

Analyze the economy of hong kong economics essay

[Economics](#)



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1. 0 Introduction

Business Times on date reported that Hong Kong's economy for the first quarter of year 2010 increased 8. 2% which is a very close range of the 8. 3% as forecasted by the economists. It was a revised of 2. 5% as compared to the fourth quarter for the year 2009. The city's growth is said to be driven by China's economic comeback. In the first quarter of 2010 alone, the country had welcomed 5. 5 million visitors. After the global crisis, there's a rise in the inflows of capital, demand for exports and increase in retail spending in the country. The unemployment rate has also slide to a low of 4. 4% in the first quarter. Hong Kong's government is also adopting preventive measures to prevent a property bubble as the home prices has rose 10% in the first four months of 2010 after gaining as much as 29% in the year before. In this essay, we will study and analyze the economy of Hong Kong so that we can have a better understanding what aids in the growth of the gross domestic product (GDP) in an economy, the effects it has on the aggregate supply-aggregate demand (ASAD) model, how the government intervention and adoption of the expansionary fiscal policy is helpful in boosting the nation's economy, problems caused by the property bubble and the solution from central bank and lastly how the growth and decline of the economy will affect the supply and demand of money.

1. 0 GDP growth

GDP is measured by the total cost of producing everything in the economy in one year (Harford, 2006). Potential GDP growth is achieved when the economy's labour, capital, land and entrepreneurial ability are fully utilized,

coupled with the increase of the aggregate working hours and also giving training and relevant courses to upgrade the skills of the workers so as to bring forth technological change and increasing human capital. All these are the drivers that supported an economy growth.

2.0 The effect on the aggregate supply- aggregate demand (ASAD) model

Logically, we know that when there is a decrease in price level, it would lead to an increase for export (as stated in the article) as local goods and services have become cheaper, firms are purchasing more plants, equipment and buildings (increase in investment, I) to meet the high demand and to fill up the inventory. What this statement above highlight, and which Forstater (2007) agreed is that, higher prices mean lower demand and lower prices means higher demand. Thus this has also lead to a decrease for import as it is no longer wise to buy in foreign goods as it now cost more to purchase them. Trade surplus occurs in this situation when a country's exports are more than its imports, ($\text{Net Export} = \text{Export [EX]} - \text{Import [IM]}$). People are now earning more and with more wealth on hand, they are also spending more (increase in consumption, C) and saving less, so it will lead to an increase to the GDP demanded. Increase in the consumption is also equivalent to an increase in the aggregate demand (AD). Forstater (2007) has also extended to this idea that growth of employment and output were determined by the growth of AD. This is what it is happening in Hong Kong as there is an inflow of capital, with the aid from the 5.5 million visitors, retails spending went up too. Households and individuals' consumption spending is a powerful motor of a market economy (Forstater, 2007). It is no surprise

that Hong Kong's economy grew. The ASAD model is made up of an imaginary market for the real GDP. In a short-run effect, when there is a rise in the demand of Hong Kong's goods, the AD₀ curve would shift to AD₁.

Figure 2 (a)C: UsersacerDesktopSHORT RUNThese are the few factors that shift Short-Run Aggregate Supply (SAS) curve to the right. When there is a lower cost, (justified by the increase for export). When there are more capital and more labour (justified by the inflow of capital and low employment rate of 4. 4%)When the government gives aids for the poor, by giving tax cuts and creating infrastructure projects. Figure 2 (b)C: UsersacerDesktopSAS INCREASEWhen we have all the graphs combined Figure 2 (c), we will have a clearer picture in what is happening to the Hong Kong economy at present.

Figure 2 (c)C: UsersacerDesktopADAS COMBINED

3. 0 Government intervention, the expansionary fiscal policy

It is also stated in the article that the Hong Kong government has tried to intervene in a few ways by supporting consumption and employment rate with tax cuts, giving aids for the poor and some other subsidies and by creating infrastructure projects. Government can also pay firm wage subsidies so as to promote higher wages and employment as suggested by Phelps (1997). This is an increase in the government spending. To close up the recessionary gap due to the economic crisis, Hong Kong government is adopting the expansionary fiscal policy with a combination of all the measurements that it has taken. The expansionary fiscal policy is also targeted at increasing the AD to return the economy to its potential output which will in turn reduce the unemployment rate and increasing real GDP.

When a recession occurs, the expansionary fiscal policy is implemented by

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increasing the government expenditure, G (bigger multiplier effect) and reducing the taxes (smaller multiplier effect) which drives the AD to go up, therefore the consumption level would increase hence closing the recessionary gap which would be beneficial. According to Parkin (2010), if the real GDP is below the potential GDP, and the government wants to restore a full employment, discretionary fiscal policy may then be used. Like what the Hong Kong government had done, they increase the expenditure on goods and services and cut taxes. These action would rise the AD and if they were correctly timed, full employment rate could be restored. Parkin (2010) continued by saying that an increase in G or a tax cut would increase AE by ΔE . The AD curve would become $AD + \Delta E$ in Figure 3 (a) below. However the multiplier process is tag along with the fiscal policy which would increase the consumption expenditure hence the AD curve shifts rightward to AD1. The article also tells us that the jobless rate in Hong Kong has slide to a 15 month low of 4.4% in the first quarter of 2010. Figure 3 (a)C: UsersacerDesktopexpansionary fiscal policy graph Taking the potential GDP at \$12 billion and real GDP at \$11 billion. The \$1 billion would be the recessionary gap. A rise in government expenditure or a tax cut would increase the expenditure by ΔE . The multiplier effect would be the space in between $AD_0 + \Delta E$. The AD_0 curve would then shift rightward to AD1, where the price level rises to 115 and the real GDP to \$12 billion, hence closing up the recessionary gap. Short-run aggregate supply is the relationship between the quantity of real GDP supplied and the price level, Parkin (2010)

4. 0 Cause of the property bubble and the solution

This philosophy by Robert Eisner, mentioned that a big federal deficit and a growing national debt are useful in stimulating an economy in a recession caused by insufficient spending. However, if an economy is already at full employment or nearly at full capacity, a rise in AD will cause inflation. On the contrary, the Hong Kong government and the International Monetary Fund (IMF) are now worried that Asia is facing overheating and is in a risk of asset-bubble as they see a rise of as much as 10% in the property prices in the first four month of 2010. This is due to the fact that in a long run situation, when the employment rate increase and when the household (C) has got more money to spend; more people will invest and one of the investment is to buy more properties. To "cool down" the property market, central bank would have to interfere by reducing the money supply. This can be done by increasing the interest rate of the loans for buying property. This is so as when the interest rate is high, people would be less willing to invest in property as it now costs more to buy a property. This would in term keep the inflation in check.

5. 0 Supply and demand of money and the money curve

In general, when an economy is performing well, there will be an increase in the demand for money (M_d) as there are more people being employed (Infrastructure projects created by the government) and therefore creating more transactions (bigger multiplier effect). When people have more to spend on goods and services, as we know that the people are now spending more in retail after the rebound from the crisis, the supply of money would also increase to meet the surging demand of the population. Figure 5(a)C:

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UsersacerDesktopgraph. gifAn increase in real GDP increases the demand of money, therefore shifting the money curve rightward from Md0 to Md2. On the reverse side, when there's a decrease in the real GDP, the demand of money decreases as well, hence shifting the money curve leftward, from Md0 to Md1.

6. 0 Conclusion

We know that it is important to strike a balance in an economy. According to Parkin (2010), The IMF wants countries with a budget surplus or low government debt to adopt an expansionary fiscal policy to eliminate the recessionary gap. However during times when other issues occurs, take the example of the property bubble, the central bank would have to adopt other measures to counter the situation such as increasing the discount rate which is the interest rate that commercial banks have to pay to the central bank to borrow from it. When the discount rate has been increased, the less commercial banks would want to borrow therefore reducing the money supply. By adopting this policy, it would discourage Hong Kong people from investing in property.