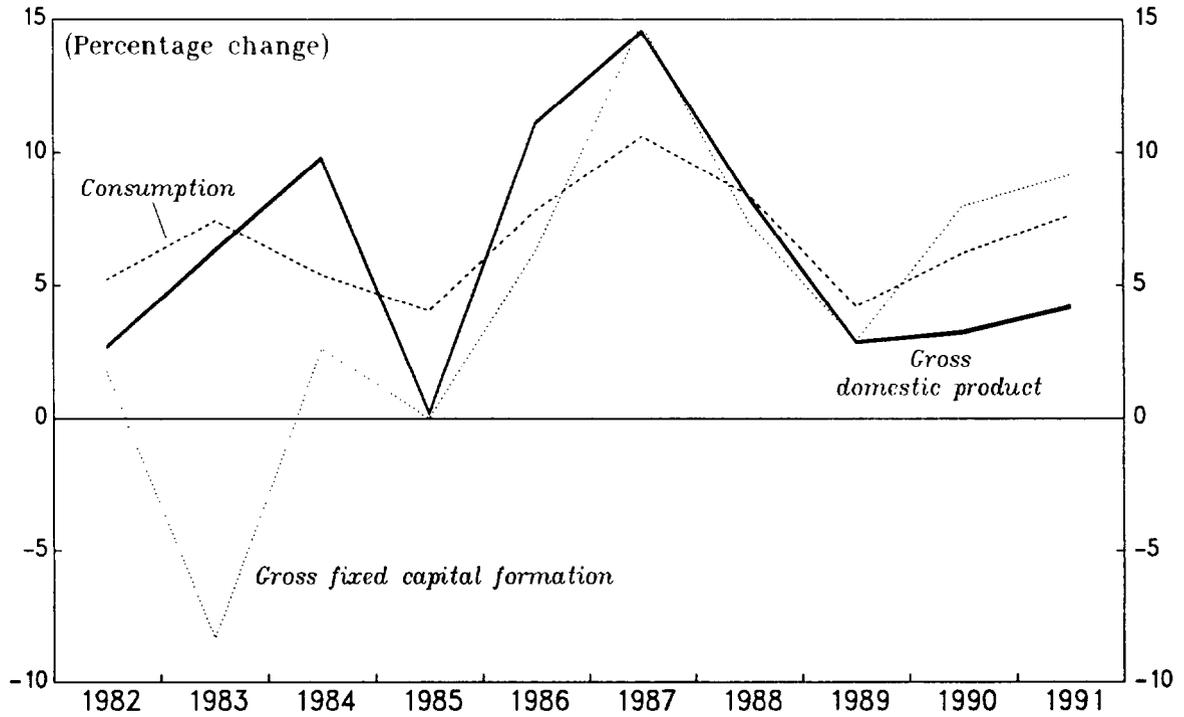
1/ Percentage changes calculated over corresponding year-earlier periods.

2/ First half of year.

CHART 1

HONG KONG

GROSS DOMESTIC PRODUCT AT 1980 CONSTANT PRICES, 1982-91



Source: Census and Statistics Department, Hong Kong Monthly Digest of Statistics.

purchases of interest-sensitive items, such as consumer durables, including motor vehicles. Indeed, purchases of consumer durables increased sharply in 1991 and the first half of 1992, with motor vehicle sales showing particularly large gains (see following tabulation).

	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u> Jan. - June <u>1/</u>
	<u>(Percentage change)</u>					
Private consumption (at constant prices)	11.3	8.7	4.0	6.2	7.7	7.8
Retail sales <u>2/</u>	9.8	12.8	-0.5	0.8	10.3	13.6
Durable goods <u>2/</u>	11.6	12.7	-6.8	4.8	15.1	34.3
Of which:						
Motor vehicles <u>2/</u>	30.4	26.7	5.1	-1.3	14.9	68.8
Hang Seng Stock Index <u>3/</u>	47.2	-11.4	8.8	8.9	14.7	48.9
Real interest rate <u>4/</u> (in percent)	-1.9	2.1	0.3	-1.2	-1.4	-2.1

Investment expenditures have also grown strongly, with gross domestic investment rising by 9 1/4 percent in 1991 and by 8 percent in the first half of 1992 (year on year). Over this period, increases in investment in plant, machinery, and equipment were particularly rapid, reaching 17 percent in 1991 as well as the first half of 1992. Investment in buildings and construction, on the other hand, declined in 1991 and the first half of 1992, following strong growth in both 1989 and 1990 (see following tabulation and Appendix Table 2).

1/ Percentage change over corresponding year-earlier period.
2/ In volume terms.
3/ Based on period averages.
4/ End of period. Defined as Best Lending Rate, less year-on-year increase in CPI(A).

	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u> Jan. - June <u>1/</u>
	<u>(Percentage change)</u>					
Gross fixed capital formation (at constant prices)	14.8	7.4	2.9	8.0	9.2	8.1
Buildings and construction (at constant prices)	5.9	3.7	9.7	7.4	-0.9	-3.8
Plant, machinery, and equipment (at constant prices)	27.3	15.5	1.8	6.0	17.0	17.1

Several factors have contributed to the strengthening in investment. First, in light of the capacity constraints and tight labor market situation which emerged with the rapid economic expansion of the second half of the 1980s, firms began to invest heavily in plant, machinery, and equipment in order to expand their productive capacity, for both current and future demand. Second, increased optimism regarding long-term growth prospects for Hong Kong and southern China, especially in light of the continuing economic integration between Hong Kong and southern China and the ongoing liberalization of the Chinese economy, has played an important role in boosting investment. This optimism was further underpinned by the signing of the airport agreement in 1991. Third, low real interest rates, coupled with favorable stock market conditions, made both debt and equity financing of investment relatively cheap. Finally, the real appreciation of the Hong Kong dollar over the past several years lowered the relative price of imported capital goods, thereby stimulating imports of machinery and equipment, especially in 1991 and the first half of 1992.

3. Developments in external demand

Notwithstanding rapid growth of total exports, the trade balance swung from a surplus of 1 1/2 percent of GDP in 1989 to a deficit of 1/2 percent of GDP in 1990. The trade deficit widened further, to 2 percent of GDP, in 1991. The widening of the trade deficit reflected a surge in imported goods, which were buoyed by the rapid increases in domestic demand. In addition, the surge in imports was in part attributable to the real effective appreciation of the Hong Kong dollar--resulting from the relatively rapid rate of inflation in Hong Kong compared with those registered in trading partner countries--over the past several years. With imports of nonfactor services also expanding rapidly, and hence a decline in the

1/ Percentage increase over corresponding year-earlier period.

surplus on nonfactor services transactions, the surplus on trade in goods and nonfactor services declined substantially between 1989 and 1991, falling from 8 1/2 percent of GDP in 1989 to 3 3/4 percent of GDP by 1991. 1/ As a result, there was a substantial withdrawal of external stimulus, equivalent to slightly more than 3 1/4 percent, in each of the past two years. This trend continued into 1992, with the withdrawal of external stimulus for the first half of the year matching the rate registered in 1991.

4. Economic activity by sector

During the latter half of the 1980s, the structure of production in Hong Kong underwent a substantial change, with the manufacturing sector's share of total output declining steadily, from 22 1/4 percent of GDP in 1986 to 17 1/4 percent in 1990. 2/ At the same time, the financial services sector 3/ grew in importance, with its share in GDP rising from 17 1/4 percent in 1986 to 20 3/4 percent by 1990. The wholesale and retail sector's 4/ share of GDP also rose over this period, from about 21 1/4 percent of GDP to 24 1/4 percent of GDP (Chart 2 and Appendix Table 3).

The declining share of the manufacturing sector and the rising importance of the financial services and wholesale and retail sectors are mainly attributable to the strengthening of economic linkages between Hong Kong and southern China since the mid-1980s. The opening up of China, which has provided Hong Kong firms with a cheap and abundant supply of both labor and land, has induced Hong Kong firms to transfer an increasing number of labor-intensive manufacturing processes across the border. At the same time, Hong Kong's geographic location and close cultural and economic ties with China have allowed it to serve as a center for financial and other trade-related services for the rapidly growing Chinese economy. As a reflection of this structural transformation, re-exports from and to China have expanded rapidly since 1986, even during the relatively sluggish period of 1989-90. 5/

1/ On a balance of payments accounts basis. See Chapter V.

2/ Throughout this paragraph, GDP refers to the production-based estimates at factor cost. See Appendix Table 3 for details.

3/ Including finance, insurance, real estate, and business services.

4/ Including the wholesale, retail, and export and import trades, as well as the restaurant and hotel sectors.

5/ While precise data are not available, it appears that the domestic value-added component of total re-exports has increased steadily, as evidenced by the increasing gap between re-exports and nonretained imports (Appendix Tables 8 and 9). This reflects Hong Kong's increasingly important role as an intermediary for Chinese trade as well as the increasing concentration of domestic economic activity on higher value-added activities such as trade-related finance, management, financial services, marketing, and shipping.

5. Labor market developments

Labor market conditions tightened significantly in 1989-90 before easing somewhat in 1991 and 1992. The tightening of the labor market during 1989-90 was due primarily to a slowing of labor force growth, but also reflected the recovery of economic activity beginning in the second half of 1990. The total labor force hardly grew between 1987 and 1990, owing both to a fall in the labor force participation rate (from 65 percent to 63 percent) and to the effects of an earlier drop in the birth rate. In addition, a significant increase in emigration from Hong Kong, which reached over 62,000 in 1990, also contributed to the tightness in the labor market. As a result, the unemployment rate averaged less than 1 1/4 percent in 1989-90 (Table 2).

In 1991, conditions in the labor market eased slightly, and the unemployment rate rose above 1 3/4 percent. The easing reflected in part the inflow of foreign workers under two new government schemes and a reduction in net emigration, as emigration of Hong Kong residents slowed while the number of returnees grew. ^{1/} The slight rise in the unemployment rate was also related to the accelerating pace with which the manufacturing sector shed labor, especially in light of the ongoing relocation of labor-intensive manufacturing processes to southern China. In addition, the easing was also attributable to a fall in construction employment, which dropped by about 14 percent in 1991 as a result of the decline in buildings and construction investment.

Labor market conditions eased further in the first half of 1992, as the unemployment rate rose to 2 percent. However, conditions tightened in the latter part of the year, with the unemployment rate falling to 1 3/4 percent during the three-month period ending August.

Recent developments in sectoral employment continue to point to Hong Kong's transition to a more service-based economy. The decrease in employment in the manufacturing sector was largely picked up by service-oriented sectors. Thus, while manufacturing sector employment fell by 87,000 in 1991, employment in the financial, wholesale and retail, and community and social services sectors increased by 78,000.

6. Inflation

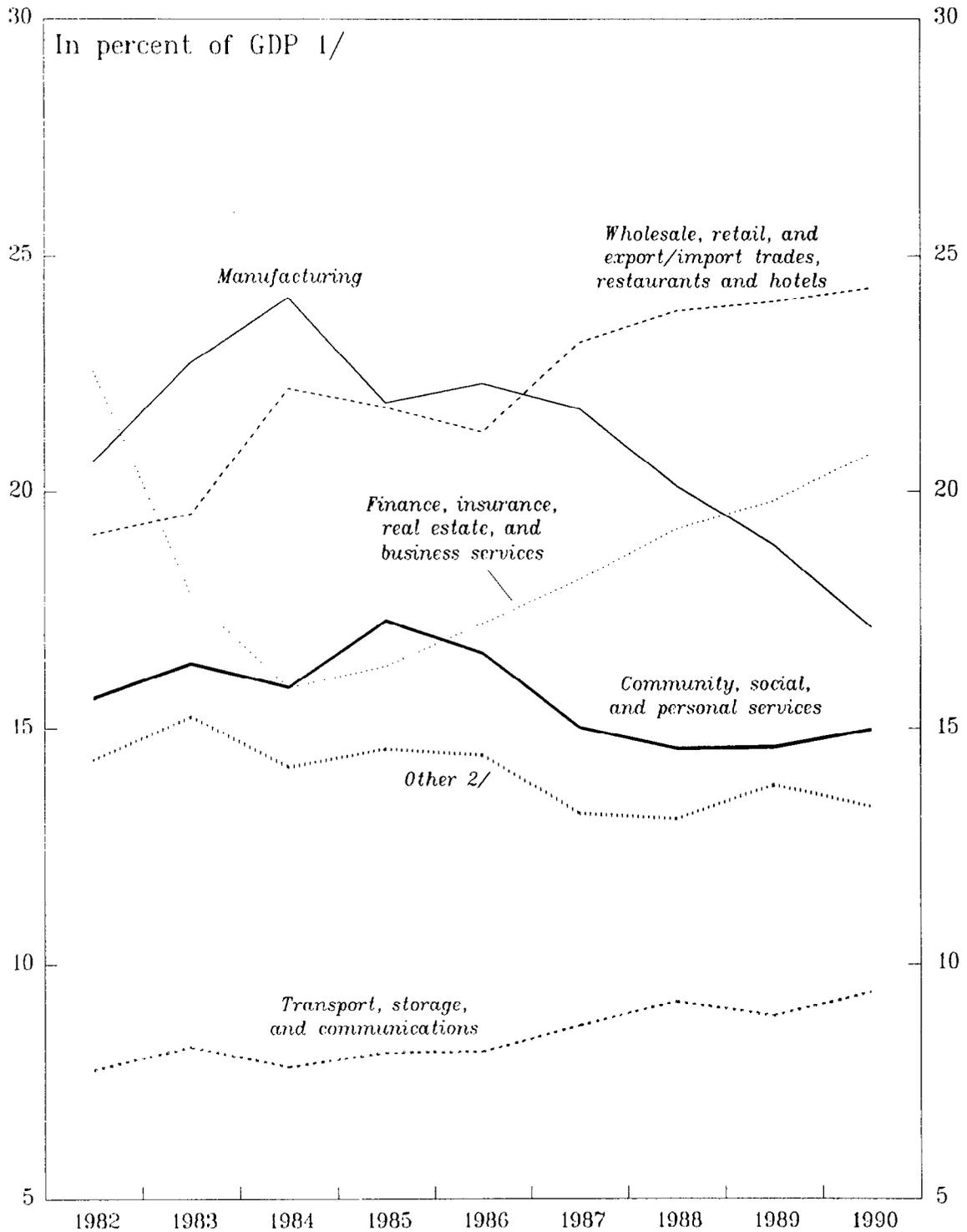
Consumer price inflation rose steadily in the late 1980s and early 1990s and reached 12 percent in 1991 (Table 3 and Chart 3). The rising rate of inflation stemmed from a combination of excess demand pressures and structural factors. The rapid economic expansion in the second half of the

^{1/} Data provided by the authorities indicate that emigration edged down from about 62,000 in 1990 to 60,000 in 1991 and 1992. Precise data on the number of returnees are not available, but discussions with the authorities suggest that the number has been increasing.

CHART 2

HONG KONG

CONTRIBUTIONS OF MAIN ECONOMIC SECTORS TO GDP
AT CURRENT PRICES, 1982-90



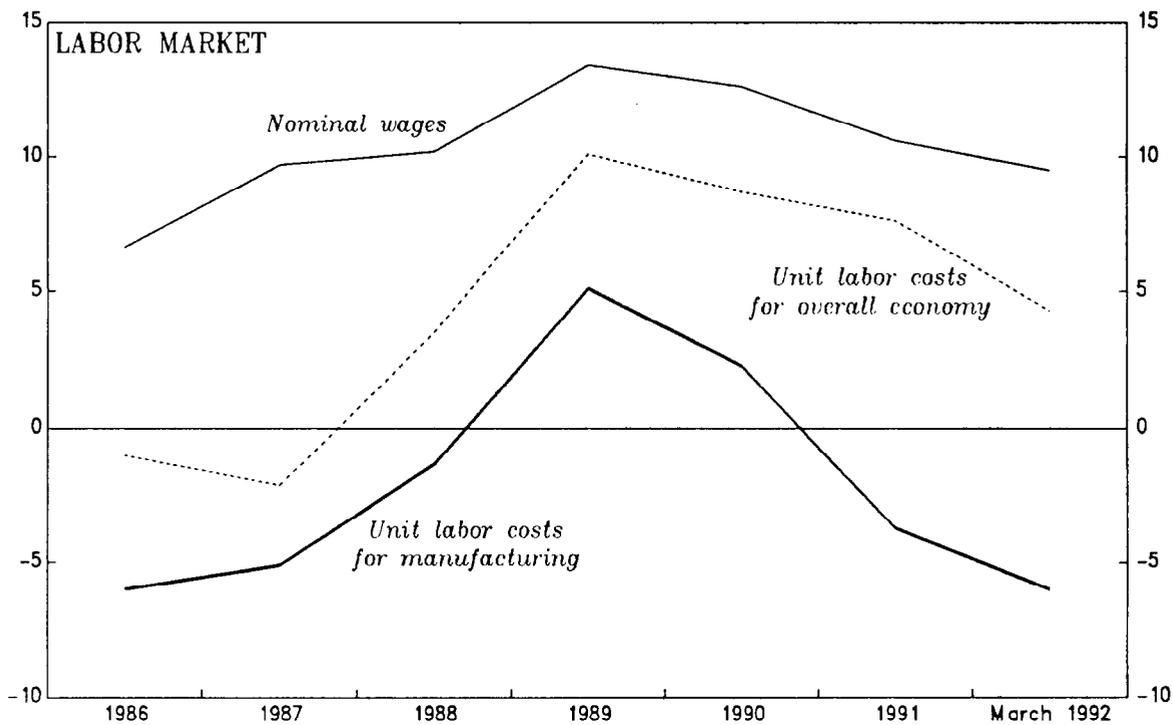
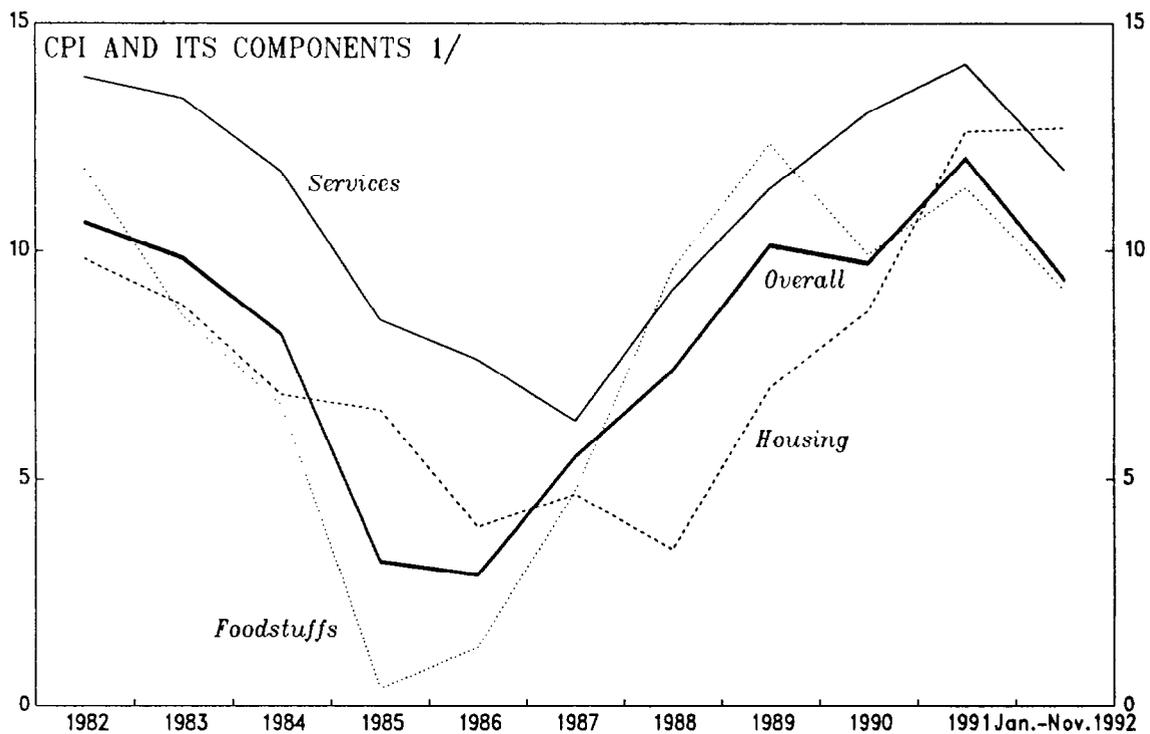
Sources: Census and Statistics Department and staff estimates.

1/ GDP at factor cost (production-based estimate).

2/ Includes construction; electricity, gas, and water; mining and quarrying; agriculture and fishing; and ownership of premises.

CHART 3

HONG KONG
SELECTED INDICATORS OF PRICES AND COSTS, 1982-92
(Percentage change)



Source: Census and Statistics Department, Hong Kong Monthly Digest of Statistics.
1/ Based on CPI(A).

Table 2. Hong Kong: Labor Force, Employment, and Unemployment, 1987-92

	1987	1988	1989	1990	1991	1992	
						Q1	Q2
(In thousands)							
Labor force <u>1/</u>	2,728	2,763	2,753	2,748	2,799	2,780	2,804
Employed	2,681	2,725	2,723	2,711	2,749	2,722	2,746
Unemployed	47	38	30	37	50	58	58
(In percent)							
Unemployment rate <u>2/</u>	1.7	1.4	1.1	1.3	1.8	2.1	2.1
Labor force participation rate	64.9	64.7	63.7	63.2	63.4	62.4	62.7
(In thousands)							
Employment in selected sectors <u>2/</u>							
Manufacturing	868	837	792	716	629	605	...
Finance, insurance, and business services	212	235	255	277	296	303	...
Wholesale and retail trades <u>3/</u>	658	711	774	830	872	863	...
Building and construction	72	76	69	69	59	62	...
Community, social, and personal services	215	225	236	250	267	265	...
Transport, storage, and communication	106	116	126	133	134	138	...
Civil service	182	185	188	190	190	187	...

Source: Census and Statistics Department, Hong Kong Monthly Digest of Statistics.

1/ Period average.

2/ End of period, except for civil service. Data for civil service is as of January 1 of each year.

3/ Wholesale, retail, import and export trades, restaurants, and hotels.

Table 3. Hong Kong: Selected Price Indicators, 1987-92

(Percentage change)

	1987	1988	1989	1990	1991	1992 1/		
						Q1	Q2	Q3
Prices 2/								
CPI (A)	5.5	7.4	10.1	9.7	12.0	10.1	9.0	9.0
Of which:								
Foodstuffs	4.7	9.6	12.4	9.9	11.4	11.1	9.5	7.6
Services	6.3	9.2	11.4	13.0	14.1	10.9	11.8	12.3
Durable goods	5.7	5.9	3.3	3.0	4.4	2.7	2.4	2.1
Housing	4.7	3.5	7.0	8.7	12.6	11.6	11.8	13.0
CPI (B)	5.3	7.4	9.7	9.7	11.7	10.0	9.3	9.5
Residential price index	22.6	21.9	26.2	11.3	37.3	55.6	45.4	...
GDP deflator	7.6	8.9	11.9	8.6	10.4	12.4	10.7	...
Domestic demand deflator	7.8	9.8	10.2	8.2	8.6	7.9	7.0	...
Export unit values	3.7	3.1	5.0	2.7	2.6	1.5	0.8	...
Import unit values	4.1	4.1	3.6	2.5	1.9	-0.3	0.4	...

Sources: Census and Statistics Department, Hong Kong Monthly Digest of Statistics; and Government Secretariat, Half-Yearly Economic Report, 1992.

1/ Increase over corresponding year-earlier period.

2/ Data for CPI(A) and CPI(B) for 1987-91 use October 1984-September 1985 as the base year. Beginning in 1992, data for CPI(A) and CPI(B) use October 1989-September 1990 as the base year. The expenditure weights of the rebased CPIs are derived from the results of the Household Expenditure Survey conducted in 1989-90. For CPI(A), the weights are derived from the expenditure pattern of urban households with monthly expenditures between HK\$2,500 and HK\$9,999. For CPI(B), the weights are derived from the expenditure pattern of urban households with monthly expenditures between HK\$10,000 and HK\$17,499. Before the rebasing, these ranges were HK\$2,000-HK\$6,499 for CPI(A), and HK\$6,500-HK\$9,999 for CPI(B).

1980s, coupled with the sharp drop in labor force growth, brought the economy to an extremely high degree of resource utilization. At the same time, structural shifts associated with the increased outprocessing of manufacturing activities in southern China, as well as Hong Kong's strategic advantages in providing services to support China's external trading relationships, led to large productivity gains, concentrated primarily in the traded goods sector. Taken together, the high degree of resource utilization and the productivity gains resulted in substantial upward pressure on wages, with the result that the prices of many labor-intensive goods and services, especially in the nontradable sector, rose sharply. 1/ Beyond these two factors, low interest rates in the United States at a time of a cyclical upswing in economic activity in Hong Kong added to excess demand pressures, which in turn translated into higher prices, again especially in the nontradables sector.

Inflation showed some signs of moderating in 1992. The year-on-year increase in the consumer price index (CPI(A)) 2/ slowed to 10 percent in the first quarter of 1992 and further to 9 percent in the subsequent two quarters, from an average of 11 1/2 percent in the second half of 1991 (year-on-year rates). Several special factors were conducive to restraining inflation in 1992. First, the reversal of indirect tax increases in 1991 helped to dampen measured inflation in the early part of 1992. Second, as a result of a good harvest in China, food prices have been more stable. World energy prices have also been fairly stable, thereby tempering the increases in the fuel component of the CPI(A). The moderation of inflation also partly reflected a slight easing of wage pressures. Following a 12 1/2 percent increase in 1990, growth in nominal wages fell to 10 1/2 percent in 1991 and further to 9 1/2 percent in the first quarter of 1992 (year on year). 3/

Despite the easing in inflation, strong underlying price pressures were evident in 1992. Compared with an increase of 10 1/2 percent in 1991, the GDP deflator rose by 12 1/2 percent in the first quarter and by 10 3/4 percent in the second quarter of 1992 (year on year). Core consumer price inflation (i.e., excluding energy and food for home use) also remained high. Indeed, with the dissipation of the effects of special factors, inflation picked up in the latter part of 1992, with core inflation in the 10-11 percent range (year on year) in the three-month period ending November.

1/ In the tradable sector, the productivity gains helped to ensure that the relatively high wage settlements did not undermine external competitiveness.

2/ See Table 3 for a definition of CPI(A).

3/ Along with the slowing of wage growth, unit labor cost increases for the overall economy slowed from an 8 3/4 percent pace in 1990 to a 7 1/2 percent pace in 1991. In the manufacturing sector, unit labor costs fell by 3 3/4 percent in 1991, owing to both a sharp rise in labor productivity and moderate wage growth (see Appendix Table 5).

II. Asset Market Developments

The recovery and acceleration of economic activity has been accompanied by substantial gains in asset prices. Both equity and property prices have risen dramatically over the last few years, driven in part by increased optimism regarding long-term growth prospects for Hong Kong and the southern China region. This chapter briefly reviews these asset price developments, providing, where possible, historical and international comparisons.

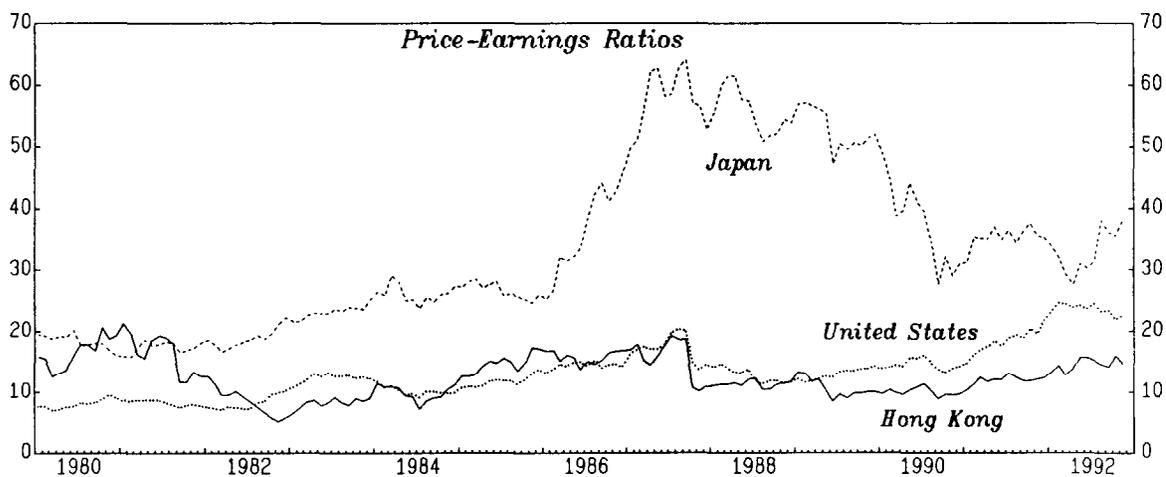
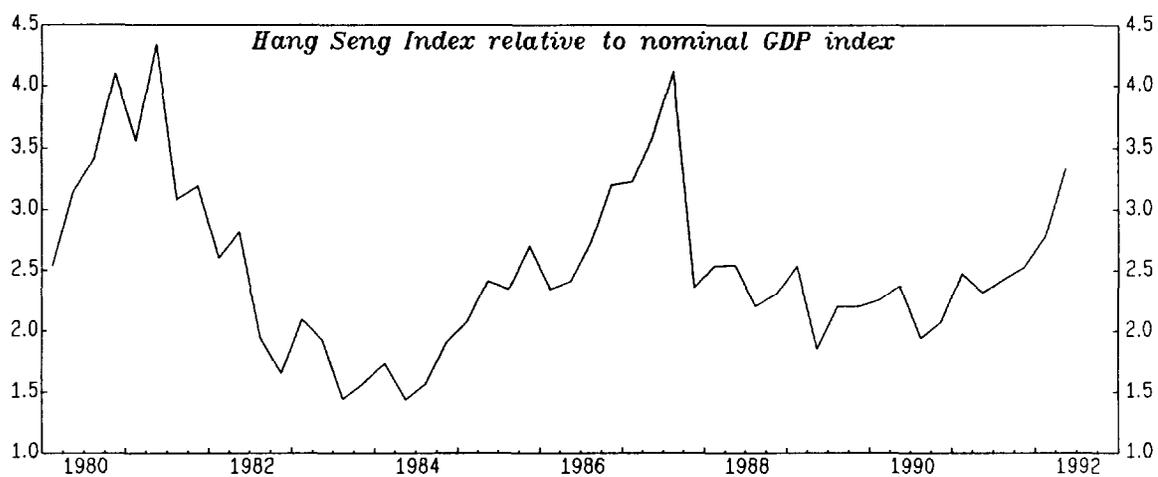
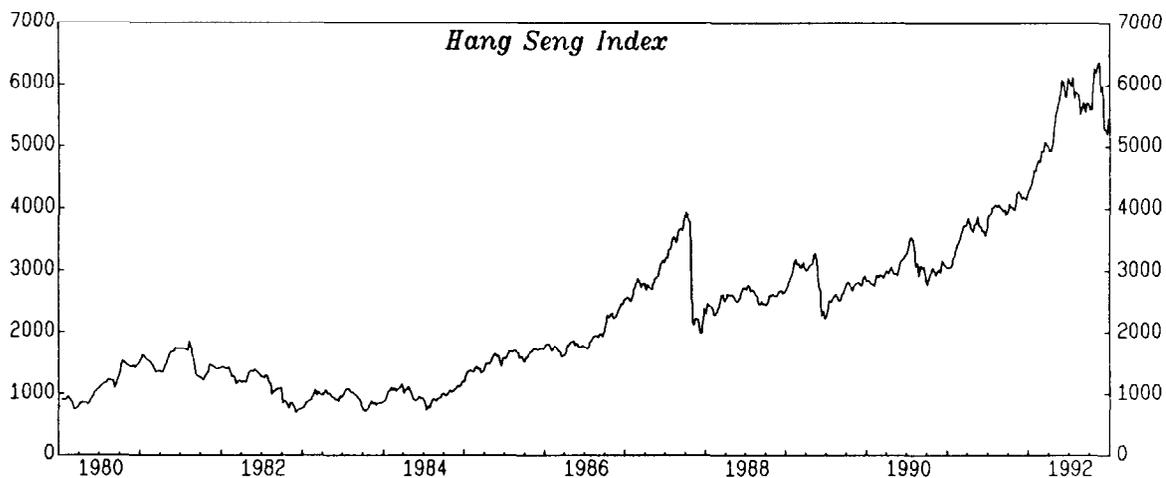
1. Equity market

After declining sharply following events in China in June 1989, equity prices in Hong Kong have risen markedly. From end-June 1989 to mid-November 1992, the Hang Seng Index of stock prices increased over two-and-a-half fold, rising from 2274 to a high of 6447. The upward trend of stock prices was reversed in mid-November 1992, however, following the escalation of political tension between the United Kingdom and China as well as disagreements related to the financing of the new Hong Kong airport. The Hang Seng Index declined by 23 percent in the subsequent two-and-a-half weeks, falling below 5000 in early December. Nevertheless, and with stock prices rebounding somewhat in the final weeks of 1992, the Hang Seng Index at end-1992 remained about 20 percent above its end-1991 level (Chart 4).

Several factors have played key roles in the rise of stock prices. First, in recent years, it appears that the "risk discount" attaching to the Hong Kong stock market has narrowed. Hong Kong's stock market has traditionally been extremely sensitive to external developments, especially the political relations between China and the United Kingdom regarding Hong Kong and its post-1997 status. As a result, stock market valuation levels have typically reflected a risk discount. This discount was especially prominent in the early 1980s, reflecting the uncertainty created by the Sino-British discussions over the transfer of sovereignty over Hong Kong to China in 1997. In recent years, however, as the Hong Kong and southern Chinese economies have become substantially integrated, and as economic reforms in China and the associated opening of the Chinese economy have continued, Hong Kong's long-term economic prospects have become increasingly favorable, and investor concern regarding the impact of the transfer of sovereignty in 1997 appears to have diminished substantially. ^{1/} Second, cyclical economic recovery in both Hong Kong and China and favorable growth prospects for the two economies have also helped to underpin the rise in equity prices. Finally, relatively high inflation, coupled with low interest rates, may also have made investing in the equity market an attractive alternative for the household and business sectors.

^{1/} Of course, the impact on equity prices of political disagreements in late 1992 clearly indicates that investor confidence remains highly sensitive to developments in Sino-British relations.

CHART 4
HONG KONG
STOCK MARKET INDICATORS, 1980-92



Sources: Data Resources Incorporated; and staff estimates.



While judgments about stock market valuation are extremely difficult at best, several factors would suggest that the rise in stock market prices does not represent the type of asset bubble phenomenon that has occurred in other countries, such as Japan. Rather, the recent rise seems primarily to reflect a re-establishment of more normal historical valuation levels, following the long period of uncertainty related to the transfer of sovereignty. For example, in 1992, the ratio of the Hang Seng Index to an index of nominal GDP has been within the range of historical experience prior to the collapse in confidence in 1983. In addition, the price-earnings ratio has not strayed significantly from its long-term average. ^{1/} Finally, by way of international comparison, the price-earnings ratio of the Hong Kong stock market has continued to remain below those of the Tokyo and New York stock markets. Overall, while political and economic uncertainties could alter stock market developments dramatically at any time, current valuation levels of the Hang Seng Index do not appear out of line with the underlying "fundamentals," especially growth prospects, of Hong Kong's economy.

2. Property market

Property prices in Hong Kong have fluctuated substantially over the past ten years. Following a collapse in 1982-83, real estate prices began to rebound strongly in the latter half of the 1980s. Prices of office property showed the largest gains, increasing at an average annual rate of 50 percent between 1987 and mid-1989, while prices of industrial (i.e., factory space) and residential property also increased markedly. After a slowdown during the second half of 1989 and 1990, real estate prices resumed their upward trend in 1991 and 1992, with residential and retail property prices showing particularly steep increases. By mid-1992, residential and retail property prices were 1 1/2-2 times their average levels of 1990 (Table 4 and Chart 5).

Faced with the rapid escalation of property prices, especially in the residential property market, the Government sought to discourage property market speculation. In May and again in November of 1991, the Government advised banks to tighten mortgage lending policies. As a result, banks adjusted their loan-to-value ratios from up to 90 percent to 70 percent. In addition, banks did not cut mortgage interest rates commensurately with the decline in other interest rates. In early November 1991, the authorities moved to discourage property speculation by making the existing stamp duty on property transactions payable on each sale and purchase agreement. In response to these measures, the property market appears to have cooled down somewhat. Investment in buildings and construction declined in 1991; in addition, the number of property transactions decreased considerably in late 1991, compared with a year earlier. Finally, on a quarter-on-quarter basis,

^{1/} Thus, for example, for the first 11 months of 1992, the price-earnings ratio of the Hang Seng Index averaged 14 1/2, compared with an average of 12 1/2 during 1982-91.

Table 4. Hong Kong: Real Estate Price and Rental Indices, 1987-92 ^{1/}

	1987	1988	1989	1990	1991	1992 ^{2/}	
						Q1	Q2
Price indices							
	(1989 = 100)						
Private domestic premises	65	79	100	111	153	193	205
of which: 40-69.9 m ²	64	78	100	111	155	195	205
100 m ² and above	65	80	100	105	134	174	191
Private retail premises ^{3/}	57	76	100	112	143	172	...
Offices	41	62	100	96	97	112	...
Flatted factories	57	79	100	106	114	130	...
	(Percent change)						
Private domestic premises	22.6	21.5	26.6	11.0	37.8	55.6	45.4
of which: 40-69.9 m ²	23.1	21.9	28.2	11.0	39.6	56.0	44.4
100 m ² and above	16.1	23.1	25.0	5.0	27.6	56.8	55.3
Private retail premises ^{3/}	21.3	33.3	31.6	12.0	27.7	38.7	...
Offices	36.7	51.2	61.3	-4.0	1.0	23.1	...
Flatted factories	35.7	38.6	26.6	6.0	7.5	20.4	...
Rental indices							
	(1989 = 100)						
Private domestic premises	68	79	100	110	119	124	127
Private retail premises ^{3/}	69	81	100	112	126	136	136
Offices	48	61	100	101	95	96	94
Flatted factories	55	77	100	105	109	112	110
	(Percent change)						
Private domestic premises	9.7	16.2	26.6	10.0	8.2	8.8	8.5
Private retail premises ^{3/}	13.1	17.4	23.5	12.0	12.5	15.3	9.7
Offices	26.3	27.1	63.9	1.0	-5.9	--	--
Flatted factories	17.0	40.0	29.9	5.0	3.8	6.7	3.8

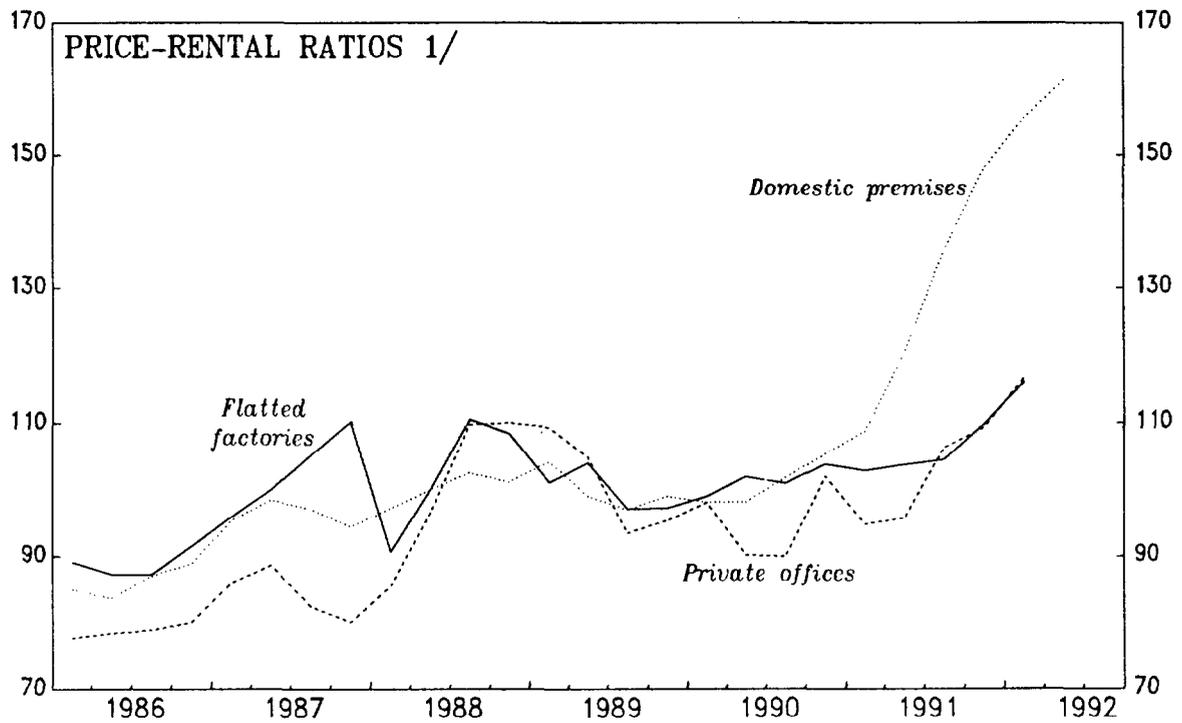
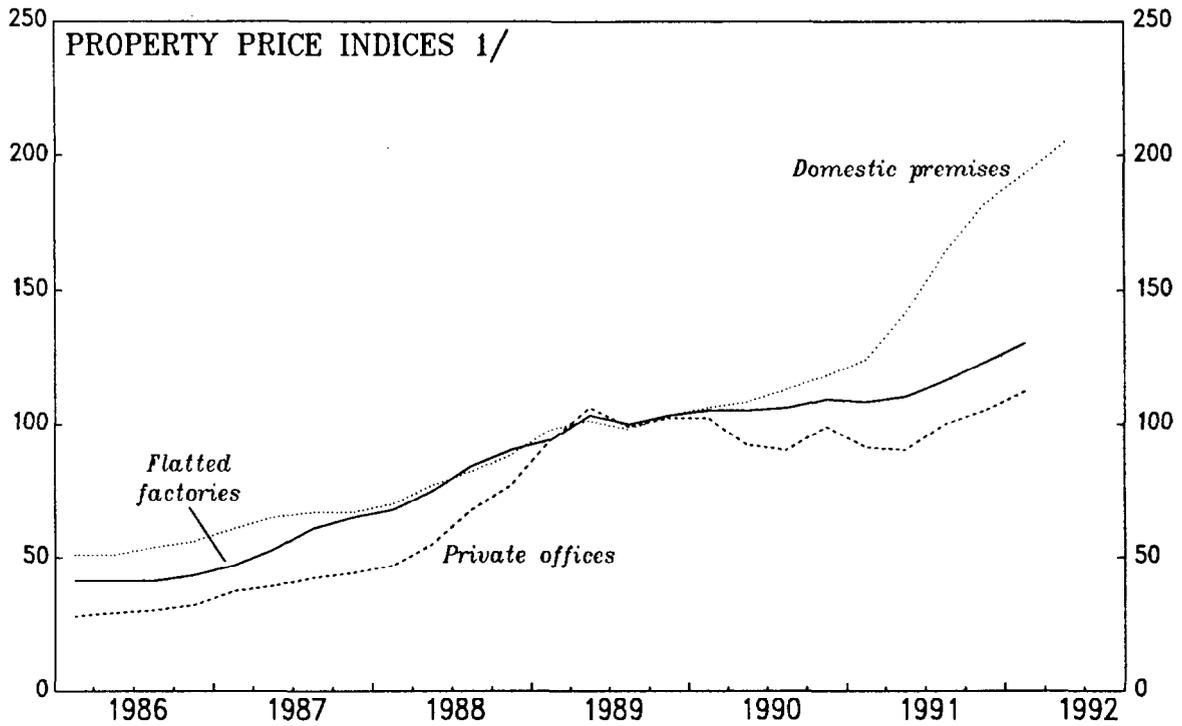
Source: Hong Kong Monthly Digest of Statistics.

^{1/} Data are period averages.

^{2/} Percentage changes are calculated over corresponding year-earlier periods.

^{3/} From 1989, the indices are in respect of all types of retail premises. They are not strictly comparable with the earlier indices which are in respect of shop premises with street frontage only.

HONG KONG
PROPERTY PRICE DEVELOPMENTS, 1986-92



Sources: Census and Statistics Department, Hong Kong Monthly Digest of Statistics; and staff estimates.
1/ 1989=100.

the rate of increase in the prices of residential property began to slow in 1992.

A number of factors have played an important role in the recent rise of property prices. First, in terms of underlying fundamental conditions, the limited supply of land, coupled with a high population density and a rapid rise in household income in the second half of the 1980s, has been an important driving force behind the rise in property prices. Also important is the fact that, as in the case of the equity market, the real estate market in Hong Kong has traditionally been highly sensitive to changes in the economic and political environment. Another important factor has been the easing of monetary conditions in recent years: low nominal interest rates, coupled with double-digit domestic inflation, stimulated investment in property by both individual and corporate investors.

As in the case of equity prices, it is difficult to precisely assess the appropriateness of current property price levels, with different indicators pointing in different directions. On the one hand, the rise in residential property prices has not been dramatic when measured in relation to growth in nominal GDP. An index of residential property prices relative to an index of nominal GDP stood at about 2 1/2 in the first half of 1992, significantly below the average of 3 1/2 registered in 1980-81, prior to the collapse in confidence associated with the Sino-British discussions on the future status of Hong Kong. Similar ratios in other sectors of the property market during the first half of 1992 were also substantially lower than the levels recorded in 1980-81. On the other hand, prices in various sectors have risen significantly relative to rentals. While prices of residential property rose by over 100 percent between 1989 and mid-1992, rental rates increased by only 27 percent. The price-rental ratio for shopping space property also rose, by more than 26 percent between 1989 and the first quarter of 1992. 1/

III. Fiscal Policy and Developments

1. Public finance setting and basic policy approach

Throughout its history, fiscal policy in Hong Kong has been based on a strategy of "positive noninterventionism," which holds that the primary role of the Government is to provide the necessary infrastructure and a stable legal and administrative framework conducive to economic growth and development. 2/ In adhering to this underlying approach, the Government has maintained, over time, a coherent set of neutral economic and budgetary

1/ The price-rental ratios for office and industrial property, however, have remained relatively stable in the past two to three years.

2/ The adjective "positive" refers to the government stance toward interventionist proposals, which are evaluated strictly on the basis of their long-term economic benefits and costs, as perceived by the Government.

policies that have aimed at preserving the predominance of the private sector and the flexibility of the cost-price structure. More specifically, the Government has made efforts to contain the growth of the public sector, to maintain a broad balance of revenue and expenditure, to finance at least half of the Government's capital expenditure from operating surpluses, and to maintain a simple tax structure with low tax rates so as to provide maximum incentives and a stable environment for both labor and domestic and foreign investment.

Owing to the small size and open nature of its economy, fiscal policy in Hong Kong also has been to a large extent dictated and constrained by the specific circumstances facing the economy at any given time. While the Government has broadly sought to balance its budget position over the course of economic cycles, revenues have been heavily influenced by pronounced fluctuations in external demand and the concomitant volatility of profits, which represent the largest component of the tax base. Accordingly, the authorities have tended to err on the side of fiscal surpluses, in order to maintain ample reserves to deal with unfavorable swings in the economic environment. ^{1/} The need for a surplus-prone budget--deficits were recorded in only 6 out of 46 postwar years--has also been justified by the constraints placed on domestic financing of budgetary deficits by a currency board system.

The basic approach of the Hong Kong Government with regard to taxation has been to derive revenues from a limited number of sources and to maintain low tax rates with a flat profile. In comparison with OECD countries, Hong Kong has a simple tax structure, with low peak rates of tax on salaries (15 percent) and profits (17 1/2 percent). Income tax is limited to income arising in or derived from sources within Hong Kong, with no tax imposed on capital gains, dividends, and interest income. Indirect taxes are levied on a limited number of commodities, primarily nonessential items. Property taxes ("rates"), whose base is periodically adjusted for inflation, are largely borne by top income groups. This simple structure of taxation has remained basically unaltered since it was first introduced in 1947.

As for expenditures, the basic approach has been to provide a relatively narrow range of public goods for which Government supply is deemed efficient, while keeping spending increases in line with revenue growth. The changing pattern of the major components of public expenditure--general administration, economic services, social services, community and external affairs, and infrastructure--reveals that spending priorities have been gradually changing (Appendix Table 6). In terms of GDP shares, social services (education, health care, housing, and social welfare) show the fastest growth. The Government's general stance against tax-based income redistribution has thus been moderated by rearranging the allocation of expenditures. Another category exhibiting rapid growth has been infra-

^{1/} The Government's reserve balances stood at about HK\$100 billion (15 1/2 percent of GDP) at end-March 1992.

structure spending, whose importance is expected to rise further with the implementation of the Port and Airport Development Strategy (PADS). Spending on general administrative services (including security) and community and external affairs has been stable as a proportion of GDP, while economic services (which include subsidies to certain public bodies) have taken up a small and declining share of the budget as well as the GDP.

Data for 1947-91 indicate that the trend annual growth rates of revenues and expenditures have been almost identical (at about 15 percent) and that both grew more rapidly than nominal GDP (13 3/4 percent per year). While expenditure growth was slightly more buoyant, the propensity to tax was higher than the propensity to spend. 1/ These results show that, owing to a buoyant tax system and rapid economic growth, the increases in public sector expenditure were largely financed by the growth of the economy.

2. Recent budgetary developments

After growing steadily during 1986/87-1988/89, 2/ the consolidated budget surplus declined sharply, from 4 1/4 percent of GDP in 1988/89 to 3/4 percent of GDP in 1990/91 (Table 5 and Chart 6). This deterioration reflected primarily an acceleration in expenditures owing to increases in public sector salaries and spending for infrastructure and social services (Table 6), as well as a slowing in revenues because of the effect on business profits of slower economic growth as well as lower land sales revenue (Table 7).

In 1991/92, however, the consolidated budget surplus widened sharply and unexpectedly, to the equivalent of 3 1/4 percent of GDP (HK\$21 1/2 billion), compared with an initial budget of near balance. The favorable outturn resulted from both an 8 1/4 percent excess of revenues (HK\$8 3/4 billion), and a 12 percent slippage in expenditures (HK\$12 1/2 billion). Almost all of the additional revenue was accounted for by higher stamp duties and land premia. The incremental revenue from stamp duties reflected unexpectedly brisk activity in both the property and stock markets, whereas higher revenue from land premia was due to a significant rise in land prices during the year. The Government also

1/ During 1947-91, the buoyancy of revenues is estimated at 1.074 percent, while the buoyancy of expenditures is estimated at 1.075 percent. Over the same period, the marginal propensity to tax is estimated at 0.17, and the marginal propensity to spend is estimated at 0.14. Buoyancy measures the percentage increase in revenues or expenditures brought about by a 1 percent increase in GDP, while the propensity to tax (spend) measures the dollar increase in revenues (expenditures) resulting from a one dollar increase in GDP.

2/ The fiscal year runs from April 1 to March 31.

Table 5. Hong Kong: Consolidated Government Account, 1987/88-1992/93

	1987/88	1988/89	1989/90	1990/91	1991/92		1992/93	
					Budget	Actual	Budget	Proj.
<u>(In millions of Hong Kong dollars)</u>								
General revenue account								
Revenue	54,643	65,781	74,365	82,674	96,775	101,456	113,560	115,323
Expenditure	37,422	42,643	51,962	62,627	73,560	72,851	84,595	86,966
Current	35,729	41,260	49,077	60,378	71,230	70,773	81,935	81,457
Capital	1,693	1,383	2,885	2,249	2,330	2,078	2,660	5,509
Surplus before transfers	17,221	23,138	22,403	20,047	23,215	28,605	28,965	28,357
Transfers to funds	5,601	6,310	17,700	20,210	26,760	20,550	18,790	18,790
Surplus/deficit (-) after transfers	11,620	16,828	4,703	-163	-3,545	8,055	10,175	9,567
Consolidated account funds ^{1/}								
Revenue ^{2/}	6,234	6,877	8,064	6,849	8,100	12,144	12,760	13,086
Capital expenditure	10,953	11,153	19,404	22,929	31,210	19,340	36,580	36,370
Deficit before transfers	-4,719	-4,276	-11,340	-16,080	-23,110	-7,196	-23,820	-23,284
Transfers from general revenue account	5,601	6,310	17,700	20,210	26,760	20,550	18,790	18,790
Surplus/deficit (-) after transfers	882	2,034	6,360	4,130	3,650	13,354	-5,030	-4,494
Total consolidated account								
Revenue	60,877	72,658	82,429	89,523	104,875	113,600	126,320	128,409
Expenditure	48,375	53,796	71,366	85,556	104,770	92,191	121,175	123,336
Current	35,729	41,260	49,077	60,378	71,230	70,773	81,935	81,457
Capital	12,646	12,536	22,289	25,178	33,540	21,418	39,240	41,879
Surplus	12,502	18,862	11,063	3,967	105	21,409	5,145	5,073
<u>(In percent of GDP)</u>								
Total consolidated account ^{3/}								
Revenue	16.6	16.8	16.5	16.0	16.9	17.6	17.5	17.2
Expenditure	13.2	12.4	14.3	15.3	16.9	14.3	16.8	16.5
Current	9.7	9.5	9.8	10.8	11.5	11.0	11.4	10.9
Capital	3.4	2.9	4.5	4.5	5.4	3.3	5.4	5.6
Surplus	3.4	4.3	2.2	0.7	--	3.3	0.7	0.7
<u>(Percentage change)</u>								
Total consolidated account								
Revenue	25.3	19.4	13.4	8.6	17.1	26.9	11.2	13.0
Expenditure	13.3	11.2	32.7	19.9	22.5	7.8	31.4	33.8
Current	10.2	15.5	18.9	23.0	18.0	17.2	15.8	15.1
Capital	23.0	-0.9	77.8	13.0	33.2	-14.9	83.2	95.5
<u>(In millions of Hong Kong dollars)</u>								
Memorandum item:								
Borrowing ^{4/}	...	...	...	...	1,200	1,098	2,400	2,400

Source: Data provided by the Government Secretariat, Finance Branch.

^{1/} Consists of the Capital Works Reserve Fund, Development Loan Fund, Mass Transit Fund, and Student Loan Fund prior to 1990/91; Capital Works Reserve Fund, Capital Investment Fund, and Loan Fund beginning 1990/91.

^{2/} Excluding borrowing (government definition includes revenue from the sale of bonds in Consolidated Account Funds).

^{3/} Figures for 1992/93 are based on staff's estimate of GDP.

^{4/} The Government Bond Program was launched in November 1991 in an effort to develop a market in fixed-income securities and facilitate the funding of long-term government infrastructural projects. The bonds are issued before the Government actually requires the funds. The size of the Program is limited to HK\$5 billion of gross debt outstanding as of June 30, 1997.

HONG KONG
CONSOLIDATED GOVERNMENT ACCOUNT, 1986/87-1992/93

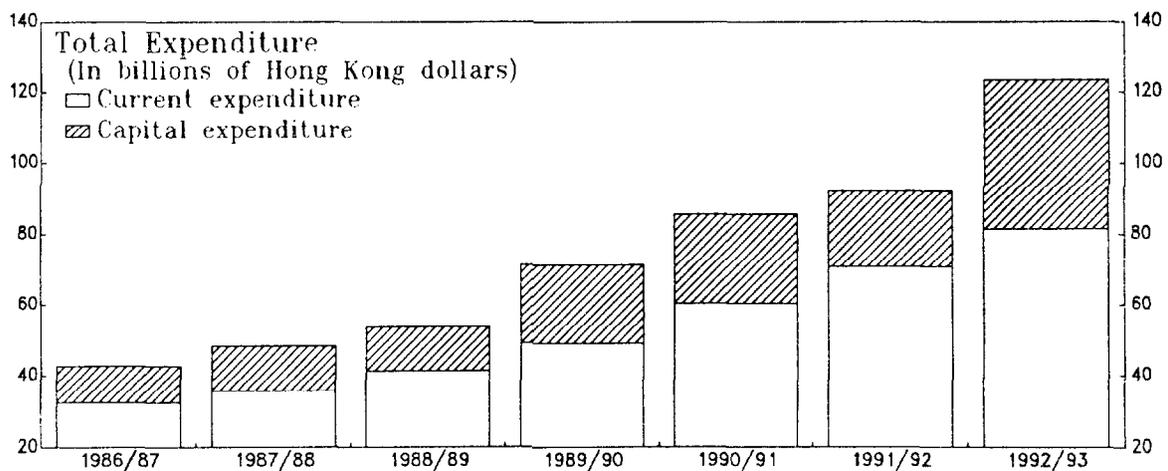
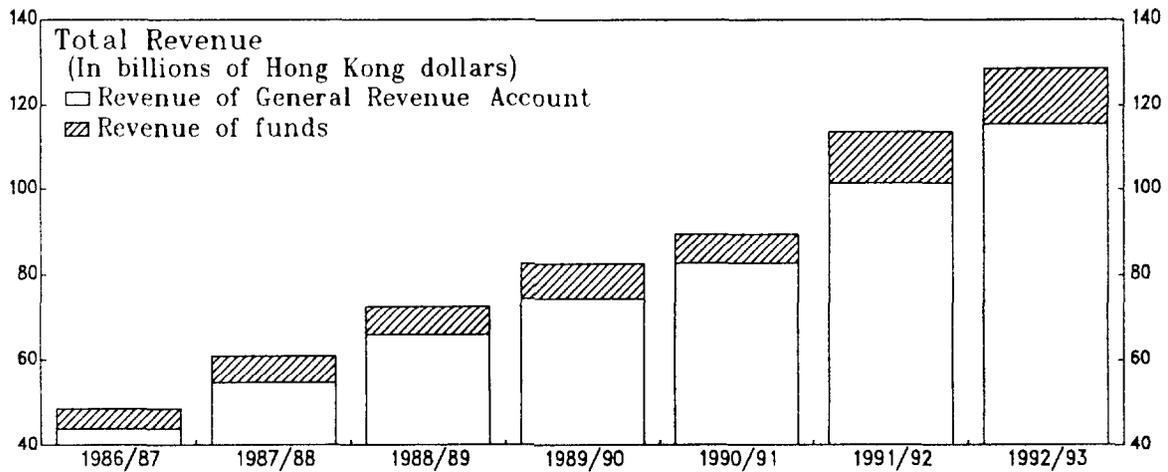
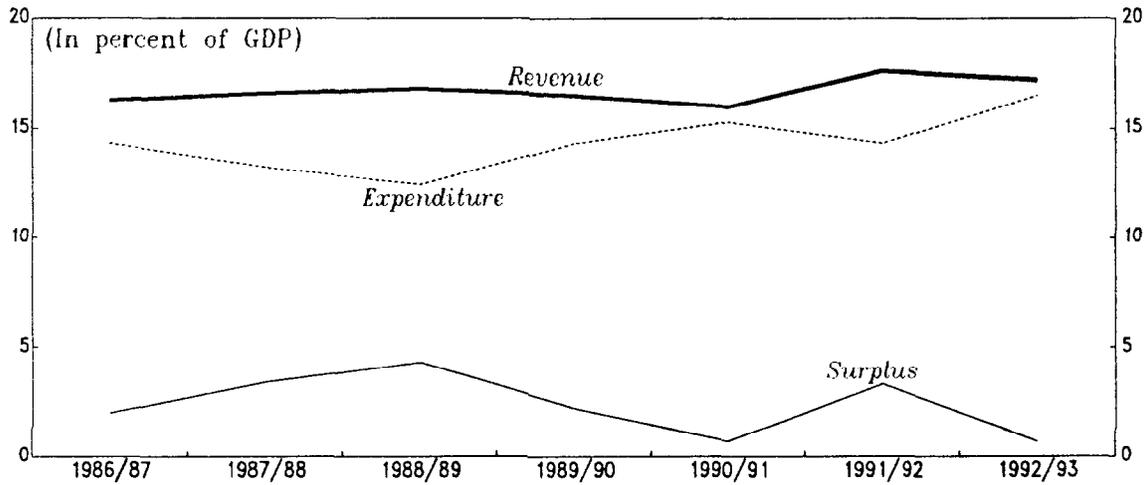


Table 6. Hong Kong: Government Expenditure Under the
General Revenue Account, 1987/88-1992/93 1,2/

(In millions of Hong Kong dollars)

	1987/88	1988/89	1989/90	1990/91	1991/92		1992/93	
					Budget	Actual	Budget	Proj.
Current expenditure	<u>35,729</u>	<u>41,260</u>	<u>49,077</u>	<u>60,378</u>	<u>71,230</u>	<u>70,773</u>	<u>81,935</u>	<u>81,457</u>
Personal emoluments	13,500	15,828	18,855	23,443	26,699	25,286	25,785	25,785
Personnel-related expenses	2,846	3,221	3,752	4,937	6,288	6,584	7,560	7,710
Departmental expenses	3,557	3,667	3,850	4,552	5,319	4,782	4,685	4,184
Other charges	5,545	6,632	8,402	9,712	11,051	10,939	11,710	11,784
Subventions	10,281	11,912	14,218	17,734	21,873	23,182	32,195	31,994
Capital expenditure <u>3/</u>	<u>8,293</u>	<u>7,693</u>	<u>20,585</u>	<u>22,459</u>	<u>29,090</u>	<u>22,628</u>	<u>21,450</u>	<u>24,299</u>
Plant, equipment, and works	427	406	643	776	918	758	810	773
Other nonrecurrent	590	775	2,029	1,091	1,006	904	1,365	4,016
Subventions	676	202	213	382	406	416	485	720
Transfers to funds	6,600	6,310	17,700	20,210	26,760	20,550	18,790	18,790
Capital Works Reserve Fund/Public Works	5,080	6,200	8,800	15,200	21,210	15,000	15,450	15,450
Development Loan Fund	1,000	--	8,900	--	--	--	--	--
Mass Transit Fund	500	100	--	--	--	--	--	--
Capital Investment Fund	--	--	--	4,100	3,900	3,900	3,340	3,340
Loan Fund	--	--	--	910	1,650	1,650	--	--
Other	20	10	--	--	--	--	--	--
Total expenditure	<u>44,022</u>	<u>48,953</u>	<u>69,662</u>	<u>82,837</u>	<u>100,320</u>	<u>93,401</u>	<u>103,385</u>	<u>105,756</u>

Source: Data provided by the Government Secretariat, Finance Branch.

1/ The fiscal year runs from April 1 to March 31.

2/ Accounts of the funds established under the Public Finance Ordinance, and revenue and expenditure of the Urban Council, Regional Council, and Housing Authority are not included.

3/ Includes capital expenditure financed directly from the General Revenue Account (GRA) and from transfers from the GRA to Consolidated Account Funds.

Table 7. Hong Kong: Revenue (General Revenue Account), 1987/88-1992/93 ^{1/}

(In millions of Hong Kong dollars)

	1987/88	1988/89	1989/90	1990/91	1991/92		1992/93	
					Budget	Actual	Budget	Proj.
Taxes	<u>41,833</u>	<u>48,811</u>	<u>54,577</u>	<u>61,914</u>	<u>73,660</u>	<u>78,922</u>	<u>87,690</u>	<u>90,713</u>
Direct taxes	25,258	30,109	34,039	36,997	44,210	45,553	53,310	53,310
Earnings and profits tax	24,772	29,662	33,549	36,341	43,610	44,870	52,630	52,630
Estate duty	486	447	490	656	600	683	680	680
Indirect taxes	16,565	18,702	20,539	24,917	29,450	33,369	34,380	37,403
Duties	3,389	4,173	4,628	5,729	7,980	6,844	6,865	6,866
General rates	1,373	1,517	1,663	3,039	3,520	3,494	5,290	4,350
Internal revenue	9,724	10,423	11,559	13,143	14,079	18,400	17,985	21,945
Bets and sweeps tax	3,303	4,076	4,830	5,884	6,900	7,110	8,741	8,741
Entertainment tax	124	132	129	136	145	141	10	10
Hotel accommodation tax	187	242	271	269	310	260	285	285
Stamp duties	5,237	5,095	5,464	5,939	5,299	9,569	7,540	11,500
Air passengers' departure tax	685	683	669	718	1,229	1,120	1,210	1,210
Cross Harbour Tunnel passage tax	188	195	196	197	196	200	199	199
Motor vehicles taxes	1,448	1,922	1,735	2,054	2,768	3,437	2,960	2,957
Royalties and concessions	511	598	746	816	913	886	1,030	1,033
Taxi concessions	120	69	208	136	190	308	250	252
Nontax revenue	<u>13,819</u>	<u>16,970</u>	<u>19,787</u>	<u>20,760</u>	<u>23,115</u>	<u>22,534</u>	<u>25,870</u>	<u>24,610</u>
Fines and penalties	462	495	578	652	680	885	791	791
Properties, investments, and interest	2,133	4,971	7,279	6,086	5,803	4,640	6,141	4,881
Of which: Interest	1,373	2,818	4,942	4,505	4,342	2,771	4,420	4,450
Reimbursements and contributions	1,528	1,765	1,705	2,172	2,602	2,777	3,679	3,679
Utilities	3,412	4,094	4,857	5,617	6,819	6,650	7,244	7,244
Fees and charges	4,804	4,682	5,132	5,992	7,011	7,170	7,767	7,767
Land transactions ^{2/}	461	365	212	241	200	412	248	248
Other	1,020	598	24	--	--	--	--	--
Total revenue	<u>55,643</u>	<u>65,781</u>	<u>74,365</u>	<u>82,674</u>	<u>96,775</u>	<u>101,456</u>	<u>113,560</u>	<u>115,323</u>

Source: Data provided by the Government Secretariat, Finance Branch.

^{1/} The fiscal year runs from April 1 to March 31.

^{2/} Includes only land transactions completed before the coming into force of the Joint Declaration (5/27/85), or land transactions conferring a benefit that expires before June 30, 1997. Revenue from other land transactions is credited to the Suspense Account of the Capital Works Reserve Fund.

benefited from the sale of two major sites postponed from the previous year. The underspending reflected lower-than-projected capital spending. Expenditure from the Capital Works Reserve Fund, which is used primarily to finance public works and land acquisition for infrastructure and housing programs, was 32 percent below the original budget estimate, largely because of delays in the Airport Core Program (ACP) and savings on public works contracts occasioned by lower construction prices. These factors also led to lower equity investments and net lending.

The initial budget for 1992/93, announced in March 1992, projected a substantial decline in the budget surplus to HK\$5 billion (3/4 percent of GDP). Expenditures were projected to increase by 30 percent, owing to accelerated capital spending on the airport project as well as on port facilities, sewerage, health, and education, that more than offset retrenchment in some areas of current spending; and to a moderate expansion in spending on social welfare.

Revenue measures announced in the 1992/93 budget included higher tax rates on corporate profits (up 1 percentage point to 17 1/2 percent), an expansion in the coverage of stamp duties, and increases in the betting tax and duties on tobacco, hydrocarbon oils, alcoholic beverages, and alcohol. At the same time, a number of tax concessions were announced. 1/ The net revenue yield from these proposed measures was estimated at HK\$1.1 billion (1/4 percent of GDP) for 1992/93. Following the presentation of the budget for FY 1992/93, however, it became apparent that the final outturn for the 1991/92 budget surplus was substantially more favorable, 2/ and in May 1992 the Government decided to rescind the increase in property taxes (worth HK\$940 million) announced at the time of the Budget Speech.

A detailed review of the financial position completed in August 1992 indicated that the buoyancy in revenue experienced in 1991/92, as well as the underspending on public infrastructural projects, has continued into the current fiscal year. These developments are estimated to yield HK\$6 billion

1/ Tax concessions included increases in personal income tax allowances, elimination of duties on soft drinks and the entertainment tax on cinema tickets, exemptions for franchised bus companies from duty on diesel oil, and a reduction in the stamp duty on stock transfers.

2/ At the time of the Budget Speech, the 1991/92 surplus was estimated at HK\$14 billion (2 1/4 percent of GDP), HK\$7 1/4 billion less than the actual outcome.

(3/4 percent of GDP) in additional funds in 1992/93. 1/ These additional funds were subsequently matched by new spending initiatives announced by the Governor in October 1992. 2/ In particular, HK\$2 1/4 billion is to be injected to the Lotteries Fund to finance social welfare initiatives over the period 1994-97, and HK\$3 billion is to be set aside as the Government's equity contribution into a special fund to finance a new sewage system (the Government's contribution to this fund would be spent over 1994-99). Together with some other capital grants, both equity injections would take place during the remainder of this fiscal year, and thus the projected surplus for 1992/93 would remain unchanged.

3. Airport Core Program

The Airport Core Program is part of the Port and Airport Development Strategy agreed between China and the United Kingdom in July 1991. It aims at upgrading Hong Kong's physical infrastructure, which has been severely strained by three decades of rapid growth in international traffic (by air and sea) and the marked expansion of cross-border trade with China since the mid-1980s. 3/ The PADS will allow for a five-fold increase in container handling capacity by the year 2006 and increases in air passenger and air cargo capacity of about 80 percent.

The ACP includes a new airport at Chek Lap Kok Island and nine related infrastructural projects providing urban infrastructural services to the new airport, the most important being transportation links to Kowloon and the Island of Hong Kong. 4/ The Government estimates that the new airport would increase Hong Kong's GDP by at least HK\$420 billion (1/2 percent of GDP annually) during 1997-2010.

1/ This amount consists of HK\$3 billion in higher revenue from stamp duties, resulting from a further heightening of activity in the stock market and an extension of the coverage of the stamp duty on property transactions; HK\$1 billion in higher profit taxes, resulting from higher-than-expected economic activity and corporate profits; and HK\$2 billion in underspending on public infrastructural projects, resulting from lower tender prices on investment projects and slippages in the letting of previously concluded contracts.

2/ The Governor outlined proposals in six priority areas: social welfare, environmental protection, education, health care, retraining, and housing. The proposals would increase annual spending by over HK\$8 billion (1 percent of GDP) by the end of 1996/97.

3/ Hong Kong's Kai Tak International Airport has been operating at or close to full capacity since the early 1980s, in spite of continual expansion. The container port in Hong Kong is presently one of the busiest in the world in terms of throughput.

4/ Including railway and highway links to the airport, the development of a new town community near the airport, two suspension bridges, an upgrading of some existing expressway links, a new harbor tunnel crossing, and two land reclamation projects.

The total cost of the ACP was originally estimated at HK\$98 1/2 billion at March 1991 prices, of which 44 percent was for the new airport. In April of this year, the estimated cost of the ACP was raised by 14 percent to HK\$112 billion (still at March 1991 prices). 1/ In current prices, the latest estimates put the total cost of the ten airport-related projects at HK\$164 billion, assuming completion by the end of June 1997. 2/ More than three fourths of ACP investments are scheduled to take place between 1994/95 and 1996/97, with peak investment in 1995/96 of 27 percent of total project costs.

The airport master plan was completed in 1991 and revised in August 1992. A number of major contracts have already been awarded, mostly to international consortia, and some preparatory works have been completed. 3/ Up to 18,500 people are expected to work at Chek Lap Kok alone during the airport's peak construction period in 1995, and a total of 40,000 jobs would be created at the airport and adjacent areas by 1997. To safeguard against delays and cost overruns, the contracts for ACP projects are stipulated as "fixed-price" agreements involving lump-sum payments with only mild adjustments for inflation. All contractors must secure "performance bonds," which hold the contractor financially liable for any failure to complete a project. Most of the consortia that will design and construct the airport-related projects will also operate them under long-term contracts; eventually, ownership will be transferred to the Government.

The implementation of the ACP is presently stalled because of a disagreement between China and the United Kingdom over its financing. In particular, China has expressed concern that the Hong Kong Government's financial assets would be depleted beyond the HK\$25 billion limit set in the Sino-British Memorandum of Understanding on the PADS, 4/ and that the ACP would incur a large debt (above the HK\$5 billion ceiling set in the Memorandum) that would be handed over to the Special Administrative Region

1/ Most of the additional cost represents a revised cost estimate for the railway (the estimate has been raised from HK\$12 1/2 billion to HK\$22 billion).

2/ Financing charges associated with private sector lending are estimated at an additional HK\$13 1/2 billion.

3/ The largest contract so far--a HK\$9 billion contract for site preparation at Chek Lap Kok Island--was activated in December 1992.

4/ According to the Sino-British Memorandum of Understanding on the Port and Airport Development Strategy, agreed in July 1991, the Hong Kong Government must leave at least HK\$25 billion in its fiscal reserves on June 30, 1997. The Memorandum also stipulates that the Hong Kong Government would take responsibility for financing the ACP up to June 30, 1997 (after this date, the Chinese Government would honor obligations to foreign investors entered into by the Hong Kong Government) and that China would be consulted on all airport matters up until 1997.

(SAR) on July 1, 1997. 1/ In an attempt to address China's concerns, the British Government proposed, at the end of September 1992, to increase the level of equity that the Hong Kong Government would contribute to the ACP by HK\$40 billion (36 percent of total project costs) to HK\$60 1/4 billion. The funds would be generated from extra land sales between 1993 and June 30, 1997. The Chinese Government has objected to this latest proposal on the grounds that it violates the Sino-British agreement on the amount of land that can be sold by the Hong Kong Government prior to July 1, 1997, as well as the principle that all proceeds from land sales would be shared equally between the Hong Kong Government and the SAR.

IV. Monetary Developments

Since the establishment of the linked exchange rate system in October 1983, monetary policy in Hong Kong has been directed toward maintaining the market exchange rate at close to the linked rate of HK\$7.8 per U.S. dollar set for the note issue. 2/ This framework for monetary and exchange rate management was introduced following a severe financial crisis in September 1983, when the then-floating Hong Kong dollar depreciated sharply. The floating exchange rate regime, in place since late 1974, had proved to be unsatisfactory: with the authorities lacking both the institutional framework and suitable instruments to pursue an independent monetary policy, money and credit growth had been persistently excessive, leading to depreciation of the currency and inflation. The linked exchange rate system has been successful in preserving financial and exchange rate stability since its introduction, and it remains the centerpiece of the Government's strategy to underpin financial confidence and stability in the lead up to 1997.

In recent years, the continued commitment to the linked exchange rate system has been accompanied by further efforts to strengthen the framework for financial and monetary management. Most notably, in mid-1988, the

1/ China's concern has focused on the use of "callable equity," the additional funds in the amount of HK\$20 billion that the Airport Authority and the MTRC would be able to call on if necessary. The Hong Kong Government has argued that the callable equity would only be drawn down in the event of some specified adverse circumstances, such as a drop in property income for the MTRC or a simultaneous rise in MTRC costs and a drop in its revenues.

2/ See "United Kingdom - Hong Kong - Recent Economic Developments," (SM/91/2, 1/4/91) for a detailed description of the note-issuance and arbitrage mechanism. Briefly, the note issues of the Hongkong and Shanghai Banking Corporation (HSBC) and Standard Chartered Bank (SCB) must be fully backed by non-interest-bearing, but redeemable, certificates of indebtedness issued by the Exchange Fund and sold by the Fund against U.S. dollars at the linked exchange rate. The system is designed so that arbitrage will encourage the market-determined rate to move toward the linked rate.

authorities introduced the New Accounting Arrangements, which greatly enhanced their ability to influence conditions in the interbank market and thereby maintain exchange rate stability. 1/ In 1992, further steps to strengthen the framework for monetary and financial management included the introduction of a discount window, the revelation of the assets of the Exchange Fund, and the passage of enabling legislation for the creation of a central monetary authority. This chapter first reviews these recent efforts to enhance the management of the monetary and financial system. 2/ In addition, it analyzes recent developments in monetary and credit aggregates, the behavior of key interest rates, and the evolution of the exchange rate. Finally, it reviews prudential issues related to capital adequacy and the liquidation of the Bank of Credit and Commerce Hong Kong (BCCHK).

1. Structural changes to the monetary system

a. Liquidity Adjustment Facility

On June 8, 1992, the Office of the Exchange Fund (OEF) opened the Liquidity Adjustment Facility (LAF, or discount window) to formalize the existing, but smaller-scale and discretionary, overnight liquidity assistance arrangement. 3/ The main purpose of the LAF is to assist licensed banks in making late adjustments to their liquidity positions. 4/ Under the LAF, overnight funds are normally provided on a secured basis through a sale and repurchase agreement of a bank's holding of Exchange Fund bills or

1/ For further details on the New Accounting Arrangements, see SM/91/2 (1/4/91). Briefly, with the introduction in mid-1988 of the New Accounting Arrangements governing the operations of the Hongkong and Shanghai Banking Corporation as the clearing house of the banking system, the Exchange Fund became the ultimate provider of liquidity in the interbank market. As such, the Exchange Fund could influence interbank liquidity, and hence interbank interest rates and ultimately the exchange rate, through the purchase or sale of foreign exchange, short-term borrowing in the interbank market, and the shifting of treasury deposits from the banking system into sterilized Exchange Fund deposits. In March 1990, the Exchange Fund further expanded its ability to affect the interbank market by initiating the Exchange Fund Bills program, the sale and purchase of which affects interbank liquidity.

2/ For a detailed description of Hong Kong's financial system and monetary policy framework, see SM/91/2 (1/4/91), Chapter V.

3/ Before the introduction of the LAF, overnight assistance was provided on an unsecured basis. In recognition of the credit risk associated with such unsecured operations, the Exchange Fund followed strict credit limits and guidelines and would only provide overnight assistance to those banks that maintained a business relationship with the Exchange Fund. Because overnight loans are generally secured by Exchange Fund bills or government debt under the LAF, credit risk and access are no longer impediments to overnight assistance.

4/ The liquidity position is defined as the balance that a licensed bank maintains in its clearing account with its settlement bank.

government bonds. The OEF may also lend on an unsecured basis, but the interest rate charged is determined at the absolute discretion of the OEF and, at a minimum, is higher than the offer rate on secured lending. In addition, under the LAF, banks can lend their surplus funds at the bid rate. The bid rate has thus far been set at 2 percentage points below the offer rate, although the spread can be varied if conditions warrant. 1/

While the LAF does not include a penalty rate, the offer rate is generally set above the (recent average) overnight interbank rate, so as to prevent round-tripping activities as well as to deter unnecessary borrowing at the window. Moreover, the LAF is only open for a limited period of time (between 4 and 5 p.m. on weekdays and 11:30 and noon on Saturdays), so that banks are inclined to cover their shortfalls in the interbank market. Both of these aspects of the LAF also minimize the moral hazard problem of reserve management (i.e., under the LAF arrangement, banks still have strong incentives to effectively manage and monitor their reserve positions).

The LAF provides the OEF with an additional instrument to maintain exchange rate stability, that is, greater influence over short-term interbank interest rates. Its introduction can be viewed against the gradual strengthening of monetary control procedures that the authorities have been pursuing over the past several years. In particular, the LAF complements the OEF's ability to influence short-term interest rates under the New Accounting Arrangements.

Moreover, the LAF has successfully reduced volatility in the interbank market, as the bid and offer rates of the LAF have effectively become the floor and ceiling of the overnight interbank rate. 2/ Initial experience indicates a drop in the fluctuation of overnight interbank interest rates dropped, from a maximum of 4 1/2 percentage points (for the period January 1 to June 4, 1992) to about 1 1/2 percentage points since the introduction of the LAF, with a normal fluctuation of between 1/2 and 1 percentage point for most of the time since its introduction.

b. Revelation of assets of the Exchange Fund

In mid-July 1992, the Government took action to reveal the assets of the Exchange Fund. This step was prompted by several factors, including a

1/ In setting the bid and offer rates for the LAF, the Exchange Fund considers a number of factors, including the exchange rate between the Hong Kong and U.S. dollar, the interest differential between the Hong Kong and U.S. dollar, and local money market conditions.

2/ At inception (June 5), the bid and offer rates for the LAF were set at 2 1/2 percent and 4 1/2 percent respectively. However, following the half percentage point cut in the U.S. discount rate on July 2, the rates were adjusted to 2 percent and 4 percent, respectively, to prevent a widening in the interest rate gap between Hong Kong and U.S. dollar-denominated instruments.

belief that greater openness in government was warranted, as well as the belief that, with the strengthening of monetary management over the past few years, the system was now less vulnerable to speculative pressures. In addition, disclosure of the asset position is intended to provide prospective lenders and credit-rating agencies with a realistic assessment of Hong Kong's creditworthiness in advance of the bulk of airport and port projects.

The information released indicates that, at end-1991, foreign currency assets of the Exchange Fund stood at HK\$225 billion (US\$28.9 billion), the second highest level in the world on a per capita basis (Table 8). Excluding liabilities, such as Hong Kong dollars in circulation, Exchange Fund bills, and fiscal reserves, the Exchange Fund's net worth (i.e., net accumulated earnings) stood at HK\$98.6 billion (US\$12.6 billion).

c. Creation of the Hong Kong Monetary Authority

In early November 1992, enabling legislation for the new Hong Kong Monetary Authority (HKMA) was passed, and it is expected that the new Authority will be operational by the first quarter of 1993. The decision to set up the HKMA was motivated almost exclusively by the need to maintain a high degree of continuity and professionalism among the personnel entrusted with monetary management in Hong Kong, and the need to have greater flexibility to recruit and retain essential staff. Its creation is the culmination of several years of effort to create, in advance of 1997, an institution that could carry out the objective of maintaining the exchange rate link and financial stability with maximum effectiveness.

Under the enabling legislation, the Office of the Exchange Fund and the Office of the Commissioner of Banking (OCB) were merged into a single monetary authority, 1/ which is accountable to the Government through the Financial Secretary as well as to an enlarged, but independent, Exchange Fund Advisory Committee. 2/ The primary objective of the HKMA will be the maintenance of the exchange rate link, but it will also have the secondary responsibility of ensuring the stability and integrity of the monetary and financial system of Hong Kong, with a view to maintaining Hong Kong as an international financial center. 3/ In the event that the primary and secondary responsibilities were to conflict, the enabling legislation

1/ The merger of the OEF and the OCB was accomplished without any significant changes to their existing organizational structures or staffing levels.

2/ Other parts of the Monetary Affairs Branch, including the Insurance Commission and Registrar General, would be absorbed by other departments.

3/ This secondary function will allow the Authority to assume responsibility for banking supervision and address problems with systemic implications. However, it is not envisaged that the Authority will be used to bail out individual banks per se, though there may be occasions in which a rescue of an individual bank may be necessary if its failure were to have systemic implications.

Table 8. Hong Kong: Exchange Fund Balance Sheet, 1986-91

(In millions of Hong Kong dollars; end of year)

	1986	1987	1988	1989	1990	1991
Assets						
Foreign currency	84,715	113,089	127,089	149,142	192,323	225,333
Hong Kong dollar	3,876	5,746	5,962	9,625	3,874	10,788
Total	88,591	118,835	133,051	158,777	196,197	236,121
Liabilities						
Certificates of indebtedness <u>1/</u>	20,531	26,831	31,731	37,191	40,791	46,410
Transfers of fiscal reserves <u>2/</u>	23,359	32,557	38,269	52,546	63,226	69,802
Coins in circulation	1,441	1,470	1,890	2,012	2,003	2,299
Exchange Fund bills	--	--	--	--	6,671	13,624
Other <u>3/</u>	4,103	4,453	2,554	1,603	391	4,834
Balance of banking system <u>4/</u>	--	--	860	978	480	500
Total	49,434	65,311	75,304	94,330	113,562	137,469
Accumulated earnings	39,157	53,524	57,747	64,447	82,635	98,652

Source: Office of the Exchange Fund.

1/ As backing for their bank note issues, the two note-issuing banks are required to hold non-interest-bearing certificates of indebtedness issued by the Exchange Fund. Since October 17, 1983 these certificates have been issued to or redeemed from the two banks against payment in U.S. dollars at a fixed rate of HK\$7.80=US\$1.00.

2/ Fiscal reserves that have been transferred from the General Revenue Account, Capital Investment Fund, Loan Fund, and Capital Works Reserve Fund to the Exchange Fund on an interest-bearing basis.

3/ Other liabilities comprise expenses accrued at the year's end, primarily interest due on fiscal reserve transfers, contingency reserves for bank rescue operations, and any other borrowings.

4/ In accordance with the Accounting Arrangements introduced in July 1988, the Hongkong and Shanghai Banking Corporation Ltd., as the Management Bank of the Clearing House of the Hong Kong Association of Banks, is required to maintain a Clearing Account with the Exchange Fund. The balance in the Account, which represents the level of liquidity in the interbank market, can only be altered by the Fund. The Accounting Arrangements enable the Fund to maintain exchange rate stability more effectively by influencing the level of interbank liquidity through money market operations.

clearly delineates that the primary objective should prevail. Finally, the creation of the HKMA does not entail the assumption of further central banking functions. There is no intention for the new Authority to assume the two residual central banking functions (i.e., bank note issue and check clearing).

2. Monetary developments in 1992

Under the linked exchange rate system, the overriding objective of monetary policy is to maintain a stable exchange rate between the Hong Kong and U.S. dollars. Against this background, monetary developments in 1992 were characterized by two important features. First, with the easing of monetary conditions in the United States, interest rates in Hong Kong were cut on several occasions, thereby continuing the downward trend begun in 1989. Second, the low levels of interest rates, coupled with an inflow of investor funds poised to take advantage of conditions in the local stock market as well as several large share flotations, resulted in rapid (but uneven) expansion of credit and monetary aggregates.

a. Interest rate developments

Interbank interest rates generally trended downward during the year. Overnight HIBOR, which averaged 4 1/2 percent during the first quarter of the year, declined gradually and averaged slightly less than 3 percent during the third quarter. During the fourth quarter of 1992, the general downward trend in overnight HIBOR was interrupted, as a number of large share flotations resulted in temporary squeezes on interbank liquidity. Reflecting these squeezes overnight HIBOR firmed substantially in both early November and early December. ^{1/} Notwithstanding the concomitant turbulence in the stock market, the squeezes on interbank liquidity eased quickly, and overnight HIBOR moved back to more normal ranges following the share flotations.

As regards lending rates, cuts in the Best Lending Rate (BLR) lagged behind cuts in the U.S. prime rate during the early part of the year, so that Hong Kong rates remained on average about 2 percentage points higher (Table 9 and Chart 7). However, with indications of some moderation in inflation in early 1992, and with banks facing losses on interbank

^{1/} For example, as a result of a large share flotation in early December, overnight HIBOR rose to over 5 1/2 percent, compared with the offer rate of 4 percent under the LAF.

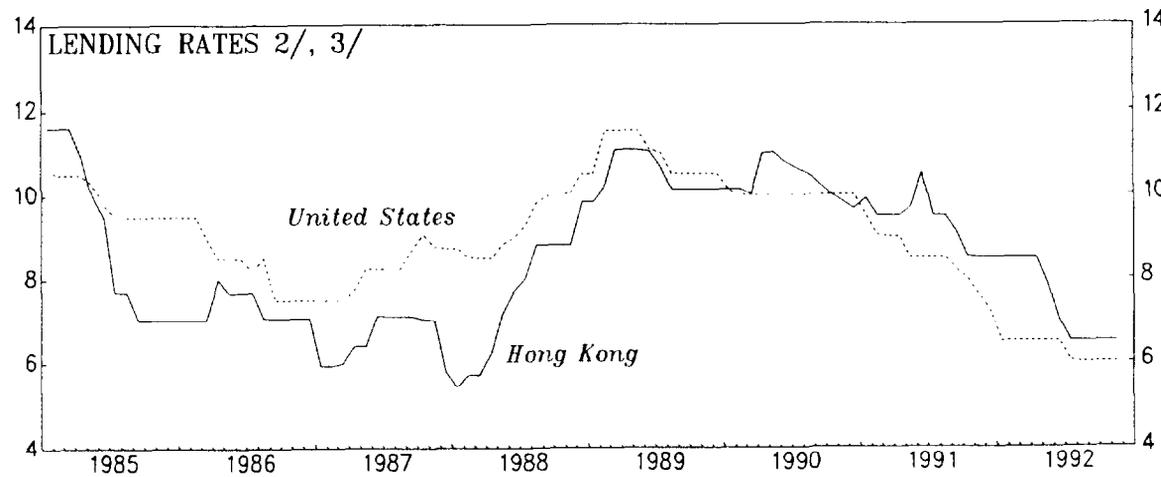
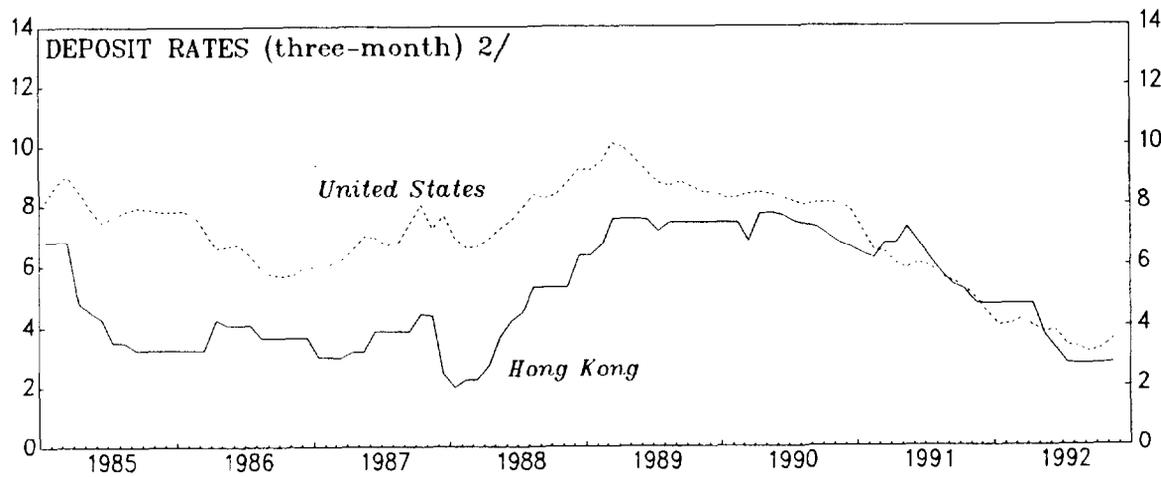
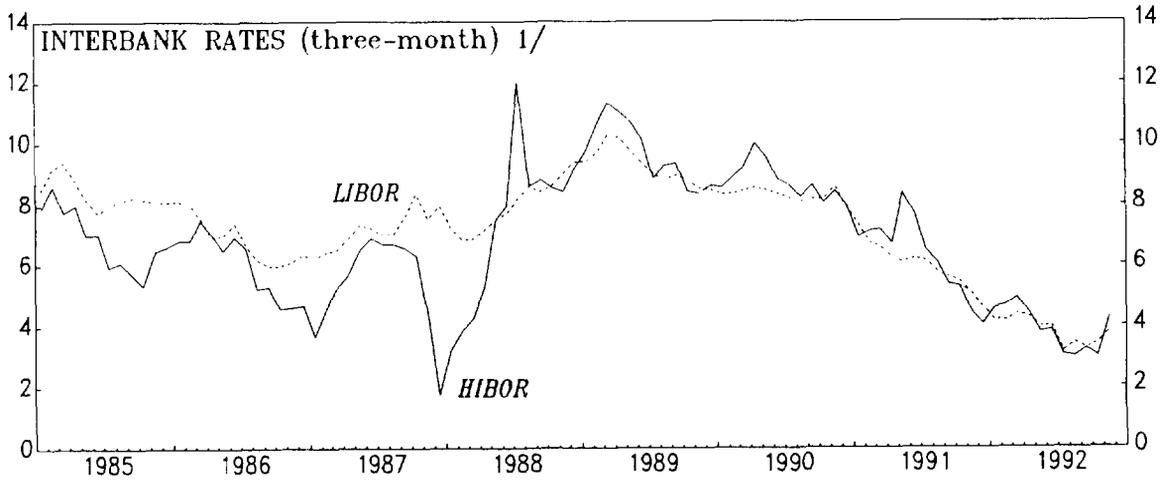
Table 9. Hong Kong: Interest Rate Differentials, 1988-92

	Interbank Rates 1/			Deposit Rates 2/			Lending Rates 3/,4/		
	HIBOR	LIBOR	Differential	Hong Kong dollars	U.S. dollars	Differential	HSBC's BLR	U.S. Prime Rate	Differential
1988									
January	3.2	7.3	-4.0	2.0	6.9	-4.9	5.4	8.8	-3.3
February	3.9	6.8	-3.0	2.2	6.6	-4.4	5.7	8.5	-2.8
March	4.2	6.9	-2.6	2.2	6.6	-4.4	5.7	8.5	-2.8
April	5.3	7.2	-1.9	2.7	6.9	-4.2	6.2	8.5	-2.3
May	7.5	7.5	--	3.7	7.2	-3.6	7.2	8.8	-1.7
June	8.0	7.7	0.3	4.2	7.5	-3.3	7.7	9.0	-1.3
July	12.0	8.2	3.8	4.5	7.9	-3.4	8.0	9.3	-1.3
August	8.6	8.6	--	5.3	8.3	-3.0	8.8	9.8	-1.0
September	8.8	8.4	0.4	5.3	8.2	-2.9	8.8	10.0	-1.2
October	8.6	8.6	-0.1	5.3	8.4	-3.0	8.8	10.0	-1.2
November	8.4	9.0	-0.6	5.3	8.8	-3.5	8.8	10.0	-1.2
December	9.2	9.4	-0.2	6.3	9.2	-2.9	9.8	10.5	-0.7
1989									
January	9.8	9.4	0.3	6.3	9.2	-2.9	9.9	10.5	-0.6
February	10.7	9.7	0.9	6.7	9.5	-2.8	10.2	11.5	-1.3
March	11.3	10.3	1.0	7.6	10.1	-2.5	11.1	11.5	-0.4
April	11.0	10.2	0.8	7.6	9.9	-2.4	11.1	11.5	-0.4
May	10.7	9.8	0.9	7.6	9.6	-2.0	11.1	11.5	-0.4
June	10.1	9.4	0.7	7.5	9.2	-1.7	11.0	11.1	--
July	8.9	9.0	-0.1	7.2	8.8	-1.6	10.7	11.0	-0.3
August	9.3	8.8	0.5	7.4	8.6	-1.2	10.1	10.5	-0.4
September	9.4	9.0	0.4	7.4	8.8	-1.3	10.1	10.5	-0.4
October	8.4	8.8	-0.4	7.4	8.6	-1.2	10.1	10.5	-0.4
November	8.4	8.5	-0.2	7.4	8.4	-1.0	10.1	10.5	-0.4
December	8.6	8.5	0.1	7.4	8.4	-1.0	10.1	10.5	-0.4
1990									
January	8.6	8.4	0.2	7.4	8.2	-0.8	10.1	10.1	--
February	8.9	8.4	0.6	7.4	8.2	-0.8	10.1	10.0	0.1
March	9.2	8.5	0.8	6.8	8.4	-1.5	10.0	10.0	--
April	10.0	8.6	1.4	7.7	8.4	-0.7	11.0	10.0	1.0
May	9.6	8.5	1.1	7.8	8.3	-0.6	11.0	10.0	1.0
June	8.8	8.4	0.5	7.7	8.2	-0.6	10.8	10.0	0.8
July	8.6	8.2	0.4	7.4	8.1	-0.6	10.6	10.0	0.6
August	8.2	8.1	0.2	7.3	8.0	-0.6	10.5	10.0	0.5
September	8.6	8.2	0.4	7.2	8.1	-0.8	10.2	10.0	0.2
October	8.1	8.2	-0.1	7.0	8.1	-1.1	10.0	10.0	--
November	8.4	8.6	-0.2	6.8	8.0	-1.3	9.8	10.0	-0.2
December	8.0	7.9	0.1	6.6	7.8	-1.2	9.7	10.0	-0.3
1991									
January	6.9	7.3	-0.4	6.4	7.2	-0.8	9.9	9.5	0.4
February	7.1	6.7	0.4	6.2	6.5	-0.3	9.5	9.0	0.5
March	7.2	6.6	0.6	6.8	6.4	0.3	9.5	9.0	0.5
April	6.7	6.2	0.5	6.8	6.1	0.7	9.5	9.0	0.5
May	8.4	6.1	2.3	7.2	5.9	1.3	9.7	8.5	1.2
June	7.7	6.2	1.5	6.8	6.1	0.7	10.5	8.5	2.0
July	6.5	6.1	0.4	6.2	6.0	0.3	9.5	8.5	1.0
August	6.1	5.8	0.3	5.8	5.7	0.1	9.5	8.5	1.0
September	5.4	5.6	-0.2	5.4	5.5	-0.1	9.1	8.2	0.9
October	5.3	5.5	-0.2	5.2	5.3	-0.1	8.5	8.0	0.5
November	4.4	5.1	-0.7	4.8	4.9	-0.2	8.5	7.6	0.9
December	4.1	4.6	-0.5	4.8	4.5	0.3	8.5	7.2	1.3
1992									
January	4.6	4.2	0.4	4.8	4.1	0.7	8.5	6.5	2.0
February	4.7	4.2	0.5	4.8	4.1	0.7	8.5	6.5	2.0
March	4.9	4.4	0.5	4.8	4.2	0.5	8.5	6.5	2.0
April	4.4	4.3	0.1	4.8	4.0	0.8	8.5	6.5	2.0
May	3.8	4.0	-0.2	3.7	3.8	-0.1	7.9	6.5	1.4
June	3.9	4.0	-0.1	3.2	3.9	-0.6	7.0	6.5	0.5
July	3.1	3.2	-0.1	2.8	3.4	-0.6	6.5	6.0	0.5
August	3.0	3.4	-0.4	2.8	3.3	-0.6	6.5	6.0	0.5
September	3.2	3.3	--	2.8	3.1	-0.4	6.5	6.0	0.5
October	3.0	3.4	-0.4	2.8	3.3	-0.5	6.5	6.0	0.5
November	4.2	3.8	0.4	2.8	3.6	-0.8	6.5	6.0	0.5

Sources: Census and Statistics Department, Hong Kong Monthly Digest of Statistics; and IMF, International Financial Statistics.

- 1/ Three-month end-of-period rates.
- 2/ Three-month period average rates.
- 3/ Monthly period average.
- 4/ U.S. prime lending rates and HSBC's quoted Best Lending Rates.

HONG KONG
INTEREST RATES, 1985-92
(Percent per annum)



Sources: Census and Statistics Department, Hong Kong Monthly Digest of Statistics; and IMF, International Financial Statistics.

1/ End-of-period London interbank offered rate and Hong Kong interbank offered rate.

2/ Monthly period averages.

3/ U.S. prime lending rate and the Hongkong and Shanghai Banking Corporation's quoted Best Lending Rate.

lending, 1/ the BLR was cut by a full percentage point on May 25 to 7 percent. As a result, the margin between the BLR and the U.S. prime rate was reduced to 1/2 percentage point. Overnight deposit rates were also cut by 1 percentage point to 2 percent.

Following the subsequent cut in the U.S. prime rate in early July, the Hong Kong Association of Banks (HKAB) lowered the BLR to 6 1/2 percent and overnight deposit rates to 1 1/2 percent, where they remained during the rest of the year. Of significance in this round of interest rate cuts was the "lead" role played by the OEF through the LAF: following the cut in the U.S. prime rate, the OEF decided to cut the discount rate by 1/2 percentage point to 4 percent on the morning of Friday, July 3, thereby setting the tone for the HKAB's weekly meeting held the same afternoon. Subsequent to the Friday afternoon meeting, the BLR was reduced to 6 1/2 percent the following Monday.

b. Money and credit developments

With rates of interest substantially negative in real terms, 2/ credit, and hence money supply, expanded rapidly during 1992. The rapid rates of money and credit growth also reflected an inflow of investor funds poised to take advantage of buoyant conditions in the local stock market, as well as the impact of several large share flotations, especially in the latter part of the year. The effects of the share flotations, however, led to substantial variation in the growth of the monetary aggregates (Table 10). Thus, for example, for the 12 months ending in October, the broadest measure of the money supply (M3) grew by 22 1/2 percent, compared with about 14 percent in the preceding month (Chart 8). The Hong Kong dollar component of M3 grew even more rapidly, registering a 37 percent

1/ Interbank rates had slipped below rates paid on deposits. Thus, banks were faced with a situation in which a large inflow of new deposits could, in the short term, only be invested in the interbank market at yields below the deposit rates. The large increase of new deposits reflected, among other things, a large inflow of overseas investment funds for the eventual purchase of Hong Kong stocks.

2/ With the interest rate reductions and despite the easing of inflationary pressures, real interest rates remained negative in real terms in 1992. In November, on the basis of the year-on-year increase of CPI(A), the BLR in real terms was negative 2 3/4 percent, while the three-month deposit rate in real terms was about negative 6 1/2 percent.

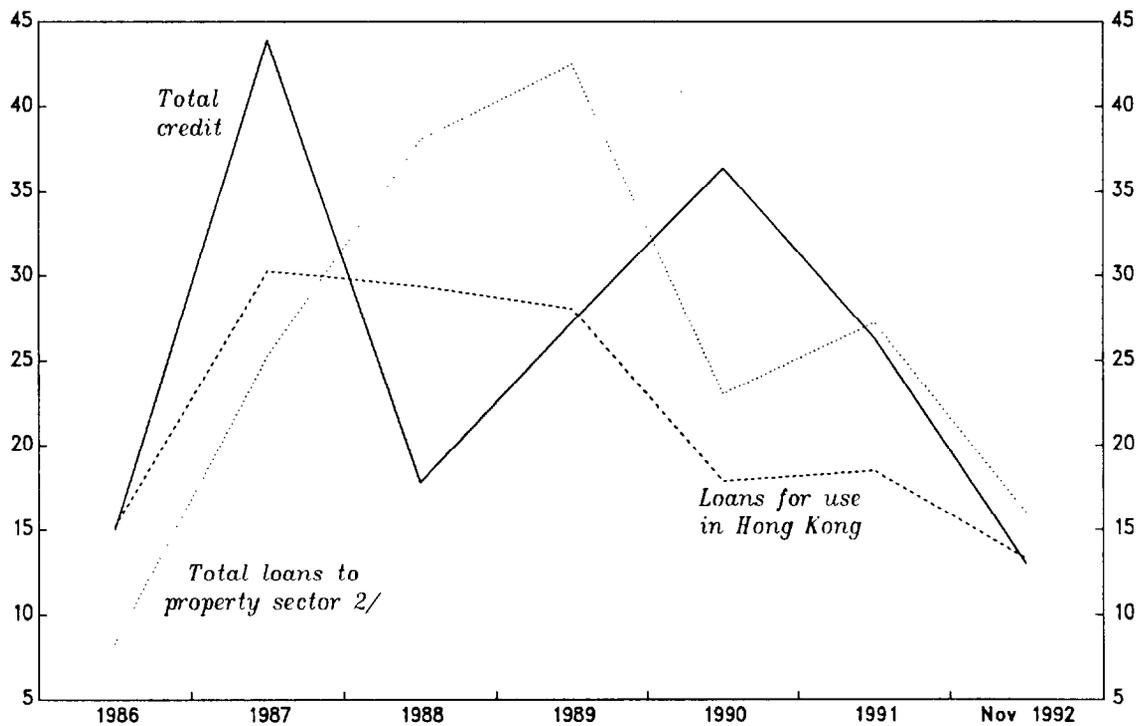
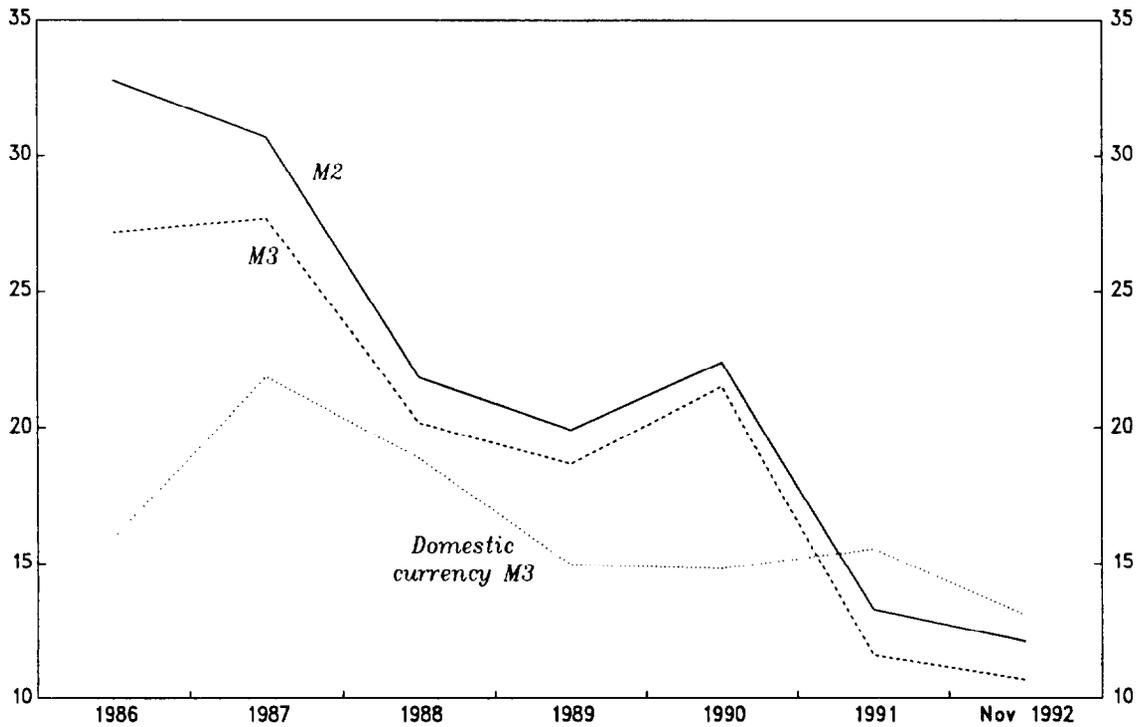
Table 10. Hong Kong: Monetary Indicators, 1987-92 ^{1/}

	1987	1988	1989	1990	1991	1992 ^{2/}		
						Sept.	Oct.	Nov.
(Percentage change)								
Annual rate of growth								
M1	46.0	8.5	6.8	13.3	19.5	31.5	99.5	20.9
M2	30.7	21.8	19.9	22.4	13.3	15.3	24.6	12.1
M3	27.7	20.2	18.7	21.5	11.6	13.7	22.5	10.7
Hong Kong dollar ^{3/}	21.8	18.9	15.0	14.8	15.6	17.0	37.1	13.1
Foreign currency ^{4/}	33.8	21.4	22.2	27.4	8.4	10.7	10.0	8.7
Total credit	43.9	17.8	27.3	36.4	26.3	22.0	22.4	13.0
Hong Kong dollar	22.2	27.3	27.6	16.9	18.9	16.8	32.4	13.7
Foreign currency	59.3	12.6	27.2	48.5	30.0	24.5	17.7	12.8
Of which:								
Total loans	55.6	23.5	32.2	40.6	25.4	23.9	23.9	13.6
Hong Kong dollar	23.6	30.8	29.8	15.6	19.2	17.1	34.4	13.4
Foreign currency	87.5	18.8	33.9	58.3	28.6	27.4	18.7	13.7
(Percent of total)								
Currency composition								
M1								
Hong Kong dollar ^{3/}	90.1	89.2	89.8	85.4	87.0	90.4	93.2	88.3
Foreign currency ^{4/}	9.9	10.8	10.2	14.6	13.0	9.6	6.8	11.7
M3								
Hong Kong dollar ^{3/}	49.0	48.4	46.9	44.3	45.9	47.7	51.5	47.3
Foreign currency ^{4/}	51.0	51.6	53.1	55.7	54.1	52.3	48.5	52.7
Velocity								
M2	0.54	0.53	0.50	0.46	0.47	...	...	...
M3	0.49	0.49	0.47	0.43	0.45	...	...	...
Memorandum items:								
GDP (bn. HK\$)	367.6	433.7	499.2	559.6	643.7	...	...	...
Nominal growth in GDP (percent)	23.1	18.0	15.1	12.1	15.0	...	...	...

Sources: Government Secretariat, Monetary Affairs Branch; and Census and Statistics Department, Hong Kong Monthly Digest of Statistics.

- ^{1/} Monetary stocks at end of period; unadjusted for valuation changes in foreign-currency-denominated deposits.
^{2/} Year-on-year growth rates.
^{3/} Adjusted to include foreign currency swap deposits.
^{4/} Adjusted to exclude foreign currency swap deposits.

HONG KONG
MONEY SUPPLY, 1986-92 1/
(Percent per annum)



Source: Census and Statistics Department, Hong Kong Monthly Digest of Statistics.

1/ End-of-period percentage changes.

2/ For 1992, year-on-year growth rate for September.

year-on-year rise in October, compared with a 17 percent rise in September. 1/

With the October share flotations substantially oversubscribed, liquidity (and credit) growth decelerated in November, as borrowers and other bidders who did not receive a share purchase allotment retired their loan balances or redeployed their funds to other purposes. Hong Kong dollar M3 growth decelerated to a 13 percent year-on-year pace, while M1 growth declined to 21 percent. At the same time, the Hong Kong dollar proportions of M1 and M3 declined to about 88 percent and 47 percent, respectively, bringing them back closer to their recent historical averages.

Credit growth also continued its rapid pace of expansion in 1992. 2/ In the 12 months ending in September, "loans for use in Hong Kong" grew by about 17 percent (Table 11). While growth in bank lending to the property sector remained rapid, it nonetheless slowed, from 27 percent (year on year) in 1991 to 16 percent by the third quarter of 1992. This deceleration reflected, for the most part, the impact of the Government's anti-speculation measures adopted in 1991. 3/ Growth in other loans also remained rapid, with loans to other key sectors of the economy growing in the range of 10-13 percent. Reflecting the rapid pace of stock market activity, loans to financial concerns and stockbrokers grew rapidly, by 22 percent and 185 percent, respectively, in the 12 months ending September. For the 12 months ending October, loans for use in Hong Kong grew by about 32 percent (in light of the share flotations), but decelerated to a 13 percent pace in November. 4/

c. Exchange rate developments

The market exchange rate of the Hong Kong dollar against the U.S. dollar moved within a narrow range of between HK\$7.723 and HK\$7.779 during 1992, a deviation from the linked rate of HK\$7.8 of less than 1 percent.

1/ The rapid increase in Hong Kong dollar M3 in October reflected the impact of several stock flotations, which are estimated to have tied up about HK\$160 billion earmarked for share subscriptions, including bank loans extended to potential investors for the purchase of the new issues. This development was even more evident in the unusually high rate of growth of Hong Kong dollar M1, which grew by over 113 percent in the year ending October.

2/ The high degree of internationalization of the banking system (which involves the booking of a large variety and volume of transactions unrelated to local economic activity) complicates the analysis of credit developments. In assessing the impact of credit developments on the Hong Kong economy, it is therefore more appropriate to examine trends in those loans that are ultimately used in Hong Kong.

3/ See Chapter II for a description of these measures.

4/ Disaggregated data are not currently available for October and November.

Table 11. Hong Kong: Loans for Use in Hong Kong, 1987-92 ^{1/}

	1987	1988	1989	1990	1991	1992 Sept. ^{2/}
	(Percentage change)					
Loans for use in Hong Kong	30.3	29.4	28.1	17.9	18.5	16.7
Of which:						
Manufacturing	18.7	30.8	18.6	6.6	10.6	10.3
Transport and transport equipment	8.5	19.3	59.0	10.9	24.3	13.0
Building, construction, and property development	14.2	49.0	63.6	12.3	16.3	11.6
Wholesale and retail trade	29.0	37.6	4.9	19.1	7.8	9.6
Miscellaneous	39.8	25.4	24.2	20.9	21.5	20.7
Of which:						
To purchase flats in the Home Ownership Scheme and Private Sector Participation Scheme	19.8	15.5	22.5	28.8	39.6	32.5
To purchase other residential property	35.1	33.6	28.6	32.8	34.9	18.4
To financial concerns	49.3	54.0	60.6	23.0	8.6	21.6
To stockbrokers	17.1	-15.4	6.6	-19.2	38.6	185.3
Memorandum items:						
GDP (HK\$ bn.)	367.6	433.7	499.2	559.6	643.7	...
Nominal growth in GDP (percent)	23.1	18.0	15.1	12.1	15.0	...

Sources: Government Secretariat, Monetary Affairs Branch; and Census and Statistics Department, Hong Kong Monthly Digest of Statistics.

^{1/} Based on outstanding loans at the end of the period.

^{2/} Year-on-year growth rates.

From its low point of HK\$7.779 at the beginning of the year, the Hong Kong dollar gradually appreciated over the first quarter. In mid-April, partly reflecting an inflow of foreign funds associated with stock market activity, the exchange rate strengthened to about HK\$7.730. However, following two liquidity injections by the Exchange Fund and the subsequent easing in interbank interest rates, the exchange rate eased somewhat, before firming up again to close the second quarter at HK\$7.732. The exchange rate in the latter half of the year continued to be influenced by investor flows and reached a peak of HK\$7.723 at the end of September. Following the escalation of political tensions between China and the United Kingdom in early December, the exchange rate depreciated slightly to close the year at HK\$7.741.

In real effective terms, the Hong Kong dollar appreciated steadily through April, reflecting the strengthening of the U.S. dollar against other currencies as well as the impact of inflationary pressures in Hong Kong (Table 12 and Chart 9). With the weakening of the U.S. dollar in the second and third quarters, however, the Hong Kong dollar declined in real effective terms. At end-September, the Hong Kong dollar was at about its same level in real effective terms compared with its year earlier level.

3. Prudential issues

a. Capital adequacy

Hong Kong has fully implemented the Basle capital adequacy framework since December 31, 1989. At that time, all locally incorporated institutions met the minimum ratios set for end-1992, and, with the exception of the Bank of Credit and Commerce Hong Kong (BCCHK), have continued to do so to date. At end-1991, the capital adequacy ratio of the banking sector as a whole was well above levels required under the Basle Concordat, with the consolidated capital adequacy ratio for the industry as a whole at almost 13 percent, somewhat higher than the comparable figure for end-1990. Moreover, in 1991, no individual institution's ratio fell below 8 percent, although one bank and two deposit-taking companies went below (higher) "trigger levels" set by the Banking Commission. ^{1/} The institutions concerned, however, were able to promptly rectify the situation, mainly by adjusting their asset portfolios.

^{1/} These trigger ratios, which are set at a margin above the capital ratio requirement, provide an early warning system to the Banking Commission, so that action can be taken as soon as possible. In the event that a trigger ratio is breached, the institution in question is asked to consult the Commissioner of Banking promptly concerning the steps it will take to avoid a breach of the statutory ratio.

Table 12. Hong Kong: Exchange Rate Indices, 1988-92 ^{1/}/_{2/}

	Real Effective Exchange Rate	Nominal Effective Exchange Rate	Exchange Rate
1988			
January	82.8	64.6	63.9
February	83.8	65.1	63.8
March	83.0	64.4	63.8
April	82.7	63.9	63.7
May	82.7	64.0	63.7
June	84.0	65.0	63.7
July	86.2	66.4	63.7
August	86.8	66.9	63.7
September	87.0	66.9	63.7
October	85.1	65.7	63.7
November	83.7	64.1	63.7
December	83.9	64.0	63.7
1989			
January	85.7	65.1	63.7
February	86.9	65.3	63.8
March	87.1	65.8	63.8
April	87.7	66.1	63.9
May	89.7	67.4	64.0
June	91.5	68.3	63.9
July	90.1	67.0	63.8
August	90.9	67.2	63.7
September	92.5	68.0	63.7
October	91.4	67.1	63.7
November	91.8	67.1	63.7
December	92.8	67.6	63.7
1990			
January	93.8	68.0	63.7
February	93.5	67.8	63.7
March	95.9	69.1	63.7
April	96.7	69.6	63.8
May	96.4	68.9	63.9
June	96.9	69.0	63.9
July	96.3	68.0	64.0
August	94.9	66.9	64.0
September	94.3	66.2	64.1
October	92.5	64.5	64.0
November	92.9	64.3	63.8
December	95.0	65.4	63.8
1991			
January	95.5	65.6	63.8
February	95.2	64.9	63.8
March	99.3	67.1	63.9
April	101.8	68.1	63.8
May	102.7	68.6	63.9
June	105.0	70.1	64.3
July	104.7	69.7	64.1
August	104.4	69.0	64.1
September	103.8	68.3	64.2
October	103.6	67.9	64.2
November	102.5	67.0	64.1
December	101.7	66.1	64.0
1992			
January	102.1	65.9	64.1
February	104.1	66.7	64.1
March	106.5	68.0	64.2
April	106.7	68.1	64.3
May	105.6	67.2	64.2
June	104.9	66.2	64.3
July	103.6	65.1	64.3
August	103.6	64.9	64.3
September	104.2	65.0	64.4

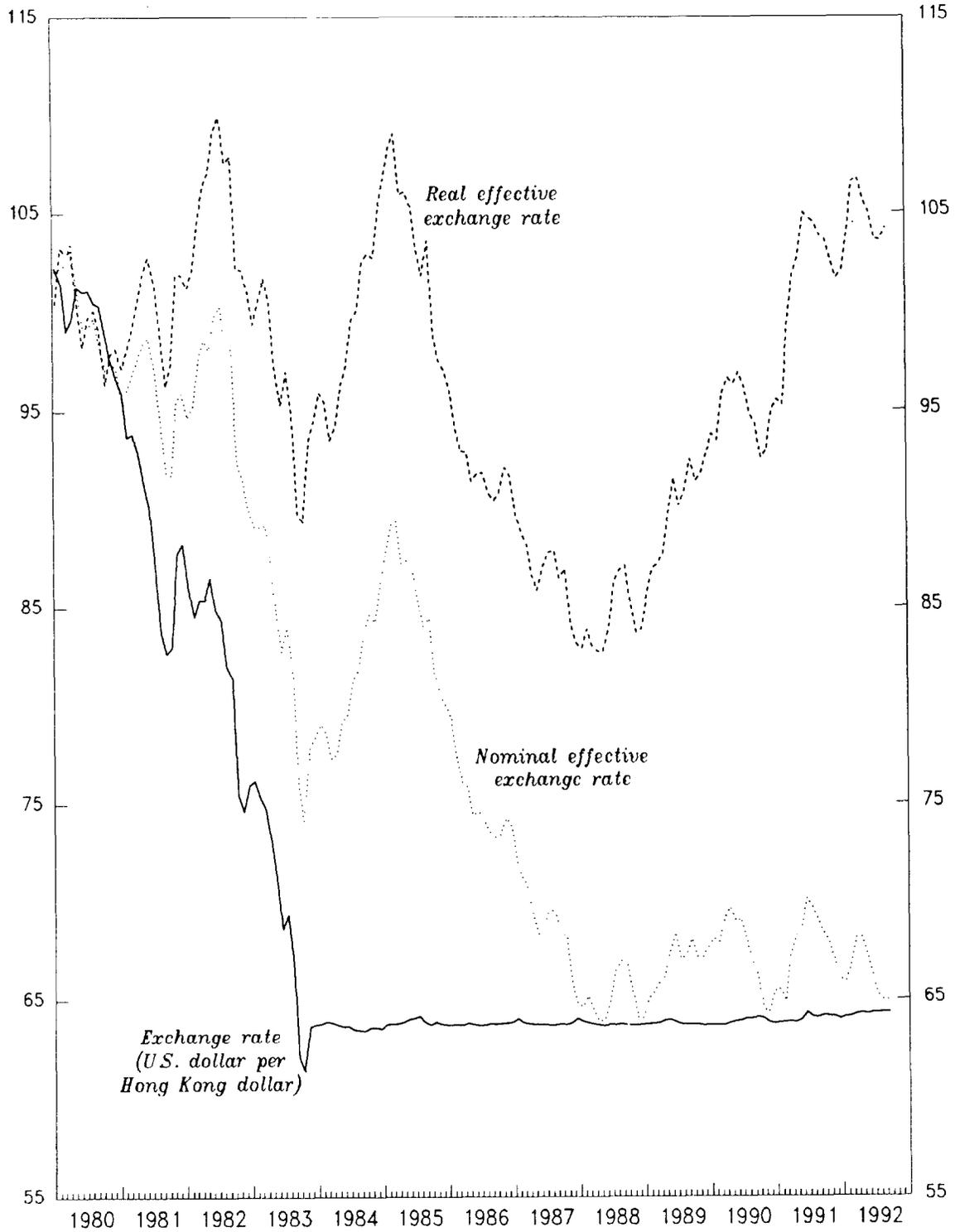
Source: IMF, Information Notice System.

^{1/} Base year, 1980=100.

^{2/} Increase indicates appreciation.

CHART 9

HONG KONG
EXCHANGE RATE DEVELOPMENTS, 1980-92 1/
(1980=100)



Source: IMF, Information Notice System.
1/ Increase indicates appreciation.

b. Liquidation of BCCHK

In July 1991, following the shutdown of the Bank of Credit and Commerce International (BCCI), the Hong Kong authorities recognized that BCCHK's ability to operate normally was seriously impaired, particularly in the absence of a confirmation of financial support from its principal overseas shareholder. 1/ As a result, the decision was taken to close the bank in order to prevent a run on its deposits and to safeguard its assets. 2/ Immediately upon its closure, however, a court-appointed Provisional Liquidator began negotiations with a number of parties that had expressed an interest in acquiring BCCHK, and, by November, a preliminary agreement to sell the bank in its entirety was reached.

In the event, the provisional agreement was terminated in February 1992 as a result of a growing set of claims against BCCHK from members of the Bank of Credit and Commerce Group as well as other banks with whom BCCI had business associations. With the termination of the provisional sale agreement, the Hong Kong authorities decided to complete the liquidation of the bank. To date, all small depositors have been paid off in full, and, by October, all other creditors had received a dividend of at least 40 percent of their claims. It is expected that, ultimately, creditors will receive 70 cents on the dollar, depending on the resolution of a complex set of cross-claims arising from other parts of the BCC Group as well as other larger banks that held BCCHK placements.

V. External Developments

From its recent peak of 8 1/2 percent of GDP in 1989, Hong Kong's surplus on merchandise trade and nonfactor services transactions has narrowed substantially, falling to 5 1/2 percent of GDP in 1990 and further to 3 3/4 percent of GDP in 1991. The decline in the surplus has primarily reflected a deterioration of the merchandise trade balance. Notwithstanding an acceleration of exports in the face of strong demand from China, as well as a further expansion in re-exports of goods produced in China, the trade balance swung from a surplus of HK\$7 3/4 billion (1 1/2 percent of GDP) in 1989 to a deficit of HK\$13 billion by 1991 (2 percent of GDP). This deterioration of the trade balance reflected a surge in imported goods, especially consumer and capital goods, which was buoyed by the rapid increase in domestic demand as well as the real effective appreciation of the Hong Kong dollar over the past several years. At the same time, the net balance on nonfactor services also declined by slightly more than 1 percentage point of

1/ Although it was part of the Bank of Credit and Commerce Group, BCCHK was a locally incorporated institution with its own management and capital resources.

2/ The closure of BCCHK led to nervousness in the financial community and minor runs on several banks. In all cases, however, the banks were able to meet the withdrawals in an orderly and timely manner.

GDP, from a surplus of nearly 7 percent of GDP in the 1988-89 to about 5 3/4 percent of GDP by 1991. In the first half of 1992, total imports continued to grow more rapidly than total exports, and the merchandise trade deficit widened somewhat. However, exports of nonfactor services picked up substantially in the first half of 1992, outstripping the growth of imports of nonfactor services; and the nonfactor service surplus rose substantially (Table 13 and Chart 10).

1. Merchandise trade

a. Exports

(i) Domestic exports

The growth of domestic exports has slowed substantially in recent years. This decline, however, must be viewed against the ongoing structural transformation of the Hong Kong (as well as the southern Chinese) economy. The progressive relocation of Hong Kong's manufacturing base into the southern China region has resulted in an increasing proportion of goods being shipped out of Hong Kong as re-exports of Chinese origin. Operations in southern China have increasingly taken up production of many of Hong Kong's traditional exports, including simple household equipment, toys, and sporting goods.

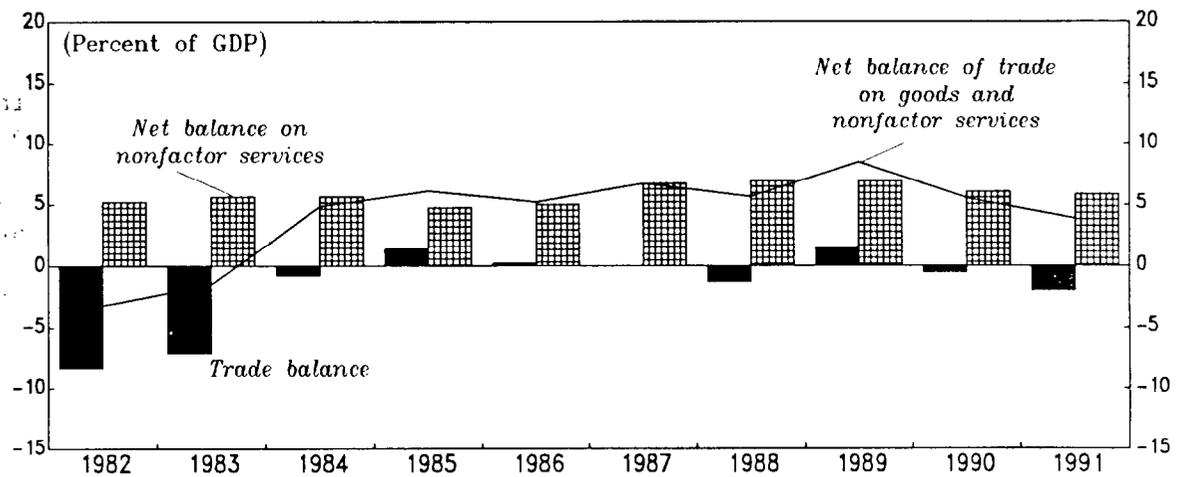
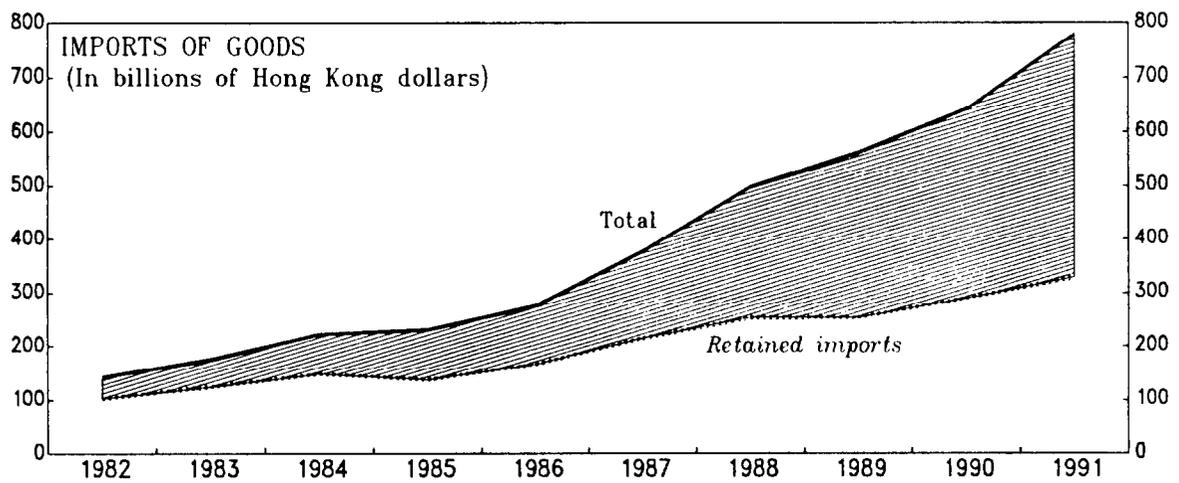
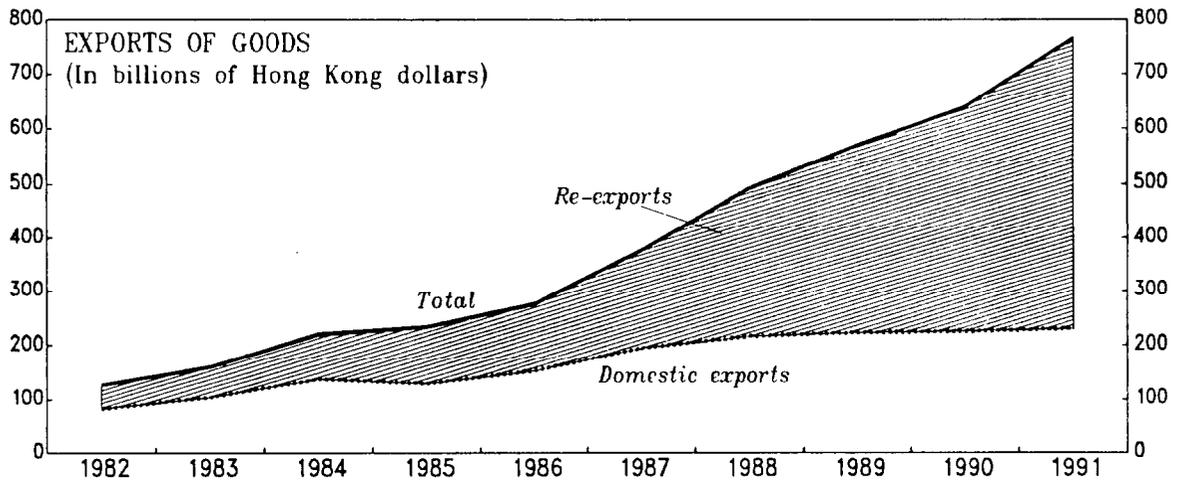
Thus, after rising by 27 percent as recently as 1987, growth of domestic exports tapered off rapidly. Following less than 1 percent growth in 1990, domestic exports expanded at a 2 1/4 percent pace in 1991. The slight recovery of domestic exports in 1991 was due primarily to strong demand in China. In sharp contrast to all other major markets--including the United States, Japan, Germany, and the United Kingdom, where Hong Kong's domestic exports either declined or hardly grew--domestic exports to China registered a 14 1/2 percent increase in 1991. Through September 1992, domestic exports grew by about 2 percent, compared with the corresponding year-earlier period.

(ii) Re-exports

With the shift of various types of manufacturing and processing activities from Hong Kong into China, re-exports have grown rapidly in recent years. Following average annual growth in re-exports of 50 percent in 1987-88, re-export growth slowed in 1989 and 1990 to an average annual rate of 23 percent. Supported by a sustained rapid increase in re-exports involving China, however, re-export growth accelerated in 1991, registering a 29 1/4 percent increase. This accelerating trend was sustained into the first nine months of 1992, as re-exports increased by 30 3/4 percent,

HONG KONG

EXTERNAL SECTOR DEVELOPMENTS, 1982-91



Source: Census and Statistics Department, National Income Branch and Trade Analysis Section.

Table 13. Hong Kong: Balance of Trade in Goods and Nonfactor Services, 1987-92

	1987	1988	1989	1990	1991	1992 Jan.-Sept.
(In billions of Hong Kong dollars)						
Trade balance	0.1	-5.7	7.7	-2.7	-13.1	-24.3
Exports of goods	378.0	493.1	570.5	639.9	765.9	665.6
Domestic exports of goods	195.3	217.7	224.1	225.9	231.0	170.3
Re-exports	182.8	275.4	346.4	414.0	534.8	495.3
Imports of goods	377.9	498.8	562.8	642.5	779.0	689.9
Of which: Retained imports	215.3	253.7	254.2	289.9	329.4	...
Net balance on nonfactor services	24.7	30.1	34.7	33.7	37.4	23.3 ^{1/}
Exports of nonfactor services	70.8	85.5	98.0	110.8	127.3	70.7 ^{1/}
of which: Transportation	32.1	37.6	44.3	...	...	...
Travel	25.8	33.9	37.6	40.0	...	...
Imports of nonfactor services	46.2	55.4	63.4	77.1	89.9	47.4 ^{1/}
of which: Transportation	17.0	19.8	22.2	...	...	...
Travel	19.3	24.2	27.8	34.0	...	...
Net balance of trade on goods and nonfactor services	24.8	24.3	42.4	31.0	24.3	...
(In percent of GDP)						
Trade balance	--	-1.3	1.5	-0.5	-2.0	...
Total exports	102.8	113.7	114.3	114.3	119.0	...
Domestic exports of goods	53.1	50.2	44.9	40.4	35.9	...
Re-exports	49.7	63.5	69.4	74.0	83.1	...
Imports of goods	102.8	115.0	112.7	114.8	121.0	...
Of which: Retained imports	58.6	58.5	50.9	51.8	51.2	...
Net balance on nonfactor services	6.7	6.9	6.9	6.0	5.8	...
Exports of nonfactor services	19.3	19.7	19.6	19.8	19.8	...
Imports of nonfactor services	12.5	12.8	12.7	13.8	14.0	...
Net balance of trade on goods and nonfactor services	6.7	5.6	8.5	5.5	3.8	...
(Percentage change)						
Total exports	36.7	30.4	15.7	12.2	19.7	21.9 ^{2/}
Domestic exports of goods	26.8	11.5	3.0	0.8	2.3	2.0 ^{2/}
Re-exports	49.2	50.7	25.8	19.5	29.2	30.7 ^{2/}
Imports of goods	37.0	32.0	12.8	14.2	21.2	22.8 ^{2/}
Of which: Retained imports	29.0	17.8	0.2	14.0	13.6	...
Exports of nonfactor services	30.5	20.7	14.7	13.0	14.9	22.8 ^{2/}
Imports of nonfactor services	17.4	20.2	14.3	21.6	16.6	13.6 ^{2/}

Source: Census and Statistics Department, National Income Branch and Trade Analysis Section, Hong Kong Annual Digest of Statistics.

^{1/} First half of year.

^{2/} Percentage change over corresponding year-earlier period.

compared with the corresponding year-earlier period. 1/ With China the largest market for, as well as the most important source of, re-exports passing through Hong Kong, a buoyant Chinese economy was a key factor contributing to the acceleration in re-exports in 1991-92.

b. Imports

After growing by 12 3/4 percent in 1989, total import growth gradually accelerated, increasing by 21 1/4 percent in 1991 and by 23 percent in January-September 1992. While much of the recent pickup of imports is related to outprocessing activity in China, growth of retained imports has also accelerated. With robust consumer and investment demand and with the real effective appreciation of the Hong Kong dollar, retained imports grew by 14 percent in 1990 and by a further 13 1/2 percent in 1991, following little growth in 1989. Among major commodity groups, the most notable increase in retained imports came from capital goods, which increased by nearly 22 percent in 1991. Retained imports of consumer goods also grew rapidly, registering a 12 percent increase in 1991 (Appendix Table 8).

2. Trade in nonfactor services

Over the past decade, Hong Kong has maintained substantial annual surpluses on its nonfactor services account. 2/ These surpluses reflect Hong Kong's role as a major international center for tourism, transportation, insurance, and financial services, and have benefited from the increasingly important function Hong Kong plays in providing the southern China region with trade-related and financial services. Over the past few years, the surplus on nonfactor services has remained large, registering nearly 7 percent of GDP in both 1988 and 1989 before declining somewhat to about 6 percent of GDP in 1990-91. With exports of nonfactor services as a ratio to GDP remaining fairly stable, the recent decline has been attributable to rapid growth of imports of nonfactor services, which has in turn been related to the rapid rate of import growth. On the other hand, with the resumption of travel following the end of the Middle East crisis, net receipts from tourism are estimated to have risen.

In the first half of 1992, the trend of the past two years in the balance of nonfactor services was reversed. During this period, the surplus of invisible trade rose sharply to HK\$23 1/4 billion, with exports of nonfactor services growing by 22 3/4 percent and imports of nonfactor services growing by only 13 1/2 percent, compared with the corresponding year-earlier period. The strong growth in exports of nonfactor services was partly due

1/ Reflecting the restructuring of export activity, the share of re-exports in total exports reached 74 percent in the first nine months of 1992, compared with 48 percent five years earlier and 35 percent a decade ago.

2/ At present, Hong Kong does not collect data on factor services or capital flows.

to a surge in the number of visitors to Hong Kong, which increased by 20 percent (year on year) in the first half of 1992. The surge in exports of services also appears to be partly attributable to a pickup in demand for trade-related services (e.g., insurance and shipping) related to re-exports.

3. Regional trade flows

Hong Kong conducts most of its trade with Asia, North America, and Western Europe. China, the United States, and Japan are by far Hong Kong's most important trading partners, together accounting for over 60 percent of Hong Kong's total exports as well as imports. Among them, however, China's share has assumed increasing importance (Table 14 and Appendix Table 9).

With regard to re-exports by origin, China has been the predominant supplier for many years, with its share increasing rapidly throughout the second half of 1980s to nearly 60 percent of the total by 1991. This upward trend reflected Hong Kong's increasingly important role as a conduit for Chinese exports to the rest of the world as well as the increase in out-processing activities in the southern China region. In terms of re-exports by destination, China and the United States represent the largest two markets, accounting for nearly half of Hong Kong's total re-exports in recent years.

North America, Asia, and Western Europe have traditionally been Hong Kong's largest markets for its domestic exports, with the Asian market assuming increasing importance. By 1991, domestic exports to the Asian region reached over 40 percent of total domestic exports, while domestic exports to North America slipped below 30 percent of total domestic exports. Particularly noticeable has been the steady increase in the share of domestic exports destined for China, and the steady decline in the share of domestic exports destined for the United States.

Traditionally, most of Hong Kong's imports have come from Asia, with China and Japan accounting for over half of the total. In recent years, the share of imports from China has risen steadily, while the share of imports from Japan has declined. The share of imports from the United States has also declined steadily.

4. Trade policy issues and developments

In the face of a free regime for external trade and capital transactions and a virtual absence of domestic distortions to obstruct goods or capital flows, the focus of Hong Kong's trade policy has been almost exclusively on efforts to preserve and strengthen an open and fair international trading system. ^{1/} In recent years, the trade policy issues of importance

^{1/} For an overview of the institutional structure of Hong Kong's external trade and investment policies, see SM/91/2 (1/4/91), pp. 39-41.

Table 14. Hong Kong: Direction of Trade by Area and Major Partners, 1987-92

(Percent of total)

	1987	1988	1989	1990	1991	1992 Jan.-Sept.
Imports	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
North America ^{1/}	9.1	8.8	8.7	8.5	8.0	7.4
Of which:						
United States	8.5	8.3	8.2	8.1	7.6	7.1
Western Europe	13.9	13.1	12.5	12.3	11.2	11.5
Asia	72.5	73.4	74.5	75.7	77.5	77.7
Of which:						
China	31.1	31.2	34.9	36.8	37.7	37.3
Japan	19.0	18.7	16.6	16.1	16.4	17.2
Taiwan Province of China	8.8	8.9	9.2	9.0	9.6	9.2
Korea	4.5	5.3	4.5	4.4	4.5	4.7
Other	4.5	4.7	4.3	3.6	3.3	3.3
Domestic exports	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
North America ^{1/}	40.2	36.2	35.0	31.8	29.4	29.5
Of which:						
United States	37.3	33.5	32.2	29.4	27.2	27.3
Western Europe	25.7	25.8	23.8	24.3	24.3	21.0
Of which:						
Germany ^{2/}	7.7	7.5	7.0	8.0	8.4	6.7
United Kingdom	6.6	7.1	6.5	6.0	5.9	5.4
Asia	26.7	31.1	34.9	37.9	40.6	44.2
Of which:						
China	14.3	17.5	19.3	21.0	23.5	26.3
Japan	4.9	5.3	5.8	5.3	5.0	4.9
Other	7.5	6.9	6.3	6.0	5.7	5.2
Re-exports (destination)	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
China	32.9	34.5	29.9	26.8	28.7	30.1
United States	17.8	18.0	20.8	21.2	20.7	21.8
Germany ^{2/}	3.2	3.3	3.9	5.7	6.0	4.8
Japan	5.3	6.3	6.4	5.9	5.5	5.4
Taiwan Province of China	5.3	5.1	4.8	5.1	4.6	3.9
United Kingdom	2.3	2.3	2.6	2.9	2.7	2.9
Korea	4.9	4.3	3.8	3.1	2.7	2.0
Other	28.3	26.3	27.8	29.3	29.0	29.0
Memorandum items:						
Re-exports (origin)	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
China	46.1	47.8	54.3	58.1	59.0	58.7
Japan	13.5	13.7	11.3	10.2	10.7	12.0
Taiwan Province of China	6.9	7.7	7.8	7.3	7.8	7.8
United States	7.4	7.0	6.4	5.9	5.0	4.7
Korea	3.4	4.7	3.3	2.8	2.8	2.9
Germany ^{2/}	1.7	1.6	1.4	1.3	1.3	1.3
United Kingdom	1.3	1.2	1.1	1.1	1.1	1.1
Other	19.7	16.4	14.4	13.2	12.3	11.5

Source: Census and Statistics Department, National Income Branch and Trade Analysis Section, Hong Kong Annual Digest of Statistics.

^{1/} Puerto Rico was classified under the region of North America before 1988, but under the region of Central and South America with effect from 1988.

^{2/} Data prior to October 1990 have been adjusted to include trade figures from the former German Democratic Republic, so as to ensure comparability of these trade figures with those after German unification.

for Hong Kong have been market access for Hong Kong exports, successful completion of the Uruguay Round of Multilateral Trade Negotiations, the emergence of regional trading blocks, and U.S.-Chinese trade relations.

With regard to market access for Hong Kong exports, the Hong Kong authorities have been concerned with antidumping measures taken against domestic firms. Between May 1981 and September 1992, a total of 16 antidumping actions were raised against Hong Kong by producers in a number of countries, with antidumping duties having been imposed in almost all cases. The position taken by the Hong Kong Government is that, given the economy's small size, openness, and highly competitive environment, neither Hong Kong businesses nor the Government has been in a position to subsidize exports. In several cases, the Government has also taken the position that dumping accusations against Hong Kong producers have not been valid on formal grounds (GATT rules require that a whole industry be affected, rather than simply one or two companies, which in any case may no longer be competitive), and that, as a result, the system has been subject to abuse. Although there have been no legal rulings against Hong Kong on charges of dumping, the Government is of the view that dumping accusations have had a harassing effect and have often inflicted considerable economic damage over the protracted period of time required for the litigation. In accordance with these concerns, the Government has pressed, in the context of the Uruguay Round, for a strengthening of the discipline of GATT rules on the initiation and settling of antidumping actions.

Also in the area of market access, the Government in recent years has worked closely with other exporters of textiles and clothing to press for a phase-out of Multifiber Arrangement (MFA) restrictions and the integration of the textiles sector into the GATT framework. Pending the resolution of multilateral negotiations, the Government has also played an important role in forging consensus on the extension of the MFA. 1/

In the area of services, the Hong Kong Government believes that market liberalization commitments from major industrial countries could be strengthened further. In addition, it has urged the GATT Secretariat to help speed up the formation of rules and common approaches for making commitments in respect of the telecommunications, financial, and maritime sectors by issuing the relevant consultation and decision papers.

In the Uruguay Round tariff negotiations, Hong Kong was the first of 14 Contracting Parties that have submitted comprehensive line-by-line draft final schedules on proposed tariff reductions. The Government has offered

1/ Hong Kong's bilateral textile agreements with the United States, Canada, Finland, Sweden, and the European Community (EC) all expired in 1991. The Government negotiated a four-year extension of its agreement with the United States, two-year extensions with Canada and Finland, and a one-year extension with the EC. With Sweden, it agreed to abolish all textile export quotas.

to bind 25 percent of Hong Kong's import items (using 1988 trade data) at a zero tariff rate; currently, Hong Kong binds 70 tariff lines at zero. Such bindings could help to lock in Hong Kong's current liberal trade regime beyond July 1, 1997, and would thus diminish trade-related uncertainty for investors.

With respect to increased regionalism, the Hong Kong Government is of the view that Article XXIV of the GATT, which lays down the broad conditions for the formation of customs unions and free trade areas among GATT members, does not provide an effective deterrent or sanction against trade diversion resulting from the establishment of a regional trade block. The authorities have, therefore, made a proposal to strengthen Article XXIV in the Uruguay Round. The Government has not yet taken formal positions with respect to the North American Free Trade Area and the ASEAN Free Trade Area, owing to their preliminary nature.

In view of the close and expanding economic linkages between Hong Kong and China, U.S.-Chinese trade relations have occupied an important place in Hong Kong's trade policy arena. 1/ Most recently, the United States has conducted two special investigations under Section 301 of the 1988 Trade Act, and the U.S. Congress was involved in a renewal of China's most favored nation (MFN) trading status. The first Section 301 action related to insufficient protection of copyrights, patents, and other intellectual property rights in China, and could have seriously affected Hong Kong's direct investments in the pharmaceutical, computer software, and entertainment sectors in China. Negotiations were successfully completed in January 1992 with agreement reached on improving patent, copyright, and trade secret protection in China. The second Section 301 action--one on market access barriers, including high tariffs, quotas, and nontransparent trade regulations in China--was also potentially significantly damaging to the Hong Kong economy. 2/ The market access negotiations were successfully concluded on October 10, 1992, with China agreeing to reduce tariffs and various non-tariff barriers over a period of several years and to make its external trade legislation more transparent.

A remaining issue for Hong Kong is the annually recurring renewal of China's MFN trading status, which at present is valid through mid-1993. Based on 1991 figures, the Hong Kong authorities estimate that, if China's MFN status were to be withdrawn, Hong Kong's re-exports from China to the United States could be reduced by 35-47 percent (US\$4 3/4-6 1/4 billion).

1/ In 1991, re-exports of Chinese products to the United States amounted to HK\$104 billion, representing 33 percent of Hong Kong's re-exports of Chinese-origin goods.

2/ Official estimates indicate that, had punitive tariffs on US\$3.9 billion worth of Chinese exports to the United States been fully imposed, Hong Kong's annual growth of real GDP would have been reduced by 3/4 of a percentage point, 16,600 jobs would have been lost, and re-exports would have been reduced by 13 1/2 percent.

Together with other related trade flows, this could result in losses in Hong Kong of up to 60,000 jobs. In addition, annual growth of real GDP could be curtailed by 2 1/2 percentage points. There would, moreover, be further losses in income and jobs for Hong Kong if China were to cut back on its imports from the United States, and if there were a consequent weakening of investment in China by Hong Kong and foreign companies.

Table 1. Hong Kong: Gross Domestic Product by Expenditure
at Current Market Prices, 1987-91

	1987	1988	1989	1990	1991
	(In millions of Hong Kong dollars)				
Consumption	243,490	281,811	320,907	372,665	440,506
Private	217,711	251,803	284,581	329,103	388,777
Government	25,779	30,008	36,326	43,562	51,729
Gross fixed capital formation	91,645	115,742	134,821	152,856	177,751
Private	80,750	102,359	117,419	...	...
Government	10,895	13,383	17,402	...	...
Final domestic demand	335,135	397,553	455,728	525,521	618,257
Private	298,461	354,162	402,000	...	...
Government	36,674	43,391	53,728	...	...
Change in stocks	9,746	14,132	3,463	5,728	4,221
Total domestic demand	<u>344,881</u>	<u>411,685</u>	<u>459,191</u>	<u>531,249</u>	<u>622,478</u>
Net exports of goods and nonfactor services	<u>22,722</u>	<u>21,972</u>	<u>39,966</u>	<u>28,374</u>	<u>21,250</u>
Exports of goods and nonfactor services	448,866	578,559	668,549	750,644	893,150
Exports of goods	378,034	493,069	570,509	639,874	765,886
Domestic exports	195,254	217,664	224,104	225,875	231,045
Re-exports	182,780	275,405	346,405	413,999	534,841
Exports of nonfactor services	70,832	85,490	98,040	110,770	127,264
Imports of goods and nonfactor services	426,144	556,587	628,583	722,270	871,900
Imports of goods ^{1/}	379,989	501,174	565,219	645,200	782,042
Imports of nonfactor services	46,155	55,413	63,364	77,070	89,858
Gross domestic product	<u>367,603</u>	<u>433,657</u>	<u>499,157</u>	<u>559,623</u>	<u>643,728</u>
	(In percent of GDP)				
Memorandum items:					
Consumption	66.2	65.0	64.3	66.6	68.4
Gross fixed capital formation	24.9	26.7	27.0	27.3	27.6
Final domestic demand	91.2	91.7	91.3	93.9	96.0
Change in stocks	2.7	3.3	0.7	1.0	0.7
Total domestic demand	93.8	94.9	92.0	94.9	96.7
Net exports of goods and nonfactor services	6.2	5.1	8.0	5.1	3.3

Source: Data provided by the Census and Statistics Department.

^{1/} The national income accounts data on imports of goods adjust the balance of payments data (shown in Table 13) to include an estimate of imports of gold for industrial and commercial use.

Table 2. Hong Kong: Composition of Gross Fixed Capital Formation
at Constant 1980 Market Prices, 1987-91

	1987	1988	1989	1990	1991
(In millions of 1980 Hong Kong dollars)					
Gross fixed capital formation	<u>58,443</u>	<u>62,753</u>	<u>64,559</u>	<u>69,710</u>	<u>76,092</u>
Private	51,447	55,727	56,596	...	...
Public	6,996	7,026	7,963	...	...
Transfer costs of land and buildings	3,649	3,396	2,973	...	...
Private	3,649	3,396	2,973	...	...
Public	--	--	--	...	...
Buildings and construction	18,633	19,317	21,188	22,756	22,562
Private	12,082	12,947	13,978	...	...
Public	6,551	6,370	7,210	...	...
Residential buildings	8,201	8,937	8,920	...	...
Private	5,826	6,426	6,247	...	...
Public	2,375	2,511	2,673	...	...
Nonresidential buildings	5,939	5,918	7,011	...	...
Private	4,848	4,976	5,556	...	...
Public	1,091	942	1,455	...	...
Other construction	4,493	4,462	5,257	...	...
Private	1,408	1,545	2,175	...	...
Public	3,085	2,917	3,082	...	...
Real estate developers' margin	13,518	13,879	13,757	...	...
Private	13,518	13,879	13,757	...	...
Public	--	--	--	...	...
Plant, machinery, and equipment	22,643	26,161	26,641	28,233	33,041
Private	22,198	25,505	25,888	...	...
Public	445	656	753	...	...
Transport equipment	3,979	3,190	3,812	...	...
Private	3,791	2,913	3,453	...	...
Public	188	277	359	...	...
Machinery, other plant, and equipment	18,664	22,971	22,829	...	...
Private	18,407	22,592	22,435	...	...
Public	257	379	394	...	...
(Percentage change)					
Memorandum items:					
Total gross domestic fixed capital formation	14.8	7.4	2.9	8.0	9.2
Private	15.7	8.3	1.6	...	...
Public	9.0	0.4	13.3	...	...
Private investment in residential construction	-11.5	10.3	-2.8	...	...
Private investment in plant, machinery, equipment, and other construction work	27.1	12.6	5.0	...	...
Other private	10.7	0.6	-3.2	...	...

Sources: Census and Statistics Department, Hong Kong Annual Digest of Statistics; and Government Secretariat, Half-Yearly Economic Report, 1992.

Table 3. Hong Kong: Gross Domestic Product by Sector at Current Prices, 1986-90

	1986	1987	1988	1989	1990
<u>(In millions of Hong Kong dollars)</u>					
Agriculture and fishing	1,332	1,358	1,437	1,415	1,441
Mining and quarrying	346	257	229	224	210
Manufacturing	62,779	75,761	83,182	89,645	92,241
Electricity, gas, and water	8,385	9,691	10,200	10,860	12,612
Construction	13,556	16,400	19,900	24,437	29,836
Wholesale, retail and export/import trades, restaurants and hotels	59,890	80,720	98,518	113,998	130,528
Transport, storage, and communications	22,895	30,309	38,053	42,214	50,526
Finance, insurance, real estate, and business services	48,588	63,365	79,436	94,030	111,543
Community, social, and personal services	46,778	52,298	60,195	69,224	80,334
Ownership of premises	30,053	35,901	43,525	51,732	58,165
Adjustment for financial services <u>1/</u>	-13,079	-17,743	-21,313	-23,800	-30,828
Gross domestic product at factor cost	<u>281,523</u>	<u>348,317</u>	<u>413,362</u>	<u>474,479</u>	<u>536,708</u>
Indirect taxes less subsidies	14,750	18,649	21,451	25,390	29,614
Gross domestic product at market prices <u>2/</u>	<u>296,273</u>	<u>366,966</u>	<u>434,813</u>	<u>499,869</u>	<u>566,322</u>
<u>(In percent of GDP)</u>					
Memorandum items: <u>3/</u>					
Manufacturing	22.3	21.8	20.1	18.9	17.2
Wholesale retail and export/import trades, restaurants, and hotels	21.3	23.2	23.8	24.0	24.3
Finance, insurance, real estate, and business services	17.3	18.2	19.2	19.8	20.8
Community, social, and personal services	16.6	15.0	14.6	14.6	15.0

Source: Census and Statistics Department.

1/ An imputed service charge, equal to net interest receipts for the banking sector.

2/ Production-based estimate. Difference between production-based estimate and expenditure-based estimate (see Appendix Table 1) reflects statistical discrepancy.

3/ Measured relative to production-based GDP at factor cost.

Table 4. Hong Kong: Housing Stock and Construction Activity, 1987-92

(In thousands of housing units)

	1987	1988	1989	1990	1991	1992 Q1
Stock of permanent housing ^{1/}						
Total stock	1,493.1	1,562.0	1,629.5	1,710.5	1,758.8	1,803.1
Public rental housing	587.5	610.4	638.0	666.7	676.6	679.6
Public rental/total stock (in percent)	39.3	39.1	39.2	39.0	38.5	37.7
Completion of new housing units						
Total	67.6	70.6	95.8	81.9	82.9	11.9
Private	33.6	30.1	30.6	31.5	40.7	6.7
Public rental	25.0	31.7	46.4	32.9	25.5	5.2
Home Ownership Scheme	9.0	8.8	18.8	17.5	16.7	...

Source: Census and Statistics Department, Hong Kong Monthly Digest of Statistics.^{1/} Annual housing stock data are measured at the end of the third quarter for total housing stock and at the end of year for public rental housing.

Table 5. Hong Kong: Indicators of Labor Productivity, Wages, and Unit Labor Costs, 1986-92

(Percentage change)

	1986	1987	1988	1989	1990	1991	1992 March <u>1</u> /
Labor productivity							
Overall economy <u>2</u> /	7.7	12.1	6.5	2.9	3.7	2.8	5.0
Manufacturing sector <u>2</u> /	12.6	15.7	9.9	6.6	9.7	14.7	15.6
Nominal wages <u>3</u>/							
Overall economy	6.6	9.7	10.2	13.4	12.6	10.6	9.5
Manufacturing sector	6.0	9.8	8.6	12.1	12.3	10.4	8.7
Wholesale and retail trade	6.2	10.3	12.8	13.4	11.0	10.4	10.3
Business services	10.3	8.4	17.0	19.0	16.5	10.9	12.3
Unit labor costs							
Overall economy	-1.0	-2.1	3.5	10.1	8.7	7.6	4.3
Manufacturing sector							
Wage-based <u>2</u> /	-5.8	-5.1	-1.3	5.1	2.3	-3.7	-6.0
Payroll-based <u>2</u> /	1.5	-6.1	6.2	8.3	--	-0.7	-4.0

Sources: Data provided by the Hong Kong authorities; and staff estimates.

1/ Percentage change over previous 12 months.2/ Based on employment; data on man-hours unavailable.3/ Annual wage data are calculated as of September of each year.

Table 6. Hong Kong: Public Expenditure by Function, 1985/86-1992/93 1/

(In millions of Hong Kong dollars)

	1985/86		1986/87		1987/88		1988/89		1989/90	
	Recurrent	Capital	Recurrent	Capital	Recurrent	Capital	Recurrent	Capital	Recurrent	Capital
Economic	1,920	228	2,665	222	2,885	365	3,105	529	3,609	491
Security	5,699	741	6,288	765	6,823	477	8,259	1,187	10,187	1,129
Internal security	4,930	563	5,378	583	5,806	421	6,997	1,124	8,631	1,017
Immigration	330	17	387	27	456	12	583	12	761	35
Other	439	161	523	155	561	44	679	51	795	77
Social services	5,606	607	6,251	607	6,951	826	8,566	911	10,519	1,550
Social welfare	2,335	185	2,468	87	2,759	97	3,633	171	4,426	336
Health	3,271	422	3,783	520	4,192	729	4,933	740	6,093	1,214
Education	6,679	561	7,817	780	8,569	862	9,906	1,449	11,439	1,591
Environment	27	427	43	348	63	365	98	422	573	620
Community and external affairs	2,622	603	2,507	728	2,860	859	3,299	1,052	3,899	1,503
Recreation, culture, and amenities	2,252	582	2,053	708	2,329	832	2,665	1,017	3,077	1,445
District and community relations	247	14	254	15	312	13	428	11	540	10
Other	123	7	200	5	219	14	206	24	282	48
Infrastructure	2,176	3,868	2,666	4,156	2,997	4,564	3,088	5,666	4,097	9,823
Transport	759	1,263	880	1,265	969	1,906	807	2,259	906	3,296
Land and buildings	580	2,129	791	2,278	842	2,058	811	2,804	1,093	5,800
Water supply	837	476	995	613	1,186	600	1,470	603	2,098	727
Support	5,575	541	5,923	586	6,558	796	7,064	533	7,985	1,361
Housing	2,250	3,314	1,785	3,794	2,254	4,562	3,035	6,720	3,710	7,859
Total public expenditure	32,554	10,890	35,945	11,986	39,960	13,676	46,420	18,469	56,018	25,927

Table 6. Hong Kong: Public Expenditure by Function, 1985/86-1992/93 ^{1/} (concluded)

(In millions of Hong Kong dollars)

	1990/91		1991/92 Actual		1992/93 Budget	
	Recurrent	Capital	Recurrent	Capital	Recurrent	Capital
Economic	4,178	1,073	4,797	1,071	5,810	2,380
Security	12,105	1,458	13,186	1,392	14,190	15,855
Internal security	10,203	1,295	10,995	1,289	11,880	1,570
Immigration	935	80	1,051	82	1,110	70
Other	967	83	1,140	21	1,200	25
Social services	13,084	2,014	15,981	1,686	20,130	22,615
Social welfare	5,360	451	6,606	307	7,550	435
Health	7,724	1,563	9,375	1,379	12,580	2,050
Education	14,464	1,610	16,235	2,661	19,210	3,685
Environment	672	1,353	752	1,925	970	3,070
Community and external affairs	4,828	1,760	5,337	1,374	6,220	7,870
Recreation, culture, and amenities	3,914	1,721	4,351	1,339	5,240	1,550
District and community relations	639	17	696	15	690	80
Other	275	22	290	20	290	20
Infrastructure	4,747	7,153	5,941	8,304	6,610	23,180
Transport	1,118	3,320	1,262	2,485	1,500	4,320
Land and buildings	1,342	3,074	1,918	5,170	2,130	11,160
Water supply	2,287	759	2,761	649	2,980	1,090
Support	10,390	1,893	13,129	1,614	14,950	1,835
Housing	3,999	8,417	5,123	7,454	5,640	8,870
Total public expenditure	68,467	26,731	80,481	27,481	93,730	42,210

Source: Data provided by the Government Secretariat, Finance Branch.

^{1/} Public expenditure comprises expenditure by the Housing Authority, the Urban Council, the Regional Council, expenditure financed by the Government's statutory funds, and all expenditure charged to the General Revenue Account. Expenditure by institutions in the private or quasi-private sector is included to the extent of their subventions. The activities of government departments that are partly financed by charges raised on a commercial basis are also included (e.g., airport, waterworks). Excluded is expenditure by those organizations in which the Government has only an equity position, including statutory organizations such as the Mass Transit Railway Corporation and the Kowloon-Canton Railway Corporation. Similarly, debt repayments and equity payments are excluded as they do not reflect the actual consumption of resources by the Government.

Table 7. Hong Kong: Trade Indices, 1987-92

	1987	1988	1989	1990	1991	1992 Jan.-Aug. <u>1/</u>
(Percentage change)						
Total exports						
Value	36.7	30.4	15.7	12.2	19.7	22.1
Unit value	3.7	3.1	5.0	2.7	2.6	1.1
Quantity	31.9	26.4	10.2	9.2	16.6	20.8
Domestic exports						
Value	26.8	11.5	3.0	0.8	2.3	1.8
Unit value	4.4	2.3	2.8	1.4	1.8	0.8
Quantity	21.3	9.0	0.1	-0.5	0.5	1.1
Re-exports						
Value	49.1	50.7	25.8	19.5	29.2	31.1
Unit value	2.2	3.4	6.1	3.0	2.3	1.1
Quantity	45.9	45.7	18.6	16.0	26.4	29.7
Imports						
Value	37.0	32.0	12.8	14.2	21.2	22.6
Unit value	4.1	4.1	3.6	2.5	1.9	0.3
Quantity	31.7	26.7	8.9	11.5	19.0	22.1
Terms of trade	-0.4	-1.0	1.4	0.2	0.8	0.7

Source: Census and Statistics Department, Trade Analysis Section; and Census and Statistics Department, Hong Kong Annual Digest of Statistics.

1/ Percentage change from corresponding year-earlier periods.

Table 8. Hong Kong: Imports, Re-Exports, and Retained Imports, 1981-91

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
(In billions of Hong Kong dollars)											
Raw materials and semimanufactures <u>1/</u>											
Imports	55.9	56.4	75.3	99.7	97.4	119.5	165.5	216.3	230.5	248.7	297.3
Re-exports	16.4	16.8	21.4	34.7	42.8	49.2	72.5	108.2	119.5	127.2	158.0
Retained imports	...	...	...	...	...	...	...	...	121.3	133.0	150.7
Consumer goods <u>1/</u>											
Imports	37.0	38.6	46.7	58.4	66.7	85.2	120.0	164.4	201.5	247.7	304.7
Re-exports	17.3	18.1	22.8	30.6	38.5	49.5	77.4	117.0	166.1	219.3	289.0
Retained imports	...	...	...	...	...	...	...	...	55.4	69.2	77.5
Capital goods <u>1/</u>											
Imports	20.3	19.9	22.5	32.8	36.3	39.5	56.9	77.2	84.4	94.6	120.5
Re-exports	5.2	5.9	7.6	13.4	18.5	16.3	24.2	37.8	46.6	53.5	71.1
Retained imports	...	...	...	...	...	...	...	...	43.9	48.8	59.5
Foodstuffs											
Imports	14.7	16.8	19.7	20.7	20.8	23.5	26.8	32.1	34.0	37.0	41.3
Re-exports	2.6	3.2	4.0	4.3	5.1	6.9	7.9	11.3	11.4	11.4	13.2
Retained imports	...	...	...	...	...	...	...	...	23.5	26.6	29.6
Fuels											
Imports	10.6	11.1	11.3	11.8	10.3	8.3	8.8	8.8	12.5	14.5	15.3
Re-exports	0.3	0.3	0.4	0.5	0.4	0.8	0.8	1.1	2.8	2.5	3.5
Retained imports	...	...	...	...	...	...	...	...	10.0	12.3	12.1
Total imports	138.4	142.9	175.4	223.4	231.4	276.0	377.9	498.8	562.8	642.5	779.0
Total re-exports	41.7	44.4	56.3	83.5	105.3	122.5	182.8	275.4	346.4	414.0	534.8
Total retained imports	101.2	103.4	125.3	149.1	137.7	166.9	215.3	253.7	254.2	289.9	329.4
(In percent of GDP)											
Raw materials and semimanufactures <u>1/</u>											
Imports	33.9	30.4	36.5	40.2	37.3	40.0	45.0	49.9	46.2	44.4	46.2
Re-exports	10.0	9.0	10.4	14.0	16.4	16.5	19.7	25.0	23.9	22.7	24.5
Retained imports	...	...	...	...	...	...	...	...	24.3	23.8	23.4
Consumer goods <u>1/</u>											
Imports	22.5	20.8	22.6	23.6	25.5	28.5	32.6	37.9	40.4	44.3	47.3
Re-exports	10.5	9.7	11.1	12.3	14.7	16.6	21.1	27.0	33.3	39.2	44.9
Retained imports	...	...	...	...	...	...	...	...	11.1	12.4	12.0
Capital goods <u>1/</u>											
Imports	12.3	10.7	10.9	13.2	13.9	13.2	15.5	17.8	16.9	16.9	18.7
Re-exports	3.2	3.2	3.7	5.4	7.1	5.5	6.6	8.7	9.3	9.6	11.0
Retained imports	...	...	...	...	...	...	...	...	8.8	8.7	9.2
Foodstuffs											
Imports	8.9	9.0	9.6	8.3	8.0	7.9	7.3	7.4	6.8	6.6	6.4
Re-exports	1.6	1.7	1.9	1.7	2.0	2.3	2.1	2.6	2.3	2.0	2.1
Retained imports	...	...	...	...	...	...	...	...	4.7	4.8	4.6
Fuels											
Imports	6.4	6.0	5.5	4.8	3.9	2.8	2.4	2.0	2.5	2.6	2.4
Re-exports	0.2	0.2	0.2	0.2	0.2	0.3	0.2	0.3	0.6	0.4	0.5
Retained imports	...	...	...	...	...	...	...	...	2.0	2.2	1.9
Total imports	84.0	76.9	85.1	90.1	88.6	92.5	102.8	115.0	112.8	114.8	121.0
Total re-exports	25.3	23.9	27.3	33.7	40.3	41.0	49.7	63.5	69.4	74.0	83.1
Total retained imports	61.4	55.7	60.8	60.1	52.7	55.9	58.6	58.5	50.9	51.8	51.2

Source: Census and Statistics Department, Trade Analysis Section.

1/ As there was a reclassification of commodities in 1986, figures for 1985 (but not for 1981-1984) have been revised according to the new classification to permit comparison with those for 1986.

Table 9. Hong Kong: Structure of Trade with China, 1981-92

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992 Jan.-Aug.
<u>(In billions of Hong Kong dollars)</u>												
China												
Trade balance	-18.8	-21.3	-24.4	-16.2	3.2	-21.1	-27.2	-18.5	-43.8	-71.6	-77.6	-47.0
Total exports	11.0	11.8	18.4	39.3	61.2	58.9	88.0	132.9	146.8	158.4	207.7	170.2
Domestic exports	2.9	3.8	6.2	11.3	15.2	18.0	27.9	38.0	43.3	47.5	54.4	39.4
Re-exports (to China)	8.0	8.0	12.2	28.1	46.0	40.9	60.2	94.9	103.5	110.9	153.3	130.8
Total imports	29.7	33.1	42.8	55.5	58.0	80.0	115.2	151.5	190.6	230.0	285.3	217.2
Of which: Re-exports (from China)	12.8	14.7	19.7	28.1	34.6	51.6	84.3	131.5	188.3	240.4	315.7	251.4
<u>(Percent of GDP)</u>												
China												
Trade balance	-11.4	-11.5	-11.8	-6.5	1.2	-7.1	-7.4	-4.3	-8.8	-12.8	-12.1	...
Total exports	6.7	6.4	8.9	15.8	23.4	19.7	23.9	30.6	29.4	28.3	32.3	...
Domestic exports	1.8	2.0	3.0	4.6	5.8	6.0	7.6	8.8	8.7	8.5	8.5	...
Re-exports (to China)	4.9	4.3	5.9	11.3	17.6	13.7	16.4	21.9	20.7	19.8	23.8	...
Total imports	18.0	17.8	20.8	22.4	22.2	26.8	31.3	34.9	38.2	41.1	44.3	...
Of which: Re-exports (from China)	7.8	7.9	9.6	11.3	13.3	17.3	22.9	30.3	37.7	43.0	49.0	...

Source: Census and Statistics Department, Trade Analysis Section.

