



## **Hong Kong's recent economic situation and short-term outlook**

The Government has just released the Third Quarter Economic Report 2004 at end-November. The Economic Report, together with the press release containing the updated economic forecasts for the whole year of 2004, have been furnished to LegCo Members.

This paper analyses Hong Kong's overall economic growth and the developments in regard to external trade, domestic demand, labour market, asset markets and consumer prices in the most recent period. It then briefly describes the updated economic forecasts by the Government for 2004 as a whole and gives a broad assessment of the economic outlook for 2005.

Economic Analysis Division  
Economic Analysis and Business Facilitation Unit  
Financial Secretary's Office  
26 November 2004

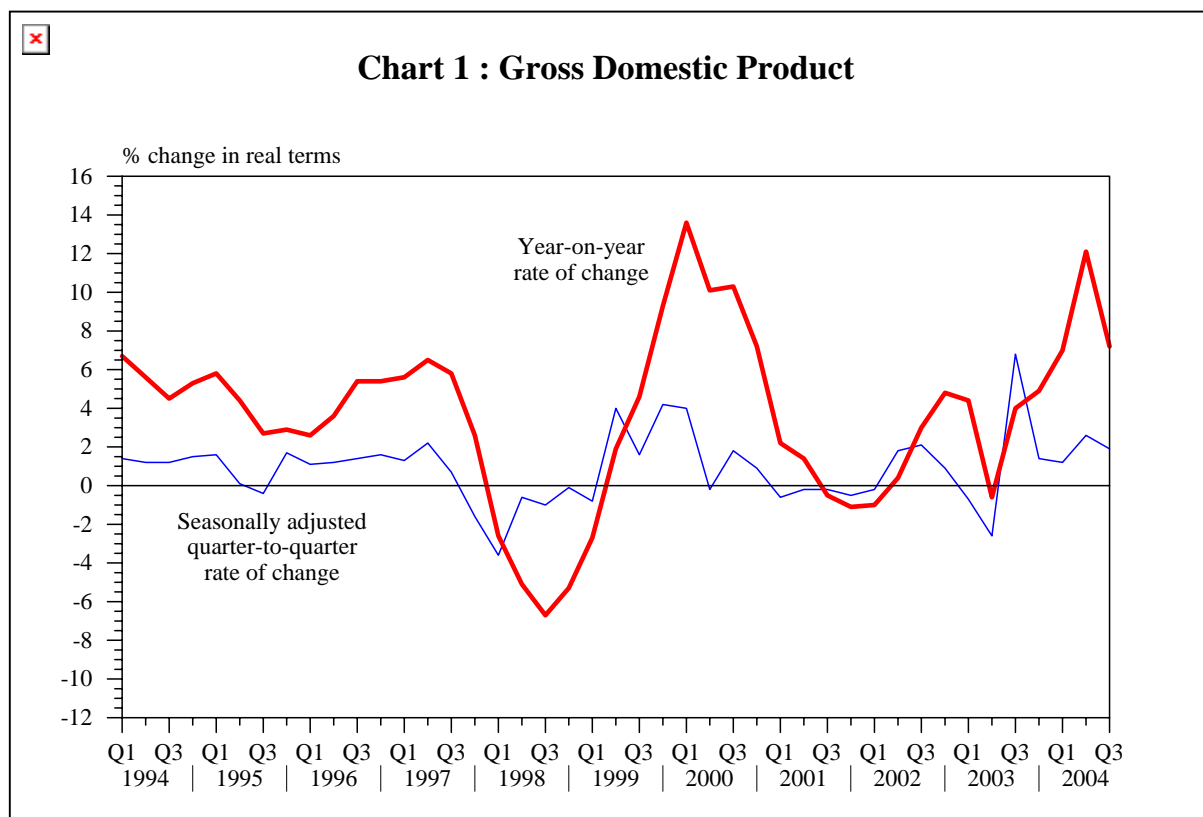
# Recent situation and near-term outlook for the Hong Kong economy

## Introduction

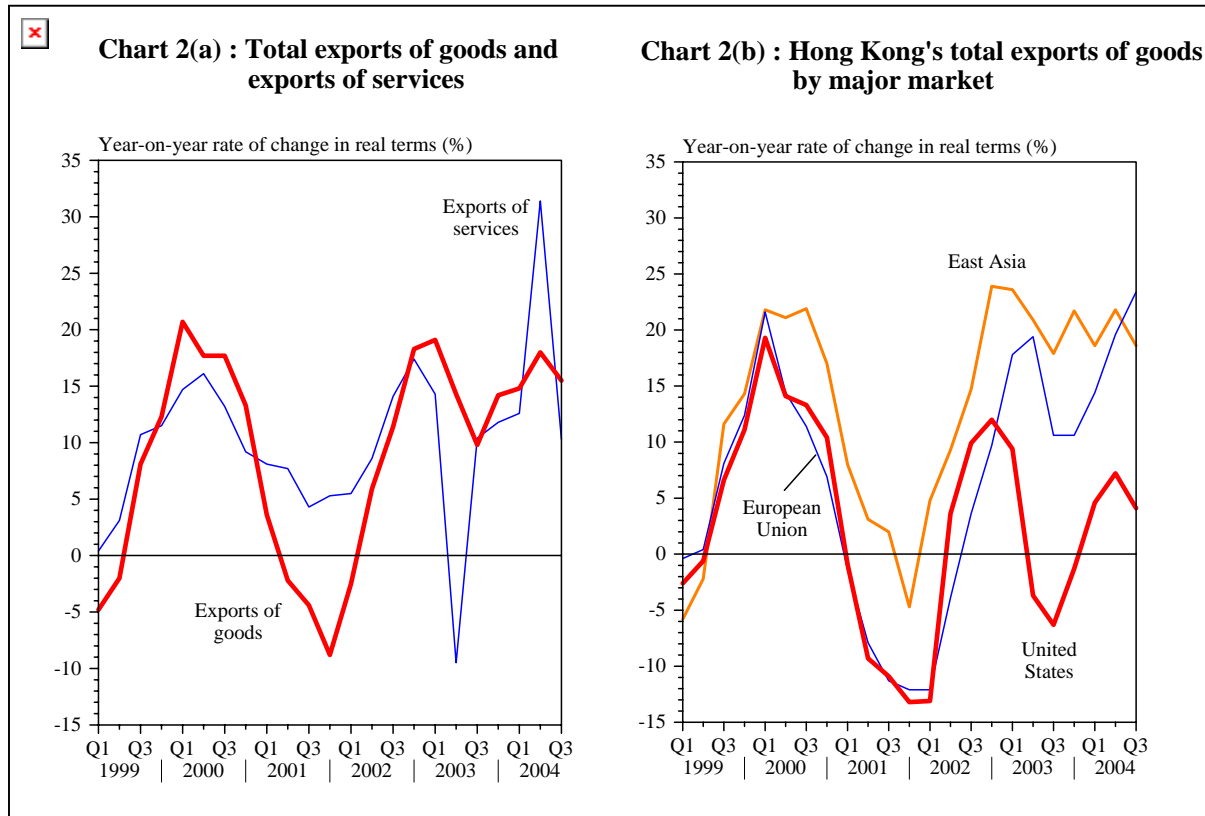
This paper analyses latest developments in the Hong Kong economy and briefly describes the updated economic forecasts for 2004 as a whole released at end-November. It concludes with a brief discussion of the economic outlook for 2005.

## Recent economic situation

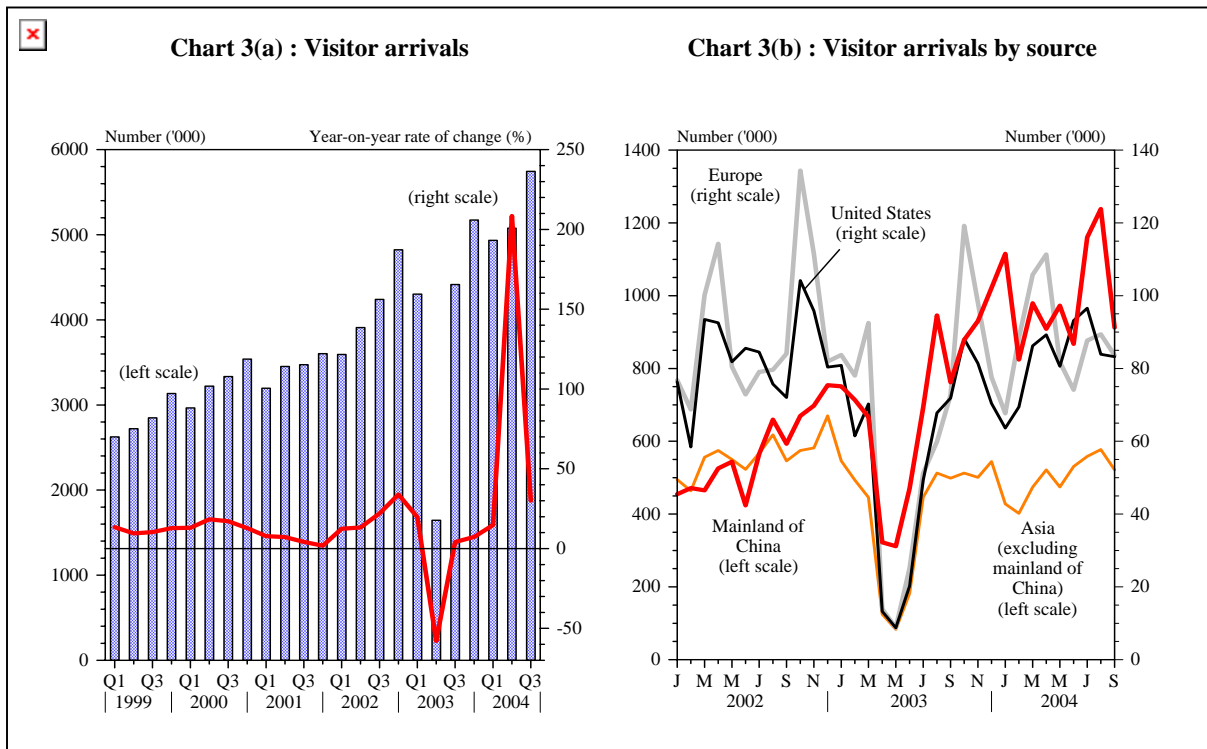
2. The economic upturn extended well into the third quarter of 2004, spurred by thriving merchandise exports and offshore trade, by continued growth in inbound tourism, and also by further solid growth in consumer and investment spending. The *Gross Domestic Product* (GDP) attained a further notable growth at 7.2% in real terms in the third quarter over a year earlier, after a 12.1% leap in the second quarter against an exceptionally low base caused by Severe Acute Respiratory Syndrome (SARS) last year. On a seasonally adjusted quarter-to-quarter comparison, GDP expanded for the fifth consecutive quarter, by 1.9% in real terms in the third quarter of 2004, after the 2.6% growth in the second quarter (*Chart 1*).



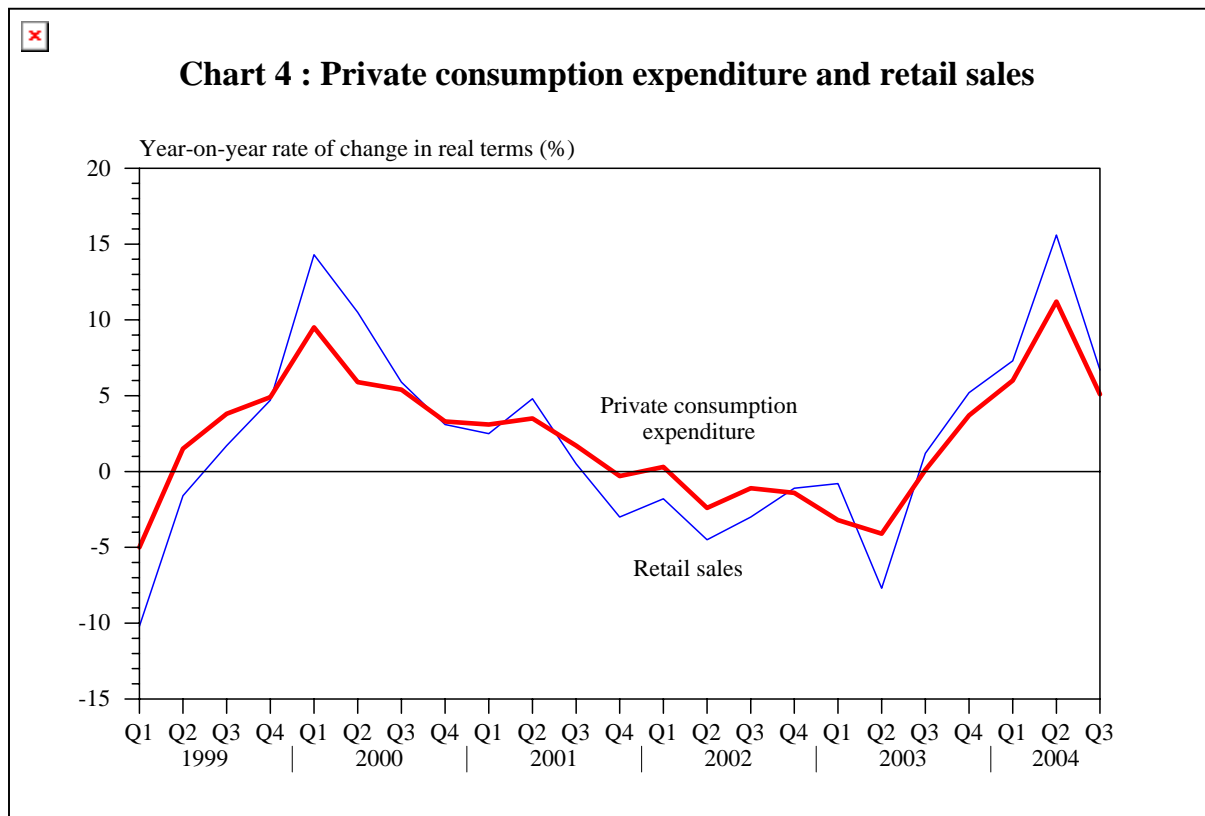
3. Despite increasing uncertainties in the global economic environment stemming from oil price hikes, activity still held up rather well across regions. With continued sturdy demand in the industrialised economies and in Asia, *total exports of goods* surged by 15.5% in real terms in the third quarter over a year earlier, after the 18.0% growth in the second quarter (**Chart 2(a)**). The robust export performance was manifested in sustained double-digit growth in exports to almost all major markets in East Asia and the European Union. Exports to the US market also grew further, albeit still lagging behind the other markets amidst continuing structural shift to offshore trade (**Chart 2(b)**).



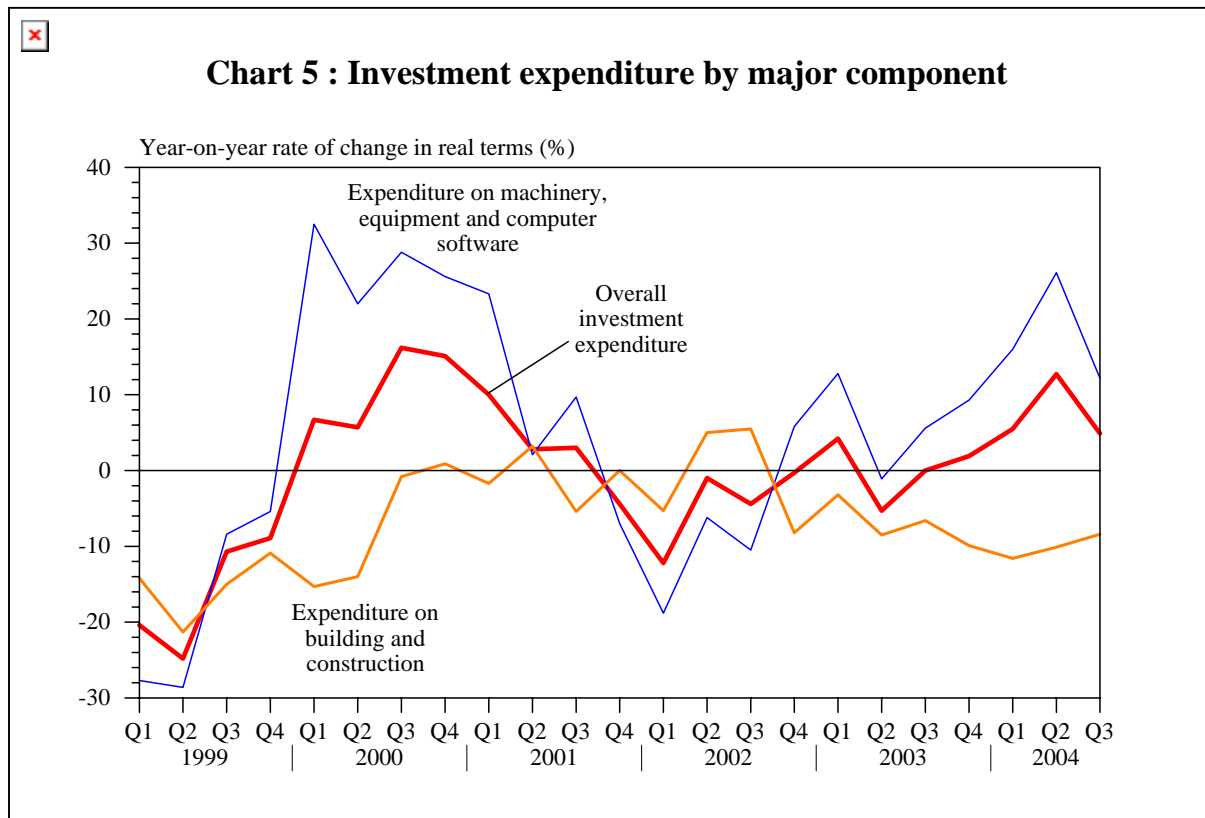
4. On invisible trade, inbound tourism stayed resilient, with the number of visitor arrivals hitting successive record monthly highs during the third quarter (**Chart 3(a)**). Apart from continued surge in Mainland visitors under the support of Individual Visit Scheme, visitors from almost all of the other major sources grew notably further in the quarter (**Chart 3(b)**). Coupled with continued robustness in offshore trade, *exports of services* leaped further by 10.3% in real terms in the third quarter of 2004 over a year earlier, after soaring by 31.4% in the second quarter against an abnormally low base caused by SARS last year (**Chart 2(a)**).



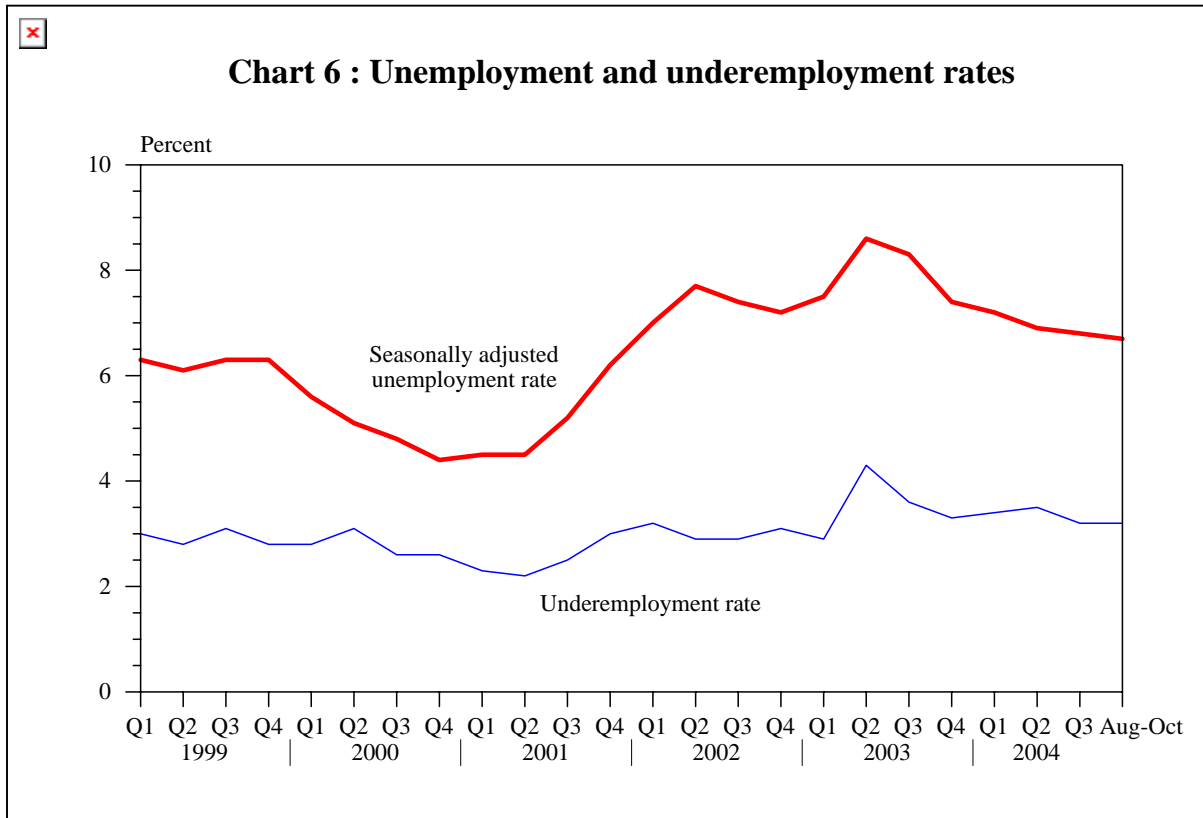
5. In the domestic sector, local consumer spending held firm as labour market conditions improved and sentiment remained generally positive. *Private consumption expenditure* attained a solid increase of 5.1% in real terms in the third quarter of 2004 over a year earlier, after the 11.2% leap in the second quarter against an exceptionally low base of comparison due to SARS last year (*Chart 4*).



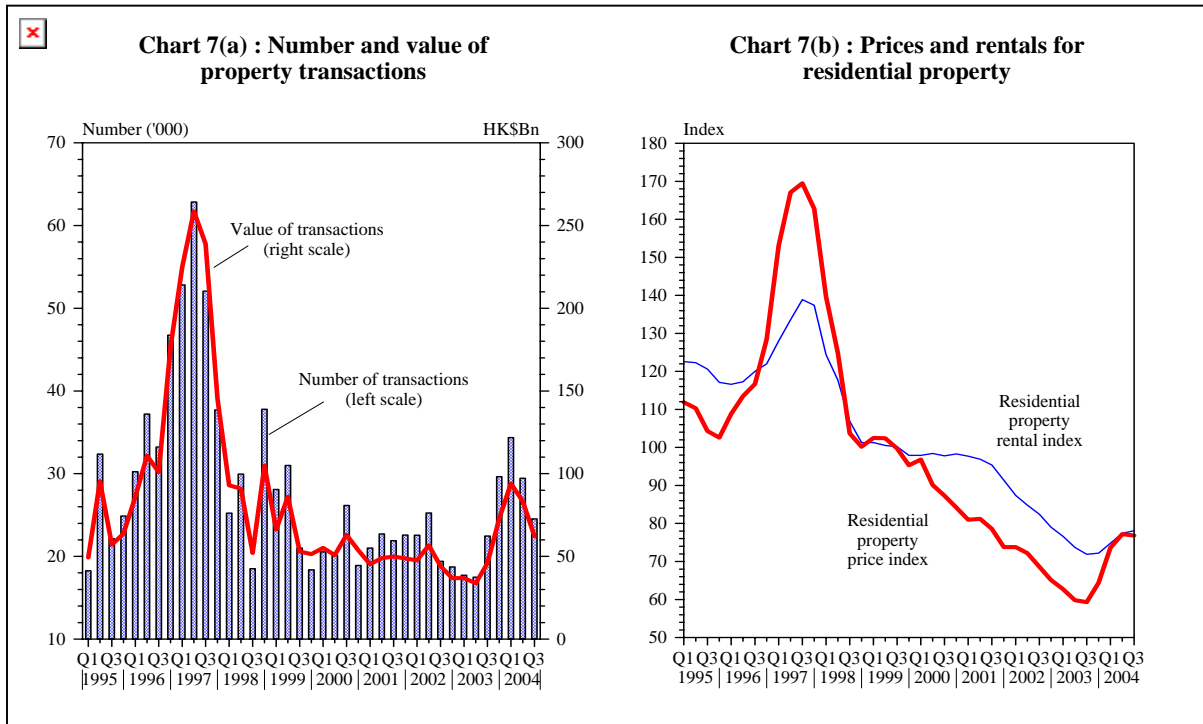
6. Overall investment spending went up by 4.9% in real terms in the third quarter of 2004 over a year earlier, primarily driven by further double-digit surge in machinery and equipment investment, in turn buoyed by continued growth in business activity and improved business sentiment. But the slack construction output owing to the completion of a number of prominent private sector building projects and priority railway projects over the past year is still holding back the upturn in investment (*Chart 5*).



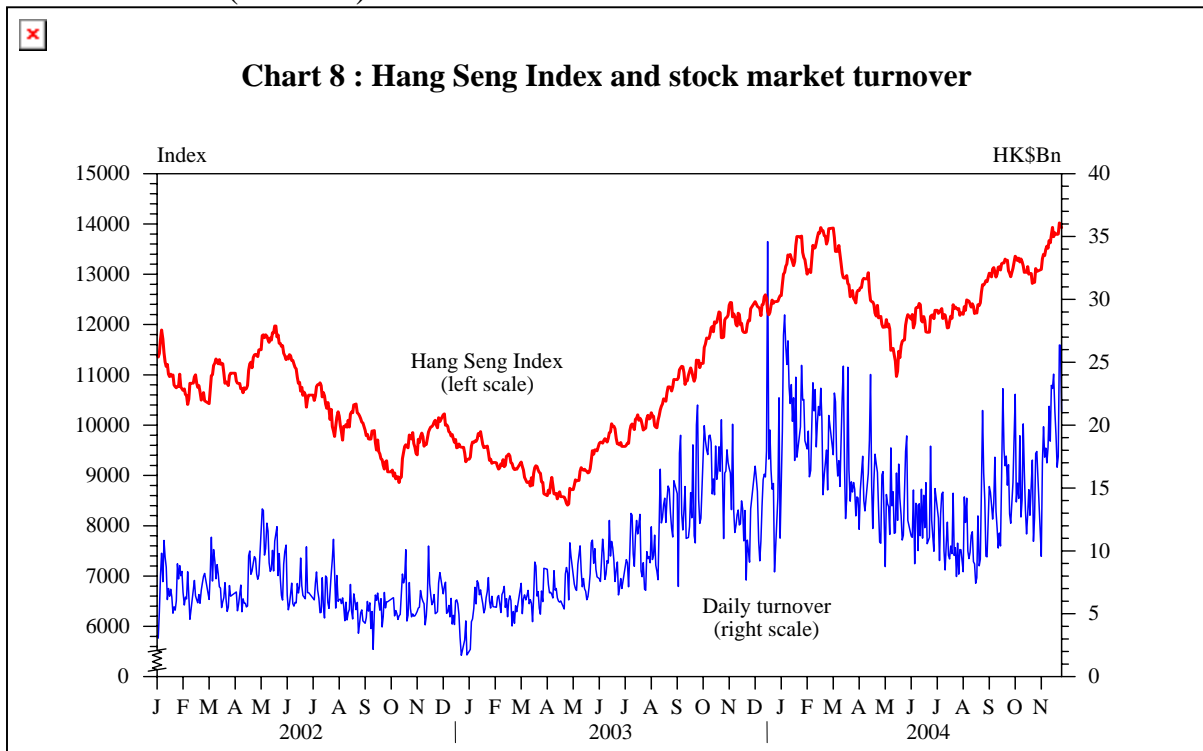
7. The economic upturn over the past year has trickled down to benefit the labour sector, with expanding employment and surging vacancies across sectors. In August - October 2004, *total employment* expanded by nearly 110 000 over the trough in mid-2003. Hence, the *seasonally adjusted unemployment rate* fell from a peak of 8.6% in the second quarter of last year to a 32-month low of 6.7% in August - October of this year (*Chart 6*). The *underemployment rate* likewise fell over the same periods, from a peak of 4.3% to a near 1½-year low of 3.2%. Also, overall labour earnings rebounded to a modest year-on-year increase in money terms in the second quarter of 2004, arresting the downtrend over the past two years or so.



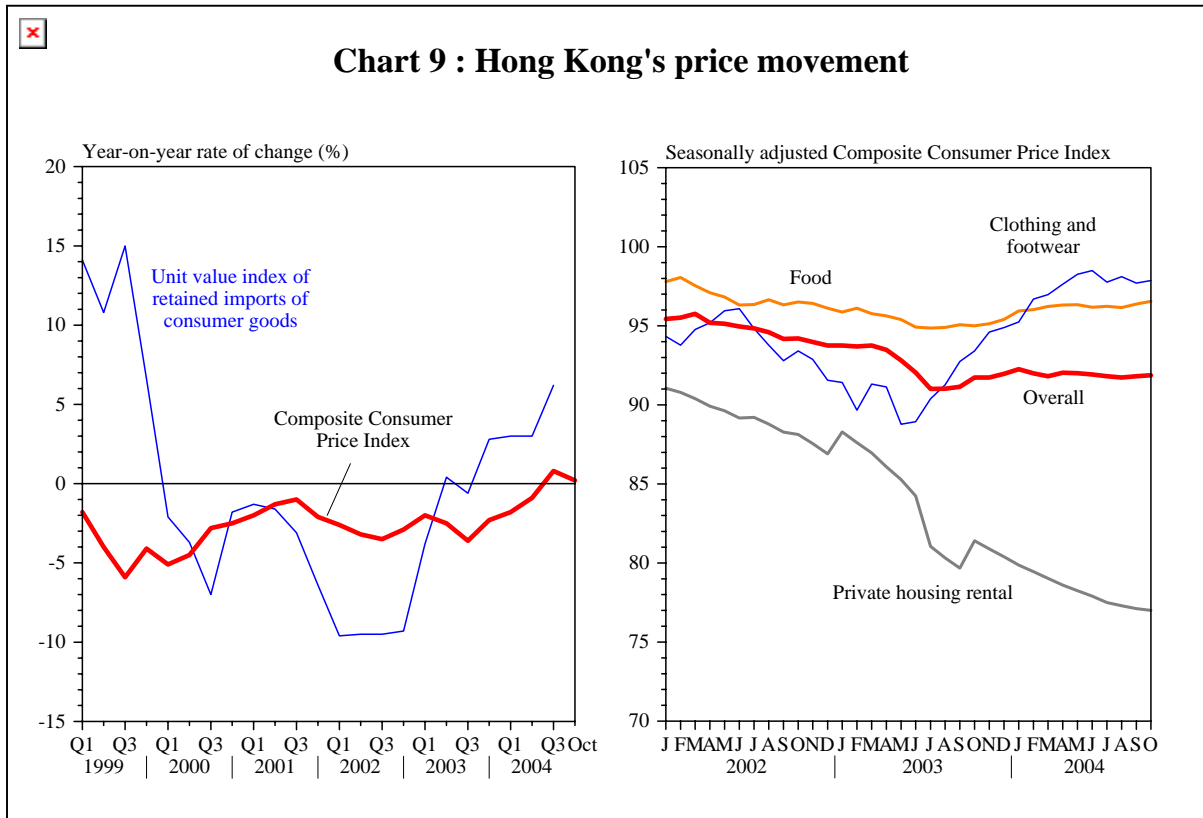
8. Having consolidated during the summer, the *property market* regained momentum in recent months, with a strong rebound in trading activity in September (*Chart 7(a)*). Acquisition interest for residential property was rekindled by a launch of mortgage financing up to 95% of the assessed value of residential flats, successful release of two more plots of government land for auction, and the enthusiastic response in the primary sales of flats in certain developments. Market sentiment turned more upbeat after the release of the July CPI figure signaling the end of the deflation era in Hong Kong, especially for the luxury end of residential property. By September 2004, flat prices have risen by around 6% over June, resulting in a cumulative rebound of around 36% from the trough in mid-2003. Concurrently, flat rentals firmed up by around 1% in the third quarter, after a 3% rise in the second quarter (*Chart 7(b)*).



9. The local *stock market* rallied strongly since late August, as sentiment was successively buoyed by the announcement of favourable corporate earnings results, release of upbeat GDP and CPI figures, as well as the announcement of additional liberalisation measures under the second phase of Closer Economic Partnership Arrangement (CEPA II). From late October onwards, it was further boosted by the distinct easing in crude oil prices and substantial fund inflows into Hong Kong amidst a renewed weakness of US dollar. The Hang Seng Index soared to hit a 44-month high of 14 023 on 23 November, distinctly up by 14.1% over end-June. The stock market turnover also picked up visibly in recent months (*Chart 8*).



10. Consumer prices have increased for the fourth month in a row in October 2004, having arrested the 68-month long deflation in July. In parallel with a much improved consumer spending, the pricing power of retailers seems to be returning. Also, the continued rise in import prices since end-2003 is progressively passing through to the retail price level. The *Composite Consumer Price Index* rose by an average of 0.8% in the third quarter of 2004 over a year earlier, reversing the 0.9% decline in the second quarter. It went up less in October, by just 0.2%, mainly due to dissipation of the low base effect caused by rates concession in the third quarter of last year (*Chart 9*).



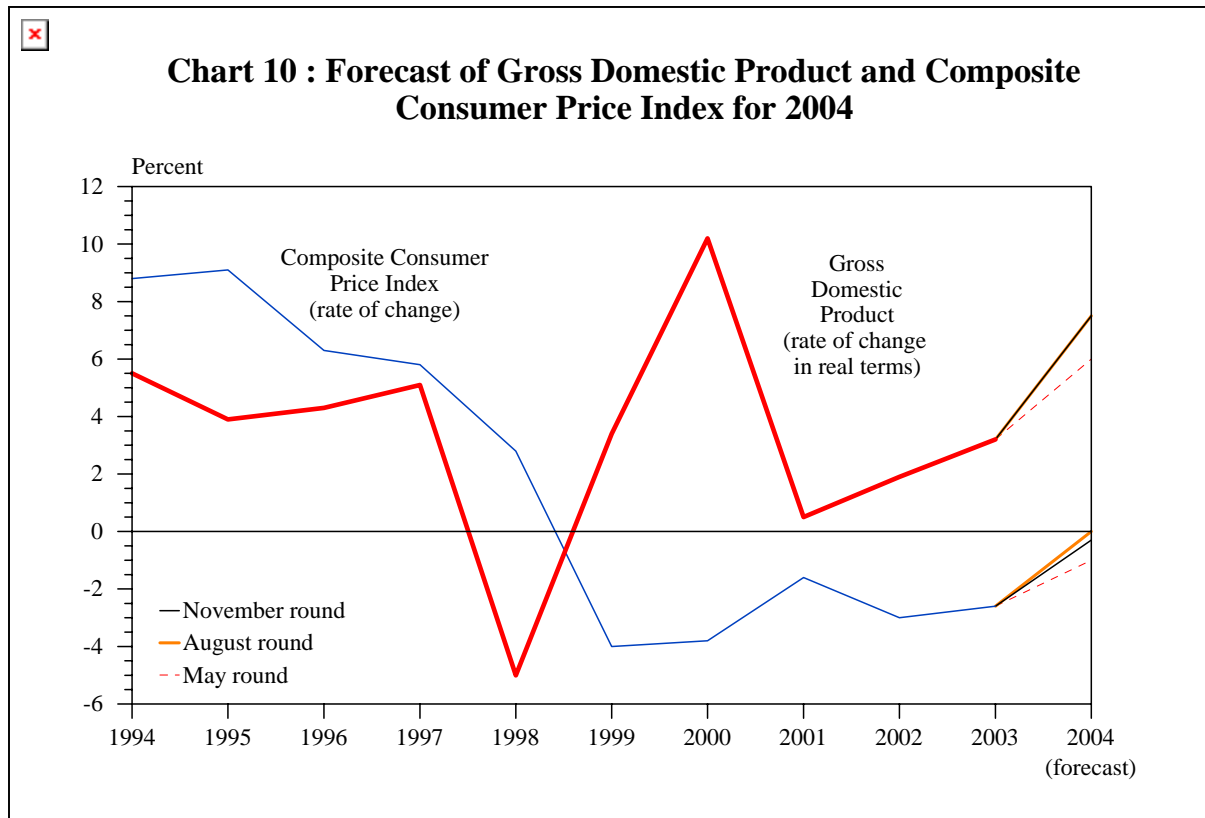
### Updated short-term economic forecast for 2004

11. There are some encouraging developments in the external economic environment recently. The distinct easing in crude oil prices mitigates the worry over the adverse impacts brought about by the earlier oil price hikes. The US interest rate hike so far has proceeded at a measured pace, and the world economy appears to be better prepared for this interest rate up-cycle. In the Mainland, while the cooling measures have worked to unwind some of the imbalances in the economy, the mild increase in renminbi interest rates lately is a welcome market-based measure which should not derail the growth momentum of the Mainland economy to any significant extent.



12. This apart, the renewed weakness in the US dollar lately should enhance Hong Kong's external competitiveness and render further support to our exports. Furthermore, the weak dollar has helped to drive fund inflows into Hong Kong, leading to lower Hong Kong dollar interest rates. Locally, consumer and investment expenditure are poised for further growth amidst continuing economic upturn. Against this backdrop and given the favourable outturn in the first three quarters, *GDP* should be on track for a 7.5% growth in real terms for 2004 as a whole (*Chart 10*).

13. On the price front, consumer prices are expected to stay positive in the rest of 2004, yet the pace of its upturn is still being held back by the earlier fall-off in housing rentals. The *Composite CPI* is now forecast to have a modest decline of 0.3% for 2004 as a whole, down marginally from the forecast of zero change put out in August. This merely represents a minor technical revision to take account of the actual outturn of a 0.6% decline in the first ten months of the year (*Chart 10*).



### Economic outlook for 2005

14. The economic outlook for 2005 still hinges critically on the developments in the global economy, including whether the global economy and the US in particular could sustain solid growth momentum; to what extent the lagged effect brought about by the earlier oil price hikes would hurt the global economy; the extent of US dollar movements and its impact on global financial market stability; the pace of interest rate hike, etc.

15. Yet at this juncture, the widely held view is that the above risk factors may slow, but not severely retard, the growth momentum of the world economy next year. If so, Hong Kong's external trade can be expected to put up good performance for another year in 2005. Also, Hong Kong's external competitiveness would continue to hold up well given the following positive factors :

- While Hong Kong is inevitably subject to the vicissitudes of the global economic environment, the substantial restructuring over the past few years has considerably improved the competitiveness of Hong Kong's enterprises.
- A rapidly growing Mainland economy with expanding market potential will continue to render the key impetus to Hong Kong economy.
- The implementation of the second phase of CEPA as from January 2005 should present Hong Kong businesses with considerable new trading and business opportunities.

16. Locally, as the property market has by now rebounded distinctly, and as employment conditions continue to improve, the recovery in the domestic sector should gather more pace in 2005. Overall, it is believed that the Hong Kong economy would have another year of solid growth in 2005, though probably not as fast as this year. International Monetary Fund lately forecasts that Hong Kong's economic growth will grow by around 4% in 2005.

Economic Analysis Division  
Economic Analysis and Business Facilitation Unit  
Financial Secretary's Office  
26 November 2004