



恒生銀行

HANG SENG BANK

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RESILIENT ECONOMIC GROWTH IN HONG KONG AND MAINLAND CHINA TO CONTINUE IN 2006

The drivers of economic growth in both mainland China and Hong Kong in 2005 are likely to remain intact in 2006, states the latest issue of *Hang Seng Economic Monthly*, which forecasts 2006 real GDP growth of 5.3% and 9% for Hong Kong and the Mainland respectively.

Hong Kong

In Hong Kong, exports of goods and services are still growing at an upbeat pace, and domestic spending and investment are being supported by positive consumer sentiment and the improving labour market.

According to the report, interest rates will likely be the biggest influence on Hong Kong's economic performance next year. The resilience of the economy against the backdrop of persistent rate rises over the past year has been a pleasant surprise. However, there is growing speculation over how long this can last if rates remain on an uptrend.

The impact of higher interest rates on external demand is likely to be mitigated by the continuing strength of Mainland exports. But higher rates could potentially have a bigger impact on a domestic front. The report notes that a drop in domestic demand was responsible for slowing the real GDP growth rate by 1.7 percentage points during the last interest rate up-cycle in 1994-95.

However, the report also highlights the differences between the 1994-95 cycle and this latest one: the cost of borrowing by households and corporations is still lower than the level reached in 1995, the labour market is still buoyant and the property market recovery appears sustainable. These factors mean that the negative impacts of rising rates are likely to be moderated.

The value of the US dollar will also affect Hong Kong's economy in 2006, states the report. Following a 10-15% appreciation against most major currencies in 2005, the US dollar is likely to start weakening next year. This will generally improve the economic outlook for Hong Kong, since the Hong Kong dollar closely follows movements in its US counterpart.

Thus, although higher interest rates and the flattening of the global economy may slow the pace of growth seen in 2004 and 2005, the overall strength of Hong Kong's economy is likely to be maintained during 2006. Interest rates are widely expected to rise by a total of 50 basis points by January. If this marks the end of the current up-cycle, Hong Kong should achieve GDP growth of 5.3% in 2006, states the report.

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However, if rates continue to rise the impact could become more marked. The report notes that an extra one percentage point increase on top of the 50 basis points would pull real GDP growth down towards the 4% level.

Mainland China

In mainland China, the government has managed to maintain rapid economic growth while keeping inflation low. Real GDP growth for 2005 is forecast to exceed 9% for the third consecutive year.

The report attributes the fast pace of growth to the upswing in foreign direct investment inflows following the Mainland's entry into the World Trade Organisation in 2001. This has led to a significant expansion in the export base and an investment boom in a wide range of industries.

Inflationary pressure has eased as additional capacity in upstream industries has come on line and government policies have served to mitigate industrial bottlenecks.

The report notes that there are concerns that the Mainland's development model is not sustainable as it is too reliant on exports and investment for growth, and that domestic consumption is still too weak to absorb the impact of any slowdown in these two drivers.

The report states that focusing on export growth makes economic sense in the context of the Mainland's comparative advantage of a very large pool of cheap labour. Further, there is still huge pent-up demand for investment as domestic industrialisation and urbanisation are both still in their early stages, particularly in inland areas.

The report notes that the widening trade surplus and rapidly accumulating foreign reserves continue to present challenges to economic development. The Mainland also needs to improve the efficiency of capital allocation and continue to reform state enterprises so that a balance in its investment structure can be achieved without constant government intervention.

The report believes that the Mainland's economic engine will remain in high gear in 2006, with exports and investment continuing as key drivers. Government tax and other policies may also stimulate domestic demand. Weaker demand from the US may lead to a slight slowing of pace, but a still respectable 9% real GDP growth is forecast for 2006.

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