

Press Release

LCQ3: Impact of US interest rate hikes

Wednesday, January 20, 2016

Following is a question by the Hon Christopher Cheung and a reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (January 20):

Question:

The United States (US) Federal Open Market Committee established in December 2008 the target range of zero to 1/4 per cent for the federal funds rate, and it was only last month that the target range was raised to 1/4 to 1/2 per cent, which ended a seven-year era of near-zero interest rates and set off a cycle of rising US dollar interest rates. As Hong Kong maintains a Linked Exchange Rate System with the Hong Kong dollar pegged to the US dollar, the Hong Kong dollar interest rates will definitely climb along with the US dollar interest rates in the long run. In this connection, will the Government inform this Council:

(1) given the slowdown of the economic growth on the Mainland in recent months and the contraction in local industries such as retailing and tourism, etc., whether the Government has assessed if the Hong Kong economy can withstand the impact of persisted interest rate hikes, and the maximum magnitude of interest rate hikes Hong Kong can withstand in light of the prevailing market conditions; if it has assessed, of the details; if not, the reasons for that;

(2) given that while the Government launched a number of measures to stabilise the property market one after another in recent years so as to combat speculative activities in the property market and curb external demands, a cycle of rising Hong Kong dollar interest rates has been set off and property transactions have shown clear signs of decline both in volume and prices in recent months, whether the Government has drawn up plans for abolishing some of the property market-stabilisation measures; if it has, of the objective criteria for deciding whether or not to abolish some of the measures, the implementation timetable, and other details; if not, the reasons for that; and

(3) whether it has assessed the impact of rising interest rates on Hong Kong's non-property asset markets and capital flow; if it has assessed, of the details; if not, the reasons for that?

Reply:

President,

(1) The impact of the US interest rate hikes on the global and Hong Kong economies hinges not only on the magnitude and the pace of the increase, but also on the global economic performances, monetary policies of other major central banks, geopolitics, the ability of emerging market economies in managing capital outflows, and so on.

In this respect, the uncertainty over the US interest rate normalisation is one of the major challenges facing the global economy this year. The uncertainty is underscored by the sluggish and uneven global economic growth and diverging policies of central banks, which may trigger volatility in the global financial markets and swings in exchange rates and capital flows, impacting on the already fragile economic environment.

Under a complicated international monetary environment, the influence of possible fund reversals will have a bearing on local asset prices, in turn affecting local consumption and investment appetite. Moreover, any further strengthening of the US dollar may exert downward pressures on Hong Kong's exports and inbound tourism. We will monitor closely these developments and their impact on the overall economy and employment. The Financial Secretary will announce in his 2016-17 Budget next month the economic growth forecast for this year.

(2) Regarding the property market, despite signs suggesting downward movements of private property prices and rentals, and the US Federal Reserve's decision to raise the interest rate in December 2015, imbalance persists between the supply and demand in the local property market. Property prices remain at levels beyond the affordability of the general public. The home purchase affordability ratio (Note) has risen to about 64 per cent in the third quarter of 2015, remarkably higher than the long-term average of 46 per cent over 1995 to 2014. Therefore, the Government has no intention to withdraw the

demand-side management measures.

Interest rate is not the only factor affecting the property market. With the Government's sustained efforts in providing land for residential development, the medium-term supply of residential flats has increased significantly. The Government will remain vigilant and prudent, and continue to closely monitor property market movements and ever-changing external conditions, with reference to a series of indicators (including property prices, home purchase affordability ratio, transaction volume, flat supply, and local and global economic developments).

(3) As for the asset markets, amid uncertainties over the magnitude and pace of interest rate hikes, coupled with a misty global economic outlook, the global financial markets are expected to remain fragile. Fund flows could reverse thereby affecting local asset prices. That said, interest rate is not the sole factor affecting asset prices. In the stock market for example, prices are also affected by investors' risk appetite and corporate profitability outlook. It is therefore difficult to predict the impact of US interest rate normalisation on the Hong Kong stock and other asset markets.

In terms of fund flows, the US Federal Reserve's interest rate hikes will widen the Hong Kong dollar-US dollar interest rate spreads. As capital gradually flows from the Hong Kong dollar to the US dollar, the Hong Kong dollar exchange rate will weaken against the US dollar. Upon the triggering of the weak-side Convertibility Undertaking at 7.85 under the established mechanism, HKMA will sell US dollar for Hong Kong dollar. Hong Kong dollar outflows following the triggering of the weak-side Convertibility Undertaking, and the subsequent contraction of the Hong Kong dollar monetary base, will set the inevitable course for Hong Kong dollar's interest rate to normalise alongside US dollar interest rates.

That said, with strong economic fundamentals, and a mature and robust financial system, Hong Kong is capable of withstanding capital flows. We will keep a close watch of the external financial conditions and ensure the normal functioning of Hong Kong's financial system, against any systemic risk in the financial markets. In light of an array of external and other uncertainties, investors and the financial sectors should conduct proper risk management and act with prudence and vigilance.

Thank you, President.

Note: The home purchase affordability ratio refers to the ratio of mortgage payment of a 45-square metre flat to median income of households (excluding those living in public housing).

Ends