



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

The Government released the Third Quarter Economic Report 2009 in mid-November. The Economic Report, together with the press release containing the updated economic forecasts for the whole year of 2009, 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 2009 as a whole, and briefly discusses the various factors which may affect the outlook in 2010.

Economic Analysis Division  
Economic Analysis and Business Facilitation Unit  
Financial Secretary's Office  
30 November 2009

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

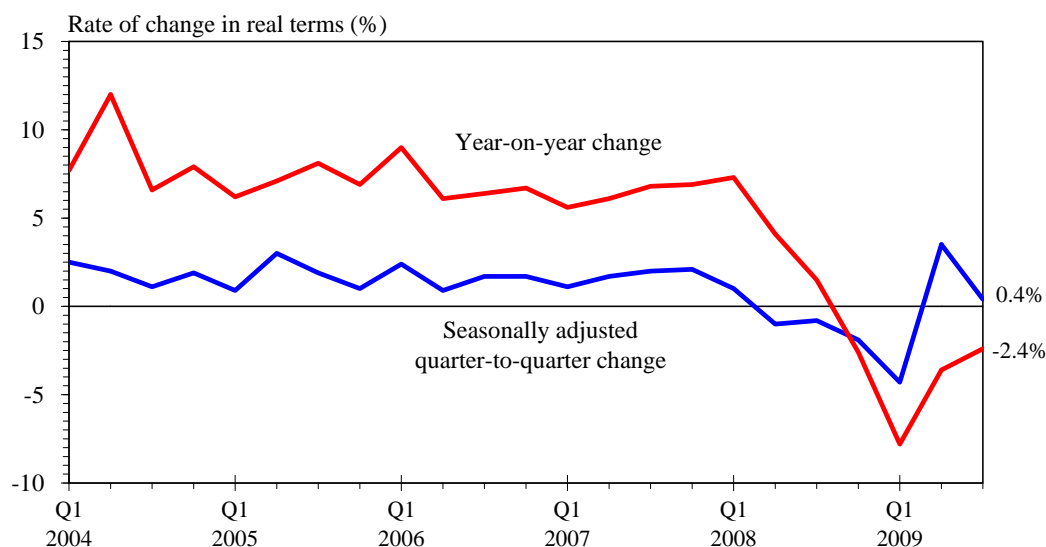
## Introduction

This paper analyses the latest developments in the Hong Kong economy and briefly discusses the updated economic forecasts for 2009 as a whole and the economic outlook for 2010.

## Recent economic situation

2. The Hong Kong economy has entered the nascent stage of recovery. Real GDP expanded further by 0.4% in the third quarter on a seasonally adjusted quarter-to-quarter basis, after a notable rebound in the second quarter, leading to a further tapering of the year-on-year decline from 3.6% to 2.4% (*Chart 1*). The performance in the third quarter was led mainly by further improvement in the domestic sector, offsetting the drag from the weak external demand.

**Chart 1 : Overall situation of the Hong Kong economy improved further in the third quarter**

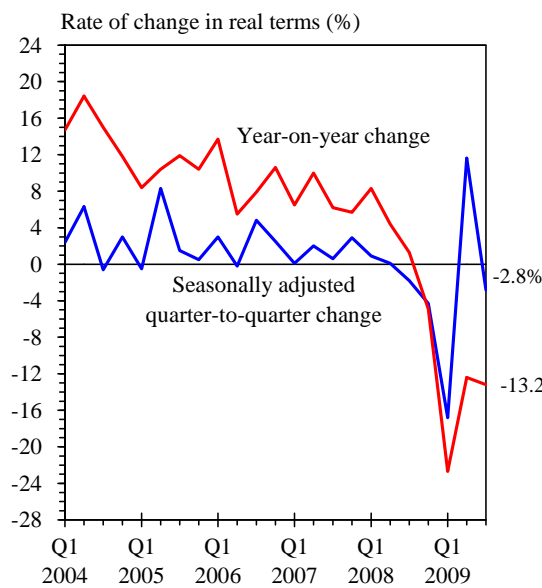


3. Total exports of goods continued to fall notably by 13.2% in real terms year-on-year in the third quarter of 2009, following the decline of 12.4% in the preceding quarter (*Chart 2(a)*). Although the global economy had entered the initial stage of recovery, import demand in the advanced economies remained sluggish and continued to weigh heavily on exports of Asian economies.

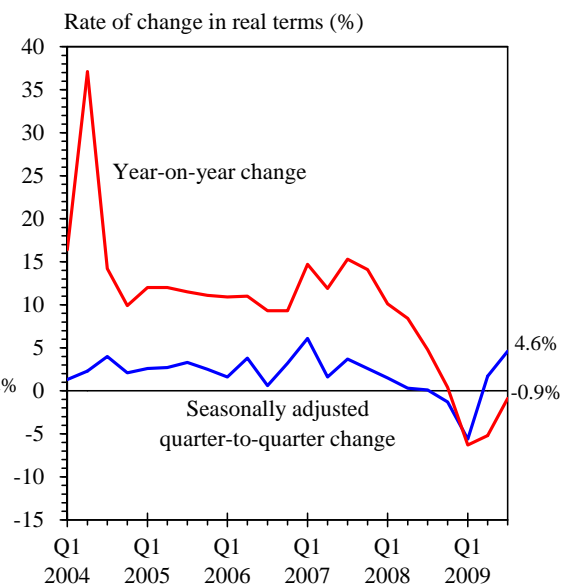
Indeed, many other Asian economies continued to record double-digit declines in exports in the quarter.

4. Exports of services showed a visible improvement in the third quarter of 2009. On a seasonally adjusted quarter-to-quarter basis, exports of services expanded rapidly by 4.6% in the third quarter, with a distinct tapering in the year-on-year rate of decline to just 0.9%, from that of 5.2% in the second quarter (*Chart 2(b)*). Exports of financial services continued to improve alongside the further revival in financial market activities. Exports of travel services likewise reverted to an increase, thanks to a rebound in visitor arrivals. Yet exports of transportation services and trade-related services were still weak, under the drag of the much slackened trade flows in goods.

**Chart 2(a) : Total exports of goods remained on a notable decline in the third quarter of 2009**



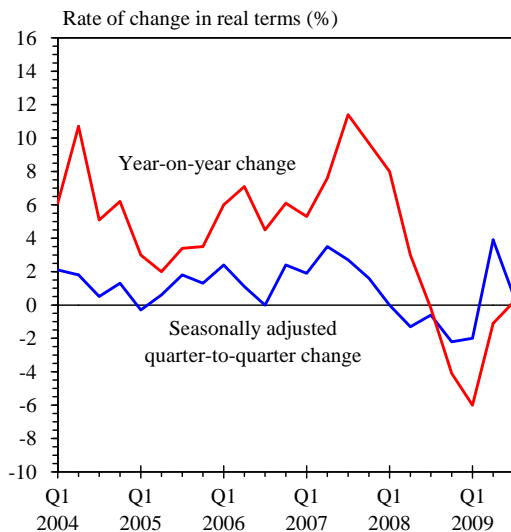
**Chart 2(b) : Exports of services displayed more resilience**



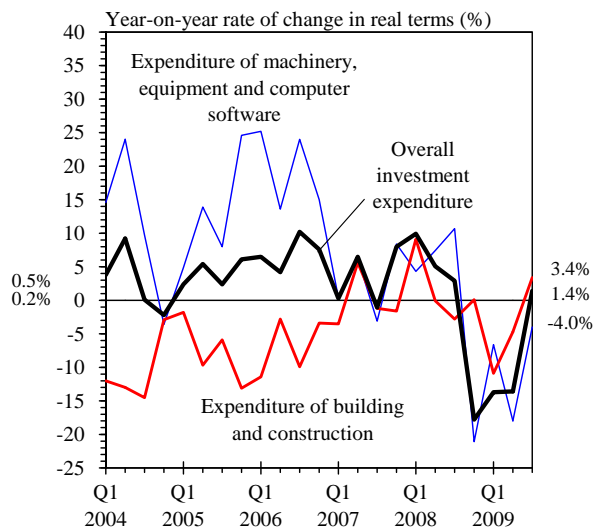
5. Local consumer sentiments revived further in the third quarter, riding on a stabilised labour market, and aided by the Government's several rounds of relief measures and favourable asset market conditions. Private consumption expenditure expanded further by 0.5% in real terms in the third quarter on a seasonally adjusted quarter-to-quarter basis, after a strong rebound in the second quarter. The year-on-year change also reverted to a small increase of 0.2%, after falling for four consecutive quarters (*Chart 3(a)*).

6. Overall investment spending reverted to a small increase of 1.4% in the third quarter over a year earlier, after three quarters of double-digit declines. Expenditure on building and construction rose by 3.4% in the same quarter, arresting the decline of 4.7% in the second quarter (*Chart 3(b)*). This was driven by a 34.4% surge in public sector construction work as the Government’s efforts to expedite public sector projects began to show effect. The year-on-year decline in machinery and equipment investment also eased notably to 4.0% in the third quarter. In general, business sentiments turned up distinctly in the third quarter, with the latest Quarterly Business Tendency Survey results showing the first positive net balance on near-term business prospect since the global financial crisis last year.

**Chart 3(a) : Private consumption resumed growth in the third quarter**

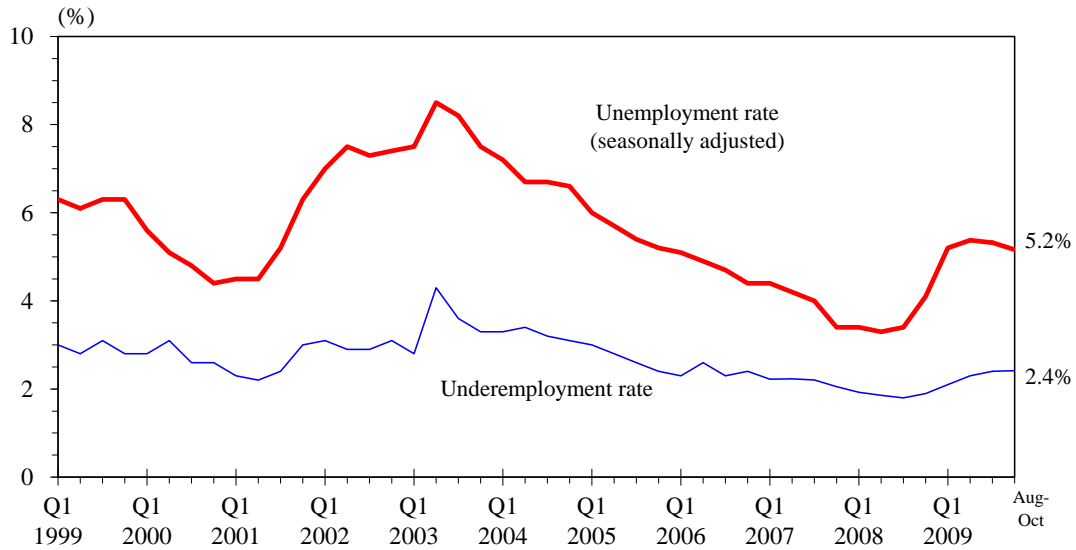


**Chart 3(b) : Overall investment reverted to an increase as business sentiments turned more upbeat**



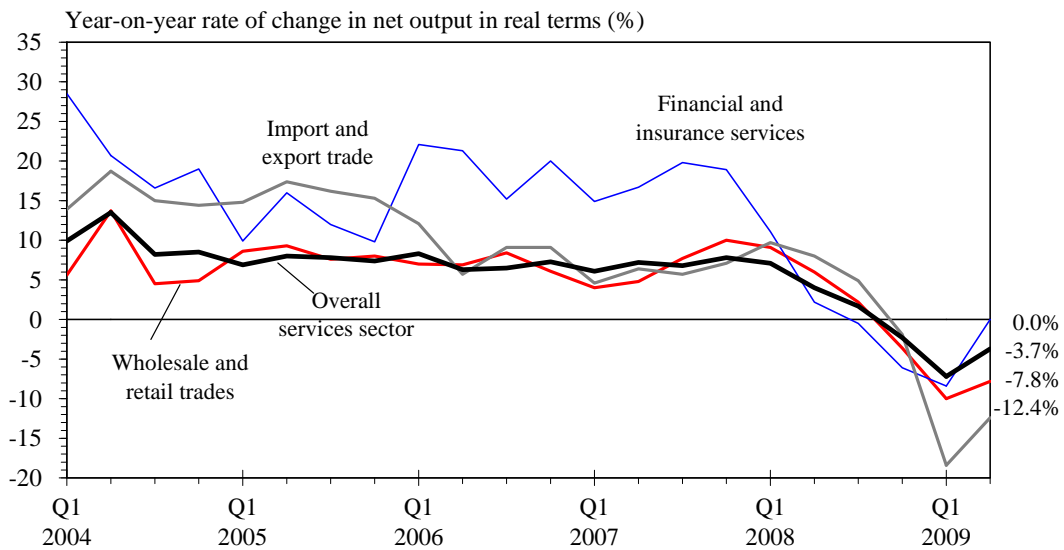
7. Labour market showed signs of improvement after a period of successive worsening since late 2008. The seasonally adjusted unemployment rate showed the first decline in the third quarter since the onset of the global financial crisis, and edged down further to 5.2% in August-October 2009 (*Chart 4*). Yet total employment was still falling, suggesting that it may take some time for the labour market to keep up with the pace of economic rebound.

**Chart 4 : Labour market showed initial signs of improvement after a period of successive worsening since late 2008**



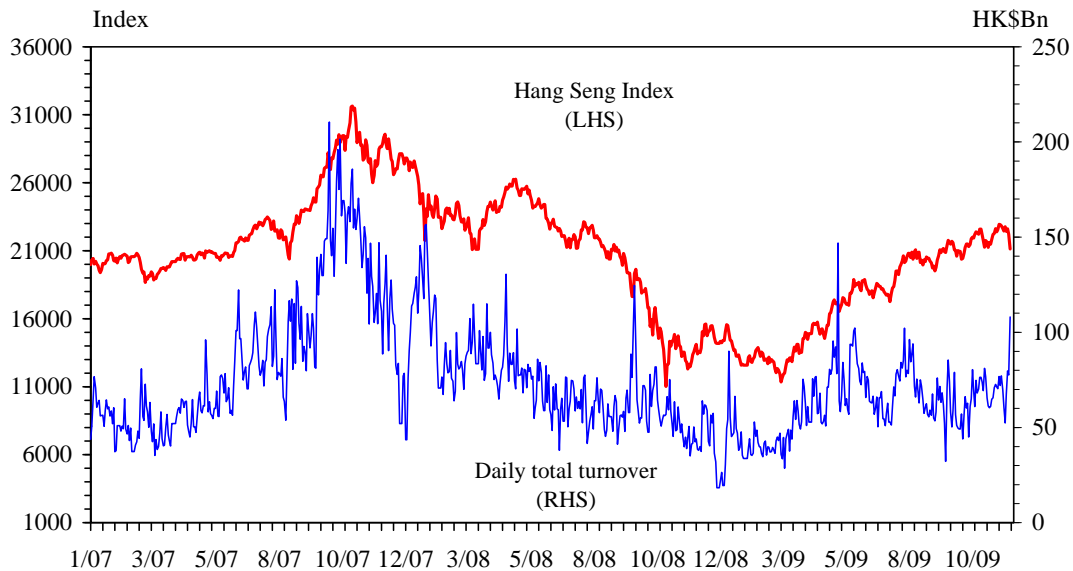
8. The services sector accounts for over 90% of the economy. Latest available figures indicate that net output of the services sector as a whole declined notably less by 3.7% in the second quarter over a year earlier as compared to the 7.2% decline in the first quarter. In fact, many service sectors showed relative improvements in the second quarter. Among the major service sectors, import and export trade still showed the largest decline in net output, followed by transport and storage, restaurants and hotels, and wholesale and retail trades. On the other hand, net output of financing and insurance, real estate, and business services held largely stable on a year-on-year comparison. Net output of the manufacturing sector fell markedly again, while construction output declined only modestly, thanks to a strong rebound in the public sector segment (*Chart 5*).

**Chart 5 : Services sector showed relative improvement in the second quarter**



9. Amidst the low interest rate environment consequential to the quantitative easing around the world, and boosted further by signs of recovery in the global economy, the earlier market risk aversion sentiment subsided, leading to a continued inflow of funds into asset markets in Asia. The local stock market has seen a strong rebound since March 2009, and rallied further in the third quarter. The Hang Seng Index (HSI) rose to a 17-month high of 22 944 on 16 November 2009, 25% higher than at end-June 2009 and 108% up from the trough in October 2008. The local stock market then saw another round of major correction along with the global stock market plunge towards the end of November. On 26 November, the announcement of a standstill in debt payment by Dubai World triggered renewed turmoil in the financial markets around the world. The HSI closed at 21 135 on 27 November, down 5% in a single day. On the daily turnover front, it averaged at \$61.7 billion in the first ten months of 2009, still 20% lower than a year earlier (*Chart 6*). There had been a notable revival in IPO activities since September 2009. In the first ten months of 2009, a total of \$107.2 billion was raised through IPOs, of which \$79 billion was raised in September and October.

**Chart 6 : HSI showing renewed volatility again towards end-November**



10. The residential property market firmed up further in the third quarter of 2009. The total number of sale and purchase (S&P) agreements for residential property received by the Land Registry jumped by 89% over a year earlier to 35 558 in the third quarter (*Chart 7(a)*), but the rate of increase was exaggerated by a low base of comparison when the property market was hard hit by the global financial crisis. This was also partly due to the realisation of pent-up demand that had been held back amidst the immense economic uncertainties in the first half of this year. Taking the first nine months of 2009 as a whole, the total number of S&P agreements went up by only 5% over a year earlier, with those of luxurious flats posting a more distinct increase.

11. Sale prices of residential property rose further by 7% between June and September 2009. Compared with December 2008, there was a cumulative gain of 23%, but this should be viewed against the sharp fall of 17% between June and December 2008 when the market came under the severe shocks from the global financial crisis. As a result, overall flat prices in September have only slightly exceeded the peaks in June 2008. Analysed by the size of property, prices of small/medium-sized flats in September were only 3% higher than the peaks in 2008, while those for large flats were broadly the same. Having fallen by a cumulative 23% between July 2008 and March 2009, flat rentals began to pick up in April and rose by a further 6% between June and September. Yet compared with the peaks in 2008, flat rentals in September

were still 14% lower (*Chart 7(b)*).

12. While the exorbitant prices fetched by some luxurious flats in the primary market were particularly eye-catching, it is worth noting that the luxury end accounted for only 1-2% in terms of both the stock and transactions. Indeed, nearly 90% of all transactions in the secondary market in the first nine months of 2009 fell in the category of flats with a saleable area of less than 70 square metres. Transactions for flats valued at over \$10 million amounted to less than 6% of total transactions. Also reflecting the combined effects of property prices, income and mortgage rate, the home purchasing affordability (i.e. the ratio of mortgage payment for a 45-square metre flat to median household income, excluding those living in public housing) notched up to 36% in the third quarter of 2009, but still notably lower than the average of 53% over the past 20 years. The level of speculative activities in the first nine months of this year was still slightly lower than the average in the past five years, indicating that the market was largely end-user led.

13. With a view to maintaining banking stability and enhancing banks' risk management on mortgage lending to high end residential properties, the HKMA advised banks on 23 October 2009 to cap the loan-to-value ratio at 60% for residential properties valued at \$20 million or more and set the maximum loan amount at \$12 million for mortgages on properties valued at below \$20 million. The HKMA also reminded lenders to be prudent in valuating properties and calculating borrowers' debt servicing ratios. Initial signs suggested that the property market have eased back somewhat as a consequence. In particular, potential home buyers have turned more cautious following the cumulative sharp rise in property prices in the preceding months. The number of sale and purchase agreements of residential property dropped by 24% in October from September. The overall property prices have tended to stabilise as well.

14. The Government's policy is to maintain a fair and stable environment to enable a sustainable and healthy development of the property market. It is the Government's wish to see the market develop naturally, adjusting and regulating by itself according to the market force. The Government is mindful that sharp fluctuations in property prices could affect macroeconomic stability and social stability, and hence will act prudently when it becomes necessary to consider appropriate measures to stabilise the property market. As the Chief Executive pointed out in the Policy Address, the Government will closely monitor the development and changes, including factors on supply and demand,



in the private property market in the coming months. When necessary, the Government will fine-tune the land supply arrangements and discuss with the Urban Renewal Authority and MTR Corporation Limited with a view to quickening the pace of bringing readily available residential sites to the market. The Government is of the view that developers should ensure and enhance market transparency when launching new projects for sale.

### Chart 7 : The residential property market eased back somewhat in October

Chart 7(a) : Transaction in property market fell by 24% in October

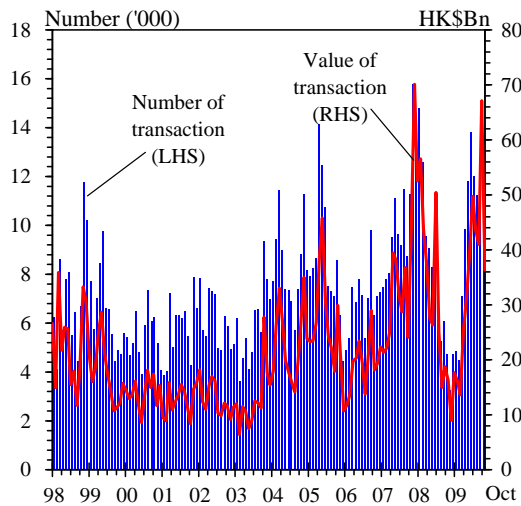
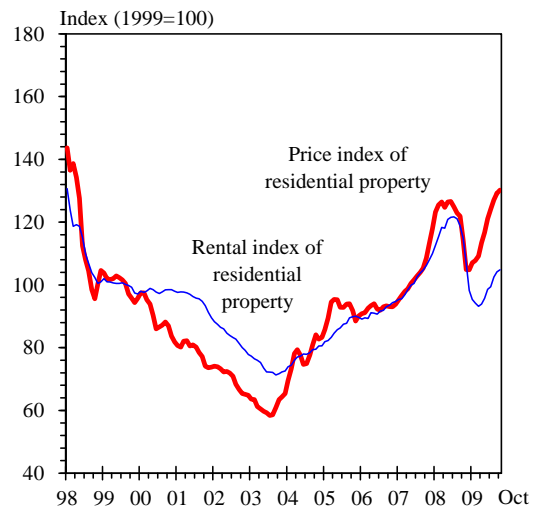
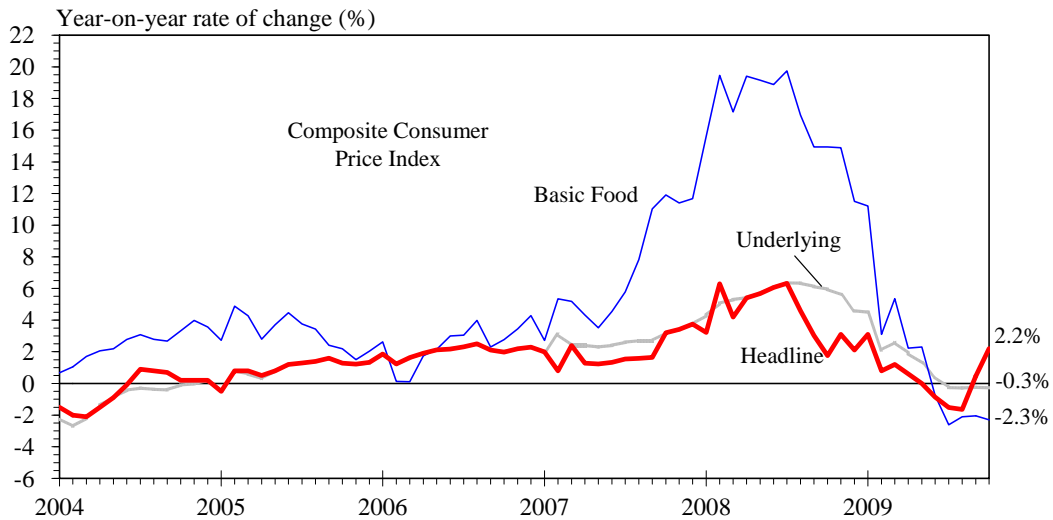


Chart 7(b) : Property prices have broadly stabilised recently



15. Inflationary pressure basically subsided, as local business costs were contained and import prices softened in the aftermath of the global financial tsunami. Headline Composite Consumer Price Index declined by 0.9% in the third quarter from a year earlier, yet the index for September reverted to an increase of 0.5%, as the effects of the Government's subsidy on electricity charges began to fade out. In October, headline inflation went up further to 2.2%, due to the low base of comparison resulting from the Government's payment of public housing rentals and the electricity charge subsidy in October last year. After netting out the effects of Government's one-off relief measures, underlying consumer price inflation turned slightly negative in July, and held steady at the -0.3% level from July to October (*Chart 8*).

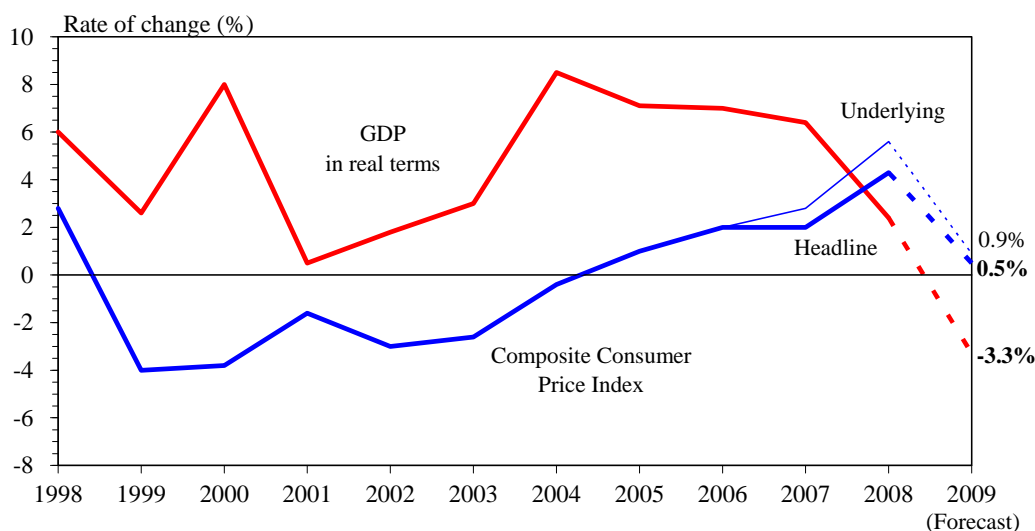
**Chart 8 : Inflationary pressure remained subdued**



**Updated short-term economic forecasts for 2009**

16. With export orders bouncing back somewhat, exports are expected to show some relative improvement in the fourth quarter. Local consumption and investment are also likely to pick up further. Given a relatively low base of comparison in the final quarter of last year when the economy began to dip into year-on-year contraction, the economy is likely to resume a year-on-year growth by the fourth quarter. GDP for 2009 as a whole is now forecast to contract by 3.3% in real terms, revised up from the earlier forecast decline of 3.5-4.5% in the August round (*Chart 9*).

**Chart 9 : Economy is forecast to contract by 3.3% in 2009**



17. On inflation outlook, both local and external price pressures are virtually absent, as local costs remain contained and as the supply capacity of the global economy still out-runs demand by a sizable margin. Nevertheless, the underlying deflationary pressure had tended to stabilise in recent months on a seasonally adjusted basis, and hence the deflationary pressure facing the economy has been relatively contained thus far. With the development on the price front largely in line with the earlier expectations, the forecast headline and underlying consumer price inflation rates are at 0.5% and 0.9% respectively for 2009 as a whole, same as the forecasts in the August round.

### **Economic outlook for 2010**

18. Following the exceptionally large stimulus measures by governments and central banks to shore up demand and stabilise the financial markets, the global economy is finally expanding again. The improvement has been more evident in Asia, with the Mainland economy taking the lead in the return to a faster growth path. Against this backdrop, many international organizations have revised upwards their global economic forecasts for 2010. Specifically, the International Monetary Fund (IMF) revised upwards its global growth forecast for 2010 from 2.5% to 3.1% in October. Yet this growth rate is still far below the growth rates achieved before the global financial crisis, a reflection of the various uncertainties in the external environment. Nevertheless, as the recessionary pressures on the global economy subside and

the global economy grinds through a slow recovery, together with the expected inventory restocking by overseas buyers, Hong Kong's exports should progressively stabilise going forward.

19. Yet Hong Kong's economic recovery next year is still subject to downsides, especially when the advanced economies currently are still being single-handedly supported by large fiscal measures. It remains to be seen whether the global economic recovery can be sustained after the effects of these temporary stimulus measures wane. The "toxic assets" in the US and European financial systems, the deleveraging process that is needed to restore health in the banking sector, the timing and pace of exit strategies by the governments of major economies, and the potential rise in protectionism are key risk factors that have to be closely watched over. On the domestic front, the continuous inflow of funds has also increased the risk of an asset market bubble. Lately, a standstill announcement in debt payment by Dubai World and the ensuing turmoil in the financial markets is a timely reminder that the risks of the financial turmoil are still very real. In the light of this, the Government is closely monitoring the situation of asset markets, with a view to stepping up macroeconomic prudential measures and risk management from a forward looking perspective. The Government will also ensure the smooth running and high degree of transparency in the markets, so as to forestall the risk of undue gyrations in the local economy.

20. Overall, granting no major relapse in the global economy to the extent of disrupting the recovery process now in Asia, the Hong Kong economy is poised to return to positive annual growth in 2010. However, judging from the current situation in the external environment, the pace of growth of the Hong Kong economy next year is likely to be weaker-than-usual. Fortunately, the expected pick-up in momentum in the construction of infrastructure projects should add some impetus to Hong Kong's recovery process and provide some cushion against the expected weakness in the external sector which should yet to fully recover by then. The Government will closely monitor the developments in the coming months and announce the economic forecast for 2010 along with the Budget Speech in February next year. As a reference, the IMF's latest 2010 economic growth forecast for Hong Kong is 5%, while the private sector analysts' prevailing forecasts average at around 4%.

21. As to the inflation outlook for 2010, both local and external price pressures are virtually absent in the aftermath of the financial tsunami, and short-fall in demand relative to supply capacity in the global economy will remain in place for some time. Against this background, inflation is likely to remain subdued during most of 2010. The IMF's latest inflation forecast for Hong Kong next year is 0.5%.

Economic Analysis Division

Economic Analysis and Business Facilitation Unit

Financial Secretary's Office

30 November 2009

## Recent situation of household income<sup>(1)</sup>

### Background

This Annex provides a regular update 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. Household income showed almost an across-the-board decline in the third quarter of 2009 compared to a year earlier, reflecting the impact of the recession and the ensuing drag on income across almost all segments of the economy. With the general downshift in income distribution, the proportion of households with average monthly income below \$4,000 (at current price), \$4,000-\$7,999, \$8,000-\$11,999 and \$12,000-\$15,999 all reverted to an increase over this period, while the shares of households with \$16,000 or above, regardless of their income intervals, correspondingly declined quite visibly (*Table 1*).

**Table 1: Distribution of domestic households by monthly household income**

	<u>Q3 2006</u>	<u>Q3 2008#</u>	<u>Q3 2009</u>
	(%)	(%)	(%)
Less than \$4,000	8.0	6.8	7.6
\$4,000 - \$7,999	13.0	12.2	12.7
\$8,000 - \$11,999	14.2	12.8	13.5
\$12,000 - \$15,999	12.6	12.1	12.5
<b>\$16,000 - \$23,999</b>	<b>18.2</b>	<b>18.1</b>	<b>17.5</b>
<b>\$24,000 - \$39,999</b>	<b>18.7</b>	<b>19.6</b>	<b>18.9</b>
<b>\$40,000 - \$99,999</b>	<b>12.9</b>	<b>15.4</b>	<b>14.5</b>
<b>\$100,000 or above</b>	<b>2.4</b>	<b>3.0</b>	<b>2.8</b>

Notes: The purchasing power of the income (as measured by the Composite CPI) in Q3 2006 and Q3 2008 were 105% and 99% of that in Q3 2009 respectively.

# Statistics in 2008 have been revised to take into account the results of the revised population.

---

(1) Foreign domestic helpers are excluded from the analysis.

### Households with monthly household income below \$4,000

3. In the third quarter of 2009, the number of households with monthly household income below \$4,000 (“low-income households”) increased notably by 20 700 (or 13.3%) over a year earlier to 177 000. With the onset of the economic recession, the unemployment rate of lower-skilled workers shot up from 3.8% in a year earlier to 5.8% in the third quarter of 2009, thereby leading to a distinct rise-back in the number of economically active low-income households (i.e. with at least one economically active household member). Meanwhile, the number of economically inactive low-income households (i.e. with all members being economically inactive) and elderly low-income households (i.e. with all members aged 60 or above) also increased. Taken together, the proportion of low-income households in total domestic households increased from 6.8% to 7.6%.

4. Yet, when comparing with the picture ten years ago, the proportion of low-income households in total domestic households actually fell, thanks to the distinct improvement in income of economically active households during the strong economic upturn between 2004 and mid-2008, which enabled these households to leave the low-income bracket. The share of elderly low-income households was nearly 60% and that of economically inactive low-income households over 20%. Their numbers have both increased over time. These mainly reflected the demographic phenomenon of ageing population, featured by a visible increase in the number of retired elderly households. Indeed, 62% of low-income households were 1-person households, of which the majority (75%) were elderly persons aged 60 or above (*Table 2*).

**Table 2: Number and breakdown of low-income\* households**

	<u>Elderly households</u>	<u>Economically inactive households</u>	<u>Economically active households</u>	<u>Total</u>
Q3 1999	97 800 (4.9)	26 100 (1.3)	36 800 (1.8)	160 600 (8.0)
Q3 2006	115 000 (5.2)	37 900 (1.7)	25 000 (1.1)	177 900 (8.0)
Q3 2007	115 700 (5.2)	35 100 (1.6)	23 700 (1.1)	174 400 (7.8)
Q3 2008#	102 000 (4.5)	33 200 (1.5)	21 100 (0.9)	156 300 (6.8)
Q3 2009	106 000 (4.6)	39 800 (1.7)	31 200 (1.3)	177 000 (7.6)

Notes : ( ) Share in all domestic households.

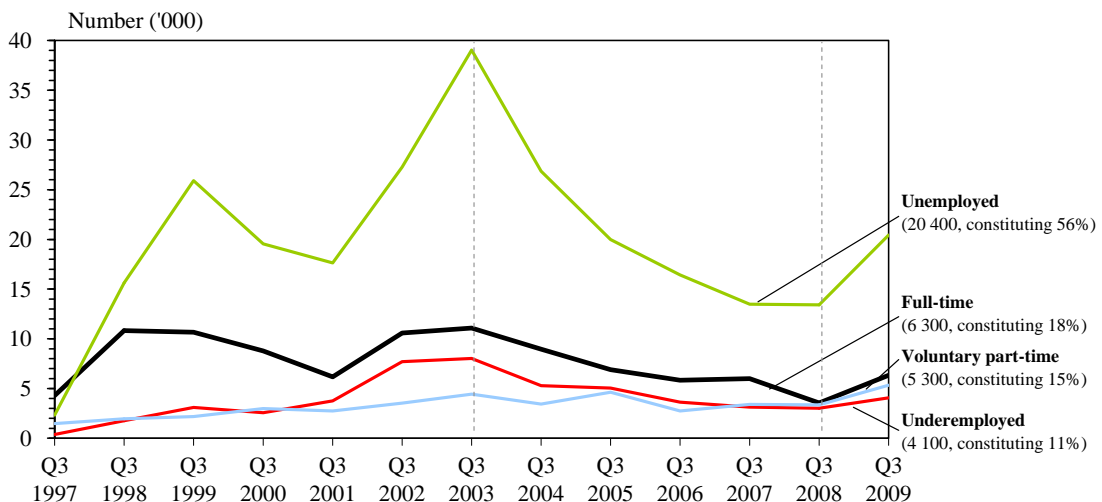
\* Low-income households refer to households with a monthly household income of \$4,000 or below.

# Statistics in 2008 have been revised to take into account the results of the revised population.

5. Further analysis of low-income households in the third quarter of 2009 yields the following observations:

- In the third quarter of 2009, 36 200 economically active persons were living in economically active low-income households, up visibly from that of 23 400 persons a year earlier. This was mainly due to a deterioration in unemployment situation, as manifested by the surge in number of unemployed persons from 13 400 to 20 400 over the period. This constituted more than one-half (56%) of total economically active persons living in economically active low-income households.
- As can be seen from **Chart 1**, the number of economically active persons living in low-income households, especially the unemployed, have moved in tandem with the economic cycle. For example, the number of unemployed persons surged successively as the economy was hit by the global economic downturn in 2001 and then by the outbreak of SARS (Severe Acute Respiratory Syndrome) in the first half of 2003; then, as the economy rebounded strongly after mid-2003, the employment situation of these people improved instantly, and as a result many people in the grassroots were able to climb out of the low-income group over the past few years. From this, it is clear that the unemployment situation in the lower segment is more affected by economic downturns, and consequently their income situation would also worsen. The numbers of part-time (working voluntarily for less than 35 hours per week, or involuntarily for the same amount of time, i.e. underemployed) and full-time employment likewise follow closely the vicissitudes of the economy. Thus, similarly, they have all risen in the third quarter of 2009 along with the economic recession.

**Chart 1 : Composition of economically active persons in low-income households\***

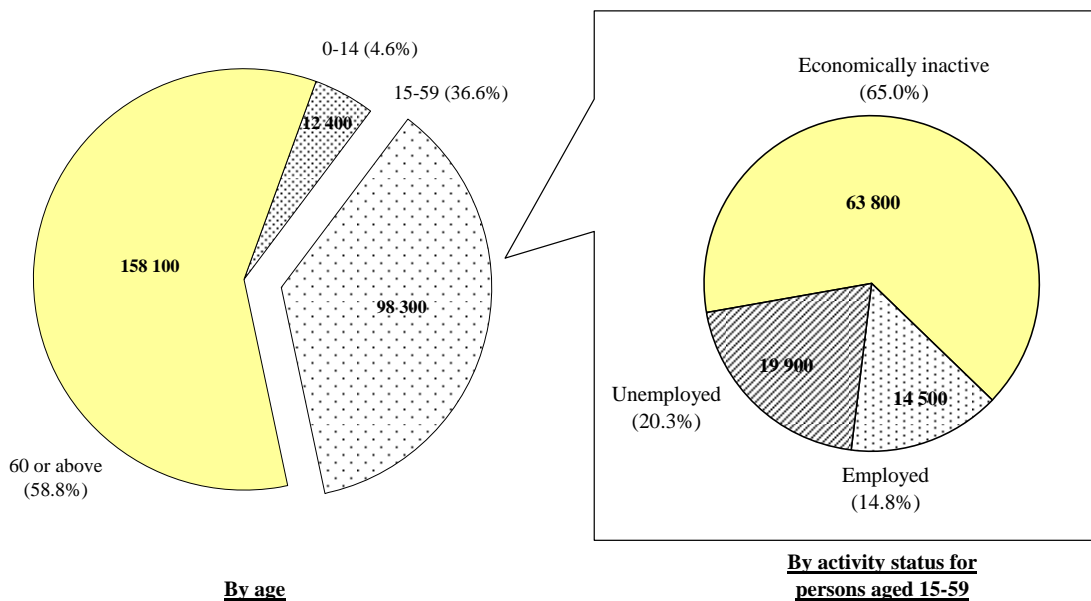


Notes : (\*) This does not include economically active persons in the low-income households with elderly members only, but the numbers involved are insignificant.  
 Figures in brackets represent the number of economically active persons in Q3 2009.



- There were 72 600 persons living in economically inactive low-income households. Among them, 24% were aged 60 and above, and most of them (93%) were retirees, while 12% were aged 20 and below (mainly students). With regard to the remaining 64% or 46 200 persons aged 20-59, 27% were home-makers, 17% were persons suffering prolonged illness and 22% were retirees.
- With regard to the 268 800 persons living in low-income households, nearly 60% were elderly persons aged 60 or over. For the 98 300 persons aged between 15-59, over two-third (65%) of them were economically inactive, while the remaining 20% and 15% were unemployed and employed persons respectively (**Chart 2**). When compared with a year earlier, the proportion of economically active persons living in low-income households (including unemployed, part-time and full-time workers) reverted to an increase. As analysed in the previous paragraphs, this was mainly a result of falling income amidst the deterioration in labour market conditions in the aftermath of the economic recession.

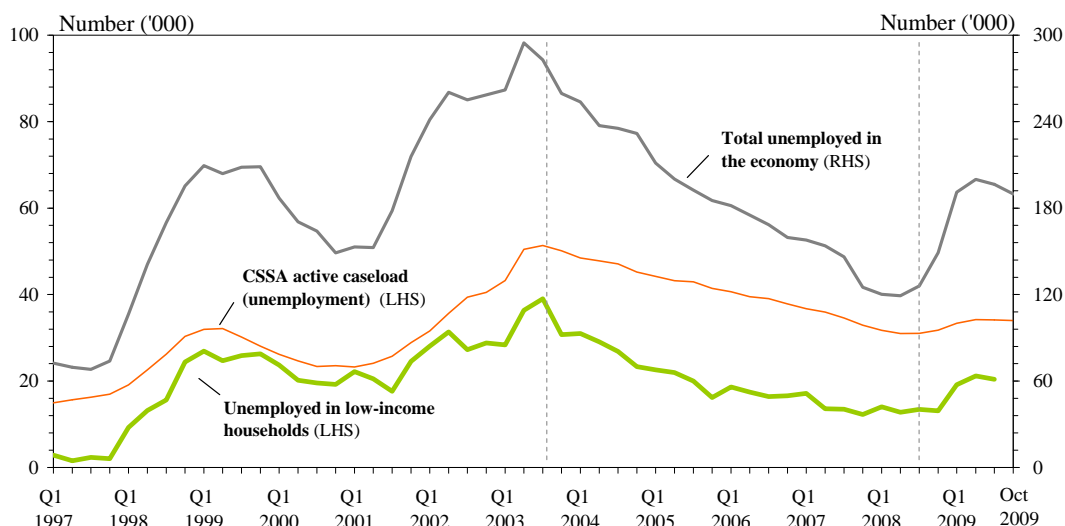
**Chart 2 : Persons living in low-income households  
by age and activity status, Q3 2009**



- Yet, in tandem with the economic rebound recently, the labour market has begun to show successive signs of improvement. The overall unemployment rate has fallen for two consecutive months, while the unemployment situation of lower-skilled workers concurrently improved slightly. Furthermore, the number of CSSA cases came down slightly in both September and October 2009 following a period of almost uninterrupted uptrend in the past year. So did the unemployment

caseload, which reverted to a consecutive month-to-month declines of 0.4% in both months (*Chart 3*). All these indicated that the basket of relief measures announced by the Government after the outbreak of global financial tsunami, including the initiatives to support job seekers and create employment, has started to bear fruits.

**Chart 3 : The relationship between the unemployed in low-income households\*, CSSA active caseload (unemployment)^, and the total unemployed in the economy**



Notes : (\*) This does not include economically active persons in the low-income households with elderly members only, but the numbers involved are insignificant.

(^) Monthly period-end figures.

- The Government attaches great importance to the situation of low-income households, and will continue to adopt a multi-prong approach through the social safety net and through stepping up various training/re-training opportunities, to help alleviate the difficulties of the grassroots. In the longer term, creating more job opportunities through promoting overall economic development would still be the most efficient and fundamental way to improve the livelihood of these people in low-income households. The Government will continue to strive to provide the low-paid and the unemployed with all the necessary employment support services, such as the “Job Matching Programme”, the “Employment Programme for the Middle-aged” and the “Work Trial Scheme”, so as to help these people rejoin the labour market. This should in turn help improve the income situation of these people.