



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

The Government released the Third Quarter Economic Report 2015 on 13 November. The Economic Report, together with the press release containing the updated economic forecasts for the whole year of 2015, 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 2015 as a whole, and provides some preliminary analysis on the outlook in 2016.

Economic Analysis and Business Facilitation Unit
Financial Secretary's Office
30 November 2015

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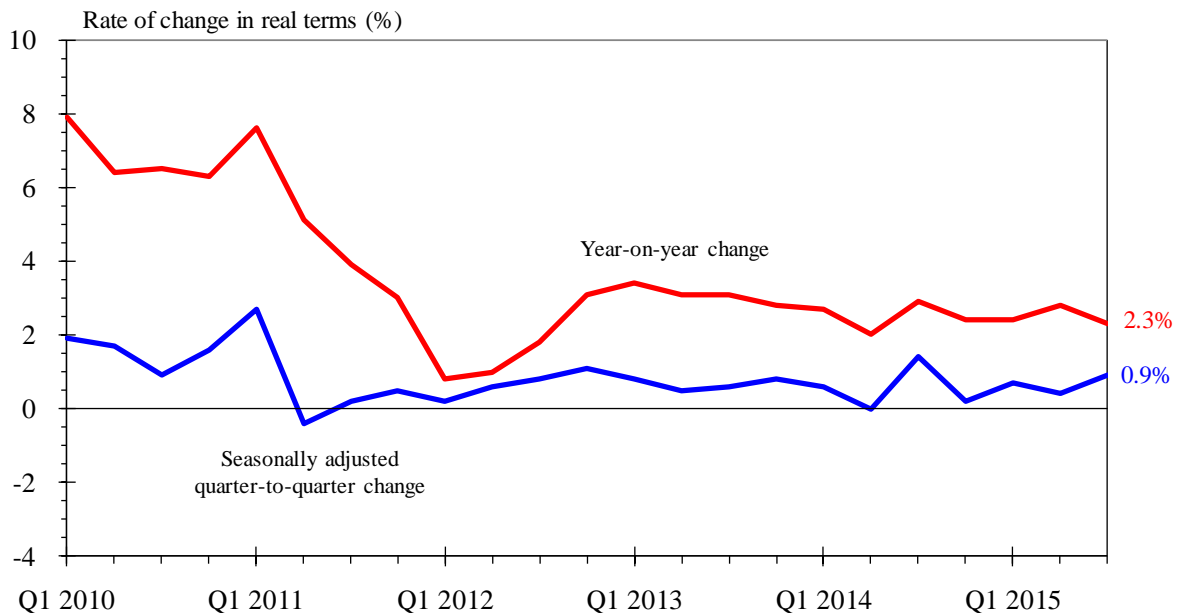
Introduction

This paper analyses the latest development in the Hong Kong economy and briefly discusses the updated economic forecasts for 2015 as a whole and the economic outlook for 2016.

Recent economic situation

2. Hong Kong's economic growth slowed to 2.3% year-on-year in real terms in the third quarter of 2015, from 2.8% in the second quarter. The growth slowdown was part of a region-wide phenomenon amid a lacklustre global economy, and reflected the intensified impact on the economy from weaker external demand. The domestic segment, while staying relatively stable, also expanded at a slower pace. On a seasonally adjusted quarter-to-quarter comparison, real GDP grew by 0.9% in the third quarter, after the 0.4% growth in the preceding quarter (*Chart 1*).

Chart 1 : The Hong Kong economy grew modestly in the third quarter of 2015



External trade

3. The global economic environment was highly unsteady in the third quarter. The US economy lost some momentum in the third quarter, after a notable rebound in the second quarter. The economic performance of the eurozone remained lacklustre, while Japan entered recession again, with both economies facing deflation risks. Many emerging market economies came under pressure and experienced varying degrees of growth slowdown. Shifting market expectations about the timing of the Federal Reserve's interest rate lift-off and increased downside risks to the global economic outlook also instigated sharp stock market corrections and currency depreciations during the quarter. All these unfavourable developments weighed on regional trade flows and production activities.

4. Against such an austere external environment, exports of Asian economies extended the decline in the third quarter. Hong Kong's total exports of goods also contracted for the second consecutive quarter, down by 3.2% year-on-year in real terms in the third quarter, further to a 3.6% decline in the preceding quarter (*Chart 2(a)*). Among the advanced markets, exports to the US slackened to a modest decline, while exports to the EU and Japan trended lower. Exports to major Asian economies, including Taiwan, Korea, Singapore and the Mainland, fell notably. The declines in exports of raw materials and semi-manufactures as well as capital goods reflected the slack in regional production activities in the face of the subdued global demand conditions. Latest available statistics indicated that merchandise exports continued to fall in value terms in October.

5. Exports of services slackened again to a decline, falling by 1.3% in real terms in the third quarter over a year earlier (*Chart 2(b)*). Exports of trade-related services and transportation services saw further declines, dragged by the continued fall in regional trade and cargo flows under an increasingly difficult external trading environment. The highly volatile financial conditions during the quarter also affected cross-border financial and fund-raising activities, leading to a concurrent growth slowdown in exports of financial and other business services.

Chart 2(a) : Total exports of goods fell further in the third quarter

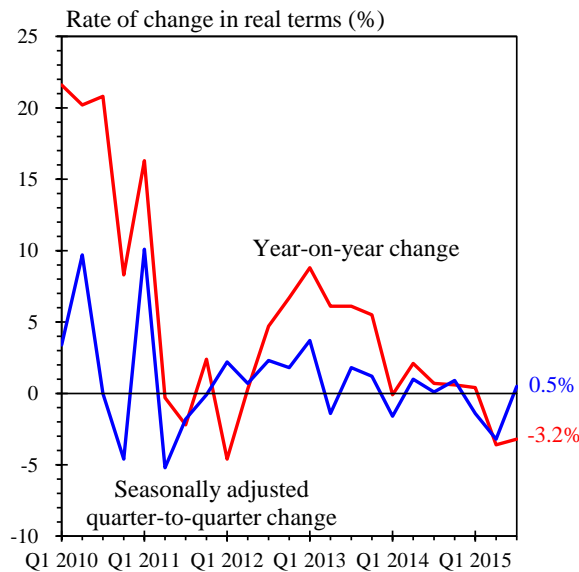
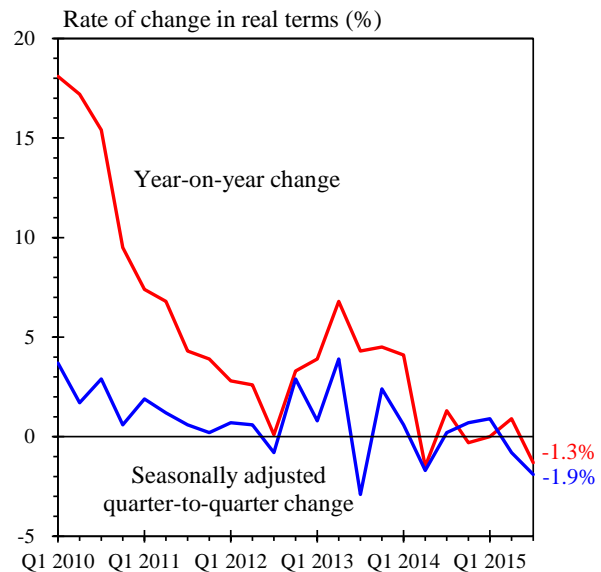


Chart 2(b) : Exports of services slackened to a decline



6. The slowdown in exports of travel services continued in third quarter, down by 5.6% year-on-year in real terms, as visitor arrivals slackened further to record its first year-on-year decline of 6.4% since the third quarter of 2009. Among the visitor arrivals, those from the Mainland (accounting for more than 70% of the total) and non-Mainland fell by 7.3% and 3.0% respectively. Apart from the mediocre global economic performance, depreciations of many currencies against the US dollar conceivably led some visitors to reduce travel and possibly diverted some to other popular travel destinations.

Domestic sector

7. Domestic demand expanded at a slower pace in the third quarter, but remained the major driver of the economy in the face of external headwinds. Private consumption expenditure sustained a solid, albeit somewhat slower, year-on-year growth of 4.3% in real terms in the third quarter, supported by broadly favourable job and income conditions (*Chart 3(a)*).

8. Overall investment spending declined by 6.5% year-on-year in real terms in the third quarter, after a 5.2% growth in the second quarter. The decline largely reflected the plunge in the typically volatile machinery and equipment acquisition, by 10.5% year-on-year, conceivably due to increased cautiousness among enterprises in the face of a dimmer global economic outlook and notable financial market volatility during the quarter. Overall building and construction expenditure, on the other hand, posted further growth of 4.2% year-on-year, backed by the ongoing large-scale infrastructure works and the steady expansion of private sector

building and construction activity (*Chart 3(b)*).

Chart 3(a) : Private consumption expenditure subsisted further growth, thanks to broadly favourable job and income conditions

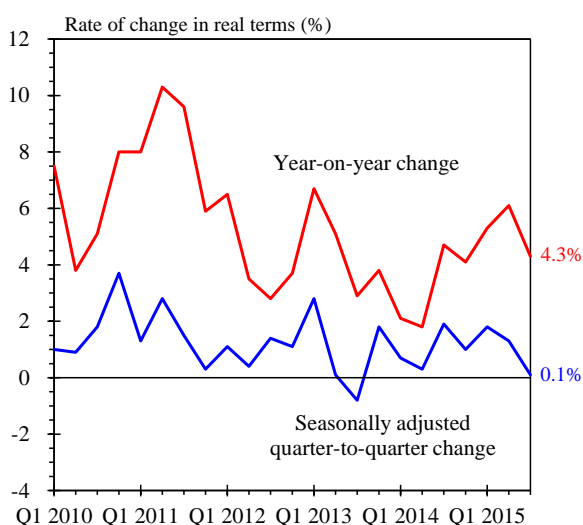
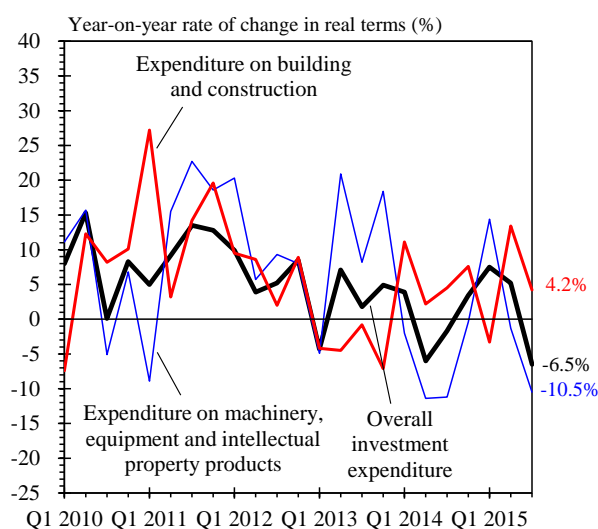


Chart 3(b) : Investment spending declined



9. As for foreign direct investment (FDI), country breakdowns of FDI flow data are available up to end-2013 only. The Mainland remained prominent as a major source of Hong Kong’s external direct investment, accounting for 32% of the total position of Hong Kong’s inward direct investment. According to the latest balance of payments figures, FDI inflows⁽¹⁾ surged by 51% to \$899 billion (US\$116 billion or 40% of GDP) in 2014. It jumped considerably further by 112% year-on-year in the first half of 2015 to \$1,015 billion (US\$131 billion or 89% of GDP), partly attributable to some significant corporate restructuring and related merger and acquisition activities taking place in the period. Separately, the number of business operations in Hong Kong with parent companies overseas and in the Mainland climbed to a new high of 7 904 in the survey in 2015, with the Mainland enterprises showing strong rises in recent years, accentuating Hong Kong’s unique role as the major springboard for Mainland companies to go global, and also demonstrating its significant position as an international financial and business hub.

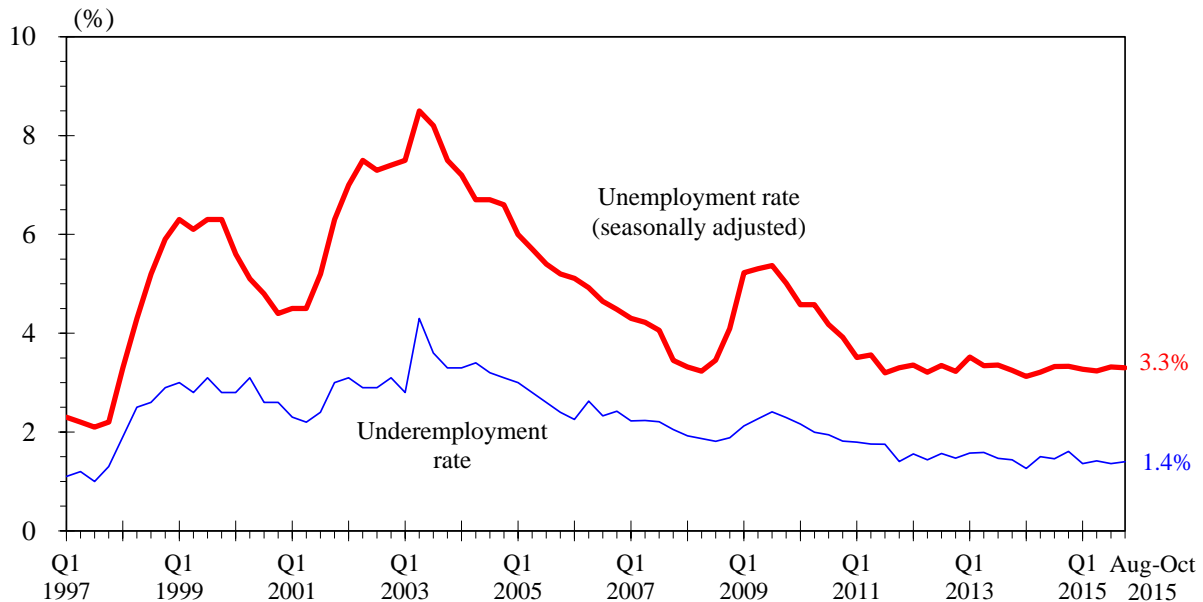
Labour Market

10. The labour market held largely stable up to October 2015. The seasonally adjusted unemployment rate stayed at a relatively low level of 3.3% in August – October 2015 for the fourth consecutive period. The underemployment rate likewise remained low at 1.4% (*Chart 4*). Both total employment and labour force sustained moderate year-on-year growth at 0.6% in overall terms. Yet data

(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.

collected from private sector establishments pointed to some easing in labour demand, particularly in sectors that were more affected by the relapse in exports and the slowdown in inbound tourism.

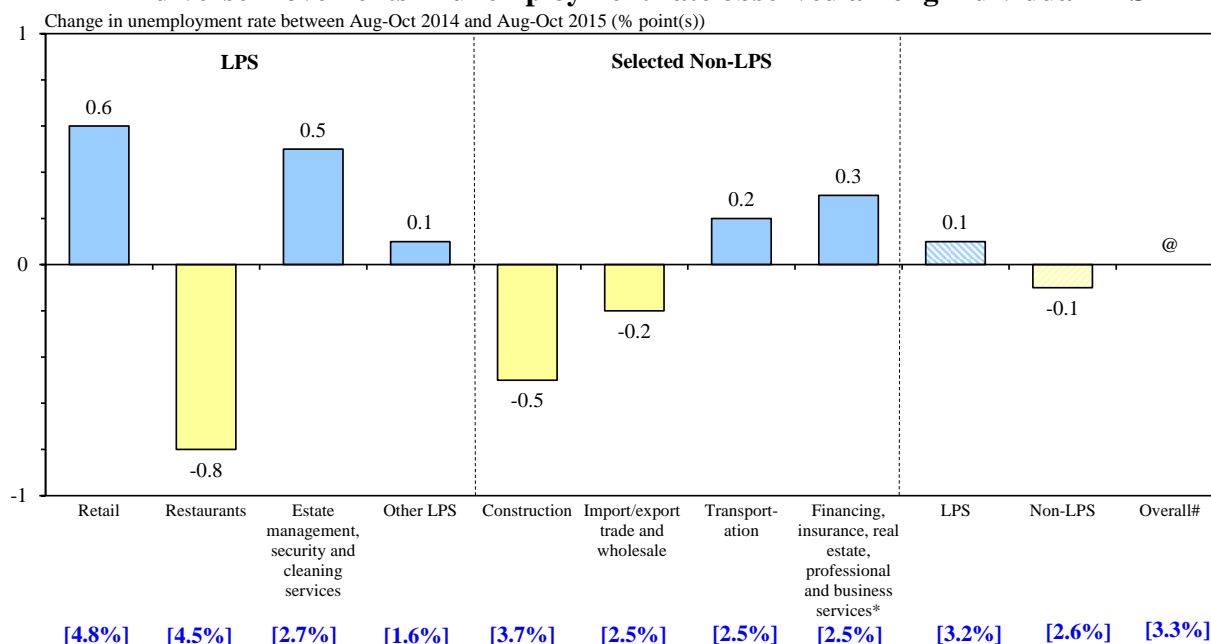
Chart 4 : The labour market held largely stable



11. Since the implementation of Statutory Minimum Wage (SMW), overall economy maintained moderate growth during most of the period, thereby relieving to some extent the pressure on the labour market brought about by SMW. The overall seasonally adjusted unemployment rate stayed low at 3.3% in August – October 2015, though up marginally by 0.1 percentage point from the level right before the SMW uprating in May 2015 (3.2% in February – April 2015). On a year-on-year comparison, the unemployment rate for the low paying sectors (LPS)⁽²⁾ as a whole inched up by 0.1 percentage point to 3.2%, while that for the non-low paying sectors (non-LPS) edged down by 0.1 percentage point to 2.6% (*Chart 5*). In view of the continued slowdown in inbound tourism, the subsequent development of the unemployment situation among related sectors, in particular retail and accommodation services, warrants our concerns.

(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 : Unemployment rate of LPS as a whole inched up over a year earlier despite diverse movements in unemployment rate observed among individual LPS



Notes: Figures in brackets refer to the unemployment rate for that sector in Aug-Oct 2015 (provisional figures).

(*) Excluding real estate maintenance management, security and cleaning services.

(#) Seasonally adjusted.

(@) Change less than 0.05 percentage point.

12. Analysed by skill segment, in August – October 2015, the unemployment rates for the higher-skilled segment rose by 0.2 percentage point to 1.8% over February – April 2015 (*Table 1*), while that of the lower-skilled segment went down by 0.5 percentage point to 3.3%. Compared to a year ago, the unemployment rate of higher-skilled segment held at a broadly similar level. On the other hand, that of the lower-skilled segment was down marginally by 0.1 percentage point. In terms of employment, the lower-skilled segments increased by 1.0% over a year ago while that of the upper-skilled segments held broadly unchanged.

Table 1 : The unemployment situation in both skill segments were largely stable

	Employment [#]					Unemployment rate [#]		
	Aug – Oct 2015	Change as compared to Feb – Apr 2015 (before the implementation of the revised SMW rate)		Change as compared to Aug – Oct 2014 (a year earlier)		Aug – Oct 2015	Change as compared to Feb – Apr 2015 (before the implementation of the revised SMW rate)	Change as compared to Aug – Oct 2014 (a year earlier)
	(No.)	(No.)	(%)	(No.)	(%)	(%)	(% point)	(% point)
Higher-skilled	1 438 100	+4 900	+0.3	^	@	1.8	+0.2	*
Lower-skilled	2 351 800	-7 300	-0.3	+23 800	+1.0	3.3	-0.5	-0.1
Lower-skilled (excl. government employees and live-in domestic workers)	1 949 400	+2 900	+0.1	+4 800	+0.2			

Note : (#) Provisional figures.

(^) Change less than 500.

(@) Change less than 0.05%.

(*) Change less than 0.05 percentage point.

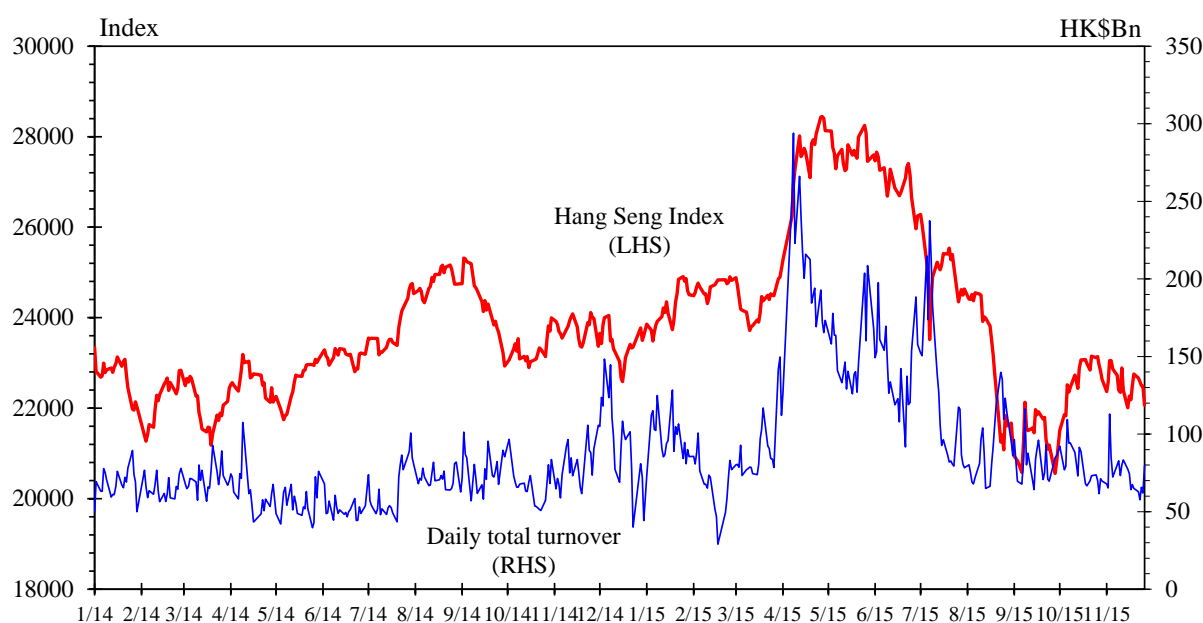
13. Amid the broadly stable labour market, the overall earnings situation remained largely favourable up to June 2015. Both overall nominal wage and payroll registered a further broad-based year-on-year increase of 4.6%. After discounting inflation, real wages and earnings grew by 0.1% and 1.6% respectively. Thanks to the upward adjustment of SMW rate since May 2015, grassroots workers enjoyed even more appreciable wage growth. More recent data showed that the average monthly employment earnings for full-time employees engaged in elementary occupations recorded a notable nominal growth at 8.0% year-on-year in the third quarter of 2015, translating into a real increase of 5.1% after discounting inflation (Please refer to *Annex* for details).

Asset markets

14. The local stock market underwent a sharp correction during the third quarter. Such a phenomenon was widespread in equity markets across the globe, as investor sentiment was dented by worries over the global economic outlook and the

uncertainties associated with the timing of the US interest rate lift-off. The Hang Seng Index (HSI) finished September at 20 846, 20.6% below the level at end-June. While HSI rebounded somewhat from the low in the past month or so, its performance remained choppy, and it closed at 22 068 on 27 November, still 6.5% below the level at end-2014. Trading activities quietened down in parallel in recent months. Average daily turnover fell from the record-high of \$164.9 billion in the second quarter to \$101.5 billion in the third quarter and further to \$79.6 billion in October (*Chart 6*).

Chart 6 : Local stock market underwent a sharp correction in the third quarter



15. The residential property market has quietened down visibly since July. The number of sale and purchase agreements for residential property received by the Land Registry fell by 18% from the second quarter to a monthly average of 4 213 in July to October 2015, and there was an even sharper 36% fall when compared with a year earlier (*Chart 7(a)*).

16. Overall flat prices rose by a decelerated 2% between June and September 2015. The monthly increase in flat prices moderated from 0.9% in July to 0.2% in September. During the first nine months of 2015, overall flat prices rose by a cumulative 10%, led by a 10% rise in the prices of small/medium-sized flats (less than 100 square metres) (*Chart 7(b)*). Meanwhile, overall flat rentals in September 2015 rose by 2% over June, and were 6% higher than in December 2014.

Chart 7 : Residential property market quietened down visibly in recent months

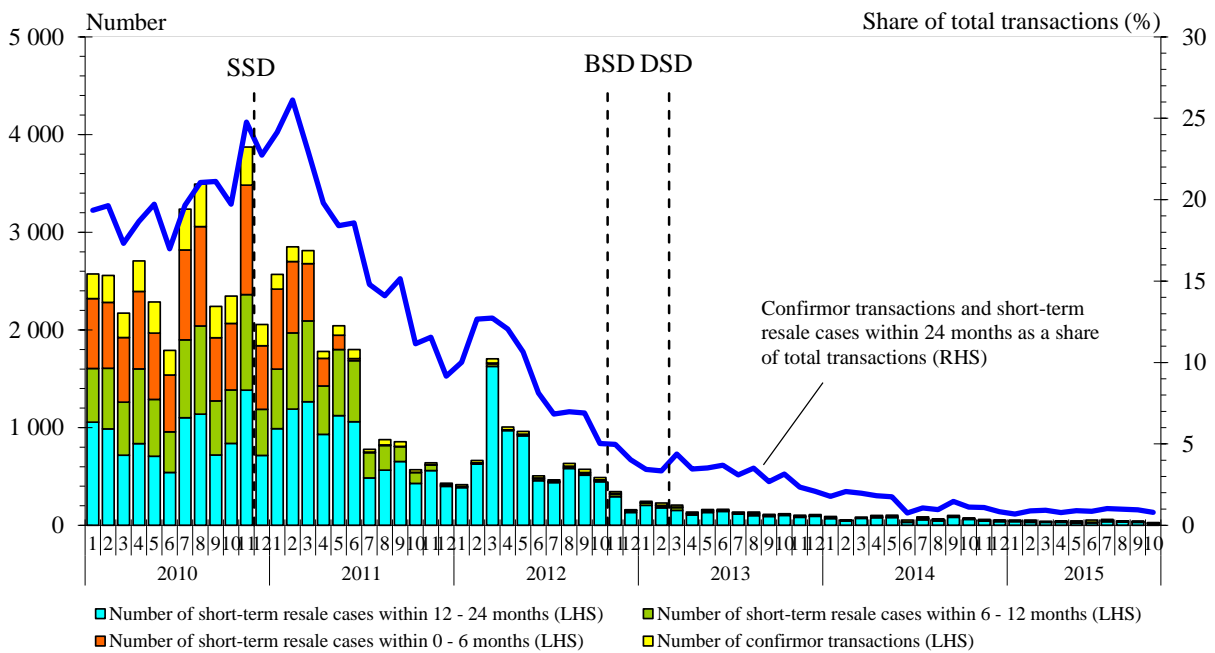


17. Raising flat supply through increasing land supply is the Government’s top policy priority in ensuring the healthy and stable development of the property market. As announced in September 2015, the Government will put up for sale a total of four residential sites in the fourth quarter, capable of providing about 2 850 flats. Combining the various sources (including Government land sale, railway property development projects, the Urban Renewal Authority’s projects and private re-development/development projects), the private housing land supply for the first three quarters of financial year 2015/16 (i.e. from the second to the fourth quarter of 2015) is estimated to be able to provide about 16 950 units, representing 89% of the 2015/16 private housing land supply target of providing 19 000 units. Over the medium term, the total supply of flats in the coming few years (comprising unsold flats of completed projects, flats under construction but not yet sold and flats on disposed sites where construction can start any time) rose further from 83 000 units as estimated at end-June to 86 000 units as estimated at end-September.

18. As it takes time to increase 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) stayed low at 47 cases per month or 0.9% of total transactions in the first ten months of 2015, compared with 82 cases per month or 1.4% a year earlier and 2 661 cases per month or 20.0% in January to November 2010 (i.e. the period before the introduction of the Special Stamp Duty) (*Chart 8*). Reflecting the effects of the

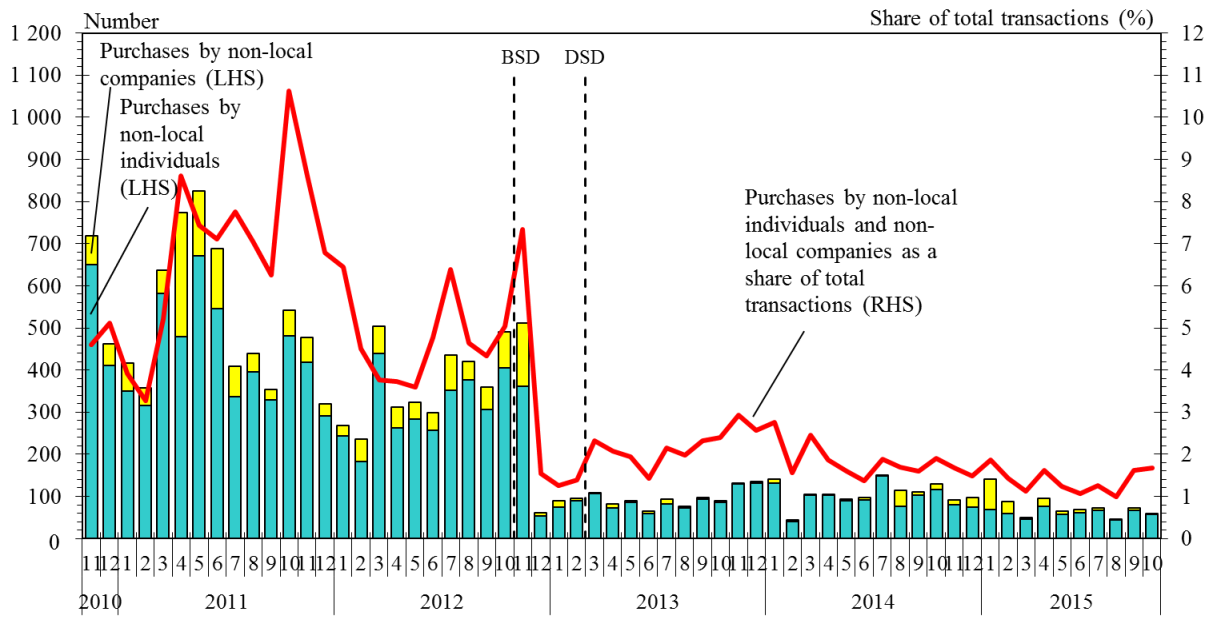
Buyer's Stamp Duty, purchases by non-local individuals and non-local companies also declined from 109 cases per month or 1.8% of total transactions a year earlier to 76 cases per month or 1.4% in the first ten months of 2015, much lower than the monthly average of 365 cases or 4.5% in January to October 2012 (*Chart 9*). As to mortgage lending, the average loan-to-value ratio of new mortgages notched down from 56% a year earlier to 52% in the first nine months of 2015, below 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 8 : Speculative activities stayed subdued



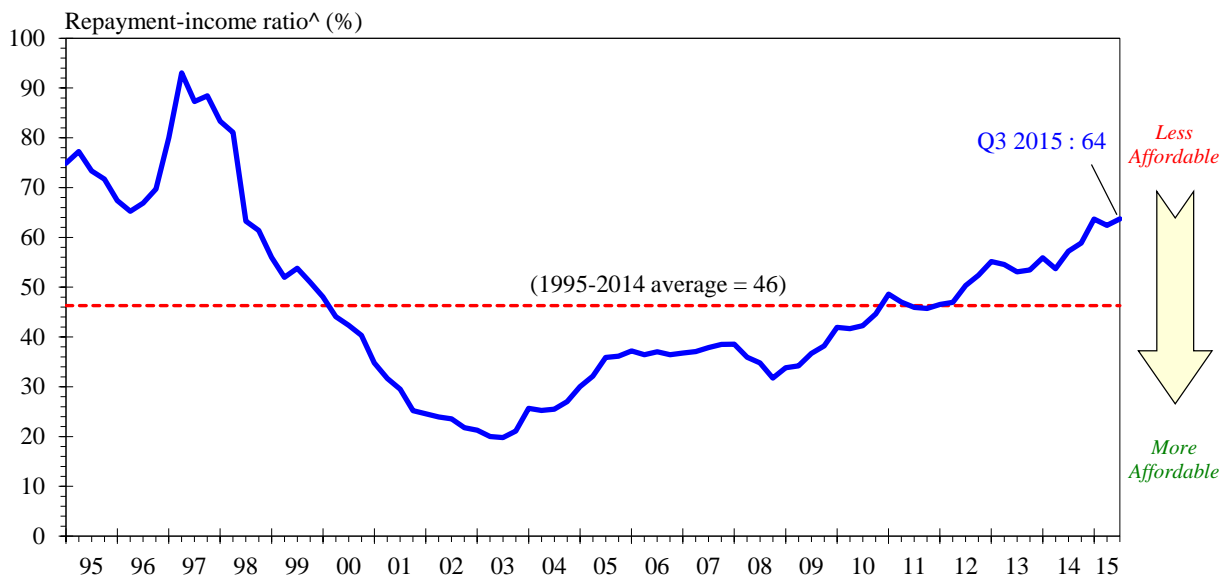
Note : Confirmor transactions refer to resale before assignment.

Chart 9 : Purchases by non-local buyers remained low



19. With the further increase so far this year, overall flat prices in September 2015 have surpassed the 1997 peak by 77%. Home purchase affordability (i.e. the ratio of mortgage payment for a 45-square metre flat to median income of households, excluding those living in public housing) rose to around 64% in the third quarter, exceeding the long-term average of 46% over 1995-2014 (*Chart 10*). Should interest rates rise by three percentage points to a more normal level, the ratio would rise to 83%.

Chart 10 : Mortgage-to-income ratio rose

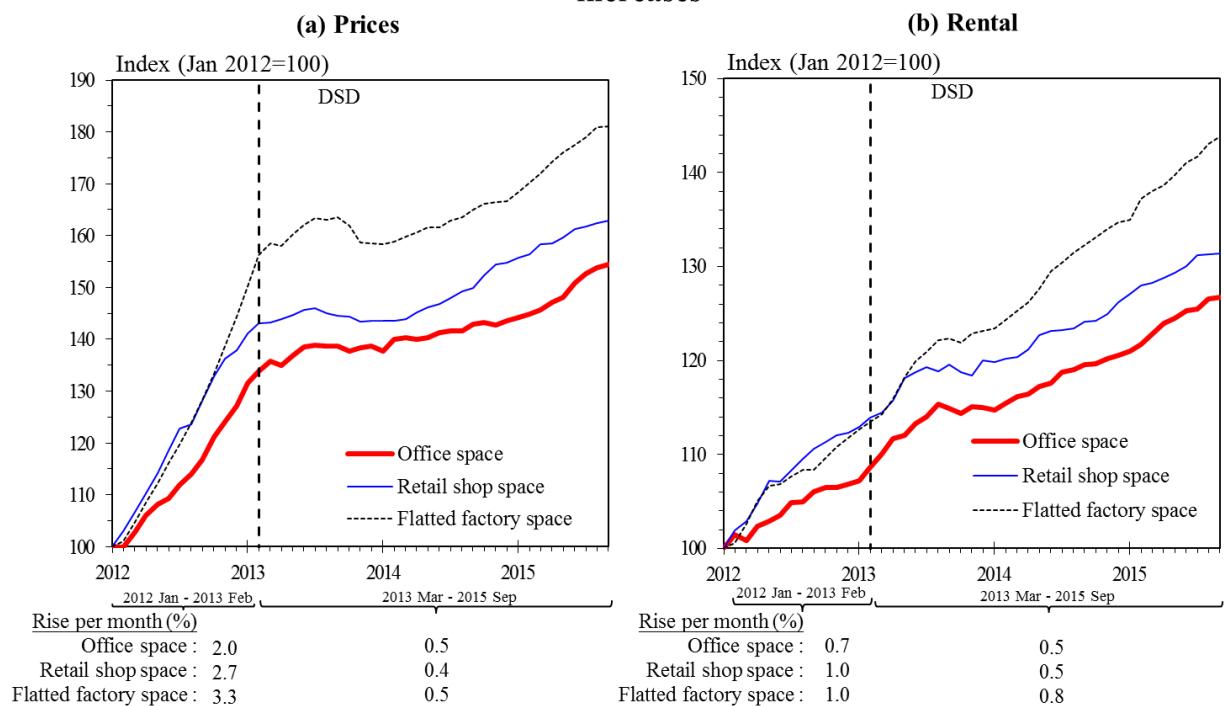


Note : (^) The ratio of mortgage payment for a flat with saleable area of 45 sq m (assuming 70% loan-to-value ratio and tenor of 20 years) to median income of households (excluding those living in public housing). This ratio is different from the debt servicing ratio published by the HKMA, which is the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

20. Looking ahead, the residential property market will be subject to considerable uncertainties. Externally, the economic environment is still highly unsteady. The market recently has expected that the US Federal Reserve would raise interest rate soon, though the exact timing and pace of the interest rate hike are still uncertain. Domestically, following the Government’s sustained efforts in providing enough residential land, the medium-term supply of flats has increased noticeably. With these various forces simultaneously exerting their effects, the residential property market might show larger fluctuations in the period ahead. The Government will closely monitor the data and trend of the property market, and also the changes in the overall economic environment.

21. The commercial and industrial property markets generally stayed steady. Both sale prices and rentals of retail shop space rose by 1% between June and September 2015. Over the same period, overall sale prices and rentals of office space rose by 2% and 1% respectively, while sale prices and rentals of flatted factory space both rose by 2% (*Chart 11*). Trading activities for most market segments quietened down though.

Chart 11 : Prices and rentals of non-residential properties continued to record moderate increases



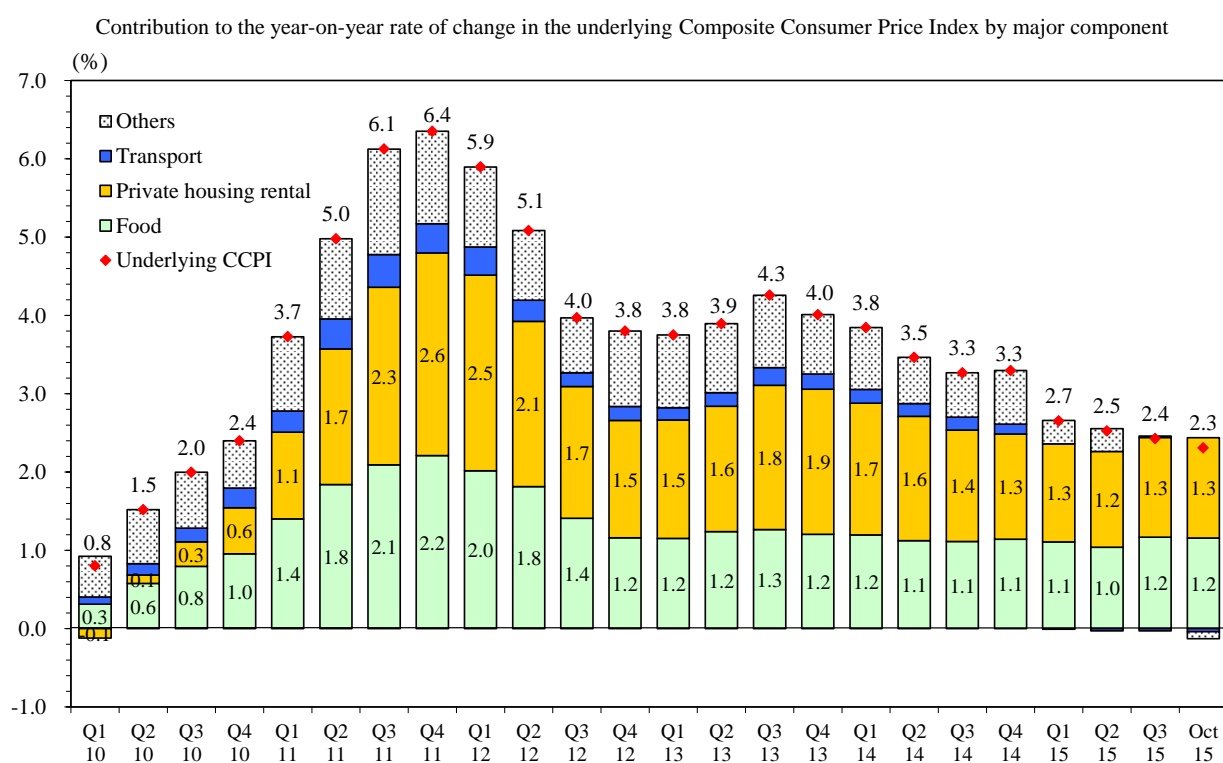
Inflation

22. Underlying inflation followed an easing trend. Locally, the growth in labour costs remained steady and the feed-through of rising fresh-letting residential and commercial rentals earlier this year was still initial and gradual. All these helped keep domestic cost pressures contained. Meanwhile, external price

pressures continued to recede, thanks to the soft international food and commodity prices, the low inflation in Hong Kong’s major import partners, and the strength of the US dollar.

23. Netting out the effects of the Government’s one-off relief measures to more accurately reflect the underlying inflation trend, underlying consumer price inflation eased to 2.4% in the third quarter and 2.3% in October, averaging 2.5% in the first ten months of 2015, down from the annual average of 3.5% in 2014 (*Chart 12*).

Chart 12 : Underlying consumer price inflation eased successively



24. Analysing inflation by major components of the underlying Composite CPI showed that the abatement of price pressures was still generally widespread (*Table 2*). On the two largest components by weight, food inflation (including cost of dining out) in the first ten months of 2015 combined remained modest, averaging at 4.0%, somewhat lower than the 4.1% in the fourth quarter of 2014, notwithstanding fluctuations in the monthly prices of some basic foodstuffs. Rental inflation likewise stayed contained, with the year-on-year increase in private housing rental component holding steady so far this year in the range of 4% to 4.5%, reflecting the continued feed-through of a slower increase in fresh-letting rentals last year. As to other components, prices of clothing and footwear continued to register year-on-year decline in recent months, reflecting subdued imported inflation, and the pressure to cut prices in a bid to boost sales. The still-low international oil prices, plummeted from year-ago levels, also contributed to a visible fall in prices of motor

fuel within the transport component. Moreover, the price decline in the electricity, gas and water component was particularly distinct, down by 6.1% in both the third quarter and October, thanks to the special fuel rebate in electricity starting from mid-August. Meanwhile, the secular downtrend in durable goods prices continued with a faster pace of decline, conceivably due to a distinctly lower yen and euro. Price pressures on miscellaneous goods and services also eased further on a broad front amid muted import price pressures and modest economic expansion locally.

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

Expenditure component	Weighting (%)	2014					2015			
		2014	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Oct
Food	27.45	4.1	4.3	4.0	4.0	4.1	4.0	3.7	4.2	4.1
<i>Meals bought away from home</i>	17.07	4.6	4.5	4.7	4.6	4.6	4.4	4.3	4.3	4.1
<i>Other foodstuffs</i>	10.38	3.4	4.0	3.1	3.1	3.5	3.3	2.8	4.0	4.2
Housing ^(a)	31.66	5.0 (6.7)	5.3 (5.6)	5.0 (5.0)	4.8 (7.6)	5.0 (8.5)	4.7 (8.2)	4.7 (4.2)	4.5 (4.1)	4.0 (4.0)
<i>Private dwellings</i>	27.14	5.2 (6.0)	5.9 (6.4)	5.5 (5.6)	4.9 (4.9)	4.6 (7.1)	4.3 (6.8)	4.2 (3.8)	4.3 (3.9)	4.3 (4.3)
<i>Public dwellings</i>	2.05	3.4 (18.3)	-0.1 (-1.8)	0.4 (-0.9)	3.6 (101.4) ^(b)	9.8 (29.0)	9.8 (29.0)	9.4 (10.0)	6.1 (6.4)	0.0 (0.0)
Electricity, gas and water	3.10	2.5 (14.9)	4.4 (5.5)	2.7 (3.4)	1.6 (24.9)	1.3 (25.5)	-1.4 (21.5)	-0.7 (22.8)	-6.1 (-4.6)	-6.1 (-4.7)
Alcoholic drinks and tobacco	0.59	6.5	3.3	7.6	7.4	7.6	4.3	-0.1	0.3	1.0
Clothing and footwear	3.45	0.9	2.1	2.2	0.8	-1.4	-0.8	-2.7	-1.9	-1.2
Durable goods	5.27	-3.4	-3.3	-2.7	-3.3	-4.4	-5.5	-5.7	-5.6	-5.8
Miscellaneous goods	4.17	2.3	3.1	2.0	2.4	1.5	1.2	1.3	0.6	0.9
Transport	8.44	2.0	2.2	2.1	2.1	1.6	-0.1	-0.4	-0.4	-0.5
Miscellaneous services	15.87	2.3 (3.0)	3.1 (4.4)	2.0 (3.2)	1.9 (2.3)	2.1 (2.1)	0.8 (0.8)	1.4 (1.4)	1.1 (1.1)	1.3 (1.3)
All items	100.00	3.5 (4.4)	3.8 (4.2)	3.5 (3.6)	3.3 (4.8)	3.3 (5.1)	2.7 (4.4)	2.5 (3.0)	2.4 (2.3)	2.3 (2.4)

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

- (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 increases in the public housing rental component of the Composite Consumer Price Index in the third quarter of 2014 were due to a low base of comparison resulted from the Government's payment of public housing rentals in September 2013.

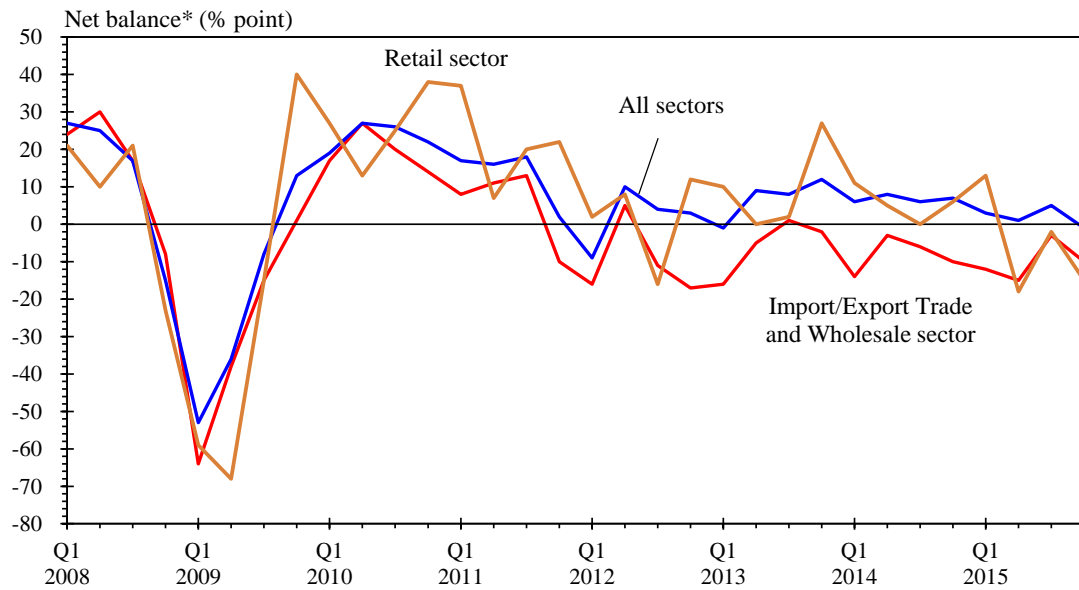
Updated short-term economic forecasts for 2015

25. In the near term, global economic growth is likely to remain sluggish, marked by increasing downside risks. Recovery of advanced economies is slow and patchy, with downward pressures on emerging market economies still prominent. The slack in global demand will continue to curtail Asia's exports and intra-regional trade. Also, international financial markets will likely remain highly volatile, in view of the prospect for eventual US interest rate lift-off, diverging monetary policy among major central banks and heightened geopolitical tensions. This would add headwinds to the already fragile global economy. Thus, the outlook for Hong Kong's merchandise exports is likely to remain bleak going forward. The near-term outlook for services exports is also not encouraging, given the slowdown in inbound tourism and the lull in regional trade and cargo flows.

26. Against the challenging external environment, the major impetus to Hong Kong's economic growth in the rest of the year will continue to count on domestic demand. Further expansion of consumption demand, on the back of steady job and income conditions, and intensive infrastructure works will likely render support to the domestic economy. However, as the US Federal Reserve is prepared to hike interest rates and as the global outlook is still subject to various downside risks, the possible adverse repercussions on local asset prices and economic sentiment need to be watched closely. The latest Quarterly Business Tendency Survey already also showed more cautiousness on the near-term outlook among the large enterprises (*Chart 13*). Moreover, given the slowdown in inbound tourism, the possible spill-over on the job market remains a source of concern.

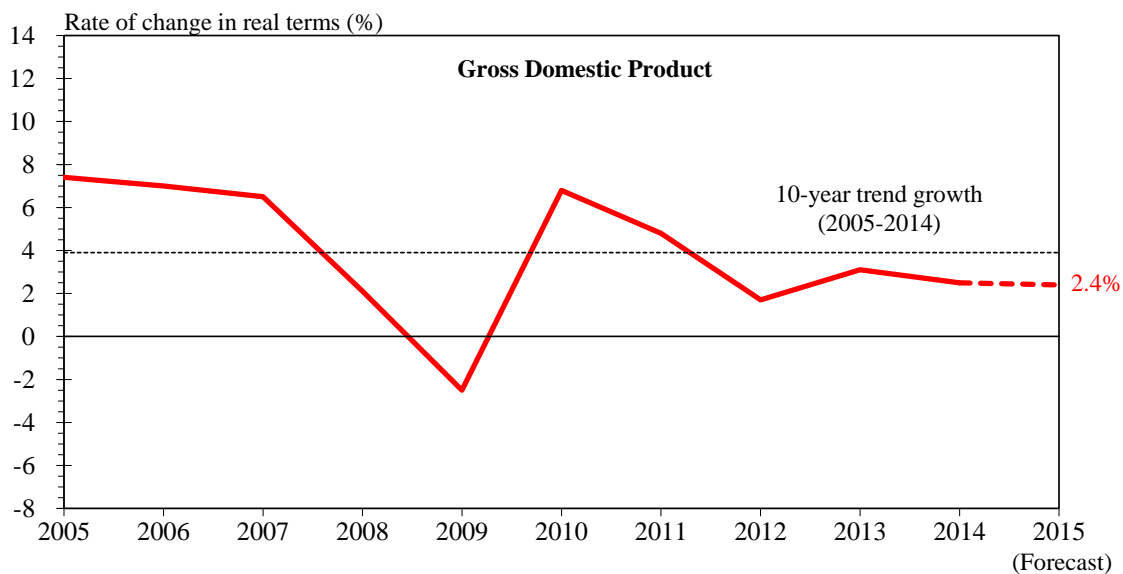
27. Taking into account the actual year-on-year GDP growth outturn of 2.5% in the first three quarters, and even with due cognizance of a still lacklustre external segment in the fourth quarter, the real GDP growth for 2015 as a whole is still expected to attain moderate growth at 2.4%, within the range forecast of 2-3% announced in the August round (*Chart 14*). For reference, the International Monetary Fund (IMF) in October projected Hong Kong's economic growth for this year at 2.5%, whereas the latest forecasts by private sector analysts mostly range from 2.0% to 2.6%, averaging around 2.3%.

Chart 13 : Large enterprises turned more cautious on the near-term business outlook



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.

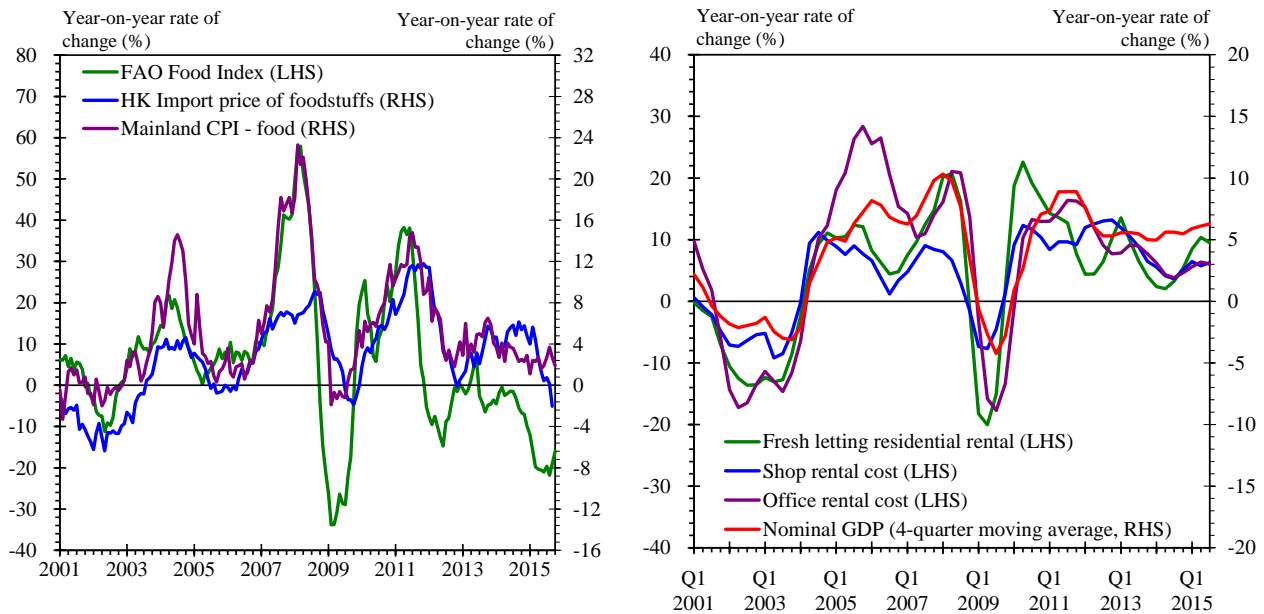
Chart 14 : Economic growth for 2015 as a whole is forecast at 2.4%



28. On inflation outlook, the upside risks to inflation should remain well contained in the months ahead, given the mild external price pressures and growth slowdown of the local economy (*Chart 15*). Taking into account the actual inflation outcome of 2.5% in the first nine months this year, the forecast underlying consumer price inflation for 2015 is revised slightly down from 2.6% in the August round to 2.5% in the November round of review. The forecast for headline inflation in 2015 is likewise marked down from 3.1% to 3.0%. For reference, the

IMF in October forecast Hong Kong's headline consumer price inflation for this year at 2.9%, whereas the latest forecasts by private sector analysts mostly range from 2.4-3.5%, averaging around 3.0%.

Chart 15 : Upside risks to inflation in the near term should remain well contained in the months ahead, given the plunge in international food and commodity prices and growth slowdown of the local economy



Economic outlook for 2016

29. The external environment is likely to remain unsteady in 2016. The IMF in October revised down the global economic forecast for 2016 to 3.6%. Though somewhat faster than the growth estimate for this year, the forecast indicates that global economic growth would remain slow and patchy.

30. Among the advanced economies, the US economic recovery has a stronger footing. Despite some moderation in growth momentum in the third quarter, US economy still attained a 2.6% year-on-year growth in the first three quarters, with further solid growth in personal consumption and residential investment in the third quarter (*Chart 16*). The economy will hopefully continue to grow moderately next year. The labour market has improved further, with job gains far exceeding market expectation and the unemployment rate falling to 5% in October, which set the stage for the interest rate lift-off.

Chart 16 : The US economy continued to expand moderately recently

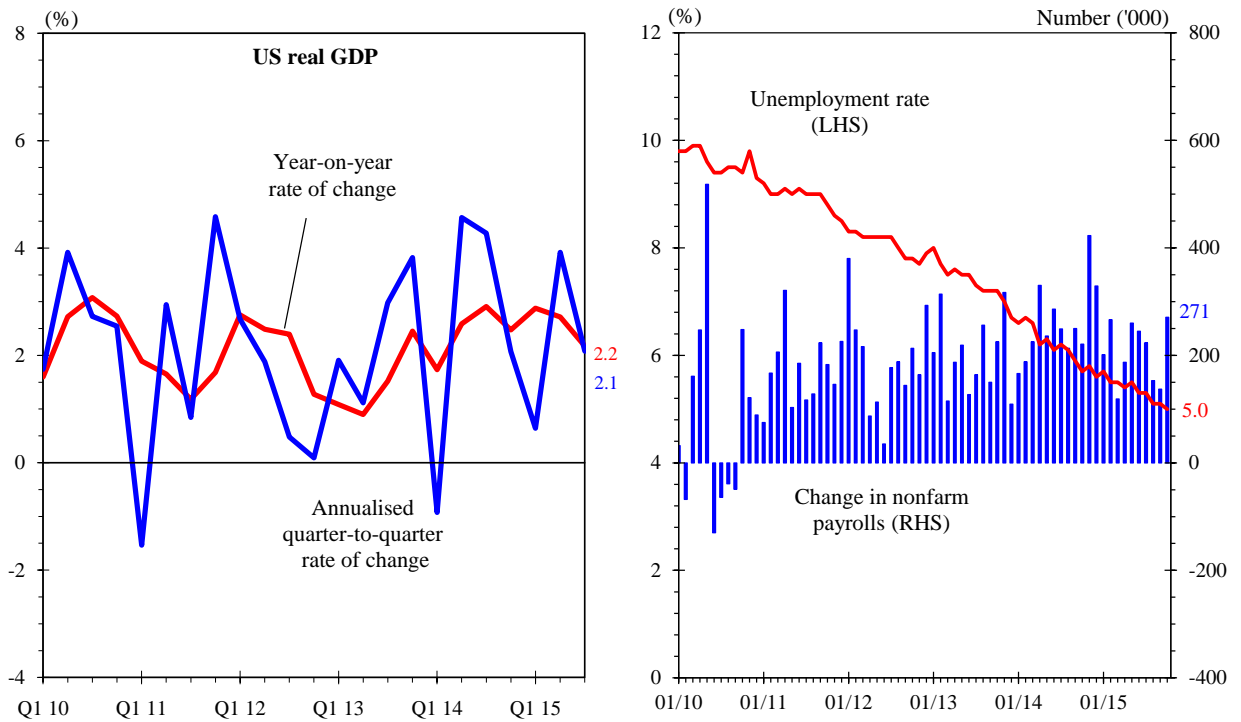


Chart 17 : The eurozone economy still lacked momentum, constrained by many structural issues

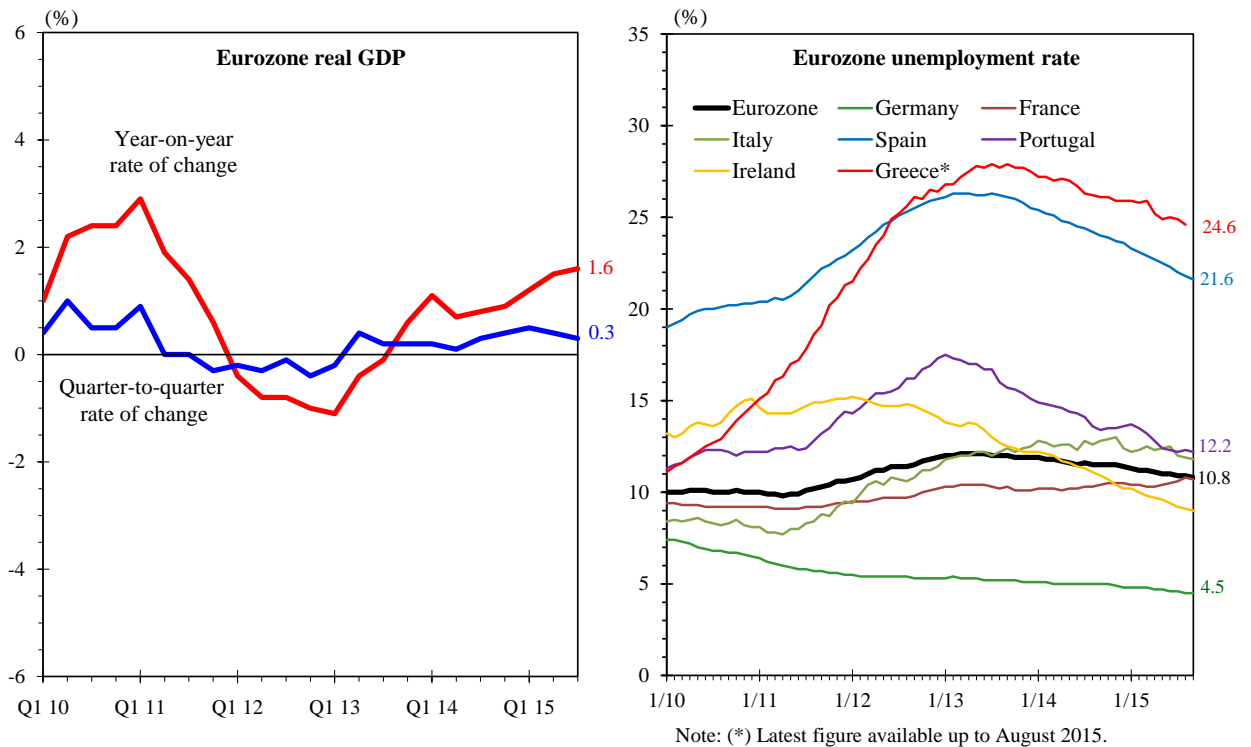
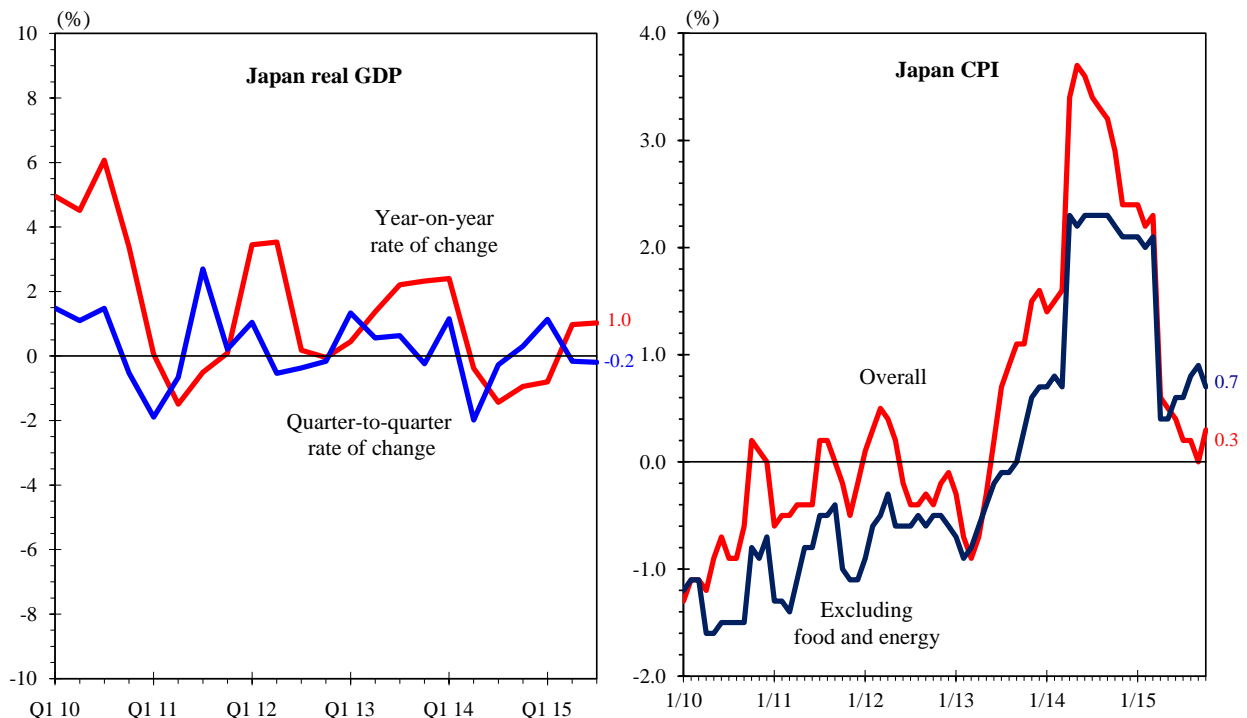


Chart 18 : Japan's economy mired in technical recession again



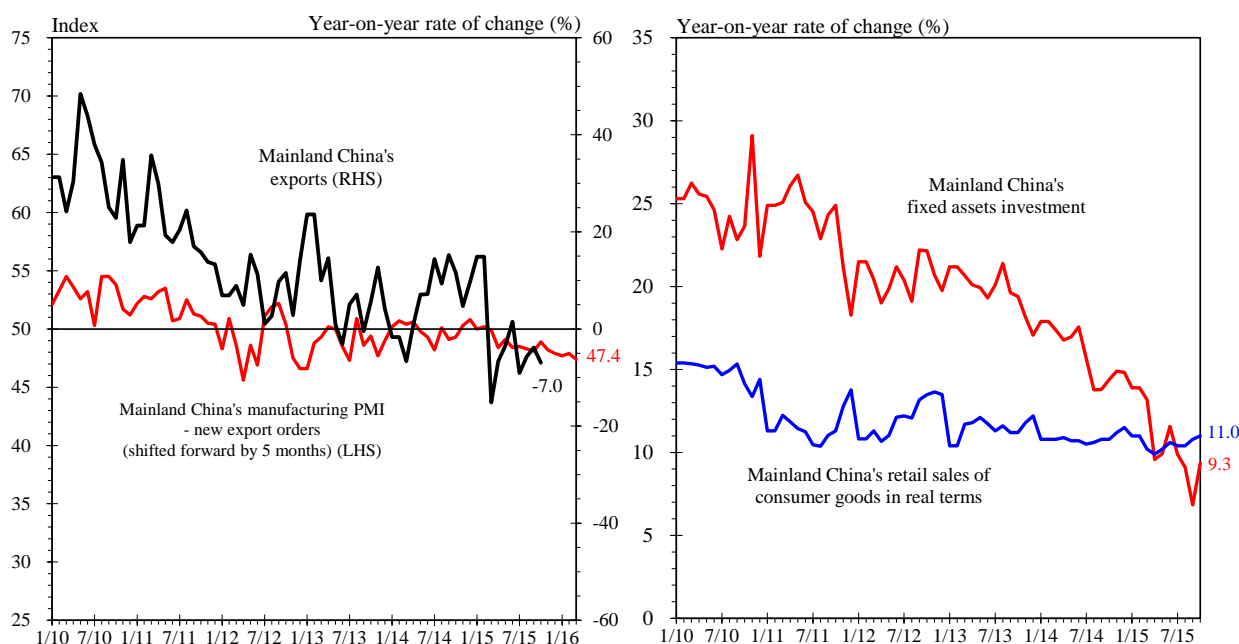
31. As for the eurozone, although the Greek debt crisis has been temporarily averted, the economic growth for the region remained stuck in the slow lane in the first three quarters, up by 1.4% year-on-year. Real GDP growth slowed further to only 0.3% quarter-to-quarter in the third quarter. There remain difficulties preventing eurozone's growth momentum from picking up in any significant way in the near term, as the afflictions of deep-seated structural issues including elevated unemployment and heavy debt burden persist (*Chart 17*). The heightened geopolitical tensions and the recent mass influx of refugees will further complicate the situation. Moreover, deflation risks remain, with consumer price inflation rate at merely 0.1% in October. Stripping the effect of energy and food prices, core consumer price index rose only by 1.1% year-on-year, lower than the target of the European Central Bank (ECB). Given the downward pressures on economic growth and inflation, the ECB president in the post-meeting press conference in October indicated that the monetary policy stance needed to be re-examined in December, fueling market expectation for further easing measures.

32. Japan's economic performance was even more unstable. After a strong rebound in the first quarter, the economy experienced quarter-to-quarter contraction in the second and the third quarter, thereby sliding into technical recession again (*Chart 18*). Business investment declined and overall domestic demand stayed weak in the third quarter, despite a modest rebound in private consumption. The fragile recovery in Japan reflected the diminishing effects of the monetary stimulus,

while structural problems lingered on. Coupled with continued deflation risks, the Bank of Japan (BOJ) has recently cut Japan’s economic growth and inflation projections for the next fiscal year, putting pressure for further monetary policy easing down the road.

33. Emerging market economies in general saw weakening growth performance so far this year, with Brazil and Russia miring in recession. Amid the spillover of weak global demand, Asia’s exports have declined since the second quarter, denting the performance of many export-dependent economies in the region and posing an additional drag on intra-regional trade. The Mainland economy grew by 6.9% year-on-year in the first three quarters of 2015, in line with the official full year target of around 7% (*Chart 19*). Under the influences of subdued external demand and structural transformation, the economy saw somewhat moderated growth this year compared with last year, and is still facing downward pressures in the near term. However, the Mainland authorities should have ample policy room to maintain economic growth at a medium-to-high pace.

Chart 19 : The Mainland economy grew solidly in the first three quarters



34. The complicated international monetary environment is likely to remain a notable source of uncertainties. The US monetary policy normalisation will start soon, while the ECB and BOJ are inclined to ease monetary policy further in light of the weak economic conditions in the eurozone and Japan. The divergence in monetary policy stance among major central banks is poised to deepen. The associated uncertainties could alter investment sentiment, and lead to further gyrations in international financial conditions and capital flows, posing downside

risks to the global economic outlook and financial stability. Due to continued strength in the US dollar and uncertainties over US interest rate outlook, the international financial markets were exceptionally volatile in the third quarter. Emerging market economies saw capital outflows, with some of their currencies hitting multi-year lows. Such a scenario might happen repeatedly in the period ahead. Hence, the vulnerability of emerging market economies to capital flight also warrants concern.

35. In sum, there are still hurdles to overcome before the global economy could shift to a higher gear, including the fragile states of recovery in many advanced economies, repercussions of future US interest rate hikes and divergent monetary policies among major central banks on financial market volatility, economic slowdown of emerging markets and heightened geopolitical risks. The unsteady external environment is likely to constrain the performance of Asia's trade flows and continue to cloud Hong Kong's exports outlook in the near term.

36. On the domestic front, the stable job and income conditions in the recent past should render support to local consumption. However, the uncertainties stemming from the US interest rate hikes and global economic outlook might spark fluctuations in global and local asset prices and dent consumption and investment sentiments. Moreover, the slowdown in inbound tourism has already put a dent on the performance of our retail and tourism-related sectors. If the weak trend of inbound tourism persists and spills over to the employment market, the impact on the overall economy will be amplified. The Government is concerned about the recent slowdown in inbound tourism. Apart from the various measures announced in the 2015/16 Budget, an additional one-off \$10 million matching fund was allocated to the Hong Kong Tourism Board in September in order to attract more high-spending overnight visitors to consume in Hong Kong through stepping up overseas promotion. The domestic segment has been the key growth driver cushioning the economy against the unsteadiness in the external environment over the past few years, and the downside risks it is facing warrant particular concern.

37. The Government will closely monitor the developments on the domestic and external fronts, take account of relevant factors and announce the economic forecasts for 2016 along with the 2016/17 Budget in February next year. For reference, the IMF's latest 2016 economic growth forecast on Hong Kong is 2.7%. The prevailing forecasts from private sector analysts are mostly in the range of 1.6-2.8%, averaging 2.2%.

38. The inflation outlook of Hong Kong in 2016 will depend on a host of factors, including exchange rates, international commodity prices, inflation in our

major imported sources and local labour costs. Externally, international energy and raw material prices hovered at low levels in recent periods, and import prices remained soft. These should help alleviate inflationary pressure. However, international commodity prices are vulnerable to such factors as the demand-supply balance in the source countries, geopolitics and exchange rate fluctuations, and therefore could shift down the road. Locally, domestic cost pressure is likely to stay moderate. For reference, the latest 2016 headline consumer price inflation forecast for Hong Kong by the IMF is 3.0%, and those by private sector analysts averaged 2.6%.

Economic Analysis and Business Facilitation Unit
Financial Secretary's Office
30 November 2015

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 \$30 per hour to \$32.5 per hour since May 2015, the benchmark of monthly household income for low-income households is also increased from \$7,000 to \$7,600 (at constant Q2 2015 prices), adjusted by inflation⁽²⁾, so as to reflect the latest circumstance.

Overall situation of household income and employment earnings

2. The labour market held broadly stable in 2015 so far. Both total employment and the labour force grew further. The seasonally adjusted unemployment rate for August – October stayed at a low level of 3.3%. Median monthly household income, a reflection of the overall income, increased by 6.4% year-on-year in the third quarter of 2015, or 4.0% in real terms after adjusting for inflation.

3. On the back of the broadly stable labour market, the further increases in earnings of various segments were broad-based. The average employment earnings of full-time employees (excluding bonus) increased by 5.1% year-on-year in the third quarter of 2015, or 2.8% in real terms. Benefiting from the SMW uprating since May 2015, the year-on-year growth of average employment earnings of full-time unskilled employees accelerated somewhat to 8.0% in the third quarter. After netting out inflation, there was a real improvement of 5.1%. For higher-skilled staff, in June 2015, the Salary Index for Managerial and Professional Employees indicates that employees in the same company and occupation enjoyed nominal and real salaries growth of 5.7% and 3.6% respectively over a year earlier (*Table 1*).

(1) Foreign domestic helpers are excluded from the analysis except general labour market statistics.

(2) Being adjusted based on Consumer Price Index (A).

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

Period	Median monthly household income		Overall employment earnings of employees*		Employment earnings of unskilled employees [^]		Salaries of managerial and professional employees [~]		
2013	Q1	6.4	(2.6)	3.2	(-0.4)	6.2	(2.0)		
	Q2	7.8	(3.7)	3.2	(-0.8)	7.2	(2.5)	6.0	(2.2)
	Q3	10.2	(4.6)	5.4	(0.0)	5.7	(-1.6)		
	Q4	6.7	(2.3)	4.8	(0.5)	7.4	(2.9)		
2014	Q1	4.5	(0.4)	4.6	(0.4)	7.1	(2.7)		
	Q2	2.3	(-1.3)	6.3	(2.6)	6.0	(2.1)	5.3	(1.8)
	Q3	4.0	(-0.8)	6.1	(1.2)	6.7	(-0.5)		
	Q4	5.8	(0.7)	5.6	(0.5)	6.9	(-0.2)		
2015	Q1	6.5	(2.0)	6.0	(1.5)	5.1	(-1.3)		
	Q2	7.9	(4.7)	3.0	(-0.1)	6.3	(2.0)	5.7	(3.6)
	Q3	6.4	(4.0)	5.1	(2.8)	8.0	(5.1)		

Notes: (*) Average employment earnings of full-time employees (excluding bonus).
 (^) Average employment earnings of full-time employees.
 (~) The index is released annually for June.
 () Rate of change (%) in real terms.

Economically active households with monthly household income below \$7,600 in real terms

4. In the third quarter of 2015, the number of economically active households with monthly household income below \$7,600 in real terms (referred to as “low-income households” thereafter) amounted to 55 900, down by 3 500 or 5.9% over the level a year ago. The corresponding proportion in total domestic households was 2.3%⁽³⁾.

5. Analysing the number and proportion of low-income households over the past ten years or so suggests that their changes 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 4.9% 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 also fell back. At 2.3% in the third quarter of 2015, which was 0.1 percentage point lower than a year ago, such proportion was the lowest over the past ten years (*Table 2 and Chart 1*).

(3) All figures pertaining to low-income households in the third quarter of 2015 are provisional figures.

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

<u>Period</u>	Household type:		<u>Total</u>	Of which:
	<u>Elderly Households[#]</u>	<u>Non-elderly households</u>		<u>Economically active persons therein</u>
Q3 2003	3 000 (0.1)	101 900 (4.8)	104 900 (4.9)	125 500 [3.6]
Q3 2008	2 000 (0.1)	60 400 (2.6)	62 500 (2.7)	69 300 [1.9]
Q3 2009	1 300 (0.1)	70 900 (3.1)	72 200 (3.1)	82 700 [2.2]
Q3 2010	1 500 (0.1)	68 600 (2.9)	70 000 (3.0)	79 200 [2.2]
Q3 2011	3 500 (0.1)	52 600 (2.2)	56 100 (2.4)	62 600 [1.7]
Q3 2012	3 400 (0.1)	58 100 (2.4)	61 500 (2.6)	66 500 [1.8]
Q3 2013	4 200 (0.2)	62 800 (2.6)	67 100 (2.8)	74 000 [1.9]
Q3 2014	5 600 (0.2)	53 800 (2.2)	59 400 (2.4)	64 800 [1.7]
Q3 2015	3 500 (0.1)	52 400 (2.1)	55 900 (2.3)	62 600 [1.6]

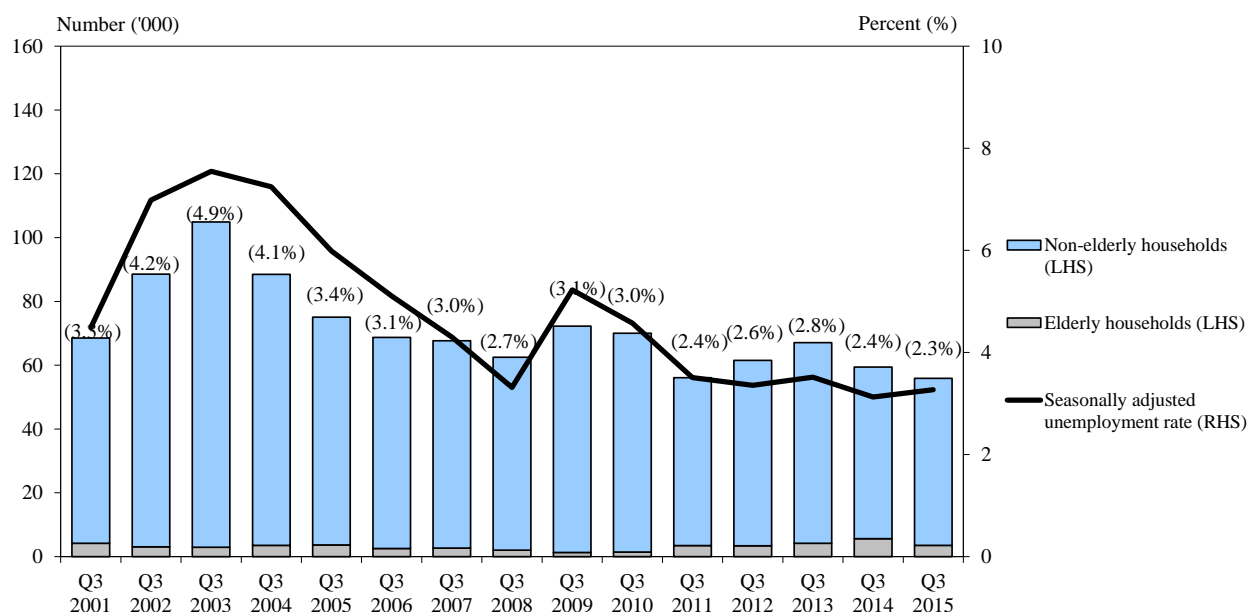
Notes : (*) Low-income households refer to households with monthly household income less than \$7,600 at constant Q2 2015 prices. This does not include households with all members being economically inactive.

(#) Elderly households refer to domestic households with all members aged 65 and above.

() Proportion in all domestic households (%).

[] Proportion in total labour force (%).

Chart 1 : Number of low-income households^(*)



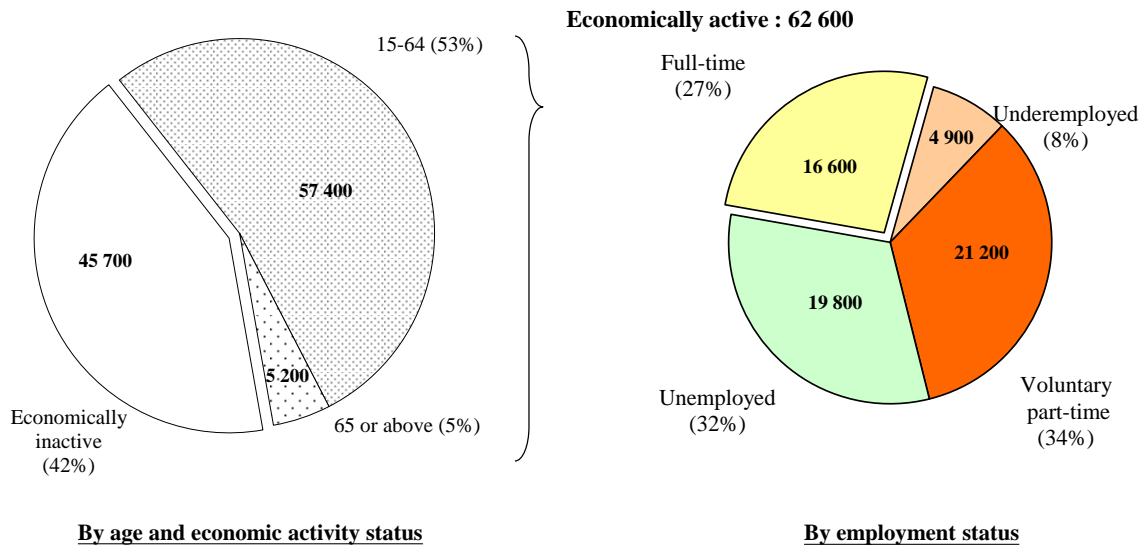
Notes : (*) Low-income households refer to households with monthly household income less than \$7,600 at constant Q2 2015 prices. This does not include households with all members being economically inactive. Figures in brackets are the proportions of low-income households in all domestic households.

Socio-economic characteristics of low-income households

6. Further decomposition of low-income households in the third quarter of 2015 reveals the following observations:

- 108 300 persons were residing in the households in question, among whom 62 600 were economically active. Most of these individuals (57 400 or 92%) were persons aged 15-64, with the majority within the age group of 40-64 (42 700 or 68%), whilst those aged 65 or above amounted to 5 200 (8%).
- The remaining 45 700 persons were economically inactive. 20 100 of them (44%) were either children aged below 15 or elderly persons aged 65 or above.
- A more in-depth analysis by employment status shows that among these 62 600 economically active persons, 27% were full-time workers, while the respective proportions for unemployed, voluntary part-timers, and underemployed were 32%, 34% and 8% respectively (*Chart 2*).

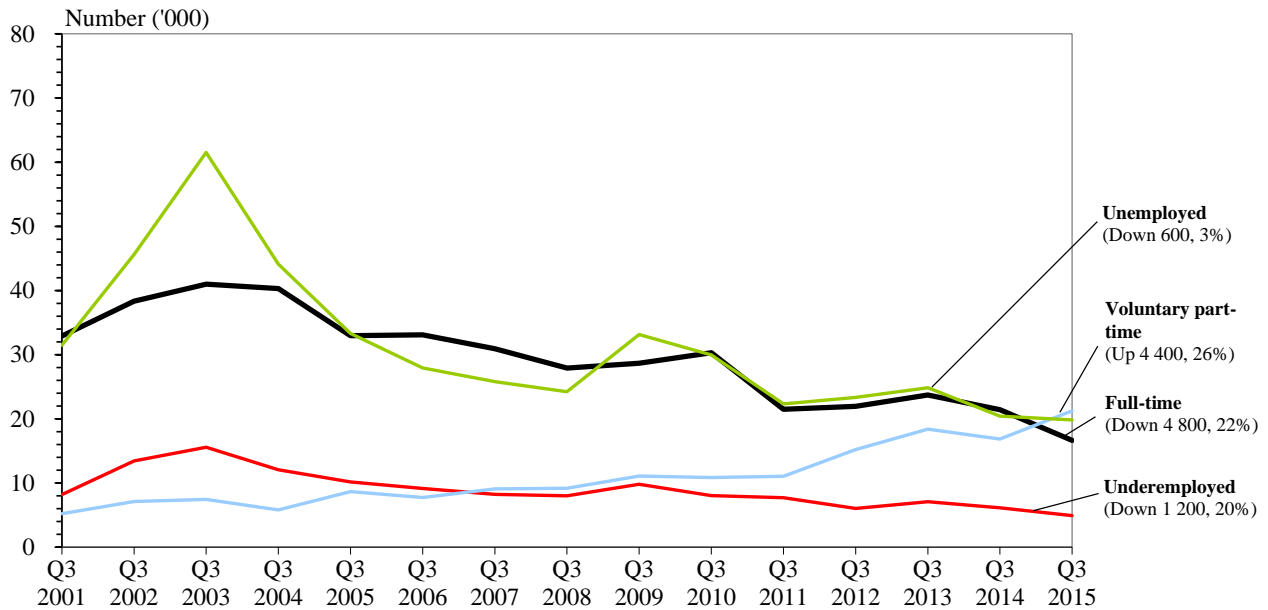
**Chart 2 : Persons living in low-income households*
by age and economic activity status, Q3 2015**



Note : (*) Low-income households refer to households with monthly household income less than \$7,600 at constant Q2 2015 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 (87%) were lower-skilled workers (among whom 42% were elementary workers, and 25% were service and sales workers). A breakdown by economic sector revealed that most of them were engaged in the retail, accommodation and food services sector (9 600 or 22%), followed by repair, laundry, domestic and other personal service activities (6 600 or 15%).
- There were 62 600 economically active persons living in low-income households, down 3.4% over a year ago. Among them, the year-on-year decline in number of full-timers and underemployed were most notable, while that of voluntary part-timers rose (*Chart 3*).

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

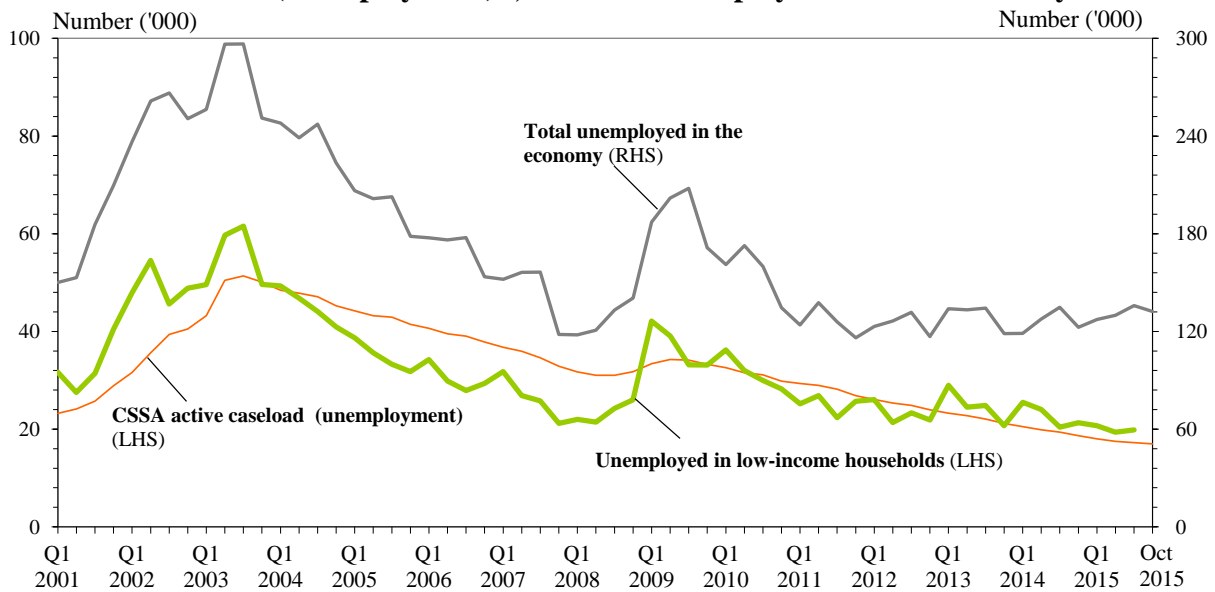


Notes : (*) Low-income households refer to households with monthly household income less than \$7,600 at constant Q2 2015 prices. This does not include households with all members being economically inactive. Figures in brackets are the year-on-year changes in number of economically active persons in Q3 2015.

The number of CSSA cases

7. Demand for grassroots labour remained sturdy. In August – October 2015, the lower-skilled unemployment rate was at a low-level of 3.3%. In the meantime, the number of overall CSSA caseload continued to decline, by 8 681 (or 3.4%) to 246 092 in October 2015 as compared to a year earlier. The decrease in unemployment cases was even more distinct, down by 2 345 (or 12.1%) to 16 991 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 stable labour market conditions over the past year.

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 \$7,600 at constant Q2 2015 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 continued modest economic growth this year, the labour market is still at the state of full employment.

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, the employment outlook will continue to hinge on the overall economic situation and business sentiment. In view of the recent further slackening of inbound tourism, we need to observe closely its impact on the employment situation of relevant sectors. 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. The Government will implement the “Low-income Working Family Allowance” in the second quarter of 2016, which aims at encouraging continuous employment for self-reliance, and can alleviate the poverty situation of the working poor.

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30 November 2015