



# First Quarter Economic Report 2006

Government of the Hong Kong  
Special Administrative Region

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## **Press Release**

(embargoed until 4:15 p.m. on 23 May 2006)

### **Economic Situation in the First Quarter of 2006 and Latest GDP and Price Forecasts for 2006**

The Government released today (Tuesday) the First Quarter Economic Report 2006, together with the preliminary figures on Gross Domestic Product for the first quarter of 2006.

The Government Economist, Mr K C Kwok, described the economic situation in the first quarter of 2006 and provided the latest GDP and price forecasts for the year.

#### **MAIN POINTS**

- \* The Hong Kong economy sustained its strong upturn in the first quarter of 2006, with GDP leaping by a stronger-than-expected 8.2% in real terms over a year earlier, following an already robust 7.5% growth (revised from the 7.6% estimate released on 22 February) in the preceding quarter. The economy expanded briskly on a broad front, driven by robust external trade, distinct pick-up in consumer spending, as well as continued surge in investment in machinery and equipment. Thus, while external trade continues to boom, domestic demand is also playing an increasingly important role in the current economic upturn.
- \* Externally, notwithstanding various lingering uncertainties in the trading environment, merchandise exports continued to grow markedly in the first quarter, by 14.4% in real terms over a year earlier, thanks to surging intra-regional trade, with the Mainland again as the key growth driver. Exports to the EU also fared well, while those to the US grew further. Exports of services were also robust, up 8.9% in real terms in the first quarter, with both offshore trade and inbound tourism growing distinctly further.
- \* On the domestic front, private consumption expenditure picked up to a 4.5% growth in real terms in the first quarter, on the back of improving employment incomes, but also boosted in part by stronger household balance sheet along with higher share prices and a reviving property market. Consumer sentiments remained largely upbeat, even though interest rates rose further during the quarter.
- \* Overall investment expenditure maintained strong growth momentum, up 8.5% in real terms in the first quarter. Expenditure on machinery and equipment remained the key growth driver, with a 23.3% growth, supported by higher corporate profits, briskly expanding business volume and sanguine economic outlook. Yet building and construction activity was still the laggard.
- \* Labour market conditions continue to improve, with the seasonally adjusted unemployment rate now down to a 4 1/2-year low of 5.2% in the first quarter

and further to 5.1% in February-April. Since the trough in 2003, some 240 000 additional jobs have been created. The number of long-term unemployed has also come down markedly, indicating that many of those who had difficulties in finding jobs in the past are now being absorbed back into the labour market gradually. Labour incomes are increasing and more job openings are now available, thanks to the economic upturn.

- \* Consumer price inflation remained benign, running at 1.6% year-on-year in the first quarter. The successive rises in private housing rentals over the past two years have begun to creep into consumer prices to a greater extent. Yet inflationary pressure has been mitigated by the easing in import prices of food and consumer goods. Also, despite rising rentals and wages, the cost pressure from these two cost elements was not that significant when viewed against the concurrent surge in business turnover and also the rapid labour productivity growth stemming from the hefty investment in machinery and equipment.
- \* On the near-term economic prospects, locally, consumption looks set to hold up rather well, along with better job prospects and rising employment incomes. Investment in plant and equipment seems likely to increase further in tandem with the much improved corporate profits and also to cater for the growth in business. But construction is likely to remain weak in the near term, thereby capping the upside of overall investment.
- \* Although the global economy continued to show a fairly strong performance in the first quarter, the external environment is still much clouded by various downside risks viz. recent hike in oil prices to around US\$70/barrel; rising US interest rates; avian flu; global trade imbalances; and lately, the tightening measures in the Mainland. Some of these risks in fact have intensified recently from the situation a few months earlier. How these various risk factors will play out is critical to Hong Kong's trade and economic performance in the coming quarters.
- \* Given the exceptionally strong GDP outturn of an 8.2% growth in the first quarter of 2006, the Hong Kong economy should have little difficulty in attaining the forecast GDP growth of 4-5% as released in the Budget round. Indeed, as the prospects for the global economy are still largely positive, there could be some upsides from the external side. However, in view of the wide range of uncertainties still prevailing in the external environment as well as the recent volatilities in the international financial markets, it is more prudent to maintain the forecast GDP growth for 2006 unchanged at 4-5% in the present round, pending a full update in the next round three months from now.
- \* As to the inflation outlook, consumer price inflation, though creeping up, is likely to be still at a moderate and healthy level for 2006 as a whole. To take on board the release of the new 2004/05-based Composite CPI series, which is on average about 0.4 percentage point lower than the old 1999/00 series, the

forecast rate of increase in the Composite CPI for 2006 as a whole is revised down slightly, from 2.3% to 2%. As to the forecast rate of change in the GDP deflator, it is kept unchanged at 0.5%.

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## **DETAIL**

### **GDP**

According to the preliminary figure on the *Gross Domestic Product (GDP)* released today by the Census and Statistics Department, GDP grew robustly by 8.2% in real terms in the first quarter of 2006 over a year earlier, following a 7.3% growth (same as in the earlier release) for 2005 as a whole and an 8.6% strong growth in 2004. On a seasonally adjusted quarter-to-quarter comparison, GDP expanded for the eleventh straight quarter, by 2.4% in real terms in the first quarter of 2006 (*Chart*).

2. The latest figures on GDP and its major expenditure components up to the first quarter of 2006 are presented in *Table 1*. Developments in different segments of the economy in the first quarter of 2006 are described below.

### **External trade**

3. External trade continued to thrive on entering 2006, thanks to the strong global economy and surging intra-regional trade, with the Mainland again as the key growth driver. Exports to the EU also fared well, while those to the US grew further. Re-exports continued to surge, a manifestation of the key role of Hong Kong facilitating trade flows between the Mainland and the rest of the world. Domestic exports also grew markedly further, continuing the trend that started in mid-2005. *Total exports of goods* accelerated to a 14.4% growth in real terms in the first quarter of 2006 over a year earlier, following an 11.2% increase in 2005. On a seasonally adjusted quarter-to-quarter comparison, total exports of goods rose further by 2.2% in real terms in the first quarter, similar to that in the preceding quarter.

4. *Exports of services* were likewise robust in the first quarter, up 8.9% in real terms, after an 8.7% growth for 2005 as a whole, underpinned by vibrant offshore trade and further strong growth in inbound tourism. On a seasonally adjusted quarter-to-quarter comparison, exports of services rose by 0.8% in the first quarter, following a 1.1% increase in the preceding quarter.

### **Domestic sector**

5. Domestic demand is playing an increasing role in the current economic upturn, a sign that the economic recovery has become more entrenched. Consumer demand picked up again in the first quarter of 2006, supported by rising employment incomes and the better performance of the property and stock markets. Consumer sentiments remained largely upbeat, although interest rates rose further

during the quarter. *Private consumption expenditure* rose by 4.5% in real terms in the first quarter over a year earlier, up from the 3.4% growth for 2005 as a whole. On a seasonally adjusted quarter-to-quarter comparison, private consumption expenditure likewise accelerated, to a 1.7% growth in real terms in the first quarter, from a 0.9% growth in the preceding quarter.

6. Overall investment spending in terms of the *gross domestic fixed capital formation* sustained a distinct growth at 8.5% in real terms in the first quarter, similar to the momentum in the preceding quarter but distinctly faster than that of 4.1% for 2005 as a whole. Expenditure on machinery and equipment remained the key driver of overall investment growth, surging by 23.3% in the first quarter, reflecting the strong investor confidence on business outlook as well as the need to expand capacity to capture the sustained increase in business opportunities. Building and construction activity was however still sluggish, falling by 8.7% in the first quarter, dragged mainly by the fall-off in public sector construction along with the winding down of such major projects as the Shenzhen-Hong Kong Western Corridor and Deep Bay Link.

### **The labour sector**

7. The labour market continued to improve in the first quarter. The *seasonally adjusted unemployment rate* fell to a 4 1/2-year low of 5.2% in the first quarter and further to 5.1% in February - April. Since the trough of 2003, some 240 000 additional jobs were created at all levels of the occupational hierarchy and across different service sectors. The number of long-term unemployed persons also came down markedly, from the peak of 93 000 in 2003 to about 46 000 in February - April 2006. Reflecting improving demand for labour, the total number of job vacancies in the private sector continued to surge in December 2005 over a year ago, and labour incomes also rose further.

### **Prices**

8. Consumer price inflation remained benign, with the *Composite Consumer Price Index* rising by 1.6% in the first quarter of 2006 over a year earlier, slightly up from the 1.3% increase in the preceding quarter (by reference to the new 2004/05-based CPI series). The successive rises in private housing rentals have begun to creep into consumer prices to a greater extent. Yet inflationary pressure was mitigated by the concurrent easing in import prices of food and consumer goods, thanks to a continued fall in the prices of food imported from the Mainland as well as the earlier appreciation of the Hong Kong dollar along with the US dollar. Also, despite rising rentals and wages, the cost pressure from these two cost elements was not that significant when viewed against the concurrent surge in business turnover and also the rapid labour productivity growth stemming from machinery and equipment investment. On a seasonally adjusted quarter-to-quarter comparison, the Composite CPI showed a 0.4% increase in the first quarter, following a 0.5% increase in the preceding quarter. As to the *GDP deflator*, it eased back again to a slight 0.4% decline in the first quarter over a year earlier, having registered a 0.7%

increase in the preceding quarter. While local consumer prices were climbing up, there was a renewed slackening in the terms of trade resulting from a fall-off in export prices.

### **Latest GDP and price forecasts for 2006**

9. Locally, consumption looks set to hold up rather well, in tandem with better job prospects and rising employment incomes. Investment in plant and equipment seems likely to increase further in tandem with the much improved corporate profits and also to cater for the growth in business. But construction activity is likely to remain weak in the near term, thereby capping the upside of overall investment.

10. Externally, notwithstanding the increase in oil prices and higher interest rates, the global economy continued to show a fairly strong performance in the first quarter of 2006, providing significant growth impetus to Hong Kong's external trade. The US economy grew at an above-trend rate in the first quarter; the Japanese economy was on track to a sustained recovery; and the EU economies were also improving. The Mainland economy was particularly buoyant. The trade boom throughout the region had led to a surge in intra-regional trade and hence solid growth in most other Asian economies.

11. Although the performance of the global economy in the first quarter was unexpectedly strong, the external environment is still much clouded by various downside risks viz. recent hike in oil prices to around US\$70/barrel; rising US interest rates; avian flu; global trade imbalances; and lately, the tightening measures in the Mainland. Some of these risks in fact have intensified recently from the situation a few months earlier. How these various risk factors will play out is critical to Hong Kong's trade performance and hence Hong Kong's overall economic growth in the coming quarters.

12. Given the exceptionally strong GDP outturn of an 8.2% growth in the first quarter of 2006, the Hong Kong economy should have little difficulty in attaining the forecast GDP growth of 4-5% as released in the Budget round. Indeed, as the prospects for the global economy are still largely positive, there could be some upsides from the external side. However, in view of the wide range of uncertainties still prevailing in the external environment as well as the recent volatilities in the international financial markets, it is more prudent to maintain the forecast GDP growth for 2006 unchanged at 4-5% in the present round, pending a full update in the next round three months from now (*Table 2*). For comparison, the forecasts of Hong Kong's GDP growth by a selection of international organisations and local analysts are summarised in *Table 3*.

13. As to outlook for consumer price inflation, the actual outturn of consumer price inflation so far was in line with the earlier expectations. Consumer price inflation, though creeping up progressively along with the brisk pace of economic expansion, is likely to be still benign for 2006 as a whole. To take on board the release of the new 2004/05-based Composite CPI series, which is on average about

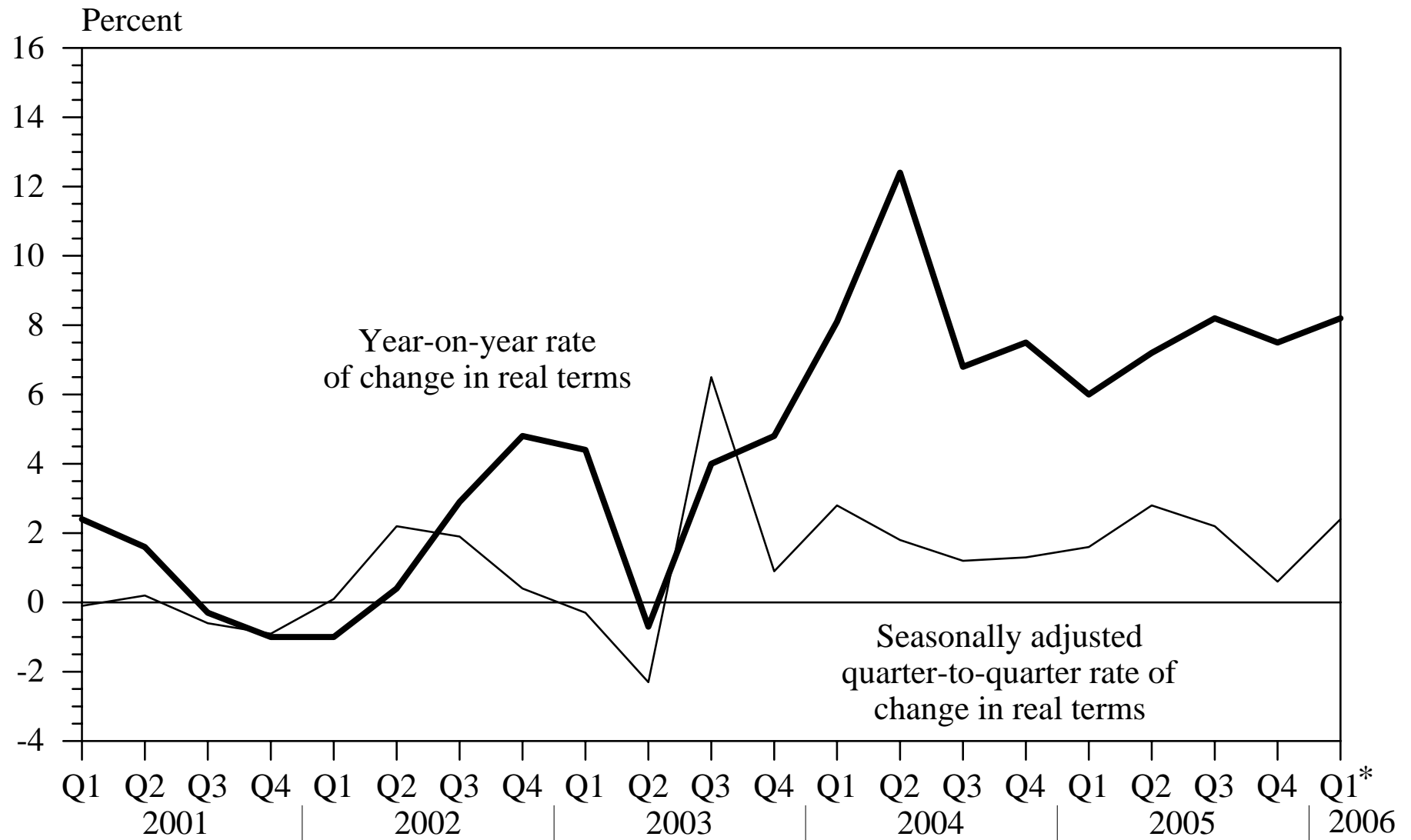
0.4 percentage point lower than the old 1999/00 series, the forecast rate of increase in the *Composite CPI* for 2006 as a whole is revised slightly down, from 2.3% to 2%. The refinement is entirely due to the technical revision of the CPI series, as the earlier forecast of 2.3% was made by reference to the old 1999/00-based CPI series, whereas the latest forecast is made by reference to the newly released 2004/05-based CPI series. As to the forecast rate of change in the *GDP deflator* for 2006 as a whole, it is kept unchanged at 0.5%, with the effect of rising local prices hopefully cushioning somewhat the continuing drag from the terms of trade.

(The First Quarter Economic Report 2006 can now be purchased on-line at <http://www.statisticalbookstore.gov.hk>, or by calling the Publications Sales Section of the Information Services Department (ISD) at 2537 1910. The hard copy of the report is available for sale at \$74 per copy (15% discount offered if purchased on-line), yet with a postage charge. The download version of the report is available for sale at a 25% discount.)

(The GDP figures up to the First quarter of 2006 are published in the Report of the Gross Domestic Product, First Quarter 2006, which can also be purchased on-line at <http://www.statisticalbookstore.gov.hk>, or by calling the Publications Sales Section of ISD. The hard copy of the report is available for sale at \$36 per copy (15% discount offered if purchased on-line), yet with a postage charge. The download version of the report is available for sale at a 25% discount.)



# Hong Kong's Gross Domestic Product



Note : (\*) Preliminary figures.

**Table 1**

**Gross Domestic Product and its main expenditure components  
and the main price indicators  
(year-on-year rate of change (%))**

	<u>2004<sup>#</sup></u>	<u>2005<sup>#</sup></u>	<u>2005</u>				<u>2006</u>
			<u>Q1<sup>#</sup></u>	<u>Q2<sup>#</sup></u>	<u>Q3<sup>#</sup></u>	<u>Q4<sup>#</sup></u>	<u>Q1<sup>+</sup></u>
<i>Change in real terms of GDP and its main expenditure components (%)</i>							
Private consumption expenditure	7.3	3.4	4.1 (0.4)	2.4 (0.5)	3.6 (1.3)	3.4 (0.9)	4.5 (1.7)
Government consumption expenditure	0.7	-3.1	-4.6 (-2.6)	-2.3 (-0.7)	-1.6 (0.3)	-3.8 (-1.0)	1.3 (2.7)
Gross domestic fixed capital formation	3.0	4.1	0.4 (N.A.)	4.9 (N.A.)	2.8 (N.A.)	8.4 (N.A.)	8.5 (N.A.)
<i>of which :</i>							
Building and construction	-11.7	-6.1	-1.0	-7.5	-5.2	-10.7	-8.7
Machinery, equipment and computer software	11.0	10.6	0.8	10.7	7.1	24.0	23.3
Total exports of goods	15.3	11.2	8.9 (0.1)	11.1 (6.0)	12.8 (3.1)	11.4 (2.2)	14.4 (2.2)
Imports of goods	14.1	8.6	3.8 (1.9)	7.0 (5.1)	11.0 (2.2)	12.0 (2.6)	14.0 (3.3)
Exports of services	17.9	8.7	8.7 (0.4)	9.1 (2.4)	8.9 (4.3)	8.2 (1.1)	8.9 (0.8)
Imports of services	14.6	2.9	6.0 (-2.1)	-0.1 (3.7)	3.5 (0.7)	2.3 (-0.3)	4.8 (0.9)
<b>Gross Domestic Product</b>	<b>8.6</b>	<b>7.3</b>	<b>6.0</b> <b>(1.6)</b>	<b>7.2</b> <b>(2.8)</b>	<b>8.2</b> <b>(2.2)</b>	<b>7.5</b> <b>(0.6)</b>	<b>8.2</b> <b>(2.4)</b>
<i>Change in the main price indicators (%)</i>							
<b>GDP deflator</b>	<b>-3.6</b>	<b>-0.2</b>	<b>-1.4</b> <b>(0.1)</b>	<b>-0.6</b> <b>(0.2)</b>	<b>0.2</b> <b>(*)</b>	<b>0.7</b> <b>(0.5)</b>	<b>-0.4</b> <b>(-1.2)</b>
<b>Composite Consumer Price Index</b>	<b>-0.4</b>	<b>1.0</b>	<b>0.4</b> <b>(0.1)</b>	<b>0.8</b> <b>(0.3)</b>	<b>1.4</b> <b>(0.3)</b>	<b>1.3<sup>@</sup></b> <b>(0.5)<sup>@</sup></b>	<b>1.6<sup>@</sup></b> <b>(0.4)<sup>@</sup></b>
<i>Change in nominal GDP (%)</i>	<b>4.7</b>	<b>7.0</b>	<b>4.6</b>	<b>6.6</b>	<b>8.4</b>	<b>8.2</b>	<b>7.8</b>

Notes : (#) Revised figures.

(+) Preliminary figures.

( ) Seasonally adjusted quarter-to-quarter rate of change.

N.A. Not applicable, as no clear seasonal pattern is found in gross domestic fixed capital formation, due to the presence of considerable short-term fluctuations.

(@) By reference to the new 2004/05-based CPI series.

(\*) Change of less than 0.05%.

**Table 2****Latest economic forecasts for 2006  
(year-on-year rate of change (%))**

	Forecasts for 2006 as released on 22.2.2006 (%)	Latest forecasts for 2006 released on 23.5.2006 (%)
<b>Gross Domestic Product (GDP)</b>		
<i>Real GDP</i>	4 to 5	4 to 5
<i>Nominal GDP</i>	4.5 to 5.5	4.5 to 5.5
<b>Composite Consumer Price Index</b>	2.3*	2.0 <sup>#</sup>
<b>GDP Deflator</b>	0.5	0.5

Notes : (\*) By reference to the old 1999/2000-based CPI series.

(#) By reference to the new 2004/2005-based CPI series.

**Table 3**

**2006 GDP and price forecasts for Hong Kong put out by selected international organisations and private sector analysts**

	Date of release	GDP	Private consumption expenditure ( growth rate	Gross Domestic fixed capital Formation in real	Total Exports of goods of services (% )	Exports of services	Rate of change in consumer prices (%)	Reference source
<b>International organisations:</b>								
IMF	Jan 2006	5.5	--	--	--	--	1.5	Staff Report for the 2005 Article IV Consultation Discussions, 6 Jan 2006.
	Apr 2006	5.5	--	--	--	--	1.8	World Economic Outlook, Apr 2006.
ADB	Apr 2006	5.5	--	--	--	--	2.5	Asian Development Outlook 2006, Apr 2006.
World Bank	Mar 2006	5.3	--	--	--	--	--	East Asia Update, Mar 2006.
<b>Private sector analysts:</b>								
<i>(a) Major local banks</i>								
HSBC	Feb 2006	5.5	3.2	2.5	4.9	6.4	2.2	Apple Daily, 21 Feb 2006.
	Apr 2006	5.5	3.2	2.5	--	--	2.2	Global Economics, Q2 2006.
Standard Chartered Bank	Feb 2006	6	--	--	--	--	2.5	On The Ground - Asia, 21 Feb 2006.
Hang Seng Bank	Dec 2005	5.3	3	2	8.5	6.4	2.3	Hang Seng Economic Monthly, Nov/Dec 2005.
	May 2006	5.3	--	--	--	--	2.2	Hang Seng Bank, 16 May 2006.
Bank of China (HK)	Dec 2005	5	3.3	3	8.5	8	2.5	Economic Review Monthly, Dec 2005.
Bank of East Asia	Jan 2006	5.2	4.5	1	9	6	2.5	Economic Analysis, Jan 2006.
ABN Amro Bank	Feb 2006	4.5	--	--	--	--	3	Asia Vision, 10 Feb 2006.
	May 2006	5.5	--	--	--	--	2.5	Asia Vision, 12 May 2006.
Citigroup	Feb 2006	5	--	--	--	--	2.8	Hong Kong Economics, 9 Feb 2006.
	May 2006	5.7	3.8	3.8	10.6	8.2	2.6	Hong Kong Economics, 17 May 2006.
<i>(b) Investment bank</i>								
JP Morgan Chase	Feb 2006	5.7	--	--	--	--	2	JP Morgan Chase, 16 Feb 2006.
	May 2006	5.8	--	--	--	--	2.2	JP Morgan Chase, 16 May 2006.
Goldman Sachs Asia	Jan 2006	5.4	--	--	--	--	2.8	HK Economic Times, 3 Jan 2006.
	Feb 2006	5.8	--	--	--	--	2.4	Asia-Pacific Economics Flash, 6 Feb 2006.
Morgan Stanley Asia	Nov 2005	5	3	3	--	--	2	Hong Kong Economics, 28 Nov 2005.

**Table 3 (cont'd)**

**2006 GDP and price forecasts for Hong Kong put out by selected international organisations and private sector analysts**

	Date Of release	GDP	Private consumption expenditure ( growth rate	Gross domestic fixed capital formation in real	Total Exports of goods terms (%) )	Exports of services	Rate of change in consumer prices (%)	Reference source
Merrill Lynch	Jan 2006	6	--	--	--	--	3.9	The Asian Market Economist, 16 Jan 2006.
Credit Suisse First Boston	Jan 2006	4.7	3.6	2.5	--	--	2.6	Asian Daily, 10 Jan 2006.
	Mar 2006	5	4.2	3	--	--	2.3	Global Emerging Markets Outlook, Q2 2006, 24 Mar 2006.
Lehman Brothers	Feb 2006	5.5	--	--	--	--	3.4	Asia Ex-Japan Weekly Economic Monitor, 10 Feb 2006.
	May 2006	6	--	--	--	--	3	Global Weekly Economic Monitor, 16 May 2006.
<i>(c) Others</i>								
Economist Intelligence Unit	Feb 2006	4.2	3.5	4	--	--	1.4	Country Forecast, Feb 2006.
	Apr 2006	4.7	3.7	4	--	--	1.4	Country Forecast, Apr 2006.
Hong Kong General Chamber of Commerce	Dec 2005	3.5	--	--	--	--	2.5	Hong Kong Economic Forecast, HKGCC, 2 Dec 2005.
	Feb 2006	4	--	--	--	--	2.5	HKGCC, 14 Feb 2006.
	May 2006	4.5	--	--	--	--	2	HKGCC, 16 May 2006.
Hong Kong University	Jan 2006	5	--	--	--	--	2.5	RTHK Online News, 5 Jan 2006.
	Apr 2006	5 - 6	--	--	--	--	2.5 - 3	Sing Tao Daily, 7 Apr 2006.
Federation of Hong Kong Industries	Jan 2006	5 - 5.5	--	--	--	--	--	Press release, 11 Jan 2006.

**Observation :**

The forecasts of GDP growth in real terms for 2006 from the private sector analysts listed above are mostly in the range of 4.5-6%, averaging at 5.4%.