



Hong Kong's Recent Economic Situation and Near-term Outlook

The Government released the Third Quarter Economic Report 2007 in mid-November. The Economic Report, together with the press release containing the updated economic forecasts for the whole year of 2007, have been furnished to LegCo Members.

This paper analyses Hong Kong's overall economic development in the most recent period, summarises the updated economic forecasts by the Government for 2007 as a whole, and briefly discusses the various factors which may affect the outlook in 2008.

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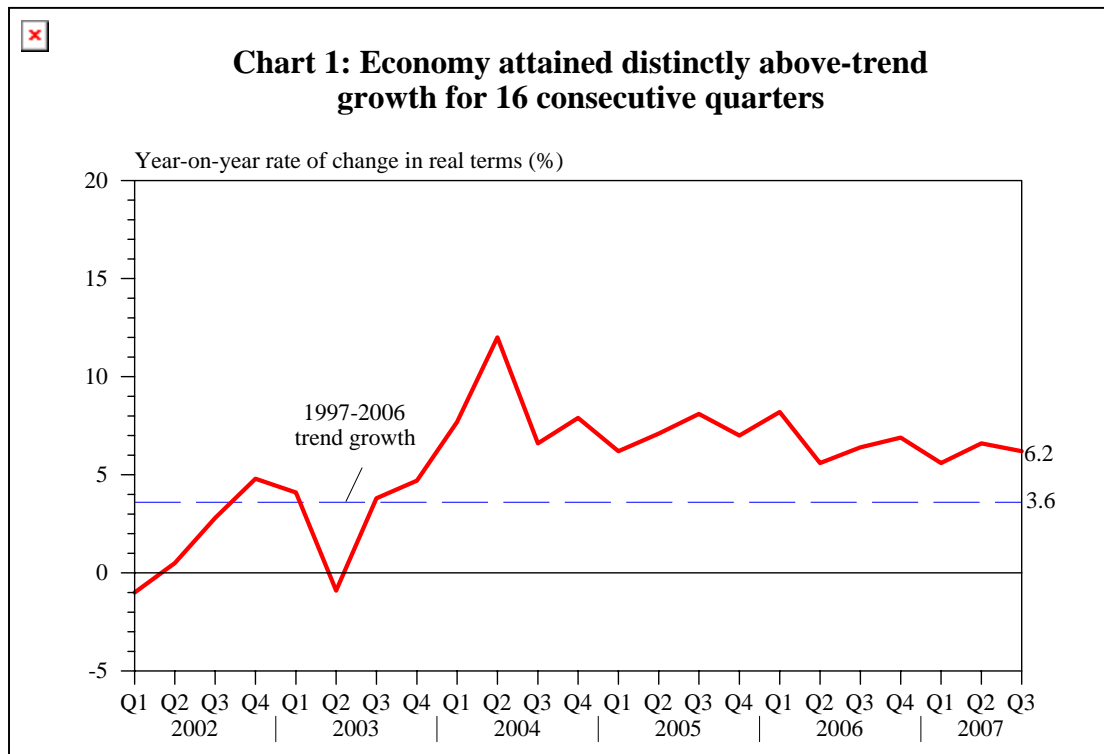
Recent Situation and Near-term Outlook For the Hong Kong Economy

Introduction

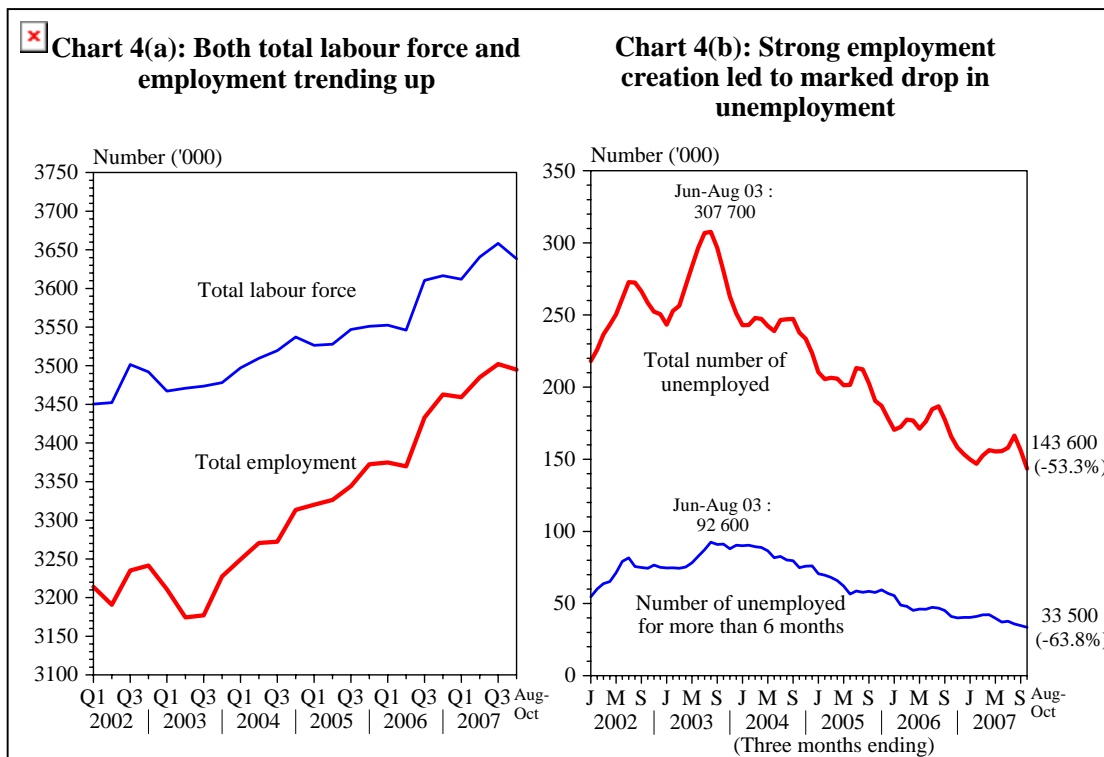
This paper analyses latest developments in the Hong Kong economy and briefly discusses the updated economic forecasts for 2007 as a whole and the economic outlook for 2008.

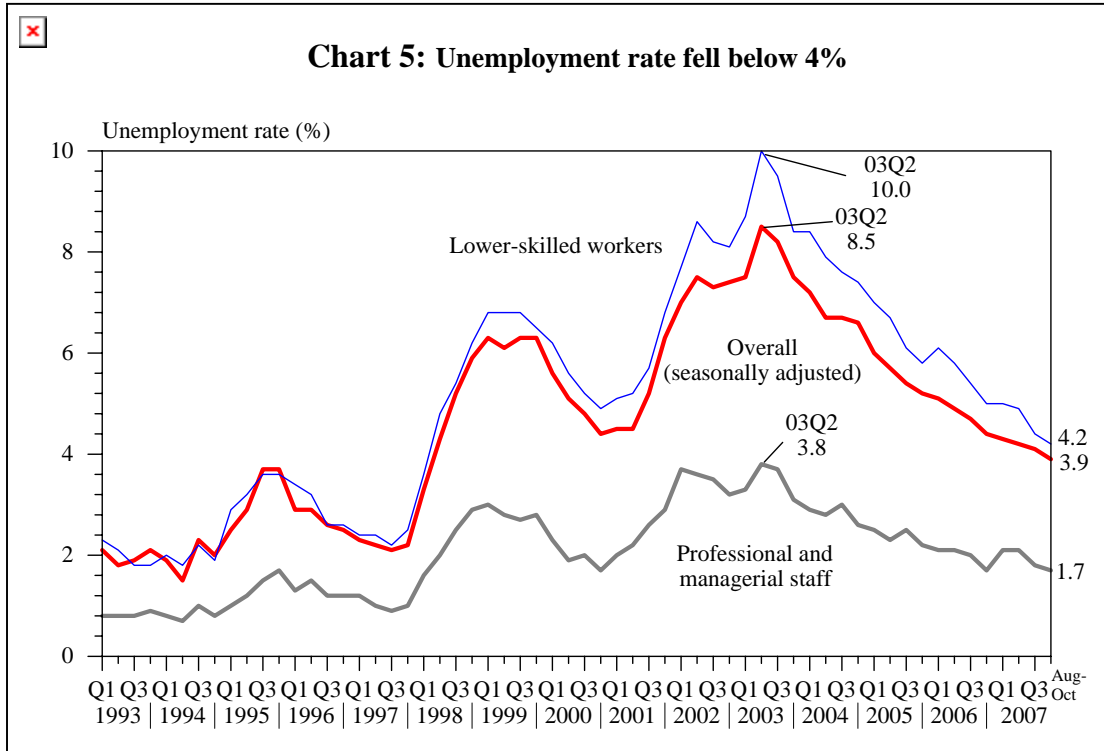
Recent economic situation

2. The Hong Kong economy continued to be vibrant in the third quarter of 2007, with real GDP leaping by 6.2% over a year earlier. This followed a robust 6.1% growth in the first half of the year. By now our economy has attained distinctly above-trend growth for 16 consecutive quarters (*Chart 1*). Despite the global financial market turbulence in August and September, external trade grew notably further and domestic demand continued to display strength in the third quarter.

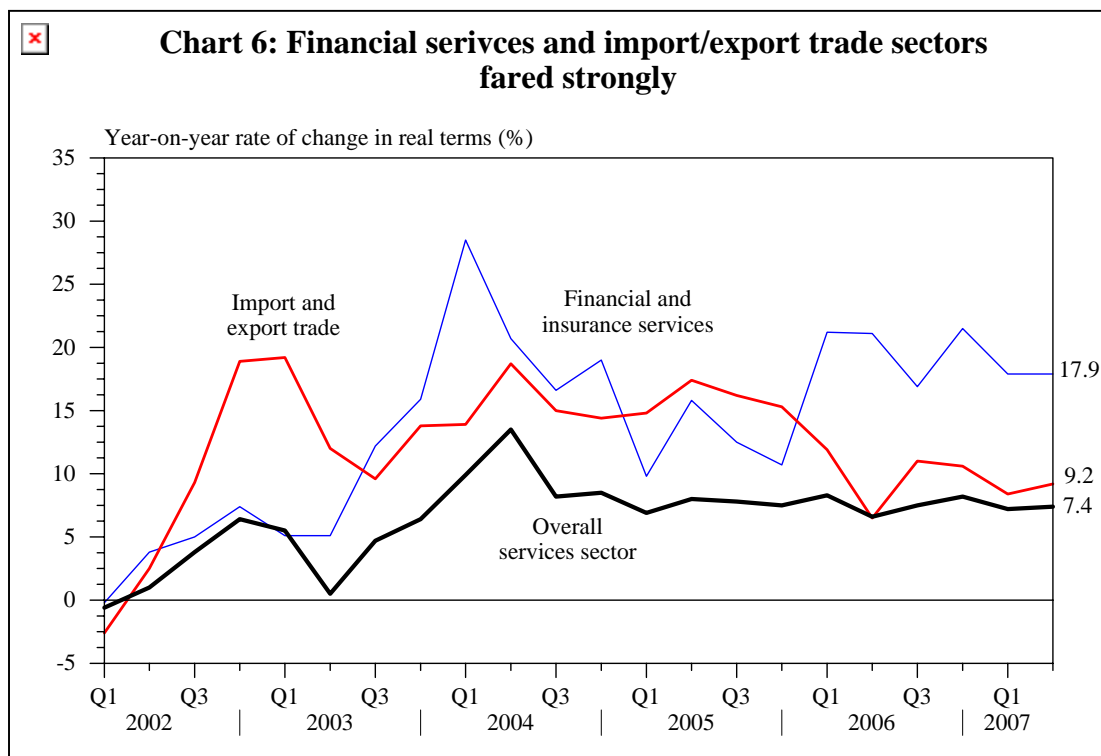


7. The sustained strength of the local economy continued to translate into job opportunities and benefit a wide spectrum of the labour sector (*Chart 4(a)*). Since the economic trough in mid-2003, a total of some 330 000 net additional jobs had been created. With the strong employment creation, the number of long-term unemployed also fell markedly, by 64% as compared to the peak in mid-2003 (*Chart 4(b)*). The seasonally adjusted unemployment rate went further down to 3.9% in the three months ending October, the lowest in nine and a half years (*Chart 5*). Workers at the lower end of the labour market also saw a significant improvement in employment situation. Wages and earnings picked up further in June 2007 over a year earlier, representing increases in real terms after netting out inflation. Job vacancies continued to surge.

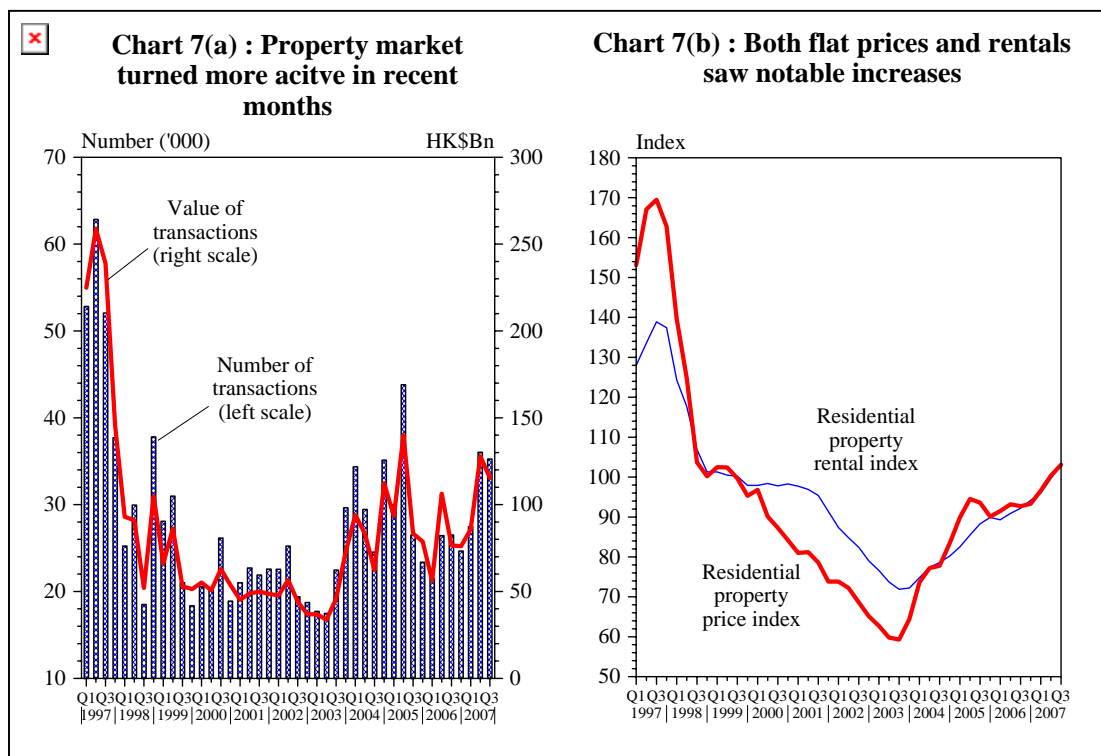




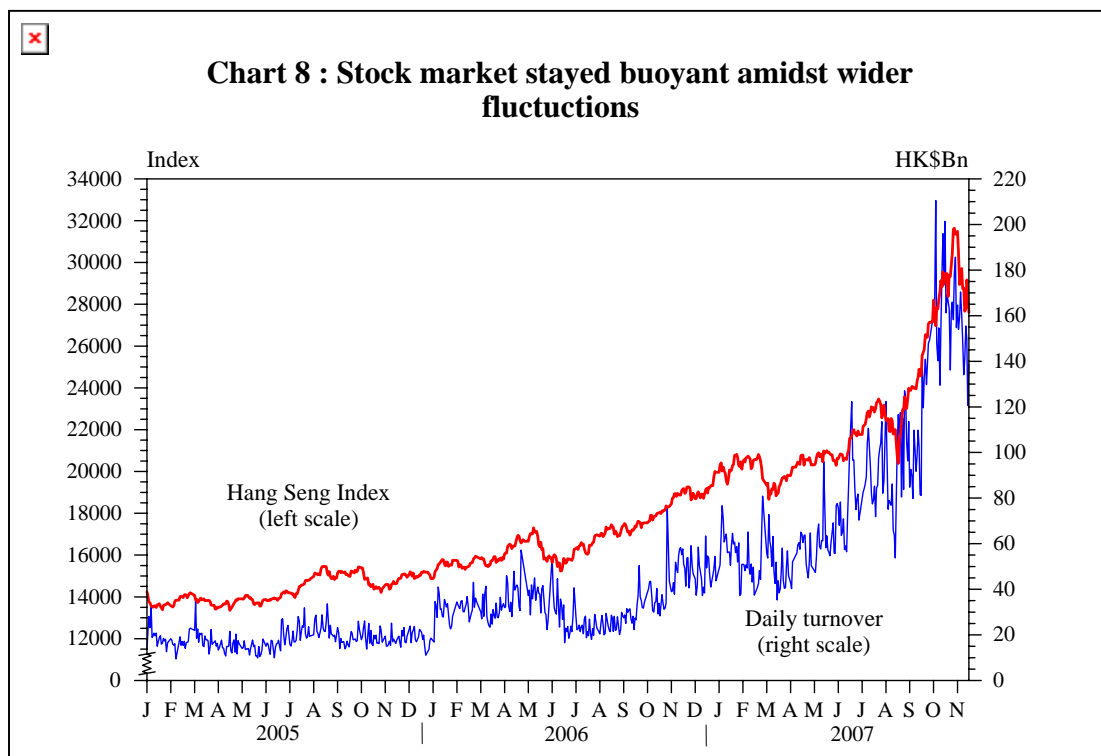
8. In recent years, Hong Kong has been successful in enhancing its role as an international financial centre and maintaining its position as a leading trading hub in the region. Output in the financial services sector surged at an average annual rate of 17.7% in real terms over the past three years, and further by 17.9% in the first half of 2007. Output in import and export trade also attained a robust average annual growth of 13.7% during 2004 to 2006, and grew notably further by 8.8% in the first half of 2007 (*Chart 6*). Wholesale and retail trades, and restaurants and hotels also performed well in recent quarters, on the back of strong consumption demand and thriving inbound tourism.



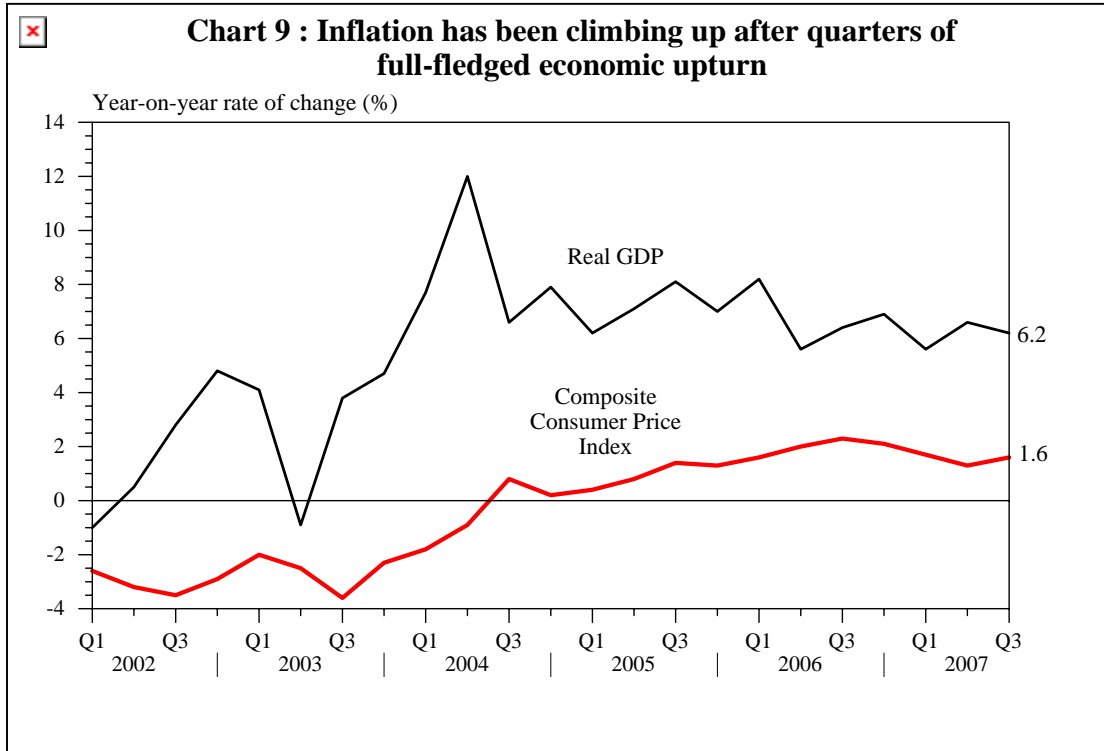
9. The residential property market continued to gain momentum. Trading in the residential property market turned more active in recent months (*Chart 7(a)*), with more notable increases in both prices and rentals (*Chart 7(b)*), as the households' financial positions became stronger, confidence in economic prospects increased, and expectations of interest rate cuts prevailed. Residential flat prices in September 2007 were 2.2% higher as compared with June, and 11.3% higher than in September 2006. Compared with the trough in 2003, residential flat prices in September 2007 rebounded substantially but were still 40% lower than the peak in 1997. Flat rentals also went up distinctly by 3.7% during the third quarter, reflecting strong leasing demand. The markets for commercial properties, i.e. retail premises and offices, also fared strongly given businesses' expansion plans amidst sustained economic upturn.



10. Amidst the global financial market turbulence and the uncertain outlook for the US economy, the local stock market, along with other major overseas stock markets, showed much greater volatility in recent months. The Hang Seng Index (HSI) was on an uptrend in July, then fell to an intra-day low of 19 387 in mid-August upon the global equity market adjustment, and again went on surging starting from the second half of August on the prospects for more fund inflows, as well as the resurgence of the global equity markets. The rising momentum of the stock market, in terms of both prices and turnover, extended into October, with the HSI attaining successive new highs in the month and closed above the 30 000-mark for the first time. However, as concerns about the adverse effects of global credit market turbulence re-emerged, the HSI fell to 26 005 on 22 November 2007, 18 % lower than the record closing high of 31 638 on 30 October (*Chart 8*). The local stock market capitalisation stood at \$23.1 trillion at end-October, up 73% from end-December 2006. IPO activities stayed robust in recent months, although the amount of capital raised fell short of the distinctly high level in 2006. In terms of IPO funds raised during the first three quarters of 2007, Hong Kong was ranked fourth in the world.

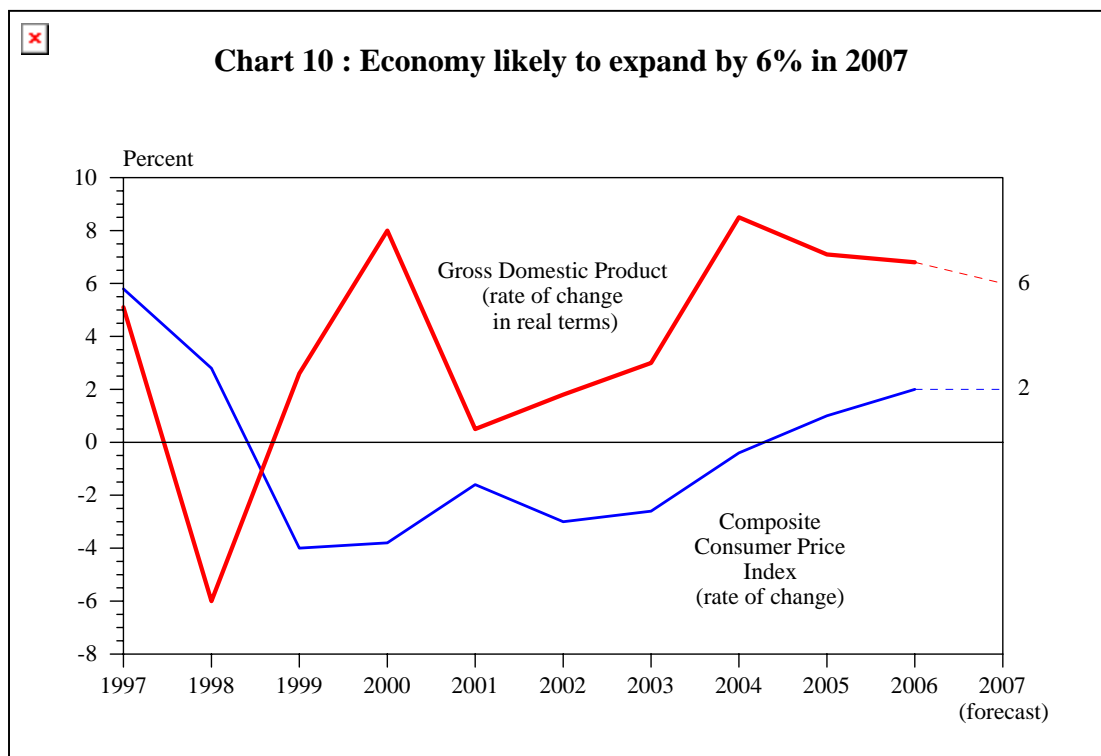


11. With a sustained strong economic upturn, inflation has been climbing up gradually. In the first ten months of 2007, the headline CPI inflation averaged at 1.7% year-on-year, and the underlying inflation at 2.6% after netting out the effects of the rates concession and public rental waiver in February (*Chart 9*). External cost pressures are increasing, with the pick-up in food inflation globally, the weak US dollar and the accompanying appreciation of RMB, as well as the resurgence of oil prices. The upward price pressures from the increases in wages and rentals on local business costs, however, have remained largely in check, with unit labour cost being tamed by sustained increases in productivity, and unit rental cost also being contained by solid expansion in business volume.



Updated short-term economic forecasts for 2007

12. With the strong outturn of a 6.1% GDP growth in the first three quarters of 2007 and given the prevailing strength in domestic demand, the Hong Kong economy should be able to attain a 6% growth in real terms for 2007 as a whole (*Chart 10*). Barring any abrupt adverse changes in the external environment, the economy looks set for further strong growth in the fourth quarter.



13. The headline inflation rate is expected to go higher in the fourth quarter, due to the dissipation of the favourable effect of the rates concession after September, the persistent rapid increase in food prices, and the factors mentioned in paragraph 11 above. For 2007 as a whole, Composite CPI inflation is forecast at 2%. The corresponding forecast underlying inflation rate, which discounts the effects of rates concession and public housing rental waiver for February, would be 2.7% for 2007 as a whole.

Economic outlook for 2008

14. The 2008 economic outlook for Hong Kong, given its openness, necessarily hinges crucially on how the global economy would fare. While the global credit market turbulence left the Hong Kong economy relatively unscathed so far, the external trading environment has turned more uncertain. The repercussions of the credit market turbulence have yet to be fully played out. Also, the US economy, which is being overshadowed by the housing market slump, sub-prime mortgage problem and tightening credit, poses as the main downside risk to global economic growth in the coming months.

15. Barring an unexpectedly steep recession in the US, there

are still certain important positive developments which would render some support to Hong Kong's external trade. The strong growth momentum in the Mainland economy is likely to continue. Currently the Mainland market accounts for almost half of Hong Kong's total exports. Many other emerging Asian markets have been doing well, and the economic prospects in Europe have also remained positive. The depreciation of the HK dollar against many of the Asian currencies should continue to help Hong Kong's export competitiveness.

16. Moreover, the sustained economic upturn locally has placed Hong Kong on a much sounder footing than before. Consumer demand is well underpinned by better labour market, rising incomes and strong household financial positions. Business sentiment also stays strong, against the backdrop of a successful economic integration between Hong Kong and the Mainland. Domestic demand can be expected to provide support to overall economic growth in 2008, at a time when the trade outlook is subject to more uncertainties.

17. Inflationary pressures are likely to build up further in the near term, particularly if the economic upturn continues to proceed at an above-trend pace. The inflation prospects for 2008 will also depend on whether the weakness in US dollar and the accompanying renminbi appreciation would continue, and whether the recent rapid increases in global food and oil prices would persist. More attention should also be paid to local wage and rental increases, and how far such increases could be absorbed by sustained labour productivity growth thus reducing the risk of a significant pick-up in inflation. The rates concession for the first quarter of 2008 announced in the Policy Address would help lower the Composite CPI inflation in 2008 by 0.3 percentage point. The Government will continue to stay alert to the upside risks to inflation, particularly in view of the impact of escalating costs on people in the lower economic strata of the community.

18. Overall, the Hong Kong economy is likely to expand further in 2008, although the growth pace should be slower than that achieved over the past four years. The economic forecast for 2008 will be announced along with the Budget Speech in February next year. As a reference, the IMF's latest 2008 economic growth forecast for Hong

Kong is 4.7%. Most private sector analysts also expect the Hong Kong economy to show further solid growth in 2008, with prevailing forecasts averaging at around 5.1%.

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Recent situation of household income⁽¹⁾

Background

This Annex provides regular updates on the movement of household income both in overall terms and with respect to households with monthly household income below \$4,000.

Latest situation

2. Supported by further growth in jobs and labour earnings, household income continued to increase generally over the past few months. Average monthly household income in Q3 2007, at \$25,700, was 6.0% higher in money terms than a year earlier. After discounting price changes, the gain was 4.3% in real terms. Also worth noting is that the share of households with monthly income less than \$24,000 (at current prices) decreased over the past year, while the share of households with \$24,000 or above rose (*Table 1*).

Table 1: Distribution of domestic households by monthly household income

	<u>Q3 2004</u>	<u>Q3 2006</u>	<u>Q3 2007</u>
	(%)	(%)	(%)
Less than \$4,000	8.6	8.0	7.7
\$4,000 - \$7,999	14.1	13.0	12.6
\$8,000 - \$11,999	14.8	14.2	13.5
\$12,000 - \$15,999	13.2	12.6	12.4
\$16,000 - \$23,999	17.1	18.2	17.7
\$24,000 - \$39,999	17.8	18.7	19.0
\$40,000 - \$99,999	12.3	12.9	14.4
\$100,000 or above	2.0	2.4	2.7

Note : The purchasing power of the income (as measured by the Composite CPI) in Q3 2004 and Q3 2006 were 105% and 102% of that in Q3 2007 respectively.

(1) Foreign domestic helpers are not included in this analysis.

Households with monthly household income below \$4,000

3. In Q3 2007, the number of households with monthly household income below \$4,000 (“low-income households”) dropped by 4 300 (or 2.4%) over a year earlier to 173 600. Decreases were observed across different types of low-income households. In particular, the number of economically inactive low-income households (i.e. with all members being economically inactive) posted a more notable decline, after rising for five consecutive years. This is likely a reflection of an increase in labour force participation rate alongside the further improvement in unemployment situation especially among lower-skilled workers (their overall unemployment rate dropped from 5.4% in Q3 2006 to 4.4% in Q3 2007). The number of elderly (i.e. with all members aged 60 or above) and economically active (i.e. with at least one economically active household members) low-income households also continued to fall. Taken together, the proportion of low-income households in all domestic households edged down from 8.0% in Q3 2006 to 7.7% in Q3 2007.

4. Comparing Q3 2007 with Q3 1997, although there was still a rise in the low-income households in both absolute and proportional terms, it was mainly driven by a significant increase in the number of retired elderly households and a decline in the average household size (*Table 2*).

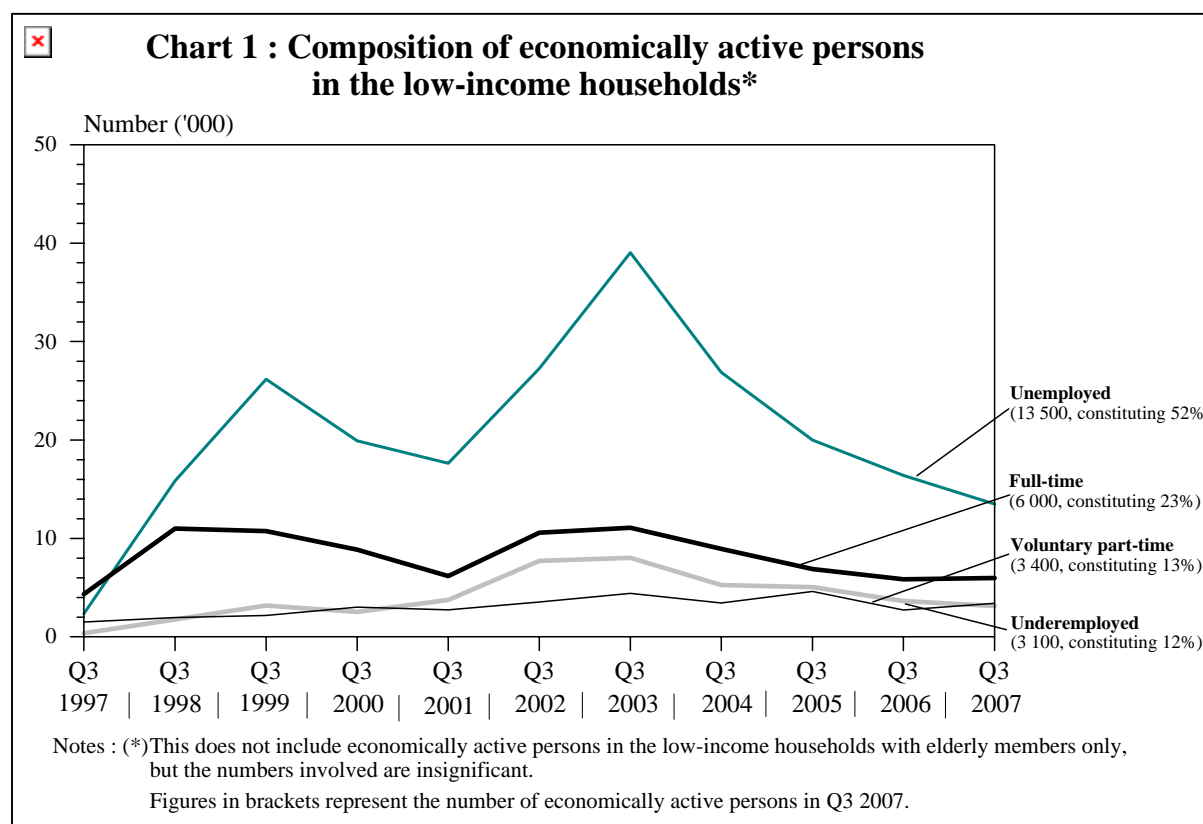
Table 2: Number and share of low-income households

	<u>Elderly households</u>	<u>Economically inactive households</u>	<u>Economically active households</u>	<u>Total</u>
Q3 1997	62 700 (3.3)	15 300 (0.8)	7 500 (0.4)	85 600 (4.4)
Q3 2004	115 700 (5.3)	32 700 (1.5)	38 000 (1.7)	186 400 (8.6)
Q3 2005	119 700 (5.5)	34 500 (1.6)	31 900 (1.5)	186 100 (8.5)
Q3 2006	115 000 (5.2)	37 900 (1.7)	25 000 (1.1)	177 900 (8.0)
Q3 2007	114 800 (5.1)	35 100 (1.6)	23 700 (1.1)	173 600 (7.7)

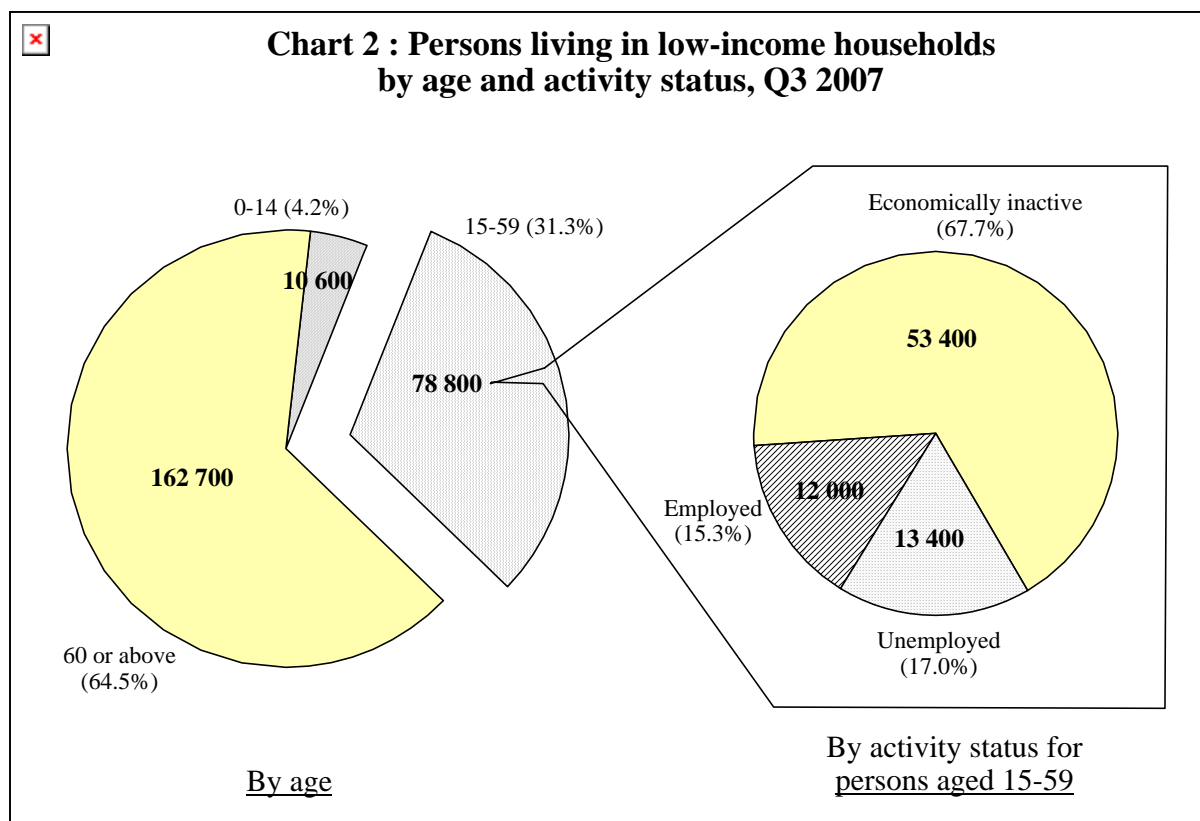
Note : () Share in all domestic households.

5. A further breakdown of the low-income households yielded the following salient observations:

- Two-thirds of the low-income households in Q3 2007 were 1-person households, the majority of which (78%) were elderly persons aged 60 or above.
- There were 64 300 household members living in economically inactive low-income households. More than one-third (35%) of them were aged below 20 and aged 60 or above (mainly students and retirees). The bulk of the remaining 41 500 persons aged 20-59 were home-makers (26%), persons suffering prolonged illness (17%) and retirees (23%).
- Of the 26 000 economically active persons living in economically active low-income households, 52% were unemployed, 25% were part-time workers (working voluntarily for less than 35 hours per week, or involuntarily, i.e. underemployed), and the remaining 23% were full-time workers. The notable decline in the number of these household members over the past few years suggested that some of them had earned higher income, thus moving up to household groups of higher income (*Chart 1*).



- With regard to the 252 100 persons living in low-income households in Q3 2007, a significant portion (64.5%) were elderly persons aged 60 or over. Nearly one-third of them were aged 15-59, of whom over two-thirds were economically inactive (*Chart 2*).



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