

Press release

LCQ6: Impact of sub-prime mortgage problem in the United States on Hong Kong's economy

Wednesday, January 16, 2008

Following is a question by the Hon Tam Heung-man and a reply by the Secretary for Financial Services and the Treasury, Prof K C Chan, in the Legislative Council today (January 16):

Question:

Regarding the impact of the sub-prime mortgage problem in the United States on Hong Kong's economy, will the Government inform this Council:

- (a) whether it has made use of data to monitor if currently there is a considerable outflow of funds from Hong Kong's economy or a risk of hot money attacking the linked exchange rate because of the sub-prime mortgage problem, and whether the Government has formulated relevant contingency measures;
- (b) of the Government's estimated impact of the sub-prime mortgage problem on Hong Kong's export trade and exports of services, and whether the Government has formulated relevant contingency measures; and
- (c) whether it has assessed the possibility of stagflation (i.e. concurrent emergence of economic slowdown and high inflation) in Hong Kong under the impact of the sub-prime mortgage problem and other external economic factors as well as the emergence of negative real interest rates in Hong Kong; if it has, of the assessment results and what relevant alert measures the Government has put in place?

Reply:

Madam President,

Our responses to the questions raised by Hon Tam Heung-man are as follows:

- (a) The sub-prime mortgage problem in the United States (US) is an issue of

global concern. The Administration has been keeping a close watch on the issue and the related developments. According to the information available to us, the sub-prime problem in the US has not caused any systemic implication to Hong Kong's economic and financial structures. The relevant systems remain structurally stable.

(b) On the flow of funds, Hong Kong does not have any foreign exchange control. Substantial amount of funds flow into and out of the Hong Kong dollar market daily. The Hong Kong Monetary Authority (HKMA) has been closely monitoring the flow of funds in the Hong Kong dollar market through the exchange rate of the Hong Kong dollar. So far, no information indicates that the sub-prime problem has brought about any unusual impact on the flow of funds into and out of the Hong Kong dollar market.

HKMA maintains the stability of the Hong Kong dollar market mainly through the currency board arrangement. Simply speaking, the exchange rate of Hong Kong dollar would remain stable when the magnitude of funds inflow and outflow is similar. If there is a considerable outflow of funds, the Hong Kong dollar exchange rate will rise and vice versa. According to the currency board arrangement, when the Hong Kong dollar exchange rate moves to the weak-side convertibility rate of HK\$7.85 per US dollar, HKMA will sell US dollars for Hong Kong dollars at HK\$7.85. Conversely, when the Hong Kong dollar exchange rate moves to the strong-side convertibility rate of HK\$7.75 per US dollar, HKMA will sell Hong Kong dollars for US dollars at HK\$7.75. Through such an arrangement, HKMA maintains the stability of the linked exchange rate system and the Hong Kong dollar market. These measures have been working well.

HKMA will continue to closely monitor the operations of the linked exchange rate system and the Hong Kong dollar market and ensure that the stability of Hong Kong's financial system is maintained.

(b) Given the sheer size and importance of the US economy and its financial market, a US economic slowdown would inevitably have repercussions on the rest of the world. Under such situation, Hong Kong will also be affected.

In terms of export trade, given the uncertainties caused by the US economic slowdown and the sub-prime mortgage problem, the export growth in Hong Kong has slackened in recent months when compared with last year. The year-on-year rate of increase in terms of the value of total export from January to November 2007 is 9.3% while the yearly rate of increase in 2006 is 9.4%. That said, the momentum of growth of Hong Kong's economy is still strong. This, along with the sound economic fundamentals of the Mainland which is our major export market in recent years, continues to provide support to our export trade.

In respect of export of services, a sustained appreciable growth was recorded in the first three quarters of 2007. Finance, commerce, inbound tourism as well as export of other professional services all have satisfactory performance. The year-on-year rate of increase in real terms as regards export of services in the third quarter of 2007 is 12.3%, which compared well with 9.0% and 11.6% in the first and second quarters respectively. It is anticipated that the overall export of services in Hong Kong will continue to be led by this trend and grow further.

While the Hong Kong economy is facing a number of uncertain factors, the Administration believes that with its high degree of flexibility and adaptability and the strong recovery over the last four years, it will be able to withstand possible external impact. The Administration has all along been supporting and encouraging development of the local economy at the policy level. The Closer Economic Partnership Agreement (CEPA) and the four supplemental agreements have laid a solid foundation for mutual economic cooperation between the Mainland and Hong Kong. The Administration will continue to encourage collaboration with the Pan-Pearl River Delta provinces and cities and strengthen connections with overseas markets, with a view to seeking more new opportunities for the Hong Kong economy, including the aspect of trade and commercial development.

(c) Stagflation refers to the concurrent emergence of economic stagnation and continual price inflation. According to the existing data, the outlook of Hong Kong's economic development is still positive in the midst of inflationary pressures. Hence, the Administration and the market do not expect the emergence of stagflation in Hong Kong.

Inflationary pressures has edged up inevitably as Hong Kong's economy experienced robust growth in the past four years, the unemployment rate fell to a low level and household income of most families increased. Global rise in energy and food prices, the weak US dollar and the Renminbi appreciation in recent months have also increased the pressure for price rise.

From a broader prospective, rising inflation pressure is a global phenomenon and the inflation rate in Hong Kong is still mild. While Hong Kong's economic performance is being affected by many external uncertainties, as the economies of the Mainland and the emerging markets maintain their strong growth and Hong Kong's domestic demand is vibrant, the outlook of our overall economic development is still promising, though the pace of growth may be slower when compared with that in the past four years.

The Administration will continue to closely monitor the economic

development and inflation situation of Hong Kong and review the effectiveness of the relevant policies as appropriate.