Hong Kong warns of downside growth risks

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HONG KONG, Aug 7 (Reuters) - Joseph Yam, head of Hong Kong's central bank, warned of downside risks to the territory's economic growth on Thursday, echoing analysts' views that the city is now vulnerable to global headwinds.

"We do not rule out that economic growth will be worse than expected," Yam told reporters, adding that a slower performance would disrupt a sustained period of rapid economic growth since the city's recovery from the outbreak of the SARS virus in 2003.

The government and economists forecast gross domestic product would increase by around 5 percent this year, down from average annual growth of 7.3 percent over the past four years, but economists also see downside risk in the wake of recent data.

June exports unexpectedly declined from a year earlier and a purchasing managers' index for July showed private sector business activity contracted for the first time in 3-1⁄2 years as new orders fell.

While exports could pick up in coming months, the pace of growth is unlikely to match a 9 percent rise in the first half given signs of slowing demand in both the United States and Europe, analysts say. Yam, chief executive of the Hong Kong Monetary Authority, said the fallout from a weak U.S. housing market may be more protracted than first thought.

Domestic demand in Hong Kong is solid, and likely to keep driving economic growth as low unemployment at 3.3 percent is pushing up wages and households, and companies have relatively low debt. June retail sales data, though, disappointed for a second straight month as sales in real terms grew only 4 percent from a year earlier compared with average growth of 11.2 percent over the past year.

Analysts attributed the slowdown in part to rising inflation, which is at an 11-year high, topping 6 percent in June, and starting to erode consumer purchasing power.

"The slowdown in exports and retail sales combined makes for a tougher environment," said Sean Yokota, an economist at UBS.

He forecast only 3.9 percent economic growth this year and a 4.1 percent expansion next year.

"The first half (of 2009) will be difficult as Hong Kong will be vulnerable to an export slowdown," he said. "But as the global economy starts to recover in the second half, Hong Kong will be one of the first economies to recover as well."

China's rapid economic development continues to provide a cushion for the territory, boosting tourism as mainland Chinese flock to shop here, and encouraging mainland companies to list on the Hong Kong bourse and use the services of Hong Kong lawyers, accountants and other professionals.

Kevin Lai, an economist at Daiwa Research Institute, said a weak Hong Kong dollar <HKD=>, which is pegged to the U.S. dollar, is underpinning the domestic economy as China's yuan <CNY=CFXS> currency is gradually appreciating.

"The weak currency means those services are cheaper than a year ago for mainland Chinese," he said.

However, first-half earnings reports this week highlighted the territory's exposure to global economic challenges. High oil prices pushed flagship carrier Cathay Pacific Airways (0293.HK: Quote, Profile, Research) into the red for the first time since the SARS outbreak in 2003, while Bank of East Asia's (0023.HK: Quote, Profile, Research) net profit plunged 52 percent after writedowns linked to the global credit crisis. (Editing by Jonathan Hopfner)

Source: Susan Fenton