

Press Release

(embargoed until 4:15 p.m. on 27 May 2005)

Economic Situation in the First Quarter of 2005 and Updated GDP and Price Forecasts for 2005

The Government released today (Friday) the First Quarter Economic Report 2005, together with the preliminary figure on Gross Domestic Product for the first quarter of 2005.

The Government Economist, Mr K C Kwok, described the economic situation in the first quarter of 2005 and provided updated GDP and price forecasts for the year.

MAIN POINTS

- * The notable growth momentum of the Hong Kong economy continued into the first quarter of 2005, with GDP growing solidly further by 6.0% in real terms, following a strong 8.1% growth in 2004. On a seasonally adjusted quarter-to-quarter comparison, GDP expanded for the seventh straight quarter, by 1.5% in real terms in the first quarter of 2005.
- * Externally, merchandise exports held up well for the first quarter as a whole, growing by a further 8.9% in real terms over a year earlier. This was supported by Mainland's strong trade flows and enhanced price competitiveness from the earlier weakness of the US dollar. Exports of services attained a further notable growth at 8.6% in the first quarter over a year earlier, as offshore trade continued to surge, while inbound tourism was buoyant.
- * On the domestic front, consumption demand held firm along with the more entrenched economic recovery, improving labour market conditions and a strong property market. Private consumption expenditure went up further by 4.6% in real terms in the first quarter over a year earlier.
- * Investment demand recovered after a temporary relapse in the fourth quarter of 2004, underscored by a promising business outlook. Overall investment spending reverted to a 2.2% increase in real terms in the first quarter of 2005, having temporarily suffered a 1.4% drop in the fourth quarter of 2004. Not only that investment in machinery, equipment and software resumed positive growth in the quarter, building and construction activities also turned around to a modest increase after nine straight quarters of fall-off.
- * The labour market improved notably further along with the economic upturn, with total employment rising to an all-time high in the first quarter of 2005. The seasonally adjusted unemployment rate fell to 6.1% in the first quarter and further to a 41-month low of 5.9% in the three months ending April 2005.

- * While the economy has performed well in the first quarter, the trade outlook is increasingly overshadowed by a number of risks in the external environment. Apart from the sustained high crude oil prices, signs of a regional slow-down have become more evident, leading to a general moderation in their import intake. The Mainland economy, though still having strong growth in the first quarter, may settle back somewhat in growth later in the year, in the light of the government's recent tightening measures to cool down the overheated property market. Also, if the US dollar continues to strengthen, it would entail a relative loss in Hong Kong's export competitiveness. On top of these, lately the US has taken steps to institute safeguard measures against seven categories of textile imports from China, and there is a risk that the EU will do the same. All these have added uncertainties to Hong Kong's trade outlook. Thus, compared to two months ago, the trade prospect has dimmed somewhat.

- * Against these, however, there could be some upsides from the domestic sector, not only on account of the current strength of local consumption, but also the latest improvement in construction output, the latter being the laggard and hence the main drag on the economic recovery so far. Furthermore, the opening of the Hong Kong Disneyland later this year should give a boost to inbound tourism and lift consumer sentiments further. Thus, on balance, the broad economic picture remains largely positive, despite a somewhat less upbeat trade outlook.

- * Against this backdrop and given the robust outturn in the first quarter, the forecast of GDP growth for 2005 is kept unchanged at 4.5-5.5% in real terms, same as the forecast first released in the Budget Speech in March.

- * Consumer price inflation remained benign. In the first four months of 2005, the year-on-year increase in the Composite Consumer Price Index was 0.4%. While there may be some modest price pressures from the external front stemming from the high oil prices and the earlier weakness of the dollar, local price pressures in overall terms are expected to remain rather mild over the coming few months. The expansion in supply capacity brought by the hefty capital investment over the past two years should also help alleviate the local price pressures. With the outturn so far broadly in line with the earlier expectations, the forecast rate of change in the Composite CPI for 2005 is thus kept unchanged, at 1.5%.

DETAIL

GDP

According to the preliminary figure on the *Gross Domestic Product (GDP)* released today by the Census and Statistics Department, GDP grew solidly further by 6.0% in real terms in the first quarter of 2005 over a year earlier, following a 7.1% growth in the fourth quarter of 2004 and an 8.1% growth for 2004 as a whole. On a seasonally adjusted quarter-to-quarter comparison, GDP expanded for the seventh straight quarter, by 1.5% in real terms in the first quarter of 2005 (*Chart*).

2. The latest figures on GDP and its major expenditure components up to the first quarter of 2005 are presented in *Table 1*. Developments in different segments of the economy in the first quarter of 2005 are described below.

External trade

3. Merchandise exports were strong in the first two months of 2005, but moderated in March as exports to quite a number of East Asian economies slackened along with the more noticeable slow-down in intra-regional trade towards the end of the quarter. Yet for the first quarter of 2005 as a whole, *total exports of goods* still attained notable growth at 8.9% in real terms in the first quarter of 2005 over a year earlier, following a 12.6% increase in the fourth quarter of 2004 and a 15.3% surge for 2004 as a whole. On a seasonally adjusted quarter-to-quarter comparison, total exports of goods showed little change in real terms in the first quarter of 2005, after a 2.9% rise in the fourth quarter of 2004.

4. Export performance varied widely amongst individual markets. Exports to the Mainland, Japan and Singapore maintained rather strong growth in the quarter. Exports to the EU also remained robust, partly contributed by the surge in exports of textile and clothing sourced from the Mainland. In contrast, exports to the US lost steam in March after growing briskly in the first two months, in tandem with the weaker import demand there. Exports to some other East Asian markets such as Taiwan, Korea and Malaysia moderated more noticeably, owing partly to the distinct fall-off in demand for electronic parts and components.

5. *Exports of services* attained a further notable growth at 8.6% in real terms in the first quarter of 2005 over a year earlier, after a 7.2% increase in the fourth quarter of 2004 and following a remarkable 15.0% growth for 2004 as a whole. On a seasonally adjusted quarter-to-quarter comparison, exports of services rose by 2.4% in the first quarter of 2005, having edged down by 1.0% in the fourth quarter of 2004. Offshore trade continued to flourish, while inbound tourism continued to show solid and broad-based growth.

Domestic sector

6. Local consumer spending held firm in the first quarter of 2005, as consumer confidence was boosted by the improvements in the job market and the upbeat sentiments in the property market. *Private consumption expenditure* went up further by 4.6% year-on-year in real terms in the first quarter of 2005, compared with the 5.9% growth in the fourth quarter of 2004 and a 6.9% growth for 2004 as a whole. On a seasonally adjusted quarter-to-quarter comparison, private consumption expenditure expanded slightly further, by 0.2% in real terms in the first quarter of 2005, after a 2.0% growth in the fourth quarter of 2004.

7. Overall investment spending in terms of the *gross domestic fixed capital formation* reverted to a 2.2% increase in real terms in the first quarter of 2005 over a year earlier, having temporarily suffered a relapse in the fourth quarter of 2004. Investment in machinery and equipment resumed growth on support of the continued business upturn. Also relevant was the delivery of several aircraft during this period. Concurrently, building and construction activities, which have been persistently lagging behind in the recovery process, also turned around to a modest growth in the first quarter, the first increase since the third quarter of 2002, and also representing a significant relative improvement against the double-digit decline in 2004.

The labour sector

8. The labour market continued to improve. *Total employment* expanded further by 0.8% in the first quarter of 2005 over the preceding quarter to a new peak of 3.35 million. The *seasonally adjusted unemployment rate* fell distinctly further from 6.5% in the fourth quarter of 2004 to 6.1% in the first quarter of 2005, and further to a 41-month low of 5.9% in February-April. Vacancies continued to surge in many sectors at end-2004, as business operators started to ramp up hiring of workers to meet the expected business expansion. Downward pressures on wages and labour earnings also seem to be receding as the economic recovery continues.

Prices

9. Consumer price inflation has been running at a moderate pace in recent months. From a business cost perspective, rents for premises have been rising but labour costs remain generally soft. The pace of upturn in the CPI continued to be kept down by the very modest housing cost due to the earlier fall-off in private housing rentals. The *Composite Consumer Price Index* edged up by 0.4% in the first quarter of 2005 over a year earlier, following a 0.2% increase in the fourth quarter of 2004. On a seasonally adjusted quarter-to-quarter comparison, there was a mild increase of 0.4% in the first quarter of 2005, following a 0.3% increase in the preceding quarter. As to the *GDP deflator*, the decline narrowed further to 1.9% year-on-year in the first quarter of 2005, from 2.1% in the fourth quarter of 2004 and 2.8% for 2004 as a whole. This was mainly attributable to the relative improvement in terms of trade, as the drag from the earlier weakness of the US dollar waned.

Updated GDP and price forecasts for 2005

10. While the economy has performed well in the first quarter, the trade outlook is increasingly overshadowed by a number of risks in the external environment. Crude oil prices, whilst easing back somewhat after reaching a new high in early April, remained high and hovered at US\$45-50 per barrel lately. The surge in oil prices last year seems to be taking a toll on global demand gradually. Signs of a regional slow-down have become more evident, leading to a general moderation in their import intake. The Mainland economy, though still having strong growth in the first quarter, may settle back to a more moderate growth pace later in the year, in the light of the government's recent tightening measures to cool down the overheated property market. Also, if the US dollar continues to strengthen, it would entail a relative loss in Hong Kong's export competitiveness. On top of these, lately the US has taken steps to institute safeguard measures against seven categories of textile imports from China, and there is a risk that the EU will do the same. All in all, compared to two months ago, the trade prospect has dimmed somewhat. It is thus likely to see the negative impact on Hong Kong's export growth emerging more visibly in the coming months.

11. While external demand seems to have slowed recently, domestic demand has so far performed better than expected. Along with the improvement in the labour market and a still generally upbeat sentiment, local consumption can be expected to hold up well in the year. The recovery in overall investment demand should gain further ground. In addition to the envisaged solid growth in machinery and equipment investment, there would be additional impetus from construction investment, if private sector building activity can sustain its reviving trend, now that it has finally turned around. Overall, despite a somewhat weaker trade outlook, there should be cushion from the domestic sector, stemming from a reviving property market and improving employment conditions. Furthermore, the opening of the Hong Kong Disneyland later this year should give a strong boost to inbound tourism and lift consumer sentiment further.

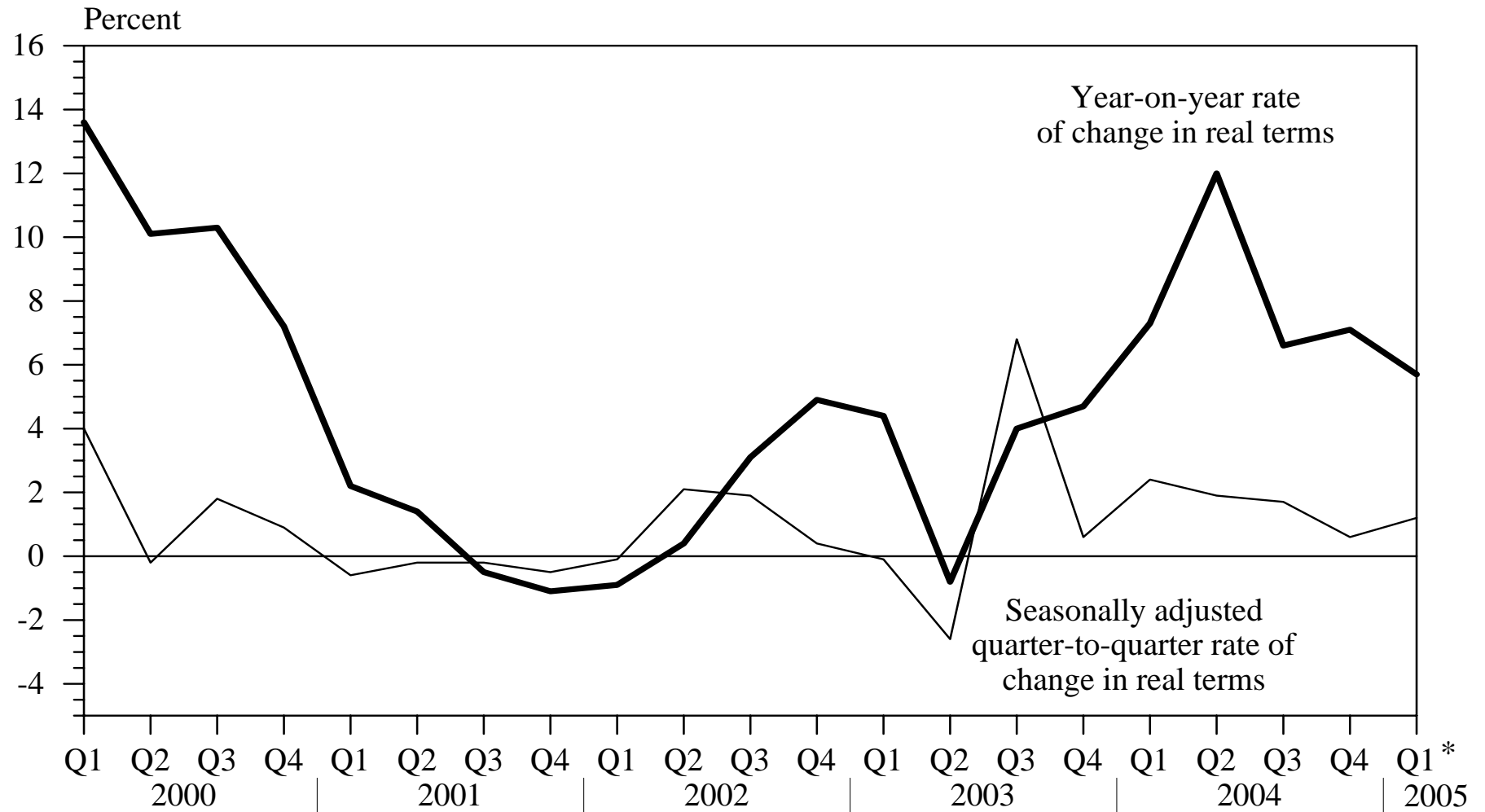
12. With the downside risks from the external front broadly balanced by the upsides from the domestic sector, the forecast GDP growth in real terms for 2005 is maintained at 4.5-5.5% in the current update, same as that put up in the Budget Speech in March (*Table 2*). For comparison, the forecasts of Hong Kong's GDP growth by a selection of international organisations and local analysts are summarised in *Table 3*. The latest known forecasts of GDP growth in real terms for 2005 from the private sector analysts are mostly between 4% to 5%.

13. As to the inflation forecasts, the outturn so far are broadly in line with the earlier expectations. The forecast rates of change in both the *Composite CPI* and the *GDP deflator* for 2005 thus are likewise maintained at 1.5% and -1% respectively in this round, same as the forecasts announced in the Budget Speech in March. While there may be some modest price pressures from the external front stemming from high oil prices and the earlier weakness of the US dollar, local price pressures in overall terms are expected to remain mild over the coming few months. The expansion in supply capacity brought by the hefty capital investment over the past two years should also help alleviate local price pressures.

(The First Quarter Economic Report 2005 can now be purchased on-line at http://www.statisticalbookstore.gov.hk/desc_eng.htm, or by calling the Publications Sales Section of the Information Services Department (ISD) at 2537 1910. Both the hard and soft copies of the report are available for sale at \$84 a copy, yet with a postage charge for the hard copy.)

(The GDP figures up to the first quarter of 2005 are published in the Report of the Gross Domestic Product, First Quarter 2005, which can also be purchased on-line at http://www.statisticalbookstore.gov.hk/desc_eng.htm, or by calling the Publications Sales Section of ISD. Both the hard and soft copies of the report are available for sale at \$32 per copy, yet with a postage charge for the hard copy.)

Hong Kong's Gross Domestic Product



Note : (*) Preliminary figures.

Table 1

**Gross Domestic Product and its main expenditure components
and the main price indicators
(year-on-year rate of change (%))**

	<u>2003</u> [#]	<u>2004</u> [#]	<u>2004</u>				<u>2005</u>
			<u>Q1</u> [#]	<u>Q2</u> [#]	<u>Q3</u> [#]	<u>Q4</u> [#]	<u>Q1</u> ⁺
<i>Change in real terms of GDP and its main expenditure components (%)</i>							
Private consumption expenditure [@]	-1.1	6.9	5.7 (1.0)	10.9 (2.2)	5.3 (0.2)	5.9 (2.0)	4.6 (0.2)
Government consumption expenditure	1.9	0.7	5.6 (0.1)	* (-3.3)	-1.3 (*)	-1.7 (1.4)	-4.2 (-2.4)
Gross domestic fixed capital formation	0.9	4.1	5.1 (N.A.)	11.5 (N.A.)	2.1 (N.A.)	-1.4 (N.A.)	2.2 (N.A.)
<i>of which :</i>							
Building and construction	-5.6	-11.1	-12.4	-13.4	-14.3	-3.7	3.4
Machinery, equipment and computer software	6.7	12.4	16.3	26.9	11.9	-2.1	0.8
Total exports of goods	14.2	15.3	15.0 (2.5)	18.7 (5.8)	15.3 (0.6)	12.6 (2.9)	8.9 (*)
Imports of goods	13.1	14.1	16.3 (3.7)	20.3 (3.6)	14.2 (-1.1)	7.0 (0.6)	3.8 (1.6)
Exports of services [@]	8.1	15.0	13.8 (1.3)	33.0 (0.8)	11.7 (5.7)	7.2 (-1.0)	8.6 (2.4)
Imports of services	-2.1	10.7	3.5 (-4.4)	30.1 (6.0)	7.2 (3.0)	6.2 (1.0)	5.5 (-4.2)
Gross Domestic Product	3.1	8.1	7.3 (2.4)	12.0 (1.9)	6.6 (1.7)	7.1 (0.6)	6.0 (1.5)
<i>Change in the main price indicators (%)</i>							
GDP deflator	-6.1	-2.8	-4.0 (*)	-2.8 (-1.1)	-2.6 (-0.7)	-2.1 (-0.2)	-1.9 (*)
Composite Consumer Price Index	-2.6	-0.4	-1.8 (0.3)	-0.9 (-0.1)	0.8 (-0.2)	0.2 (0.3)	0.4 (0.4)
<u>Change in nominal GDP (%)</u>	-3.2	5.1	3.0	8.8	3.9	4.9	4.0

Notes : (#) Revised figures.

(+) Preliminary figures.

(@) Figures for 2004 have been revised following the release of enhanced estimates on tourism expenditure by Mainland visitors by the Hong Kong Tourism Board. Estimates for 2002 and 2003 were revised accordingly to enable comparability of the data series. The overall GDP nevertheless is not affected.

() Seasonally adjusted quarter-to-quarter rate of change.

N.A. Not applicable, as no clear seasonal pattern is found in gross domestic fixed capital formation, due to the presence of considerable short-term fluctuations.

(*) Change of less than 0.05%.

Table 2**Forecast growth rates of the Gross Domestic Product
and forecast rates of change in the main price indicators for 2005**

	Forecasts for 2005 as released on 16.3.2005 (%)	May update of the forecasts for 2005 released on 27.5.2005 (%)
Gross Domestic Product (GDP)		
<i>Real GDP</i>	4.5 to 5.5	4.5 to 5.5
<i>Nominal GDP</i>	3.5 to 4.5	3.5 to 4.5
Composite Consumer Price Index	1.5	1.5
GDP Deflator	-1	-1

Table 3
2005 GDP and price forecasts for Hong Kong put out by
selected international organisations and private sector analysts

	<u>Date of release</u>	<u>GDP</u>	<u>Private consumption expenditure</u> (growth rate	<u>Gross domestic fixed capital formation</u> in real	<u>Total exports of goods</u> terms (%))	<u>Exports of services</u>	<u>Rate of change in consumer prices</u> (%)	<u>Reference source</u>
International organisations:								
IMF	Feb 2005	4	2.4	1.1	--	--	1	Country Report No. 05/63, Feb 2005.
	Apr 2005	4	--	--	--	--	1	World Economic Outlook, Apr 2005.
ADB	Apr 2005	5.7	--	--	--	--	1.5	Asian Development Outlook 2005, Apr 2005.
World Bank	Apr 2005	4.6	--	--	--	--	--	East Asia Update, Apr 2005.
United Nations	Jan 2005	6	--	--	--	--	1.5	World Economic Situation and Prospects 2005.
Private sector analysts:								
<i>(a) Major local banks</i>								
HSBC	Jan 2005	4	2.6	2.8	--	--	1	Asian Economics, Q1 2005.
	May 2005	4	2.6	2.8	--	--	1	Asian Economics Insight, 6 May 2005.
Standard Chartered Bank	Apr 2005	4	--	--	--	--	1.5	Special Report, 4 April 2005.
Hang Seng Bank	Dec 2004	4	2.8	2.8	9.5	9.8	1	Hang Seng Economic Monthly, Nov/Dec 2004.
Bank of China (HK)	Dec 2004	4.5	4.2	4.5	8.6	10.5	1.2	BOC Economic Review Monthly, Dec 2004.
Bank of East Asia	Jan 2005	4.5	4.5	4	8.5	11	1.5	Economic Analysis, Jan 2005.
ABN Amro Bank	May 2005	4	--	--	--	--	1.5	Asia Vision, 20 May 2005.
Citigroup	Jan 2005	4.7	--	--	--	--	--	Oriental Daily News, 21 Jan 2005.
	Feb 2005	4.5	--	--	--	--	1.4	Hong Kong Financial Market Weekly, 21 Feb 2005.

Table 3 (cont'd)

**2005 GDP and price forecasts for Hong Kong put out by
selected international organisations and private sector analysts**

	<u>Date of release</u>	<u>GDP</u>	<u>Private consumption expenditure</u> (growth rate	<u>Gross domestic fixed capital formation</u> in real	<u>Total Exports of goods</u> terms	<u>Exports of services</u> (%)	<u>Rate of change in consumer prices</u> (%)	<u>Reference Source</u>
<i>(b) Investment bank</i>								
JP Morgan Chase	Mar 2005	5	--	--	--	--	2.2	Global Data Watch: Asia, 11 Mar 2005.
Goldman Sachs Asia	Mar 2005	4.5	--	--	--	--	1.3	Asia-Pacific Economics Analyst, 8 Mar 2005.
	Mar 2005	5	--	3.6	--	--	1.3	Economics Flash, 17 Mar 2005.
Morgan Stanley Asia	Nov 2004	4.5	4	5.7	7.6	8	0.5	Hong Kong Economics, 29 Nov 2004.
	May 2005	4.5	4.5	4.4	7.5	8	0.5	Hong Kong Economic Forecast Summary, May 2005
Merrill Lynch	May 2005	5.3	--	--	--	--	2.1	The Asian Market Economist, 3 May 2005.
Credit Suisse First Boston	Mar 2005	3.5	3.2	3.8	--	--	1.4	Global Emerging Markets Outlook, 10 Mar 2005.
<i>(c) Others</i>								
Economist Intelligence Unit	Mar 2005	4.6	5	6	--	--	0.4	Country Forecast, Mar 2005.
	Apr 2005	4.6	5	4.2	--	--	0.4	Country Forecast, Apr 2005.
Hong Kong General Chamber of Commerce	Nov 2004	5.5	--	--	--	--	2.5	HKGCC, 22 Nov 2004.
	May 2005	5.5	--	--	--	--	1	HKGCC, 23 May 2005.
Hong Kong University	Jan 2005	6	--	--	--	--	3	The Sun, 12 Jan 2005.
The Better Hong Kong Foundation Forecasts	Apr 2005	6.14	--	--	--	--	2.45	RTHK Online News, 28 Apr 2005.

Observation :

The forecasts of GDP growth in real terms for 2005 from local analysts listed above range from 3.5% to 6.14%, averaging at 4.7%.



First Quarter Economic Report 2005

Government of the Hong Kong
Special Administrative Region

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