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FM HONG KONG 100800Z JUN 83

TO PRIORITY FCO

TELEGRAM NUMBER 791 OF 10 JUNE

INFO PRIORITY PEKING (PERSONAL FOR AMBASSADOR)

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FUTURE OF HONG KONG

1. MINISTERS MAY FIND IT HELPFUL TO HAVE A BRIEF SUMMARY OF THE PRESENT SITUATION IN HONG KONG, PARTICULARLY AS REGARDS THE STATE OF CONFIDENCE.
2. THE ECONOMY IS STILL SUFFERING FROM THE EFFECTS OF THE WORLD RECESSION, WHICH CAME LATE TO HONG KONG, AND THE COLLAPSE OF PROPERTY PRICES WITH ITS CONSEQUENCES FOR THE DOMESTIC FINANCIAL SECTOR. BUT THERE ARE NOW SIGNS OF AN EXPORT-LED RECOVERY. THE VOLUME OF DOMESTIC EXPORTS IS PICKING UP, AFTER HAVING FALLEN LAST YEAR: UNEMPLOYMENT IS ALMOST CERTAINLY FALLING: THE STATE OF MANUFACTURERS' ORDER BOOKS IS GENERALLY ENCOURAGING. THE PROSPECTS LOOK BRIGHT FOR FURTHER IMPROVEMENT LATER IN THE YEAR.
3. THE UNDERLYING ECONOMIC SITUATION HAS THEREFORE IMPROVED. BUT THE EVIDENCE OF RECOVERY HAS SO FAR HAD LITTLE EFFECT ON THE MARKETS. THE PROPERTY SECTOR REMAINS DEPRESSED. THE HANG SENG INDEX IS AROUND HALF OF ITS MID 1982 PEAK AND THE VOLUME OF TRADING HAS BEEN CONSISTENTLY LOW IN RECENT MONTHS. BUT THE MAIN PREOCCUPATION IS THE SHARP DECLINE IN THE EXCHANGE VALUE OF THE HONG KONG DOLLAR. THE TRADE WEIGHTED INDEX FELL FROM 89.5 AT END MAY 1982 TO 73.8 AT END MAY 1983. THIS HAS BEEN CAUSED PARTLY BY THE SURGING STRENGTH OF THE U.S. DOLLAR BUT ALSO BY INCREASING ANXIETY ABOUT THE FUTURE WHICH HAS ENCOURAGED A SWITCH FROM HONG KONG DOLLARS TO U.S. DOLLAR DEPOSITS.
4. PUBLIC CONFIDENCE IS FRAGILE. THE CAMPAIGN WAGED BY THE CHINESE OVER THE PAST NINE MONTHS HAS HAD A CUMULATIVE IMPACT. IT IS NOW WIDELY ACCEPTED THAT THE CHINESE INTENTION IS TO RECOVER SOVEREIGNTY AND CONTROL OVER HONG KONG IN 1997. ALTHOUGH THERE ARE WIDESPREAD DOUBTS ON WHETHER THIS COULD BE DONE IN A WAY WHICH WOULD (AS THE CHINESE CLAIM) PRESERVE THE TERRITORY'S PROSPERITY AND THE FREEDOMS NOW ENJOYED BY HONG KONG PEOPLE, THERE IS ALSO A GROWING BELIEF THAT A CHINESE TAKEOVER IN 1997 IS INEVITABLE. THOSE IN THE ENTREPRENEURIAL, MANAGERIAL AND PROFESSIONAL CLASSES WHO ARE MOBILE OR POTENTIALLY SO ARE BEGINNING TO MAKE THEIR DISPOSITIONS ACCORDINGLY. THERE HAS ALREADY BEEN A MARKED RISE IN THE NUMBER OF APPLICATIONS FOR RESIDENCE OVERSEAS, IN SOME CASES ACCOMPANIED BY TRANSFERS OF ASSETS. THE NUMBERS ARE NOT YET VERY SIGNIFICANT IN ABSOLUTE TERMS BUT THE TREND IS THERE.
5. THE HONG KONG GOVERNMENT IS MAINTAINING THE LEVEL OF EXPENDITURE ON RECURRENT SERVICES AND INVESTMENT PROGRAMMES DESPITE A LARGE BUDGET DEFICIT IN 1982-83 AND A LIKELY DEFICIT IN 1983-84. IT IS ALSO MAINTAINING THE IMAGE OF A GOVERNMENT CONFIDENT IN THE FUTURE AND GETTING ON WITH THE BUSINESS OF THE DAY. BUT THE NEED TO MAINTAIN CONFIDENTIALITY IN THE TALKS, AND TO AVOID A PUBLIC CONFRONTATION WITH THE CHINESE OVER THEIR PLANS HAS PRECLUDED US

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FROM RESPONDING TO THE RISING PUBLIC DEMAND FOR INFORMATION ON WHAT IS GOING ON, WITH CONSEQUENT ACCUSATIONS OF PASSIVITY, LACK OF LEADERSHIP AND SO ON. THIS HAS TO BE TOLERATED IN THE SHORT TERM BUT UNLESS THERE IS SOMETHING TO SHOW FOR THE PATIENCE WE HAVE ENJOINED ON THE PUBLIC, THE POINT WILL BE REACHED AT WHICH THE CREDIBILITY OF THE ADMINISTRATION WILL BE CALLED IN QUESTION. 6. IN SHORT, EVERYONE IS NOW LOOKING FOR PROGRESS OR AT LEAST SIGNS OF GREATER ACTIVITY THAN OVER THE PAST NINE MONTHS. IF THE CURRENT DISCUSSIONS IN PEKING LEAD TO AN EARLY START OF SUBSTANTIVE TALKS AND I ATTEND, THIS WILL BE INTERPRETED AS EVIDENCE THAT THE LOG JAM HAS BEEN BROKEN. PROVIDED THE ACCOMPANYING ATMOSPHERICS ARE RIGHT THE EFFECT ON CONFIDENCE SHOULD BE FAVOURABLE BUT CONTINUING EVIDENCE OF PROGRESS WILL BE REQUIRED AND IF NOTHING MUCH IS SEEN TO BE HAPPENING THE GLOOM IS LIKELY TO DEEPEN. THE NEXT SIX MONTHS ARE THEREFORE LIKELY TO BE CRUCIAL FOR THE FUTURE OF HONG KONG. HMG'S CONTINUING COMMITMENT TO THE TERRITORY WILL BE VERY IMPORTANT AND PEOPLE HERE WILL BE LOOKING FOR EVIDENCE THAT THEIR FUTURE REMAINS HIGH ON THE AGENDA OF MINISTERS IN LONDON.

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THIS TELEGRAM
WAS NOT
ADVANCED

FUTURE OF HONG KONG

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