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January 6, 1992

To: Members of the Executive Board

From: The Secretary

Subject: United Kingdom - Hong Kong - Staff Report for the
1991 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1991 Article IV consultation with respect to Hong Kong, which is tentatively scheduled for discussion on Friday, January 24, 1992.

Mr. Citrin (ext. 8982) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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INTERNATIONAL MONETARY FUND

UNITED KINGDOM - HONG KONG

Staff Report for the 1991 Article IV Consultation

Prepared by the Staff Representatives for the
1991 Consultation with Hong Kong

Approved by Bijan B. Aghevli and J. Ferran

January 3, 1992

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I. Introduction 1/

The 1991 Article IV consultation discussions with respect to Hong Kong were held during October 17-25. The staff team met with the Financial Secretary, the Secretary for Monetary Affairs, the Director of the Office of the Exchange Fund, and other senior officials of the Government of Hong Kong. 2/ Mr. Peretz, Executive Director for the United Kingdom, was present during some of the discussions. 3/

In concluding the 1990 Article IV consultation discussions last January, Executive Directors expressed their admiration for Hong Kong's economic achievements and the liberal policy framework upon which they had been based. With monetary policy directed at maintaining a fixed exchange rate link with the U.S. dollar, Directors noted that labor market measures--including a more liberal labor import policy--and continued fiscal restraint were the main instruments available to help reverse the rise in inflation. The issue of monetary and exchange rate management generated considerable discussion. While noting that the linked exchange rate arrangement had contributed to relatively high inflation, most Directors believed that it had resulted in substantial benefits for Hong Kong, particularly by underpinning confidence. Directors strongly endorsed the authorities' plan to contain the growth in public expenditures over the medium term, while encouraging that steps be taken to make the tax system less narrowly based.

II. Recent Economic Developments and Prospects

Hong Kong's remarkable economic success over recent decades has been based on the entrepreneurial skills of its people and the ability of management and labor to adapt flexibly to shifts in external demand and in comparative advantage. It also owes much to the Government's approach of

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.

2/ The staff team consisted of Messrs. Smith (Head, SEA), Citrin (CTA), Kronenberg (SEA), and Miranda (CTA), and Mrs. Ellyn (Staff Assistant, CTA).

3/ While Article IV consultations can be conducted only with members, the Fund can hold Article IV consultation discussions with respect to sub-parts of a member, at the member's request. Formally, these discussions are part of the 1991 Article IV consultation discussions with the United Kingdom. The first Article IV consultation discussions with respect to Hong Kong were held in October 1990, and the staff report (SM/90/233; 12/19/90) was discussed at the Executive Board on January 23, 1991 (EBM 91/8 and EBM 91/9).

maintaining a favorable climate for private business activities by combining a low rate of taxation, fiscal discipline, and limited regulation, while also playing a major role in the provision of complementary social infrastructure. Furthermore, a free international trade and finance regime has served as an important underpinning for growth.

Recent economic development has been heavily influenced by strengthening economic links with southern China. 1/ The opening of China as part of its reform process, the relative abundance of land and labor in China, and Hong Kong's ability to supply experienced entrepreneurship and capital have led to the growth of Hong Kong's role as a provider of essential managerial, financial, and other services in the development of China's economy and trading relations. At the same time, there has been a marked increase in "outprocessing" activities associated with the transfer to China of labor-intensive manufacturing activities previously undertaken in Hong Kong.

While the linkages with China provide long-term benefits to Hong Kong, they have also made its economy increasingly sensitive to events affecting China. Moreover, this sensitivity has been heightened with the prospective return of authority over Hong Kong to China in 1997. Events in China in June 1989 led to a deterioration in confidence that extended and expanded a cyclical slowdown that had begun in late 1988. Output growth fell to 2 3/4 percent in 1989 from over 8 percent the previous year, with a sharp weakening in both business investment and private consumption.

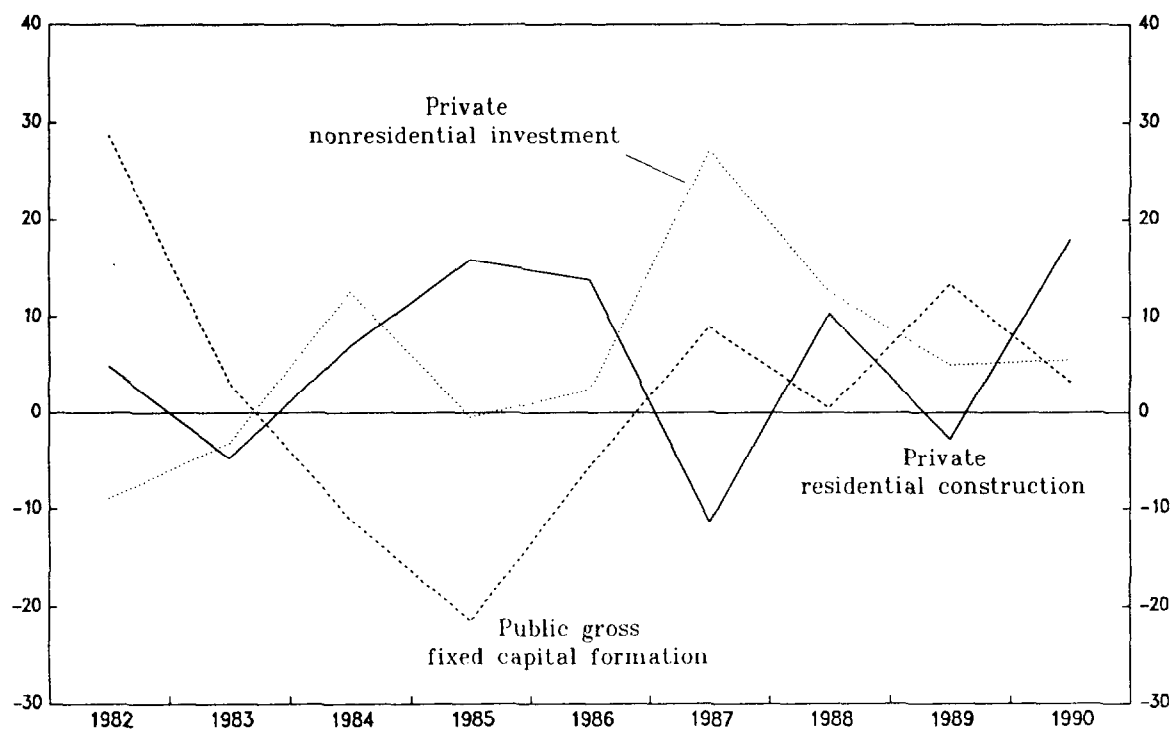
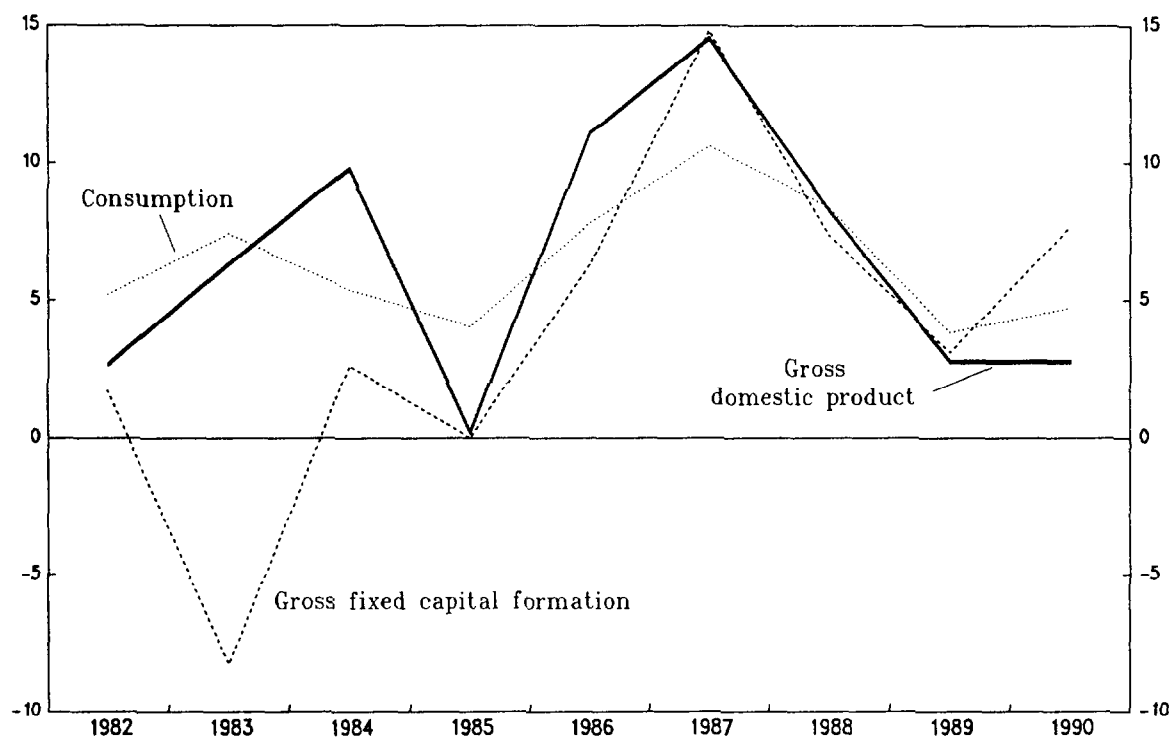
Real GDP again increased by 2 3/4 percent in 1990 (Chart 1 and Table 1). Economic activity remained sluggish in the first half of the year, with confidence still low and domestic exports declining owing to weak foreign demand as well as to the ongoing effects of the real effective appreciation of the Hong Kong dollar from mid-1988 to mid-1990. 2/ Over the course of the year, however, the economy revived, and real GDP increased by almost 4 percent on a year-on-year basis in both the third and fourth quarters. Exports strengthened owing to the economic recovery in China and the surge in demand in Germany, and domestic demand also picked up.

For 1990 as a whole, imports recovered in line with the upturn in domestic demand, while growth in total export value slowed. Merchandise

1/ See "United Kingdom - Hong Kong: 1990 Recent Economic Developments" (SM/91/2; 1/4/91), Chapter VII, for a detailed discussion of the economic links between Hong Kong and China.

2/ From April 1988 until June 1990, the real effective value of the Hong Kong dollar rose by 17 1/4 percent. It should be noted that this measure of the real exchange rate is based on relative consumer prices, and, as such, is likely to overstate the decline in competitiveness.

CHART 1
HONG KONG
GROSS DOMESTIC PRODUCT AT 1980 CONSTANT PRICES, 1982-90
(Percent change from previous year)



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

Table 1. Hong Kong--Summary Data, 1987-91

	1987	1988	1989	1990	1991 Est.
(Percentage change)					
Growth, prices, and unemployment					
Real GDP	14.5	8.3	2.7	2.8	4.0 <u>1/</u>
Real domestic demand	12.5	8.7	1.0	5.8	8.1 <u>1/</u>
Private consumption	11.3	8.7	3.6	4.5	6.0 <u>1/</u>
Gross fixed capital formation	14.8	7.4	3.1	7.7	8.5 <u>1/</u>
Foreign balance <u>2/</u>	2.6	0.1	1.8	-2.7	-3.7 <u>1/</u>
Consumer prices <u>3/</u>	5.5	7.4	10.1	9.7	12.0 <u>1/</u>
Unemployment rate (in percent)	1.7	1.4	1.1	1.3	2.1 <u>4/</u>
Money and credit (end-year)					
Narrow money (M1)	46.0	8.5	6.8	13.3	22.8 <u>5/</u>
Broad money (M3)	27.7	20.2	18.7	21.5	10.9 <u>5/</u>
Trade					
Exports	36.7	30.4	15.7	12.2	20.2 <u>6/</u>
Domestic exports	26.8	11.5	3.0	0.8	3.3 <u>6/</u>
Re-exports	49.2	50.7	25.8	19.5	29.5 <u>6/</u>
Imports	37.0	32.0	12.8	14.2	23.3 <u>6/</u>
Terms of trade	-0.4	-1.0	1.4	0.2	-0.4 <u>7/</u>
Consolidated budget account <u>8/</u>					
Revenue	25.3	19.4	13.4	8.6	16.8 <u>1/</u>
Expenditures	13.3	11.2	32.7	19.9	17.6 <u>1/</u>
(In percent of GDP)					
Trade balance	--	-1.3	1.6	-0.5	-3.3 <u>1/</u>
Exports	102.8	113.7	114.9	115.7	121.1 <u>1/</u>
Imports	102.8	115.0	113.4	116.1	124.4 <u>1/</u>
Consolidated budget balance <u>8/</u> , <u>9/</u>	3.4	4.3	2.2	0.7	0.6 <u>1/</u>
Revenue	16.6	16.8	16.6	16.2	16.7 <u>1/</u>
Expenditures	13.2	12.4	14.4	15.5	16.0 <u>1/</u>
Current	9.7	9.5	9.9	10.9	11.1 <u>1/</u>
Capital	3.4	2.9	4.5	4.6	4.9 <u>1/</u>
Interest rates (end-period in percent)					
Best lending rate	5.5	10.0	10.0	10.0	8.5 <u>10/</u>
Time deposits (three-month)	2.0	6.5	6.5	6.8	4.8 <u>10/</u>
Exchange rates					
Present linked rate (fixed)	HK\$7.80/US\$1 (December 1, 1991)				
Present market rate	HK\$7.76/US\$1 (End-November, 1991)				
Real effective exchange rate (period average; 1980=100)	86.8	84.3	89.8	94.9	104.0 <u>11/</u>

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

1/ Official projection.

2/ Contribution to change in GDP.

3/ Based on CPI (A). See footnote 2, Table 8 for definition.

4/ Seasonally adjusted rate at end-September.

5/ Year-on-year growth rate for September.

6/ January-September 1991 compared with corresponding year-earlier period.

7/ January-June 1991 compared with corresponding year-earlier period.

8/ Fiscal year beginning April 1.

9/ Fiscal year receipts and expenditure divided by calendar year GDP.

10/ As of November 1991.

11/ As of September 1991.

trade and nonfactor services transactions recorded a surplus of HK\$33 billion (6 percent of GDP), down from \$43 billion (8 1/2 percent of GDP) in 1989 (Charts 2 and 3). ^{1/}

In 1990, the labor market remained extremely tight and wage pressures remained strong. In the manufacturing sector, wages rose by 12 percent, but rapid productivity growth--partly owing to further outprocessing--held the increase in unit labor costs to 2 percent. In the services sectors, however, increases in unit labor costs were large, owing to lower rates of productivity growth as well as somewhat higher wage increases averaging 14 percent. ^{2/} These cost increases were passed through to prices and were reflected in consumer price inflation of 10 percent in 1990 (Chart 4).

The economic recovery continued in 1991. In the first half of the year, real GDP rose by 4 percent (year-on-year); available data suggest the economy also grew steadily thereafter, supported by a substantial boost to confidence from the Sino-British agreement reached in July on the new Hong Kong airport project. Export growth picked up substantially further, registering over 20 percent in January-September on a year-on-year basis. The recovery in activity also led to a sharp acceleration in imports, and the visible trade deficit widened considerably.

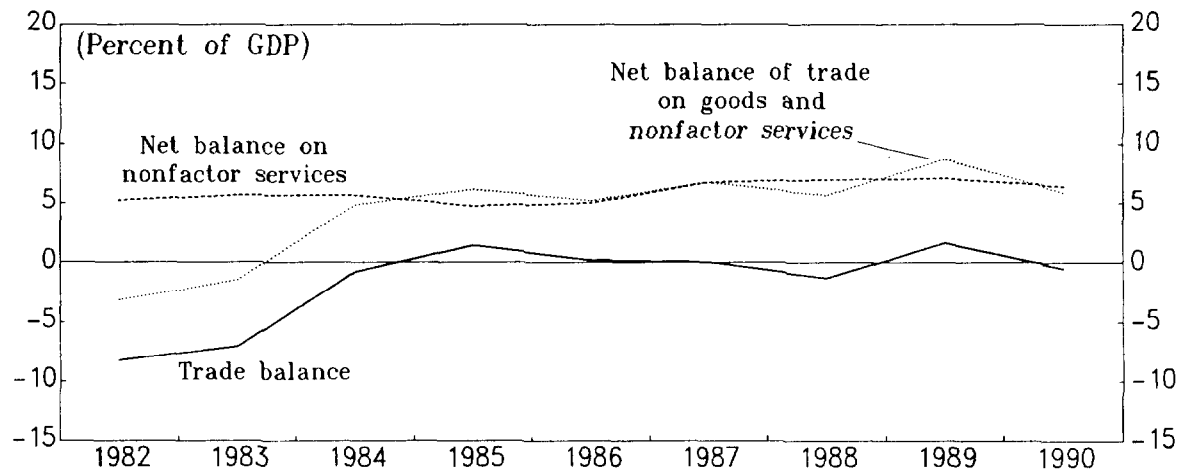
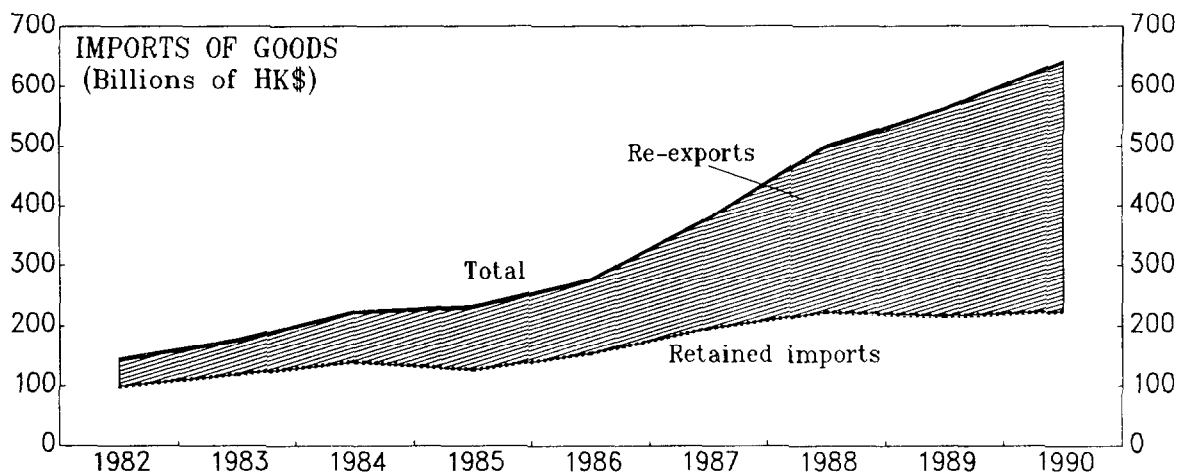
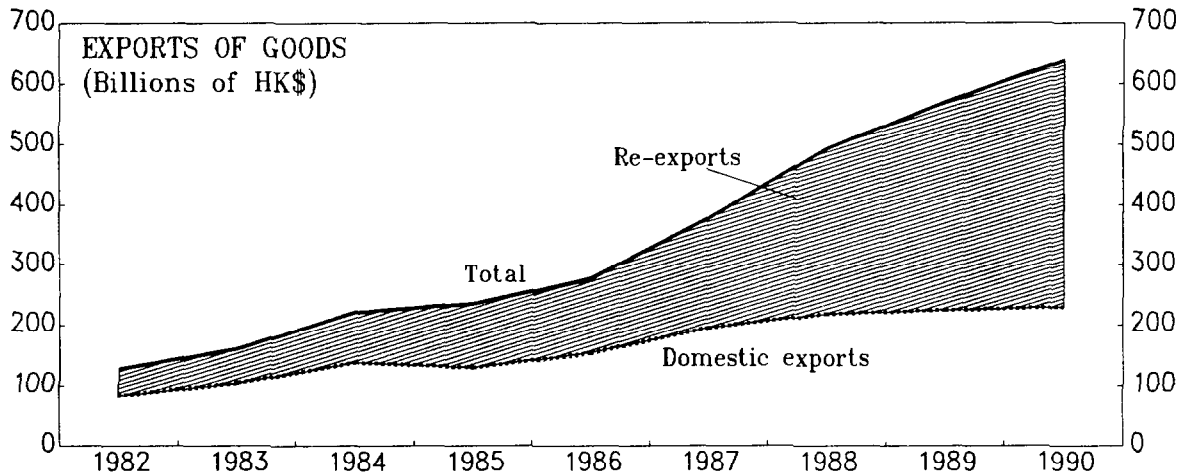
In spite of the continued recovery, labor market pressures eased somewhat in the first half of 1991; the unemployment rate rose from 1 1/2 percent in the fourth quarter of 1990 to reach 2 1/2 percent by the second quarter of 1991. This reflected a pickup in labor force growth, owing both to a reduction in net emigration and the importation of labor under two new government schemes announced in 1990. Available data indicate that there was an accompanying moderation in wage increases in most sectors. Subsequently, however, the labor market has begun to tighten again, with the unemployment rate falling to 2 percent in the third quarter.

Consumer price inflation increased further in 1991; in the first nine months of the year, consumer prices rose 12 1/2 percent, compared with the same period last year. The pickup in the headline (overall) rate of inflation was partly due to the impact of special and nonrecurrent factors, including indirect tax increases and higher food prices owing to adverse weather in China. Indeed, with the dissipation of the effects of these factors, the 12-month headline rate eased to 11 1/2 percent in September, after rising to a peak of 14 percent in April.

^{1/} A complete analysis of Hong Kong's balance of payments is not feasible because data on factor services transactions, transfers, and capital flows are not available.

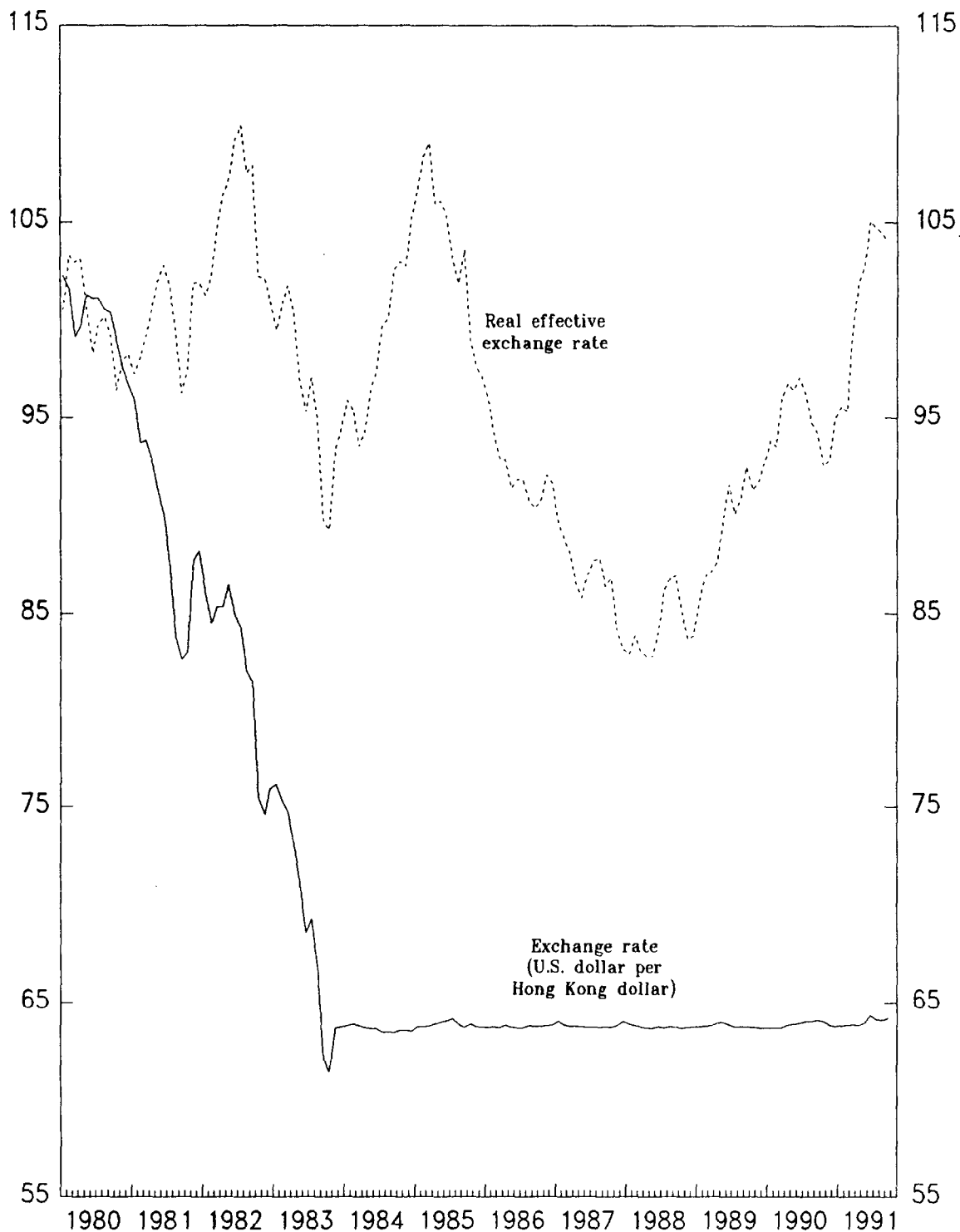
^{2/} Reliable indicators of productivity and unit labor costs in the services sectors are not available. For the overall economy (including manufacturing), however, unit labor costs increased by over 9 percent in 1990, with labor productivity rising only 3 percent.

CHART 2
HONG KONG
EXPORTS AND IMPORTS, 1982-90



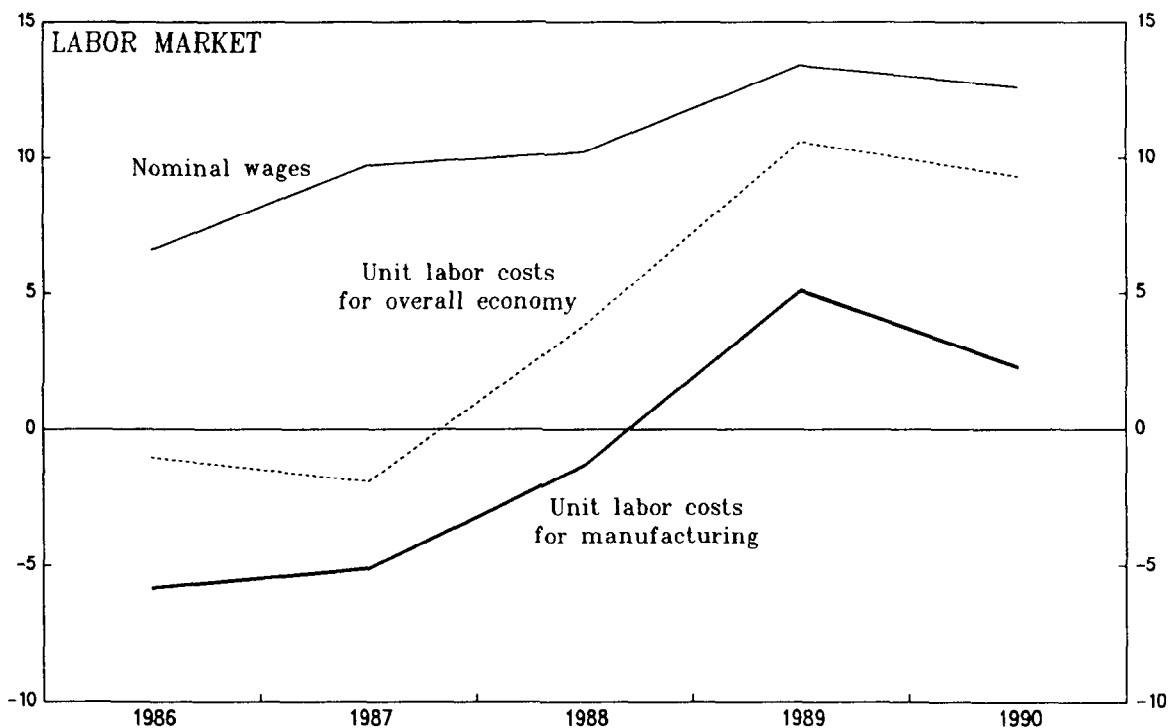
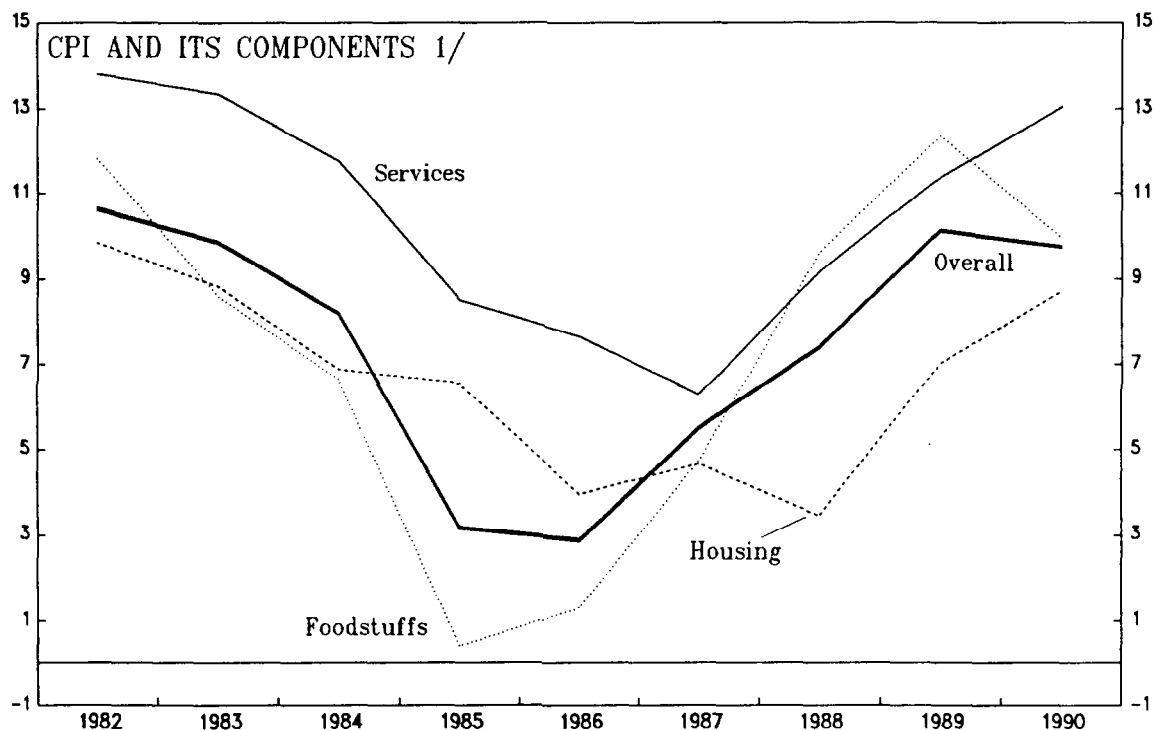
Source: Census and Statistics Department, National Income Branch and Trade Analysis Section.

CHART 3
HONG KONG
EXCHANGE RATE DEVELOPMENTS, 1980-91 1/
(1980=100)



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

CHART 4
HONG KONG
SELECTED INDICATORS OF PRICES, 1982-90
(Percentage change)



Source: Census and Statistics Department, Hong Kong Monthly Digest of Statistics.
1/ Based on CPI(A). See footnote 2, Table 8 for definition

The revised official forecast (announced in August) envisages real GDP growth of 4 percent in 1991, and the staff expects somewhat higher growth--about 4 1/2 percent. The moderation in wages in the first half of the year, along with more stable food prices, is expected to have led to some further decline in the 12-month headline rate of consumer price inflation in the last few months of the year. Nevertheless, consumer prices are estimated to have risen by 12 percent in 1991 on an average annual basis. In 1992, the recovery is expected to continue, with growth at least as strong as in 1991. In view of the continued expansion and the recent tightening in the labor market, however, any significant reduction in inflation is unlikely.

III. Policy Issues

Since the last Article IV consultation discussions, confidence in Hong Kong has recovered and concerns about the weakness of economic activity have diminished. Indeed, with the continuation of the economic upturn, there is a risk that inflation will accelerate further. Reducing inflationary pressures, so as to provide a basis for long-term growth with stability, is the key immediate issue facing policymakers.

1. Inflation: sources and issues

Hong Kong's current inflation problem originated with excess demand pressures following the rapid expansion in 1986-88 that brought the economy to a high degree of resource utilization, most evident in pressures in the labor market. ^{1/} Underpinning excess demand pressures, however, are developments of a longer-term nature that affected both the demand and supply sides of the economy during the 1980s. On the demand side, the opening of China to foreign trade and investment had, by 1985, generated a surge in demand for the complementary goods and services provided by Hong Kong. In turn, this led to a substantial increase in labor demand, especially in the trade-related service sectors, and, in addition, boosted private investment activity. At the same time, a marked decline in labor force growth--from an annual rate of 2 1/2 percent during 1981-86 to only 3/4 percent in 1987-90--had a large negative impact on supply. The slowing in labor force growth reflected several developments: a decline in the birth rate; a more restrictive policy regarding immigration from China; lower labor force participation in response to increases in family income

^{1/} The unemployment rate fell to a record low of 1 percent in 1989, and the present rate (2 percent) is still at the bottom of the range of estimates of the natural rate of unemployment.

levels; and, especially after June 1989, sizable emigration owing to uncertainties associated with the transfer of authority in 1997. 1/

Against this background, the rise in the relative importance of the services sectors in the Hong Kong economy has contributed to the persistence of wage and price pressures. Traditionally, such pressures were kept in check by the need for manufacturers to maintain their international competitiveness. In recent years, however, the ability of internationally exposed firms to shift manufacturing and some service functions to outprocessing facilities in China has accommodated relatively high wage increases without affecting price competitiveness on world markets. At the same time, in the nontradable services sectors, such wage increases have led to sizable price increases and a rise in the overall rate of consumer price inflation to well above that in the United States and other trading partner countries.

In the face of these underlying developments, financial policies have not contributed to restraining demand. Monetary policy has been geared toward maintaining the linked exchange rate with the U.S. dollar, and therefore has been precluded from attempting to slow the expansion of nominal demand, allowing sustained rapid rates of monetary expansion. Fiscal policy has also been stimulative: while the budget balance has remained in surplus, the surplus has declined markedly since its peak in 1988/89, 2/ serving to aggravate excess demand pressures.

2. Monetary policy and the exchange rate

Since October 1983, monetary policy has been aimed at maintaining stability in the market exchange rate at close to the linked rate of HK\$7.8 per US\$1 set for the note issue. 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. After the establishment of the linked exchange rate and up until 1988, the authorities relied extensively on exchange market intervention to influence the exchange rate. Since mid-1988, the introduction of new monetary management techniques has greatly

1/ Emigration peaked at an estimated 62,000 persons in 1990 (1 percent of the total population). Recent information suggests that this outflow has declined, mainly reflecting the economic downturns in North America, the United Kingdom, and Australia in the face of buoyant economic conditions in Hong Kong. Also, there are indications that some emigrants have returned to Hong Kong once overseas residency rights have been established.

2/ The fiscal year begins on April 1.

strengthened the authorities' ability to influence conditions in the interbank market and thereby maintain exchange rate stability. 1/

Under the linked exchange rate system, movements of Hong Kong dollar interest rates have generally closely followed those of U.S. dollar rates. Reflecting the easing in monetary conditions in the United States, Hong Kong dollar interest rates have trended downward since early 1989. The resulting interest rate levels have not been high enough to contain demand pressures, and have allowed rapid rates of expansion in broad money and credit (Chart 5). In 1989-90, growth of Hong Kong dollar M3 averaged 15 percent; in January-September 1991, broad money growth moderated somewhat to 12 1/2 percent on a year-on-year basis. During the first ten months of 1991 as a whole, Hong Kong dollar interest rates declined significantly further. The three-month interbank rate fell from 8 percent at the end of 1990 to 5 percent by the end of October 1991; the best (prime) lending rate also declined, but by a smaller amount as banks increased their spreads (Chart 6).

The decline in interest rates was temporarily interrupted in May 1991, when the Government raised interest rates as one element in a package of anti-inflation measures. Interbank rates rose substantially, with the gap between the three-month Hong Kong dollar interbank rate and the corresponding U.S. dollar rate widening to 2 1/2 percentage points at the end of May. However, the authorities were unable to sustain this gap, as the emergence of the large interest rate premium on Hong Kong dollar assets led to marked upward pressure on the Hong Kong dollar. When the market exchange rate reached HK\$7.71 per U.S. dollar at the end of June, the authorities acted to cut interest rates in order to maintain the link.

The authorities observed that this experience confirmed the constraints on monetary policy under the linked exchange rate system, demonstrating clearly the limited scope for an independent monetary policy aimed at fighting inflation. Nevertheless, the authorities remain firmly convinced that the system is essential in their efforts to maintain financial stability and confidence, especially in the period of uncertainty leading to 1997. They emphasize the potential instability of financial markets in

1/ In the absence of a central bank, monetary policy in Hong Kong has been formulated by the Monetary Affairs Branch (MAB) of the Government. The MAB conducts exchange market intervention by using the assets of the Exchange Fund, the holder of all official foreign reserves. With the introduction in mid-1988 of the new accounting arrangements governing the operations of the Hong Kong and Shanghai Banking Corporation (HSBC) as the clearing house of the banking system, the Exchange Fund became the ultimate provider of liquidity in the interbank market. The Exchange Fund further expanded its ability to affect the interbank market by initiating a program to issue short-term bills. For a detailed description of Hong Kong's financial system and the monetary policy framework, see "United Kingdom - Hong Kong: Recent Economic Developments" (SM/91/2; 1/4/91), Chapter V.

Hong Kong, as evidenced by periodic crises in the past, and believe that the linked exchange rate system has proven to effectively reduce financial uncertainty. In current circumstances, a strategy that permitted the Hong Kong dollar to appreciate would allow monetary policy to be used in the fight against inflation. However, the authorities' strong view remains that such a strategy would severely weaken their ability to resist downward pressure on the rate associated with any future reversal of confidence and would increase Hong Kong's vulnerability to renewed financial instability.

At the same time, the adverse consequences of the link became increasingly evident in 1991. Interest rates, governed by the link, became substantially negative in real terms. This is having an unfavorable distributional impact by eroding the real wealth and incomes of those, generally the elderly and poorer segments of society, who are on fixed incomes or less able to diversify their portfolios and hedge against inflation. Negative real interest rates have also adversely affected resource allocation, especially by encouraging excessive investment in residential property, much of it of a speculative nature. 1/ Furthermore, the persistence of inflation is likely to have led to an entrenchment of inflation expectations and threatens to reduce the economy's high degree of flexibility. In such circumstances, there is a risk that, with renewed economic expansion, inflation may ratchet up to new highs in the period ahead.

3. Land management and labor market policies

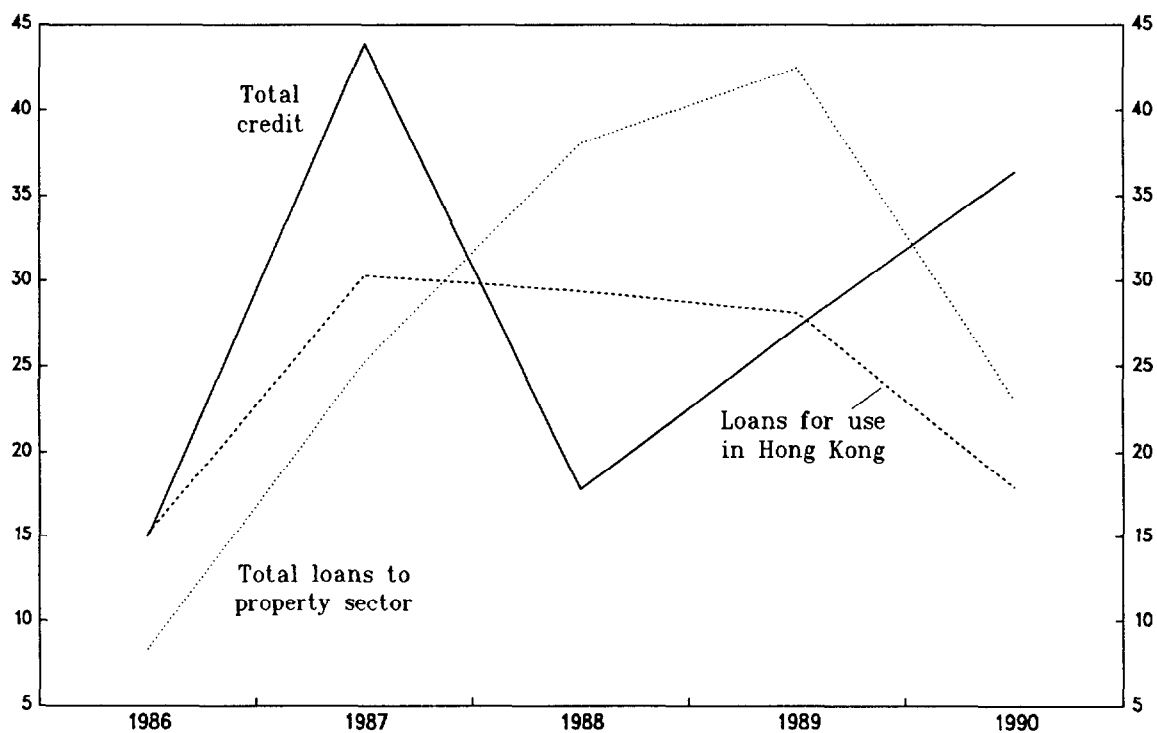
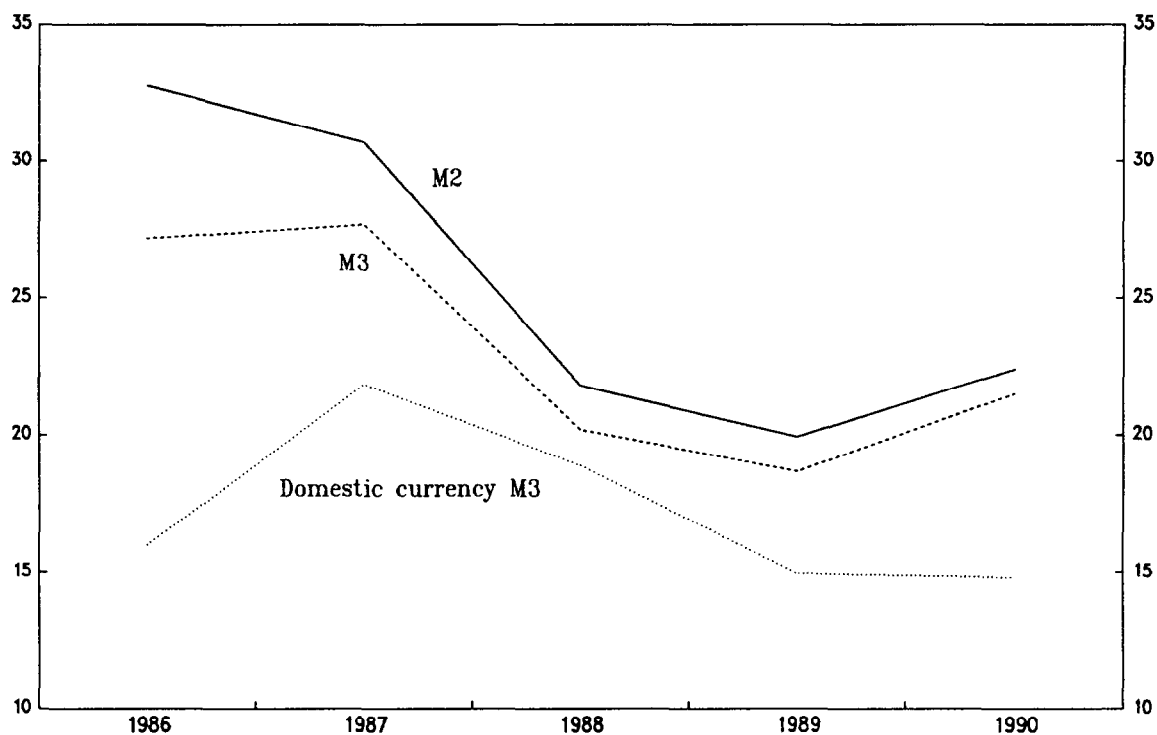
The price of property has traditionally fluctuated widely in Hong Kong in response to changes in economic conditions and shifts in confidence. Nevertheless, the boom in activity and the large increases in property prices since 1986--albeit confined to the residential property market during the past year--have been an increasing focus of attention. There has been a sharp rise in bank exposure to the property sector, most notably since mid-1990, which has raised at least some concern from the viewpoint of prudential considerations and the stability of the financial system. 2/ Although the rapid increase in property prices has had a limited direct impact on the inflation rate, it undoubtedly plays an important indirect role in the inflationary process.

In 1991, the Government took a number of measures to address the property price problem. The authorities advised banks in May and again in

1/ Although activity in the residential property market appeared to be moderating in early 1990, it has since rebounded strongly. In the second quarter of 1991, residential property prices were up 25 percent on a year-on-year basis, compared with a 10 percent increase in 1990.

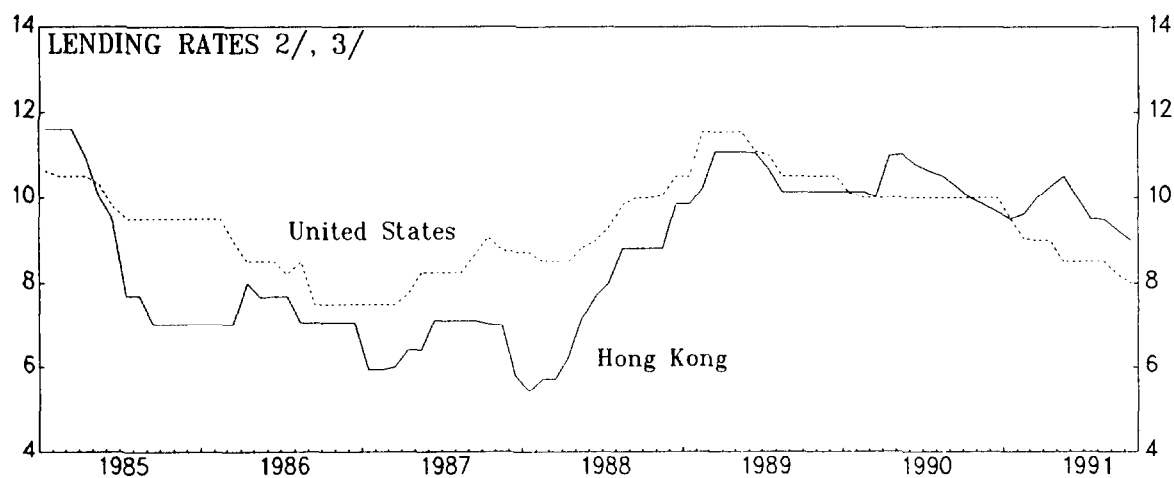
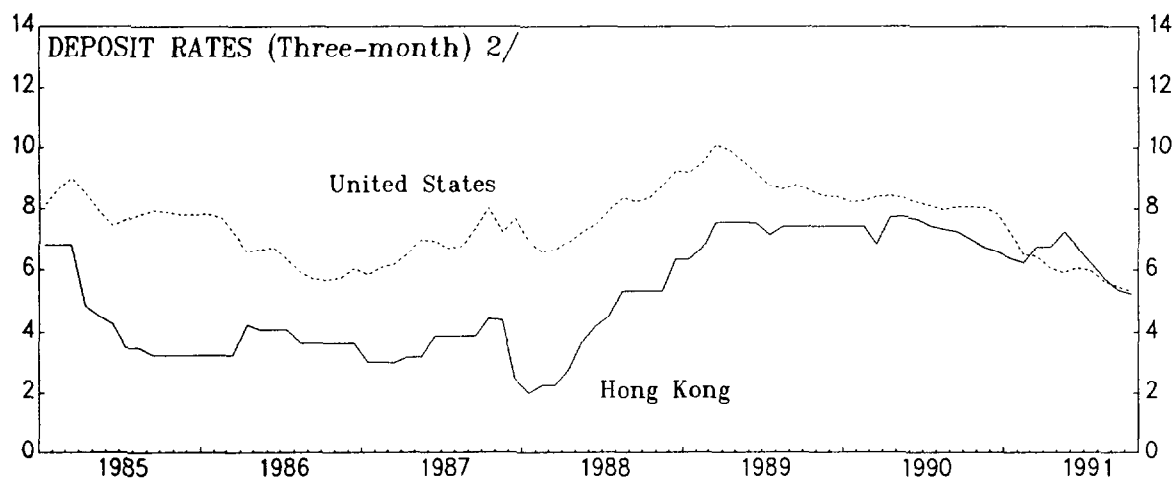
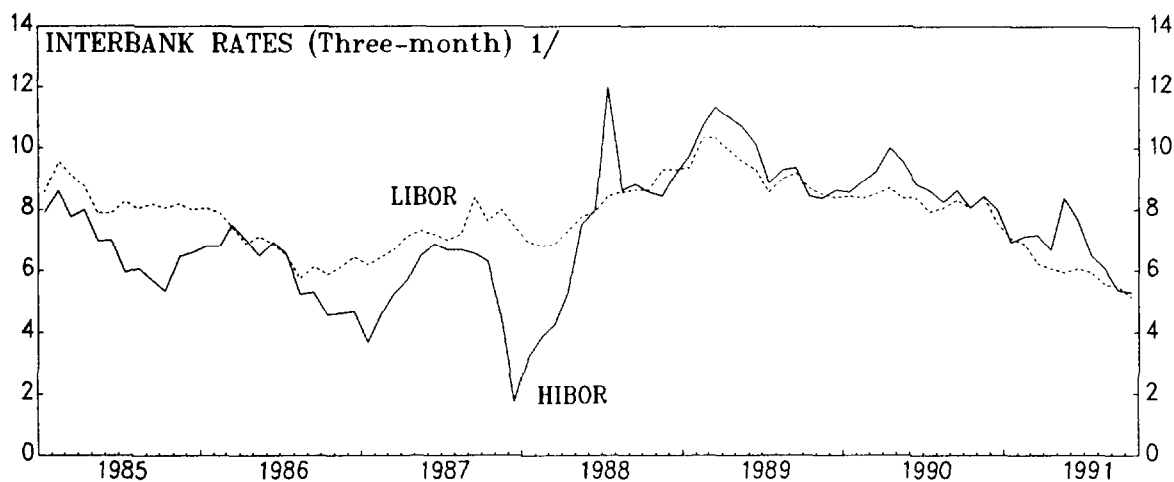
2/ As of June 1991, the share of total loans and advances outstanding for use in Hong Kong of the banking sector extended to property firms and to individuals for the purchase of property amounted to 39 percent, compared with 36 percent a year earlier and 33 percent at the end of 1985.

CHART 5
HONG KONG
MONEY SUPPLY, 1986-90 1/
(Percent per annum)



Source: Census and Statistics Department, Hong Kong Monthly Digest of Statistics.
1/ End-of-period percentage changes.

CHART 6
HONG KONG
INTEREST RATES, 1985-91
(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 Hong Kong and Shanghai Banking Corporation's quoted best lending rate.

November to tighten mortgage lending policies. Partly in response, banks have reduced the amount of new loans in relation to property valuations from 90 percent to 70-80 percent, and have not cut mortgage rates commensurately with the decline in other interest rates. For their part, the authorities have increased public land releases with a view to easing the basic supply constraint. In addition, in early November, the authorities moved to discourage property speculation by making the existing stamp duty on property transactions payable on each sale and purchase arrangement, even if the construction of the property had not been completed.

The Government has attempted to relieve the shortage of labor and ease inflationary pressures by allowing limited imports of labor, although it has stressed that it will not allow large inflows of foreign labor that would disturb the existing wage structure. Under two labor import schemes announced in July 1990, some 12,700 foreign workers were temporarily admitted into Hong Kong to alleviate particularly acute shortages of labor in certain sectors. This accounted for about one half of the easing in labor market conditions that occurred between mid-1990 and mid-1991. In early November, the Government announced its intention to permit a modest further increase in labor imports. Also, the authorities envisage additional labor imports under a special scheme in connection with the new airport project.

4. Fiscal policy

Traditionally, fiscal policy has aimed at supporting a favorable environment for private activity by maintaining a low tax burden while providing an adequate level of public services. Under this basic framework, the authorities followed a general guideline of containing expenditure growth below trend growth in GDP, while taking measures as needed to maintain the real revenue yield from direct and indirect taxes. This prudent approach resulted in growing fiscal surpluses from 1985/86 to 1988/89. During the subsequent two years, however, the consolidated government budget surplus declined sharply, from the equivalent of 4 1/4 percent of GDP in 1988/89 to 3/4 percent of GDP in 1990/91 (Table 2). This deterioration mainly reflected an acceleration in expenditures, owing to increases in public sector salaries and spending for infrastructure and social services.

The 1991/92 budget envisaged a small increase in the consolidated budget surplus. ^{1/} Spending growth was planned to slow substantially, and indirect tax measures--featuring a 200 percent increase in the duty on cigarettes--were proposed with an estimated revenue yield of 1/2 percent of GDP. Subsequently, however, the Government yielded to public concern about the impact of the tobacco tax hike on consumer prices, and cut the increase

^{1/} At the time the budget was presented in March, the 1990/91 surplus was estimated at HK\$0.2 billion, less than the final outcome; the surplus was budgeted to rise to HK\$1.3 billion (1/4 percent of GDP) in 1991/92.

Table 2. Hong Kong: Consolidated Government Account, 1986/87-1991/92

	1986/87	1987/88	1988/89	1989/90	1990/91		1991/92	
					Budget	Actual	Budget	Proj.
(In millions of Hong Kong dollars)								
General revenue account								
Revenue	43,869	54,643	65,781	74,365	84,460	82,674	96,775	95,220
Expenditure	33,828	37,422	42,643	51,962	65,260	62,627	73,560	71,830
Current expenditure	32,423	35,729	41,260	49,077	63,020	60,378	71,230	69,550
Capital expenditure	1,405	1,693	1,383	2,885	2,240	2,249	2,330	2,280
Surplus before transfers	10,041	17,221	23,138	22,403	19,200	20,047	23,215	23,390
Transfers to funds	6,100	5,601	6,310	17,700	22,940	20,210	26,760	26,760
Surplus after transfers	3,941	11,620	16,828	4,703	-3,740	-163	-3,545	-3,370
Consolidated account funds 1/								
Revenue	4,734	6,234	6,877	8,064	7,240	6,849	9,300	9,300
Expenditure	8,876	10,953	11,153	19,404	25,720	22,929	31,210	28,760
Current	--	--	--	--	--	--	--	--
Capital	8,876	10,953	11,153	19,404	25,720	22,929	31,210	28,760
Surplus before transfers	-4,142	-4,719	-4,276	-11,340	-18,480	-16,080	-21,910	-19,460
Transfers from general revenue account	6,100	5,601	6,310	17,700	22,940	20,210	26,760	26,760
Surplus after transfers	1,958	882	2,034	6,360	4,460	4,130	4,850	7,300
Total consolidated account								
Revenue	48,603	60,877	72,658	82,429	91,700	89,523	106,075	104,520
Expenditure	42,704	48,375	53,796	71,366	90,980	85,556	104,770	100,590
Current	32,423	35,729	41,260	49,077	63,020	60,378	71,230	69,550
Capital	10,281	12,646	12,536	22,289	27,960	25,178	33,540	31,040
Surplus/deficit (-)	5,899	12,502	18,862	11,063	720	3,967	1,305	3,930
(In percent of GDP)								
Total consolidated account								
Revenue	16.3	16.6	16.8	16.6	16.6	16.2	17.1	16.7
Expenditure	14.3	13.2	12.4	14.4	16.5	15.5	16.9	16.0
Current	10.9	9.7	9.5	9.9	11.4	10.9	11.5	11.1
Capital	3.4	3.4	2.9	4.5	5.1	4.6	5.4	4.9
Surplus/deficit (-)	2.0	3.4	4.3	2.2	0.1	0.7	0.2	0.6
(Percentage change)								
Total consolidated account								
Revenue	11.2	25.3	19.4	13.4	11.2	8.6	18.5	16.8
Expenditure	4.8	13.3	11.2	32.7	27.5	19.9	22.5	17.6
Current	11.2	10.2	15.5	18.9	28.4	23.0	18.0	15.2
Capital	-11.2	23.0	-0.9	77.8	25.4	13.0	33.2	23.3

Source: 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.

in the tobacco levy by one half. At the same time, various government fees and charges were temporarily frozen for the period June 1991-February 1992. Allowing for the revenue loss from these tax concessions--an estimated 1/4 percent of GDP on a full-year basis--the latest official estimates now indicate that the 1991/92 budget surplus will remain broadly unchanged from that in 1990/91.

Given the limited independence of monetary policy, fiscal policy has a potentially important role to play in containing inflationary pressures. However, developments over the past few years indicate that fiscal policy has not been playing an anti-inflationary role. Indeed, staff estimates suggest that budgetary operations contributed significantly to excess demand pressures by imparting a stimulative impulse to aggregate demand equivalent to almost 3 percent of GDP during 1989-90, and the budget is likely to have a broadly neutral impact on the economy during 1991/92. In addition, while the indirect tax cuts and freezes in fees and charges introduced in mid-1991 were aimed at reducing expected inflation, such actions serve to return spending power into the hands of consumers, and thus risk being counter-productive in relieving inflation in anything but the very short term.

Concerns regarding the role of fiscal policy and the problem of inflation also emerge from medium-term policies and prospects. Following agreement with China in mid-1991 on the ambitious airport and port development project, the authorities are moving forward quickly, with the aim of completing work on the Airport Core Program (ACP) projects by 1997. Expenditures on the ACP projects are estimated to amount to HK\$99 billion in 1991 prices, equivalent to 16 percent of GDP in 1991. Of this amount, almost 60 percent will have a direct impact on the consolidated budget, with the remaining expenditures being undertaken by the Airport Authority and private entities. Large-scale spending will begin in 1992/93, rising to a peak in 1994/95 before declining in the subsequent two years. Staff estimates suggest that, in the absence of further measures, the consolidated budget balance would move into deficit by about 1 3/4 percent of GDP by 1995/96, before improving slightly in the next fiscal year. ^{1/}

The authorities' medium-term strategy is to limit prospective deficits so as to ensure the attainment of the minimum level of reserves in 1997

^{1/} The last published official medium-term budget forecast is that contained in the 1991/92 budget. While that forecast envisaged a consolidated budget deficit of 1 3/4 percent of GDP by 1993/94, the underlying fiscal situation is now somewhat more favorable, mainly reflecting an earlier-than-anticipated economic recovery. The staff estimates assume new measures to maintain real revenue yields, but do not assume any further new measures.

specified under the Sino-British agreement on the airport project. ^{1/} In addition, they remain committed to their medium-term expenditure control guideline in the sense that the level of expenditures by the end of the period (1997) relative to that at present would be no higher than that implied by the assumed trend rate of real GDP growth of 5 percent over the medium term.

The staff's view is that the emergence of sizable deficits over the next few years, while not representing a threat to the soundness of the fiscal situation, would not be desirable from the standpoint of macro-economic management in light of the inflation problem. Including spending on the airport project by the Airport Authority, the estimated budget path in the absence of further measures implies incremental fiscal impulses to aggregate demand averaging 1 percent of GDP a year during 1992/93-1994/95; additional spending on the airport project by the private sector would imply a further demand stimulus of 1/4 percent of GDP per annum. Moreover, there is reason to be concerned that the deficit projections may be on the low side. The risk of significant cost overruns in the large and complex airport project is ever-present. In addition, the authorities are likely to face more difficulty than in the past in containing other public spending. Hong Kong's growing affluence and the shift to a more democratic political and legislative system is likely, as the authorities recognize, to lead to increased pressures to raise spending in areas such as social services and infrastructure.

The importance attached to containing inflation, and the limited alternative policy options, argue for a more restrictive fiscal policy--one that, at a minimum, does not add to demand pressures over the medium term. In view of the projected fiscal impulses on the basis of current policies, such a policy stance would require fiscal measures yielding at least a cumulative 3-3 3/4 percent of GDP over the next three fiscal years and would imply budget surpluses averaging at least 1-1 1/2 percent of GDP during 1992/93-1994/95.

Achieving such a fiscal tightening would require action on a number of fronts. With the airport project representing an average annual boost to spending of about 20 percent, expenditure measures would need to aim at major postponements or cuts in other programs extending beyond the steps already initiated to control current expenditures and to rationalize spending priorities. Even so, and particularly given that undue cuts in spending on social infrastructure and services should be avoided, it is inevitable that significant additional revenues also would be needed.

^{1/} Under the terms of the Memorandum of Understanding agreed by the Chinese and U.K. Governments, the Hong Kong Government must maintain fiscal reserves on June 30, 1997 of not less than HK\$25 billion. In addition, the Hong Kong Government must not leave a debt of more than HK\$5 billion. As of March 31, 1991, net government financial assets amounted to HK\$76.5 billion.

The narrowly based tax system would argue for measures to broaden the base of both direct and indirect taxes. For some years, the authorities have been concerned with the need to reduce the vulnerability of revenues to cyclical fluctuations and to alleviate the rising burden on the minority of taxpayers who pay direct taxes. ^{1/} To this end, the authorities have been considering a broad-based sales tax, although they believe that in the current inflationary environment, such action would be politically difficult to implement. The authorities would, in principle, also favor broadening the base of the income tax, but note that the administrative costs could be high. One measure already under discussion is an increase in property rates, whose real yield has declined significantly in recent years.

5. Other issues

Events surrounding the closure in July 1991 of the Bank of Credit and Commerce Hong Kong (BCCHK)--the local subsidiary of the Bank of Credit and Commerce International (BCCI)--have raised questions regarding the health of Hong Kong's financial system and the adequacy of bank supervision. Prior to the shutdown of BCCI, the authorities had intended to keep the local subsidiary open in view of the nature and extent of its operations. Following BCCI's shutdown, however, the authorities came to recognize 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. The closure of BCCHK led to nervousness in the financial community and minor runs on three local banks in mid-July. This was followed by runs on the local branches of two major foreign banks in August. While these runs were significant, the banks were able to manage their liquidity and meet withdrawals of deposits in an orderly manner.

The authorities emphasize that, while these incidents demonstrate the volatility of Hong Kong's retail banking sector, the financial system is fundamentally sound and has smoothly weathered this latest shock. The Basle capital adequacy standards were introduced in 1989, three years ahead of the target date, and the aggregate capital asset position of local banks is now well above the required 8 percent level. Moreover, bank profits are healthy and prospects are favorable for the further development of Hong Kong as a major financial center. Nevertheless, the authorities are examining steps to further strengthen financial confidence and stability. One measure under active study is the introduction of a limited deposit insurance scheme, although no decision has yet been taken.

In the area of trade policy, the authorities remain firmly committed to free trade and to doing their part to facilitate a successful conclusion of the Uruguay Round. A key issue in the multilateral negotiations for Hong Kong continues to be the need to increase transparency and strengthen disciplines with regard to anti-dumping measures--to which the authorities

^{1/} Direct taxes are assessed only on business profits, salaries, and income from property.

believe Hong Kong's exporters are unfairly subjected. The authorities also remain firmly opposed to the selective use of safeguards on the grounds that it would undermine the most-favored-nation principle, the cornerstone of the GATT. With regard to trade in textiles and clothing, the authorities support the transitional extension of the Multi-Fibre Arrangement and expect that the agreements reached so far in the effort to bring this sector back under GATT discipline will provide a basis for further progress. In the tariff negotiations Hong Kong, which currently applies no import duties, has offered to bind 25 percent of its import items at a zero rate. As regards bilateral trade policy issues, the authorities are hopeful that trade frictions between the United States and China will be resolved. Nevertheless, there is concern that a marked deterioration in U.S.-China trade relations would have a major adverse impact on Hong Kong.

Comprehensive balance of payments statistics that would allow a full analysis of Hong Kong's external transactions are not available. Data on factor services, transfers, and capital account transactions are not collected, and the authorities do not disclose information on the Government's total foreign reserve holdings. Although preparatory work on the compilation of the missing balance of payments statistics had begun, the Government has recently decided not to proceed further, in view of the heavy reporting burden on firms and individuals and the potential sensitivity of the information required. On the other hand, the authorities are actively considering the release of the information on international reserves.

IV. Staff Appraisal

Hong Kong's economy is now well into recovery, with the revival in growth underpinned by a strengthening of confidence, especially following the agreement with China regarding the large new airport project. The staff believes real GDP growth in 1991 may have exceeded the latest official forecast of 4 percent, and prospects are good for even stronger growth in 1992.

With earlier concerns about economic weakness having abated, inflation has become, even more than it was last year, the key policy issue. Abstracting from the impact of temporary factors that have raised the headline rate, however, underlying inflation is probably not materially above the 10 percent level that prevailed late last year. Moreover, a reduction in emigration and imports of labor contributed to some easing in the labor market in the first half of 1991. This augurs well for news on the inflation front over the coming few months. Nevertheless, any relief is likely to be short-lived, with the labor market tightening in the third quarter of 1991 and the prospect of continued strong expansion.

The orientation of monetary policy toward maintaining the market exchange rate at close to HK\$7.8 per US\$1 has served Hong Kong well since its adoption in 1983. It is a transparent policy that has buttressed confidence in and stability of the Hong Kong dollar and also has proved to

be an effective monetary anchor. These benefits of the linked exchange rate policy are undiminished. However, important adverse side effects of this policy have become more in evidence over the past year. With a rise in inflation in Hong Kong and a fall in interest rates in the United States, real interest rates in Hong Kong have now become substantially negative. This has exacerbated the tendency toward an overinvestment of resources in the property sector and has also had undesirable distributional effects.

It is clear that the linked exchange rate policy severely constrains monetary policy's ability to contain inflation. The short-lived attempt in mid-1991 to raise interest rates provides eloquent testimony to the limited room for maneuver facing the monetary authorities. Indeed, the level of interest rates consistent with maintaining the exchange rate link appears to have fallen further below that required to keep demand within levels needed for low inflation. In this situation, the start of a new cycle of expansion before excess demand has materially abated raises the possibility of a ratcheting up of overheating pressures to new highs in the period ahead.

This is not to say that a credible package of measures cannot be formulated to facilitate the control of inflation. The actions taken to advance the timing of stamp duty payments on property transactions and to restrain mortgage lending to prudentially safer levels should help to moderate the residential property boom and its inflationary consequences. More fundamentally, measures directed toward alleviating the principal supply constraints--the availability of land and labor--can play an important part. In this connection, imports of labor contributed significantly to the relief in labor market pressures over the past year. This positive result adds weight to the case for a flexible and liberal approach to additional labor imports in the future.

The authorities' monetary policy approach gives fiscal policy a particularly important role in the anti-inflation strategy. While, in 1991/92, budgetary operations are likely to have a broadly neutral impact on demand, fiscal policy has been expansionary in recent years. Looking ahead, and in light of the demands stemming from the construction of the airport core projects, the staff believes there is a need for a reassessment of fiscal prospects and policies. In the absence of significant new measures, the authorities' own medium-range outlook points to the likely emergence of sizable fiscal deficits in the next few years, and the staff sees a risk that the prospective deficits could be even larger. Even if the cumulative deficit can be held to a level consistent with the terms of the Memorandum of Understanding agreed with China, this would imply that fiscal policy would impart a large expansionary impetus to demand. Such an outcome would be unsatisfactory from the viewpoint of Hong Kong's own economic interest.

In the staff's view, the minimum aim of fiscal policy over the period up to 1997 should be that the public sector not add to underlying inflationary pressures. This would mean that the consolidated budget surplus at least rise modestly over the next five years. Efforts to contain spending will be essential to this task, and the staff strongly supports the

authorities' plans to rationalize spending priorities and eliminate excesses. However, additional revenues will also be needed, and work should begin immediately on identifying appropriate measures and planning for their implementation. A review of the tax system is called for in any case, to move toward more broad-based taxes than those which predominate at present. The staff continues to see important benefits from the timely introduction of a broad-based consumption tax; broadening the base of direct taxes also merits examination. Other possibilities should also be explored, among which an increase in property rates would be one useful option.

Hong Kong's economy remains as a remarkable example for others. Building upon a liberal policy environment, and seizing the opportunities provided by the opening of China's economy, Hong Kong has grown and developed rapidly, despite periodic shocks and setbacks. The past year has seen significant change. Confidence has been largely restored, and an economic upswing appears to be solidly based. However, the problem of inflation remains undiminished. Indeed, the possibility that inflationary pressures may even rise as the recovery continues, and the limited policy options presently available to deal with this problem, presents policymakers with a major challenge in the period ahead.

Hong Kong has been placed temporarily on the bicyclic consultation procedure, and it is proposed that the interim consultation discussions with respect to Hong Kong take place within 12 months of the completion of the 1991 Article IV consultation.

Table 3. Hong Kong: Composition of Gross Fixed Capital Formation
at Constant (1980) Market Prices, 1986-90

	1986	1987	1988	1989	1990
(In millions of 1980 Hong Kong dollars)					
Gross fixed capital formation	50,895	58,443	62,753	64,718	69,670
Private	44,474	51,447	55,727	56,755	61,462
Public	6,421	6,996	7,026	7,963	8,208
Transfer costs of land and buildings	2,621	3,649	3,396	3,132	3,180
Private	2,621	3,649	3,396	3,132	3,180
Public	--	--	--	--	--
Buildings and construction	17,600	18,633	19,317	21,188	23,269
Private	11,556	12,082	12,947	13,978	15,722
Public	6,044	6,551	6,370	7,210	7,547
Residential buildings	8,616	8,201	8,937	8,920	9,853
Private	6,581	6,826	6,426	6,247	7,368
Public	2,035	2,375	2,511	2,673	2,485
Nonresidential buildings	4,806	5,939	5,918	7,011	8,113
Private	3,648	4,848	4,976	5,556	6,486
Public	1,158	1,091	942	1,455	1,627
Other construction	4,178	4,493	4,462	5,257	5,303
Private	1,327	1,408	1,545	2,175	1,868
Public	2,851	3,085	2,917	3,082	3,435
Real estate developers' margin	12,893	13,518	13,879	13,757	15,453
Private	12,893	13,518	13,879	13,757	15,453
Public	--	--	--	--	--
Plant, machinery, and equipment	17,781	22,643	26,161	26,641	27,768
Private	17,404	22,198	25,505	25,888	27,107
Public	377	445	656	753	661
Transport equipment	2,558	3,979	3,190	3,812	4,125
Private	2,403	3,791	2,913	3,453	4,034
Public	155	188	277	359	91
Machinery, other plant, and equipment	15,223	18,664	22,971	22,829	23,643
Private	15,001	18,407	22,592	22,435	23,073
Public	222	257	379	394	570
(Percentage change)					
Memorandum items:					
Total gross domestic fixed capital formation	6.3	14.8	7.4	3.1	7.7
Private	8.2	15.7	8.3	1.8	8.3
Public	-5.6	9.0	0.4	13.3	3.1
Private investment in plant, machinery, equipment, and other construction work	2.4	27.1	12.6	5.0	5.5
Private investment in residential construction	13.7	-11.5	10.3	-2.8	17.9
Other private	15.4	10.7	0.6	-2.2	10.3

Sources: Census and Statistics Department, Hong Kong Annual Digest of Statistics; and Government Secretariat, Half-Yearly Economic Report, 1991.

Table 4. Hong Kong: Gross Domestic Product by Expenditure
at Current Market Prices, 1986-90

	1986	1987	1988	1989	1990
(In millions of Hong Kong dollars)					
Consumption	210,627	243,490	281,811	319,857	365,346
Private	187,658	217,711	251,803	283,533	321,641
Government	22,969	25,779	30,008	36,324	43,705
Gross fixed capital formation	67,655	91,645	115,742	133,018	152,622
Private	59,013	80,750	102,359	115,616	133,204
Government	8,642	10,895	13,383	17,402	19,418
Final domestic demand	278,282	335,135	397,553	452,875	517,968
Private	246,671	298,461	354,162	399,149	454,845
Government	31,611	36,674	43,391	53,726	63,123
Change in stocks	6,183	9,746	14,132	3,463	5,236
Total domestic demand	<u>284,465</u>	<u>344,881</u>	<u>411,685</u>	<u>456,338</u>	<u>523,204</u>
Net exports of goods and nonfactor services	<u>14,049</u>	<u>22,722</u>	<u>21,972</u>	<u>40,047</u>	<u>30,039</u>
Exports of goods and nonfactor services	330,816	448,866	578,559	667,964	747,707
Exports of goods	276,529	378,034	493,069	570,509	639,874
Domestic exports	153,983	195,254	217,664	224,104	225,875
Re-exports	122,546	182,780	275,405	346,405	413,999
Exports of nonfactor services	54,287	70,832	85,490	97,455	107,833
Imports of goods and nonfactor services	316,767	426,144	556,587	627,917	717,668
Imports of goods ^{1/}	277,500	379,989	501,174	565,219	645,200
Imports of nonfactor services	39,267	46,155	55,413	62,698	72,468
Gross domestic product	<u>298,515</u>	<u>367,603</u>	<u>433,657</u>	<u>496,385</u>	<u>553,243</u>
(In percent of GDP)					
Memorandum items:					
Consumption	70.6	66.2	65.0	64.4	66.0
Gross fixed capital formation	22.7	24.9	26.7	26.8	27.6
Final domestic demand	93.2	91.2	91.7	91.2	93.6
Change in stocks	2.1	2.7	3.3	0.7	0.9
Total domestic demand	95.3	93.8	94.9	91.9	94.6
Net exports of goods and nonfactor services	4.7	6.2	5.1	8.1	5.4

Source: Data provided by the Census and Statistics Department.

^{1/} The national income accounts data on imports of goods adjusts the balance of payments data (shown in Table 14) to include an estimate of imports of gold for industrial and commercial use.

Table 5. Hong Kong: Gross Domestic Product by Expenditure at Constant (1980) Market Prices, 1986-91

	1986	1987	1988	1989	1990	1991 Jan.-June 1/
	(Percentage change)					
Consumption	7.8	10.6	8.4	3.8	4.7	6.1
Private	8.0	11.3	8.7	3.6	4.5	5.9
Government	6.2	4.2	5.1	6.0	6.6	8.6
Gross fixed capital formation	6.3	14.8	7.4	3.1	7.7	9.0
Private	8.2	15.7	8.3	1.8	8.3	...
Government	2.1	5.8	3.5	8.4	5.4	...
Final domestic demand	7.4	11.8	8.1	3.6	5.5	7.0
Private	8.1	12.5	8.6	3.1	5.5	...
Government	-5.6	9.0	0.4	13.3	3.1	...
Change in stocks	328.3	43.9	29.4	-71.0	36.0	172.2
Total domestic demand	<u>9.3</u>	<u>12.5</u>	<u>8.7</u>	<u>1.0</u>	<u>5.8</u>	<u>9.4</u>
Net exports of goods and nonfactor services	<u>77.5</u>	<u>60.3</u>	<u>1.3</u>	<u>32.4</u>	<u>-37.4</u>	<u>733.6</u>
Exports of goods and nonfactor services	15.3	30.5	24.3	9.5	8.9	15.0
Exports of goods	15.2	32.9	26.4	10.2	9.2	16.2
Domestic exports	16.1	23.1	9.0	0.1	-0.5	2.2
Re-exports	14.0	45.9	45.7	18.6	16.0	24.7
Exports of nonfactor services	15.7	18.3	12.4	5.2	6.6	6.9
Imports of goods and nonfactor services	13.7	29.3	25.4	8.6	11.1	18.4
Imports of goods	13.6	31.6	26.6	8.9	11.4	19.7
Imports of nonfactor services	14.3	14.5	16.5	6.5	8.2	7.7
Gross domestic product	<u>11.1</u>	<u>14.5</u>	<u>8.3</u>	<u>2.7</u>	<u>2.8</u>	<u>3.9</u>
Contribution to growth:						
Change in stocks	1.9	1.0	0.8	-2.3	0.3	...
Net exports of goods and nonfactor services	2.1	2.6	0.1	1.8	-2.7	...
	(In millions of Hong Kong dollars)					
Memorandum items:						
Consumption	135,758	150,169	162,762	168,969	176,949	91,022 2/
Private	122,430	136,280	148,162	153,486	160,445	82,112 2/
Government	13,328	13,889	14,600	15,483	16,504	8,910 2/
Gross fixed capital formation	50,895	58,443	62,753	64,718	69,670	36,493 2/
Private	44,474	51,447	55,727	56,755	61,462	...
Government	6,421	6,996	7,026	7,963	8,208	...
Final domestic demand	186,653	208,612	225,515	233,687	246,619	127,515 2/
Private	166,904	187,727	203,889	210,241	221,907	...
Government	19,749	20,885	21,626	23,446	24,712	...
Change in stocks	4,394	6,324	8,183	2,375	3,230	4,979 2/
Total domestic demand	<u>191,047</u>	<u>214,936</u>	<u>233,698</u>	<u>236,062</u>	<u>249,849</u>	<u>132,494 2/</u>
Net exports of goods and nonfactor services	<u>8,451</u>	<u>13,547</u>	<u>13,717</u>	<u>18,156</u>	<u>11,360</u>	<u>-7,619 2/</u>
Gross domestic product	<u>199,498</u>	<u>228,483</u>	<u>247,415</u>	<u>254,218</u>	<u>261,209</u>	<u>124,875 2/</u>

Source: Data provided by the Census and Statistics Department.

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

2/ First half of year.

Table 6. Hong Kong: Labor Force, Employment, and Unemployment, 1986-91

	1986	1987	1988	1989	1990	1991	
						March	June
(In thousands)							
Labor force ^{1/}	2,702	2,736	2,779	2,779	2,778	2,817	2,824
Employed	2,626	2,688	2,741	2,749	2,741	2,676	2,756
Unemployed	76	48	38	30	37	42	68
(In percent)							
Unemployment rate	2.8	1.7	1.4	1.1	1.3	1.8 ^{2/}	2.4 ^{2/}
Labor force participation rate	65.1	64.8	64.5	63.5	63.0	63.2	63.0
(In thousands)							
Employment in selected sectors ^{3/}							
Manufacturing	866	868	837	792	716	697	681
Finance, insurance, and business services	194	212	235	255	277	277	284
Wholesale and retail trades ^{4/}	620	658	711	774	830	853	874
Building and construction	71	72	76	69	69	67	64
Community, social, and personal services	208	215	225	236	250	255	...
Transport, storage, and communication	99	106	116	126	133	131	...
Civil service	178	182	185	187

Sources: Census and Statistics Department, Hong Kong Monthly Digest of Statistics (various issues); and data provided by the Census and Statistics Department.

^{1/} Period average.

^{2/} Seasonally adjusted unemployment rate.

^{3/} End of period.

^{4/} Wholesale, retail, import/export trades, restaurants, and hotels.

Table 7. Hong Kong: Indicators of Labor Productivity, Wages,
and Unit Labor Costs, 1986-91

(Percentage change)

	1986	1987	1988	1989	1990	1991 March 1/
Labor productivity						
Overall	7.6	11.8	6.2	2.5	3.0	2.7
Manufacturing sector	12.6	15.7	9.9	6.6	9.7	10.8
Nominal wages 2/						
Overall economy	6.6	9.7	10.2	13.4	12.6	11.6
Manufacturing sector	6.0	9.8	8.6	12.1	12.3	11.6
Wholesale and retail trade	6.2	10.3	12.8	13.4	11.0	9.5
Business services	10.3	8.4	17.0	19.0	16.5	14.4
Unit labor costs						
Overall economy	-1.0	-1.9	3.8	10.6	9.3	8.7
Manufacturing sector (wage based)	-5.8	-5.1	-1.3	5.1	2.3	0.7

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

1/ Percentage change over previous 12 months.

2/ Annual wage data are calculated as of September of each year.

Table 8. Hong Kong: Selected Price Indicators, 1986-91

(Percentage change)

	1986	1987	1988	1989	1990	1991		
						Q1 1/	Q2 1/	Q3 1/
Prices 2/								
CPI (A)	2.9	5.5	7.4	10.1	9.7	11.9	13.1	12.3
Of which: Foodstuffs	1.3	4.7	9.6	12.4	9.9	10.8	11.8	12.2
Services	7.6	6.3	9.2	11.4	13.0	14.2	14.1	14.6
Durable goods	5.5	5.7	5.9	3.3	3.0	5.4	4.8	3.9
Housing	4.0	4.7	3.5	7.0	8.7	13.1	13.9	12.7
CPI (B)	3.2	5.3	7.4	9.7	9.7	11.6	12.4	11.7
Residential price index	10.6	20.0	24.7	27.8	11.5	17.0	25.0	...
GDP deflator	2.9	7.6	8.9	11.4	8.4	8.0	9.1	...
Domestic demand deflator	5.8	7.8	9.8	9.7	8.3	8.4	8.4	...
Export unit values	2.1	3.7	3.1	5.0	2.7	2.7	2.4	...
Import unit values	5.0	4.1	4.1	3.6	2.5	3.6	2.3	...

Sources: Census and Statistics Department, Hong Kong Monthly Digest of Statistics; and Government Secretariat, Half-Yearly Economic Report, 1990.

1/ Increase over corresponding period from previous year.

2/ CPI(A) is based on weights derived from the expenditure pattern of urban households with monthly expenditures between HK\$2,000 and HK\$6,499 based on a household expenditure survey. CPI(B) is based on weights derived from the expenditure pattern of urban households with monthly expenditures between HK\$6,500 and HK\$9,999 in the same survey. For both CPI(A) and CPI(B), the period October 1984 to September 1985 represents the base year (i.e., 10/84-9/85=100).

Table 9. Hong Kong: Monetary Indicators, 1986-91 ^{1/}

	1986	1987	1988	1989	1990	1991
<u>(Percentage change)</u>						
Annual rate of growth						
M1	23.9	46.0	8.5	6.8	13.3	22.8 ^{2/}
M2	32.8	30.7	21.8	19.9	22.3	12.5 ^{2/}
M3	27.2	27.7	20.2	18.7	21.5	10.9 ^{2/}
Hong Kong dollar ^{3/}	16.0	21.8	18.9	15.0	14.8	12.2 ^{2/}
Foreign currency ^{4/}	41.6	33.8	21.4	22.2	27.4	9.9 ^{2/}
Total credit	15.0	43.9	17.8	27.3	36.4	29.4 ^{5/}
Hong Kong dollar	13.0	22.2	27.3	27.6	16.9	16.4 ^{5/}
Foreign currency	16.5	59.3	12.6	27.2	48.5	36.8 ^{5/}
Of which:						
Total loans	13.8	55.6	23.5	32.2	40.6	30.3 ^{5/}
Hong Kong dollar	12.2	23.6	30.8	29.8	15.6	16.4 ^{5/}
Foreign currency	15.4	87.5	18.8	33.9	58.3	39.1 ^{5/}
<u>(Percent of total)</u>						
Currency composition						
M3						
Hong Kong dollar ^{3/}	51.3	49.0	48.4	46.9	44.3	46.3 ^{6/}
Foreign currency ^{4/}	48.7	51.0	51.6	53.1	55.7	53.7 ^{6/}
Velocity						
M2	0.58	0.54	0.53	0.50	0.46	...
M3	0.51	0.49	0.49	0.47	0.43	...
Memorandum items:						
GDP (bn. HK\$)	298.5	367.6	433.7	496.4	553.2	627.2 ^{7/}
Nominal growth in GDP (percent)	14.3	23.1	18.0	14.5	11.5	13.4 ^{7/}

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 rate for September.

^{3/} Adjusted to include foreign currency swap deposits.

^{4/} Adjusted to exclude foreign currency swap deposits.

^{5/} Year-on-year growth rate for July.

^{6/} At end-September.

^{7/} Official projection.

Table 10. Hong Kong: Loans for Use in Hong Kong, 1986-91 ^{1/}

	1986	1987	1988	1989	1990	1991 June
	(Percentage change)					
Loans for use in Hong Kong	15.2	30.3	29.4	28.1	17.9	15.8 ^{2/}
Of which:						
Manufacturing	27.4	18.7	30.8	18.6	6.6	11.0 ^{2/}
Transport and transport equipment	-8.5	8.5	19.3	59.0	10.9	20.2 ^{2/}
Building, construction, and property development	-13.7	14.2	49.0	63.6	12.3	14.6 ^{2/}
Wholesale and retail trade	13.9	29.0	37.6	4.9	19.1	10.5 ^{2/}
Miscellaneous	27.9	39.8	25.4	24.2	20.9	17.2 ^{2/}
Of which:						
To purchase flats in the Home Ownership Scheme and Private Sector Participation Scheme	9.7	19.8	15.5	22.5	28.8	11.9 ^{2/}
To purchase other residential property	36.1	35.0	33.6	28.6	32.8	36.2 ^{2/}
Memorandum items:						
GDP (HK\$ bn.)	298.5	367.6	433.7	496.4	553.2	627.2 ^{3/}
Nominal growth in GDP (percent)	14.3	23.1	18.0	14.5	11.5	13.4 ^{3/}

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 rate.

^{3/} Official projection.

Table 11. Hong Kong: Interest Rate Differentials, 1987-91

	Interbank Rates 1/			Deposit Rates 2/			Lending Rates 3/ 4/		
	HIBOR	LIBOR	Differ- ential	Hong Kong dollars	U.S. dollars	Differ- ential	HSBC's BLR	U.S. Prime Rate	Differ- ential
1987									
January	3.7	6.2	-2.5	3.0	5.9	-2.8	5.9	7.5	-1.6
February	4.6	6.4	-1.8	3.0	6.1	-3.1	5.9	7.5	-1.6
March	5.2	6.7	-1.4	3.0	6.2	-3.2	6.0	7.5	-1.5
April	5.7	7.1	-1.5	3.2	6.5	-3.3	6.4	7.8	-1.3
May	6.5	7.3	-0.8	3.2	7.0	-3.8	6.4	8.2	-1.8
June	6.9	7.2	-0.3	3.9	6.9	-3.1	7.1	8.2	-1.1
July	6.7	7.0	-0.3	3.9	6.7	-2.8	7.1	8.2	-1.1
August	6.7	7.2	-0.5	3.9	6.8	-2.9	7.1	8.2	-1.1
September	6.6	8.4	-1.8	3.9	7.4	-3.5	7.1	8.7	-1.6
October	6.3	7.6	-1.3	4.4	8.0	-3.6	7.0	9.1	-2.0
November	4.4	8.0	-3.6	4.4	7.2	-2.8	7.0	8.8	-1.8
December	1.8	7.4	-5.7	2.5	7.7	-5.2	5.8	8.8	-3.0
1988									
January	3.2	6.9	-3.7	2.0	6.9	-4.9	5.4	8.8	-3.3
February	3.9	6.8	-2.9	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	7.3	-2.0	2.7	6.9	-4.2	6.2	8.5	-2.3
May	7.5	7.8	-0.2	3.7	7.2	-3.6	7.2	8.8	-1.7
June	8.0	7.9	0.1	4.2	7.5	-3.3	7.7	9.0	-1.3
July	12.0	8.4	3.6	4.5	7.9	-3.4	8.0	9.3	-1.3
August	8.6	8.6	0.1	5.3	8.3	-3.0	8.8	9.8	-1.0
September	8.8	8.6	0.2	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	9.3	-0.9	5.3	8.8	-3.5	8.8	10.0	-1.2
December	9.2	9.3	-0.1	6.3	9.2	-2.9	9.8	10.5	-0.7
1989									
January	9.8	9.4	0.4	6.3	9.2	-2.9	9.9	10.5	-0.6
February	10.7	10.3	0.4	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	9.9	1.1	7.6	9.9	-2.4	11.1	11.5	-0.4
May	10.7	9.6	1.1	7.6	9.6	-2.0	11.1	11.5	-0.4
June	10.1	9.3	0.8	7.5	9.2	-1.7	11.0	11.1	--
July	8.9	8.6	0.3	7.2	8.8	-1.6	10.7	11.0	-0.3
August	9.3	9.0	0.3	7.4	8.6	-1.2	10.1	10.5	-0.4
September	9.4	9.2	0.2	7.4	8.8	-1.3	10.1	10.5	-0.4
October	8.4	8.7	-0.3	7.4	8.6	-1.2	10.1	10.5	-0.4
November	8.4	8.5	-0.1	7.4	8.4	-1.0	10.1	10.5	-0.4
December	8.6	8.4	0.2	7.4	8.4	-1.0	10.1	10.5	-0.4
1990									
January	8.6	8.4	0.1	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	8.7	1.3	7.7	8.4	-0.7	11.0	10.0	1.0
May	9.6	8.4	1.2	7.8	8.3	-0.6	11.0	10.0	1.0
June	8.8	8.4	0.4	7.7	8.2	-0.6	10.8	10.0	0.8
July	8.6	7.9	0.7	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	8.3	0.3	7.2	8.1	-0.8	10.2	10.0	0.2
October	8.1	8.1	--	7.0	8.1	-1.1	10.0	10.0	--
November	8.4	8.4	--	6.8	8.0	-1.3	9.8	10.0	-0.2
December	8.0	7.6	0.4	6.6	7.8	-1.2	9.7	10.0	-0.3
1991									
January	6.9	7.1	-0.1	6.4	7.2	-0.8	9.5	9.5	--
February	7.1	6.9	0.2	6.2	6.5	-0.3	9.6	9.0	0.6
March	7.2	6.2	0.9	6.8	6.4	0.3	10.0	9.0	1.0
April	6.7	6.1	0.6	6.8	6.1	0.7	10.2	9.0	1.2
May	8.4	5.9	2.4	7.2	5.9	1.3	10.5	8.5	2.0
June	7.7	6.1	1.6	6.8	6.1	0.7	10.0	8.5	1.5
July	6.5	5.9	0.6	6.2	6.0	0.3	9.5	8.5	1.0
August	6.1	5.6	0.5	5.8	5.7	0.1	9.5	8.5	1.0
September	5.4	5.5	-0.1	5.4	5.5	-0.1	9.2	8.2	1.0
October	5.3	5.1	0.2	5.2	5.3	-0.1	9.0	8.0	1.0

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 rate and the Hong Kong and Shanghai Banking Corporation's quoted best lending rate (BLR).

Table 12. Hong Kong: Revenue (General Revenue Account), 1987/88-1991/92 ^{1/}

(In millions of Hong Kong dollars)

	1987/88	1988/89	1989/90	1990/91		1991/92	
				Budget	Actual	Budget	Rev. Est.
Taxes	<u>41,822</u>	<u>48,811</u>	<u>54,577</u>	<u>63,776</u>	<u>61,914</u>	<u>73,660</u>	<u>71,870</u>
Direct taxes	25,258	30,109	34,039	39,010	36,997	44,210	43,090
Earnings and profits tax	(24,772)	(29,662)	(33,549)	(38,610)	(36,341)	(43,610)	(42,490)
Estate duty	(486)	(447)	(490)	(400)	(655)	(600)	(600)
Indirect taxes	16,564	18,702	20,538	24,766	24,917	29,450	28,780
Duties	3,389	4,173	4,628	5,916	5,729	7,980	6,430
General rates	1,373	1,517	1,663	3,016	3,039	3,520	3,520
Internal revenue	9,723	10,423	11,558	12,712	13,143	14,079	15,040
Bets and sweeps tax	(3,303)	(4,076)	(4,830)	(5,840)	(5,884)	(6,900)	(7,200)
Entertainment tax	(124)	(132)	(129)	(125)	(136)	(145)	(140)
Hotel accommodation tax	(187)	(242)	(271)	(340)	(269)	(310)	(300)
Stamp duties	(5,237)	(5,095)	(5,464)	(5,400)	(5,939)	(5,299)	(6,000)
Air passengers departure tax	(684)	(683)	(669)	(819)	(718)	(1,229)	(1,200)
Cross Harbour Tunnel passage tax	(188)	(195)	(195)	(188)	(197)	(196)	(200)
Motor vehicles taxes	1,448	1,922	1,735	2,096	2,054	2,768	2,700
Royalties and concessions	511	598	746	807	816	913	900
Taxi concessions	120	69	208	219	136	190	190
Nontax revenue	<u>13,819</u>	<u>16,970</u>	<u>19,789</u>	<u>20,682</u>	<u>20,760</u>	<u>23,115</u>	<u>23,350</u>
Fines and penalties	462	495	578	626	652	680	720
Revenues from property and investments	2,133	4,971	7,280	6,436	6,086	5,803	5,850
Reimbursements and contributions	1,528	1,765	1,705	1,777	2,172	2,602	2,550
Utilities	3,412	4,094	4,857	5,783	5,617	6,819	6,860
Fees and charges	4,804	4,682	5,132	5,885	5,992	7,011	7,180
Land transactions ^{2/}	461	365	212	175	241	200	190
Other	1,091	598	25	--	--	--	--
Total revenue	<u>55,641</u>	<u>65,781</u>	<u>74,366</u>	<u>84,458</u>	<u>82,674</u>	<u>96,775</u>	<u>95,220</u>

Source: 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.

Table 13. Hong Kong: Government Expenditure Under the
General Revenue Account, 1986/87-1991/92 1/, 2/

(In millions of Hong Kong dollars)

	1986/87	1987/88	1988/89	1989/90	1990/91		1991/92	
					Budget	Actual	Budget	Proj.
Current expenditure	<u>32,423</u>	<u>35,729</u>	<u>41,260</u>	<u>49,077</u>	<u>63,020</u>	<u>60,378</u>	<u>71,230</u>	<u>69,550</u>
Personal emoluments	12,184	13,500	15,828	18,855	24,330	23,443	26,699	26,140
Personnel-related expenses	2,650	2,846	3,221	3,752	5,876	4,937	6,288	6,440
Departmental expenses	3,159	3,557	3,667	3,850	4,868	4,552	5,319	5,160
Other charges	5,157	5,545	6,632	8,402	9,858	9,712	11,051	10,740
Subventions	9,273	10,281	11,912	14,218	18,088	17,734	21,873	21,070
Capital expenditure	<u>7,505</u>	<u>8,293</u>	<u>7,693</u>	<u>20,585</u>	<u>25,180</u>	<u>22,459</u>	<u>29,090</u>	<u>29,040</u>
Plant, equipment, and works	401	427	406	643	1,070	776	918	800
Other nonrecurrent	419	590	775	2,029	920	1,091	1,006	1,090
Subventions	585	676	202	213	250	382	406	390
Transfer to funds	6,100	6,600	6,310	17,700	22,940	20,210	26,760	26,760
Capital Works Reserve Fund/ Public Works	4,390	5,080	6,200	8,800	18,320	15,200	21,210	21,210
Development Loan Fund	1,100	1,000	--	8,900	--	--	--	--
Home Ownership Fund	--	--	--	--	--	--	--	--
Mass Transit Fund	585	500	100	--	--	--	--	--
Capital Investment Fund	--	--	--	--	4,100	4,100	3,900	3,900
Loan Fund	--	--	--	--	520	910	1,650	1,650
Other	25	20	10	--	--	--	--	--
Total expenditure	<u>39,928</u>	<u>44,022</u>	<u>48,953</u>	<u>69,662</u>	<u>88,200</u>	<u>82,837</u>	<u>100,320</u>	<u>98,590</u>

Source: 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.

Table 14. Hong Kong: Balance of Trade in Goods and Nonfactor Services, 1986-91

	1986	1987	1988	1989	1990	1991 Jan.-Sept.
(In billions of Hong Kong dollars)						
Trade balance	0.6	0.1	-5.7	7.7	-2.7	-16.1
Exports of goods	276.5	378.0	493.1	570.5	639.9	545.9
Domestic exports of goods	154.0	195.3	217.7	224.1	225.9	167.0
Re-exports	122.5	182.8	275.4	346.4	414.0	378.9
Imports of goods	276.0	377.9	498.8	562.8	642.5	562.0
Net balance on nonfactor services	15.0	24.7	30.1	34.8	35.4	...
Exports of nonfactor services	54.3	70.8	85.5	97.5	107.8	...
of which: transportation	26.0	32.1	37.6	44.3
travel	18.1	25.8	33.9	37.6	40.0	...
Imports of nonfactor services	39.3	46.2	55.4	62.7	72.5	...
of which: transportation	14.9	17.0	19.8	22.2
travel	16.0	19.3	24.2	27.8	34.0	...
Net balance of trade on goods and nonfactor services	15.6	24.8	24.3	42.5	32.7	...
(In percent of GDP)						
Trade balance	0.2	0.0	-1.3	1.6	-0.5	...
Total exports	92.6	102.8	113.7	114.9	115.7	...
Domestic exports of goods	51.6	53.1	50.2	45.1	40.8	...
Re-exports	41.1	49.7	63.5	69.8	74.8	...
Imports of goods	92.4	102.8	115.0	113.4	116.1	...
Net balance on nonfactor services	5.0	6.7	6.9	7.0	6.4	...
Exports of nonfactor services	18.2	19.3	19.7	19.6	19.5	...
Imports of nonfactor services	13.2	12.6	12.8	12.6	13.1	...
Net balance of trade on goods and nonfactor services	5.2	6.7	5.6	8.6	5.9	...
(Percentage change)						
Total exports	17.6	36.7	30.4	15.7	12.2	20.2 ^{1/}
Domestic exports of goods	18.6	26.8	11.5	3.0	0.8	3.3 ^{1/}
Re-exports	16.4	49.2	50.7	25.8	19.5	29.5 ^{1/}
Imports of goods	19.2	37.0	32.0	12.8	14.2	23.3 ^{1/}
Exports of nonfactor services	18.4	30.5	20.7	14.0	10.6	...
Imports of nonfactor services	17.1	17.5	20.1	13.1	15.6	...

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

^{1/} Percentage change over corresponding year-earlier period.

Table 15. Hong Kong: Direction of Trade by Area and Major Partners, 1986-90

(Percent of total)

	1986	1987	1988	1989	1990
Imports	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
North America ^{1/}	9.0	9.1	8.8	8.7	8.5
Of which:					
United States	8.4	8.5	8.3	8.2	8.1
Western Europe	14.3	13.8	13.0	12.5	12.3
Asia	71.9	72.6	73.4	74.5	75.7
Of which:					
China	29.6	31.1	31.2	34.9	36.8
Japan	20.5	19.0	18.7	16.6	16.1
Taiwan Province of China	8.7	8.8	8.9	9.2	9.0
Korea	4.0	4.5	5.3	4.5	4.4
Other	4.8	4.5	4.7	4.3	3.6
Domestic exports	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
North America ^{1/}	44.9	40.2	36.2	35.0	31.8
Of which:					
United States	41.7	37.3	33.5	32.2	29.4
Western Europe	24.2	25.7	25.8	23.8	24.3
Of which:					
Germany ^{2/}	7.2	7.7	7.5	7.0	8.0
United Kingdom	6.4	6.6	7.1	6.5	6.0
Asia	22.6	26.7	31.1	34.9	37.9
Of which:					
China	11.7	14.3	17.5	19.3	21.0
Japan	4.0	4.9	5.3	5.8	5.3
Other	8.2	7.5	6.9	6.3	6.0
Re-exports (destination)	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
North America ^{1/}	19.6	19.1	19.3	22.4	23.5
Of which:					
United States	18.2	17.8	18.0	20.8	21.2
Western Europe	8.7	11.4	12.4	14.1	17.9
Asia	63.0	60.7	60.4	54.9	51.0
Of which:					
China	33.4	32.9	34.5	29.9	26.8
Japan	5.4	5.3	6.3	6.4	5.9
Taiwan Province of China	4.8	5.3	5.1	4.8	5.1
Korea	4.8	4.9	4.3	3.8	3.1
Other	8.7	8.8	7.9	8.6	7.6
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>
Of which:					
China	42.1	46.1	47.8	54.3	58.1
Japan	15.2	13.5	13.7	11.3	10.2
Taiwan Province of China	7.1	6.9	7.7	7.8	7.3
United States	8.5	7.4	7.0	6.4	5.9
Korea	2.9	3.4	4.7	3.3	2.8

Source: Census and Statistics Department, Trade Analysis Section.

^{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.

Table 16. Hong Kong: Trade Indices, 1986-91

	1986	1987	1988	1989	1990	<u>1991</u> Jan. - June <u>1/</u>
<u>(Percentage change)</u>						
Total exports						
Value	17.6	36.7	30.4	15.7	12.2	19.2
Unit value <u>2/</u>	2.1	3.7	3.1	5.0	2.7	2.5
Quantity <u>2/</u>	15.2	31.9	26.4	10.2	9.2	16.3
Domestic exports						
Value	18.6	26.8	11.4	3.0	0.8	4.4
Unit value <u>2/</u>	2.1	4.4	2.3	2.8	1.4	2.1
Quantity <u>2/</u>	16.1	21.3	9.0	0.1	-0.5	2.1
Re-exports						
Value	16.4	49.1	50.7	25.8	19.5	27.3
Unit value	2.2	2.2	3.4	6.1	3.0	2.1
Quantity	14.0	45.9	45.7	18.6	16.0	24.8
Imports						
Value	19.3	37.0	32.0	12.8	14.2	23.1
Unit value	5.0	4.1	4.1	3.6	2.5	2.9
Quantity	13.6	31.7	26.7	8.9	11.5	19.7
Terms of trade <u>2/</u>	-2.8	-0.4	-1.0	1.4	0.2	-0.4

Source: Census and Statistics Department, Trade Analysis Section.

1/ Percentage change from year-earlier corresponding period.

2/ Indices for 1987 onward are not strictly comparable with those for earlier years owing to the incorporation of the specification price indices for toys and knitted outer garments.

Table 17. Hong Kong: Exchange Rate Indices, 1987-91 1/, 2/

	Real Effective Exchange Rate	Nominal Effective Exchange Rate	Exchange Rate
1987			
January	89.6	71.9	64.0
February	88.7	71.2	63.8
March	88.1	70.6	63.8
April	86.6	69.2	63.8
May	85.8	68.3	63.7
June	87.0	68.8	63.7
July	87.7	69.6	63.7
August	87.8	69.3	63.7
September	86.4	68.3	63.8
October	86.8	68.2	63.7
November	84.1	66.1	63.8
December	83.1	64.8	64.0
1988			
January	82.9	64.6	63.9
February	83.8	65.1	63.8
March	83.0	64.4	63.8
April	82.8	63.9	63.7
May	82.8	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	86.9	66.9	63.7
October	85.1	65.7	63.7
November	83.6	64.1	63.7
December	83.8	64.0	63.7
1989			
January	85.7	65.1	63.7
February	86.9	65.3	63.8
March	87.2	65.8	63.8
April	87.7	66.1	63.9
May	89.8	67.4	64.0
June	91.6	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	91.3	67.1	63.7
November	91.7	67.1	63.7
December	92.7	67.6	63.7
1990			
January	93.9	68.0	63.7
February	93.5	67.8	63.7
March	96.0	69.1	63.7
April	96.7	69.6	63.8
May	96.4	68.9	63.9
June	97.0	69.0	63.9
July	96.2	68.0	64.0
August	94.8	66.9	64.0
September	94.3	66.2	64.1
October	92.6	64.5	64.0
November	92.9	64.3	63.8
December	95.0	65.4	63.8
1991			
January	95.6	65.6	63.8
February	95.3	64.9	63.8
March	99.5	67.1	63.9
April	101.9	68.1	63.8
May	102.7	68.6	63.9
June	105.1	70.1	64.3
July	104.7	69.7	64.1
August	104.4	69.0	64.1
September	104.0	68.4	64.2

Source: IMF, Information Notice System.

1/ Base year, 1980=100.2/ Increase indicates appreciation.

Fund Relations with Hong Kong

The Fund's contacts with Hong Kong until 1989 were limited.

1. Since 1979, the staff has been making estimates for the main macroeconomic indicators of Hong Kong for the purposes of the world economic outlook exercise, based primarily on indirect sources.
2. Over the last several years, staff have visited Hong Kong to gather information and views in the preparation of the international capital markets reports.
3. A mission from the (former) Bureau of Statistics visited Hong Kong during July 13-24, 1987 with a view to compiling a balance of payments statement from available statistics and to discuss issues arising out of the recommendations of the Working Party on the statistical discrepancy in world current account balances. An internal report for limited circulation was prepared as a result of the visit.
4. The Managing Director visited Hong Kong in December 1989 and held discussions with senior officials.
5. A staff team visited Hong Kong during May-June 1990 to gather basic data and prepare the groundwork for the first Article IV consultation discussions, which were subsequently conducted in October 1990.
6. As part of the efforts to explore ways of compiling a more complete set of balance of payments statistics, two Hong Kong officials attended IMF Institute courses.