

June 2009

Hong Kong Economy: Tough Times Not Yet Over

Hong Kong's real GDP shrank 7.8% in the first quarter, the largest contraction recorded since the third quarter of 1998 when Hong Kong was plagued by the Asian financial crisis, reflecting a collapse in both domestic and external demand.

Recent economic reports seem to suggest that the first quarter may have marked the bottom of the economic cycle. The Hong Kong PMI index climbed in May. Unemployment rate, exports and retail sales were less negative in April.

Market sentiment is also more positive, fuelled by a rally in the stock and property markets. However, it should be warned that as market sentiment has gone far ahead of economic fundamentals, a sharp turnaround could not be ruled out.

Given the openness of the Hong Kong economy and its dependence on external demand, recovery in consumer demand in the US and Europe is most crucial for a sustained recovery of the local economy. Consumers in these markets still have to contend with shrinking wealth, exceptional levels of debts and rising unemployment and therefore look unlikely to substantially increase spending anytime soon.

The global economy is not out of the woods yet even though the pace of contraction may be easing. We have thus revised down Hong Kong's 2009 export forecast to a double-digit decline of 12.0% from an initial estimate of a drop of 7.5%, which is likely to drag Hong Kong into a deeper recession. We now see Hong Kong's real GDP contract 5.0% in 2009, more severe than our initial estimate of a decline of 3%.

Exhibit 1: Hong Kong's Economic Forecast

(% yoy changes)	2008	2009F
Real GDP	2.4	-5.0
Consumer prices	4.3	0.5
Unemployment rate*	3.6	6.6
Export value	5.1	-12.0
Retail sales volume	5.0	-8.0

Note: * average for the year; (F) forecast.

Sources: Hong Kong's Census and Statistics Department, Hang Seng Bank





A Steeper-than-Expected Contraction in 1Q GDP

Hong Kong's real GDP shrank 7.8%¹ in the first quarter, the lowest since September 1998 when Hong Kong was plagued by the Asian financial crisis. The sharper-than-expected contraction reflected a worse-than-expected collapse in both domestic and external demand.

The external demand shrank more than the 1997-98 cycle, declining 19.6%, compared to a 6.4% and 7.7% drop in the third and fourth quarter of 1998 respectively. Domestic demand also plunged 7.5%, although less severe than the double-digit declines recorded in the third and fourth quarter of 1998.

Exhibit 2

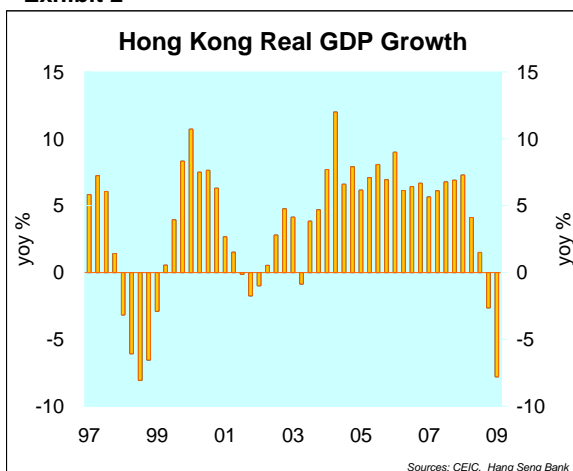


Exhibit 3

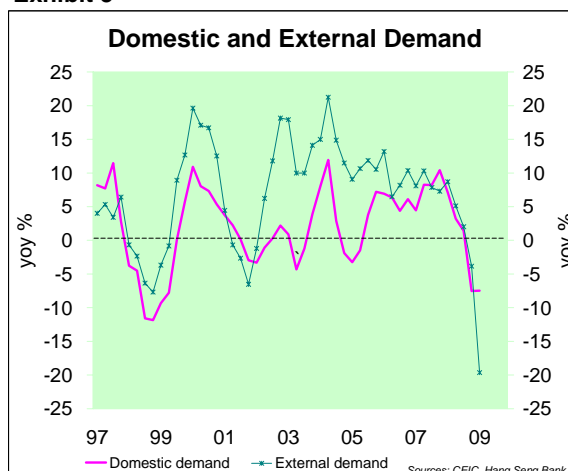


Exhibit 4: GDP Growth

	Quarterly (yoy %)				Annual (yoy %)		
	2Q08	3Q08	4Q08	1Q09	2007	2008	2009F
Private Consumption	3.0	-0.2	-4.1	-5.5	8.5	1.5	-3.8
Government Consumption	3.1	1.6	1.8	1.5	3.0	1.7	3.0
Gross Domestic Fixed Capital Formation	5.1	2.9	-17.8	-12.6	3.4	-0.5	-12.2
Export of Goods	4.4	1.3	-4.9	-22.7	7.0	1.9	-11.9
Export of Services	8.4	4.8	0.4	-8.2	14.1	5.7	-5.0
Import of Goods	4.8	2.0	-6.4	-21.4	8.8	1.8	-12.2
Import of Services	3.8	2.2	-3.4	-10.9	12.1	3.3	-4.3
Real GDP	4.1	1.5	-2.6	-7.8	6.4	2.4	-5.0
GDP Deflator	1.9	2.0	-0.2	0.5	2.9	1.4	0.9
Nominal GDP	6.1	3.5	-2.8	-7.3	9.5	3.8	-4.2

Sources: Census and Statistics Department, Hang Seng Bank

¹ Changes throughout the report are on year-on-year basis unless otherwise stated.





The latest economic indicators seem to show early signs of stabilization, fitting our view that the economic downturn might be bottoming in the first half of 2009. But it does not imply a recovery is imminent.

We believe the global and local economies are not out of the woods yet and do not expect positive year-on-year growth for the whole of 2009. We have thus revised down this year's GDP forecast for Hong Kong to a contraction of 5.0%, from an initial estimate of a decline of 3%.

The government sees a gloomier prospect, revising down this year's GDP forecast to a contraction of 5.5% to 6.5% from an initial estimate of a decline of 2% to 3%. Recognising the severity of the recession, the Chief Executive launched an extra HKD16.8 billion of stimulus measures, including temporary tax cut, waivers on property rates and public rentals.

Exhibit 5

Key Measures	HKD bn
For household	10.57
1. Raise the ceiling of one-off tax reduction for 08/09 salaries tax and tax under personal assessment from 50% to 100%, up to a maximum of HKD8,000	2.00
2. Exemption of property rates for two more quarters in 09/10, capped at HKD1,500 per quarter per household	4.20
3. Waiver of public rentals for two months	2.00
4. Additional one month payment to recipients of social welfare and disability allowance	1.80
5. HKD1,000 subsidy to each student from families receiving social welfare assistance	0.57
For business	5.57
6. Extend rental reduction for most government properties and short-term tenancies from three to six months.	0.10
7. Waiver of business registration fee for 1 year	1.70
8. Waiver of entertainment, transport, restaurant and tourism-related sectors licence fees for 1 year	0.67
9. Enhance SME Loan Guarantee program, raising the proportion of government loan guarantee ratio from 70% to 80%. Each company will be allowed to borrow a maximum of HKD12 million, double the amount under existing rules.	2.55
10. The Hong Kong Export Credit Insurance Corporation will raise the ceiling of its "small credit limit" applications from HKD0.5 million to HKD 1 million.	--
11. Injection of an additional HKD1 billion into the SME Export Marketing Fund	0.55
Others:	0.66
12. Allocate more funds for supporting continuous education, fighting against potential flu pandemic and enhancing community building activities.	
Total	16.80

Source: Financial Secretary's Office, Hang Seng Bank





Better-than-Expected Retail Sales

Retail sales volume decreased 5.5% in April, compared to a decline of 9.2% in March on improving consumer sentiment on the back of rising wealth from higher stock and property prices fuelled by a flood of liquidity. The sales volume of tourist-reliant items like jewellery, watches and clocks items stabilized, as the number of visitors fell merely 0.3% in April.

Exhibit 6

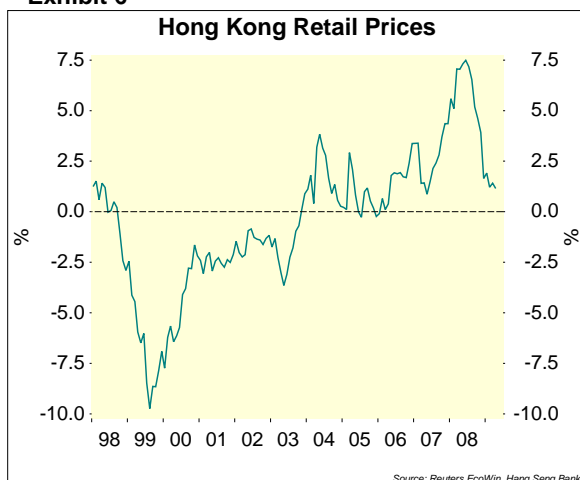
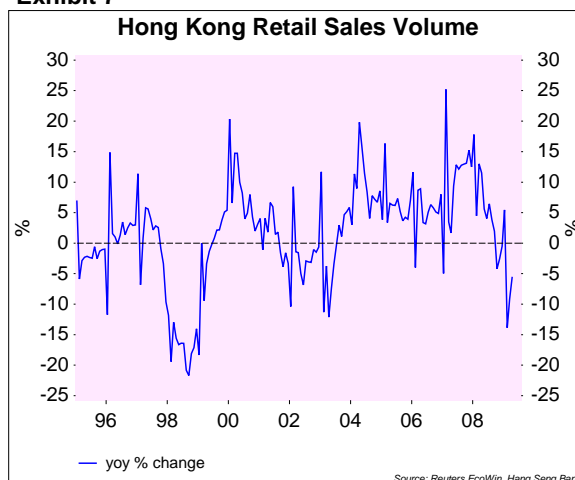


Exhibit 7



While capital flows and market sentiment may turn quickly, the economic fundamentals are weak. The latest Hong Kong PMI reading suggested that the economy might have reached bottom, but companies still planned to reduce their workforce in response to declining business activities and new orders. Rising unemployment and falling income would likely weigh on local spending. We still expect retail sales volume to decline 8.0% for the whole of 2009.

Exhibit 8: Hong Kong Retail Sales Volume

(%)	Mar 09	Apr 09
All retail outlet	-9.2	-5.5
Food, alcoholic drinks & tobacco	-2.4	-3.9
Supermarket	-3.6	-2.5
Fuel	4.6	-1.5
Clothing & footwear	-18.1	-11.4
Consumer durables	-11.0	-10.1
Department stores	-7.9	-1.7
Jewellery, watches, clocks & valuable gifts	-9.6	-0.3
Other consumer goods	-9.6	-4.8

Source: Hong Kong's Census and Statistics Department





Exports Slide Slows

Hong Kong's total exports fell 18.2% in April, slightly better than the 21.1% decline in March.

Recent economic reports from the major export markets seem to indicate that the worst of the financial crisis and economic downturn is over. Yet, the recovery may not be smooth or rapid. Consumers in these countries are still saddled by exceptional levels of debts built up during the boom years, have seen their wealth eroded by falling house values and have to worry about job losses. As such, they are unlikely to go out and spend as before, clouding the outlook for Hong Kong's exports.

We have thus revised down the 2009 export forecast to a contraction of 12% from an initial estimate of a decline of 7.5%.

Exhibit 9

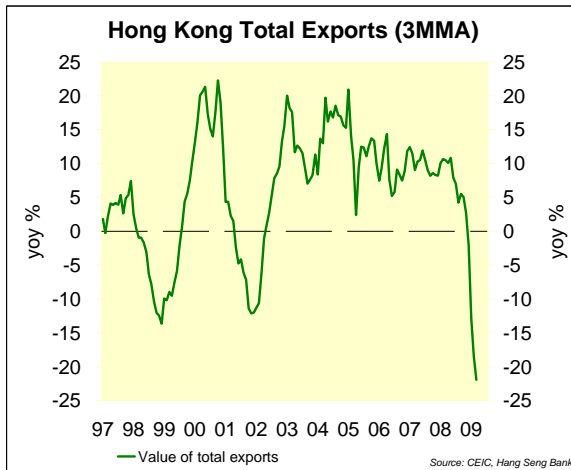


Exhibit 10

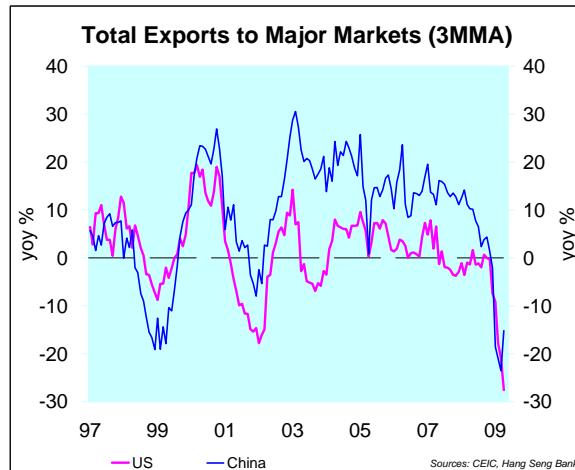


Exhibit 11: Hong Kong Trade Statistics

	Mar09	Apr 09
Total exports	-21.1%	-18.2%
Domestic exports	-41.1%	-40.2%
Re-exports	-20.5%	-17.5%
Imports	-22.7%	-17.0%

Source: Hong Kong's Census and Statistics Department



Not-So-Negative Labour Market

Hong Kong's unemployment rate rose to 5.3% in April. Total employment dropped to 3.51 million, as 5,500 jobs were lost during the month. The number of unemployed persons continued to rise, reaching 196,900.

However, the pace of increase seems to have slowed. April unemployment rate gained only 0.1 percentage point from the previous month, compared with a 0.2 percentage point increase in March.

Looking ahead, the employment prospect still looks grim. The latest Hong Kong PMI reading suggested that companies still planned to reduce their workforce in response to declining business activities.

With more new graduates soon to join the labour force, the unemployment rate looks set to rise further. We have thus revised up this year's unemployment rate forecast to an average of 6.6% from 6.3%, which implies the unemployment rate may reach as high as 8% by year-end.

Exhibit 12



Exhibit 13

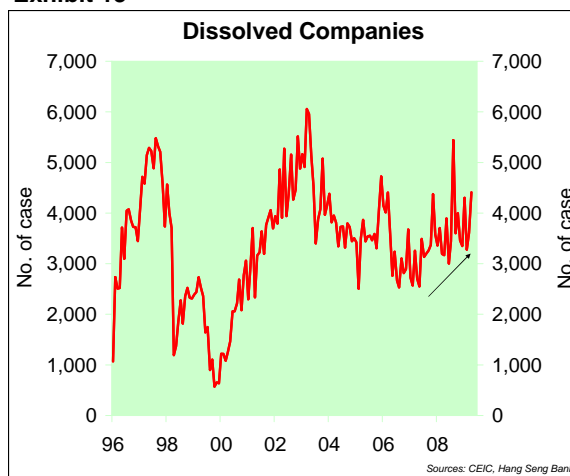


Exhibit 14: Unemployment Rate % (Major Industry)

	Import & export trade	Professional & business services	Retail	Transport & storage
Oct08	2.7	2.7	5.2	3.4
Nov08	3.0	2.6	5.7	3.6
Dec08	3.3	2.5	5.3	3.8
Jan09	3.9	3.0	5.5	4.5
Feb09	4.3	3.2	5.4	5.3
Mar09	4.6	3.7	6.0	6.0

Sources: CEIC, Hang Seng Bank





From Low Inflation to No inflation

Consumer price inflation eased to 0.6% in April, from 1.2% in March, as food prices climbed at a much slower pace. Food prices (excluding meals bought away from home) went up 2.2%, compared to a 5.4% increase in the previous month.

The reading was also affected by the government's one-off relief measures. For instance, the electricity subsidies led to a 42.9% plunge in utilities prices. Netting out the impact of these special factors, the underlying inflation was 1.9%, lower than the 2.6% in March.

Going forward, inflation is going to ease further on weak demand and the government's newly-announced measures, including waivers on property rates and public rentals. As headline inflation could ease closer to zero, we have revised down the 2009 consumer inflation forecast to 0.5%, from an initial estimate of 1.0%.

Exhibit 15

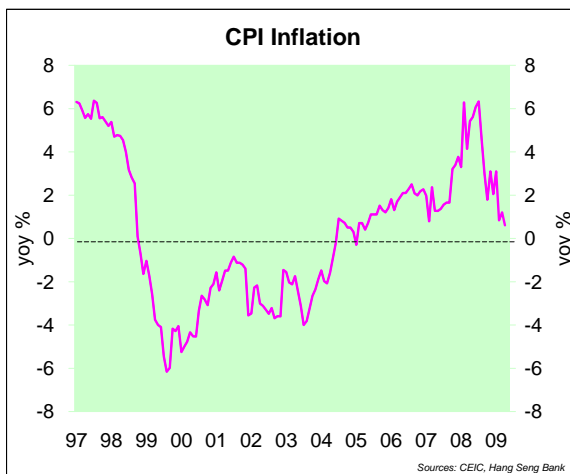


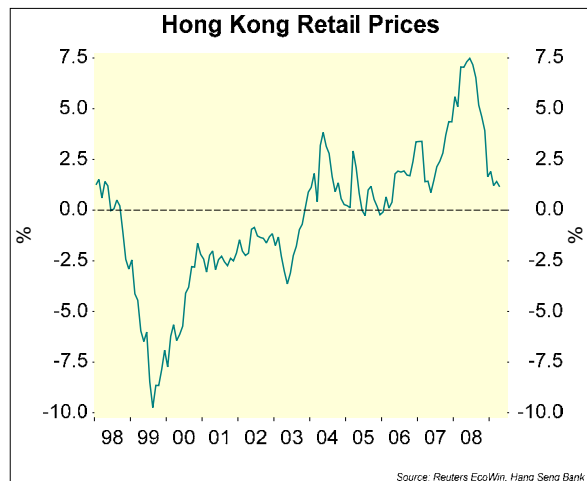
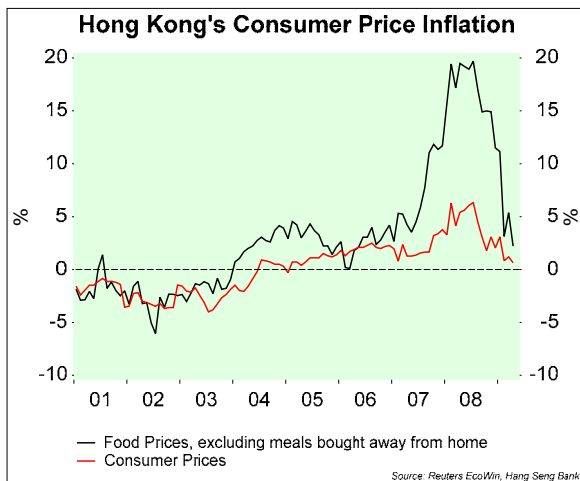
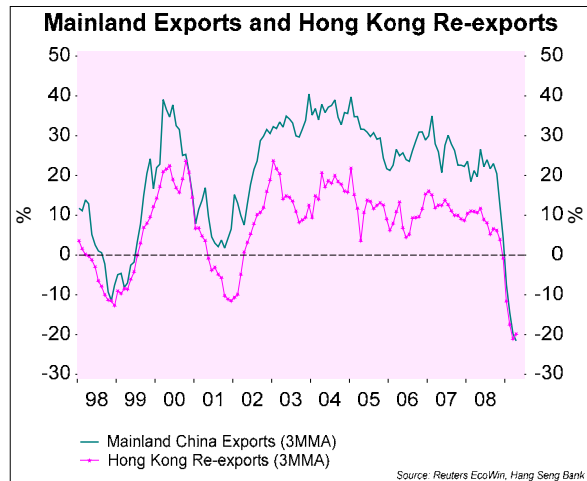
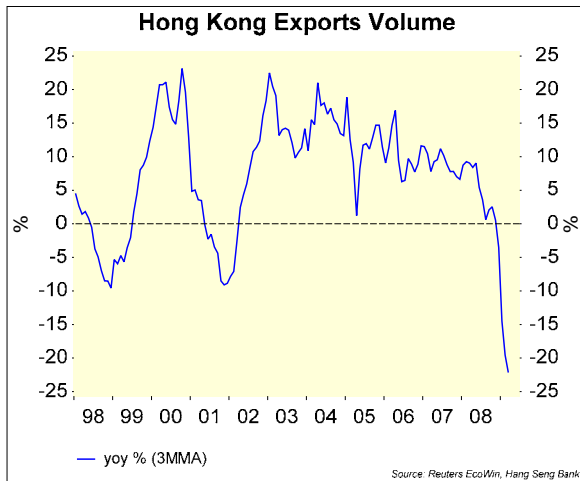
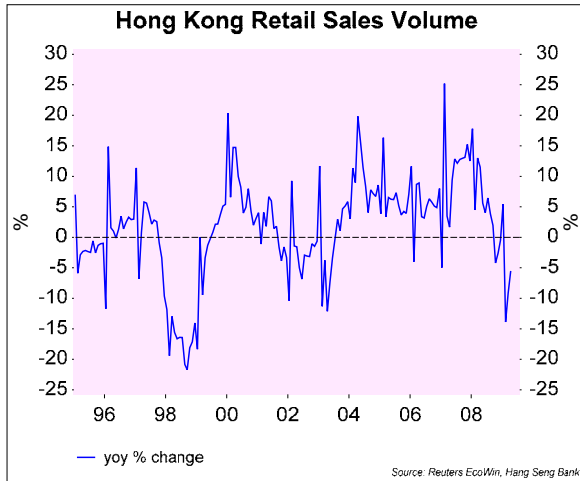
Exhibit 16: Hong Kong Composite CPI Component, yoy %

	Mar09	Apr09
All items	1.2	0.6
Food	3.8	2.2
Meals bought away from home	2.7	2.1
Exclude meals bought away from home	5.4	2.2
Housing	5.4	5.4
Electricity, gas & water	-42.9	-42.9
Alcoholic drinks & tobacco	22.2	22.7
Clothing & footwear	4.3	3.5
Durable goods	-2.5	-3.1
Miscellaneous goods	2.3	2.6
Transport	0.1	-0.1
Miscellaneous services	-2.5	-2.1

Source: Hong Kong's Census and Statistics Department

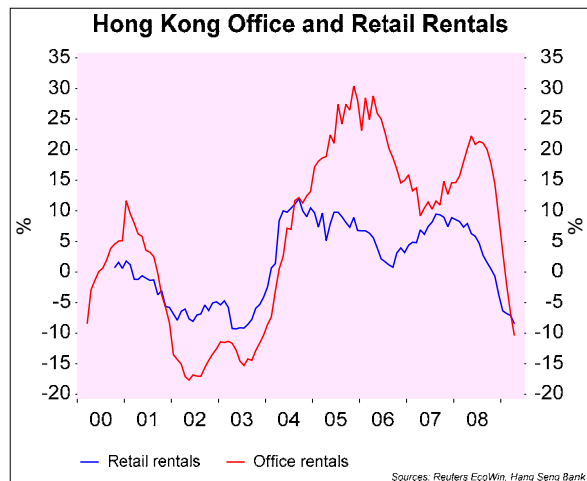
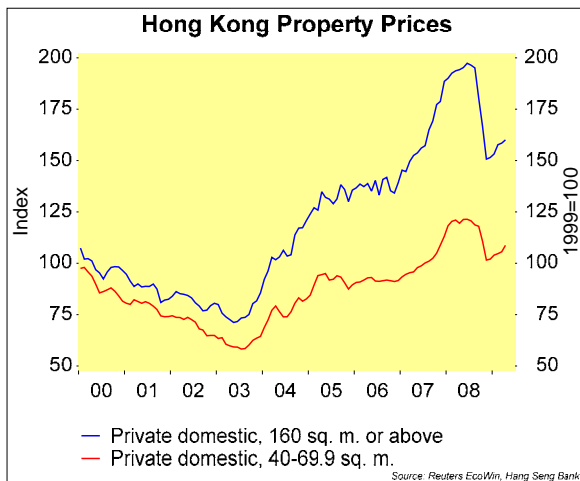
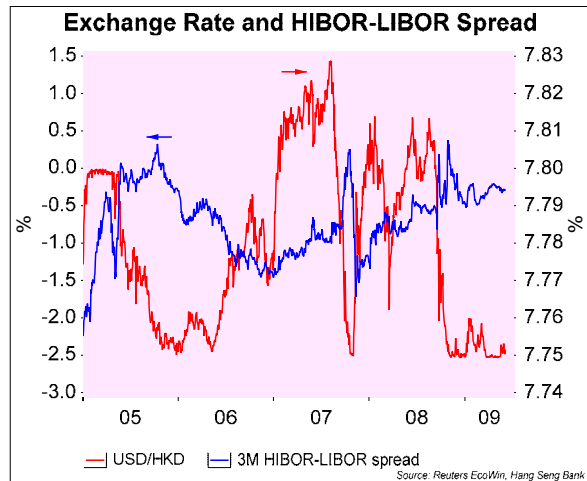
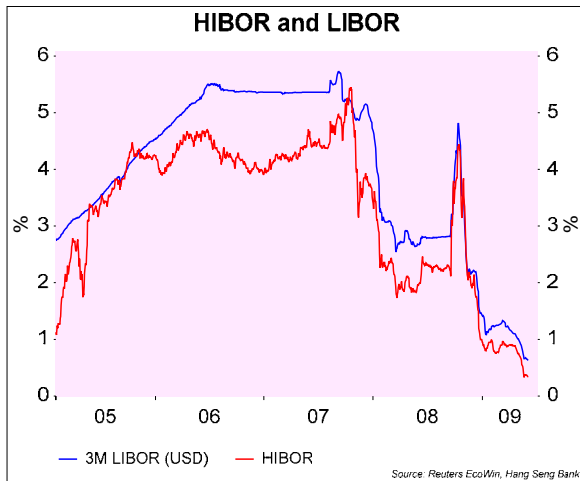
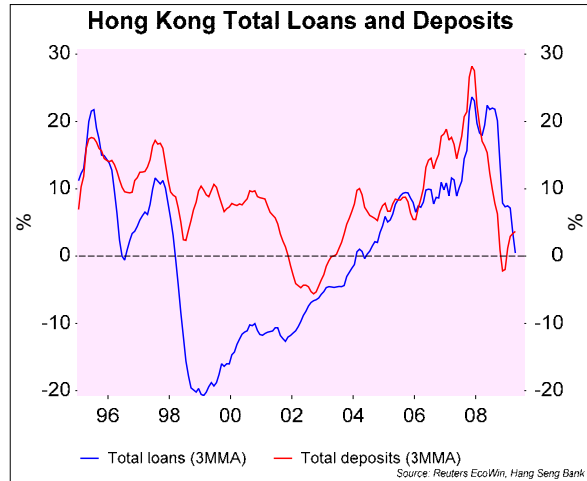
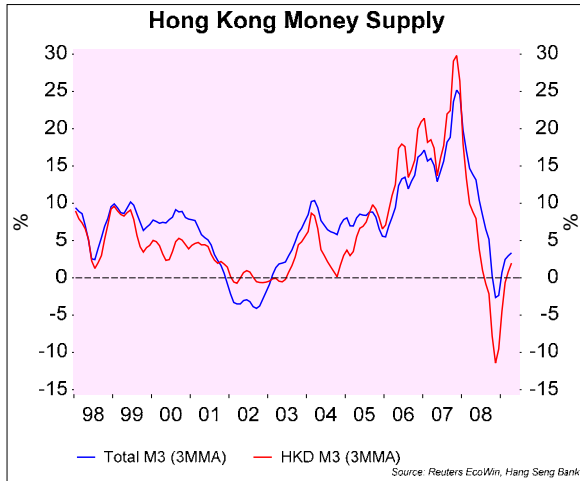
HONG KONG ECONOMIC MONITOR

Treasury Division



HONG KONG ECONOMIC MONITOR

Treasury Division



HONG KONG ECONOMIC MONITOR

Treasury Division



Hong Kong Economic Monitor Statistics

June 2009

	GDP (real)	Real GDP per capita	Retail sales (real)	Total Deposits		Total Loans		Money supply (Total M3)	Consumer prices	Unemployment rate (s.a.)
	yoy(%)	yoy(%)	yoy(%)	HKD bn	yoy(%)	HKD bn	yoy(%)	yoy(%)	yoy(%)	%
2002	1.8	1.4	-2.6	3,318	-2.6	2,076	-5.0	-0.9	-3.0	7.3
2003	3.0	3.2	-0.6	3,567	7.5	2,035	-2.0	8.3	-2.6	7.9
2004	8.5	7.6	9.1	3,866	8.4	2,156	5.9	8.6	-0.4	6.8
2005	7.1	6.6	6.1	4,068	5.2	2,312	7.3	5.2	1.0	5.6
2006	7.0	6.3	5.8	4,757	17.0	2,468	6.7	15.5	2.0	4.8
2007	6.4	5.3	10.1	5,869	23.4	2,962	20.0	20.6	2.0	4.0
2008	2.4	1.6	5.0	6,060	3.2	3,284	10.9	2.6	4.3	3.6
2009F	-5.0	NA	-8.0	6,333	4.5	3,202	-2.5	4.3	0.5	6.6
Q3 2007	6.3	NA	12.6	5,694	25.1	3,042	21.8	22.3	1.6	4.1
Q4	6.6	NA	13.5	5,869	23.4	2,962	20.0	20.6	3.5	3.6
Q1 2008	7.3	NA	11.6	5,762	15.9	3,170	18.7	13.5	4.6	3.4
Q2	4.1	NA	7.0	5,706	7.1	3,349	17.1	5.7	5.7	3.3
Q3	1.5	NA	4.1	5,847	2.7	3,425	12.6	1.9	4.6	3.4
Q4	-2.6	NA	-2.5	6,060	3.2	3,284	10.9	2.6	2.3	4.1
Q1 2009	-7.8	NA	-5.5	6,022	4.5	3,166	-0.1	2.6	2.7	5.2
Dec 2008	NA	NA	-0.5	6,060	3.2	3,284	10.9	2.6	2.1	4.1
Jan 2009	NA	NA	5.4	5,989	3.7	3,266	6.8	3.2	3.1	4.6
Feb	NA	NA	-13.9	5,926	1.9	3,221	3.8	1.5	0.8	5.0
Mar	NA	NA	-9.2	6,022	4.5	3,166	-0.1	4.2	1.2	5.2
Apr	NA	NA	-5.5	6,043	4.6	3,150	-2.2	4.3	0.6	5.3
YTD	NA	NA	-5.4	6,043	4.6	3,150	-2.2	4.3	1.4	5.3

	Foreign Trade					Property Price Index	Office Rental Index	Tourist Arrivals		HKD per USD (end of period)
	Exports		Imports		Trade balance			'000	yoy(%)	
	HK\$bn	yoy(%)	HK\$bn	yoy(%)						
2002	1,561	5.4	1,619	3.3	-58.9	-11.1	-15.4	16,566	20.7	7.798
2003	1,742	11.7	1,806	11.5	-63.3	-12.0	-12.7	15,537	-6.2	7.763
2004	2,019	15.9	2,111	16.9	-92.0	26.7	4.6	21,811	40.4	7.774
2005	2,250	11.4	2,330	10.3	-79.3	18.0	23.5	23,359	7.1	7.753
2006	2,461	9.4	2,600	11.6	-138.8	0.7	21.2	25,251	8.1	7.775
2007	2,688	9.2	2,868	10.3	-180.5	11.6	12.1	28,169	11.6	7.801
2008	2,824	5.1	3,025	5.5	-201.1	16.4	17.9	29,500	4.7	7.750
2009F	2,487	-12.0	2,643	-12.7	-156.0	-18.0	-18.0	28,763	-2.5	7.800
Q3 2007	720	8.2	757	9.4	-36.6	12.2	10.9	7,334	15.1	7.767
Q4	729	8.2	781	10.5	-52.0	21.4	14.0	7,806	16.9	7.801
Q1 2008	698	10.5	647	11.6	-51.4	29.5	16.1	7,276	10.0	7.781
Q2	706	7.9	773	9.2	-67.6	25.6	21.1	6,910	7.7	7.818
Q3	809	5.5	760	6.8	-48.4	18.5	20.8	7,583	3.4	7.763
Q4	714	-2.1	748	-4.2	-34.2	-4.6	13.6	7,722	-1.1	7.750
Q1 2009	505	-21.9	539	-22.8	-34.3	-14.0	-2.1	7,404	1.8	7.751
Dec 2008	206	-11.4	218	-16.2	-11.8	-11.1	9.0	2,768	-0.8	7.750
Jan 2009	188	-21.8	181	-27.1	7.2	-13.1	3.3	2,796	11.0	7.756
Feb	142	-23.0	165	-17.5	-23.2	-14.2	-2.3	2,162	-8.1	7.756
Mar	175	-21.1	194	-22.7	-18.2	-14.1	-6.8	2,445	1.7	7.751
Apr	199	-18.2	215	-17.0	-16.4	-9.8	-10.4	2,439	0.8	7.751
YTD	704	-20.9	754	-21.2	-50.6	-12.8	-4.1	9,843	1.5	7.751

Note: (F) Forecast

Source: CEIC, Hang Seng Bank



HANG SENG BANK

Member HSBC Group



Disclaimer

This document has been issued by Hang Seng Bank Limited (“HASE”) and the information herein is based on sources believed to be reliable and the opinions contained herein are for reference only and may not necessarily represent the view of HASE. The research analyst(s) who prepared this report certifies(y) that the views expressed herein accurately reflect the research analyst’s(s)’ personal views about the financial instrument or investments and that no part of his/her/their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report. Nothing herein shall constitute as offers or solicitation of offers to buy or sell foreign exchange contracts, securities, financial instruments or other investments. Re-distribution of any part of this document by any means is strictly prohibited.

The information contained in this document may be indicative only and has not been independently verified and no guarantee, representation, warranty or undertaking, express or implied is made as to the fairness, accuracy, completeness or correctness of any information, projections or opinions contained in this document or the basis upon which any such projections or opinions have been based and no responsibility or liability is accepted in relation to the use of or reliance on any information, projections or opinions whatsoever contained in this document. Investors must make their own assessment of the relevance, accuracy and adequacy of the information and opinions contained in this document and make such independent investigations as they may consider necessary or appropriate for the purpose of such assessment. All such information, projections and opinions are subject to change without notice.

HASE and its affiliates may trade for their own account in, may have underwritten, or may have a position in, all or any of the securities or investments mentioned in this document. Brokerage or fees may be earned by HASE or its affiliates in respect of any business transacted by them in all or any of the securities or investments referred to in this document.

The investments mentioned in this document may not be suitable for all investors. Investors must make investment decisions based on their own investment objectives, financial position and particular needs and consult their own professional advisers where necessary. This document is not intended to provide professional advice and should not be relied upon in that regard.

No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. Investment involves risk. Investors should note that value of investments can go down as well as up and past performance is not necessarily indicative of future performance. This document does not purport to identify all the risks that may be involved in the securities or investments referred to in this document.

