



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

The Government released the First Quarter Economic Report 2016 on 13 May. The Economic Report, together with the press release containing the updated economic forecasts for the whole year of 2016, have been furnished to LegCo Members.

This paper analyses Hong Kong's overall economic development in the most recent period, provides some analysis on the outlook for the rest of 2016, and summarises the updated economic forecasts by the Government for 2016 as a whole.

Economic Analysis and Business Facilitation Unit
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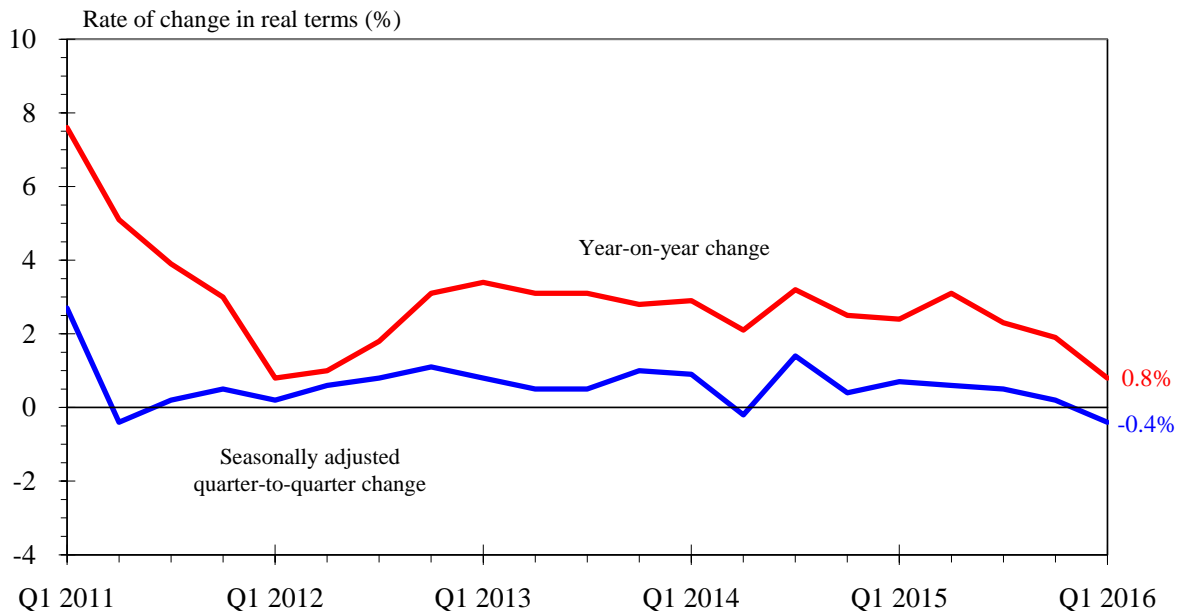
Introduction

This paper analyses the latest development in the Hong Kong economy and briefly discusses the outlook for the rest of 2016, and provides updated economic forecasts by the Government for 2016 as a whole.

Recent economic situation

2. The Hong Kong economy slowed further in the first quarter of 2016, growing by 0.8% in real terms over a year earlier. This was lower than the 1.9% growth in the preceding quarter. The external environment deteriorated during the quarter, characterised by subdued global growth and sharp gyrations in global financial and monetary conditions, leading to a deeper setback in both goods and services trade. The domestic sector also lost some momentum, as the weak global outlook with rising downside risks affected local economic sentiment. On a seasonally adjusted quarter-to-quarter comparison, real GDP fell by 0.4% in the first quarter, after a 0.2% growth in the preceding quarter (*Chart 1*).

Chart 1 : The Hong Kong economy slowed further in the first quarter of 2016



External trade

3. The global economic landscape remained lacklustre in the first quarter of 2016. The labour market in the US showed continued improvement, but economic growth was only modest in the first quarter. The economic recovery in the eurozone was still slow and faced challenges from persistent structural problems, migrant inflows, geopolitical risks and potential exit of the United Kingdom (UK) from the European Union (EU). Japan's economic recovery was likewise still unstable. As deflation risks persisted, the European Central Bank and the Bank of Japan have successively stepped up monetary stimulus this year. The sluggish global demand continued to buffet manufacturing and trading activities in Asia. Global financial markets saw heightened volatility early this year, in the face of increased global economic uncertainties and monetary policy divergence. All these developments undermined economic sentiment and also generated strong headwinds for emerging market economies.

4. Given the sluggish global demand, exports of Asian economies were hard hit. Total exports of goods in Hong Kong also weakened further and registered a year-on-year decline of 3.6% in real terms in the first quarter, after falling by 0.5% in the preceding quarter (*Chart 2(a)*). The weakness of export performance was actually part of a regional phenomenon, and the decline of Hong Kong's exports, measured in US dollar terms, was smaller than most other Asian economies. Exports to the advanced markets slid further in the first quarter given their sluggish economic conditions, while exports to the Asian markets were mostly still curbed by subdued intra-regional trade flows amid the weak global demand. The Indian market was among the few exceptions that still registered notable growth.

5. Exports of services in Hong Kong suffered another setback in the first quarter, down visibly by 4.9% in real terms over a year earlier, after the 2.7% decline in the preceding quarter (*Chart 2(b)*). Exports of travel services posed a drag, amid lower visitor arrivals and weaker visitor spending. Exports of trade-related and transportation services were also affected by subdued trade and cargo flows. Exports of financial and other business services also weakened to decline slightly, as the more volatile global financial and monetary conditions during the quarter dampened cross-border financial and commercial activities.

Chart 2(a) : Total exports of goods weakened further

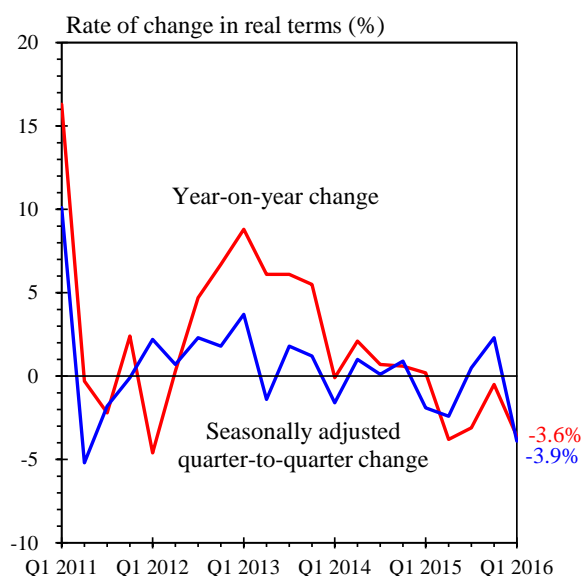
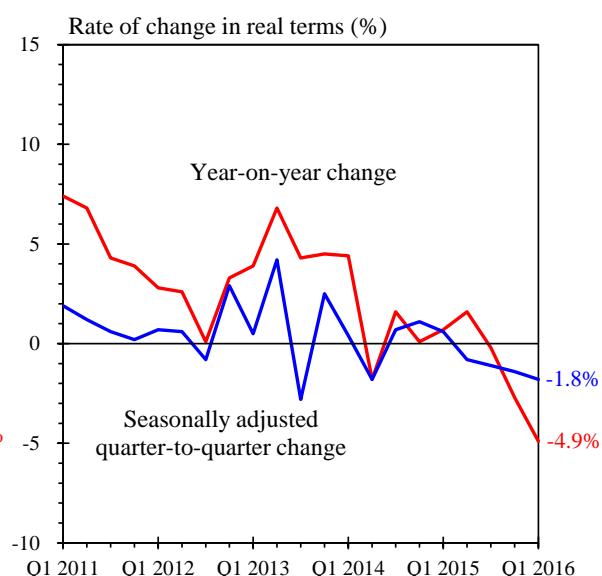


Chart 2(b) : Exports of services remained subdued



6. Specifically, exports of travel services slackened further in the first quarter, falling by 13.3% year-on-year in real terms, larger than the 6.7% fall in the fourth quarter of 2015. The weak performance was due mainly to the fall in visitor arrivals, while the weakness in tourist spending endured. The number of visitors to Hong Kong declined by 10.9% year-on-year in the first quarter, with the number of Mainland visitors (accounting for more than 70% of total) falling by 15.1% year-on-year, while the number of non-Mainland visitors grew 5.4% year-on-year. The number of same-day visitors to Hong Kong fell by 14.7% in the first quarter, and this was partly due to the implementation of “one trip per week” Individual Visit Endorsement for permanent residents of Shenzhen in April 2015. Moreover, the lagged impacts of depreciations of many currencies against the US dollar had conceivably induced some visitors to shift to other popular travelling destinations, while the subdued global economic environment also dampened the demand for travelling.

Domestic sector

7. The domestic sector lost some momentum in the first quarter, as the uncertain global economic outlook affected local economic sentiment. The asset market consolidation amid the volatile financial environment also added pressure on local consumption demand, partly offsetting the support from the broadly stable labour market conditions. Private consumption expenditure continued to moderate in momentum in the first quarter, growing only mildly by 1.1% in real terms over a year earlier, down from the 2.7% growth in the preceding quarter (*Chart 3(a)*).

Government consumption expenditure, on the other hand, grew steadily by 3.2% in the first quarter, providing some cushion to domestic demand.

8. Dragged by the slowdown in inbound tourism and weakened local consumption sentiment, retail sales weakened notably in the first quarter to register a fall of 11.3% in volume terms over a year earlier. Sales performances of most types of retail outlet were subdued.

9. Overall investment spending in terms of gross domestic fixed capital formation remained on the downtrend, falling by 10.1% year-on-year in real terms in the first quarter, after the 9.4% decline in the preceding quarter. Machinery and equipment acquisition was a key drag, down by 11.9% over a year earlier, conceivably reflecting the scaling back of investment plans amid growing pessimism over the global economic outlook. Overall building and construction activity registered a modest decline, as public infrastructure works decelerated from the elevated level last year, even though private sector building works still expanded solidly (*Chart 3(b)*).

Chart 3(a) : Private consumption expenditure continued to moderate

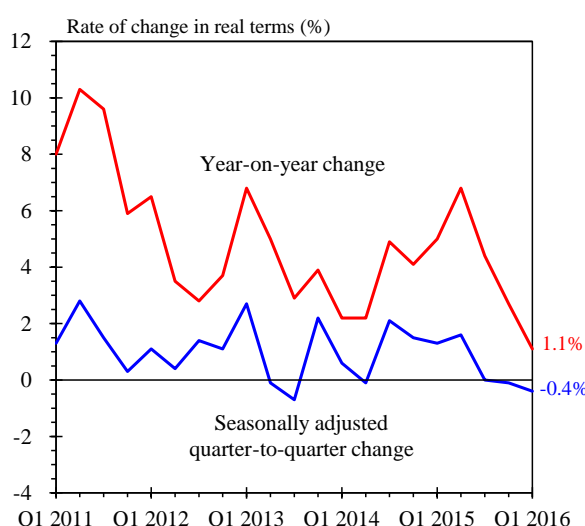
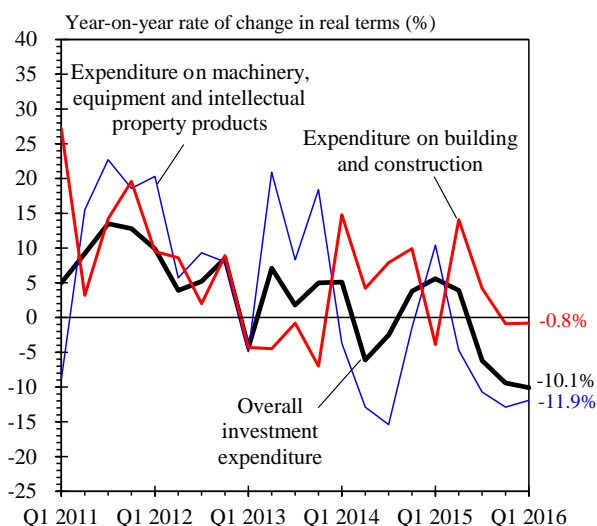


Chart 3(b) : Investment spending declined further



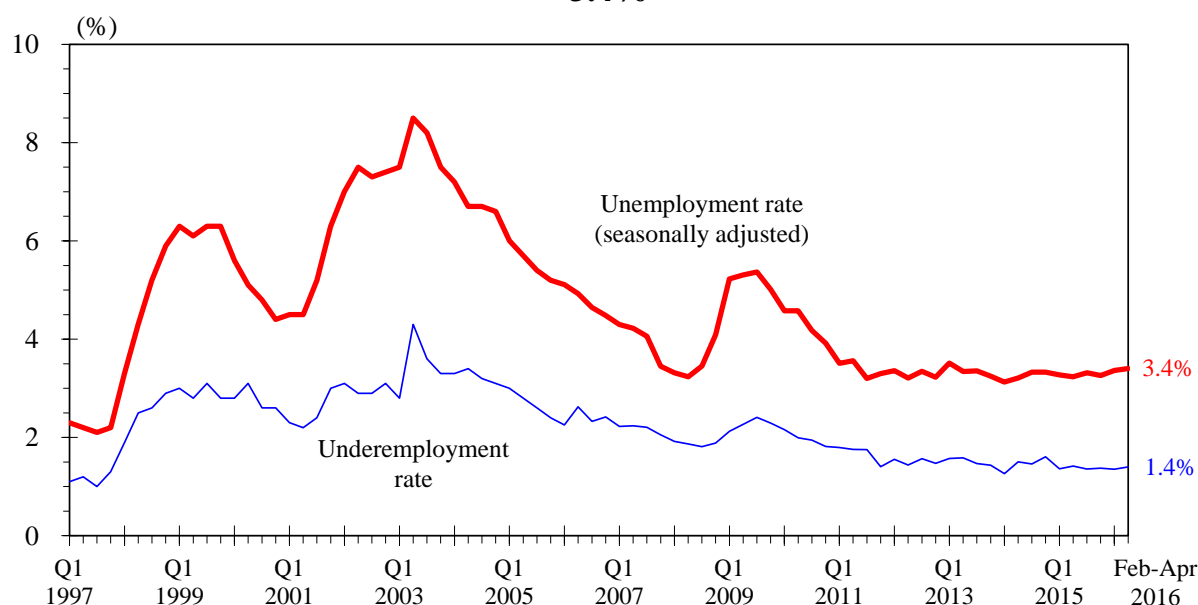
10. As for foreign direct investment (FDI), the Mainland remained an important source of Hong Kong's external direct investment, accounting for 30% of the total direct investment position in 2014. Leveraging on the established and internationalised financial markets, favourable business environment and competitive advantages of the services sector, Hong Kong not only serves as a major conduit for foreign direct investments flowing into the Mainland, but also acts as an

important bridge for Mainland’s companies to go global. There were over 1 000 offices representing Mainland Chinese companies in Hong Kong as of 2015, among which 133 served as regional headquarters. Despite volatility in global financial markets, the latest balance of payments figures still indicate that FDI inflows ⁽¹⁾ increased notably by 39% to \$1,402.0 billion (US\$180.9 billion) in 2015, representing 58% of GDP. This accentuates the significant role of Hong Kong as an international financial and business hub.

Labour market

11. The labour market held largely stable in overall terms on entering 2016. Yet, with the sluggish external trade performance, the sustained moderation in inbound tourism as well as the slackened growth momentum of local consumption lately, the seasonally adjusted unemployment rate edged up by 0.1 percentage point to 3.4% in the first quarter of 2016 and remained unchanged in February – April 2016. Meanwhile, the underemployment rate held stable at 1.4%. Although both the overall unemployment rate and underemployment rate still stayed at relatively low levels, data collected from private sector establishments up to end-2015 indicated that employment growth continued to slow and overall job vacancies fell, with signs of slackening labour demand in both trade- and tourism-related sectors.

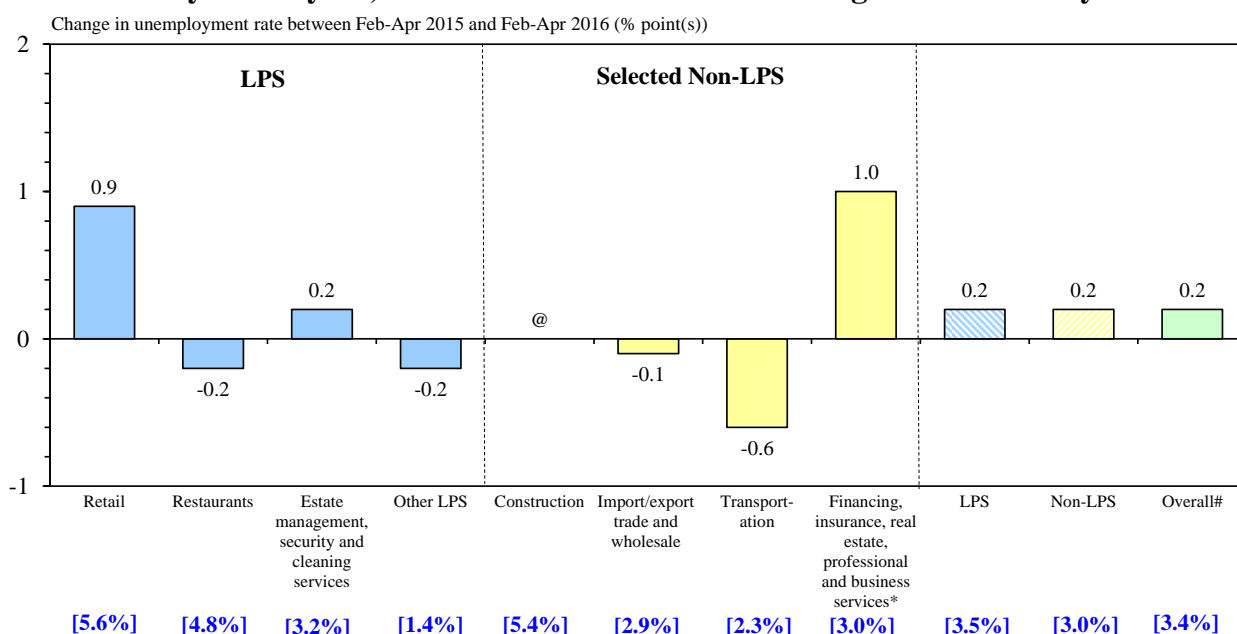
Chart 4 : The seasonally adjusted unemployment rate increased slightly to 3.4%



(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 (IMF).

12. Since the implementation of Statutory Minimum Wage (SMW), macroeconomic conditions remained largely stable, thereby relieving to a large extent the pressure on the labour market brought about by SMW. The overall seasonally adjusted unemployment rate in February – April 2016 went up by 0.2 percentage point from its year-ago level (viz before the upward adjustment of SMW level to \$32.5). Among which, the unemployment rates for both the low paying sectors (LPS)⁽²⁾ as a whole and the non-LPS counterpart rose by 0.2 percentage point to 3.5% and 3.0% respectively (*Chart 5*). The sustained weakness in inbound tourism and the slackened growth momentum of local consumption lately inflicted certain impact on the employment situation of some individual LPS, in particular retail.

Chart 5 : The unemployment rate of LPS as a whole rose by 0.2 percentage point year-on-year, with that of the retail sector rising most noticeably



Notes: Figures in brackets refer to the unemployment rate for that sector in Feb-Apr 2016 (provisional figures).

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

(#) Seasonally adjusted.

(@) Change less than 0.05 percentage point.

13. Analysed by skill segment, in February – April 2016, the unemployment rate for the higher-skilled segment rose by 0.3 percentage point year-on-year to 1.9%, while that of the lower-skilled segment edged up by 0.1 percentage point to 3.9% (*Table 1*). In terms of employment, although both the higher- and lower-skilled employment grew further, the increase in the latter was meagre.

(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.

Table 1 : The employment and unemployment situations of the two skill segments

	Employment [#]			Unemployment rate [#]	
	Feb – Apr 2016	Change as compared to Feb – Apr 2015 (a year earlier, before the implementation of the revised SMW rate)		Feb – Apr 2016	Change as compared to Feb – Apr 2015 (a year earlier, before the implementation of the revised SMW rate)
	(No.)	(No.)	(%)	(%)	(% point)
Higher-skilled	1 446 000	+12 700	+0.9	1.9	+0.3
Lower-skilled	2 360 600	+1 500	+0.1	3.9	+0.1
Lower-skilled (excl. government employees and live-in domestic workers)	1 945 600	&	*		

Notes : (#) Provisional figures.

(&) Change less than 1 000.

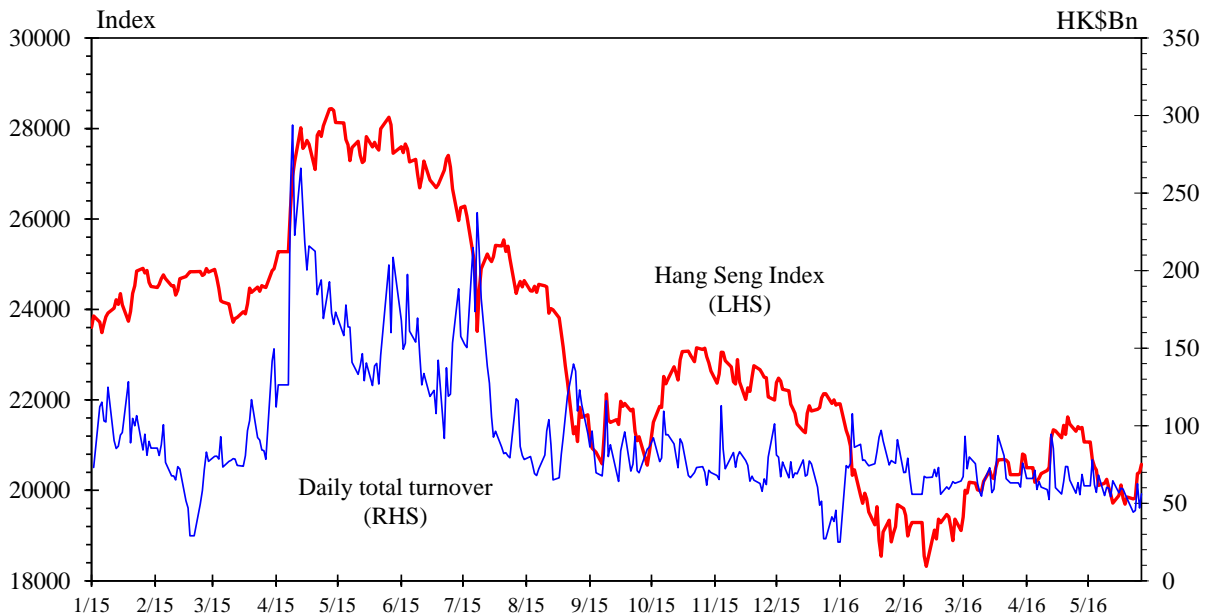
(*) Change less than 0.05%.

14. As the labour market was broadly stable in overall terms, the overall earnings situation generally stayed on the rise. Overall nominal wage and payroll registered a further year-on-year increase at a broadly similar pace of 4.2% and 4.3% respectively at end-2015. After discounting inflation, real wages and earnings grew by 1.6% and 1.9% respectively. Thanks to the upward adjustment of SMW rate since May 2015, grassroots workers enjoyed relatively faster wage growth. More recent data showed that the average monthly employment earnings of full-time employee in the lowest decile group (excluding foreign domestic helpers) increased visibly by 8.7% in nominal terms in the first quarter of 2016 over a year earlier, translating into a real increase of 5.4% after discounting inflation (Please refer to *Annex* for details). The overall income also saw increases, though with signs of moderation. The median monthly household income (excluding foreign domestic helpers) went up only modestly by 2.0% in nominal terms in the first quarter of 2016 over a year earlier, after the appreciable increase of 7.7% in 2015.

Asset markets

15. The local stock market underwent another correction at the start of 2016, as increasing worries over a slowing global economy and wider monetary policy divergence heightened global financial market volatility. The Hang Seng Index (HSI) came under pressure on entering 2016 and hit a low of 18 320 at the close of 12 February, before rebounding somewhat subsequently, but fluctuations remained. The HSI closed at 20 577 on 27 May, 6.1% lower than at end-2015 (*Chart 6*). Average daily turnover in the first four months was \$70.8 billion, broadly similar to the \$71.9 billion in the fourth quarter of last year.

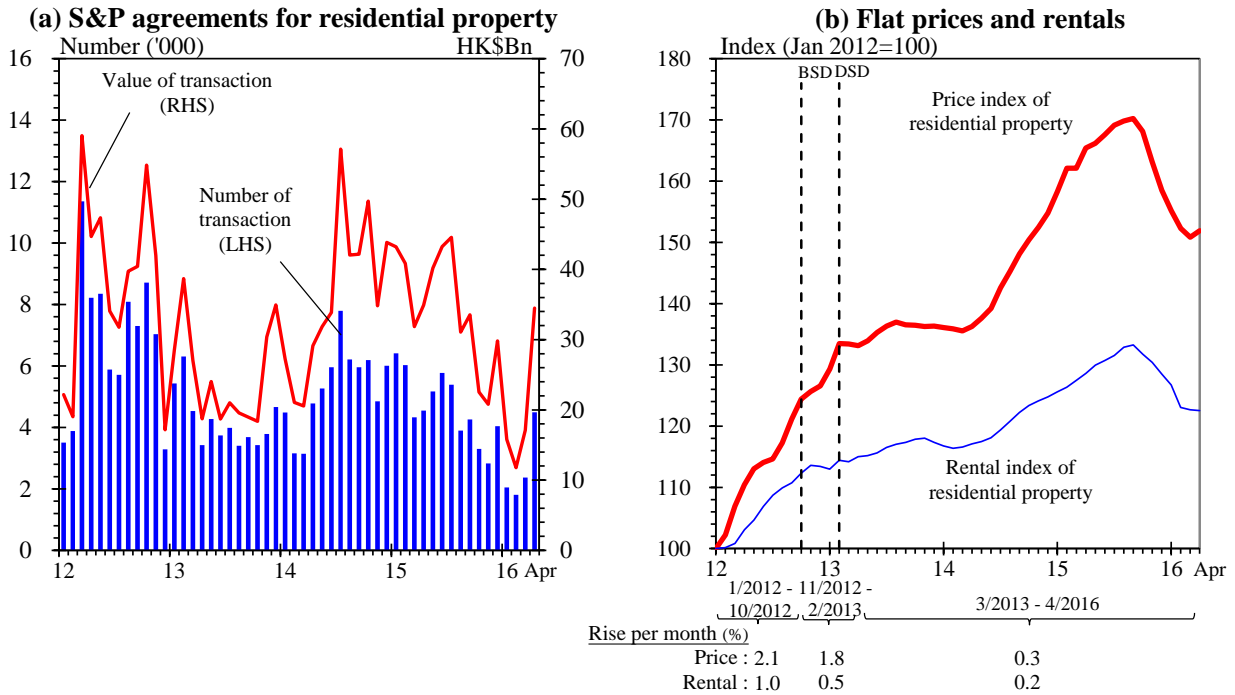
Chart 6 : Local stock market underwent another correction at the start of 2016, and its performance remained choppy in recent months



16. The residential property market was largely in a consolidation mode in the first four months of 2016, amid concerns about the economic outlook and further US interest rate hikes. The number of sale and purchase agreements for residential property received by the Land Registry dropped by 39% from the preceding quarter or 63% from a year earlier to a monthly average of 2 074 in the first quarter. Yet transactions rose to 4 494 cases in April, reflecting the rebound in trading activities over a low base of comparison (*Chart 7(a)*).

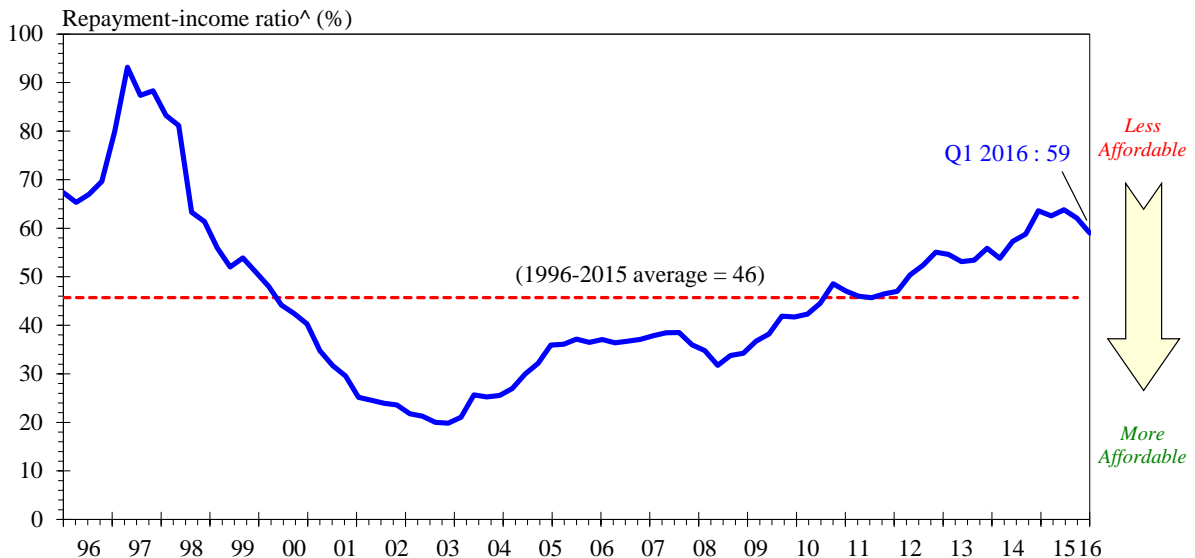
17. Overall flat prices fell by 5% between December 2015 and March 2016 before edging up by 0.7% month-to-month in April. Still, overall flat prices in April have fallen by a cumulative 4% year-to-date, and by 11% from the peak in September 2015 (*Chart 7(b)*). Meanwhile, the leasing market remained quiet in the first four months. Overall flat rentals dropped by 5% between December 2015 and April 2016, and were 8% down from the peak in September 2015.

Chart 7 : Residential property market was largely in a consolidation mode in the first four months of 2016



18. Notwithstanding the recent consolidation, overall flat prices in April still exceeded the 1997 peak by 58%. The 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) fell from 62% in the preceding quarter to around 59% in the first quarter, but still significantly higher than the long-term average of 46% over 1996-2015 (*Chart 8*). Should interest rates rise by three percentage points to a more normal level, the ratio would soar to 77%.

Chart 8 : The mortgage payment to income ratio stayed elevated

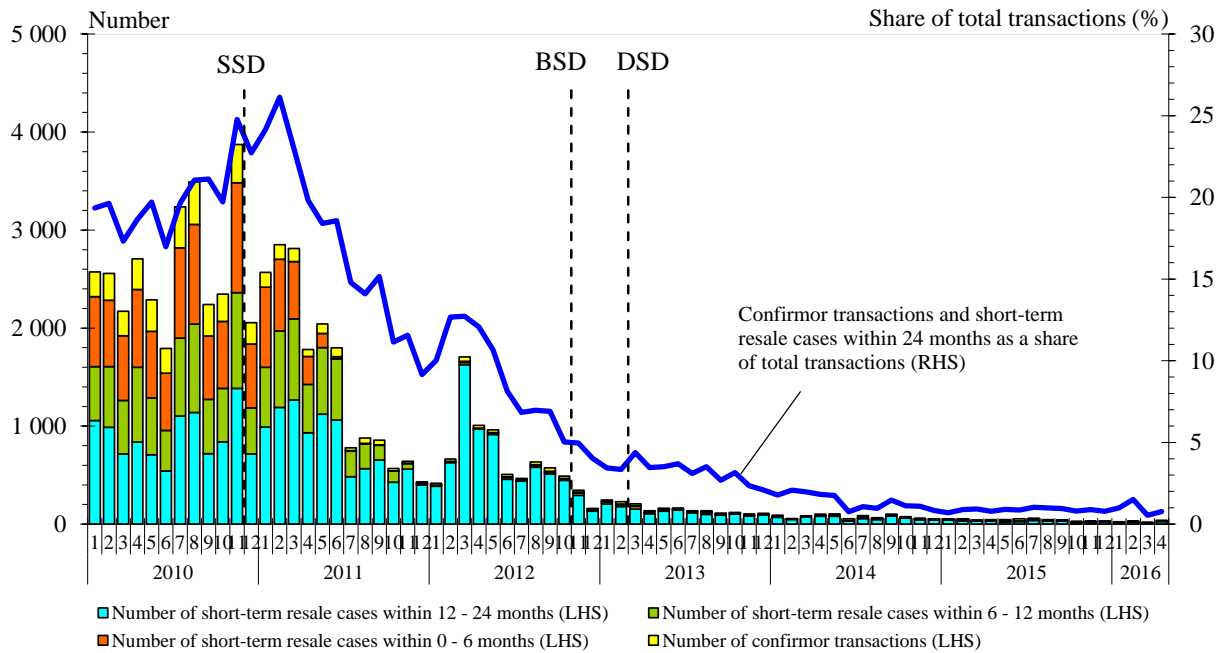


Note : (^) The ratio of mortgage payment for a flat with saleable area of 45 sq m (assuming 70% loan-to-value ratio and tenor of 20 years) to median income of households (excluding those living in public housing). This ratio is different from the debt servicing ratio published by the HKMA, which is the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

19. Raising flat supply through increasing land supply is the Government's top policy priority in ensuring a healthy and stable development of the property market. In February, the Government announced the 2016-17 Land Sale Programme, which includes 29 residential sites capable of providing a total of about 19 200 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), it is estimated that the total housing land supply in 2016-17 could provide for around 28 600 private flats, much higher than the annual housing supply target of 18 000 units. With the Government's sustained efforts, the total supply of flats in the coming three to four 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 87 000 units as estimated at end-2015 to another record high of 92 000 units as estimated at end-March 2016.

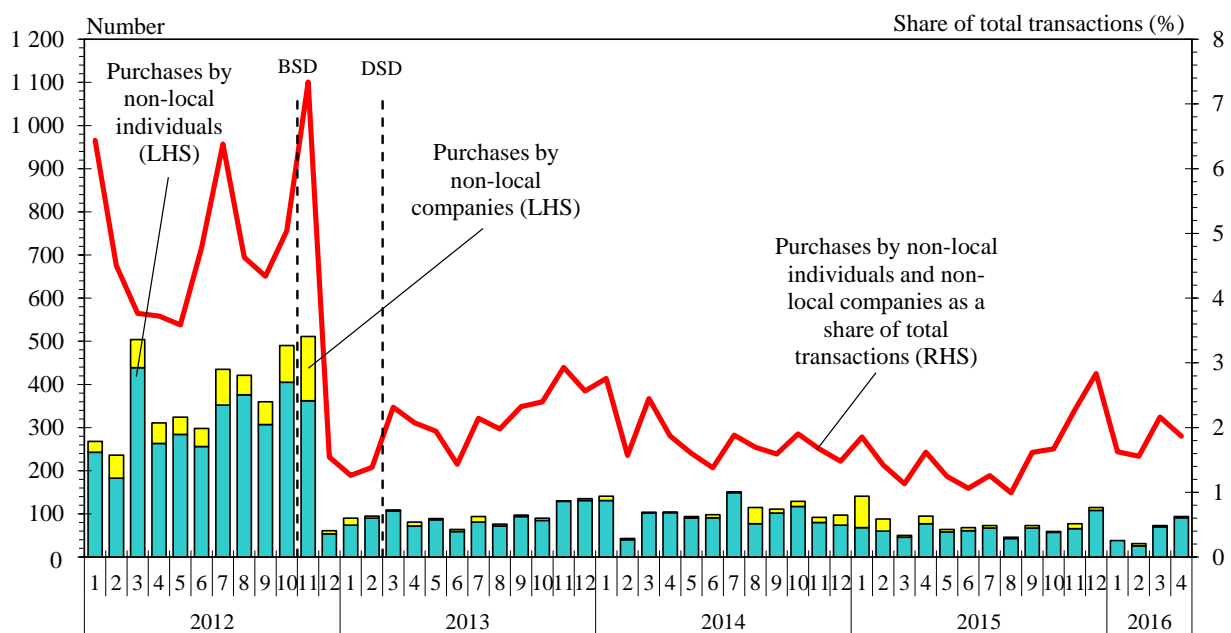
20. The Government has put in significant efforts to manage demand and reduce the possible risks to financial stability arising from an exuberant property market. These measures have yielded notable results. On speculative activities, the number of short-term resale (comprising confirmor transactions and resale within 24 months after assignment) declined further to an average of 28 cases per month or 0.9% of total transactions in the first four months of 2016, well below the monthly average of 2 661 cases or 20.0% in January to November 2010 (i.e. the period before the introduction of the Special Stamp Duty) (*Chart 9*). Reflecting the effects of the Buyer's Stamp Duty, purchases by non-local individuals and non-local companies stayed low at an average of 59 cases per month or 1.9% of total transactions in the first four months of 2016, much lower than the monthly average of 365 cases or 4.5% in January to October 2012 (*Chart 10*). As to mortgage lending, the average loan-to-value ratio of new mortgages was 50% in the first quarter of 2016, 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 9 : Speculative activities stayed subdued



Note : Confirmor transactions refer to resale before assignment.

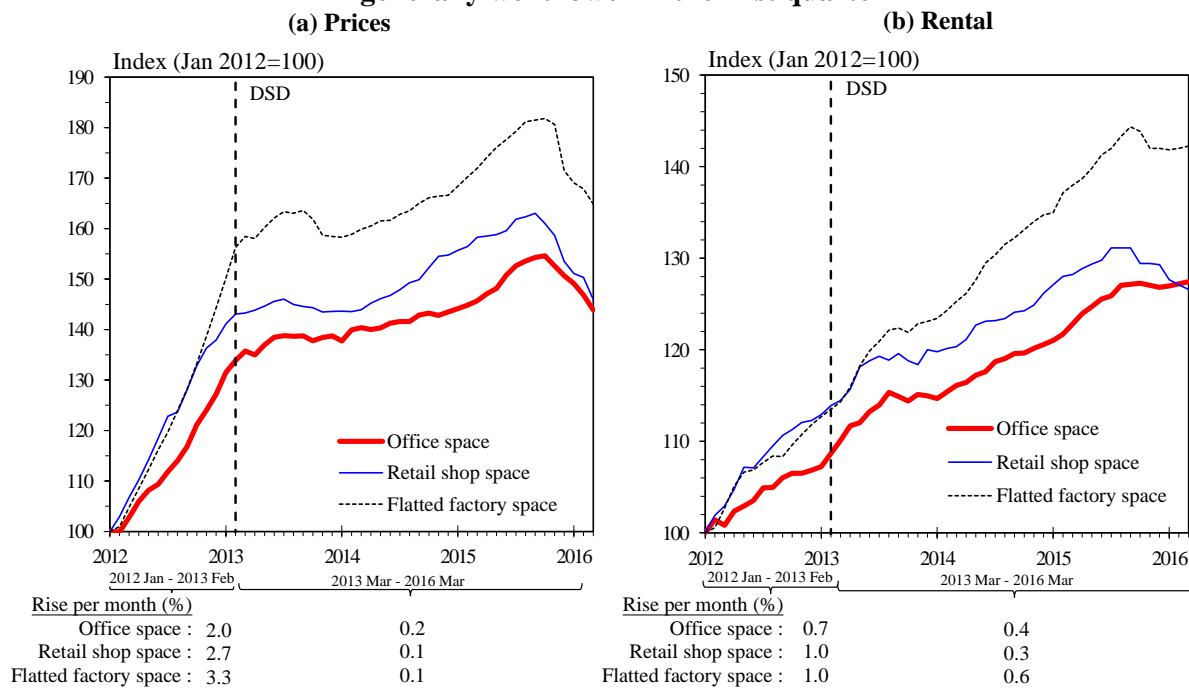
Chart 10 : Purchases by non-local buyers remained low



21. Looking forward, as a result of the Government's sustained efforts, the supply of flats will rise significantly over the medium term, helping to ease the demand-supply balance of flats. On the other hand, the economic outlook and future pace and magnitude of the US interest rate increases remain uncertain. The Government would continue to closely monitor the property market situation and ensure its healthy and stable development.

22. The commercial and industrial property markets also remained quiet in the first quarter of 2016. Sale prices and rentals of retail shop space fell by 5% and 2% respectively between December 2015 and March 2016. Over the same period, overall sale prices of office space fell by 4%, while overall rentals were little changed. Similarly, sale prices of flatted factory space went down by 4% during the first quarter of 2016, while rentals were also virtually unchanged (*Chart 11*). Trading activities for most market segments plummeted to record lows.

Chart 11 : Prices and rentals of non-residential properties generally went lower in the first quarter

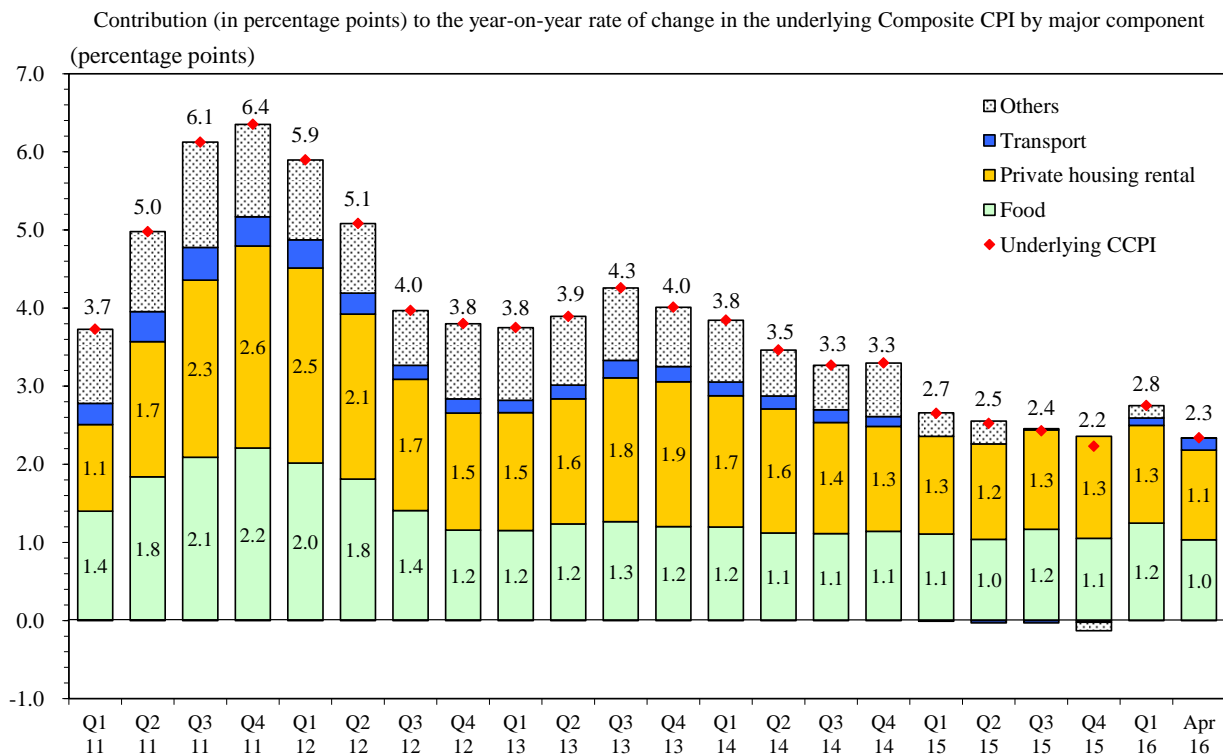


Inflation

23. Consumer price inflation stayed moderate in the first quarter. Domestic price pressures generally remained in check, given the weaker consumption demand and easing rental inflation in tandem with the property market consolidation. Besides, external price pressures were muted, thanks to the rather benign inflation in Hong Kong’s major import partners and still-low international commodity prices. Inflation picked up slightly in the first quarter, mainly driven by the surge in basic food prices amid bad weather conditions at the start of this year. As the impact of bad weather dissipated, inflation receded in April.

24. Netting out the effects of the Government’s one-off relief measures to more accurately reflect the underlying inflation trend and by reference to the new 2014/15-based series, underlying consumer price inflation went up slightly from 2.2% in the fourth quarter of last year to 2.8% in the first quarter of this year, but eased back to 2.3% in April (*Chart 12*). The headline consumer price inflation also rose slightly from 2.3% in the fourth quarter of last year to 2.8% in the first quarter of this year, before coming down slightly to 2.7% in April.

Chart 12 : Price pressures in many of the underlying Composite CPI components continued to ease



Note : The year-on-year rates of change of the underlying Composite CPIs from the fourth quarter of 2015 onwards are computed from the new 2014/15-based series, and those before are from the old 2009/10-based series.

25. By analysing the major components of the underlying Composite CPI, the slight pick-up in the underlying inflation rate in the first quarter was mainly driven by the acceleration of the year-on-year increase in food prices (excluding cost of dining out) to 6.3% amid bad weather conditions (*Table 2*). Prices of miscellaneous services also picked up somewhat in the first quarter as the charges for package tours reverted to a year-on-year increase in March, due partly to currency fluctuations, particularly the rebound of Japanese yen during the period, and partly to the difference in timing of Easter holidays (late March this year but early April last year). However, as the impact of bad weather dissipated, the year-on-year increase in food prices (excluding cost of dining out) moderated to 4.7% in April. In the same month, the charges for package tours also reverted to a year-on-year decline. Besides, price pressures in most of the other major components of the underlying Composite CPI continued to ease in the first four months of 2016. The cost of dining out rose by 3.6% year-on-year in this period, slightly lower than the 4.0% rise in the fourth quarter of last year. Alongside the consolidation in property market and lower fresh-letting residential rentals, the year-on-year increase in private housing rental component slowed further, staying within 3.8-4.2% in the first four months of this year, lower than that of 4.4% in the fourth quarter of last year. Certain price components such as clothing and footwear registered further declines in tandem with the softening of the consumption market. Prices of durable goods also continued their secular downtrend.

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

<u>Expenditure component</u>	<u>Weighting^(a)(%)</u>	<u>2015</u>				<u>2016</u>		
		<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Apr</u>	<u>Jan-Apr</u>
Food	27.29	4.0	3.7	4.2	3.9	4.6	3.8	4.4
<i>Meals bought away from home</i>	17.74	4.4	4.3	4.3	4.0	3.7	3.3	3.6
<i>Other foodstuffs</i>	9.55	3.3	2.8	4.0	3.7	6.3	4.7	5.9
Housing ^(b)	34.29	4.7	4.7	4.5	4.1	4.0	3.7	3.9
		(8.2)	(4.2)	(4.1)	(4.1)	(4.0)	(4.8)	(4.2)
<i>Private dwellings</i>	29.92	4.3	4.2	4.3	4.4	4.2	3.8	4.1
		(6.8)	(3.8)	(3.9)	(4.4)	(4.2)	(5.0)	(4.4)
<i>Public dwellings</i>	1.94	9.8	9.4	6.1	*	*	0.4	0.1
		(29.0)	(10.0)	(6.4)	(*)	(*)	(0.5)	(0.1)
Electricity, gas and water	2.67	-1.4	-0.7	-6.1	-2.2	-1.1	-1.2	-1.1
		(21.5)	(22.8)	(-4.6)	(-1.1)	(*)	(-0.2)	(*)
Alcoholic drinks and tobacco	0.54	4.3	-0.1	0.3	1.0	0.3	-0.2	0.2
Clothing and footwear	3.21	-0.8	-2.7	-1.9	-1.6	-3.3	-2.2	-3.0
Durable goods	4.65	-5.5	-5.7	-5.6	-5.8	-5.7	-6.2	-5.8
Miscellaneous goods	3.56	1.2	1.3	0.6	0.5	0.5	1.1	0.7
Transport	7.98	-0.1	-0.4	-0.4	-0.3	1.2	2.0	1.4
Miscellaneous services	15.81	0.8	1.4	1.1	1.2	2.7	1.4	2.4
		(0.8)	(1.4)	(1.1)	(1.2)	(2.7)	(1.4)	(2.4)
All items	100.00	2.7	2.5	2.4	2.2	2.8	2.3	2.7
		(4.4)	(3.0)	(2.3)	(2.3)	(2.8)	(2.7)	(2.8)

Notes : The year-on-year rates of change of the underlying Composite Consumer Price Index are calculated by netting out the effects of Government's one-off relief measures. Figures in brackets refer to the year-on-year rates of change of the headline Composite Consumer Price Index, which are calculated before netting out the effect of Government's one-off relief measures. From the fourth quarter of 2015 onwards, the year-on-year rates of change of both the headline and underlying Composite Consumer Price Indices are computed from the new 2014/15-based series, and those before are from the old 2009/10-based series.

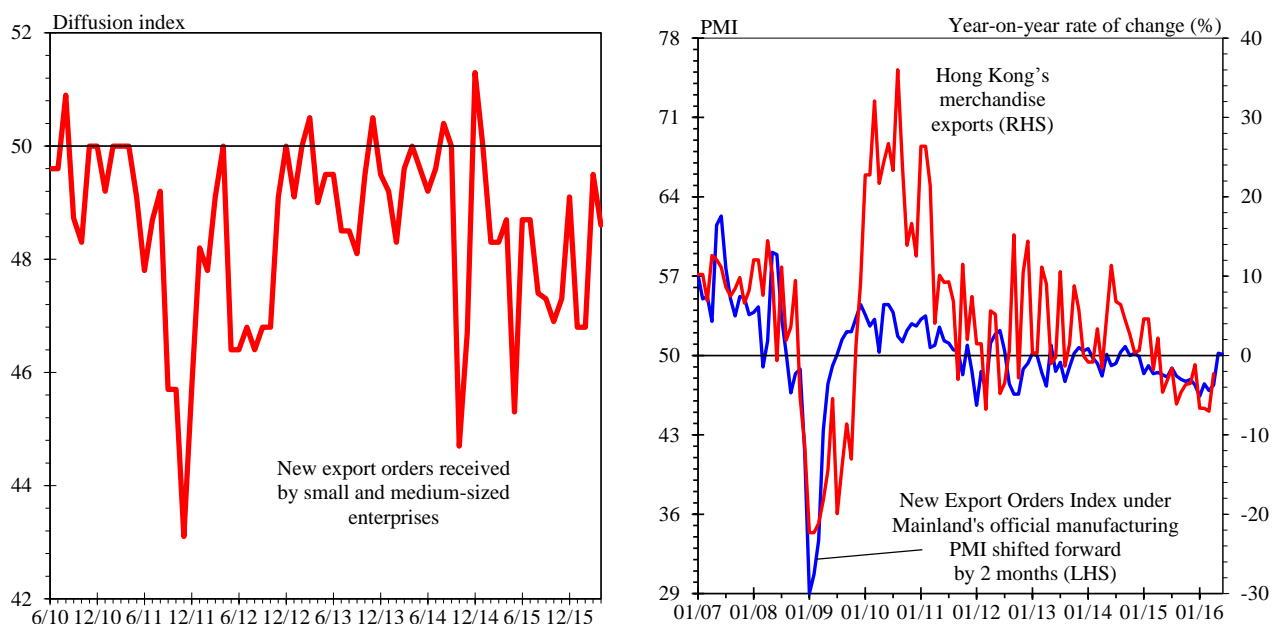
- (a) The weights quoted in this table correspond to those in the 2014/15-based index series.
- (b) The housing component covers rents, rates, Government rent, maintenance costs and other housing charges. Its sub-components on private and public dwellings as presented here, however, cover rents, rates and Government rent only. Hence, the combined weighting of private and public dwellings is slightly less than the weighting of the entire housing component.
- (*) Change within $\pm 0.05\%$.

Updated short-term economic forecasts for 2016

26. Looking ahead, global economic growth is likely to remain modest in the near term. Recoveries in many advanced economies, including Japan and those in the eurozone, are still unstable. Heightened geopolitical tensions and the uncertainty about the potential exit of the UK from the EU have also posed additional challenges. While the global stock markets have rebounded somewhat from lows early this year, the recent situation remains choppy. Moreover, the uncertainties associated with the US interest rate normalisation and increasing policy divergence among major central banks could add financial volatility again, posing risks to the global economy. In sum, the trading environment for Hong Kong's exports, as well as those of other Asian economies, will remain challenging in the coming months (*Chart 13*). Likewise, Hong Kong's exports of services will still face pressures in the near term. The performance in the rest of this year will depend not only on whether trade and cargo flows in the region would improve, but also on whether the weak inbound tourism would stabilise.

27. Locally, the uncertain global economic outlook and local asset market fluctuations may continue to impinge on economic sentiment. The latest Quarterly Business Tendency Survey and diffusion indices on small and medium-sized enterprises (SMEs) suggested that both large enterprises and SMEs have remained rather cautious about the business outlook.

Chart 13 : Hong Kong's export outlook is still overcast by external uncertainties

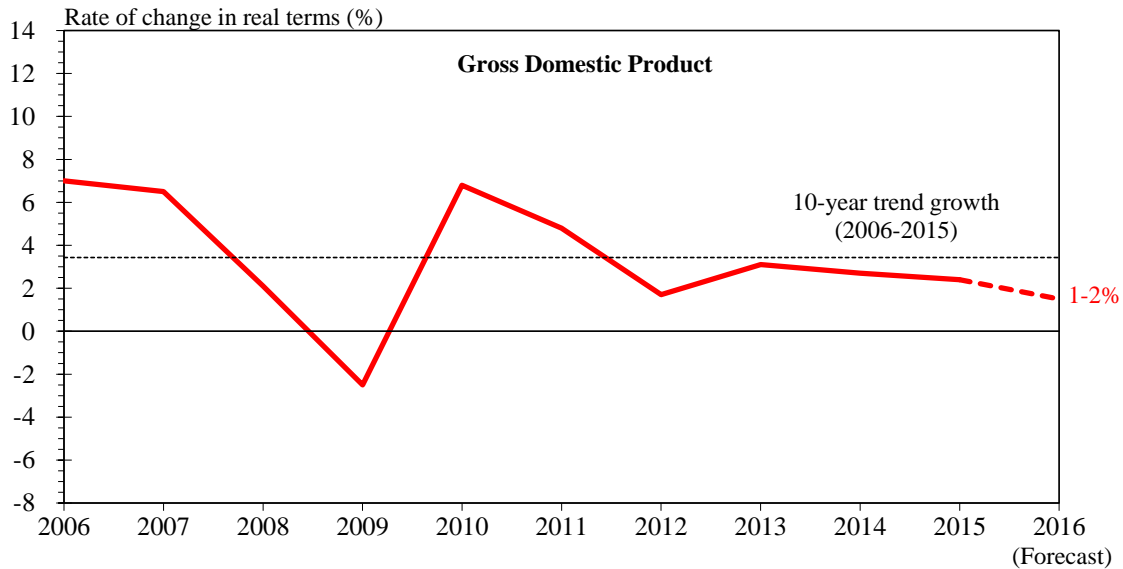


28. The 2016-17 Budget (Budget) has already pointed out that the global economy would be laden with risks this year, putting pressure on the Hong Kong economy, and forecast that the economy would grow by 1-2% in 2016, lower than the 2.4% growth last year. The growth slowdown in the first quarter was not unexpected. Given the challenges faced by the economy this year, the Budget has set out a package of relief measures, which should render some support to the economy. The Government will stay alert to the pressures stemming from slackening inbound tourism and slower economic growth on the employment market in the period ahead.

29. Entering the second quarter, the economic conditions have showed some initial signs of stabilisation. In April, the year-on-year fall of Hong Kong's goods exports moderated somewhat in value terms, and the pace of decline in visitor arrivals also eased further. Recent activity indicators suggested that the Mainland economy continued to grow solidly and is on track to attain its growth target of 6.5-7% for the year. The US economy, while losing some traction in the first quarter, is expected to show slightly faster growth in the coming quarters. Indeed, retail sales there rebounded strongly month-to-month in April. If the economic conditions in our major export markets show improvements going forward, and the stabilisation of visitor arrivals sustains, the downward pressures on Hong Kong's economy will hopefully lessen in the latter half of the year.

30. Taking into account the actual growth outturn in the first quarter and the various external uncertainties still faced by the Hong Kong economy, the forecast real GDP growth of 1-2% for 2016, was maintained in the review in mid-May (*Chart 14*). For reference, the International Monetary Fund (IMF) in April forecast Hong Kong's economic growth in 2016 at 2.2%, and the forecasts by private sector analysts in mid-May mostly ranged from 1.0-2.6%, averaging around 1.7%.

Chart 14 : Economic growth for 2016 as a whole is forecast at 1-2%



31. On inflation outlook, the upside risks should remain contained in the near term. Given subdued global inflation, and barring significant fluctuations in food and other commodity prices, import prices will likely stay soft. The further retreat in rental inflation amid the property market consolidation, coupled with the slow pace of economic expansion, should keep local cost pressures in check (*Chart 15*). As such, the forecast rates of underlying and headline consumer price inflation for 2016 as a whole put out in the Budget, at 2% and 2.3% respectively, were maintained in the review in mid-May (*Chart 16*). For reference, the IMF in April forecast Hong Kong's headline consumer price inflation rate in 2016 at 2.5%, and the forecasts by private sector analysts in mid-May mostly ranged from 1.5-3.3%, averaging around 2.5%.

Chart 15 : Upside risks to inflation should remain contained in the near term, given soft import prices and easing rental inflation

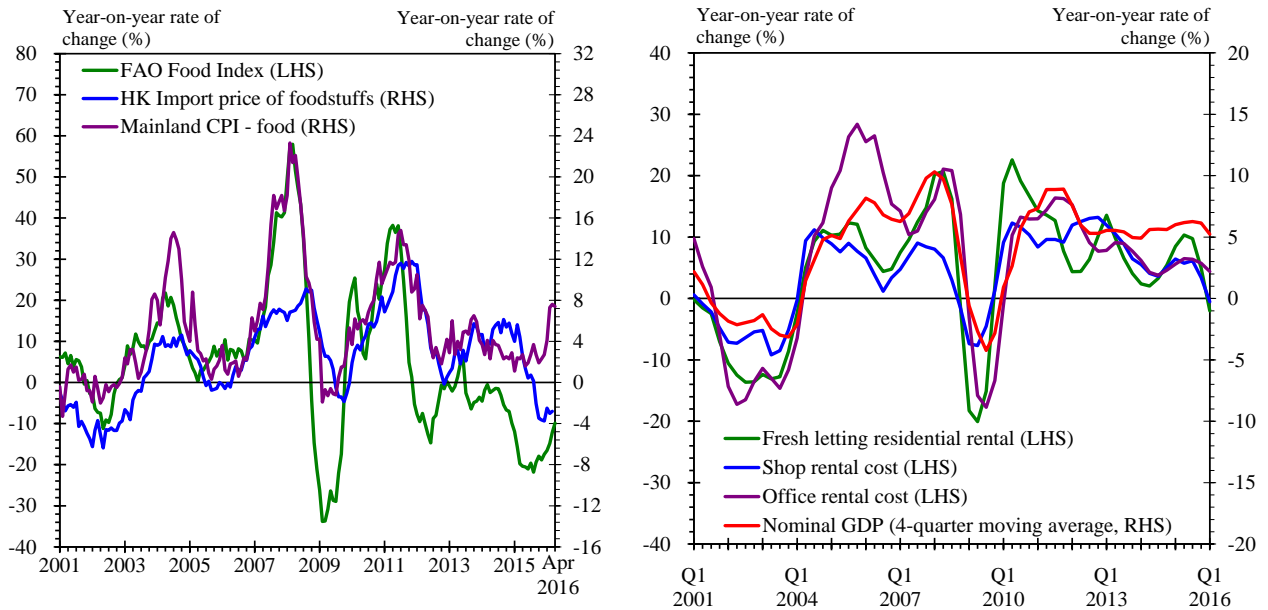


Chart 16 : Inflationary pressure should remain largely contained in 2016



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 employment earnings

2. The labour market held rather stable in overall terms on entering 2016. Yet, amid the sluggish external trade performance, persistent weakness in inbound tourism as well as slackened growth momentum of local consumption, on a year-on-year comparison, total employment in February – April 2016 grew only modestly, while the seasonally adjusted unemployment rate rose slightly to 3.4%, up 0.1 percentage point from the fourth quarter last year.

3. In respect of earnings situation, the average employment earnings of full-time employees (excluding bonus) increased by 3.4% year-on-year in the first quarter of 2016, or 0.6% in real terms. Benefitting from the SMW uprating since May 2015, the average employment earnings of full-time unskilled employees and those in the lowest decile group recorded a higher-than-overall growth rate of 6.2% and 8.7% year-on-year respectively. After netting out inflation, there was a real improvement of 3.0% and 5.4% respectively. 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 employment earnings indicators
(year-on-year rate of change (%))**

Period		Overall employment earnings of employees*		Employment earnings of unskilled employees [^]		Employment earnings in the lowest decile [^]		Salaries of managerial and professional employees [~]	
2013	Q1	3.2	(-0.4)	6.2	(2.0)	7.3	(3.0)		
	Q2	3.2	(-0.7)	7.2	(2.5)	7.2	(2.5)	6.0	(2.2)
	Q3	5.4	(@)	5.7	(-1.6)	4.9	(-2.3)		
	Q4	4.8	(0.4)	7.4	(2.9)	4.6	(0.2)		
2014	Q1	4.6	(0.4)	7.1	(2.7)	4.3	(@)		
	Q2	6.3	(2.5)	6.0	(2.1)	4.6	(0.8)	5.3	(1.8)
	Q3	6.1	(1.2)	6.7	(-0.5)	4.1	(-2.9)		
	Q4	5.6	(0.5)	6.9	(@)	4.4	(-2.4)		
2015	Q1	6.0	(1.7)	5.1	(-1.0)	3.9	(-2.2)		
	Q2	3.0	(0.1)	6.3	(2.0)	5.3	(1.1)	5.7	(3.6)
	Q3	5.1	(2.5)	8.0	(4.6)	7.4	(4.0)		
	Q4	6.2	(3.8)	6.7	(4.0)	5.9	(3.3)		
2016	Q1	3.4	(0.6)	6.2	(3.0)	8.7	(5.4)	n. a.	(n. a.)

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.
 (@) Change of less than 0.05%.
 (n.a.) Not available.

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

4. In the first quarter of 2016, 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 63 000, down by 1 600 or 2.5% over the level a year ago. The corresponding proportion in total domestic households was 2.5%⁽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 4.4% in the first quarter of 2003 to 2.8% in 2008 over the same period. After the outbreak of the global financial tsunami in late 2008, the corresponding proportion rose back to 4.2% in the first 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 2.5% in the first quarter of

(3) All figures pertaining to low-income households in the first quarter of 2016 are provisional figures.

2016, which was 0.1 percentage point lower than a year ago, such proportion was still at a relatively low level over the past ten years (*Table 2 and Chart 1*).

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>
Q1 2003	2 800 (0.1)	89 500 (4.2)	92 400 (4.4)	108 100 [3.3]
Q1 2008	2 900 (0.1)	60 900 (2.7)	63 700 (2.8)	70 700 [2.1]
Q1 2009	3 500 (0.2)	91 400 (4.0)	94 900 (4.2)	110 300 [3.2]
Q1 2010	3 900 (0.2)	84 700 (3.7)	88 600 (3.8)	101 300 [3.0]
Q1 2011	3 300 (0.1)	74 100 (3.2)	77 300 (3.3)	84 200 [2.5]
Q1 2012	3 600 (0.2)	62 200 (2.6)	65 800 (2.8)	73 900 [2.1]
Q1 2013	4 300 (0.2)	65 700 (2.8)	70 000 (2.9)	78 600 [2.2]
Q1 2014	3 200 (0.1)	62 500 (2.6)	65 800 (2.7)	75 600 [2.1]
Q1 2015	6 100 (0.2)	58 500 (2.4)	64 600 (2.6)	70 800 [1.9]
Q1 2016	4 400 (0.2)	58 600 (2.4)	63 000 (2.5)	69 700 [1.9]

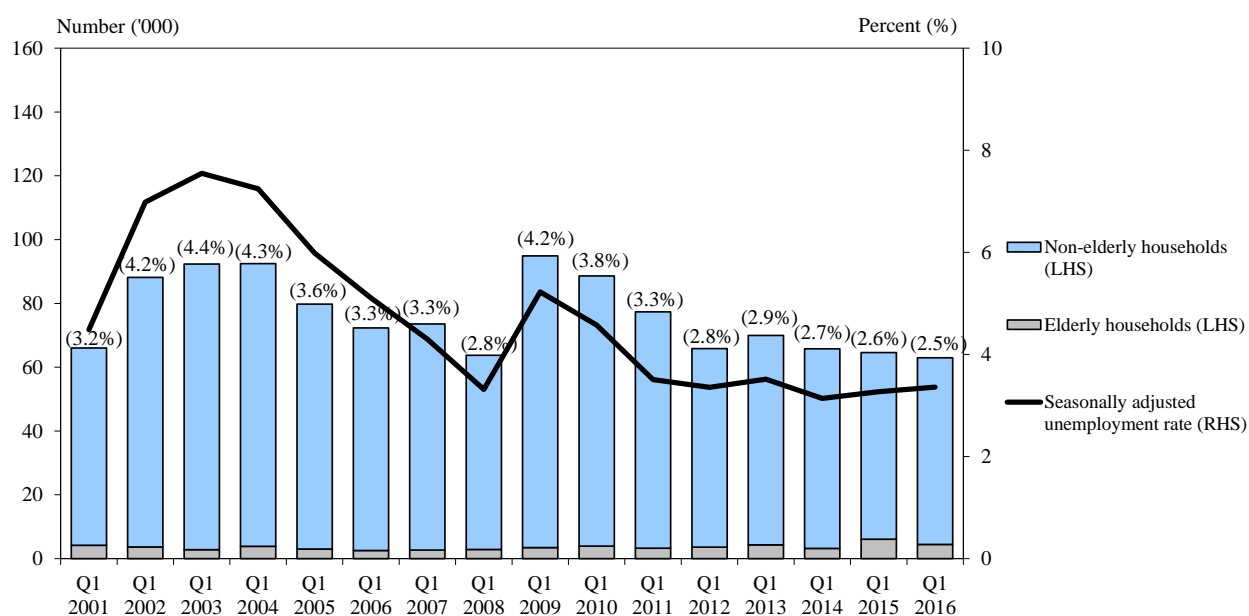
Notes : (*) Low-income households refer to households with monthly household income less than \$7,600 at constant Q2 2015 prices. This does not include households with all members being economically inactive.

(#) 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^(*)



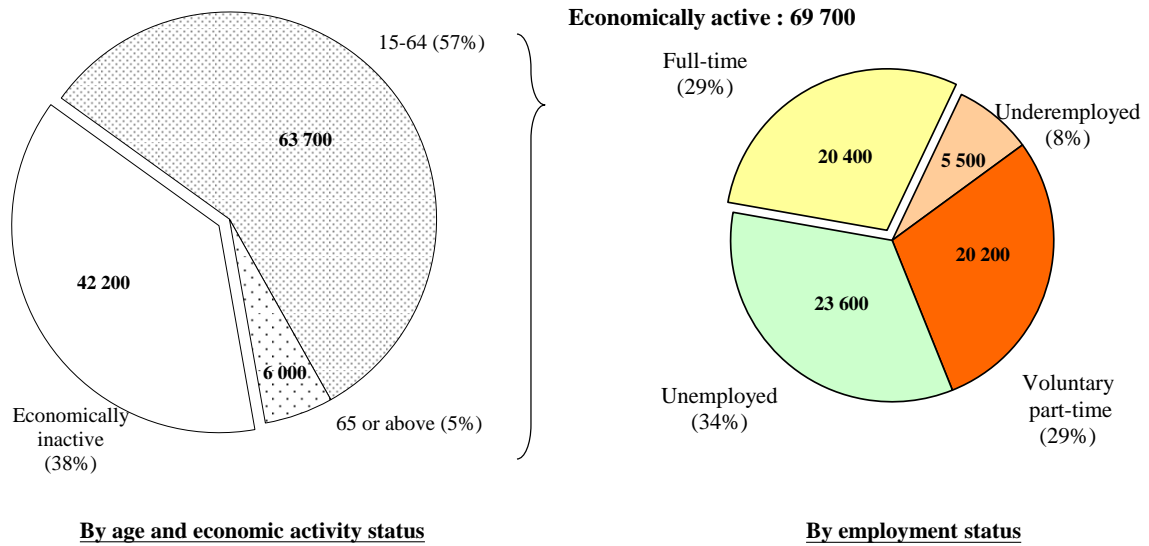
Notes : (*) Low-income households refer to households with monthly household income less than \$7,600 at constant Q2 2015 prices. This does not include households with all members being economically inactive. Figures in brackets are the proportions of low-income households in all domestic households.

Socio-economic characteristics of low-income households

6. Further decomposition of low-income households in the first quarter of 2016 reveals the following observations:

- 111 900 persons were residing in the households in question, among whom 69 700 were economically active. Most of these individuals (63 700 or 91%) were persons aged 15-64, with the majority within the age group of 40-64 (50 000 or 72%), whilst those aged 65 or above amounted to 6 000 (9%).
- The remaining 42 200 persons were economically inactive. 18 100 of them (43%) 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 69 700 economically active persons, 29% were full-time workers, while the respective proportions for unemployed, voluntary part-timers, and underemployed were 34%, 29% and 8% (*Chart 2*).

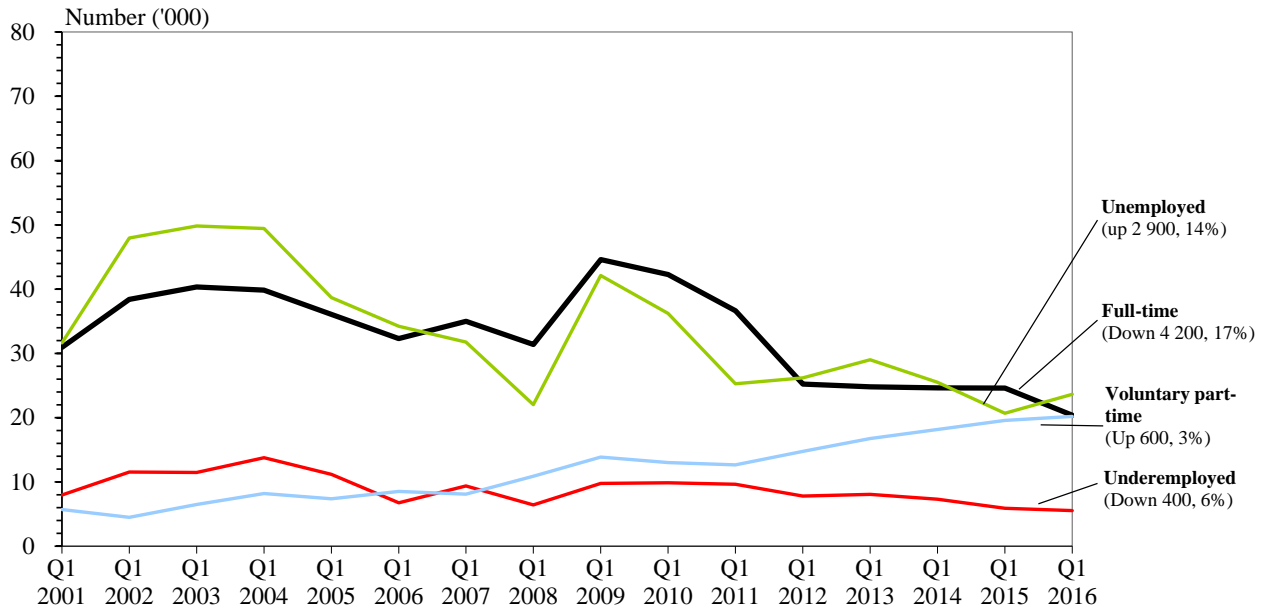
**Chart 2 : Persons living in low-income households*
by age and economic activity status, Q1 2016**



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, the majority of the employed persons living in low-income households (80%) were lower-skilled workers (among whom 32% were elementary workers, and 32% 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 (13 800 or 30%), followed by education (4 400 or 9%).
- There were 69 700 economically active persons living in low-income households, down 1.5% over a year ago. Among them, the number of full-timers and underemployed declined by 17% and 6% year-on-year respectively, while that of unemployed and voluntary part-timers rose by 14% and 3% respectively (*Chart 3*).

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

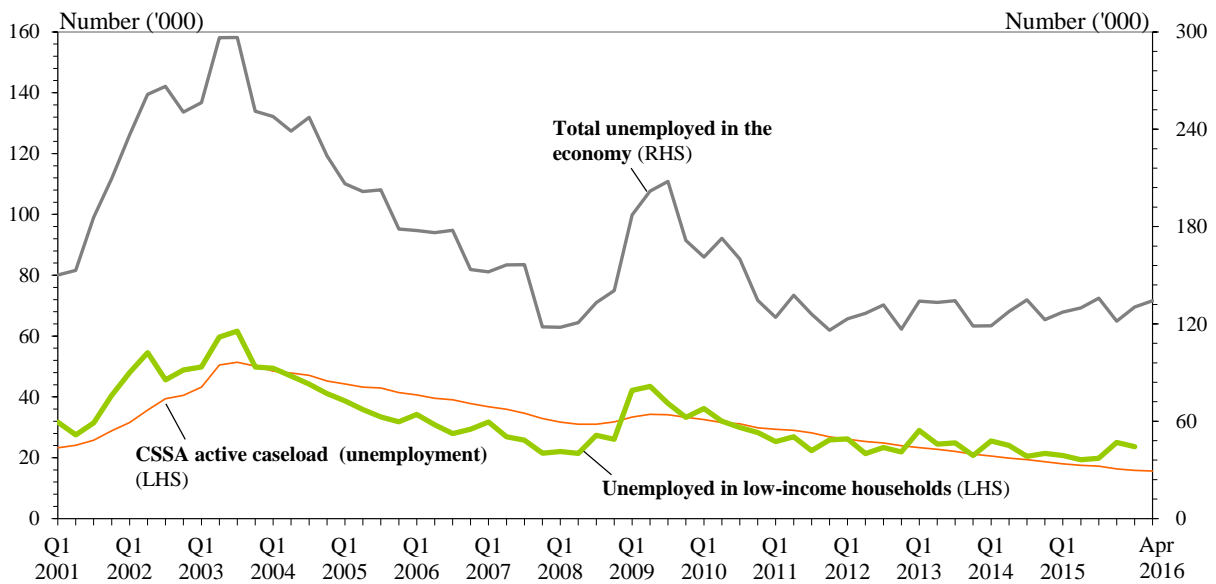


Notes : (*) Low-income households refer to households with monthly household income less than \$7,600 at constant Q2 2015 prices. This does not include households with all members being economically inactive. Figures in brackets are the year-on-year changes in number of economically active persons in Q1 2016.

The number of CSSA cases

7. The lower-skilled unemployment rate in February – April 2016, at 3.9%, rose slightly from a year ago. In the meantime, the number of overall CSSA caseload declined for the 61st consecutive month, by 8 128 (or 3.2%) to 242 308 in April 2016 as compared to a year earlier. The decrease in unemployment cases was even more distinct, down by 2 213 (or 12.4%) to 15 657 over the same period (**Chart 4**), decreasing for 80 consecutive months. This indicates a manifestation of the self-reliance of grassroots workers who are able to leave the social security net amid broadly 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. 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.

9. Despite the relatively low prevailing unemployment rate and rising earnings at varied pace for citizens from different segments, the impact of economic slowdown on the labour market has been increasingly felt. In the short term, the still significant downside risks in the external environment, persistent weakness in inbound tourism as well as the slackened growth momentum of local consumption will still pose a drag on Hong Kong's economic and employment prospects. The Government will stay 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 has implemented the "Low-income Working Family Allowance" in May this year, which aims at encouraging continuous employment for self-reliance, and can, to some extent, help alleviate the poverty situation of the working poor.

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