



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

The Government released the Third Quarter Economic Report 2013 on 15 November. The Economic Report, together with the press release containing the updated economic forecasts for the whole year of 2013, 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 2013 as a whole, and provides some preliminary analysis on the outlook in 2014.

Economic Analysis and Business Facilitation Unit
Financial Secretary's Office
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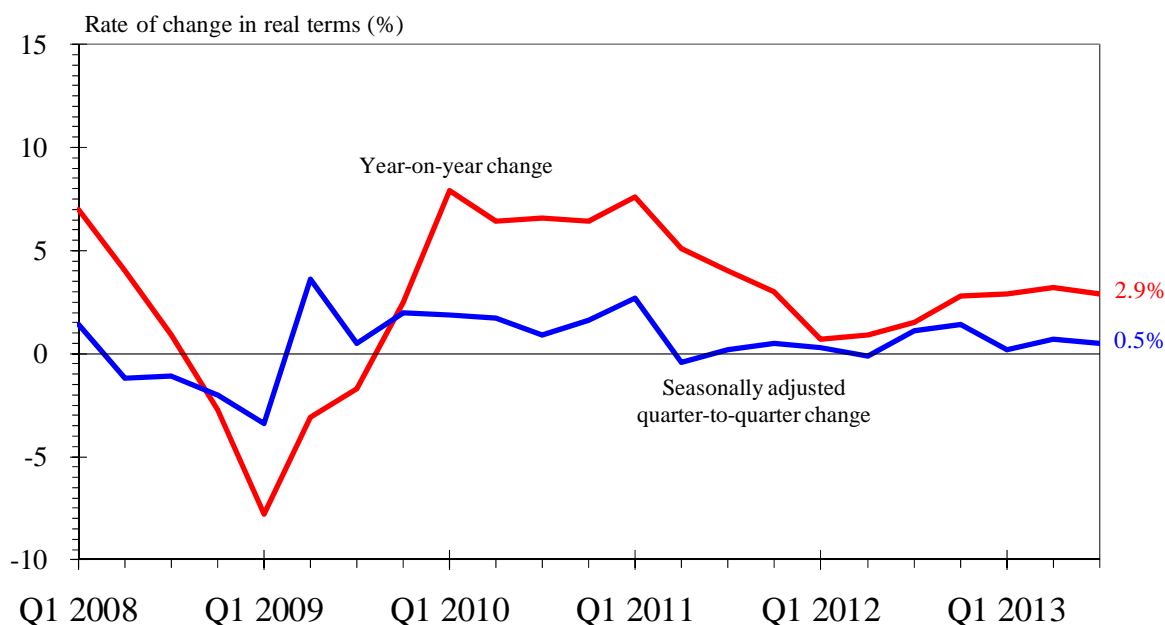
Introduction

This paper analyses the latest development in the Hong Kong economy and briefly discusses the updated economic forecasts for 2013 as a whole and the economic outlook for 2014.

Recent economic situation

2. The Hong Kong economy expanded moderately further in the third quarter of 2013, by 2.9% in real terms over a year earlier, slightly slower than the 3.2% growth in the second quarter. The external sector, with the notable exception of inbound tourism, was still constrained by the weak global economic conditions. Meanwhile, domestic demand held firm and the labour market remained in a state of full employment. On a seasonally adjusted quarter-to-quarter comparison, real GDP grew by 0.5% in the third quarter, compared to 0.7% in the preceding quarter (*Chart 1*).

Chart 1 : The economy grew moderately in the third quarter of 2013



External trade

3. The global trading environment stayed challenging. The US economy continued to expand at a moderate pace in the third quarter, dragged by the ongoing fiscal retrenchment and the job market slack. The uncertainties arising from the Fed's tapering signals and the unresolved fiscal issues also emerged as new challenges. The eurozone economy ended a six-quarter contraction in the second quarter, but the forward momentum continued to be held back by the elevated unemployment rate, lingering structural problems and austerity drive to restore economic fundamentals. The growth pace of some emerging markets, impeded by domestic capacity constraints and weaker capital flows, also slackened in recent quarters. The Mainland economy, comparatively, stayed resilient.

4. Against this background, Hong Kong's exports remained constrained in the third quarter. Total exports of goods rose by 6.2% year-on-year in real terms in the third quarter, same as that in the second quarter. Excluding the substantial increase in exports of non-monetary gold in the quarter, export performance remained modest. Merchandise exports to major advanced economies stayed weak, with those to the US and Japan registering further year-on-year declines. Exports to the EU saw a mild year-on-year growth, helped by the nascent recovery of the eurozone economy after a six-quarter contraction. Meanwhile, exports to the Mainland recorded a modest growth while the performance of major Asian markets was rather mixed. On a seasonally adjusted quarter-to-quarter basis, total exports of goods rebounded by 3.1% in real terms over the preceding quarter (*Chart 2(a)*).

5. Exports of services increased solidly by 4.9% year-on-year in real terms in the third quarter, following the notable 8.4% growth in the second quarter. Exports of travel services remained the key driving force, thanks largely to the vibrant inbound tourism. Exports of financial and other business services saw a solid growth amid further expansion of cross-border financial activity, while exports of trade-related services and those of transportation services both stayed slack, being dragged by sluggish trade flows. On a seasonally adjusted quarter-to-quarter comparison, exports of services fell back by 4.6% in the third quarter (*Chart 2(b)*).

Chart 2(a) : Total exports of goods, after excluding the surge in exports of non-monetary gold, grew modestly

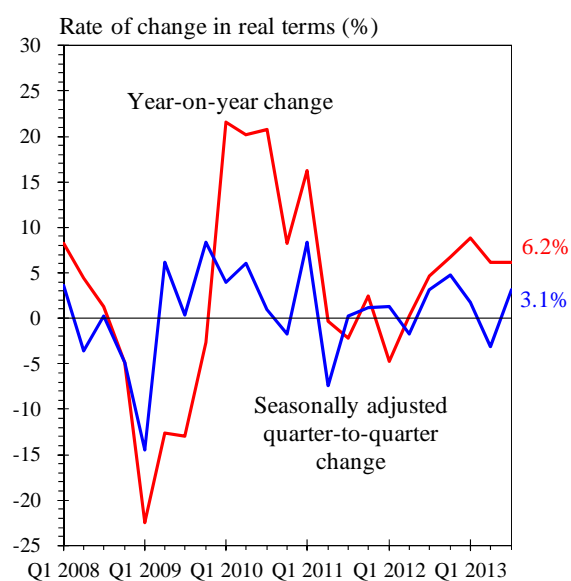
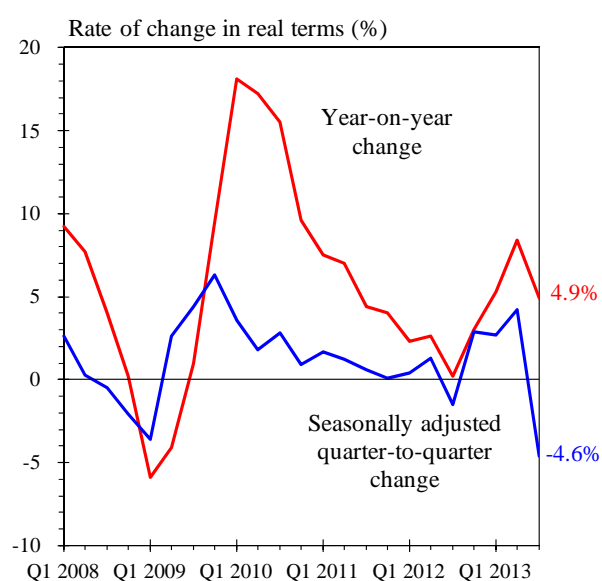


Chart 2(b) : Exports of services posted further solid year-on-year growth



6. Exports of travel services expanded strongly further by 13.6% year-on-year in real terms in the third quarter, following a remarkable 29.8% growth in the preceding quarter. The number of visitor arrivals rose visibly by 11.1% in the third quarter over a year earlier, with those from the Mainland (accounting for more than 70% of the total) increasing visibly by 15.8%, thereby rendering support to other business activities such as retail sales, transportation, hotel and catering. Those from non-Mainland markets as a whole, however, recorded a small year-on-year decline of 2.9%, reflecting the relative sluggishness in the advanced economies.

Domestic sector

7. Domestic demand expanded further. Private consumption expenditure (PCE), supported by broadly positive job and income conditions, rose by 2.8% year-on-year in real terms in the third quarter, albeit slower than the 4.2% growth in the second quarter. On a seasonally adjusted quarter-to-quarter comparison, private consumption expenditure fell by 0.8% in real terms in the third quarter (*Chart 3(a)*).

8. Overall investment spending increased by 2.2% year-on-year in real terms in the third quarter, after the notable 6.9% growth in the second quarter. Within this, machinery and equipment acquisition still recorded a solid albeit slower growth. Meanwhile, overall building and construction expenditure showed a modest year-on-year rebound in real terms in the third quarter, as the pick-up in growth of large-scale public sector infrastructure works offset the decline in private sector construction activity (*Chart 3(b)*).

Chart 3(a) : Private consumption grew moderately in the third quarter

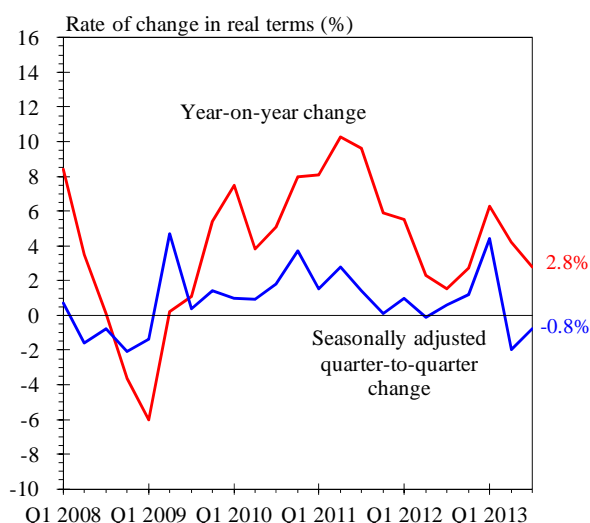
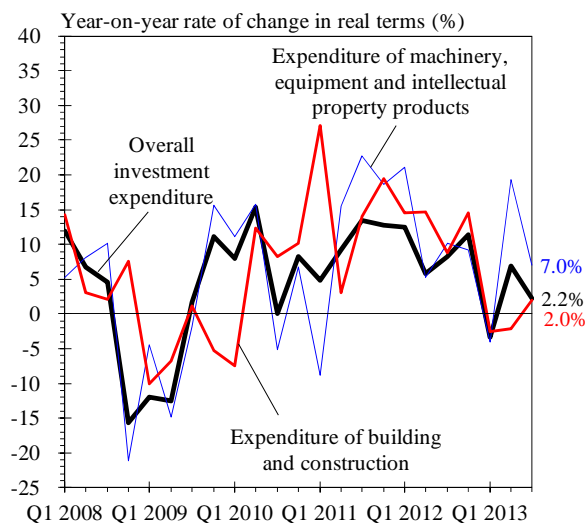


Chart 3(b) : Machinery and equipment investment still grew solidly



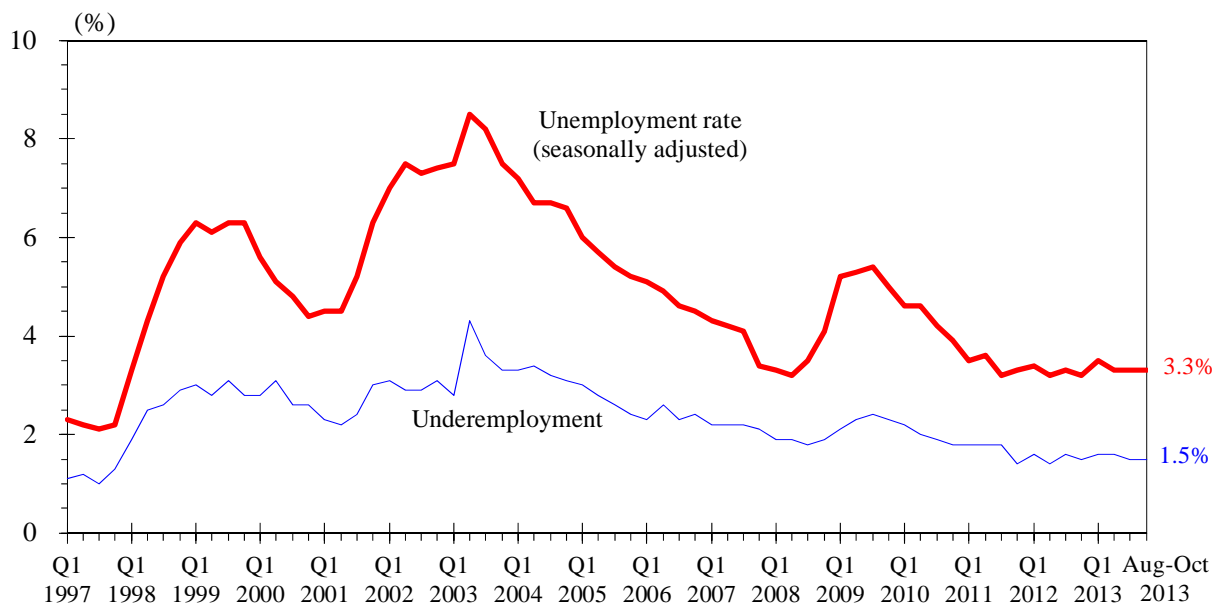
9. As for foreign direct investment (FDI), country breakdowns of FDI flow data are available up to end-2011 only. The Mainland remained the major source of Hong Kong's external direct investment, accounting for more than 40% of the total DI inflow in 2011. As an important part of our growth strategy, the Government will continue to deepen economic integration between the Mainland and Hong Kong while striving to foster trade links with new and emerging markets. The latest balance of payments figures indicate that FDI inflows⁽¹⁾ dropped by 23% to \$579 billion (US\$75 billion) in 2012, representing 28% of GDP, and decreased further by 23% year-on-year in the first half of 2013 to \$245 billion (US\$31.5 billion), representing 24% of GDP, reflecting weaker international FDI flows in 2012 and early 2013 amid an unsteady and uncertain global economic environment.

Labour Market

10. The labour market remained in a state of full employment, buttressed by the solid pace of job creation. In the three-month period ended October 2013, the seasonally adjusted unemployment rate stayed low at 3.3% (*Chart 4*), with total employment rising by 2.6% from a year ago to 3 747 800, almost 70 000 higher than the level in the fourth quarter of 2012.

(1) This item is referred to as "direct investment liability" under the international standard as stipulated in the *Sixth Edition of the Balance of Payments and International Investment Position Manual (BPM6)* released by the International Monetary Fund (IMF).

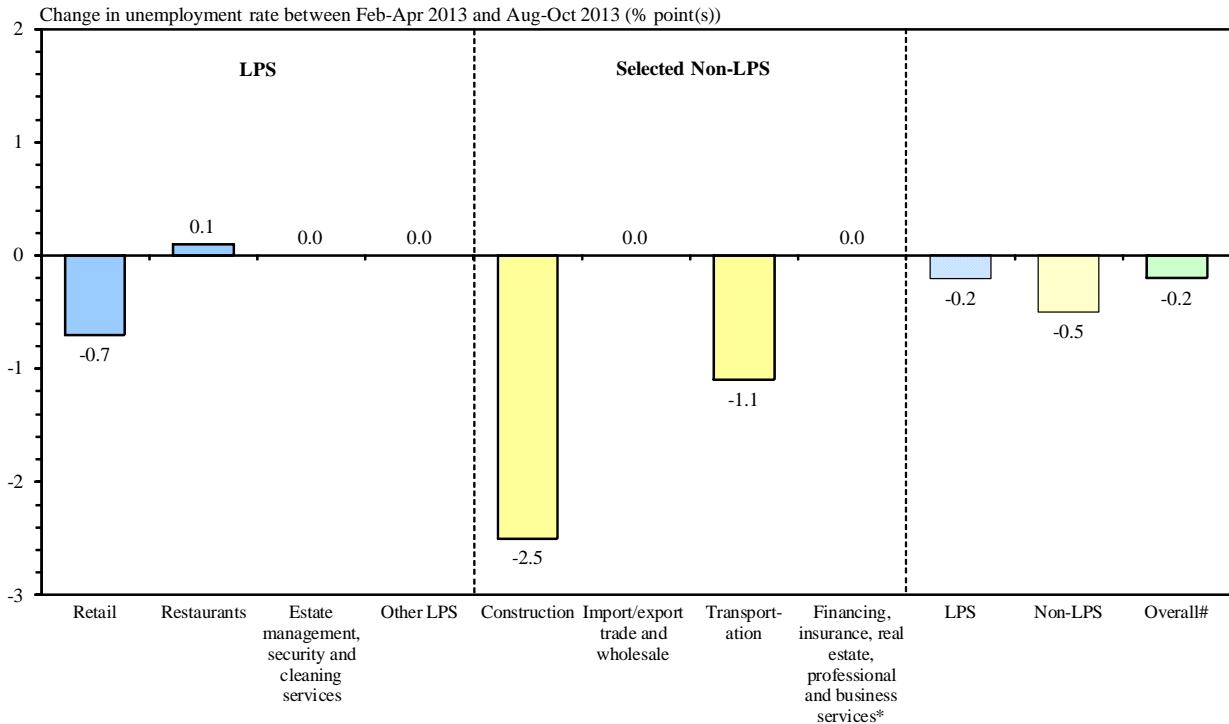
Chart 4 : The labour market remained in a state of full employment



11. The Statutory Minimum Wage (SMW) has been implemented for over two and a half years since 1 May 2011. The sturdy job creation on the back of buoyant local consumption and inbound tourism during most of the period has to a large extent helped alleviate the pressure on the labour market brought about by SMW. The overall seasonally adjusted unemployment rate in August – October 2013, at 3.3%, was lower than that before the recent upward adjustment of the SWM rate in May 2013 (3.5% in February – April 2013). The unemployment rate for the low paying sectors (LPS)⁽²⁾ as a whole fell by 0.2 percentage point to 3.1%, albeit with mixed performance amongst individual sectors. Regarding non-LPS as a whole, its unemployment rate went down visibly by 0.5 percentage point to 2.6%, alongside the notable job creation over the period (*Chart 5*).

(2) The Minimum Wage Commission identified LPS as (i) retail; (ii) restaurants; (iii) estate management, security and cleaning services; and (iv) other low-paying sectors – including: elderly homes; laundry and dry cleaning services; hairdressing and other personal services; local courier services; and food processing and production.

Chart 5 : Mixed unemployment trends amongst LPS and non-LPS after the implementation of the revised SMW rate



Notes: (*) Excluding real estate maintenance management, security and cleaning services.
 (#) Seasonally adjusted.

12. Analysed by skill segment, in August – October 2013, the unemployment rates for both the higher-skilled and lower-skilled segments fell, by 0.3 and 0.5 percentage point to 1.8% and 3.3% respectively over February – April 2013. On a year-on-year comparison, the unemployment rate of the higher-skilled segment declined by 0.2 percentage point, while that of the lower-skilled segment held steady (*Table 1*). It is nevertheless worth noting that, in terms of employment growth, the lower-skilled segment has been faring remarkably well over the past year.

Table 1 : The improvement in unemployment situation was broadly based, with the lower-skilled segment being the key driver for job creation

	Employment					Unemployment rate		
	Aug – Oct 2013	Change as compared to Feb – Apr 2013 (before the implementation of the revised SMW rate)		Change as compared to Aug – Oct 2012 (a year earlier)		Aug – Oct 2013	Change as compared to Feb – Apr 2013 (before the implementation of the revised SMW rate)	Change as compared to Aug – Oct 2012 (a year earlier)
	(No.)	(No.)	(%)	(No.)	(%)	(%)	(% point)	(% point)
Higher-skilled	1 371 200	-9 500	-0.7	+6 600	+0.5	1.8	-0.3	-0.2
Lower-skilled	2 376 600	+39 000	+1.7	+86 700	+3.8	3.3	-0.5	0.0
Lower-skilled (excl. government employees and live-in domestic workers)	1 984 200	+35 300	+1.8	+64 800	+3.4			

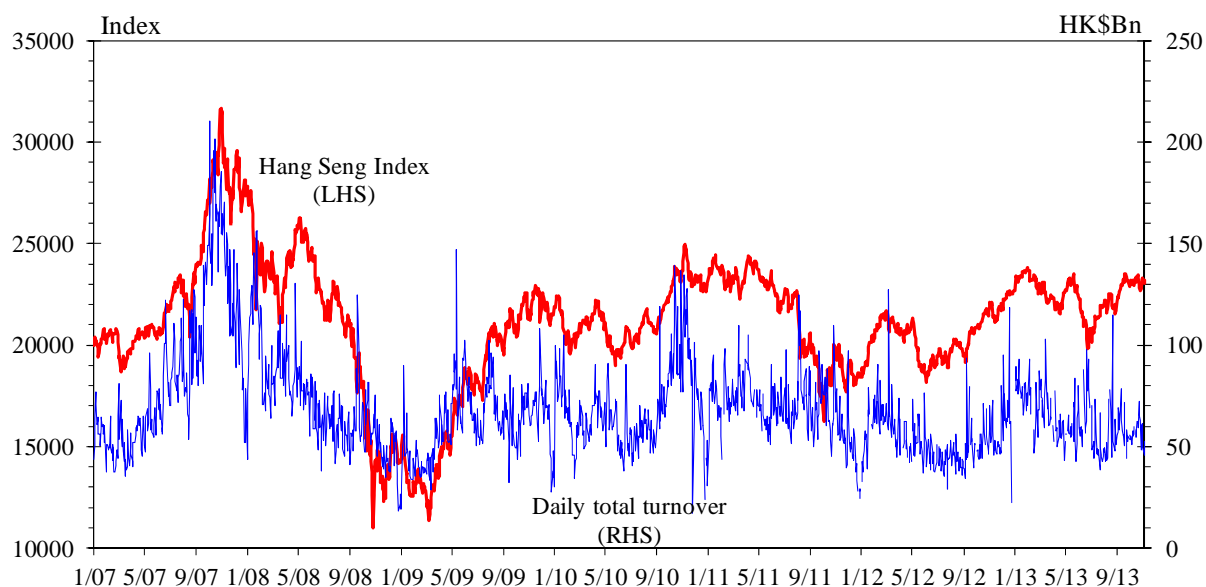
13. Thanks to the prevailing tight manpower situation (especially in the lower-skilled segment) and the boosting effect from the upward adjustment of the SMW rate in May 2013, the overall earnings situation witnessed further improvement. Wages and payroll rose notably on a broad front in the second quarter of 2013, with the corresponding nominal indices up by 5.2% and 5.0% respectively over a year earlier, or by 0.6% and 1.0% in real terms after discounting inflation. More recent data showed that grassroots workers in the lowest income decile group saw further appreciable year-on-year earnings growth of 6.8% in nominal terms in the first three quarters of 2013, translating into a real increase of 1.4% after discounting for price effects (Please refer to *Annex* for details).

Asset markets

14. The local stock market rebounded during the third quarter, fuelled by the resilient Mainland economic indicators and the US Fed’s decision to hold off tapering asset purchases in September. The Hang Seng Index became range-bound into the fourth quarter, closing at 23 206 at end-October, up 12% from end-June 2013 or 2% from end-2012. Average daily turnover of the stock market slowed, from \$68.3 billion in the first half of the year to \$55.2 billion in the third quarter (\$58.4 billion in October) (*Chart 6*). Meanwhile, the amount of equity funds raised

rose by 10% year-on-year in the first ten months of 2013.

Chart 6 : Local stock prices rebounded in the third quarter of 2013



15. The residential property market remained quiet in recent months. While the Government's various counter-cyclical measures introduced over the past few years have helped manage demand, the US Federal Reserve's indication in late June of its intention to reduce asset purchases later this year also affected market sentiment. With most buyers staying on the sideline, trading activities remained subdued. The number of sale and purchase agreements for residential property received by the Land Registry shrank further to a monthly average of 3 693 in the third quarter and hovered at a low of 3 426 in October, well below the average of 6 778 per month in 2012 (*Chart 7(a)*).

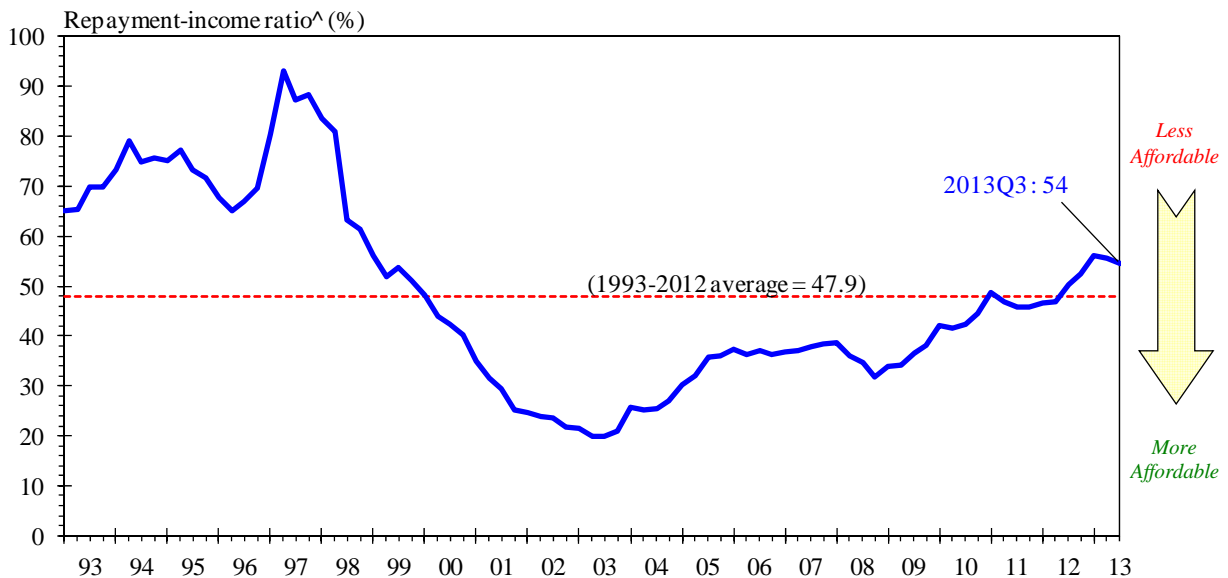
16. Overall flat prices recorded a decelerated increase of 1% during the third quarter, and there was in fact a marginal decline of 0.3% in September. While there was an 8% cumulative increase during the first nine months of the year, the uptrend in overall flat prices tapered significantly after the launch of the latest round of demand-side management measures in late February, from an average monthly increase of 2.7% in January and February to a monthly average of only 0.3% between February and September (*Chart 7(b)*). Meanwhile, flat rentals rose by 1% during the third quarter.

Chart 7 : Residential property market remained quiet in recent months



17. Home purchase affordability as measured by the mortgage-to-income ratio stayed elevated at around 54% in the third quarter, far exceeding the long-term average of 47.9% over 1993-2012 (**Chart 8**). Should interest rates rise by three percentage points to a more normal level, the ratio would soar to 71%.

Chart 8 : Mortgage-to-income ratio stayed elevated



Note : (^) The ratio of mortgage payment for a flat with saleable area of 45 sq m (assuming 70% loan-to-value ratio and tenor of 20 years) to median income of households (excluding those living in public housing). This ratio is different from the debt servicing ratio published by the HKMA, which is the ratio of actual monthly debt obligations of mortgagees to their monthly income of newly approved mortgages.

18. Raising flat supply through increasing land supply remains the Government's top policy priority in ensuring a healthy and stable development of the property market. To demonstrate the Government's firm resolve to increase land supply and to ensure a steady flat supply, the Government announced in September that a total of eight residential sites, which could provide for about 3 300 units, would be sold by tender in the fourth quarter of 2013. Taking the first three quarters of financial year 2013/14 together, residential sites put up by the Government for sale could provide for a total of about 8 200 units, reaching the figure for the whole preceding financial year. As a result of the Government's sustained efforts in increasing land supply, the total supply of flats in the coming few years increased further from 70 000 units as estimated at end-June 2013 to 72 000 units as estimated at end-September, the highest since September 2006.

19. As it takes time to raise supply, the Government has also put in significant efforts to manage demand and reduce the possible risks to financial stability arising from an exuberant property market. These measures have yielded notable results. On speculative activities, the number of short-term resale (comprising confirmor transactions and resale within 24 months after assignment) declined further to an average of 164 cases per month or 3.4% of total transactions in January to October 2013, markedly below the monthly average of 2 661 cases or 20.0% in January to November 2010 (i.e. the period before the introduction of the Special Stamp Duty) (*Chart 9*). Reflecting the effects of the Buyer's Stamp Duty, purchases by non-local individuals and non-local companies averaged at a low level of 89 cases per month or 1.9% of total transactions in the first ten months, much lower than the monthly average of 365 cases or 4.5% in January to October 2012 (*Chart 10*). As to mortgage lending, the average loan-to-value ratio of new mortgages was 55% in the third quarter, also lower than the average of 64% in January to October 2009 before the first round of macro-prudential measures for residential property mortgage lending was introduced by the Hong Kong Monetary Authority.

Chart 9 : Speculative activities stayed subdued

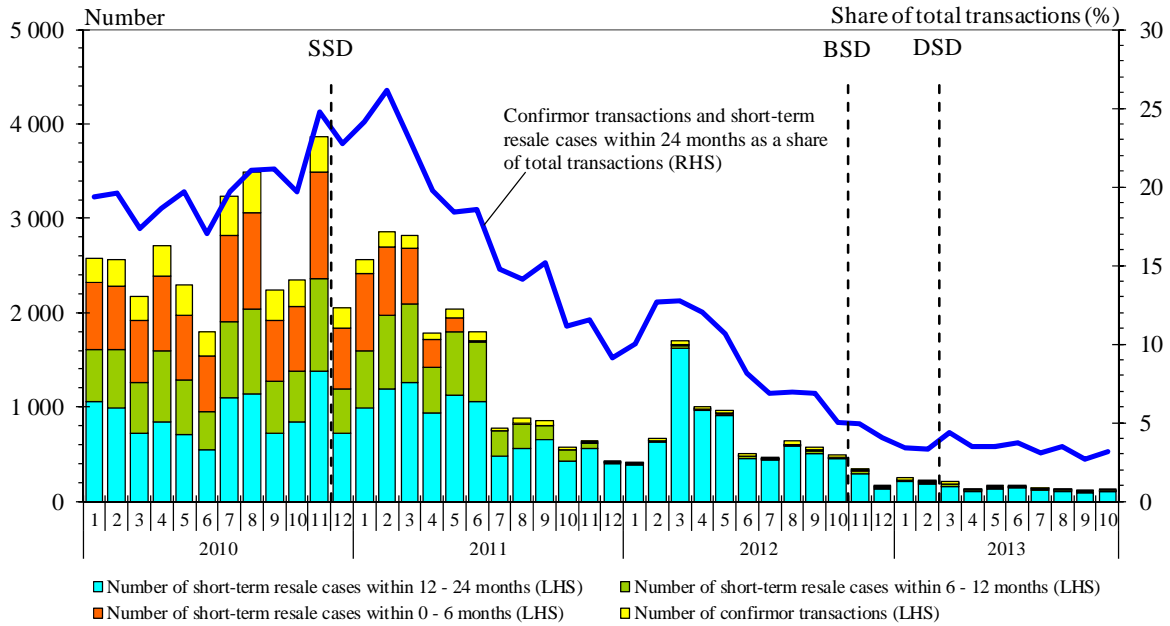
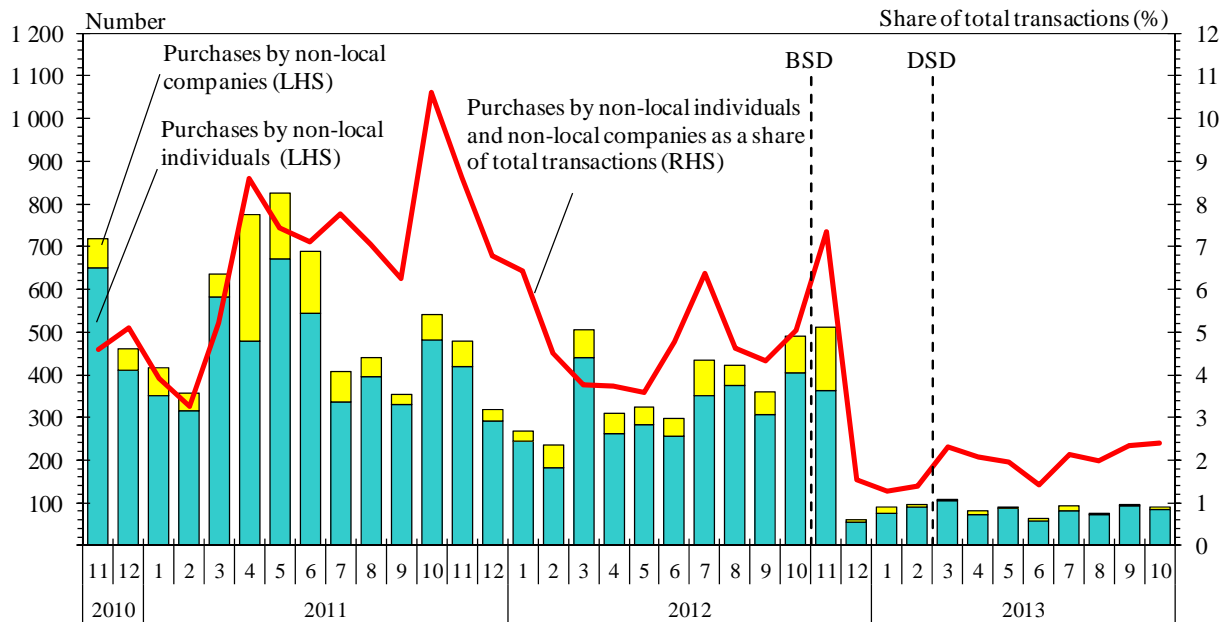


Chart 10 : Purchases by non-local buyers remained low



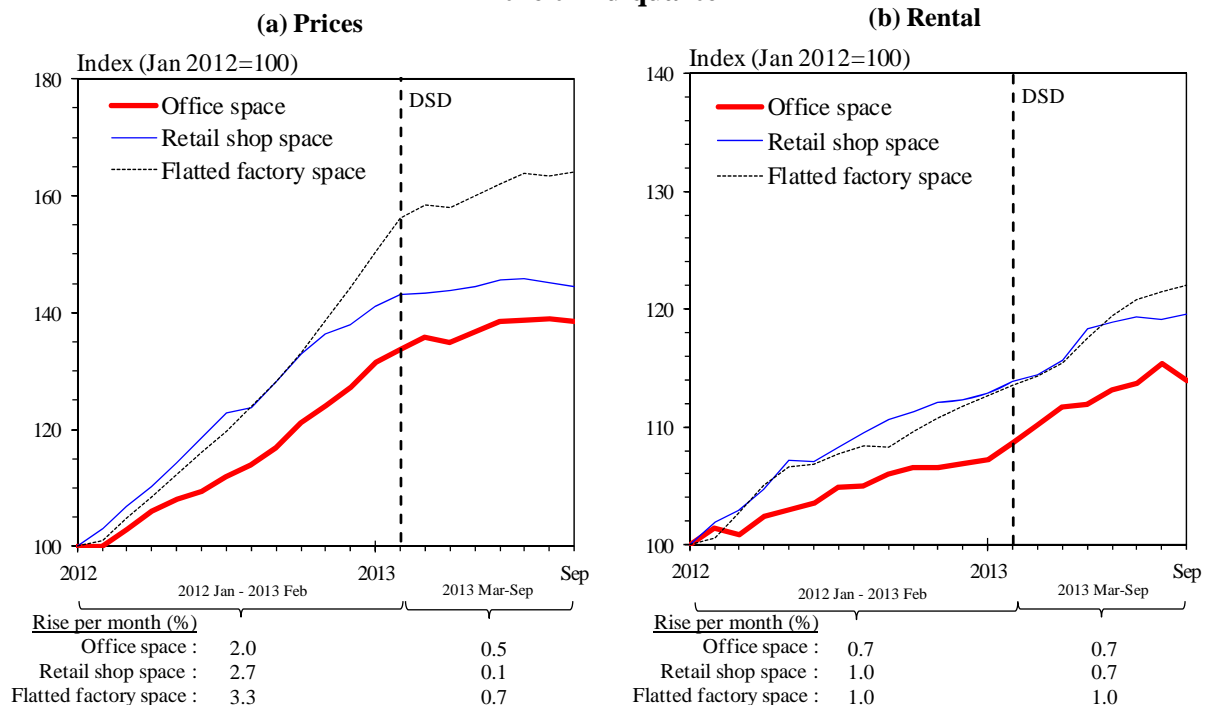
20. The commercial property markets slowed down further in the third quarter under the effect of the latest demand-side management measures. Trading activities shrank further while sale prices and rentals generally recorded moderated increases (*Chart 11*). Analysed by market segment, transactions of commercial space (mostly retail shop space) dropped by another 22% from the preceding quarter to a low level of 540 cases. Sales prices retreated by 1% between June and September. While sale prices in September 2013 were still 5% higher than in December 2012, the pace of increase has decelerated significantly from a monthly

average of 1.9% in January and February to that of 0.1% between February and September. Meanwhile, rentals increased by a marginal 1% during the third quarter and by 7% during the first nine months of 2013.

21. For office space, the number of transactions likewise decreased by 4% from the preceding quarter to 270 cases. While overall sale prices showed little change between June and September, there was indeed a small monthly decline in September. Sale prices recorded a cumulative gain of 9% during the first nine months of 2013, yet the increase decelerated from 2.6% per month in January and February to 0.5% per month between February and September. Office rentals in September edged up by 1% over June, and were 7% higher than in December 2012.

22. Transactions of flatted factory space dwindled by 16% from the preceding quarter to a low level of 580 cases in the third quarter. Meanwhile, the increases in sale prices and rentals also decelerated, to 1% and 2% respectively between June and September. Compared with December 2012, sale prices in September 2013 soared by a rampant 14%, mainly due to the surge in the first two months of 2013, while rentals rose by 9%.

Chart 11 : The non-residential property market slowed down further in the third quarter



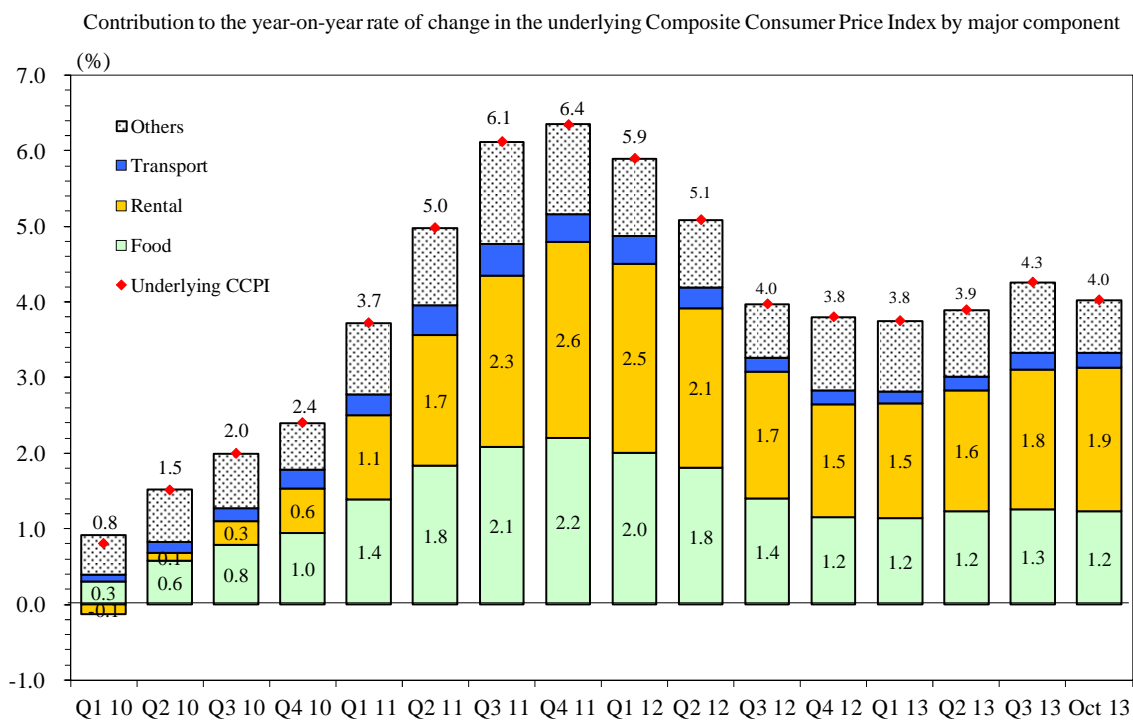
Inflation

23. Inflation eased slightly in the past two months following small upticks in the summer. Import prices remained subdued, thanks to largely stable international commodity prices and tamed inflation in many import sources. Locally, overall

labour costs continued to rise steadily alongside a relatively tight labour market, but the favourable effect of the milder increases in fresh-letting private residential rentals since the beginning of this year began to be felt in recent months, which should help contain inflation in the near term.

24. Headline consumer price inflation, as measured by the year-on-year rate of change in the Composite CPI, averaged 4.3% in the first ten months of 2013, the latest outturn in October also at 4.3%. Netting out the effects of the Government’s one-off relief measures to more accurately reflect the underlying inflation trend, underlying consumer price inflation went up slightly to 4.3% in the third quarter before easing back to 4.0% in October. For the first ten months of 2013 as a whole, underlying consumer price inflation averaged 4.0%, down from the annual average of 4.7% in 2012 (*Chart 12*).

Chart 12 : Consumer price inflation stayed largely stable so far this year



25. On a year-on-year comparison, price increases varied among the major components of the underlying Composite CPI (*Table 2*). Thanks to the generally subdued international food prices, local food inflation (including costs of dining out) was broadly stable except for some spikes in individual months, averaging 4.4% in the first ten months of 2013, a tad higher than 4.2% in the fourth quarter of 2012. Meanwhile, the increase in the private housing rental component, after rising visibly from 5.3% in the fourth quarter of 2012 to 6.6% in August 2013, tended to stabilise thereafter and stood at 6.7% in October, as the effect of the milder increases in fresh-letting rentals since early this year kicked in. The prices of electricity, gas

and water also saw a faster rise in the third quarter, due mainly to the higher fuel cost adjustment for Towngas alongside the price rise in naphtha. For many other CPI components, their year-on-year rates of price increases remained moderate, while prices of durable goods stayed on their secular downtrend.

**Table 2 : Composite Consumer Price Index by component
(year-on-year rate of change (%))**

<u>Expenditure component</u>	<u>Weighting (%)</u>	<u>2012</u>	<u>2012</u>				<u>2013</u>			
			<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Oct</u>
Food	27.45	5.8	7.4	6.6	5.1	4.2	4.1	4.5	4.6	4.5
<i>Meals bought away from home</i>	17.07	5.4	6.1	5.7	5.3	4.6	4.4	4.3	4.3	4.4
<i>Other foodstuffs</i>	10.38	6.5	9.4	8.1	5.0	3.6	3.6	4.8	4.9	4.6
Housing ^(a)	31.66	5.6 (6.4)	8.1 (8.1)	6.4 (6.7)	2.8 (5.5)	5.2 (5.4)	5.2 (5.5)	6.1 (5.8)	9.4 (6.3)	6.2 (5.9)
<i>Private dwellings</i>	27.14	6.8 (7.0)	9.2 (9.1)	7.3 (7.7)	5.8 (6.0)	5.1 (5.3)	5.0 (5.4)	6.1 (5.7)	7.0 (6.5)	7.2 (6.7)
<i>Public dwellings</i>	2.05	-7.1 (3.2)	-1.5 (-0.1)	-1.1 (0.1)	-87.8 (3.2)	9.7 (9.5)	9.7 (9.5)	8.9 (9.2)	777.6 ^(b) (5.9)	-1.8 (*)
Electricity, gas and water	3.10	-8.2 (3.6)	-17.2 (4.0)	-18.3 (3.9)	3.6 (2.8)	4.6 (3.6)	4.9 (3.6)	5.9 (4.4)	9.6 (7.2)	6.7 (5.1)
Alcoholic drinks and tobacco	0.59	3.0	11.6	0.1	0.5	0.6	1.6	1.9	1.4	1.2
Clothing and footwear	3.45	3.1	4.9	3.2	2.3	1.9	1.5	1.0	1.7	2.4
Durable goods	5.27	-1.4	-1.8	-0.9	-1.2	-1.7	-3.5	-5.0	-4.7	-4.1
Miscellaneous goods	4.17	2.2	3.4	2.2	1.4	2.0	1.4	2.2	2.5	2.7
Transport	8.44	3.0	4.4	3.3	2.2	2.2	2.0	2.2	2.8	2.4
Miscellaneous services	15.87	2.8 (2.8)	2.8 (2.8)	3.1 (3.1)	2.3 (2.3)	2.9 (3.0)	3.5 (3.5)	3.1 (3.1)	3.9 (3.1)	4.0 (2.8)
All items	100.00	4.1 (4.7)	5.2 (5.9)	4.2 (5.1)	3.1 (4.0)	3.8 (3.8)	3.7 (3.8)	4.0 (3.9)	5.3 (4.3)	4.3 (4.0)

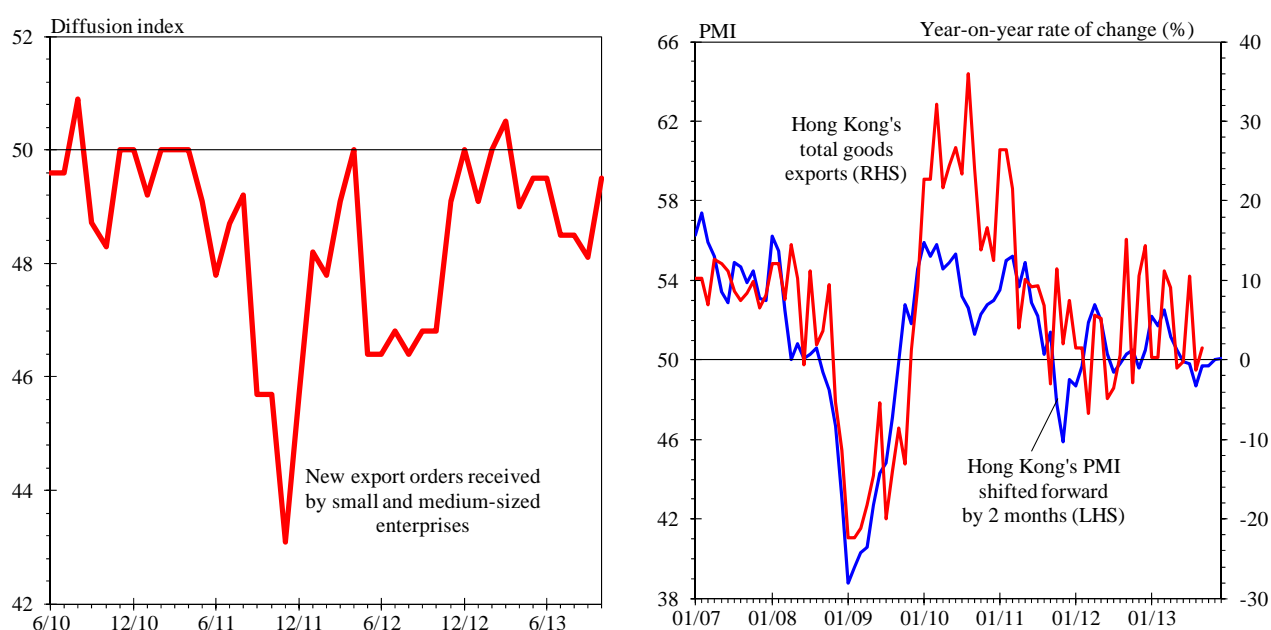
Notes : The year-on-year rates of change in the Composite Consumer Price Index are computed from the new 2009/10-based CPI series. Figures in brackets refer to the underlying rate of change after netting out the effect of Government's one-off relief measures.

- (a) The housing component covers rents, rates, Government rent, maintenance costs and other housing charges. Its sub-components on private and public dwellings as presented here, however, cover rents, rates and Government rent only. Hence, the combined weighting of private and public dwellings is slightly less than the weighting of the entire housing component.
- (b) The larger year-on-year increase in the public housing rental component of the Composite Consumer Price Index in the third quarter of 2013 was due to a low base of comparison resulted from the Government's payment of public housing rentals in July 2012.
- (*) Change of less than 0.05%.

Updated short-term economic forecasts for 2013

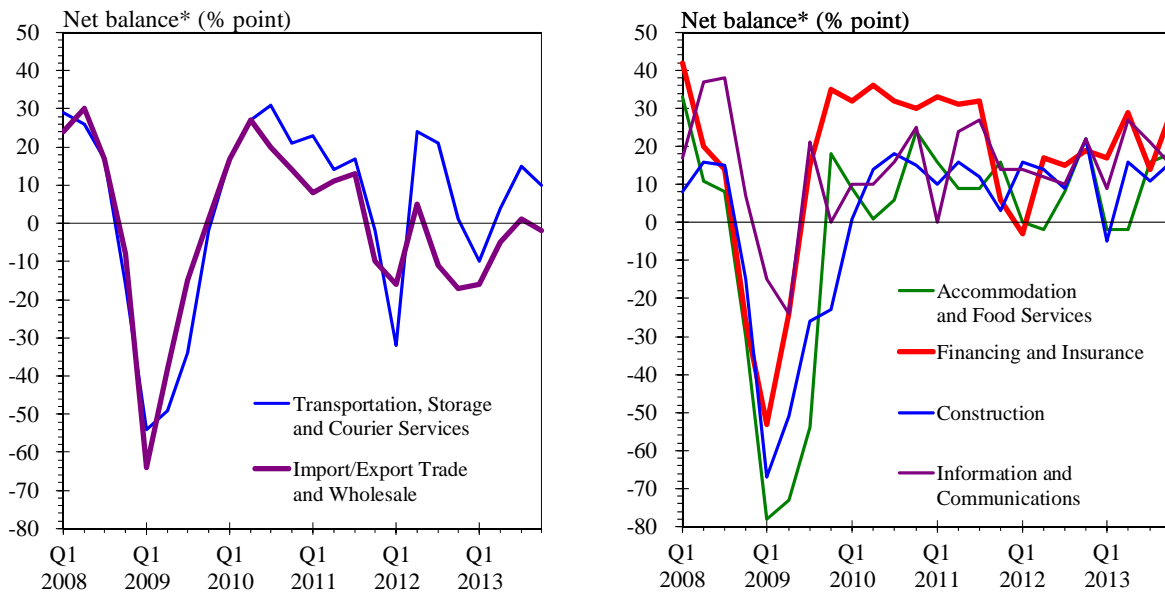
26. The global headwinds remained notable in the near term. The US economic performance in the fourth quarter may be weakened by the partial government shutdown in October. The uncertainties arising from the Fed's monetary policy and the unresolved fiscal issues would also put a drag on the US growth pace. The eurozone's recovery is likely to remain fragile, given the elevated unemployment rate and structural problems. The growth slowdown in some major emerging markets is also a source of concern. Yet, the Mainland economy has stayed resilient, which should lend some support to trade and production activity in Asia going forward. Against this backdrop, Hong Kong's merchandise trade performance may continue to see some fluctuations in the near term (*Chart 13*).

Chart 13 : Hong Kong's trading environment is still subject to uncertainty



27. Locally, consumer sentiment should still be broadly supported by the favourable job and income conditions. The further expansion of inbound tourism should also be conducive to the consumption market. Moreover, the latest Quarterly Business Tendency Survey showed that large enterprises remained largely positive about the near-term business outlook (*Chart 14*). This, coupled with the intensive infrastructure works and the boost from the package of measures in the 2013-14 Budget, would also render a solid support to the domestic economy.

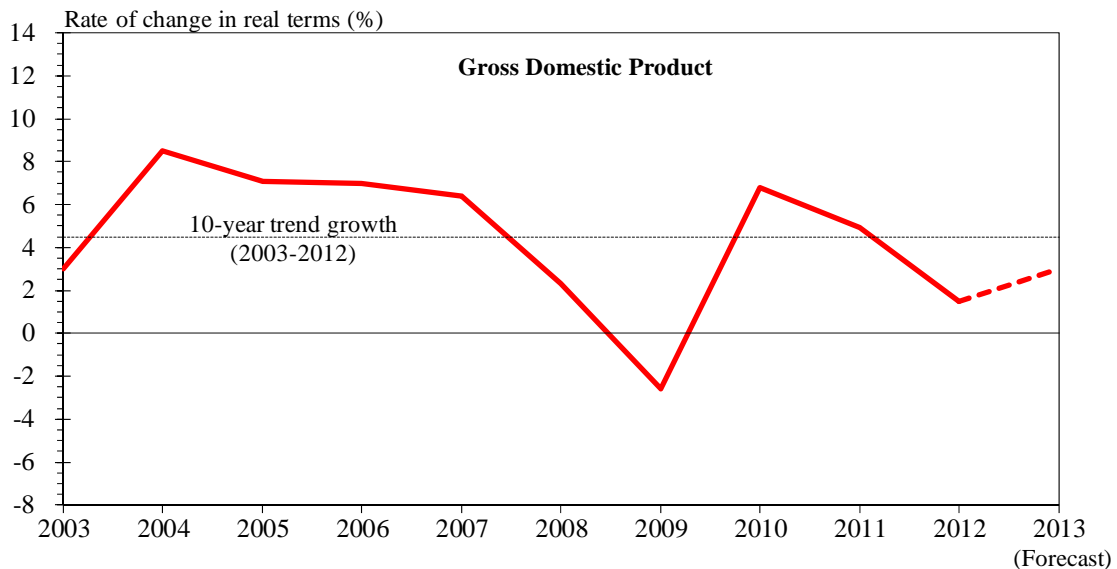
Chart 14 : Business sentiment of large enterprises were largely positive, except for the trade-related sectors



Note : * Net balance indicates the direction of expected change in business situation versus preceding quarter. It refers to the difference in percentage points between the proportion of establishments choosing "better" over that choosing "worse". A positive sign indicates a likely upward trend while a negative sign, a likely downward trend.

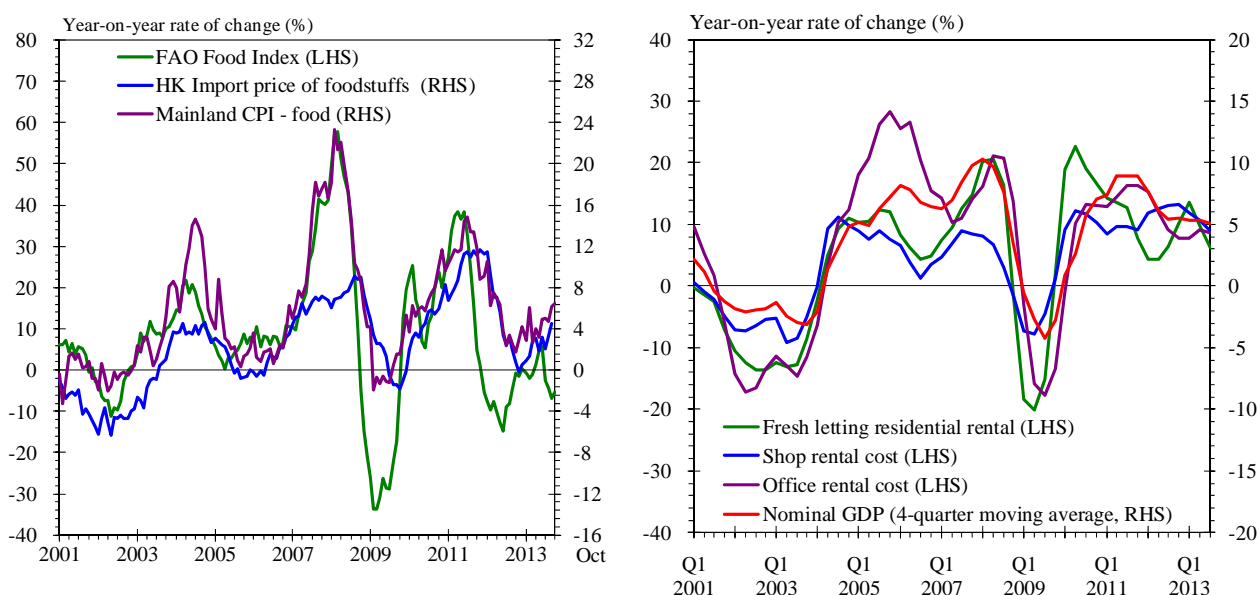
28. Given the actual outturn of the 3.0% year-on-year real GDP growth in the first three quarters of 2013, and that a further moderate growth is likely attainable in the fourth quarter, the real GDP growth for 2013 is now forecast at 3%, the mid-point of the range forecast of 2.5-3.5% announced in the August round (*Chart 15*). For reference, the IMF in October projected Hong Kong's economic growth for this year at 3.0%, whereas the latest forecasts by private sector analysts mostly range from 2.7-3.5%, averaging around 3.1%.

Chart 15 : Economic growth for 2013 is forecast at 3%



29. On inflation outlook, with the favourable effect on inflation arising from the milder increases in fresh-letting private residential rentals since the beginning of the year gradually being felt, and with external price pressures staying rather modest, the upside risks to inflation should be limited in the near term (*Chart 16*). Given that the inflation trend has so far been largely in line with earlier expectations, the forecast rates of headline and underlying consumer price inflation for 2013 as a whole are kept unchanged at 4.3% and 4% respectively. For reference, the IMF in October forecast Hong Kong's consumer price inflation in 2013 at 3.5%, whereas the latest forecasts by private sector analysts mostly range from 3.5-4.5%, averaging around 4.2%.

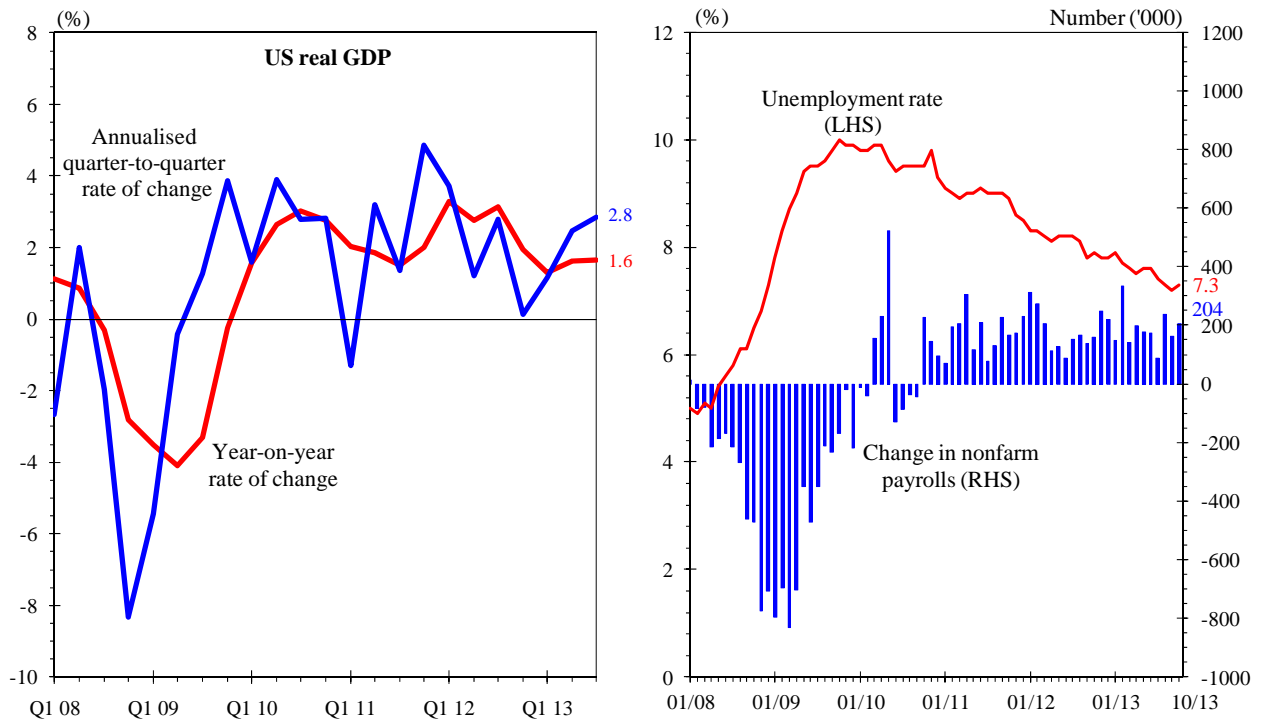
Chart 16 : The subdued imported inflation and the slower increases in rentals since early 2013 should help contain upward risks to inflation in the near term



Economic outlook for 2014

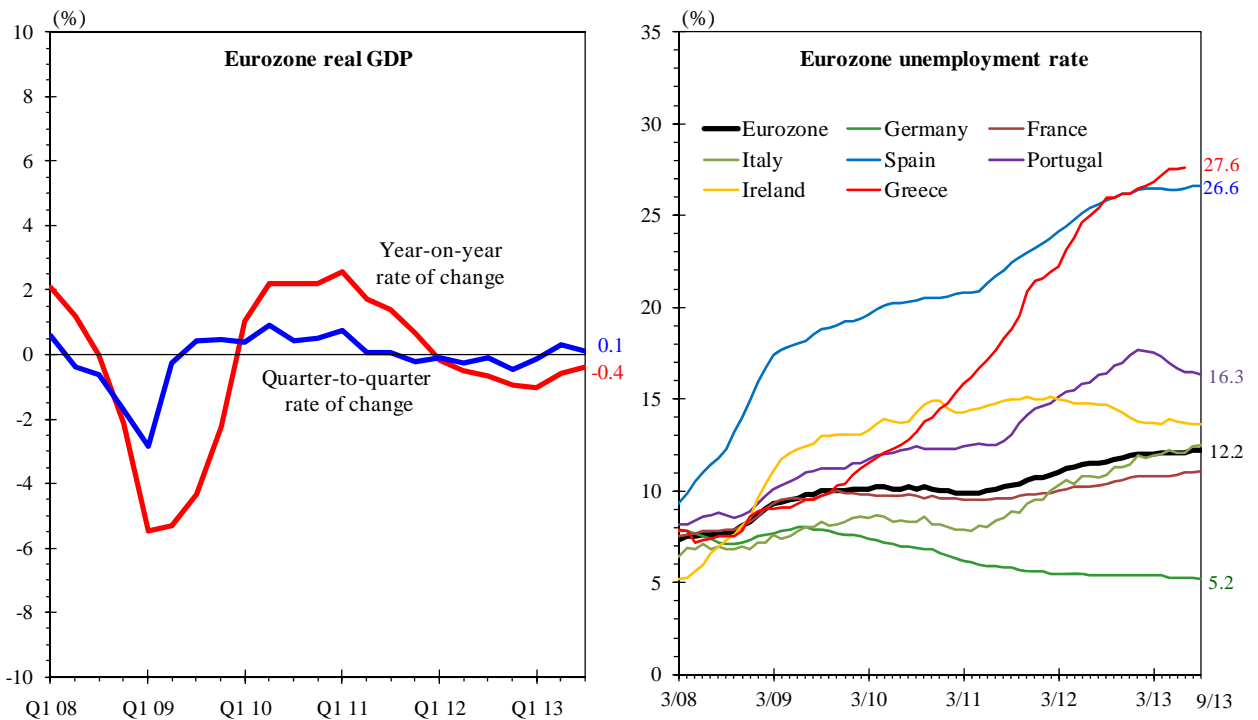
30. The external environment is likely to remain rather challenging in 2014, with the global growth prospects still subject to various uncertainties. The major source of uncertainties would be the future paths of the US fiscal and monetary policies. The fiscal issues on budget and debt limit in the US have only been postponed, which, if not addressed properly in time, could pose a serious threat to global economic sentiment and financial stability. In addition, the modest and uneven recovery of the US economy has also increased the uncertainty over the timing and the pace of Fed tapering. Market sentiment would be sensitive to, and swung by, the incoming US economic data, leading to greater volatility in the international financial and currency markets.

Chart 17 : Modest recovery in the US



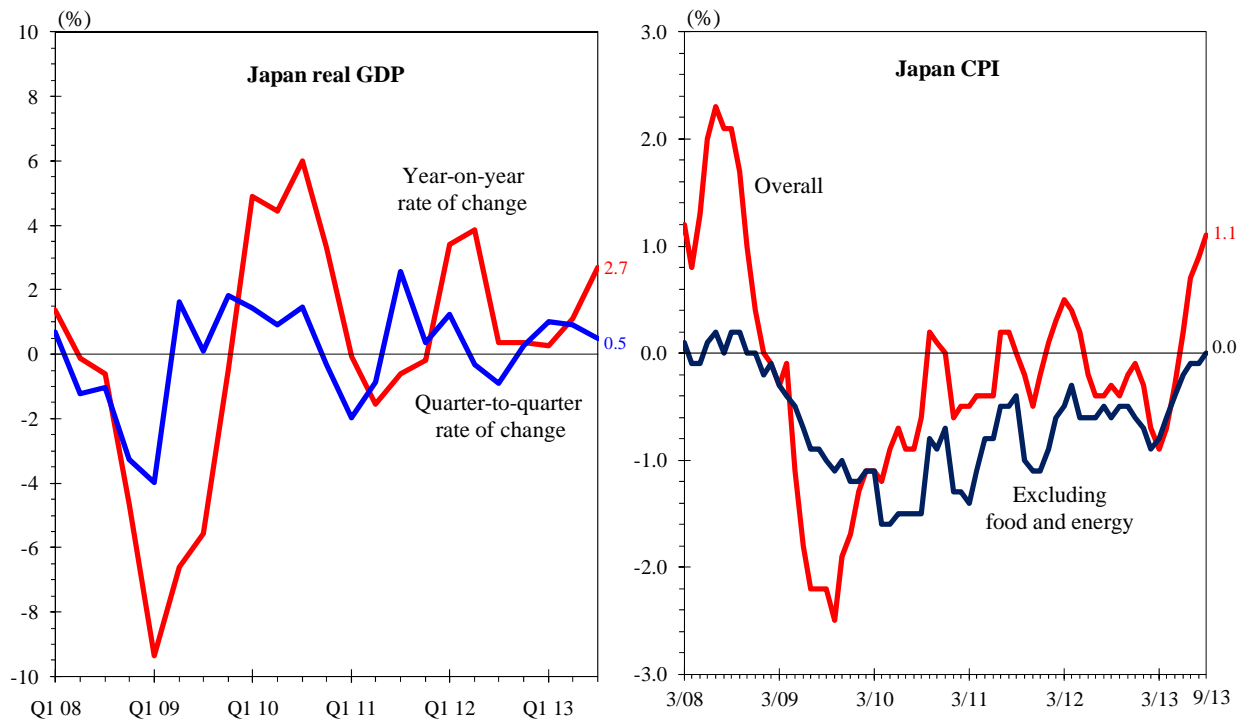
31. The euro area economy, while showing some improvement, remains weak as suggested by the European Central Bank’s recent rate cut. The road to recovery is likely to be bumpy, as domestic demand in the euro area would still be restrained by a double-digit unemployment rate, continued fiscal adjustments, the impaired credit market and other structural problems.

Chart 18 : The eurozone economy still constrained by elevated unemployment



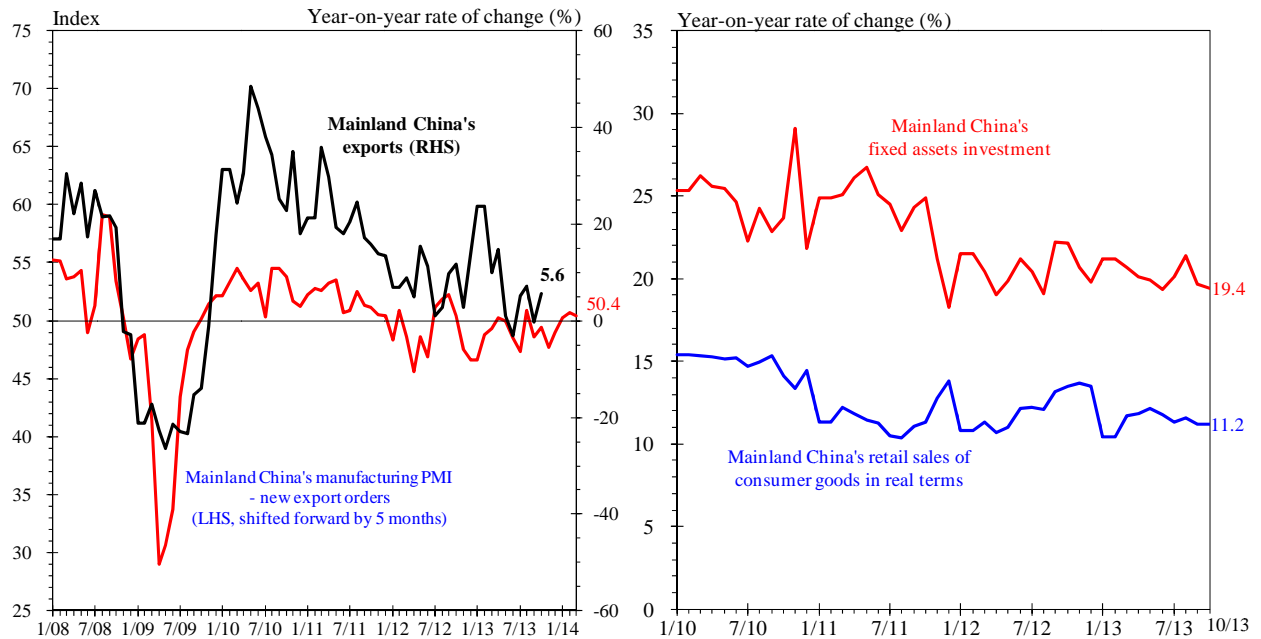
32. In Asia, Japan has revitalised the economy somewhat by undertaking aggressive reflationary policy, but the planned sales tax hike in April next year will pose a serious test ahead. Furthermore, the difficulties in carrying through structural reforms, as part of its new growth strategy, should not be underestimated. Given the weak economic fundamentals in the advanced economies, with profound structural issues overhang, the global trading environment would still fraught with uncertainties next year.

Chart 19 : Sustainability of Japan's recovery remains unclear



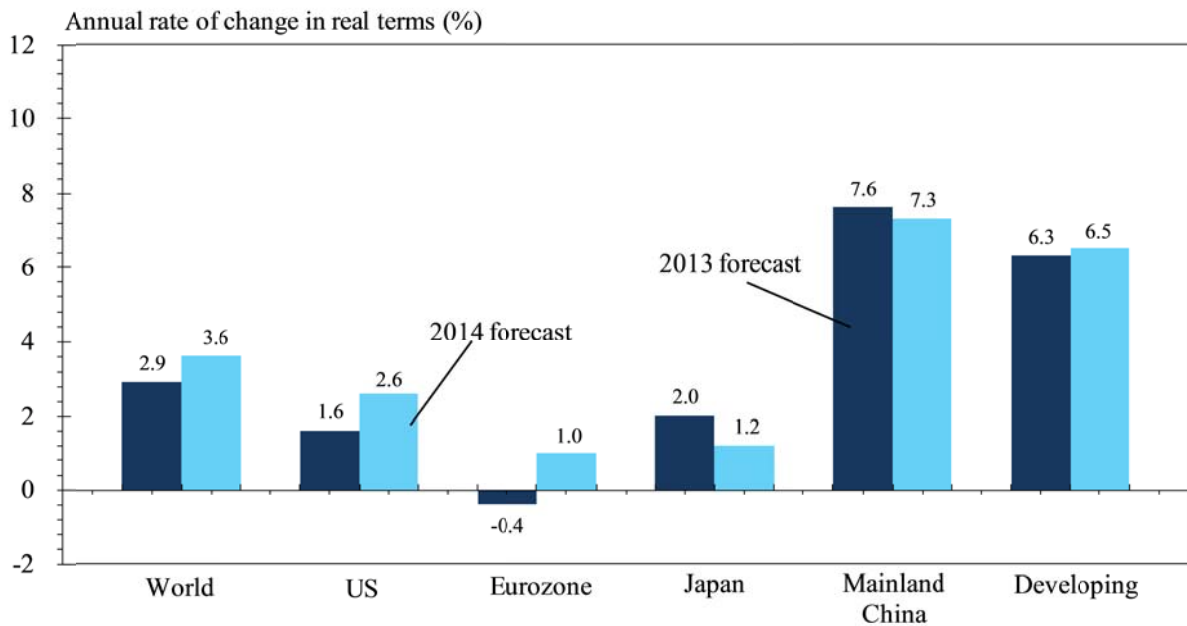
33. Yet, the Mainland economy has been displaying resilience so far this year. In spite of the challenging external trading environment, real GDP growth in the Mainland picked up from 7.5% in the second quarter to 7.8% in the third quarter, supported by robust domestic demand. Latest economic indicators including retail sales and fixed assets investment continued to register appreciable year-on-year growth in the more recent months, while the manufacturing purchasing managers' index (PMI) stayed in the expansion zone. This, coupled with the relatively sound fundamentals in most Asian economies, should lend some support to Hong Kong's trade performance going forward.

Chart 20 : The Mainland economy stayed resilient



34. For reference, the IMF in October projected developing Asia and the Mainland to grow by 6.5% and 7.3% respectively in 2014. The IMF also forecast that the global economic growth will accelerate from 2.9% in 2013 to 3.6% in 2014, provided that the downside risks from the US fiscal disputes do not materialise.

Chart 21 : IMF forecasts for 2013 and 2014 economic growth



35. Domestically, the favourable job and income conditions should continue to buttress the local consumption market. Besides, the ongoing large-scale infrastructure works, sustained growth in inbound tourism and still positive business sentiment should also render support to the domestic economy. The Government will closely monitor the developments on the external front and announce the economic forecasts for 2014 along with the 2014/15 Budget in February next year. For reference, the IMF's latest 2014 economic growth forecast on Hong Kong is 4.4%. The prevailing forecasts from private sector analysts range from 2.7-5.0%, averaging around 3.6%.

36. The inflation situation of Hong Kong in 2014 will depend on a range of factors, including exchange rate movements, international commodity prices, the inflation experiences of our major imported sources and local labour costs. In recent periods, international food and commodity prices have been largely stable, while inflation of the major imported sources, including the Mainland, stayed rather moderate. This, coupled with milder increases in fresh-letting residential rentals since early 2013, should help contain the upside risks to inflation next year. However, the large liquidity glut generated by the ultra-loose monetary policy in the advanced countries remain, which could alter Hong Kong's inflation outlook going forward by amplifying the volatility of international food and commodity prices as well as local asset prices. Domestically, the steady increases in labour costs amid the tight labour market conditions could also pose upward pressure on local prices. The Government will continue to monitor local and external factors behind inflation developments, and pay attention to the impact of inflation on lower-income people. For reference, the IMF's latest 2014 inflation forecast for Hong Kong is 3.5%, while those from private sector analysts average 3.7%.

Economic Analysis and Business Facilitation Unit
Financial Secretary's Office
25 November 2013

Recent situation of household income⁽¹⁾

Background

This Annex provides a regular update on the latest trends of household income and employment earnings among various groups. As the level of statutory minimum wage (SMW) has been raised from \$28 per hour to \$30 per hour since May 2013, the benchmark of monthly household income for low-income households is also increased from \$6,500 to \$7,000 (at constant Q2 2013 prices), adjusted by inflation⁽²⁾, so as to reflect the latest circumstance.

Overall situation of household income and employment earnings

2. Despite the still modest growth pace of the overall economy so far in 2013, the labour market stayed tight thanks to the staunch labour demand generated by buoyant domestic business activities and inbound tourism. Total employment expanded further in August - October 2013 to 3 747 800, by 2.6% as compared to a year earlier. Signifying full employment, the seasonally adjusted unemployment rate stayed low at 3.3% over the same period. Various household/employment income indicators recorded noticeable growth in tandem. Monthly median household income, a reflection of the overall income situation, grew substantially by 9.3% year-on-year in the third quarter of 2013. After netting out inflation, the corresponding real growth was still visible, at 3.7%.

3. On the back of the prevailing manpower tightness and the additional boosting effect from upward adjustment of the SMW rate, the increases in wages and earnings of various segments were likewise broad-based. For higher-skilled staff, the latest Salary Index for Managerial and Professional Employees in 2013 indicates that employees in the same company and occupation enjoyed nominal and real salaries growth of 6.0% and 2.2% respectively over a year earlier. Meanwhile, average wages of the lower-skilled workers also increased by 5.2% in nominal terms and 0.6% in real terms. As regards full-time employees in the lowest decile, their average employment earnings rose noticeably by 6.8% in the first three quarters of 2013. After taking into account price changes, the real increase was 1.4%. All these figures suggest that workers from different strata have been able to share the fruits of economic growth (*Table 1*).

(1) Except for overall labour market statistics, foreign domestic helpers are excluded from the analysis.

(2) Based on Consumer Price Index (A).

**Table 1 : Selected indicators on household income and employment earnings
(year-on-year rate of change (%))**

Period	Wages		Median monthly household income		Salaries of managerial and professional employees [~]		Employment earnings in the lowest decile [^]		
2011	Q1	4.9	(0.2)	5.6	(1.7)				
	Q2	8.0	(2.0)	9.3	(3.9)	7.5	(2.1)	10.3	(4.4)
	Q3	9.9	(4.4)	11.1	(4.4)				
	Q4	9.4	(3.9)	11.1	(5.1)				
2012	Q1	8.0	(3.6)	8.8	(3.5)				
	Q2	5.1	(1.7)	4.6	(0.4)	5.8	(2.0)	9.7	(5.9)
	Q3	4.8	(0.4)	2.5	(-0.6)				
	Q4	5.1	(0.9)	5.0	(1.2)				
2013	Q1	4.7	(0.7)	6.4	(2.6)				
	Q2	5.2	(0.6)	5.5	(1.4)	6.0	(2.2)	6.8	(1.4)
	Q3	n.a.	n.a.	9.3	(3.7)				

Notes : (^) Annual average employment earnings of full-time employees except Q1-Q3 2013 for the latest period.
 (~) The index is released annually for Q2.
 () Rate of change (%) in real terms.
 (n.a.) Not yet available.

Economically active households with monthly household income below \$7,000 in real terms

4. In the third quarter of 2013, the number of economically active households with monthly household income below \$7,000 in real terms (referred to as “low-income households” thereafter) amounted to 61 800, slightly up by 1 700 over a year earlier. The respective proportion in total domestic households edged up from 2.5% to 2.6%.

5. In fact, the number and proportion of low-income households over the past ten years or so largely followed economic vicissitudes. During 2000 and 2008, when the economy performed persistently well for most of the period, the proportion of low-income households fell successively from a peak of 4.7% in the third quarter of 2003 to 2.7% in 2008 over the same period. After the outbreak of the global financial tsunami in late 2008, the corresponding proportion rose back to 3.1% in the third quarter of 2009 as the Hong Kong economy was mired into recession. But with economic recovery taking hold afterwards, the figure gradually fell back to 2.1% in the third quarter of 2011. Regardless of the recent increases, such proportion has still remained at a relatively low level as compared to other periods when the economy’s performance was more volatile over the past ten years (*Table 2 and Chart 1*).

Table 2 : Number and proportion of low-income households*

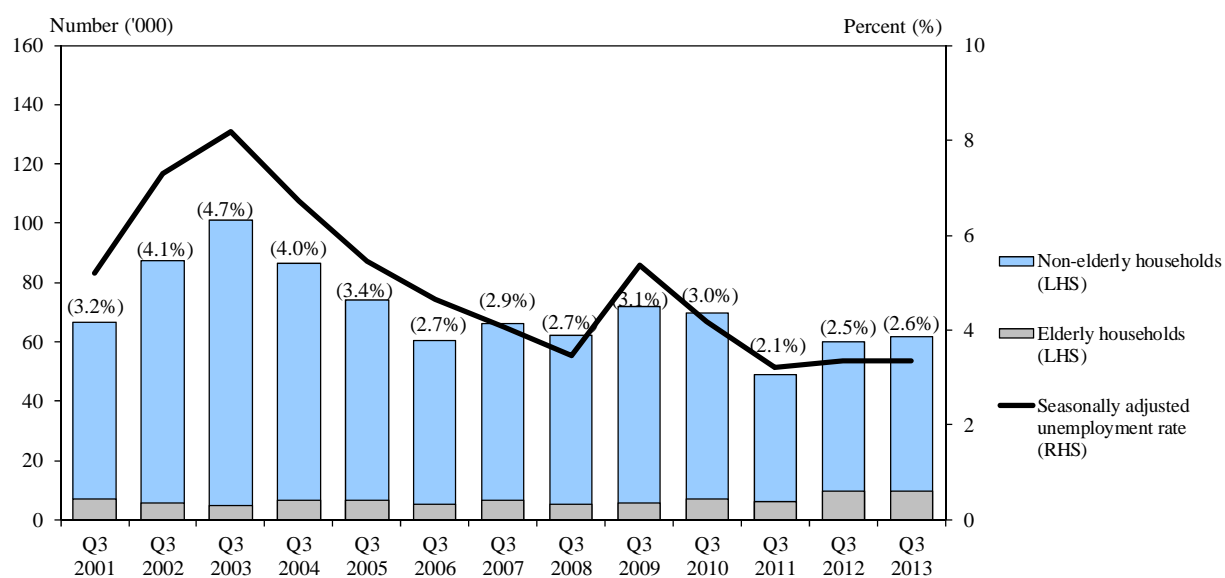
<u>Period</u>	Household type:		<u>Total</u>	Of which: <u>Economically active persons therein</u>
	<u>Elderly households</u>	<u>Non-elderly households</u>		
Q3 2003	4 900 (0.2)	96 300 (4.5)	101 300 (4.7)	121 300 [3.7]
Q3 2009	5 900 (0.3)	65 900 (2.9)	71 800 (3.1)	82 200 [2.4]
Q3 2010	7 000 (0.3)	62 700 (2.7)	69 700 (3.0)	78 800 [2.3]
Q3 2011	6 000 (0.3)	43 100 (1.8)	49 100 (2.1)	54 500 [1.6]
Q3 2012	9 600 (0.4)	50 400 (2.1)	60 000 (2.5)	65 000 [1.8]
Q3 2013	9 600 (0.4)	52 200 (2.2)	61 800 (2.6)	68 100 [1.9]

Notes : (*) Low-income households refer to households with monthly household income less than \$7,000 at constant Q2 2013 prices. This does not include households with all members being economically inactive.

() Proportion in all domestic households (%).

[] Proportion in total labour force (%).

Chart 1 : Number of low-income households*



Notes : (*) Low-income households refer to households with monthly household income less than \$7,000 at constant Q2 2013 prices. This does not include households with all members being economically inactive.

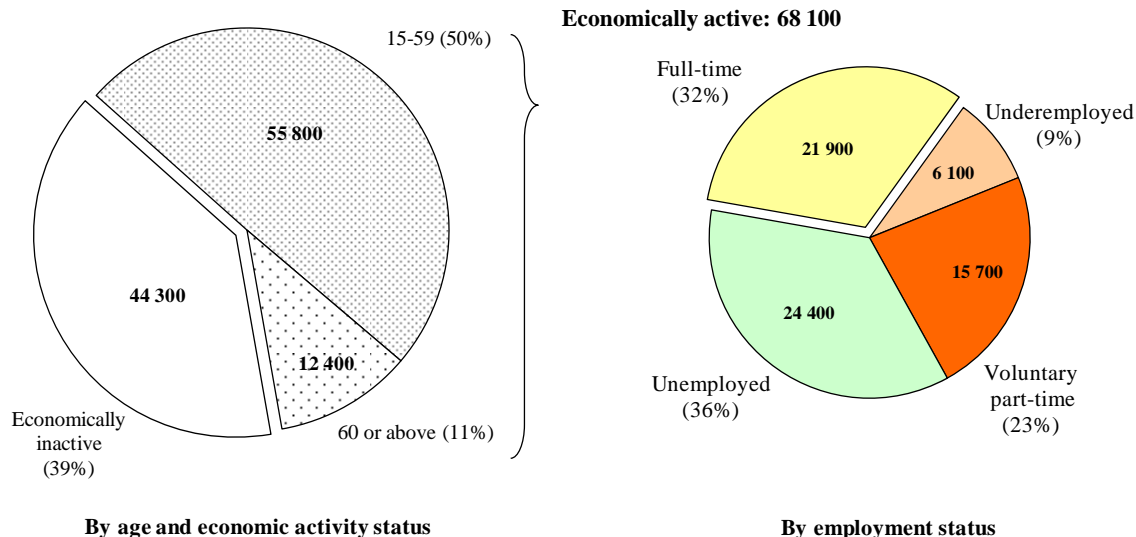
Figures in brackets are the proportions of low-income households in all domestic households.

Socio-economic characteristics of low-income households

6. Further decomposition of low-income households in the third quarter of 2013 yields the following observations:

- 112 400 persons were residing in the households concerned, among whom 68 100 were economically active. Most of these individuals (55 800 or 82%) were persons aged 15-59, with the majority within the age group of 40-59 (38 000 or 56%), whilst those aged 60 or above amounted to 12 400 (18%).
- The remaining 44 300 persons were economically inactive. More than half of them (52%) were either children aged below 15 or elderly persons aged 60 or above.
- A more in-depth analysis by employment status showed that among these 68 100 economically active persons, 32% were full-time workers, while the respective proportions for unemployed, voluntary part-timers, and underemployed were 36%, 23% and 9% respectively (*Chart 2*).

**Chart 2 : Persons living in low-income households*
by age and economic activity status, Q3 2013**

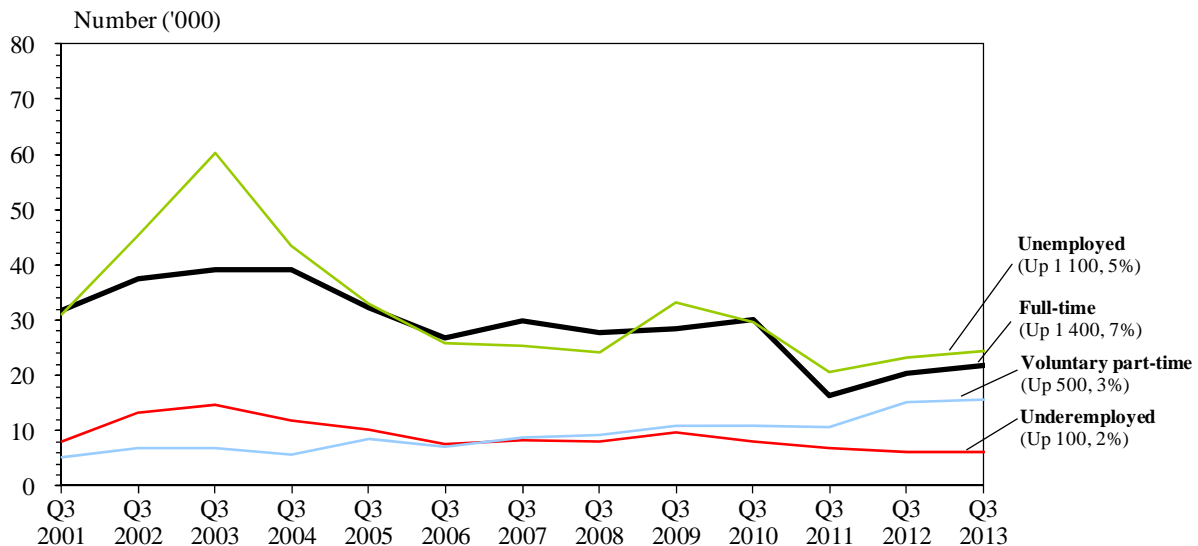


Note : (*) Low-income households refer to households with monthly household income less than \$7,000 at constant Q2 2013 prices. This does not include households with all members being economically inactive.

- Analysed by occupation, most of the employed persons living in low-income households (83%) were lower-skilled workers (among whom 40% were elementary workers, and 28% were service and sales workers). A breakdown by economic sector revealed that many of them were engaged in the retail, accommodation and food services sector (11 200 or 26%), followed by repair, laundry, domestic and other personal service activities (5 800 or 13%).

- Compared with a year ago, the number of economically active persons living in low-income households slightly increased by 3 100 (or 5%) from 65 000 to 68 100 and its proportion in total economically active persons also increased mildly from 1.8% to 1.9%. Among them, the number of full-timers were up by 7% year-on-year, to 21 900 in the third quarter of 2013. While the unemployed also edged up by 1 100 (or 5%) to 24 400, both figures still remained low as compared to 2009 or even earlier periods (*Chart 3*).
- Because full-time employees were able to enjoy distinct labour income growth after the implementation of the SMW in 2011, they could more easily climb up the income ladder and leave the low-income group. As a result, those still remaining in the low-income group were mostly unemployed, voluntary part-timers and underemployed.

Chart 3 : Composition of economically active persons in low-income households*

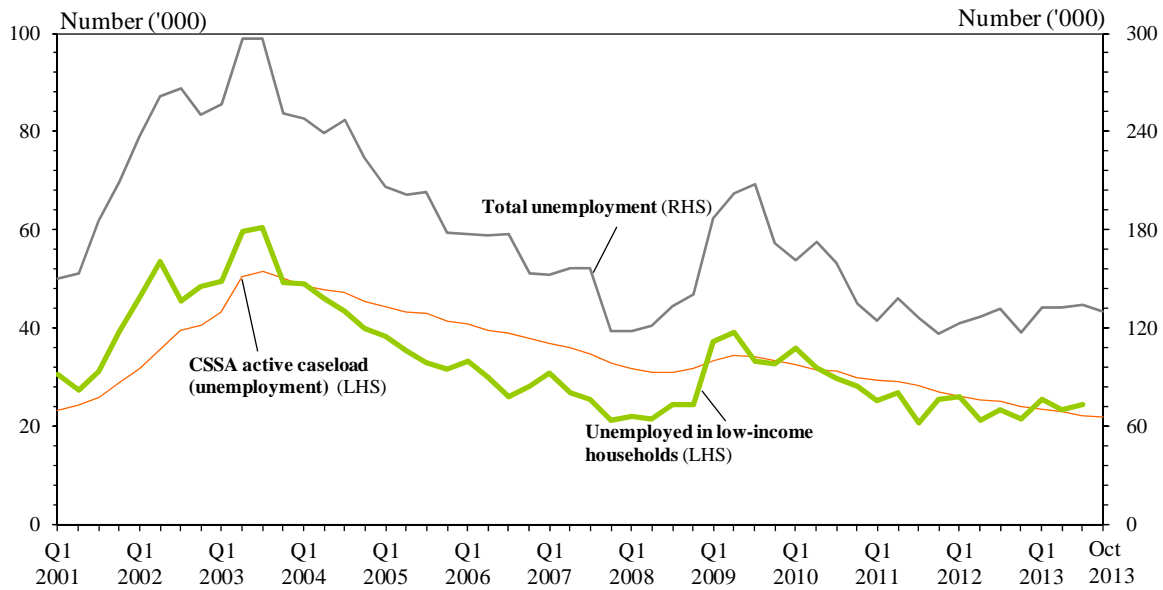


Notes : (*) Low-income households refer to households with monthly household income less than \$7,000 at constant Q2 2013 prices. This does not include households with all members being economically inactive. Figures in brackets are the year-on-year changes in number of economically active persons in Q3 2013.

The number of CSSA cases

7. Demand for grassroots labour remained strong. In August - October 2013, the lower-skilled unemployment rate held stable at 3.3%. The number of overall CSSA caseload likewise continued to decline, by 8 576 (or 3.2%) to 262 547 in October 2013 as compared to a year earlier. The decrease in unemployment cases was even more distinct, down by 2 803 (or 11.4%) to 21 801 over the same period (*Chart 4*), a manifestation of the self-reliance of grassroots workers who are able to leave the social security net amid tight labour market conditions.

Chart 4 : The relationship between the unemployed in low-income households*, CSSA active caseload (unemployment)^, and total unemployment in the economy



Notes : (*) Low-income households refer to households with monthly household income less than \$7,000 at constant Q2 2013 prices. This does not include households with all members being economically inactive.
 (^) Monthly period-end figures.

Concluding remarks

8. The Government has always attached great importance to the employment and income situations of the people, especially the impact of sub-par economic performance on the grassroots. Notwithstanding the mild economic growth for the past nine quarters, labour demand has remained staunch, contributing to a relatively stable income growth for people from different strata, with particularly noticeable improvement in wages and earnings of the grassroots workers.

9. Employment is the best route out of poverty. The Government will continue to strengthen employment / training and retraining services so as to provide support for job-seekers, and assist the vulnerable groups through social welfare, enabling them to share the fruits of economic growth. The Government will also keep on investing substantially in education in order to improve the competitiveness and skills of the workforce, increase social mobility, and reduce the child poverty risk and inter-generational poverty. To improve the livelihood of the grassroots, the fundamental solution is to promote overall economic growth so as to provide more employment and income opportunities.

10. In the short term, global economic growth is expected to remain tepid alongside the existing downside risks. While the external environment continues to be challenging, the income growth of our people should be backed by a tight local labour market in the state of full employment. The Government will remain vigilant to the employment and earnings conditions of grassroots workers and low-income households, and will provide measures and support to them when and where necessary.

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25 November 2013