



# Intellectual Exchange

Hong Kong's 2011/12 Budget

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# Economic update and outlook: Moving from strong to steady growth

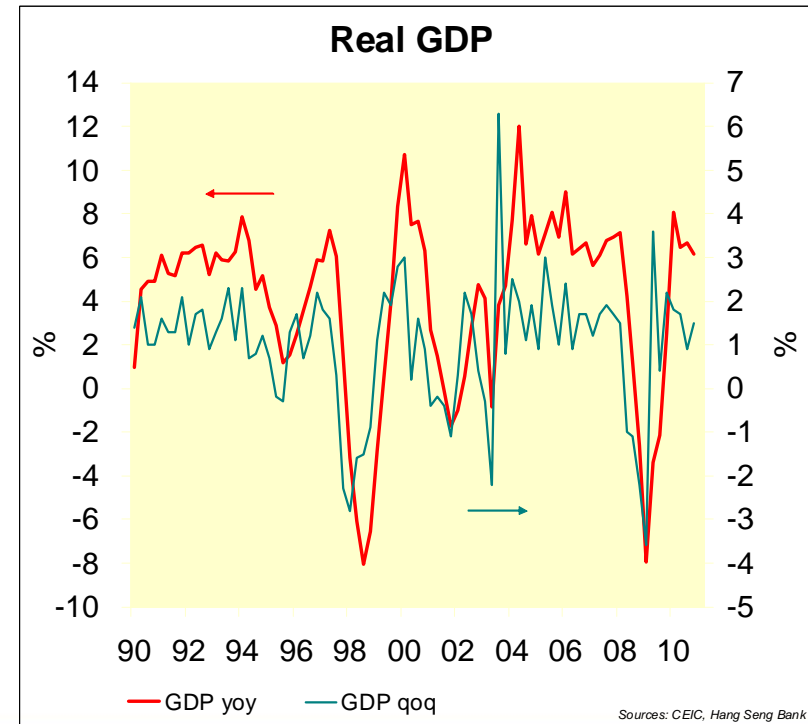
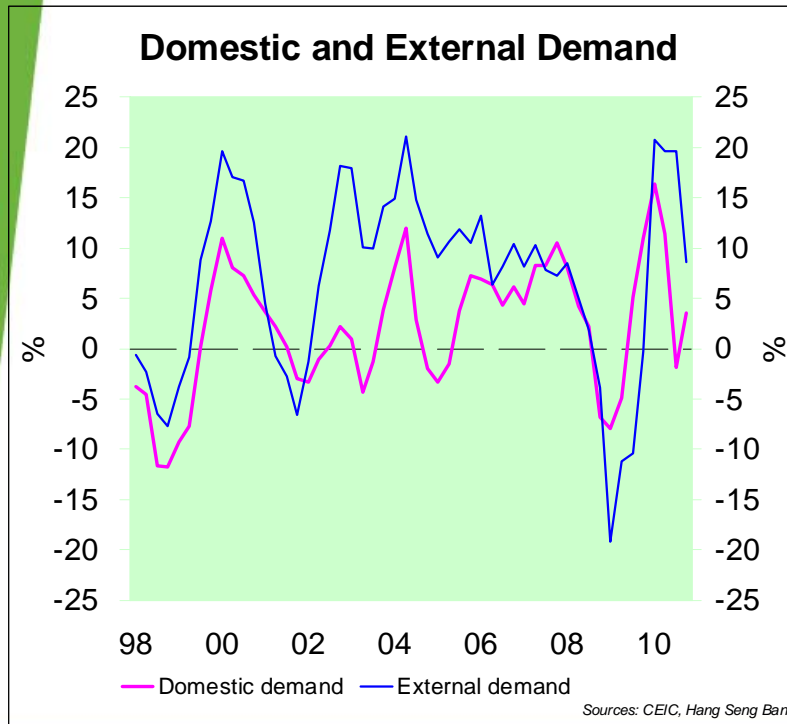


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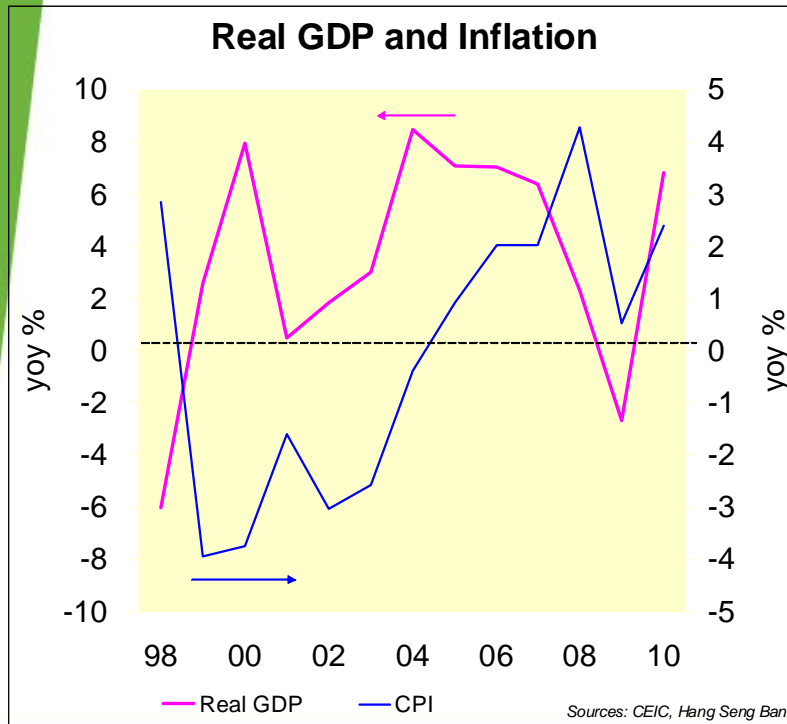


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## Underpinned by strong domestic demand, Hong Kong's 4Q GDP registered four straight quarters of above-trend growth, expanding 6.2% year-on-year



**For 2010 as a whole, the Hong Kong economy registered a robust growth of 6.8%, the fastest in four years. But inflation also trended up**



# Economic Outlook

- External demand is likely to slow as the global economic recovery remains fragile
- Domestic Demand
  - Consumer demand should continue to underpin growth, particularly in view of the improvement in the labour market
    - Jan unemployment rate dropped to 3.8%, nearly back to the pre-crisis level
  - Ongoing government infrastructure would boost investment spending
- Outlook for inflation is more uncertain, particularly in light of surging oil prices amidst the recent political turmoil in oil exporting countries in the Middle East and North Africa



# Economic Forecast

(yoy %)	2010	2011F	
		HASE	Government
Real GDP	6.8%	5.0%	4% to 5%
Headline CPI inflation	2.4%	4.7%	4.5%
Underlying CPI inflation	1.7%	4.7%	4.5%

Sources: Census and Statistics, Financial Secretary's Office, Hang Seng Bank



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# **The 2011/12 Budgetary Measures: Aiming to Provide Inflation Relief and Reduce Inflation Expectations**

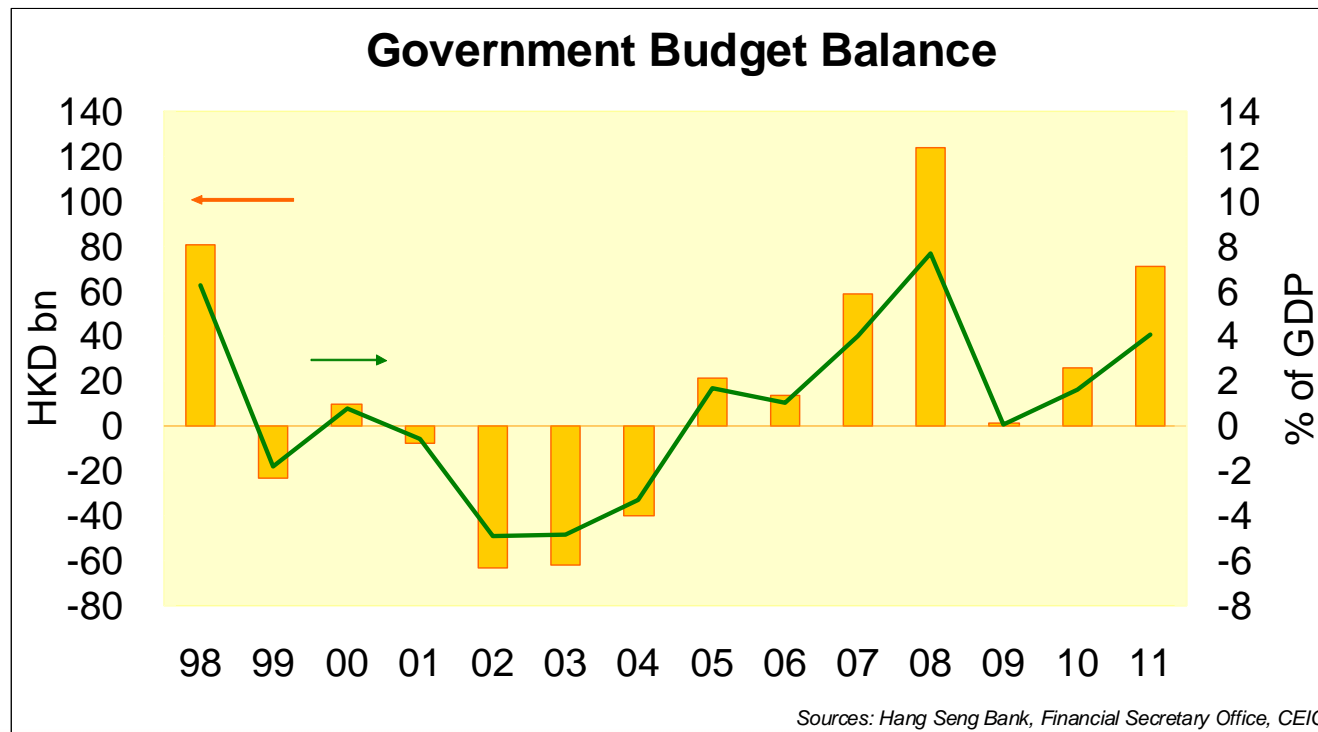


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The estimated 2010/11 consolidated budget ended with a surplus of HKD71.3 billion, the **third highest on record**, instead of government's earlier estimate of a deficit of HKD25 billion



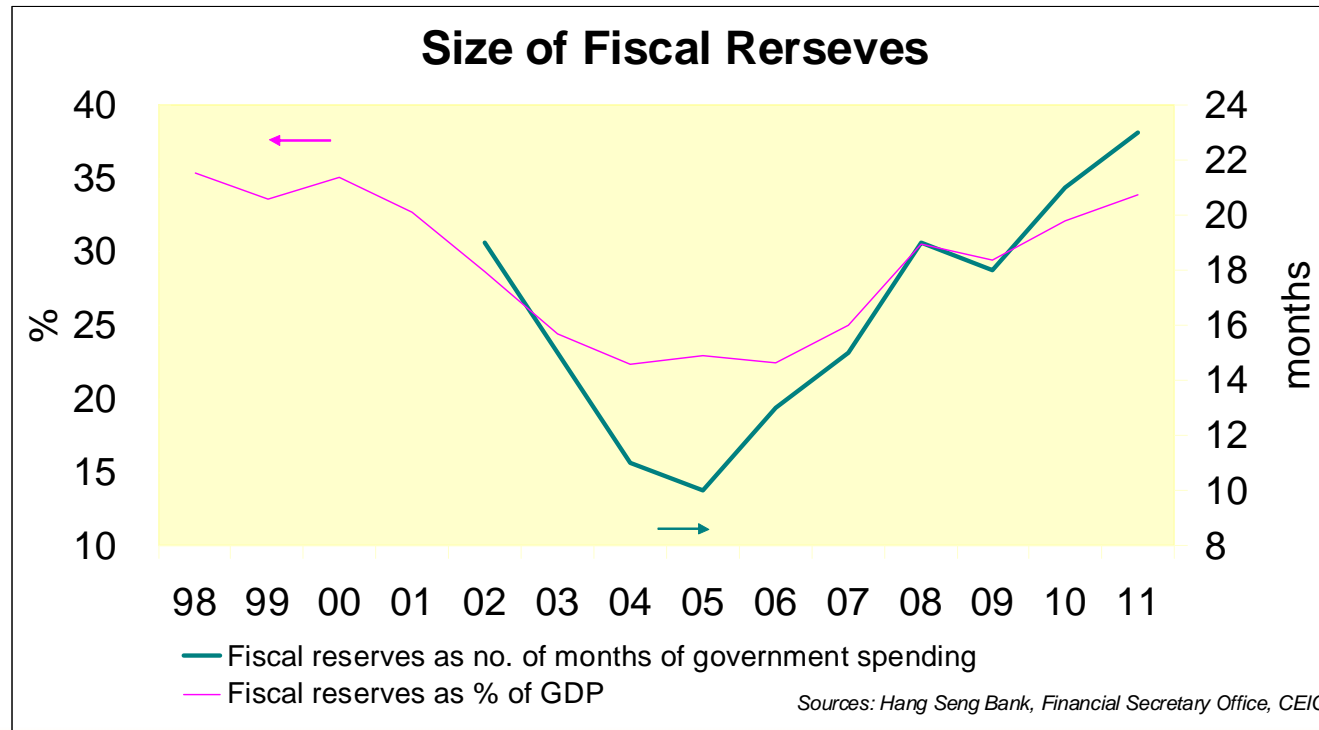
**The surplus mainly reflected larger than expected revenues from profits and salaries taxes, stock and property stamp duties, and land sales, as well as smaller government spending**

<b>HKD</b>	<b>Initial estimate</b>	<b>Revised estimate</b>	<b>Change</b>
Government Revenue	292.0	374.8	+82.8
<i>Profit and salaries tax</i>	118.3	140.5	+22.2
<i>Stock and property stamp duty</i>	30.0	51.0	+21.0
<i>Land sales</i>	34.1	62.0	+27.9
Government Expenditure	317.2	303.5	-13.7
<b>FY10/11 Budget balance</b>	-25.2	71.3	+96.5

Sources: Financial Secretary's Office, Hang Seng Bank



According to the government's latest estimate, Hong Kong's **fiscal reserves will reach a record level of HKD592 billion by end-March 2011, equivalent to 23 months of government expenditure, or 34% of GDP**



# A Balanced Budget for FY2011/12

- Despite the sizable fiscal reserves, this year's Budget contains no reductions in tax rates, for fear of further narrowing the tax base. At present:
  - 200,000 taxpayers (6% of working population), contribute 84% of the revenue from salaries tax, and
  - 1,100 corporations (0.2% of registered total) contribute 67% of profits tax revenue
- The government also has no plans to aggressively expand public spending, probably for fear of further fanning price pressures. Hong Kong's inflation rose to a 29-month high of 3.6% in January
- Instead, this year's Budget offers mainly one-off measures:
  - a HKD19.5 billion package to help relieve the rising costs of living, and
  - HKD24 billion of injection into MPF accounts of about 4 million workers
- For 2011/12, the government expects a relatively small surplus of HKD3.9 billion in the budget, equivalent to about 0.2% of GDP. This implies that the potential impact of the budget on the economy will be relatively neutral in the year ahead



# Inflation Relief Measures

- **One-off concessions worth HKD18.3 billion, such as**
  - Exemption of property rates for the four quarters of 2011/12, capped at HKD1,500 per quarter for each rateable unit
  - Waiver of public rents for two months
  - Electricity subsidy of HKD1,800 per household
- **Tax allowance for children and dependent parents would be raised at a cost of HKD1.2 billion**
- **The issuance of HKD5-10 billion of inflation indexed retail bonds to help reduce the impact of inflation on small investors**
  - But the impact could be limited. Assuming one million Hong Kong citizens subscribe to the bond issuance, at a value of HKD10,000 each, the interest income received is likely to be less than HKD500 a year (assuming an inflation rate of 5% or below)



# Increasing Land Supply

- Rising property prices and rents, in addition to food prices, are among the main culprits driving up inflation
- The government launched no new measures to curb short-term activities in the housing market
- Instead, it focuses on measures to address the structural issue of increasing supply to anchor price expectations
  - For FY11/12, the government aims to provide a potential supply of 30,000 to 40,000 housing units, more than the average annual supply of 20,000 units, by proactively offering land to the market
  - Speed up new MTRC and urban renewal tenders
- While the impacts of these changes may need more time to be seen, the latest moves do imply a fundamental change in its overall housing or land policy
- We would not be surprised to see more new measures if property prices continue to accelerate



## A neutral budget for 2011/12, with a relatively small surplus

	2010/11 (revised estimate)	2011/12 estimate
Operating account (HKD bn)		
Operating revenue	301	302
Operating expenditure	241	298
Capital account (HKD bn)		
Capital revenue	73	73
Capital expenditure	63	73
<b>Consolidated balance (HKD bn)</b>	<b>71.3</b>	<b>3.9</b>
as % of GDP	4.1%	0.2%
Fiscal reserve (HKD bn)	592	595
as no. of months of government spending	23	19
as % of GDP	33.8%	31.8%

Sources: Financial Secretary's Office, Hang Seng Bank



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# No measures to address longer-term issues

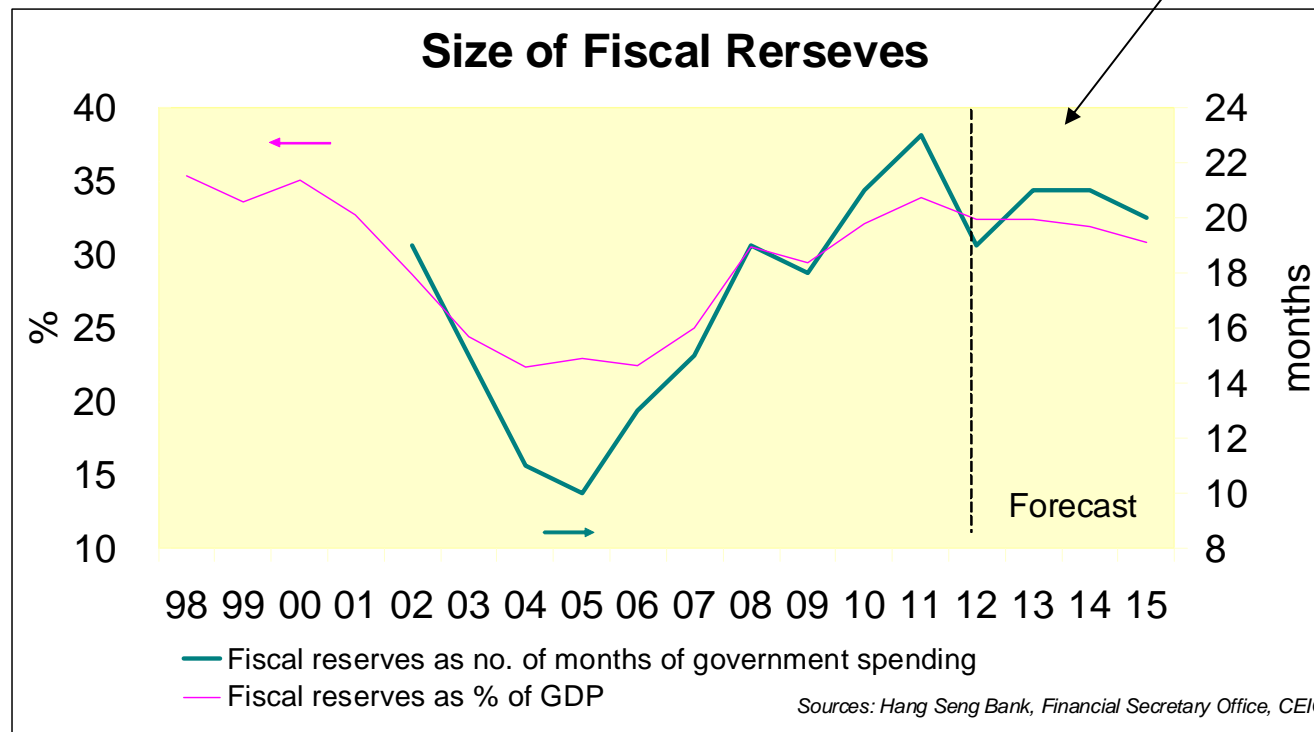


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The government still aims to keep fiscal reserves at high levels. Its medium range forecast projects fiscal reserves to stay at 19 to 21 months of government expenditure or 29% to 32% of GDP



## Hong Kong's idle reserves generate low real rate of returns

	CPI inflation	Return on total assets
2007	2.0%	11.8%
2008	4.3%	-5.6%
2009	0.5%	5.9%
3-year average (2007-2009)	2.4%	4.8%

Sources: Hong Kong Monetary Authority 2009 Annual report



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# How do other governments manage their fiscal reserves?

## Singapore

Two institutions manage the country's fiscal reserves

- (1) Temasek Holdings managed SGD248 billion (about USD200 billion at March-2010)
  - Invest in Asia's listed and private equities and real estates
  - Annual average return of 17% for the past three decades
- (2) Government of Singapore Investment Corporation (GIC)
  - Invest in US and EU
  - Mainly equities and fixed income assets
  - Annual average return of 7.1% over the past 20 years

Sources: Temasek Holdings, GIC



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## Prudent Cash Flow Management?

- The 2011/12 balanced Budget reflects the government's principles of "managing public finances prudently by keeping expenditure within the limits of revenues" for the year, with few longer-term commitments
- This long-adopted approach would also mean the government tends to be policy-neutral, distributing the surplus at its own discretions, which often invite lots of debates



## Alternative uses of the “excess” fiscal reserves

- Use fiscal and tax policy to accompany economic policy to enhance the competitiveness of Hong Kong in achieving sustainable growth in the long term?
  - Such as offering preferential tax treatment to attract investment in the six identified industries that would benefit Hong Kong’s longer-term economic development?
- To fund the reform the healthcare system?
  - Future government expenditure is likely to grow as Hong Kong’s ageing population.
  - Education, social welfare and health have been accounting for an increasing share of public expenditure and the trend is unlikely to change
- The return of a strong fiscal footing offers a good chance for the government to set out its fiscal policy to address these longer term issues



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