

HONG KONG ECONOMIC MONITOR

Treasury Division



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Hong Kong: Fourth Quarter GDP Preview Growth Reverts to Trend, Inflation Drifts Up

The Hong Kong government is set to release its fourth quarter GDP report on February 23. The latest data suggested that the upcoming 4Q GDP figure is likely to have reverted to a growth of 4.7% after three straight quarters of above-trend growth. For 2010 as a whole, the Hong Kong economy is estimated to have grown 6.5%, the fastest in four years.

Looking ahead, a two-speed world is likely to persist with the emerging economies booming while the advanced countries still struggling, the latter casting a shadow over the export outlook of Hong Kong. But local consumer demand should continue to underpin growth, particularly in view of the improvement in the labour market.

There is more evidence that inflation expectations are drifting upwards, which could result in higher inflation down the road if not anchored.

In sum, Hong Kong's growth is expected to be near trend, but inflation looks set to rise further. Our forecast for 2011 real GDP growth is for a steady growth of 4.5% but higher inflation rate of 3.7%.

Exhibit 1: Real GDP Growth

	Quarterly (yoy %)				Annual (yoy %)		
	1Q10	2Q10	3Q10	4Q10E	2009	2010E	2011F
Private Consumption	7.1	4.4	5.7	4.6	-0.4	5.4	--
Government Consumption	3.4	2.7	3.4	3.0	2.4	3.1	--
Gross Domestic Fixed Capital Formation	8.2	15.6	0.3	7.0	-1.8	7.5	--
Export of Goods	21.6	20.1	20.8	17.0	-12.7	19.7	--
Export of Services	17.9	17.1	14.0	11.0	0.3	14.7	--
Import of Goods	28.0	23.6	16.5	15.1	-9.5	20.2	--
Import of Services	10.9	12.4	9.9	7.8	-3.7	10.2	--
Real GDP	8.0	6.5	6.8	4.7	-2.8	6.5	4.5

Note: (E) estimate; (F) forecast

Source: Census and Statistics Department, Hang Seng Bank



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The Fourth Quarter GDP Preview

Final quarter GDP is likely to have registered a solid year-on-year growth of 4.7%¹, reverting to its 10-year trend after three straight quarters of above-trend growth, as exports decelerated. On a quarter-on-quarter basis, GDP growth is estimated to have slowed to 0.4% in the final quarter, from 0.7% in the third.

Exhibit 2: Year-on-year growth reverts to trend

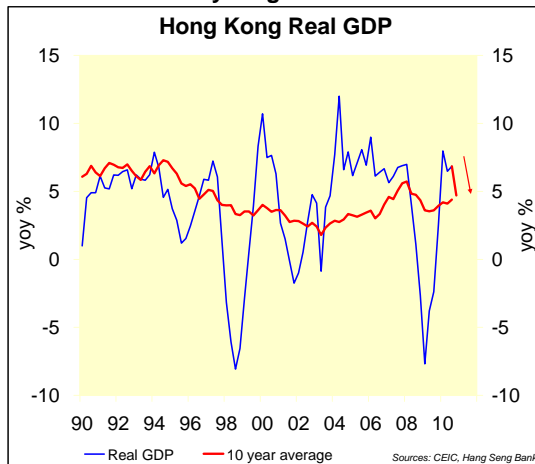


Exhibit 3: Quarter-on-quarter barely growing

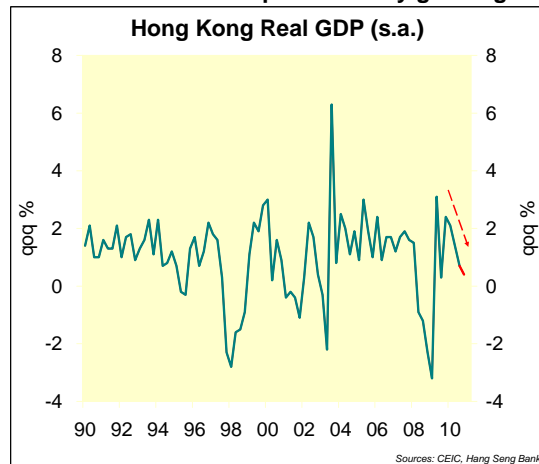
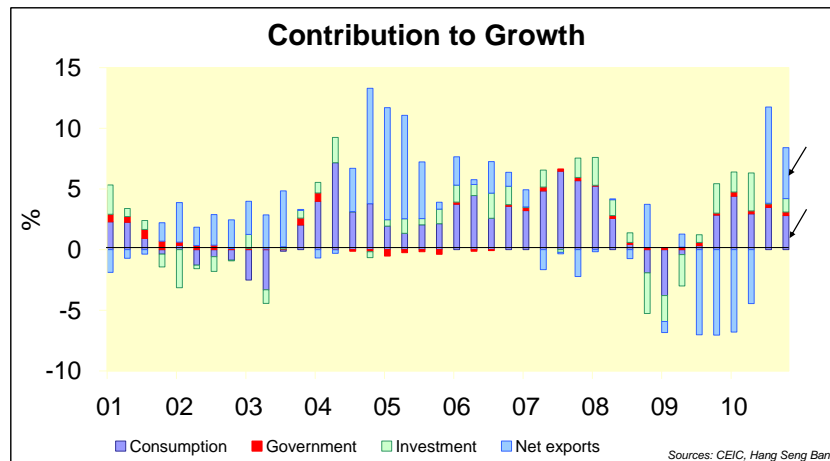


Exhibit 4



Contribution from net exports may drop

The contribution of net exports of goods and services is likely to edge down to 4.2 percentage points in the final quarter, from 8 percentage points in the third, reflecting fast cooling external demand after a few quarters of inventory replenishment.

¹ Changes throughout the report are on year-on-year basis unless otherwise stated.



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Solid support from domestic sector

Consumption spending should have stayed firm on the back of rising income and brighter job prospects. The unemployment rate dropped to a two-year low of 4.0% by year-end, from 4.9% at the beginning of the year. Wealth effects from soaring stock and property prices might have also played a role.

Investment spending is expected to expand further, as the latest survey indicated that business confidence remained at relatively high level. The booming property market and ongoing government infrastructure would have also boosted investment spending.

It is estimated that consumption and investment spending could have contributed 2.8 percentage points to the final quarter growth.

Exhibit 5

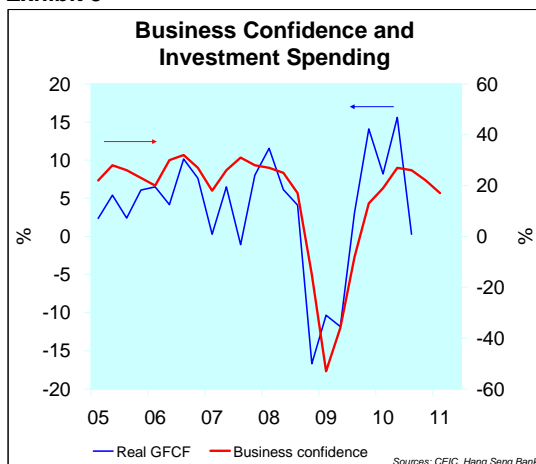


Exhibit 6

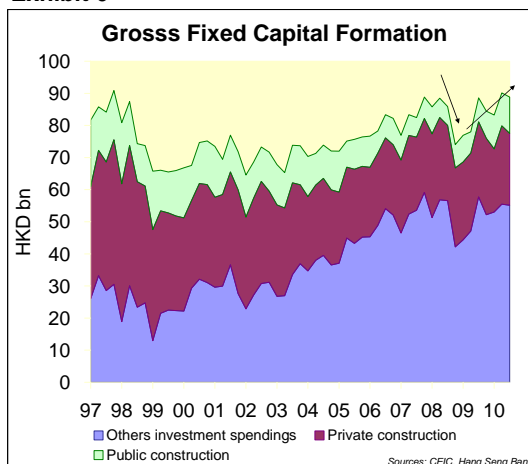


Exhibit 7: Contribution to Growth (%)

	1Q10	2Q10	3Q10	4Q10E	2009	2010E
Private consumption	4.4	3.0	3.5	2.8	-0.2	3.4
Government spending	0.3	0.2	0.3	0.3	0.2	0.3
Investment	1.7	3.1	0.1	1.1	-0.4	1.5
Inventories	8.4	4.6	-4.9	-3.7	1.2	0.8
Net exports of goods & services	-6.8	-4.5	8.0	4.2	-3.6	0.5
Real GDP	8.0	6.5	6.8	4.7	-2.8	6.5

Sources: Census & Statistics Department, Hang Seng Bank

If our estimate is correct, 2010 would likely end with a robust growth of 6.5%. Real GDP expanded at a rapid pace of 7.1% in the first three quarters of 2010.



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Looking Ahead

Strong headwinds from external demand

In the US, the unemployment rate remains at relatively high levels of above 9% and house prices are still falling.

Exhibit 8:
The US housing market remains depressed

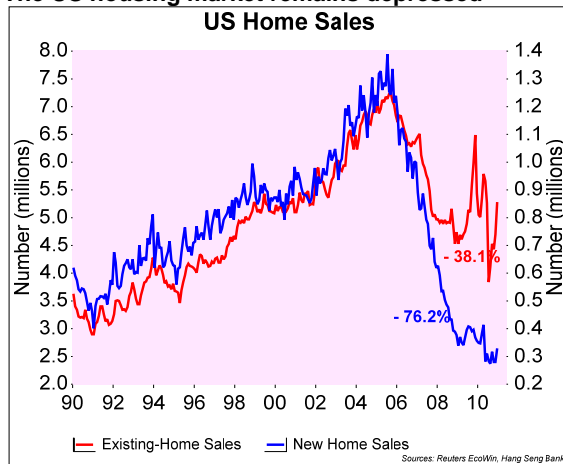
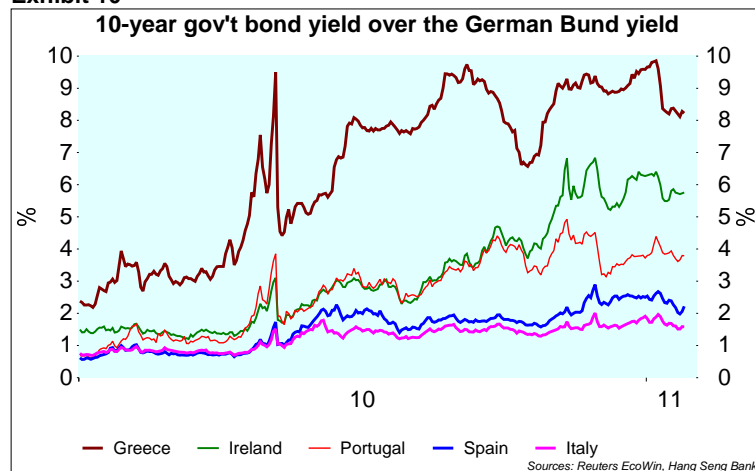


Exhibit 9:
US unemployment is another area of concern



The situation in Europe is even worse as the euro area's debt crisis is in danger of spreading from the peripheral to the core members. The fiscal consolidation in many European countries will also cast a shadow over the region's economic outlook.

Exhibit 10



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In contrast, the emerging economies have been recovering more rapidly, but rising inflation seems to be a bigger challenge. The Mainland and Indian economies grew at close to double-digit pace in 2010, but inflation is also at high levels.

Policy tightening in emerging economies looks set to accelerate further. For instance, the Mainland authorities will phase out fiscal stimulus and the People's Bank of China looks set to raise interest rates and required reserve ratios of banks to curb rising inflation and property prices, which may also put a brake on growth.

Exhibit 11

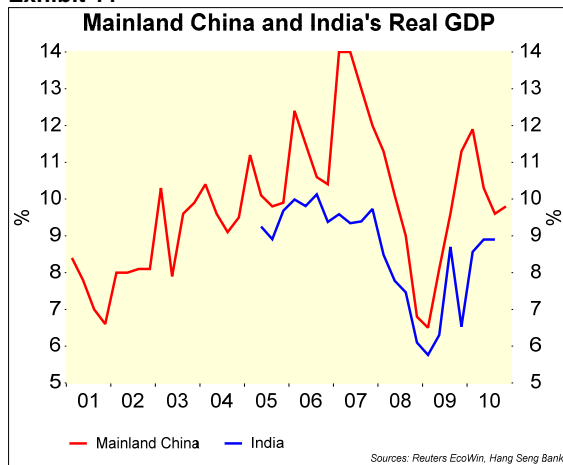
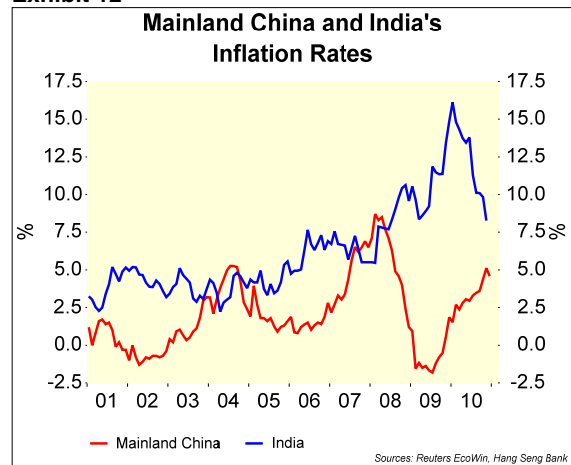


Exhibit 12



Consumers continue to underpin growth

External demand is likely to slow, but consumer demand should continue to underpin growth, particularly in view of the improvement in the labour market.

Exhibit 13

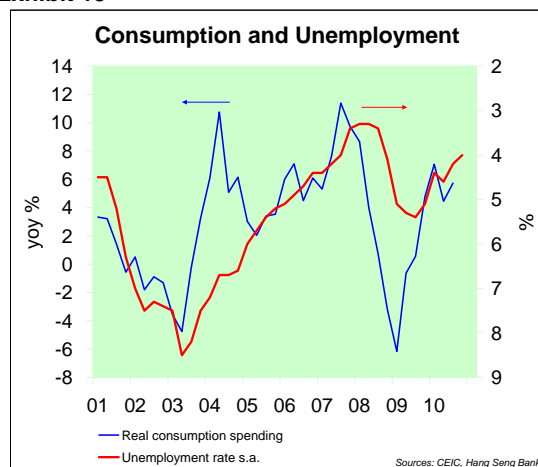
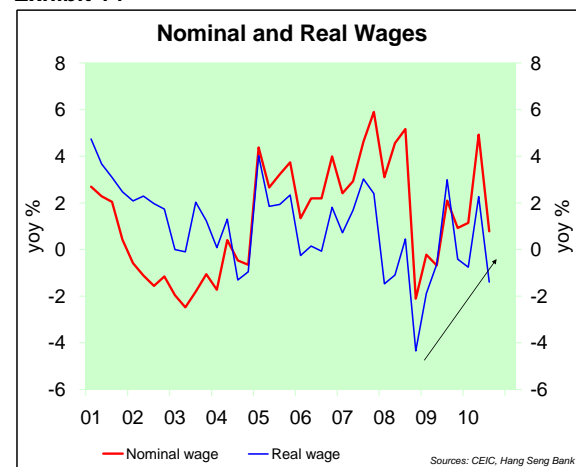


Exhibit 14



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Inflation expectation drifts up

Inflationary pressure continues to trend upward in Hong Kong, reflecting the trend in the better performing world. Headline consumer price inflation rose to 3.1% in December 2010, from 1.0% at the start of the year, on the back of higher food and energy prices. Pressure from the demand side was also reflected in the fast increases in private housing rentals. There is more evidence that inflation expectations are drifting upwards, which could result in higher inflation down the road if not anchored.

Exhibit 15

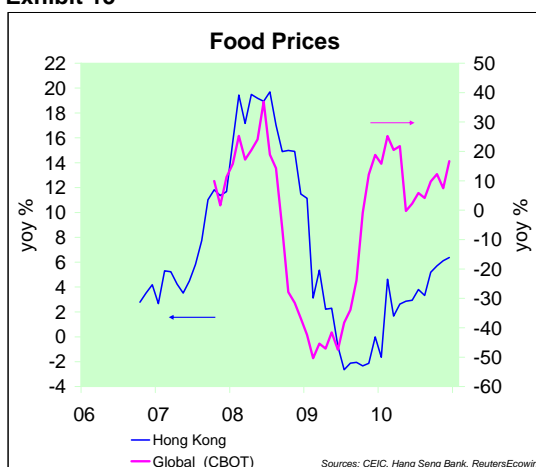
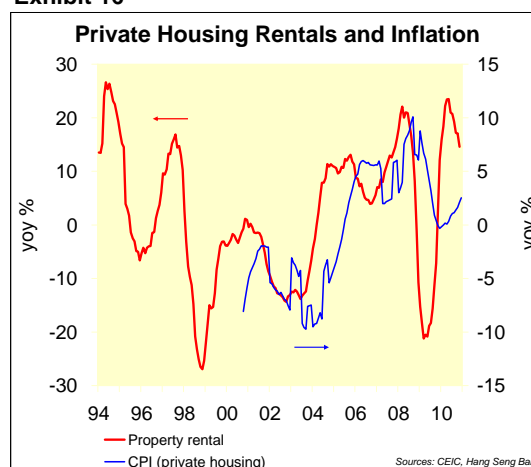


Exhibit 16



Summary

Hong Kong's growth is expected to be near trend, but inflation looks set to rise further. Our forecast for 2011 real GDP growth is a steady growth of 4.5% and inflation looks set to rise further to 3.7%.

Exhibit 17: Hong Kong's Economic Forecast

(% yoy changes)	2009	2010E	2011F
Real GDP	-2.8	6.5	4.5
Consumer prices	0.5	2.4(A)	3.7
Unemployment rate	5.4	4.3	4.0

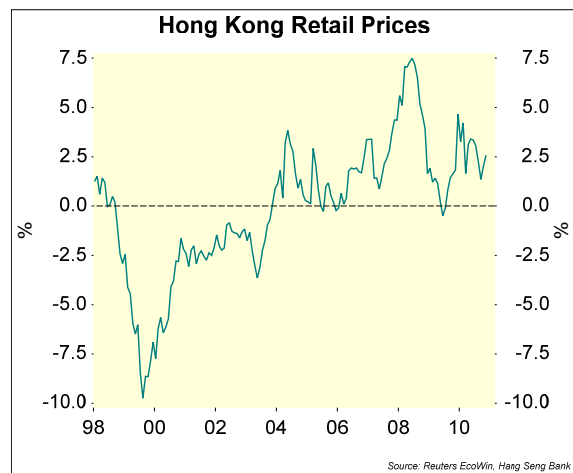
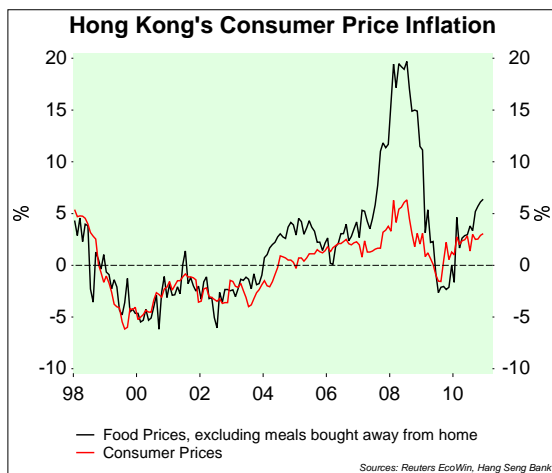
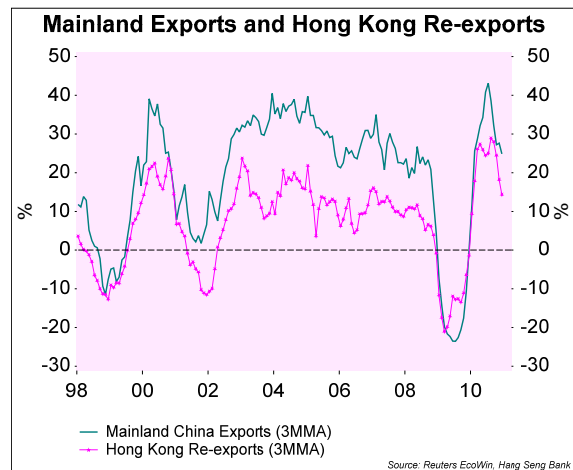
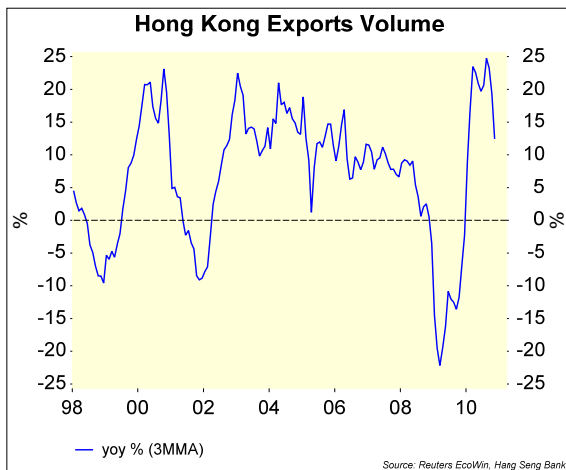
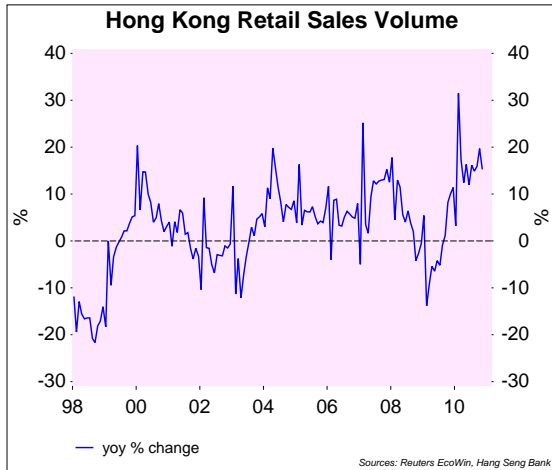
Note (F) Forecast; (A) Actual

Sources: Hong Kong's Census and Statistics Department, Hang Seng Bank



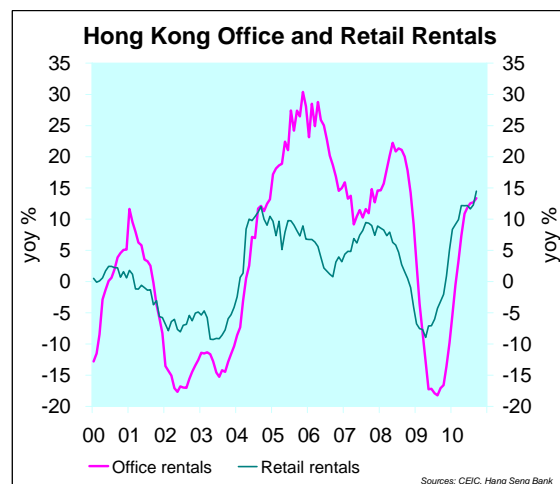
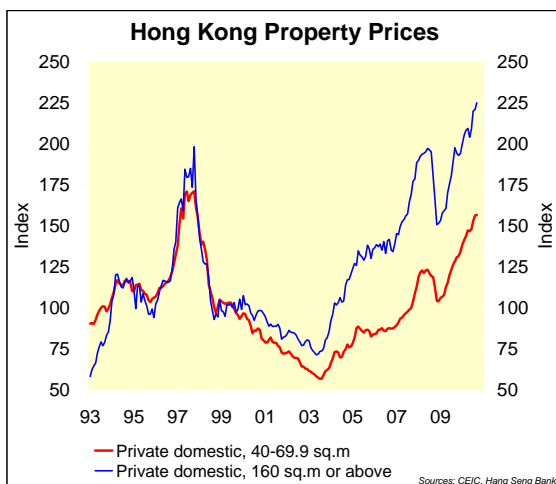
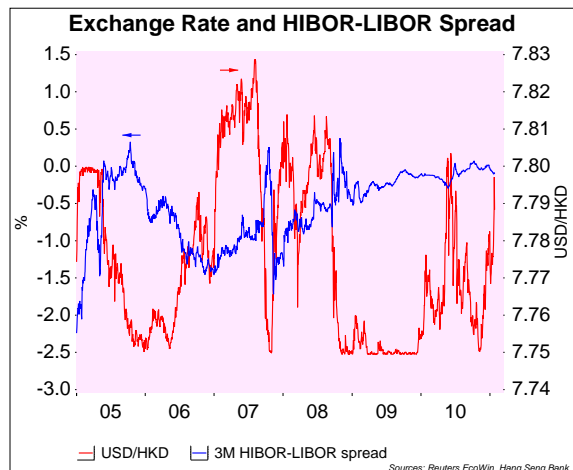
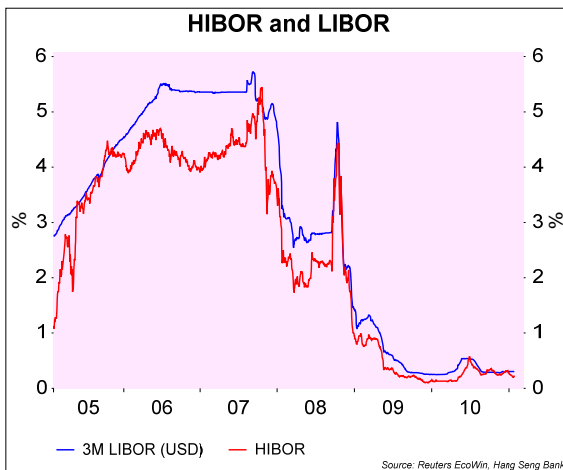
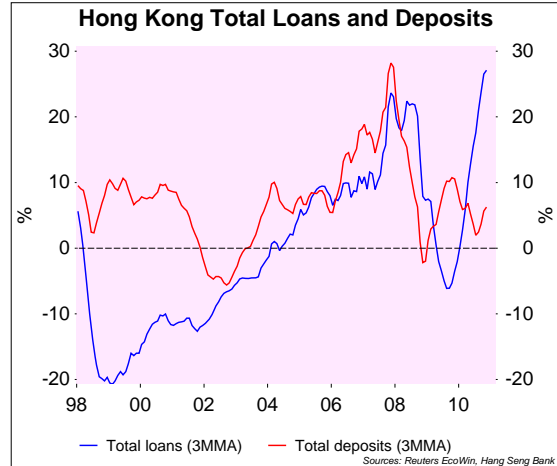
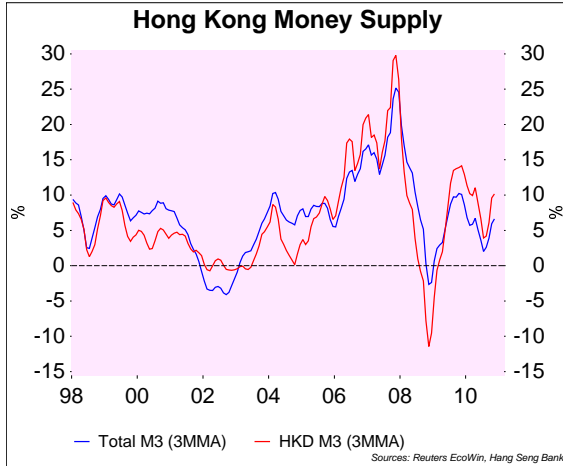
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Hong Kong Economic Monitor Statistics

Feb 2011

	GDP (real)	Retail sales (value)	Retail sales (volume)	Total Deposits		Total Loans		Money supply (Total M3)	Consumer prices	Unemployment rate (s.a.)
	yoy(%)	yoy(%)	yoy(%)	HKD bn	yoy(%)	HKD bn	yoy(%)	yoy(%)	yoy(%)	%
2002	1.8	-4.1	-2.6	3,318	-2.6	2,076	-5.0	-0.9	-3.0	7.3
2003	3.0	-2.2	-0.6	3,567	7.5	2,035	-2.0	8.3	-2.6	7.9
2004	8.5	10.8	9.2	3,866	8.4	2,156	5.9	8.6	-0.4	6.8
2005	7.1	6.8	6.1	4,068	5.2	2,312	7.3	5.2	1.0	5.6
2006	7.0	7.2	5.7	4,757	17.0	2,468	6.7	15.5	2.0	4.8
2007	6.4	12.8	10.1	5,869	23.4	2,962	20.0	20.6	2.0	4.0
2008	2.2	10.6	5.0	6,060	3.2	3,284	10.9	2.6	4.3	3.6
2009	-2.8	0.6	-0.8	6,381	5.3	3,289	0.1	5.2	0.5	5.4
2010	6.5E	18.0E	15.0E	6,892E	8.0E	4,228E	28.6E	7.5E	2.4	4.3E
2011F	4.5	14.0	10.0	7,436	7.9	4,440	8.0	7.8	3.7	4.0
Q3 2009	-2.4	-1.1	-1.8	6,424	9.9	3,277	-4.3	9.4	-0.9	5.3
Q4	2.5	12.8	9.9	6,381	5.3	3,288	0.1	5.2	1.3	4.9
Q1 2010	8.0	18.8	15.8	6,371	5.8	3,469	9.5	5.7	1.9	4.4
Q2	6.5	16.9	13.6	6,352	1.2	3,773	17.8	1.3	2.6	4.6
Q3	6.8	17.8	15.6	6,736	4.9	4,126	25.9	5.2	2.3	4.2
Q4	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	2.8	4.0
Aug 2010	NA	17.1	14.9	6,500	3.3	3,939	24.1	3.6	3.0	4.2
Sep	NA	17.2	15.8	6,736	4.9	4,126	25.9	5.2	2.6	4.2
Oct	NA	21.8	19.7	7,047	8.7	4,201	29.5	9.0	2.6	4.2
Nov	NA	17.9	15.2	6,847	5.2	4,144	25.9	5.6	2.9	4.1
Dec	NA	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	3.1	4.0
YTD	7.1	18.2	15.5	6,847	5.2	4,144	25.9	5.6	2.4	4.0

	Foreign Trade					Residential Property Price Index	Office Rental Index	Tourist Arrivals		HKD per USD (end of period)	
	Exports		Imports		Trade balance			yoy(%)	'000		yoy(%)
	HK\$b	yoy(%)	HK\$b	yoy(%)							
2002	1,561	5.4	1,619	3.3	-58.9	-11.1	-15.4	16,566	20.7	7.7980	
2003	1,742	11.7	1,806	11.5	-63.3	-12.0	-12.7	15,537	-6.2	7.7630	
2004	2,019	15.9	2,111	16.9	-92.0	26.7	4.6	21,811	40.4	7.7735	
2005	2,250	11.4	2,330	10.3	-79.3	18.0	23.5	23,359	7.1	7.7525	
2006	2,461	9.4	2,600	11.6	-138.8	0.7	21.2	25,251	8.1	7.7745	
2007	2,688	9.2	2,868	10.3	-180.5	11.6	12.1	28,169	11.6	7.8015	
2008	2,824	5.1	3,025	5.5	-201.1	16.4	17.9	29,500	4.7	7.7505	
2009	2,469	-12.6	2,692	-11.0	-223.3	0.5	-12.8	29,590	0.3	7.7555	
2010	3,031	22.8	3,365	25.0	-333.8	24.3E	8.7E	36,030	21.8	7.8000	
2011F	3,364	11.0	3,736	11.0	-371.2	15.0	11.0	39,273	9.0	7.8000	
Q3 2009	651	-14.3	724	-10.4	-72.7	3.2	-17.7	7,463	-1.6	7.7505	
Q4	669	-2.0	772	3.4	-73.0	23.1	-13.4	8,430	9.0	7.7555	
Q1 2010	636	26.0	724	34.3	-88.2	30.3	-1.0	8,625	16.5	7.7645	
Q2	763	24.3	854	29.9	-90.9	25.1	10.3	8,231	30.8	7.7855	
Q3	832	27.8	898	24.1	-66.9	20.9	13.0	9,320	24.9	7.7615	
Q4	890	14.4	800	15.1	-89.3	n.a.	n.a.	9,785	17.1	7.7745	
Aug 2010	290	36.0	302	28.4	-11.9	21.6	12.8	3,455	21.9	7.7805	
Sep	280	24.1	305	19.5	-24.4	19.9	13.1	2,728	21.2	7.7615	
Oct	274	13.9	296	14.0	-22.3	21.2	13.0	3,259	18.0	7.7495	
Nov	273	16.6	297	16.4	-23.5	23.0	13.8	3,502	17.1	7.7665	
Dec	253	12.5	297	14.8	-43.5	n.a.	n.a.	3,543	15.7	7.7745	
YTD	3,031	22.8	3,365	25.0	-333.8	24.6	8.4	36,030	21.8	7.7745	

Note: (E) Estimate; (F) Forecast

Source: CEIC, Hang Seng Bank





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