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Bank tips 6pc growth

By JOHN MULCAHY, Financial Editor

Yet another major bank has weighed in with an optimistic forecast for the Hongkong economy this year, although inflationary pressures are looming with the continuing surge of the Japanese yen.

Standard Chartered Bank, predicting an export-led revival, has projected the territory's gross domestic product growth rate at a real six per cent this year.

Other estimates have put growth this year at four to five per cent, although the consensus seems to be a significant improvement in exports is likely.

In the latest issue of the bank's Hongkong Economic Indicators, Standard Chartered's economists point to steady world economic growth as the foundation for a seven per cent growth rate in domestic exports.

This compares with a real decline of seven per cent last year, and an estimated GDP growth rate of only three per cent.

Clouding the otherwise bright outlook for the Hongkong economy has been the dramatic realignment of the world's major currencies, with the US dollar the prime victim of a concerted campaign that has seen the linked Hongkong dollar fall 10.8 per cent on a trade-weighted basis since September.

More specifically, the local currency has dropped 21.2 per cent against the yen since September, and this has serious implications for prices in view of Japan's significant role as a supplier to the local manufacturing sector.

Japan accounts for about 25 per cent of Hongkong's imports, which implies that at an unchanged volume and a 21 per cent increase in the exchange rate over the Hongkong dollar, the territory's import bill could rise five per cent purely to account for the currency adjustment.

To an extent, this effect has been offset by the devaluation in the Chinese renminbi over the past year.

From a high of 0.36 to the Hongkong dollar in January last year, the renminbi has fallen to 0.41, a decline of 12.5 per cent.

Largely indicative of its function as the territory's main food source, China is responsible for about 24 per cent of Hongkong's total imports.

The flip-side of this effect is the enhanced competitiveness Hongkong's exporters will have gained in overseas markets, and particularly in Europe.

Predictions of a distinct improvement in the export performance are based to a significant degree on the impact of the lower currency on the trade picture.

Standard Chartered sees inflation rising to about five per cent this year from 3.5 per cent last year, "partly as a result of higher import prices due to currency depreciation."

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The bank's economists refer in the report to a persistent inflow of funds into the Hongkong banking system in recent years, interpreted as fund movements resulting in an increase in the system's claims on foreign banks.

"In 1981, $7 billion flowed into the banking system. This jumped to $44 billion in 1982 and $50 billion in 1983, largely as a result of the abolition of the interest withholding tax on foreign currency deposits in February 1982."

More recently, money market operators said yesterday, the narrower differential between Hongkong dollar and US dollar interest rates had removed some of the incentive to switch out of the local currency.

Despite the savage assault on the US dollar, the Hongkong dollar has been steady at $7.80 to $7.81 for some time, indicating confidence in the market that the pegged rate is holding and is unlikely to be adjusted.

Only six months ago the Hongkong dollar rose sharply as funds poured in on speculation the currency would be revalued against the US dollar.

If anything, the justification for such action is far more pronounced now than it was at that stage, and yet there has been no whisper of adjustment.

"If there was a view the peg would be adjusted the Hongkong dollar would be pushing through $7.50 by now," one foreign exchange manager said yesterday.

The Hongkong interbank market remains highly liquid, and the paucity of new loan demand is obviating any pressures on rates that may have emerged as a result of the extensive switching into US dollars late last year.

Yesterday the three-month rate was 6¾/6½ per cent, about 1½ percentage points below the equivalent Eurodollar rate, considerably reduced from the three percentage point difference several months ago.

Standard Chartered says in its report an important effect of recent fund inflows is "a persistently wide differential, of more than three per cent at one stage, between Hongkong dollar money market interest rates and their Eurodollar counterparts."

The bank predicts a tapering off in the inflows over time, especially if stronger local demand spurs a rise in imports.

"Moreover, with Hongkong dollar/US dollar exchange rate movements shifting by no more than miniscule percentages from the $7.80 link, an increasingly narrow interest rate differential will suffice to encourage switching from Hongkong dollars to US dollar deposits.

"The current differential between Hongkong dollar and US dollar interest rates is therefore likely to diminish – if US interest rates remain stable, Hongkong dollar interest rates are likely to rise slightly."

In 1984, fund inflows into Hongkong totalled $50 billion, and rose even further to $69 billion during the first 11 months of last year.

An important source of incoming funds has been Southeast Asia, with the turnaround from a trade deficit of $15 billion in 1983 to a surplus of $4 billion last year a key contributor.