



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

The Government released the First Quarter Economic Report 2007 in mid-May. The Economic Report, together with the press release containing the updated economic forecasts for the whole year of 2007, have been furnished to LegCo Members.

This paper analyses Hong Kong's overall economic development in regard to external trade, domestic demand, labour market, asset markets and consumer prices in the most recent period. It then describes the updated economic forecasts by the Government for 2007 as a whole.

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29 May 2007

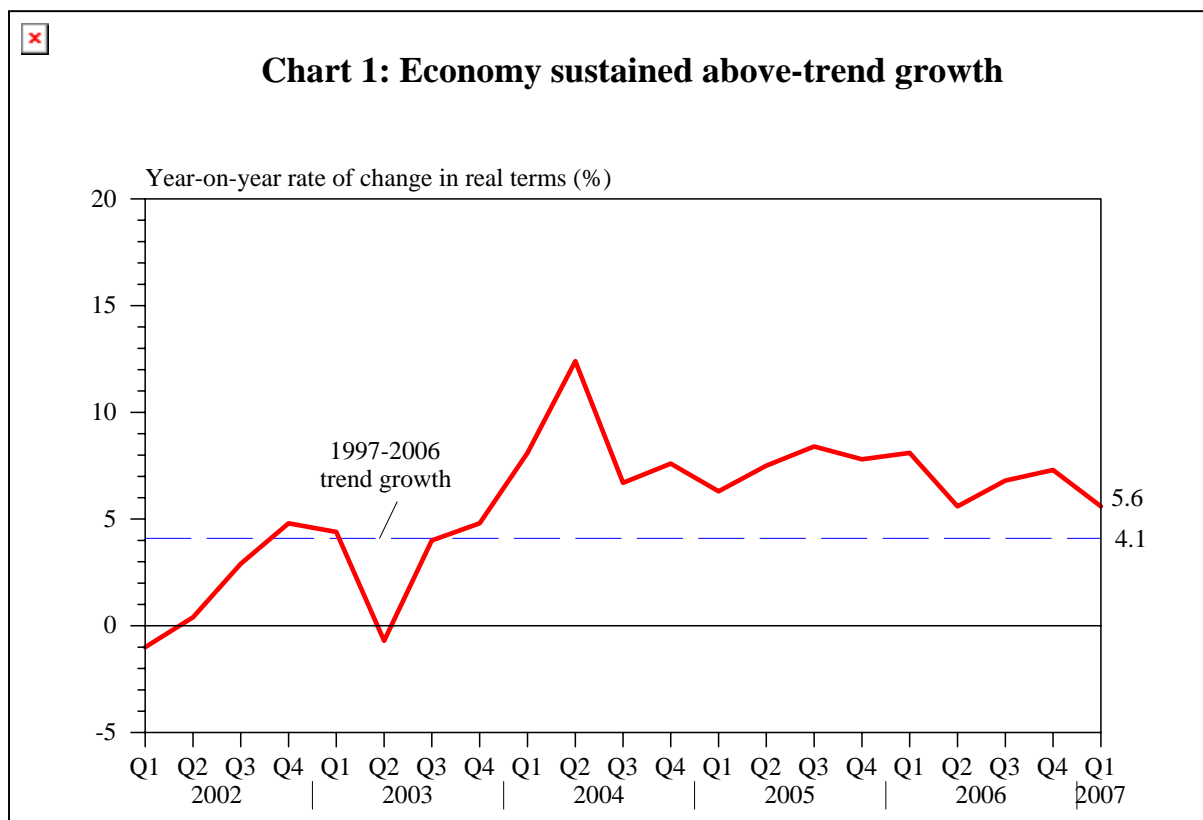
Recent Situation and Near-term Outlook For the Hong Kong Economy

Introduction

This paper analyses latest development in the Hong Kong economy and briefly discusses the updated economic forecasts for 2007 as a whole released in mid-May.

Recent economic situation

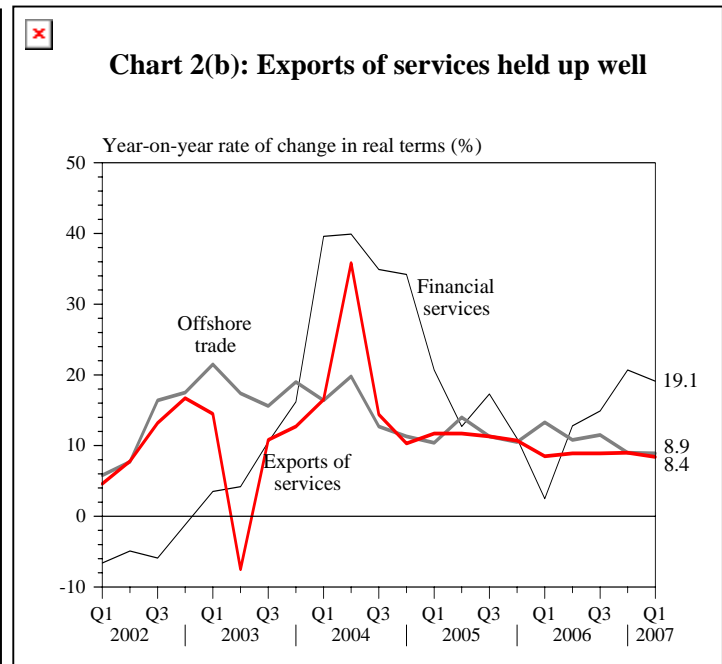
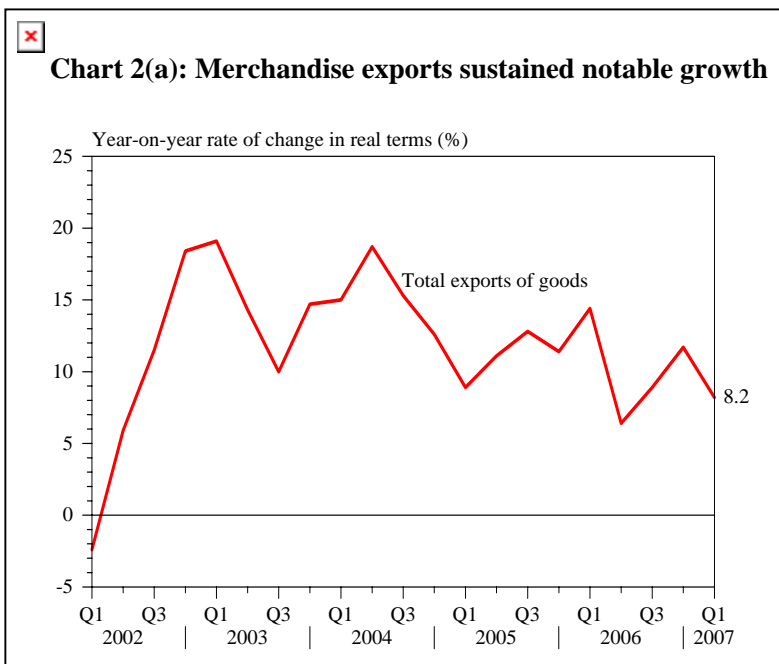
2. The Hong Kong economy continued to show broad-based expansion in the first quarter of 2007, with GDP growing solidly by 5.6% in real terms over a year earlier. Since the upturn in mid-2003, the economy has been growing at above-trend pace for 14 quarters in a row (*Chart 1*). Growth remained broad-based, with domestic demand sustaining strong momentum and export performance staying resilient.



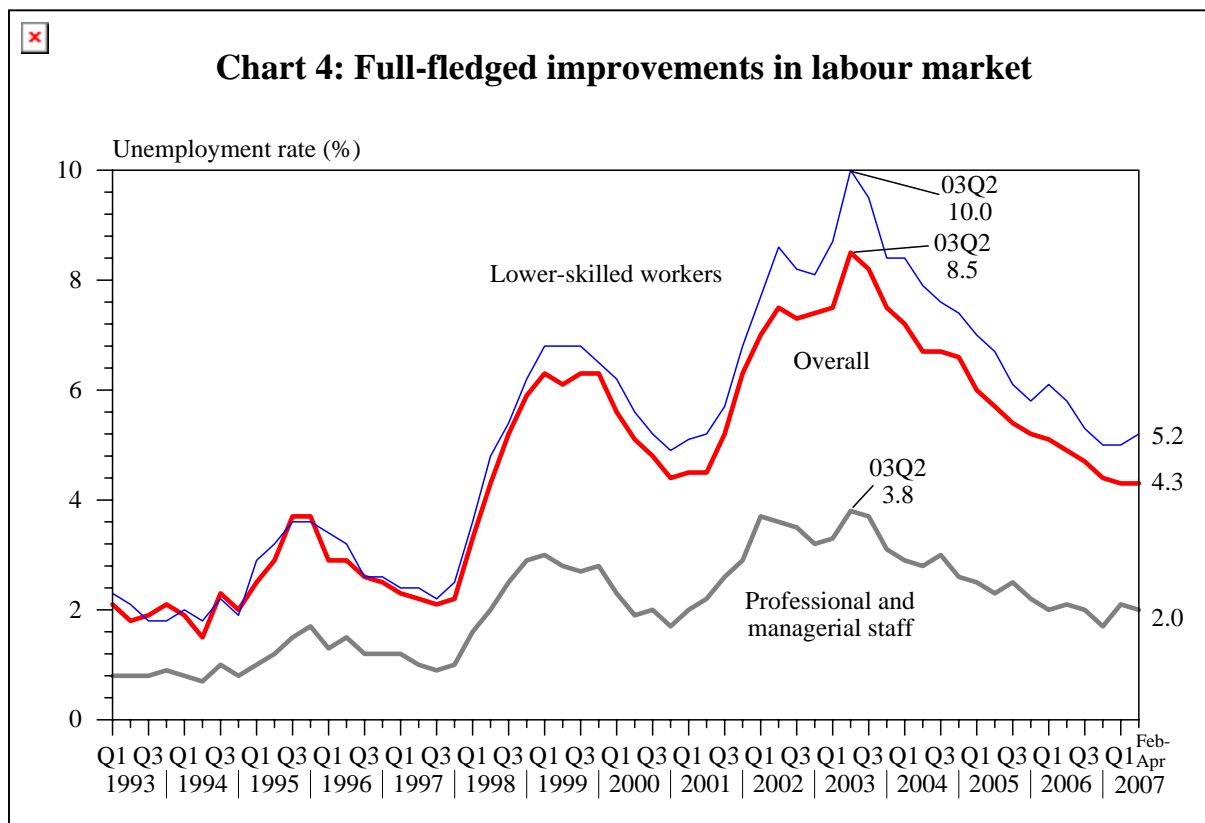
3. External demand held up well on entering 2007. Merchandise exports recorded a further notable growth at 8.2% in real terms in the first quarter over a year earlier, even when set against an exceptionally high base a year earlier. Trade flows involving the Mainland remained vibrant, thereby largely cushioning overall export performance against the weakness in the US market (*Chart 2(a)*).

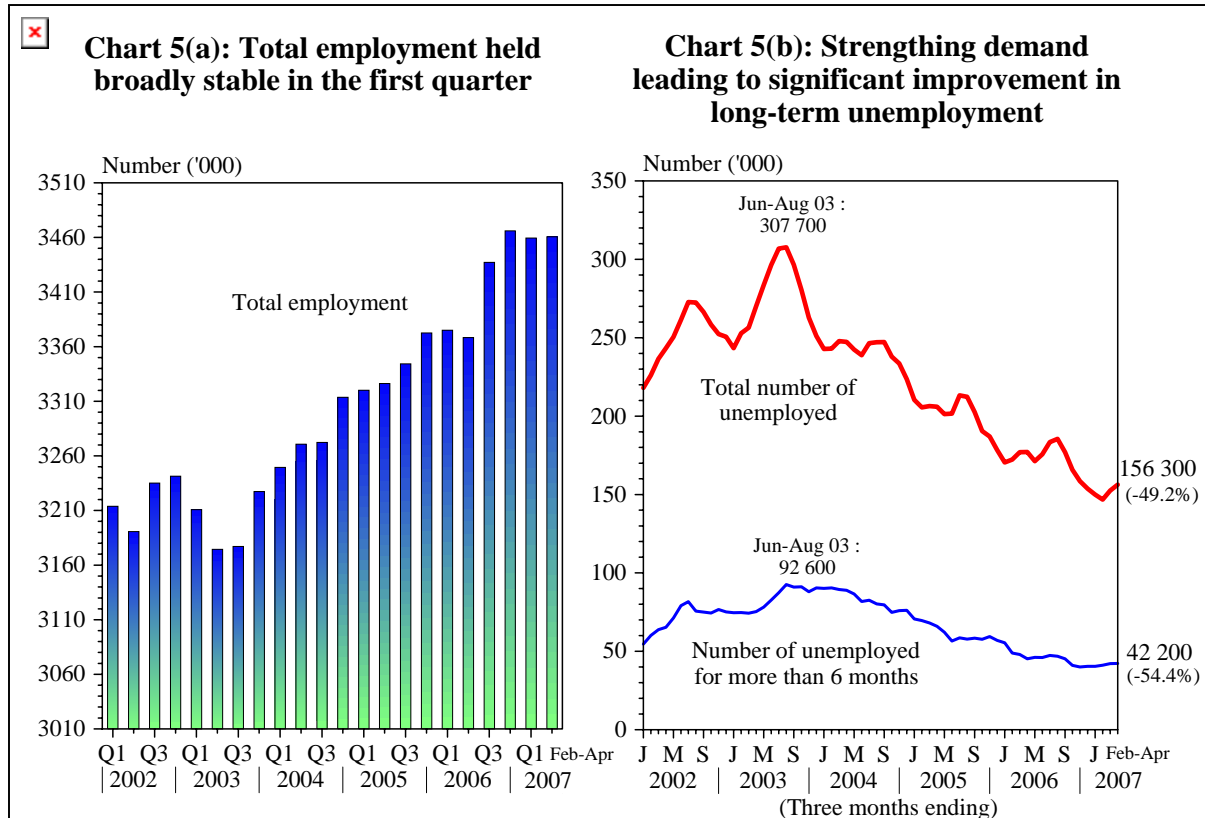
4. Analysed by market, exports to the Mainland continued to show double-digit growth in the first quarter, thanks to the strength of the domestic economy and also vibrant trade flows. Exports to the European Union showed only modest growth. Despite the improving domestic demand there, the scope for a sharper pick-up was somewhat restrained by reduced intake of raw materials amidst a weakening export sector. Exports to the US were still lackluster, owing to its weak import demand. Exports to other Asian economies showed mixed performance, with those to Thailand, Malaysia and Indonesia outperforming others.

5. Exports of services leaped by 8.4% in real terms in the first quarter over a year earlier, led by the surge in exports of financial and business services amidst the buoyant financial markets, as well as the brisk expansion of both offshore trade and inbound tourism (*Chart 2(b)*).

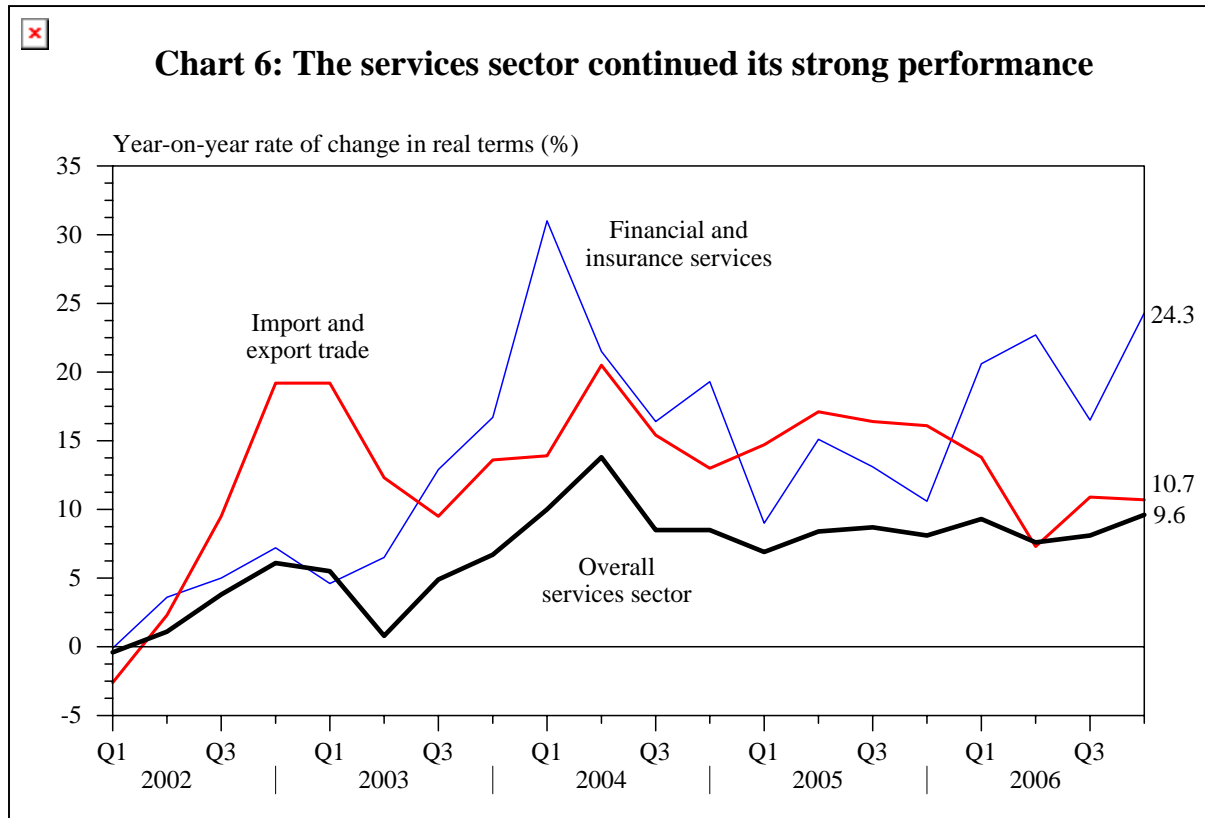


8. As demand for labour continued to rise in tandem with the economic upturn, the seasonally adjusted unemployment rate fell further to 4.3% in the first quarter (and stayed unchanged in the three months ending April), the lowest in more than 8½ years (*Chart 4*). The improvement in the labour market conditions continued to be broad-based. Since the trough in mid-2003, a total of nearly 300 000 net additional jobs have been created, benefiting workers at different skill levels across different sectors (*Charts 5(a) and 5(b)*). The number of long-term unemployed fell by more than half over the past 3½ years or so, and the number of lower-skilled unemployed workers also declined by nearly half. The total number of job vacancies in the private sector continued to rise, while wages and earnings also picked up more notably in the fourth quarter of 2006.

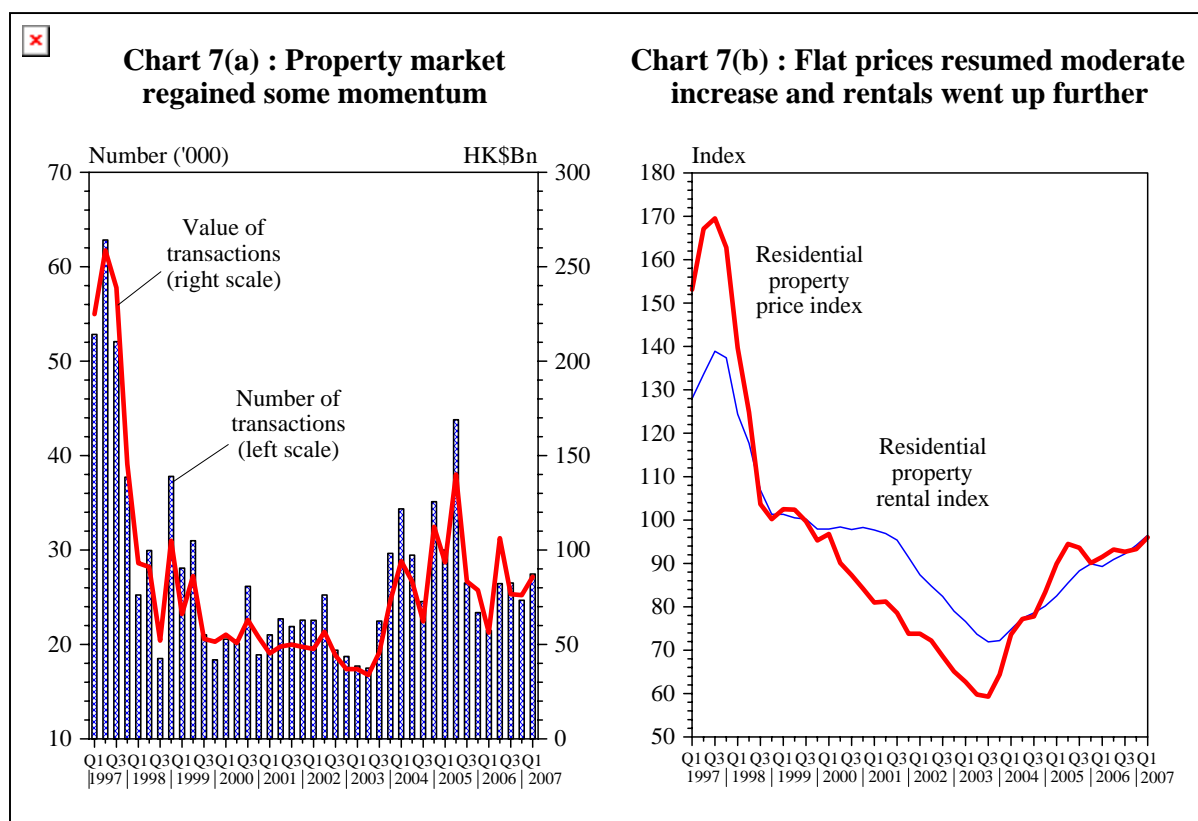




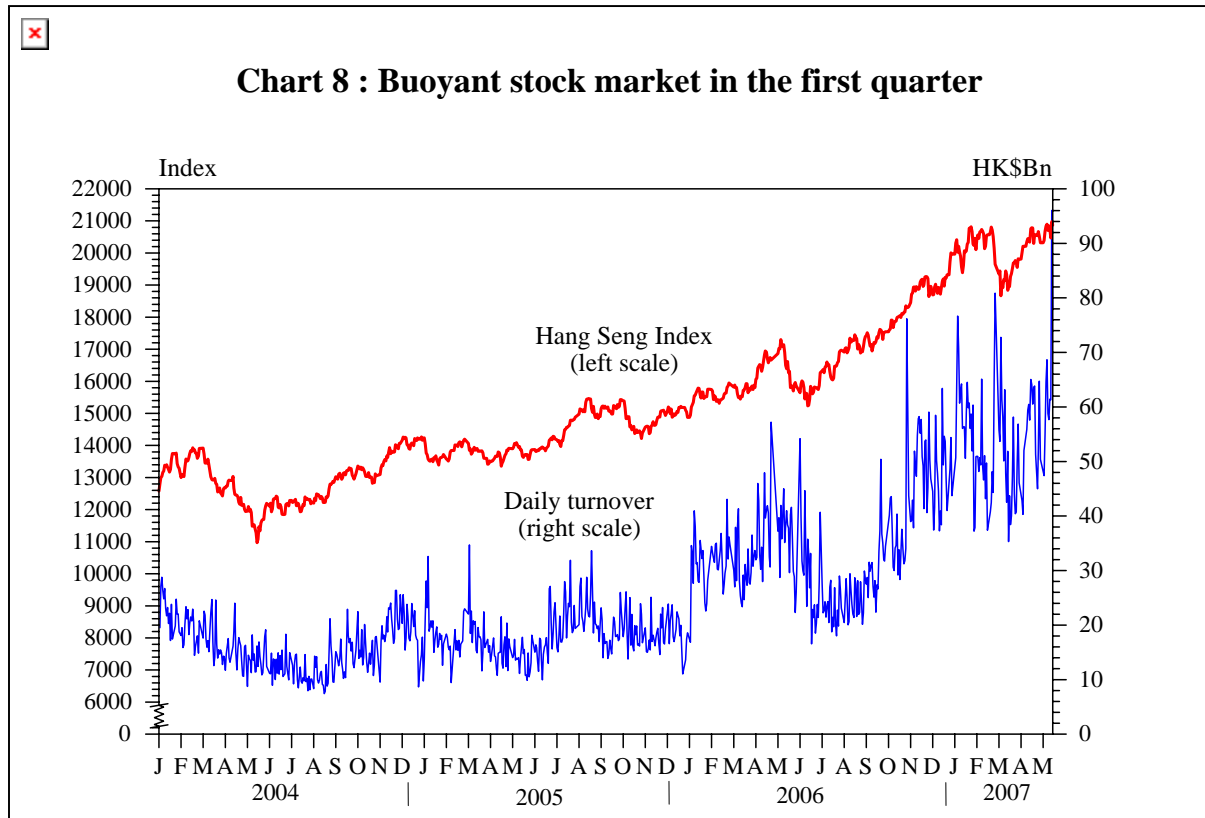
9. Hong Kong's overall economic growth has been propelled by the continued strong performance of the services sector. Latest available figures for 2006 indicate that the value added of the services sector as a whole grew robustly by 8.7% in real terms. Reflecting the buoyancy of financial market activities, financing and insurance showed the fastest growth among the constituent service sectors in 2006. This was followed by communications and import and export trade. The strengthening consumption demand and further expansion of inbound tourism also led to a vibrant growth in the value added of restaurants and hotels. On the other hand, the manufacturing sector only showed a small increase in value added and the construction sector remained slack (*Chart 6*).



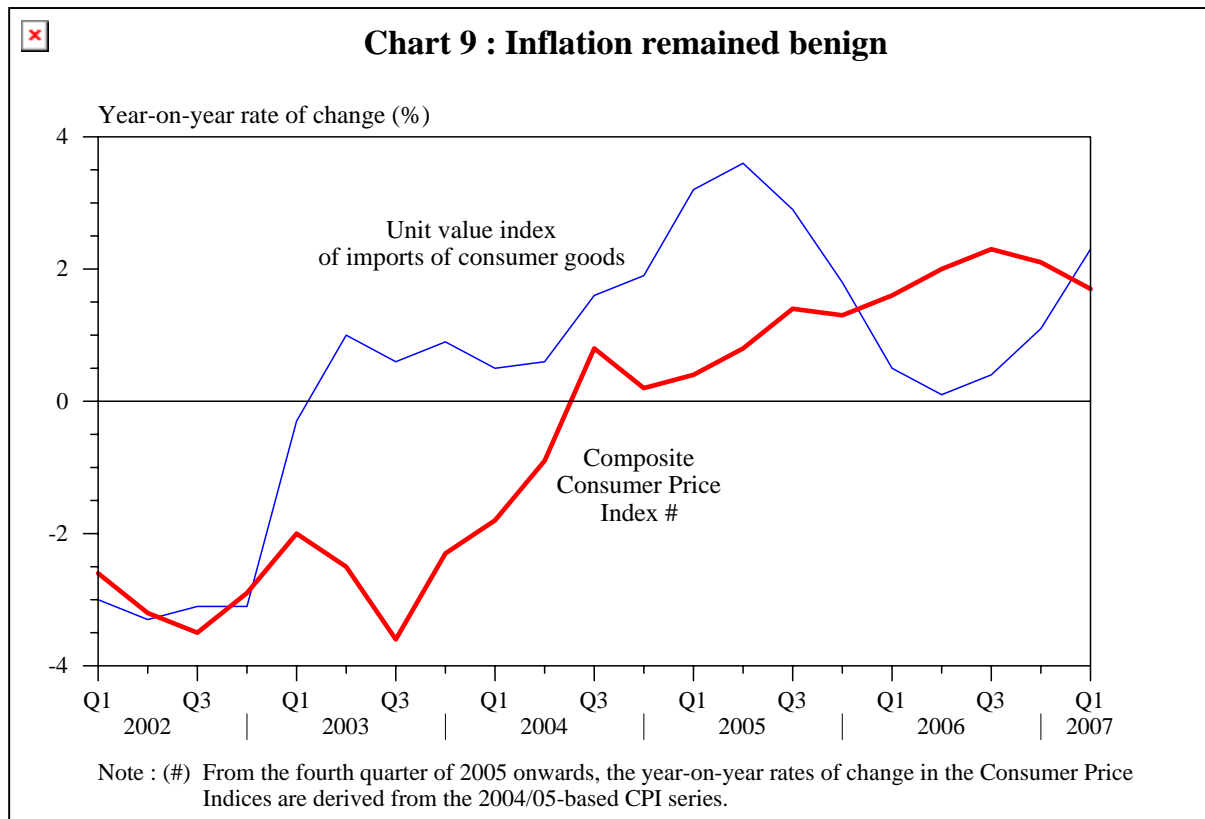
10. The residential property market regained some momentum in the first quarter of 2007. Sentiment was boosted by sanguine economic outlook, stable local interest rate environment and increased mortgage concessions by the banks. Acquisition interest for smaller flats more recently was also stimulated by the reduction in stamp duty for property transactions worth between \$1 million and \$2 million as announced in the 2007/08 Budget. Flat prices resumed a moderate increase of around 3% during the quarter, having moved narrowly for five months. Compared with the trough in 2003, flat prices in March 2007 were 66% higher, but still 44% lower than the peak in 1997. Concomitantly, flat rentals went up further by about 3% during the first quarter. As for the non-residential segment, it maintained an upturn. In particular, the strong demand for quality office space was sustained, as the economy continued to move up the value chain (*Chart 7*).



11. The local stock market held up well at the beginning of 2007, but the fall in the Mainland market together with the ensuing jitters in other overseas markets saw a rather sharp correction in late February and early March. The Hang Seng Index retreated from a high of over 20 800 in late January to below the 19 000 mark in early March. The local stock market however rebounded swiftly, backed by the rise-back in other markets, and more importantly, the favourable corporate earnings results and positive market sentiment about the economic outlook. The Hang Seng Index closed the first quarter at 19 801, not much lower than that of 19 965 at end-December 2006. Trading has been buoyant throughout the first quarter, with average daily turnover expanding sizably to a record high of \$52.9 billion, 18.4% higher than the fourth quarter in 2006 (*Chart 8*). The recent announcement to extend the scope of Mainland's QDII scheme has boosted market sentiment further. The Hang Seng Index reached successive new highs and broke the 21 000 mark for the first time in mid-May amidst hectic trading.



12. Consumer price inflation stayed moderate. The year-on-year rate of increase in Composite Consumer Price Index (CCPI) averaged at only 1.7% in the first quarter, down from the 2.1% rise in the preceding quarter, due to the waiving of public housing rentals in February. Excluding the influence of this one-off measure, the underlying inflationary pressures actually crept up, yet only slightly, mainly reflecting the feed-through of higher imported inflation due to the depreciation of the Hong Kong dollar along with the US dollar, as well as the gradual appreciation of the renminbi (*Chart 9*).



Updated short-term economic forecasts for 2007

13. The near-term outlook for the rest of 2007 is affected by a number of uncertainties arising from the external front. Although the global economy remained largely resilient so far this year, the evolving development of the US housing market and related issues of sub-prime mortgages and fall-off in construction investment continue to attract considerable concern, in particular whether the housing segment problems will eventually filter through to the wider segments of the economy and lead to a sharper-than-expected US economic slow-down, with negative spill-overs to the rest of the global economy. Along with an uncertain US outlook, there may also come more volatility in global financial markets, especially given the lingering structural weakness of global imbalances.

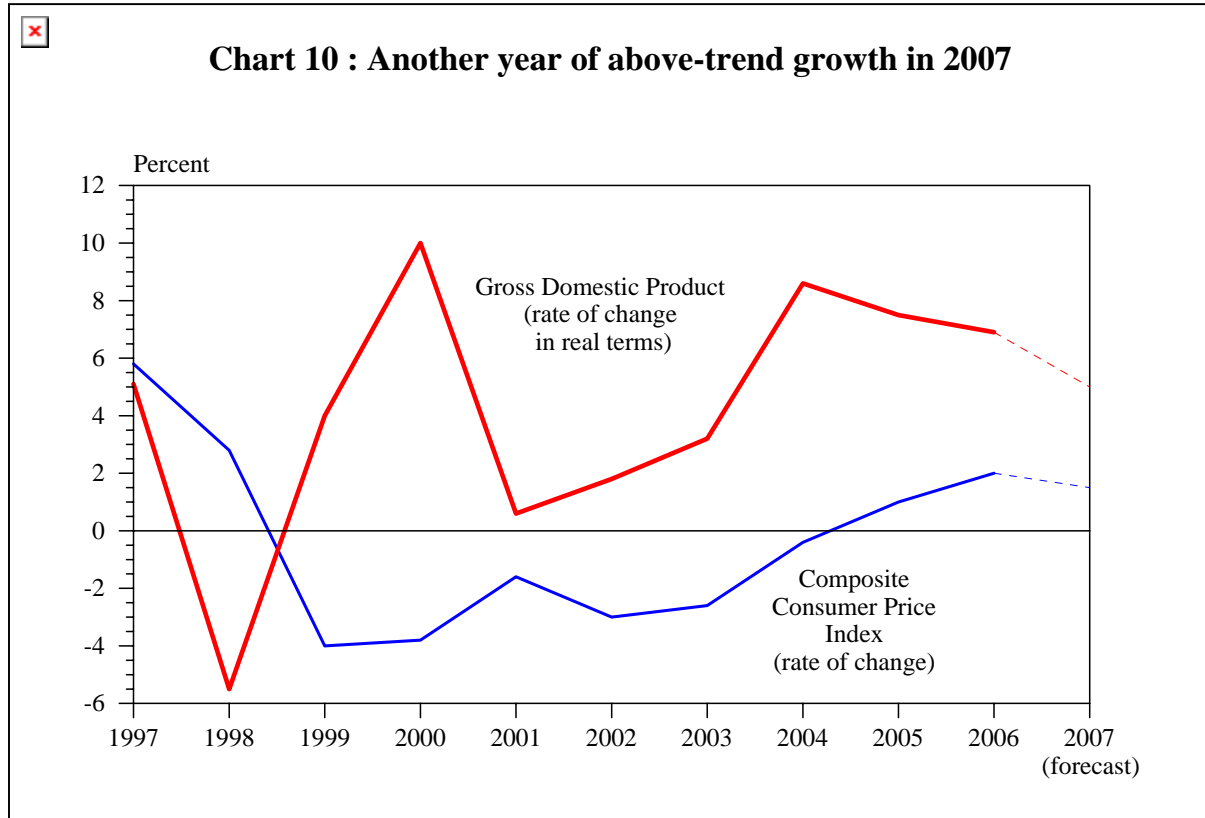
14. Yet there are also a number of positive factors which should render support to the Hong Kong economy. The European and Japan economies have finally embarked on a sustainable growth path, a much welcomed development for the global economy, at a time when the US economy is slowing. The Mainland's economy has remained vibrant, and continues to be a plus factor for Hong Kong. Even though there is concern about further macro tightening measures, these measures are intended to forestall the risk of overheating and steer the Mainland economy towards a steady and more sustainable high growth track. On the exchange rate front, the weakness of the dollar particularly against the Asian currencies would continue to aid our export competitiveness. Abundant liquidity in our banking system is another positive factor for business expansion. Moreover, after the distinct upturn over the past few years, the Hong Kong economy is now on a sounder footing to cope with external shocks.

15. Moreover, locally, domestic demand is expected to hold firm and take up a bigger role as a growth contributor, at a time when the trade prospects are subject to more uncertainties. Improving employment incomes and the positive economic prospects would continue to render support to private consumption. Vibrant business activity and the prevailing upbeat business sentiment should augur well for continued investment growth in the coming quarters.

16. Overall, the Hong Kong economy is likely to have another year of above-trend growth in 2007. With the actual GDP outturn of a 5.6% growth in the first quarter largely in line with expectations, the GDP forecast at 4.5-5.5% for 2007 announced in the Budget round in late February is kept unchanged (*Chart 10*). As a reference, the IMF lately forecasts that the Hong Kong economy would grow by 5.5% in 2007. The prevailing private sector analysts are also upbeat about further expansion of the Hong Kong economy at a solid pace, with prevailing forecasts averaging at around 5.3%.

17. As to the inflation outlook, tighter labour market conditions, weakness of the US dollar and renminbi appreciation would see cost pressure creeping up further. Yet the upturn in CCPI is likely to proceed still at a rather modest pace, being cushioned by a concurrent notable growth in labour productivity. Moreover, various one-off factors including the rates waiver for two quarters, the public housing rental cut to be implemented later this year, and the implementation of the Pre-primary Education Voucher Scheme would also

bring down the CCPI level. With the actual outturn of consumer price inflation so far in line with expectations, the forecast rate of increase in the CCPI for 2007 is also maintained at 1.5%.



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Recent situation of household income⁽¹⁾

Background

This Annex provides a regular update on the movement of household income both in overall terms and in respect of households with monthly household income below \$4,000, in response to the earlier request from the Hon Emily Lau at the 5 December 2005 meeting⁽²⁾.

Latest situation

2. In overall terms, household income continued to improve in the past few months, underpinned by further increases in job opportunities and labour earnings. The average monthly household income in Q1 2007, at \$27,000, was 2.9% higher in money terms than a year earlier and also 8.0% higher over Q1 2004. After discounting the price changes, the respective gains were 1.2% and 4.1% in real terms. Furthermore, it is worth noting that over the past three years, the proportion of households with monthly income less than \$16,000 at current prices fell, whereas that for households with \$16,000 or above rose (*Table 1*).

Table 1: Share of domestic households by monthly household income

	<u>Q1 2004</u>	<u>Q1 2006</u> (Percent)	<u>Q1 2007</u>
Less than \$4,000	9.0	8.0	7.9
\$4,000 - \$7,999	13.6	12.8	12.9
\$8,000 - \$11,999	14.5	13.7	13.4
\$12,000 - \$15,999	12.5	12.2	12.0
\$16,000 - \$23,999	16.4	17.0	16.7
\$24,000 - \$39,999	17.3	18.3	18.5
\$40,000 - \$99,999	13.9	15.1	15.5
\$100,000 or above	2.8	3.0	3.0

Note : The purchasing power of the income (as measured by the Composite CPI) in Q1 2004 and Q1 2006 were 104% and 102% of that in Q1 2007 respectively.

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

(2) Previous regular updates were submitted to the Panel in March, June and December 2006.

Households with monthly household income below \$4,000

3. In Q1 2007, the number of households with monthly household income below \$4,000 (hereafter referred to as “low-income households”) rose slightly by 1 000 or 0.6% over a year earlier to 176 600. This was primarily due to the rise in the number of economically inactive low-income households (i.e. with all of their members being economically inactive). The number of economically active low-income households (i.e. with at least one economically active household members) actually fell further, thanks to a significant improvement in the employment situation for the lower-skilled workers (as manifested by a drop in the overall unemployment rate of these workers from 6.1% in Q1 2006 to 5.0% in Q1 2007). Concurrently, the number of elderly low-income households (i.e. with all members aged 60 or above) edged down slightly. As a proportion of all domestic households, the low-income households decreased further over the past year, from 8.0% to 7.9%.

4. Comparing Q1 2007 with Q1 1997, while there was still a surge in the low-income households in both absolute and proportionate terms, it was mainly attributable to a significant increase in the number of retired elderly households as well as a decline in average household size during the period (*Table 2*).

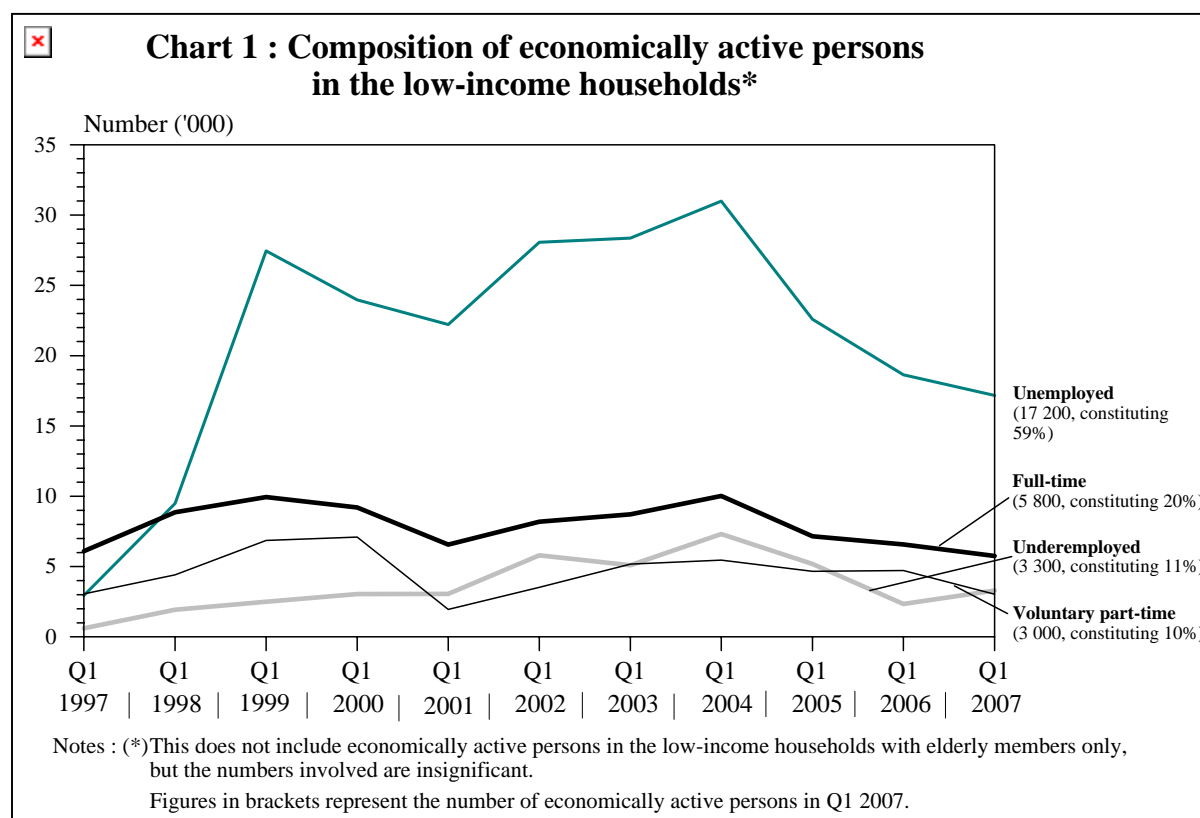
Table 2: Number and share of low-income households

	<u>Elderly households</u>	<u>Economically inactive households</u>	<u>Economically active households</u>	<u>Total</u>
Q1 1997	62 700 (3.3)	18 400 (1.0)	11 200 (0.6)	92 300 (4.8)
Q1 2004	119 300 (5.6)	29 600 (1.4)	44 300 (2.1)	193 200 (9.0)
Q1 2005	119 600 (5.5)	30 900 (1.4)	33 200 (1.5)	183 700 (8.4)
Q1 2006	114 200 (5.2)	33 000 (1.5)	28 500 (1.3)	175 600 (8.0)
Q1 2007	114 000 (5.1)	36 600 (1.6)	26 000 (1.2)	176 600 (7.9)

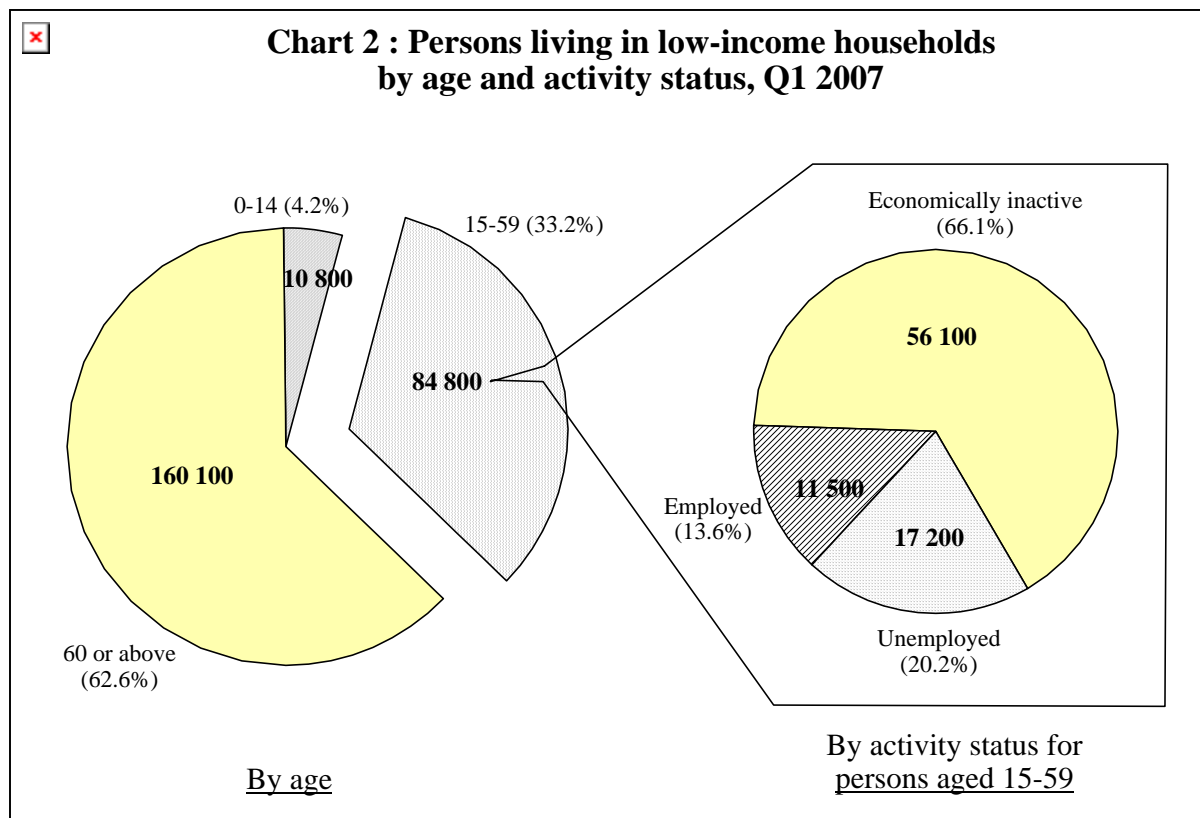
Note : () Share in all domestic households.

5. A further breakdown of these low-income households gave the following major observations:

- More than two-thirds of the low-income households in Q1 2007 were 1-person households, within which elderly persons aged 60 or above constituted the majority share.
- There were 65 900 household members living in economically inactive low-income households. More than one-third (36%) of them were aged below 20 and aged 60 or above (primarily consisting of students and retirees). The remaining 42 200 persons aged 20-59 comprised mainly home-makers (22%), persons suffering prolonged illness (19%), and retirees (19%).
- Of the 29 300 economically active persons living in economically active low-income households, 59% were unemployed, 22% were part-time workers (working voluntarily for less than 35 hours per week, or involuntarily so, i.e. underemployed), and 20% were full-time workers. The noticeable decline in the number of these household members over the past three years suggested that many of them had actually regained employment or else had earned higher income, thereby moving away from the group of low-income households (*Chart 1*).



- For all the 255 800 persons living in low-income households in Q1 2007, the great majority (62.6%) were elderly persons aged 60 or over. About one-third of them were aged 15-59, of whom a predominant proportion was economically inactive (*Chart 2*).



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