

ECONOMIC FOCUS

Treasury Division



Irina Fan
Senior Economist
irinafan@hangseng.com

Joanne Yim
Chief Economist
joanneyim@hangseng.com

24 February 2010

Hong Kong 2010/11 Budget: More One-Off Measures on Offer

Strong Asset-related Revenue Turns Deficits into Surplus

The liquidity-fuelled asset market rally contributed to higher-than-expected revenue from stamp duties, turning the 2009/10 budget into a surplus of HKD13.8 billion, or 0.8% of GDP, from an initial estimate of a deficit of HKD39.9 billion.

Concessions Again Even as Economy Returns to Growth

Last year's Budget offered over HKD40 billion of one-off concessions to buffer the economic downturn. The amount this year was reduced to about HKD18 billion.

- For households
 - A one-off rebate of 75% of the salaries tax paid, up to a maximum of HKD6,000
 - Exemption of property rates for the four quarters of 2010/11, capped at HKD1,500 per quarter for each rateable unit
 - Waiver of public rental for two months
- For businesses
 - Waiving the business registration fees for one year

New Measures to Cool the Property Market

Mounting risk of overheating in the property market pushed the government to launch new measures to cool the boiling sentiment.

- Flexible land auctions
- Raised stamp duty for residential properties priced at HKD20 million or above to 4.25% from 3.75%
- Revitalise the second-hand subsidized Home Ownership Scheme (HOS) market

Subpar Growth Ahead

- The Hong Kong economy returned to a positive 2.6% year-on-year growth in the final quarter of 2009. For 2009 as a whole, the local economy contracted 2.7%, the worst annual performance since 1998 when the local economy was hit by the Asian financial crisis.
- The Financial Secretary projected a growth of 4% to 5% for 2010 which may be too optimistic, as it takes time for global demand to return to its peak levels.

Overall: Discretions Overwhelmed Rules

Despite improving economic conditions, the government hands out short-term one-off concessions. However, there is a lack of clear guidelines on its long-term budgetary policy.



HANG SENG BANK

Member HSBC Group

ECONOMIC FOCUS

Treasury Division



Below-Trend Growth Ahead

After four quarters of contraction, the Hong Kong economy resumed year-on-year growth in the final quarter. But for 2009 as a whole, the local economy still shrank by 2.7%, which was Hong Kong's worst annual performance since 1998 when the local economy was hit by the Asian financial crisis.

While domestic demand has been taking the lead in the recovery, exports are also gathering momentum. The latter reverted to growth in the last two months of 2009 after contracting for a year, as the advanced economies rebounded from the worst recession in decades.

While the government sees the economy expand 4% to 5% in 2010, we are more cautious. Our major markets are likely to go through a long period of deleveraging following the financial crisis, weighing on global growth. As such, we only forecast a tepid growth of 3.5% for the highly trade-dependent Hong Kong economy for 2010.

Exhibit 1: Real GDP Growth

	2009 (yoy %)	2010 Forecast (yoy %)	
		Hang Seng Bank	Government
Private Consumption	-0.3	3.2	---
Government Consumption	2.0	2.0	---
Gross Fixed Capital Formation	-2.2	6.5	---
Export of goods	-12.6	8.9	---
Import of goods	-0.7	9.5	---
Export of Services	-9.7	6.1	---
Import of Services	-4.0	3.5	---
Real GDP	-2.7	3.5	4% to 5%
Domestic Demand	0.8	4.1	---
Composite CPI	0.5	2.2	2.3
Nominal GDP	-2.5	5.8	4% to 5%

Source: Census and Statistics, Financial Secretary Office, Hang Seng Bank.

Concessions Again

While last year's Budget offered HKD40 billion of concessions to buffer the economic downturn, the 2010/11 Budget handed out some HKD18 billion of one-off relief measures again, even when the economy is recovering from the worst recession in a decade.

For households

- A one-off rebate of 70% of the salaries tax paid, up to a maximum of HKD6,000
- Exemption of property rates for the four quarters of 2010/11, capped at HKD1,500 per quarter for each rateable unit.
- Waiver of public rental for two months.

For businesses

- Waiving the business registration fees for one year.



ECONOMIC FOCUS

Treasury Division



Strong Asset-related Revenue Turns Deficit into Surplus

The Financial Secretary, Mr. John Tsang delivered his third budget speech on 24 February 2010. As widely expected, the estimated 2009/10 consolidated budget ended with a surplus of HKD13.8 billion, or 0.8% of GDP, instead of an initial estimate of a large deficit of HKD39.9 billion.

The liquidity-fuelled stock and property rally contributed to higher than expected revenue from stamp duties on stock and property transactions (up 62% to HKD40.5 billion) and land revenue (more than double to HKD20.8 billion).

New Measures to Cool the Property Market

The strong property market brought not just extra revenue, but also mounting risk of overheating, pushing the government to launch new measures to cool the boiling sentiment.

Stamp duty for luxury residential properties was raised. The Hong Kong SAR government also refined its land policy to include holding land auctions at irregular intervals alongside the current application list system to boost housing supply. The Government will put up urban residential sites in the List for sale by auction or tender in the coming two years even if they have not been triggered.

The government projects the number of private residential units completed will increase to 14,300 in 2010 and 53,000 private residential units will come onto the market in the coming three to four years.

Exhibit 2

	Key Measures to Cool Property Market
Oct 2009	– The Hong Kong Monetary Authority requested banks to lower the loan-to-value ratio for residential properties worth HKD20 million or above, the so-called luxury homes, from 70% to 60%
Nov 2009	– ensure transparency in property transactions and transaction prices – Shortened the lead time for developers to make public details of transactions, – Required developers to list the price per square foot in saleable area of individual flats – Adopt a reasonable floor numbering system.
Feb 2010	– Higher stamp duty: Raise stamp duty for residential properties priced at HKD20 million or above by 0.5 percentage points to 4.25% effective on 1 April. – No deferred payment on stamp duties.
	– Flexible land auctions
	– The Hong Kong Housing Authority will actively explore means to revitalise the HOS secondary market
	– Transport and Housing Bureau is now exploring further measures to strengthen the regulation of the sale of first-hand, uncompleted private residential flats

Source: Financial Secretary Office, Hang Seng Bank.



ECONOMIC FOCUS

Treasury Division



Exhibit 3

Value (HKD mn)	Existing Rate	New Rate
Below 2.00	HKD100	same
2.00-2.35	HKD100 + 10% of excess over 2 mn	same
2.35-3.00	1.5%	same
3.00-3.29	HKD45,000 + 10% of excess over 3 mn	same
3.29-4.00	2.25%	same
4.00-4.43	HKD90,000 + 10% of excess over 4 mn	same
4.43-6.00	3.0%	same
6.00-6.72	HKD180,000 + 10% of excess over 6 mn	same
Exceed 6.72	3.75%	same
Exceed 20	3.75%	4.25%

Sources: Inland Revenue Department, Hang Seng Bank, 2010/11 Budget

Light Brushes on the Financial Sector

- The Financial Secretary stressed the importance of maintaining Hong Kong long-term standing as an international financial centre, in particular, in developing offshore RMB financial services in the region.
- New incentives are offered for exchange traded funds and bonds
 - Extend the stamp duty concession in respect of the trading of exchange traded funds (ETFs) to cover ETFs that track indices comprising not more than 40% of Hong Kong stocks. Currently, only the stamp duty for the trading of ETFs with no Hong Kong stock in the portfolio is waived.
 - Extend concessionary profits tax rate at 50% of the normal rate to the interest income and profits derived from qualifying debt instruments with a maturity period of less than three years. Currently, it covers qualifying debt instruments with a maturity period of less than seven years but not less than three years.

Healthy Fiscal Finance Even With Rising Infrastructure Spending

Hong Kong's public finance should remain healthy, although the government projects deficits for the next three years with rising spending, as a number of committed infrastructure projects, including the Hong Kong-Zhuhai-Macao Bridge, the Kai Tak Cruise Terminal and the Guangzhou-Shenzhen-Hong Kong Express Rail Link, enter their construction peaks.

According to the government's latest estimates, Hong Kong's fiscal reserves will remain sizeable. Reserves as a share of GDP range from 21.7% to 28.3% from 2010/11 to 2014/15, even with these infrastructure spending.



ECONOMIC FOCUS

Treasury Division



Exhibit 4

HKD billion	2010/11	2011/12	2012/13	2013/14	2014/15
Operating Accounts					
Revenue	248	284	300	314	331
Expenditure	251	262	272	283	294
Surplus	-4	23	28	31	40
Capital Accounts					
Revenue	44	44	45	48	50
Expenditure	66	80	80	78	72
Surplus	-21	-36	-35	-31	-22
Consolidated Surplus (Before Bond Repayment)	-25	-13	-7	0	15
Bond Repayment	4	--	--	--	10
Consolidated Surplus (After Bond Repayment)	-25	-13	-7	0	6
Budget balance as % of GDP	-1.5	-0.7	-0.4	0.0	0.7
Fiscal reserves at 31 March (bn)	483	470	463	463	469
As a no. of months of government expenditure	18	17	16	15	15
As a% of GDP	28.3	26.0	24.1	22.8	21.7

Lack of Clear Budgetary Criteria

Despite improving economic conditions, the government hands out short-term one-off concessions. However, there is a lack of clear guidelines on government's long-term budgetary policy.

In 2002, the government stated that "maintaining fiscal reserves equivalent to around 12 months of government expenditure to meet operating and contingency requirements" should be sufficient. In recent years, however, the government has been saying that it aims to maintain adequate reserves in the long run. But what is "adequate"?

Hong Kong's fiscal reserves are projected to reach HKD508 billion by end-March 2010, equivalent to 21 months of government expenditure or 31.1% of GDP. Moreover, the government's medium range forecast projects fiscal reserves to stay at 15 to 18 months of government expenditure or 21.7% to 28.3% of GDP, suggesting that Hong Kong's fiscal reserves may be more than sufficient.

Should the government consider putting the "excess" fiscal reserves to better use, such as offering preferential tax treatment to attract investment in the six identified industries that would benefit Hong Kong's longer-term economic development?



ECONOMIC FOCUS

Treasury Division



Disclaimer

This document has been issued by Hang Seng Bank Limited ("HASE") and the information herein is based on sources believed to be reliable and the opinions contained herein are for reference only and may not necessarily represent the view of HASE. The research analyst(s) who prepared this report certifies(y) that the views expressed herein accurately reflect the research analyst's(s)' personal views about the financial instrument or investments and that no part of his/her/their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report. Nothing herein shall constitute as offers or solicitation of offers to buy or sell foreign exchange contracts, securities, financial instruments or other investments. Re-distribution of any part of this document by any means is strictly prohibited.

The information contained in this document may be indicative only and has not been independently verified and no guarantee, representation, warranty or undertaking, express or implied is made as to the fairness, accuracy, completeness or correctness of any information, projections or opinions contained in this document or the basis upon which any such projections or opinions have been based and no responsibility or liability is accepted in relation to the use of or reliance on any information, projections or opinions whatsoever contained in this document. Investors must make their own assessment of the relevance, accuracy and adequacy of the information and opinions contained in this document and make such independent investigations as they may consider necessary or appropriate for the purpose of such assessment. All such information, projections and opinions are subject to change without notice.

HASE and its affiliates may trade for their own account in, may have underwritten, or may have a position in, all or any of the securities or investments mentioned in this document. Brokerage or fees may be earned by HASE or its affiliates in respect of any business transacted by them in all or any of the securities or investments referred to in this document.

The investments mentioned in this document may not be suitable for all investors. Investors must make investment decisions based on their own investment objectives, financial position and particular needs and consult their own professional advisers where necessary. This document is not intended to provide professional advice and should not be relied upon in that regard.

No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. Investment involves risk. Investors should note that value of investments can go down as well as up and past performance is not necessarily indicative of future performance. This document does not purport to identify all the risks that may be involved in the securities or investments referred to in this document.

