MR INVESTOR:
LET CAUTION BE THE NAME OF THE GAME

As interest rates fall, the prices of shares, listed on The Stock Exchange of Hongkong Ltd, are likely to rise.

However, the rise may, very well, be short-lived.

Any steep rise in the Hang Seng Index, at this juncture, can only be a temporary reaction to a change in the rate of interest, paid by, or charged by, banks in the Hongkong Special Administrative Region (HKSAR) of the People's Republic of China (PRC).

Interestingly, this has not happened of late, yet the Hang Seng Index had a quick spurt of activity, last Thursday, following an announcement, emanating from the PRC.

Last Wednesday, the People's Bank of China, in a move, clearly aimed at bolstering the faltering PRC economy, cut the annual rate on renminbei deposits from 3.78 percent to 2.25 percent, and, at the same time, reduced the one-year lending rate from 6.39 percent to 5.85 percent.

What effect this will have on the economy of the PRC is hard to imagine since it would appear to this observer to be nothing more than the PRC Government, trying to hang onto a leaf of a tree, during a roaring typhoon.

It does not change anything of any materiality with regard to the economy of the PRC.

And what effect such a move will have on the HKSAR is even harder to imagine.

Yet, it did appear, last Thursday, that the Hang Seng Index tried, very hard, to break through, and stay above, the 13,000 level. This level has not been breached since the beginning of May -- and, for good reason.

Nothing has changed in the economy of the HKSAR since May 3, when TARGET took the position that the Hang Seng Index was too high, everything considered, and, unless there was an appreciable change in economic conditions here, the Hang Seng Index was likely to drift down, towards the 10,000 level.

Since May 3, the Hang Seng Index has been locked in within a range of about 7 percent, but that was down from 13,333.

TARGET's position has not changed since that report of May 3 was penned.

As one swallow does not make a spring, so it should be that one (cosmetic) change in interest rates in the PRC's banking industry does not mean an improvement in the economy of the HKSAR.

What is apparent -- confirmed by the Governments of the PRC and the HKSAR -- is that domestic spending, both in the PRC and the HKSAR, is weak … and may be weakening, further.

It is true that, as bank interest rates fall, large deposit-holders look for alternative resting places for surplus cash in order to try to ensure that the surplus cash earns a rate of interest which is commensurate, or greater than, the rate of inflation.

What it means, when banks lower deposit rates of interest by three quarters of one percent, is that the banks are not looking for any more deposits -- because the banks can't find a use for the deposits.

Being awash with cash can, on occasions, be a bit of an embarrassment since banks have to lend out money in order to be able to afford to pay interest to deposit-holders.

In short, banks would like to rid themselves of some of its deposits since such deposits are dragging down the profitability of the banks.

At the same time, interest rates and the market price of real property are linked in that, when interest rates are low, relatively speaking, and the rate of return on renting out property is higher than the net yield which banks are offering, then investors look to purchase investment property.

Concurrent with this thinking, when interest rates fall, it becomes more attractive for prospective home-owners to purchase property as end-users since they feel that they are able to service the debt which they will incur when buying a new home.

All this theory is fine, but it all assumes an economy, which is able to afford its labour force an ability to purchase goods and services.

And that is one of the problems: The economy of the HKSAR is such that unemployment is at the highest level since 1981, at 6 percent.

Any rise in the Hang Seng Index does not appear to be able to be sustained and, again, TARGET suggests that investors play the waiting game: Let caution be the name.

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