

Hong Kong's Economic Outlook: 2005 and 2006

After a blistering economic expansion in 2004, the Asia Pacific region is poised for slower but still robust growth in 2005. Last year's growth in real GDP was the strongest in East Asia since the 1997 financial crisis, and represented a sharp rebound from 2003, which was marked by the Severe Acute Respiratory Syndrome (SARS) outbreak in parts of the region. For the global economy as a whole, real GDP growth in 2004 was the strongest in about 20 years.

Global economic growth is expected to decelerate from the high level achieved in 2004 with further monetary tightening. The growth engines of the world, namely China and the US are both projected to slow down. Of particular importance to Hong Kong, growth in Mainland China is forecast to slow to 8.5% in 2005 from 9.5% in 2004 as investment is projected to continue to decline, but its exports growth is expected to remain strong at around 20%. Growth in China is expected to remain robust at 8.2% in 2006. The US economy is forecast to slowdown from the historical high level of 4.4% in 2004 to 3.5% in 2005 and 3.3% in 2006.

Given a weaker external environment, Hong Kong's exports of goods and services are expected to grow more slowly in 2005, at 10% compared with 15.3% in 2004. Concomitant with the deceleration in export growth, the import of goods and services is forecast to grow by 9.8% in 2005, dropping from the 13.8% growth in 2004. Tourism-related sectors are expected to continue to do well in 2005. The opening of the Disneyland theme park in September will draw in a record number of visitors from the region, particularly from the Mainland. The thriving tourism industry will continue to provide stimulus to the domestic economy.

Developments in the property market will be crucial in providing support to domestic demand. Recent strong land sales reflected expectations of a sustained property market recovery. The further weakening of the US dollar will continue to make Hong Kong's assets more attractive to foreign investors. The increase in nominal interest rates is expected to be around 2%. On the other hand, consumer prices are expected to increase further, together with rising rentals. The Composite CPI is forecast to rise by 1.5% in 2005. Hence, real interest rates would remain low in Hong Kong. Further appreciation in property values will help underpin continued growth in private domestic demand. Private consumption spending is forecast to grow by 4.7% and the investment by 2.8% in 2005.

Led by strong growth in domestic demand and supported by robust growth in the net export of goods and services, real GDP is forecast to grow by 4.7% in 2005 and moderate to 4.1% in 2006 in Hong Kong, according to Dr Alan Siu,

Deputy Director, Hong Kong Institute of Economic and Business Strategy, the University of Hong Kong. Dr Siu further pointed out that the employment situation will keep on improving, albeit at a slow rate, with the unemployment rate projected to be around 6% by the end of 2005.

Uncertainties

Given the huge current-account deficit of the US, the dollar is set to continue to weaken. While a slow and orderly depreciation of the US dollar tends to enhance Hong Kong's external competitiveness, given Hong Kong's Linked Exchange Rate System, a sharp depreciation could lower growth by unsettling the global financial markets, and by dragging interest rates to a higher level than currently expected in the market.

US interest rates are expected to increase further in 2005, and Hong Kong interest rates are expected to follow suit. In 2004, the spread between Hong Kong and US interest rates widened, as substantial fund inflows in the latter part of the year drove local interest rates substantially below those of the US. The divergence between the Hong Kong and US interest rates last year is highly unusual. The gap has now been closed. There is a risk that further increase in interest rates would lower growth.