



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

The Government released the First Quarter Economic Report 2009 in mid-May. The Economic Report, together with the press release containing the updated economic forecasts for the whole year of 2009, 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 2009 as a whole.

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

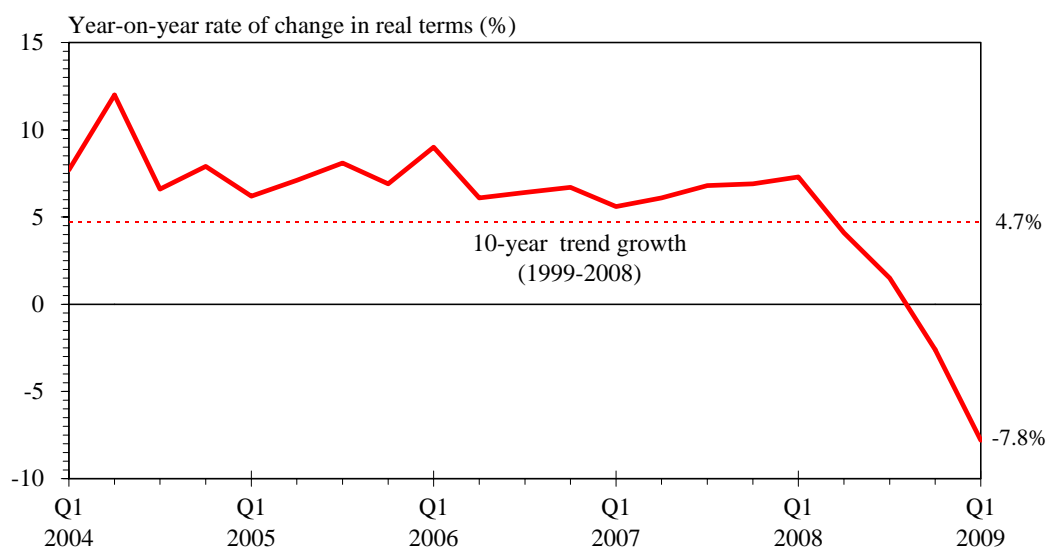
Introduction

This paper analyses latest development in the Hong Kong economy and briefly discusses the updated economic forecasts for 2009 as a whole released in mid-May.

Recent economic situation

2. The Hong Kong economy has been hard hit by the global financial tsunami and the ensuing severe recession. Following a contraction of 2.6% in the fourth quarter of 2008, Gross Domestic Product (GDP) registered a sharp year-on-year decline of 7.8% in real terms in the first quarter of 2009 (*Chart 1*). This marked the largest decline since the third quarter of 1998, when the economy was battered by the Asian Financial Crisis. This was mainly due to the plunge in external demand and its spillover effect on the domestic sector. More recently, with the global economy showing signs of stabilization, there have been some relative improvements in the performance of both the external and domestic sectors.

Chart 1 : Economy showed a steep contraction in the first quarter



3. Hong Kong's merchandise exports, like those of many other externally oriented Asian economies, faced the double blow from a plunge in global demand and an acute fall-off in intra-regional trade. Total exports of goods plummeted by 22.7% in real terms in the first quarter (**Chart 2(a)**). Exports to almost all major markets recorded sharp declines. Nevertheless, the rate of decline in the value of merchandise exports, though still notable, narrowed in April and May, mainly reflecting improved performance in exports to the Mainland.

4. Exports of services likewise slackened further, down by 8.2% in real terms in the first quarter of 2009 (**Chart 2(b)**). The collapse in world trade weighed heavily on exports of trade-related services (mainly offshore trade) as well as exports of transportation services. Exports of financial services and other business services were also much affected, as market activities remained sluggish amid the financial tsunami. Inbound tourism continued to expand in the first quarter, but visitor arrivals fell notably in May, partly reflecting the dampening effect of human swine flu on travel demand.

Chart 2(a) : Total exports of goods fell sharply in the first quarter of 2009

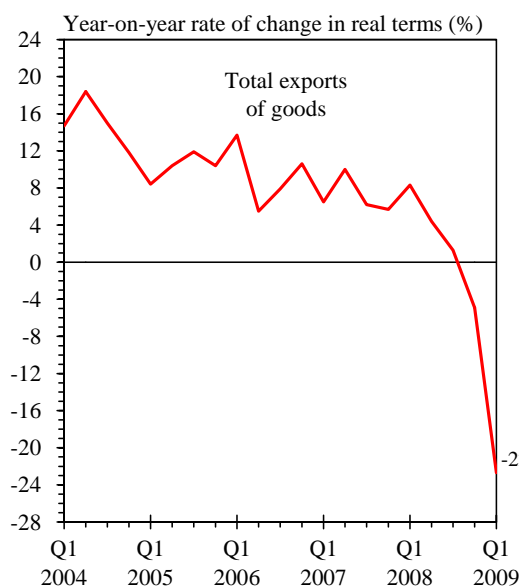
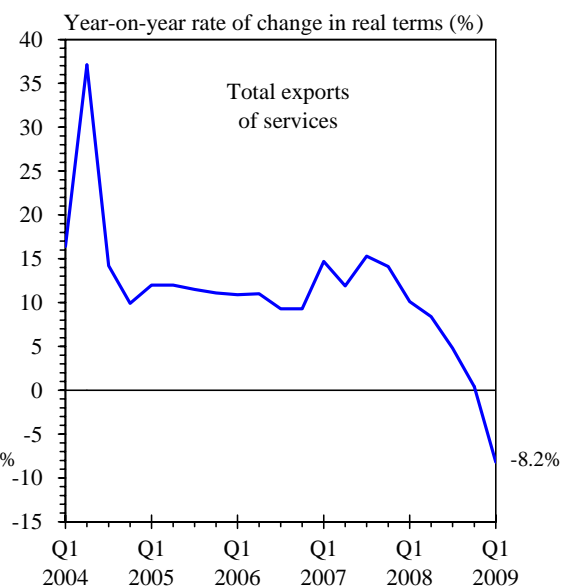


Chart 2(b) : Exports of services likewise declined in tandem with global recession



5. Domestic demand was also weak in such a difficult and uncertain global economic climate. Private consumption expenditure (PCE) fell by 5.5% in real terms in the first quarter of 2009 (**Chart 3(a)**). While private consumption was certainly dragged by the climbing unemployment and the ensuing slackened income, the year-on-year decline of PCE in the first quarter

of 2009 was also partly due to the very high base of comparison in the same quarter last year. The rebounds in the local housing and stock markets as well as the Government's relief measures have provided support to consumer sentiment. In April, the year-on-year decline in the volume of retail sales, at 5.5%, tapered visibly from the 9.2% drop in March.

6. Overall investment spending remained much in a depressed mode, down by 12.6% in real terms in the first quarter of 2009. Machinery and equipment investment fell notably, while expenditure on building and construction declined further in the first quarter (*Chart 3(b)*). The results of latest Quarterly Business Tendency Survey conducted by the Census and Statistics Department in April indicated that large companies remained rather pessimistic about the near term business situation, but the extent of pessimism seemed to have lessened somewhat compared with the survey results obtained three months earlier.

Chart 3(a) : Private consumption expenditure fell further in the first quarter

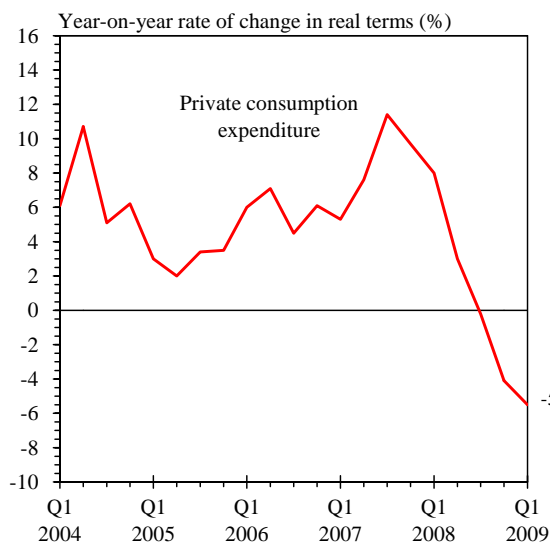
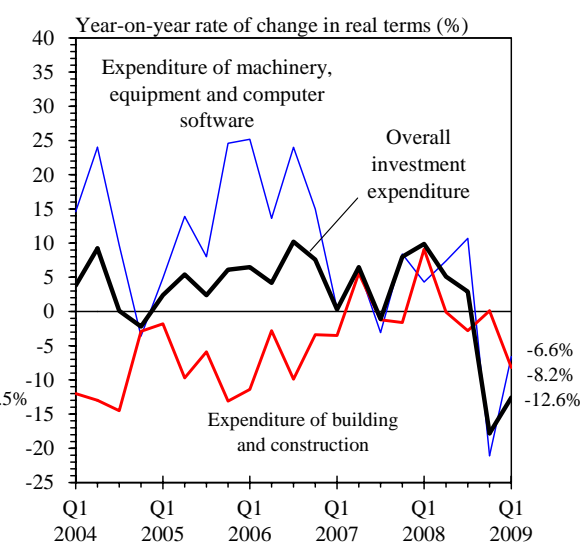


Chart 3(b) : Overall investment remained weak due to grim economic outlook



7. Labour market conditions worsened amid the economic contraction, yet exhibiting a large degree of resilience more recently. The seasonally adjusted unemployment rate leveled at 5.3% in March-May 2009, the first time after eight consecutive months of increase (*Chart 4*). It appears that many companies have exercised greater restraint in laying off workers, despite the much weakened business situation. The relative stability of domestic segments, with the additional support from the Government's relief measures,

and the greater willingness on the part of workers to adjust through reductions in wages and working days, all helped. Nevertheless, the unemployment rate will continue to face upward pressure, particularly when the fresh graduates enter the market during the summer.

8. Total employment fell by 0.5% in March-May 2009 over a year earlier (*Charts 5(a)*), but rebounded slightly when compared with February-April. Since the outbreak of the financial tsunami in September last year, total employment had so far declined by around 31 000. This was much smaller than the job loss of about 100 000 within six months during the Asian Financial Crisis. The weakened demand for labour has exerted downward pressure on wages and incomes. Labour earnings, as measured by payroll per person engaged in the private sector, fell by 0.2% in nominal terms in the first quarter of 2009 over a year earlier (*Charts 5(b)*).

Chart 4 : Labour market exhibited a large degree of resilience more recently

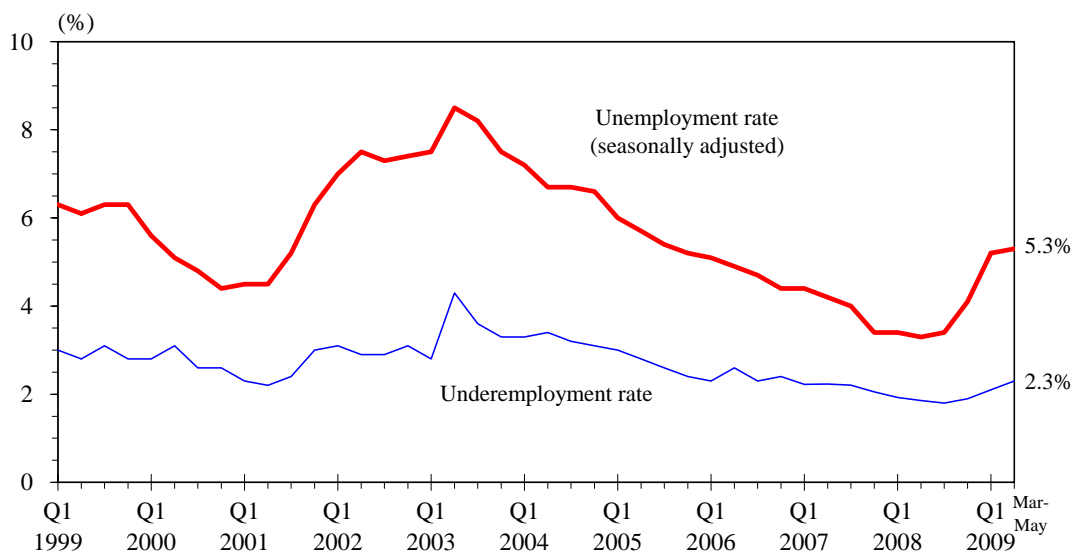


Chart 5(a) : Employment rebounded somewhat in the latest period

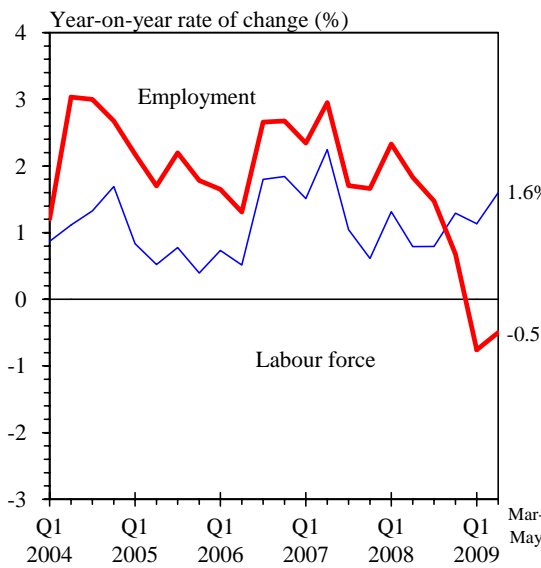
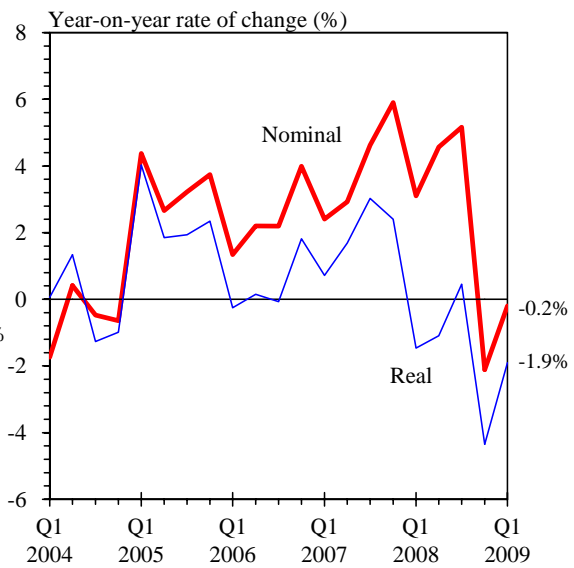
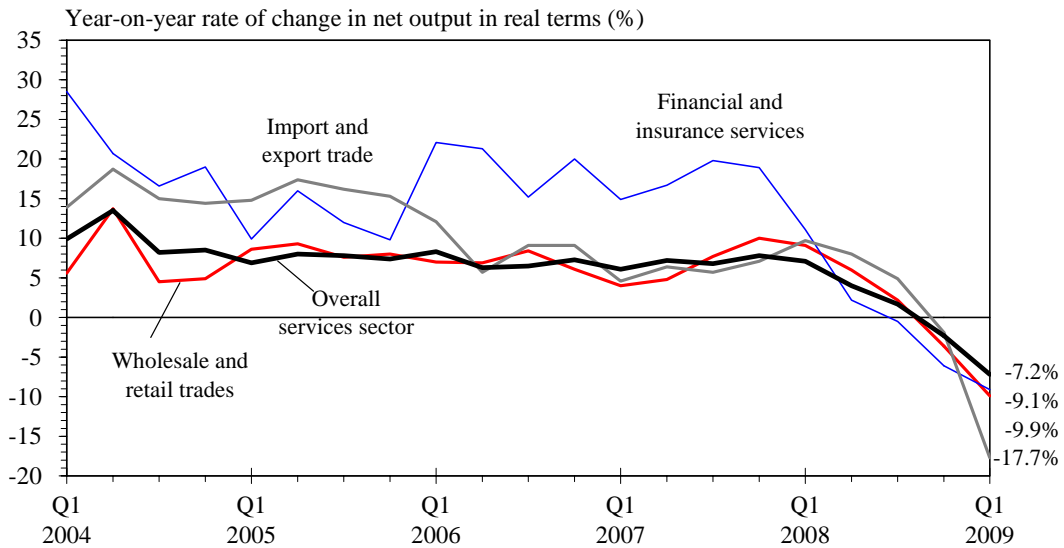


Chart 5(b) : Labour earnings adjusted downwards in response to the weak labour market conditions



9. The services sector accounts for over 90% of the economy. Latest available figures indicate that net output of the services sector contracted by 7.2% in real terms in the first quarter of 2009, after a 2.4% increase in 2008 as a whole. Among the major service sectors, import and export trade recorded the largest decline in net output, followed by wholesale and retail trades, transport and storage, and financing and insurance. As for sectors other than services, both the manufacturing and the construction sectors remained on a decline over the same period (*Chart 6*).

Chart 6 : Services sector likewise showed steep contraction in the first quarter of 2009 alongside the overall economy



10. The residential property market, having gone through a notable correction in the latter part of 2008, staged a rather distinct rebound in recent months. Both flat prices and transaction volume picked up, as buying interest re-emerged amid low interest rates and a more accommodative mortgage lending policy by local banks (*Chart 7(a)*). Signs of stabilization in the global economy also supported market sentiments. Residential flat prices rose by about 10% during the first five months of 2009, but were still 9% below the peak last year. On the leasing front, flat rentals fell by about 3% during the first five months of 2009 (*Chart 7(b)*), though stabilising somewhat in May. As regards commercial and industrial property, both acquisition and leasing demands rebounded somewhat in recent months alongside the more active residential property market, yet remained far lower than the levels just before the global financial tsunami.

Chart 7(a) : Transaction in property market bounced back in April and May

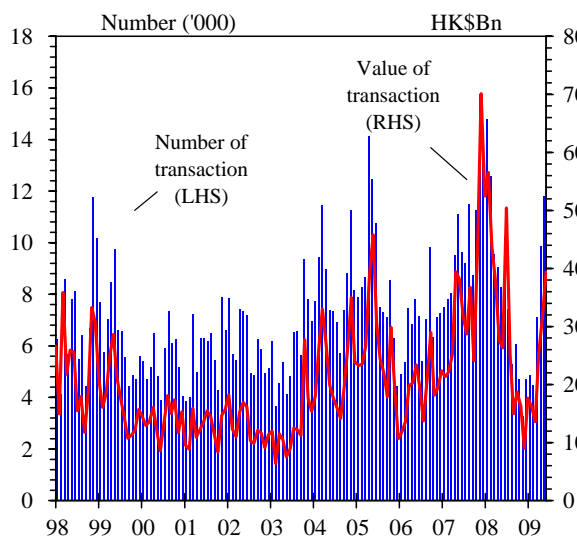
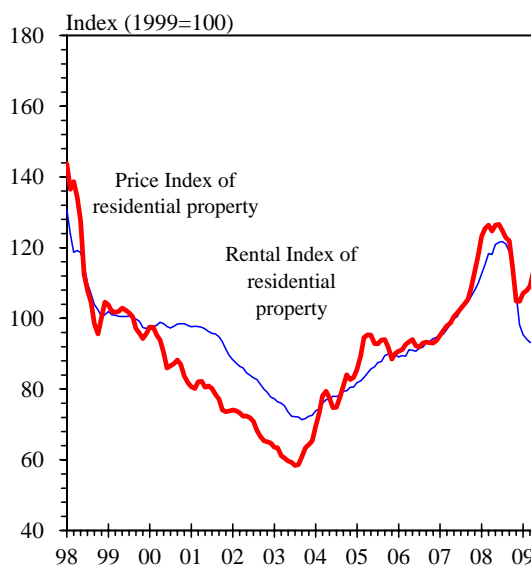
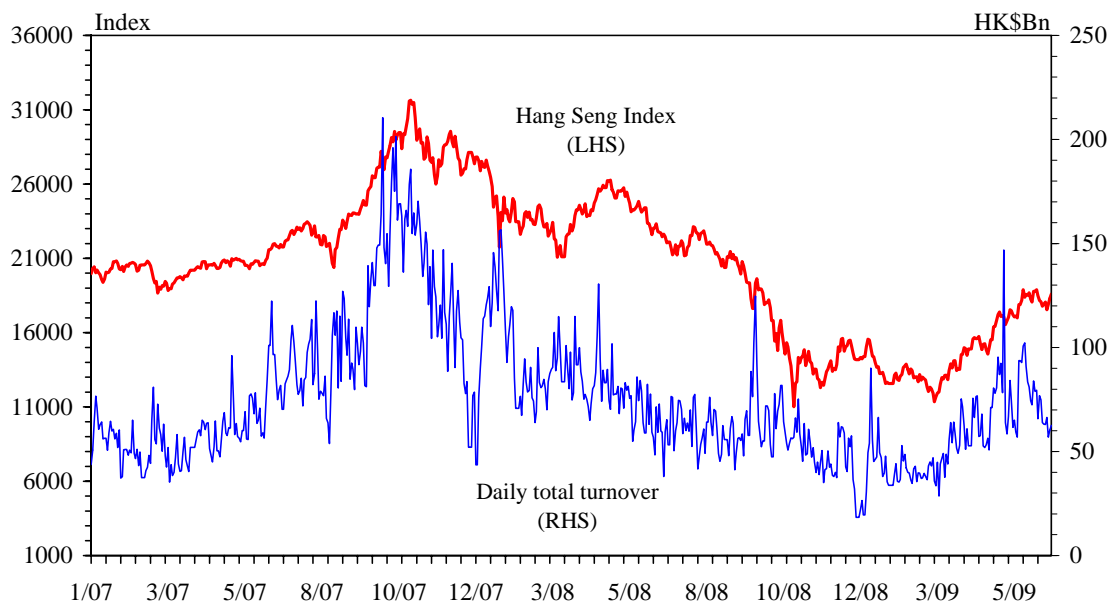


Chart 7(b) : Flat prices picking up and rentals tending to stabilise



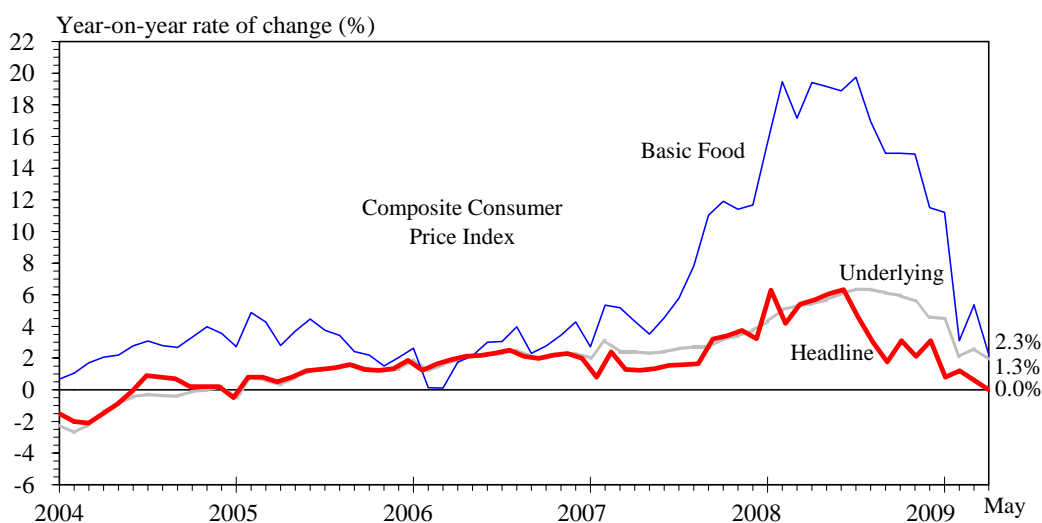
11. The local stock market slid further in the first quarter of 2009, amid mounting concerns about the generally poor financial results from the listed companies and the grim global economic outlook. Nevertheless, market sentiments improved since mid-March, as optimism grew upon sign of stabilization in the global economy. On 26 June, the Hang Seng Index (HSI) stood at 18 600, up 29% from end-2008. The average daily turnover also rose significantly from \$44.7 billion in the first quarter to \$70.6 billion in April and May, though still somewhat lower than that of \$76.1 billion in the second quarter of 2008 (*Chart 8*).

Chart 8 : Local stock market went down during most of the first quarter, but rebounded distinctly since March



12. Consumer price inflation continued to trend down as both local and external price pressures receded in the midst of the severe global economic downturn. Headline Composite CPI inflation eased to 1.1% year-on-year in the first five months of 2009. After netting out the effects of government’s one-off relief measures, underlying Composite CPI inflation averaged at 2.5% over this period (*Chart 9*).

Chart 9 : Inflationary pressure eased notably further on entering 2009



Updated short-term economic forecasts for 2009

13. According to the International Monetary Fund (IMF), world GDP would contract by 1.3% in 2009, representing the most severe recession during the post-war period. Even granting that governments of major economies would step up efforts to heal the financial sector while continuing to support demand through monetary and fiscal easing, IMF believed that a slow recovery would only begin to take hold in 2010. Against this background, the external environment will remain difficult and challenging in the rest of 2009.

14. Nevertheless, there are some early signs suggesting that the marked economic contraction in the United States, the epicentre of the global financial crisis, is beginning to taper. More importantly, the Mainland economy is set to return to a faster growth path, as the massive stimulus measures are successively in place and as export orders and production activities are also reviving concurrently. Thus, while Hong Kong's exports are likely to remain sluggish in the near term, there should be some relative improvement later this year.

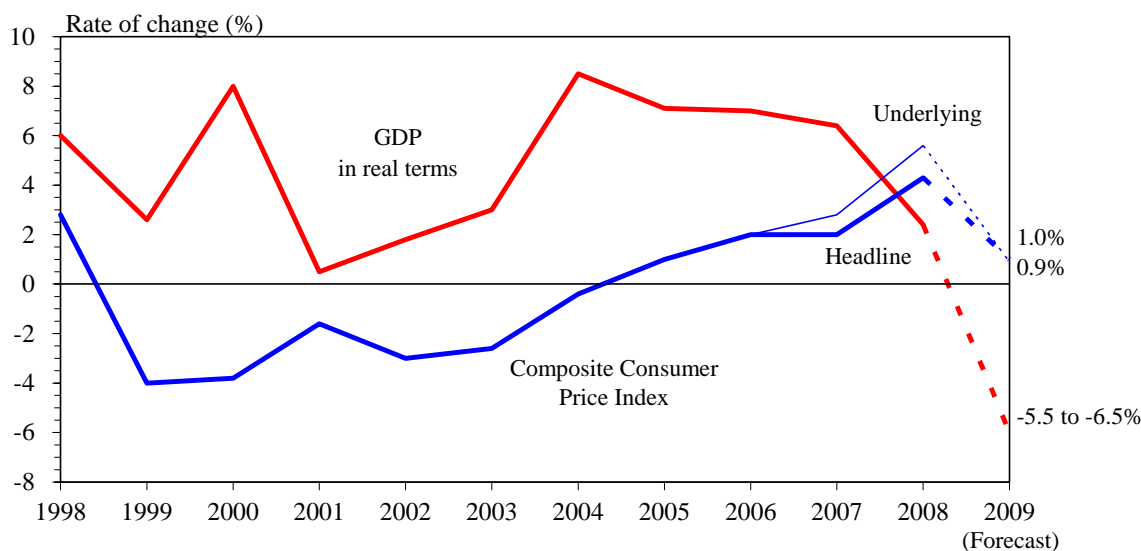
15. Domestically, consumer spending may remain in a weak state going forward, but the rebound in the local stock and housing markets in the past few months, the distinctly low interest rates, together with the Government's relief measures, should provide a relatively more stable local environment. Investment however is expected to remain slack until the local economy shows clearer signs of a turnaround.

16. The pace of deterioration in global demand in the first quarter was markedly worse than earlier expectations. Yet, with the global economy showing signs of bottoming out, the rate of economic contraction in the local economy going forward is expected to narrow gradually. Taking all these into account, in mid-May the Government forecast the economy to contract by 5.5-6.5% in 2009 (*Chart 10*). The relief measures announced on 26 May will render a further boost to the economy by about 0.5 percentage point of GDP. In total, the Government's several rounds of relief measures will lift GDP by about 2.0 percentage points this year. The economic outlook remains unusually uncertain and, with the raising of the influenza pandemic alert by the World Health Organisation to phase 6, the risk posed by the epidemic to the economy has also increased. Nevertheless, the additional round of relief measures by the Government should provide further support to the economy. Currently,

most private sector analysts are projecting the economy to contract by 3-6%, averaging at around -4.5%.

17. On inflation outlook, as an integral part of cost and price adjustments in economic downturn, price pressures from both the external and domestic fronts are receding. The headline Composite CPI for 2009 as a whole was forecast at 1% in the May round. The corresponding forecast for the underlying inflation rate was 0.9%. The one-off relief measures announced on 26 May will lower the headline inflation in 2009 as a whole further by about 0.5 percentage point.

Chart 10 : Economic forecast to contract by 5.5% to 6.5% in 2009



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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 with respect to households with monthly household income below \$4,000.

Latest situation

2. Average monthly household income held broadly stable over the first few months in 2009. However, when compared to a year earlier, average monthly household income in Q1 2009 decreased by 3.8% to \$27,800. After adjusting for price changes, the decline was 5.4% in real terms. In terms of proportions, the share of households with monthly income below \$4,000 (at current prices) decreased over a year earlier, while households with monthly income between \$4,000 and \$12,000 increased over the same period (*Table 1*).

Table 1: Distribution of domestic households by monthly household income

	<u>Q1 2006</u>	<u>Q1 2008</u>	<u>Q1 2009</u>
	<u>(%)</u>	<u>(%)</u>	<u>(%)</u>
Less than \$4,000	8.0	8.3	7.8
\$4,000 - \$7,999	12.8	11.7	12.9
\$8,000 - \$11,999	13.7	12.5	12.7
\$12,000 - \$15,999	12.2	11.4	11.4
\$16,000 - \$23,999	17.0	17.1	16.9
\$24,000 - \$39,999	18.3	18.9	18.5
\$40,000 - \$99,999	15.1	16.3	16.4
\$100,000 or above	3.0	3.7	3.4

Note: The purchasing power of the income (as measured by the Composite CPI) in Q1 2006 and Q1 2008 were 108% and 102% of that in Q1 2009 respectively.

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

Households with monthly household income below \$4,000

3. In Q1 2009, the number of households with monthly household income below \$4,000 (“low-income households”) fell by 10 100 (or 5.4%) over a year earlier to 177 200. Over the same period, the proportion of low-income households in total domestic households fell from 8.3% to 7.8%. In particular, the number of elderly low-income households (i.e. with all members aged 60 or above) and economically inactive low-income households (i.e. with all members being economically inactive) decreased by 13 700 and 3 000 respectively. On the other hand, the number of economically active low-income households (i.e. with at least one economically active household members) increased by 6 600.

4. Comparing Q1 2009 with Q1 1999, a rise in the number of low-income households can be observed. This is mainly the result of a significant increase in retired elderly households and a reduction in average household size. On the other hand, the proportion of low-income households in total domestic households decreased slightly over this period (*Table 2*).

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

	<u>Elderly households</u>	<u>Economically inactive households</u>	<u>Economically active households</u>	<u>Total</u>
Q1 1999	90 100 (4.6)	31 800 (1.6)	38 700 (2.0)	160 700 (8.1)
Q1 2006	114 200 (5.2)	33 000 (1.5)	28 500 (1.3)	175 600 (8.0)
Q1 2007	114 600 (5.1)	36 400 (1.6)	25 900 (1.2)	176 900 (7.9)
Q1 2008	125 200 (5.6)	38 400 (1.7)	23 600 (1.0)	187 300 (8.3)
Q1 2009	111 500 (4.9)	35 400 (1.6)	30 200 (1.3)	177 200 (7.8)

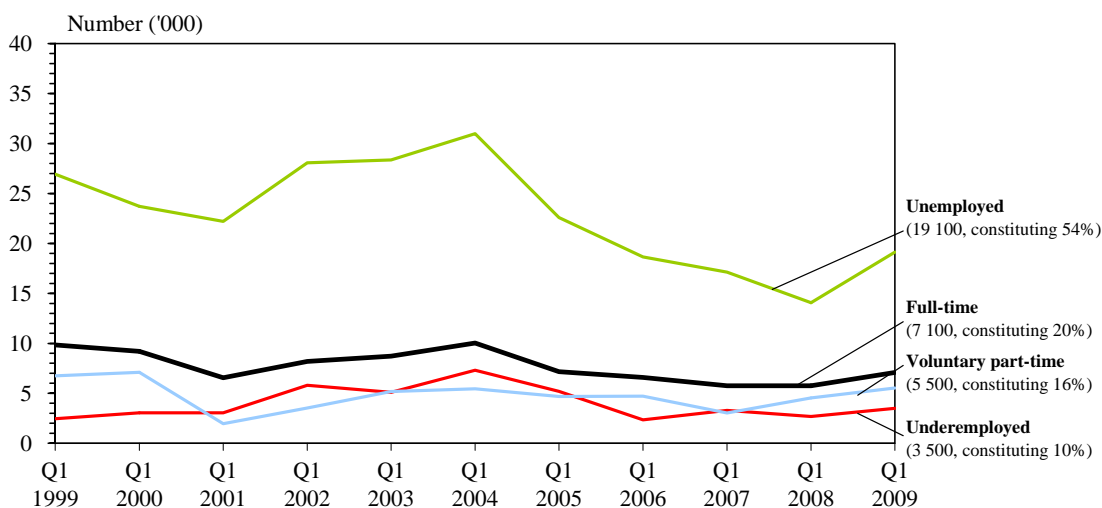
Notes : () Share in all domestic households.

* Low-income households refer to households with a monthly household income of \$4,000 or below.

5. Further analysis of low-income households in Q1 2009 yields the following observations:

- 63% of low-income households were 1-person households, of which the majority (78%) were elderly persons aged 60 or above.
- There were 65 000 persons living in economically inactive low-income households. Of these individuals, 34% of them were aged below 20 or aged 60 and above (mainly students and retirees). With regard to the remaining 66% or 43 000 persons aged 20-59, 27% were home-makers, 20% were persons suffering prolonged illness and 17% were retirees.
- Of the 35 200 economically active persons living in economically active low-income households, 54% were unemployed, 26% were employed part-time (working voluntarily for less than 35 hours per week, or involuntarily for the same amount of time, i.e. underemployed), and the remaining 20% were in full-time employment (*Chart 1*).

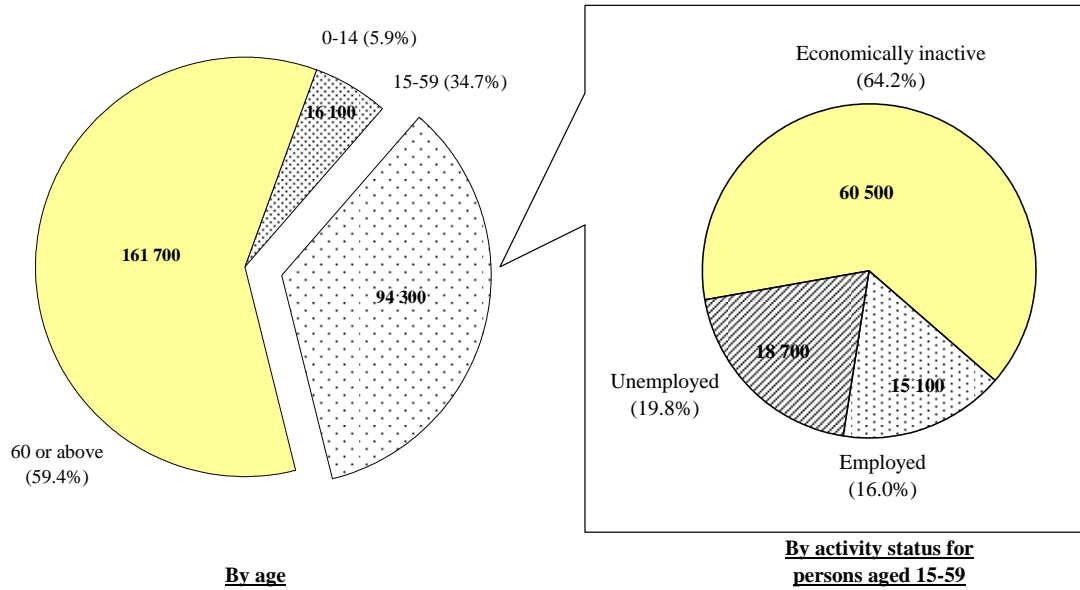
Chart 1 : Composition of economically active persons in the low-income households*



Notes : (*) This does not include economically active persons in the low-income households with elderly members only, but the numbers involved are insignificant.
 Figures in brackets represent the number of economically active persons in Q1 2009.

- With regard to the 272 100 persons living in low-income households, a significant proportion (59%) was elderly persons aged 60 or over. Over one-third (35%) were persons aged 15-59, of whom 64% were economically inactive (*Chart 2*).

**Chart 2 : Persons living in low-income households
by age and activity status, Q1 2009**



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