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Hong Kong economy to enjoy major boost from interest rate cuts - economists

HONG KONG (Thomson Financial) - Hong Kong's economy will get a major boost from this week's surprisingly steep interest rate cuts, which should encourage companies and consumers to borrow, invest and spend, economists said.

The Hong Kong Monetary Authority yesterday trimmed its base rate by half a percentage point, matching the US Federal Reserve's move on Tuesday. The rate cut, the first reduction in more than four years for both central banks, prompted HSBC Holdings, Hang Seng Bank, Standard Chartered Bank, BOC Hong Kong and other banks to reduce their lending rates.

"People are now seeing the good signs resulting from the rate cut. The stock market is climbing and the lower funding cost will boost the property market and consumer spending in general," said Kevin Lau, an economist at Standard Chartered Bank. Lau is expecting the Hong Kong economy to expand 5.5 percent this year, within the government's forecast

The economy rose 6.3 percent in the first half of the year, which was more than the government's estimate. Growth was mainly driven by consumer spending, exports and investments. That prompted the authorities to raise this year's growth forecast to 5 to 6 percent from 4.5 percent to 5.5 percent previously.

"Frankly, the Hong Kong economy does not need lower interest rates as much as the US," said David Cohen, director of Asian economic forecasting at Action Economics in Singapore.

"All in all, the Hong Kong economy will continue to do well and the rate cut will just be a bonus," Cohen said.

Hong Kong will probably expand 5.7 percent this year, Cohen said.

"The near-term outlook for the Hong Kong economy remains favorable, as the broad-based expansion is expected to continue in 2007," the HKMA said in a research report released this week.

"Domestic demand is expected to be the key contributor to growth, supported by continued solid consumer and business spending," it said.

A steady rise in household income and improving employment conditions will support domestic spending, it said.

The jobless rate hovered at a nine-year low in June to August, and the number of employed persons reached a record 3.5 million.

Investments, on the other hand, will remain steady, the HKMA said, pointing to its recent Quarterly Business Tendency Survey for the third quarter.

"Forward looking indicators pointed to continued business expansion in the third quarter," it said. The survey "suggested buoyant corporate sentiment in such components as business volume and hiring decisions."

Strong growth in China, Hong Kong's biggest buyer of its electronic goods, toys and other items, will support its exports.

"Growth in merchandise exports remained firm, benefiting from strong external demand and the robust trade performance of the Mainland," it said.

Exports rose 2.8 percent in the second quarter from the first, up from a 0.9 percent increase in January through March.

Inflation is expected to remain tame even with the rate cut and faster economic growth.

"Inflation is not going to be a threat," Cohen said.

Consumer prices will probably rise at an average of 1.7 to 1.8 percent this year, according to Standard Chartered Bank's Lau and Action Economic's Cohen, slightly higher than the government's forecast of 1.5 percent.

Consumer prices rose 2.6 percent in July from a year ago, faster than June's 2.4 percent, led by increases in the food and housing costs.

"Right now, the overall inflation story is still manageable," Lau said. "Food prices, particularly pork and other imports from China, will be the main focus for now. But China is already aggressively increasing its food supply."

With the buoyant stock market and brisk economy, property prices will likely go up, feeding inflation, Lau said.

The Hang Seng Index soared to record levels for a second day Thursday, led by property and banking stocks.

"We will probably see rents rising gradually in the next six to 12 months," Lau said.

The government, meanwhile, said turbulent global financial markets, arising from the mortgage crisis in the US, is one of the risks the economy is facing over the short term.

"There is a risk that heightened global financial market volatility could further weigh on domestic financial markets and weaken consumer sentiment, which could negatively affect private consumption," the HKMA said in its report.

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