



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

The Government released the Third Quarter Economic Report 2016 on 11 November. 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, summarises the updated economic forecasts by the Government for 2016 as a whole, and provides some preliminary analysis on the outlook in 2017.

Economic Analysis and Business Facilitation Unit
Financial Secretary's Office
28 November 2016

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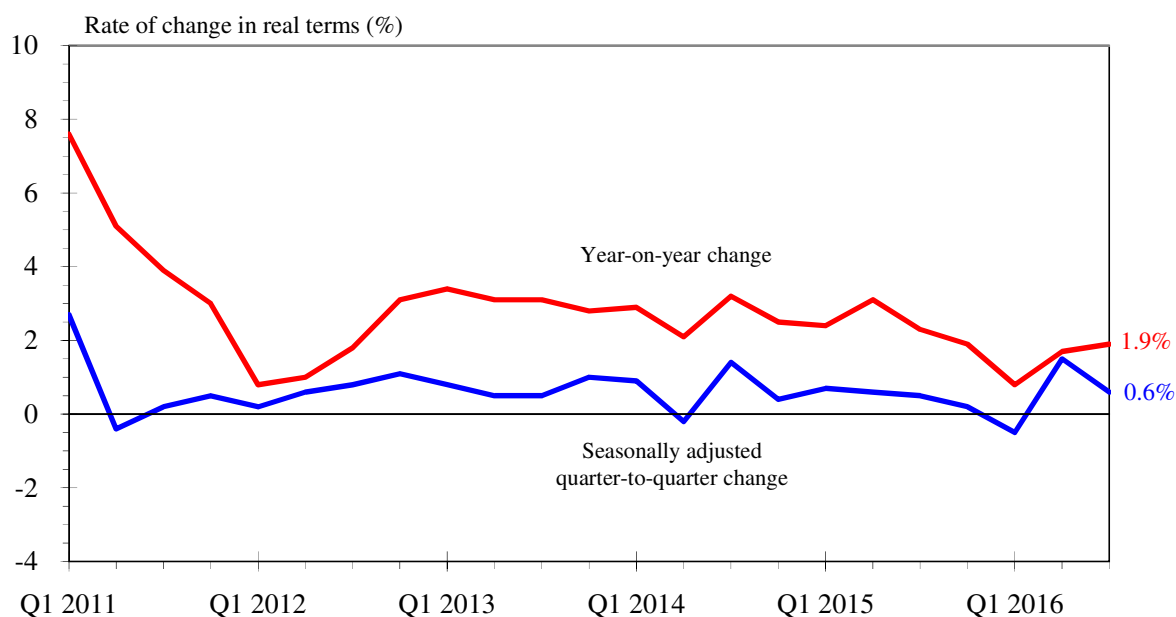
Introduction

This paper analyses the latest development in the Hong Kong economy and briefly discusses the updated economic forecasts for 2016 as a whole and the economic outlook for 2017.

Recent economic situation

2. The Hong Kong economy picked up to a 1.9% growth⁽¹⁾ in the third quarter of 2016, following a 1.7% growth in the preceding quarter. Domestic demand gathered pace, while external demand also saw relative improvements. On a seasonally adjusted quarter-to-quarter comparison, real GDP expanded further by 0.6% in the third quarter (*Chart 1*).

Chart 1 : The Hong Kong economy picked up slightly in the third quarter of 2016



(1) Unless specified, all figures in the sections of Recent economic situation, External trade and Domestic sector in this document refer to year-on-year change in real terms.

External trade

3. Global economic growth was modest in the third quarter, with the earlier acute risks waning somewhat. The US economy grew slightly faster than expected. The euro area remained on a modest growth track. The contagion effect of Brexit has been less than expected. In Asia, the economy in Japan was still subdued, but also showed some relative improvement. The Mainland economy continued to expand steadily. On balance, the external environment stabilised somewhat during the quarter, but the global economic outlook continues to face various uncertainties.

4. With the stabilisation in global demand, Hong Kong's total exports of goods grew mildly further in the third quarter, by 1.9% (*Chart 2(a)*). Many markets showed improvements of varying degrees. On a year-on-year comparison, exports to the US resumed growth, while those to Japan recorded a much slower decline. Meanwhile, exports to the Mainland continued to strengthen. Those to some other Asian markets, including India, Taiwan, Korea and Singapore, all registered notable growth. Exports to the EU slackened to a marginal decline, with the decline in the third quarter mainly dragged by a further drop in exports to the UK after the Brexit vote. Excluding the UK market, exports to the rest of EU as a whole still registered modest growth. External trade remains unsteady. The performance of merchandise exports softened somewhat in October.

5. Amid the stabilisation of regional trade and cargo flows in the third quarter, and thanks to a pick-up in initial public offering (IPO) activities, exports of services also saw visible improvement, with the decline tapering distinctly to 1.8%, from a 4.6% drop in the preceding quarter (*Chart 2(b)*). Exports of travel services were still weak, though with a smaller decline in the third quarter than that in the early part of the year.

Chart 2(a) : Total exports of goods made further growth

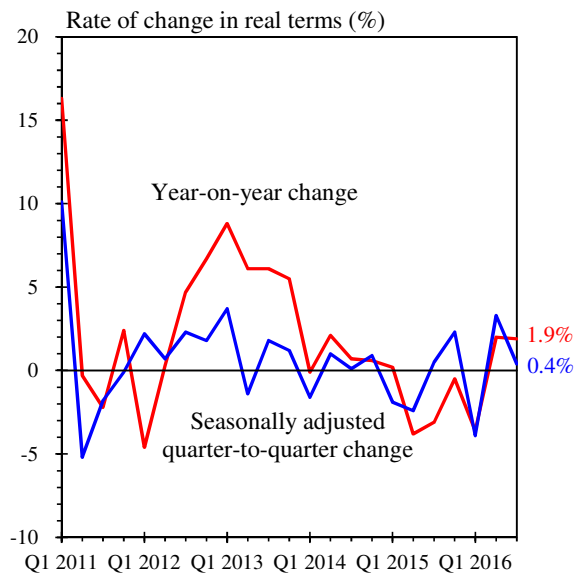
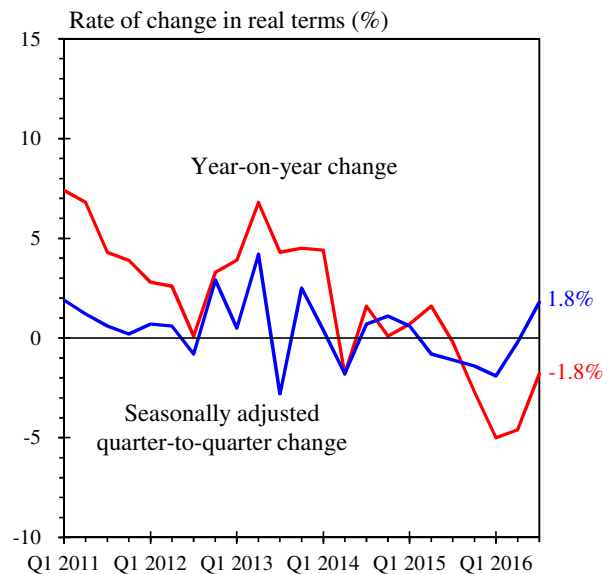


Chart 2(b) : Exports of services staged a visible improvement



Domestic sector

6. Domestic demand strengthened somewhat in the third quarter. Thanks to the broadly stable labour market, private consumption expenditure picked up slightly to grow by 1.2%, higher than the 0.5% growth in the preceding quarter (*Chart 3(a)*). Total retail sales remained weak for the third quarter as a whole, registering a fall of 7.4% in volume terms. Yet, retail sales saw some relative improvement in September, with a visibly narrower decline, reflecting the smaller decline in inbound tourism in that month while local consumer sentiment also turned better.

7. Overall investment spending in terms of gross domestic fixed capital formation rebounded visibly by 6.0% in the third quarter, ending the declines in the preceding four quarters (*Chart 3(b)*). Within this, private sector machinery and equipment acquisition bounced back by 6.7%. Overall building and construction expenditure rose by 3.4%, led by further expansion in private sector building and construction activity.

Chart 3(a) : Private consumption expenditure rose at a slightly faster pace

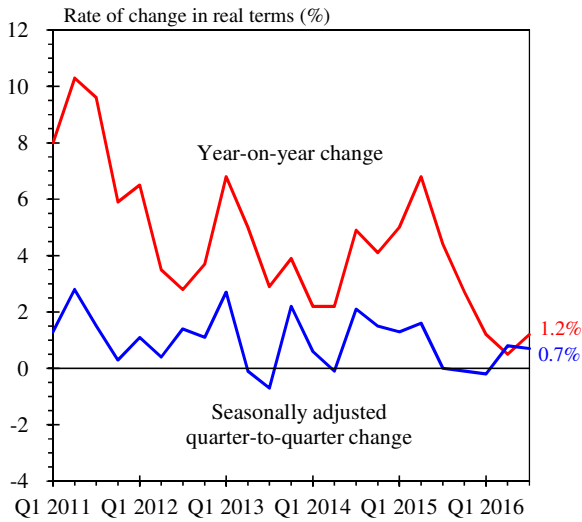
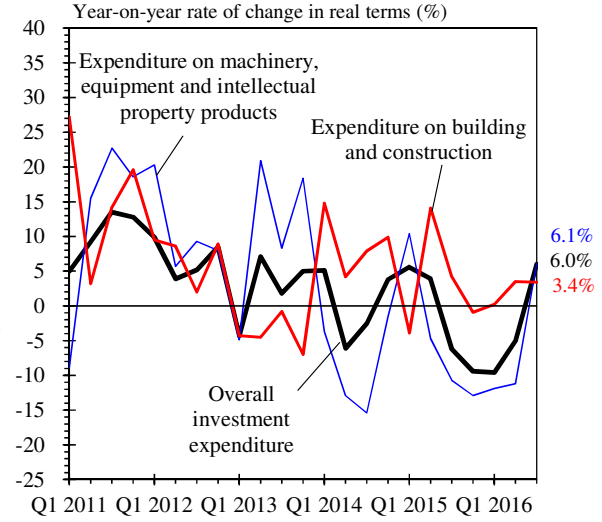


Chart 3(b) : Investment spending rebounded visibly

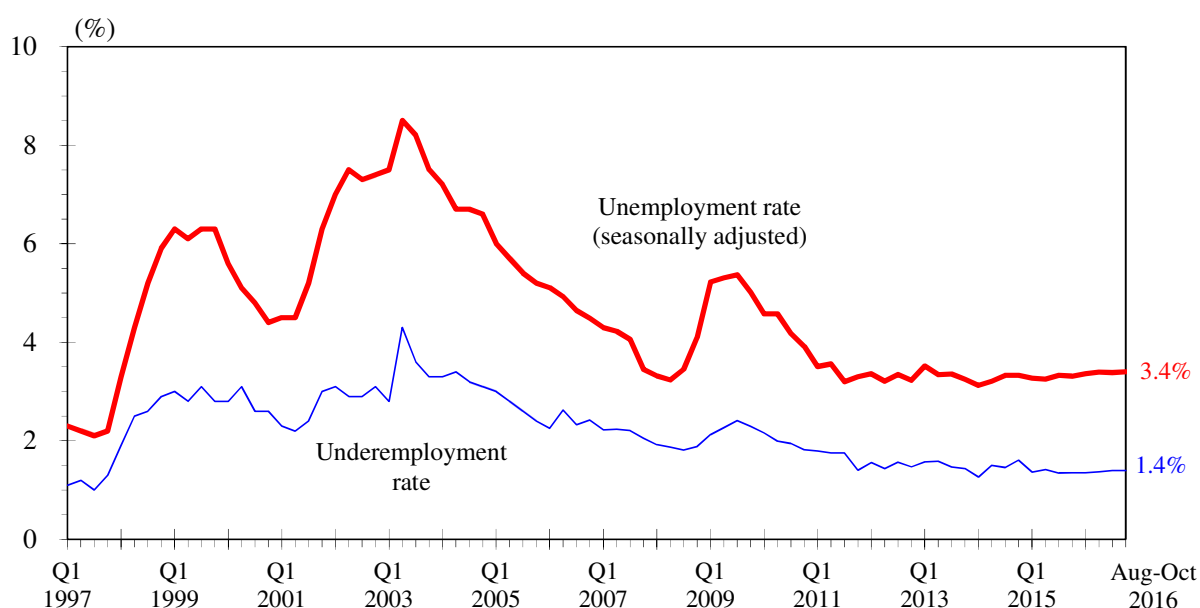


8. As for external direct investment (DI), according to country breakdowns of external DI flow data up to end-2014, the Mainland remained prominent as a major source of Hong Kong's external DI, accounting for 25% of total DI inflow in 2014. The number of business operations in Hong Kong with parent companies overseas and in the Mainland climbed up to a new high of 7 986 according to the survey results for 2016, reflecting our business friendly environment and prominent intermediary role between the Mainland and the rest of the world.

Labour Market

9. The labour market held stable in overall terms and remained in a state of full employment. The seasonally adjusted unemployment rate stayed at 3.4% in August – October 2016. The underemployment rate likewise held stable at a relatively low level of 1.4% (*Chart 4*). Total employment sustained moderate year-on-year growth, though labour demand in the trade- and consumption-related sectors was still relatively soft.

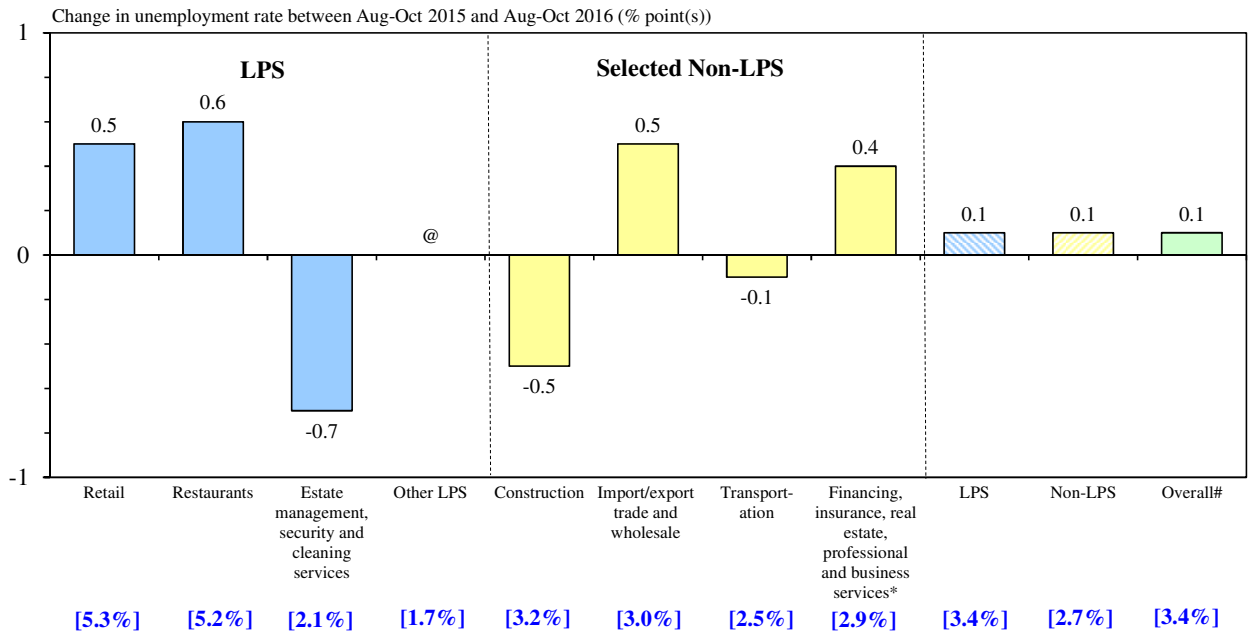
Chart 4 : The labour market held largely stable in overall terms



10. Since the implementation of Statutory Minimum Wage (SMW), macroeconomic conditions have been broadly stable, thereby relieving to a large extent the pressure on the labour market brought about by SMW. The overall seasonally adjusted unemployment rate in August – October 2016 inched up by 0.1 percentage point year-on-year. Both the unemployment rates for the low paying sectors (LPS)⁽²⁾ as a whole and the non-LPS counterpart edged up by 0.1 percentage point from a year earlier to 3.4% and 2.7% respectively (*Chart 5*).

(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.

Chart 5 : On a year-on-year comparison, unemployment rates of the trade- and consumption-related sectors were higher



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

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

(#) Seasonally adjusted.

(@) Change less than 0.05 percentage point.

11. Analysed by skill segment, in August – October 2016, the unemployment rate for the higher-skilled segment rose by 0.3 percentage point year-on-year to 2.2%, while that of the lower-skilled segment remained unchanged at 3.4% (*Table 1*). On a year-on-year basis, employment in both segments grew further.

Table 1 : The employment and unemployment situations by skill segment

	Employment [#]					Unemployment rate [#]		
	Aug – Oct 2016	Change as compared to Feb – Apr 2015 (before the implementation of the revised SMW rate)		Change as compared to Aug – Oct 2015 (a year earlier)		Aug – Oct 2016	Change as compared to Feb – Apr 2015 (before the implementation of the revised SMW rate)	Change as compared to Aug – Oct 2015 (a year earlier)
	(No.)	(No.)	(%)	(No.)	(%)	(%)	(% point)	(% point)
Higher-skilled	1 468 700	+23 800	+1.6	+10 700	+0.7	2.2	+0.6	+0.3
Lower-skilled	2 342 200	+12 100	+0.5	+26 300	+1.1	3.4	-0.4	@
Lower-skilled (excl. government employees and live-in domestic workers)	1 917 700	-5 100	-0.3	-1 700	-0.1			

Notes : (#) Provisional figures.

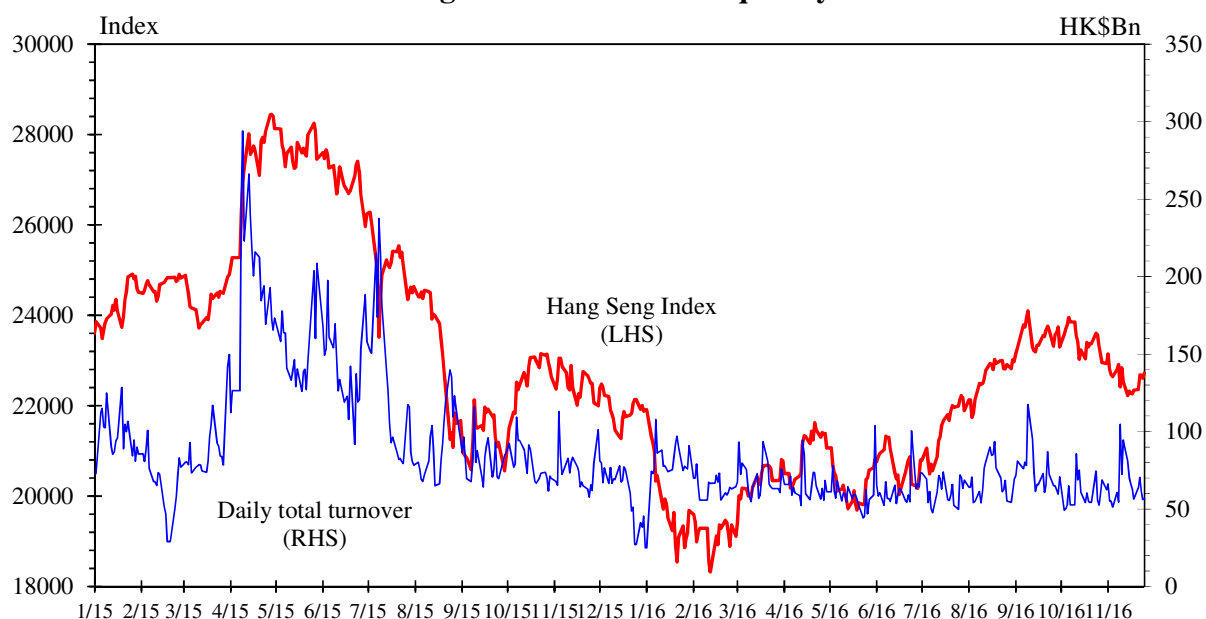
(@) Change less than 0.05 percentage point.

12. Wages and earnings sustained steady growth. Nominal wage and payroll increased by 3.8% and 4.2% respectively in June 2016. After discounting inflation, the increases in real terms were 1.2% and 1.5% respectively. Earnings of grassroots workers saw further improvement. More recent data showed that the average monthly employment earnings of full-time employees engaged in elementary occupations (excluding foreign domestic helpers) increased by 5.3% in nominal terms in the third quarter of 2016 over a year earlier, above the underlying Consumer Price Index (A) inflation of 2.4% over the same period. Overall income also sustained solid growth, with the median monthly household income (excluding foreign domestic helpers) up by 3.7% in nominal terms in the third quarter of 2016 over a year earlier, broadly the same as the growth in the preceding quarter (Please refer to *Annex* for details).

Asset markets

13. The local stock market rose during the third quarter, largely in tandem with the rally in major overseas markets. Factors including the smaller-than-expected contagion effect of Brexit, delays in US interest rate hikes and the approval of the Shenzhen-Hong Kong Stock Connect implementation plan, propelled the Hang Seng Index (HSI) to reach 24 100 on 9 September, its highest level so far this year. The HSI consolidated subsequently and the US election outcome also caused some short-lived volatility. The index closed at 22 723 on 25 November, up by 9.3% from end-June. Average daily turnover rose from \$62.6 billion in the second quarter to \$68.3 billion in the third quarter, before retreating to \$60.9 billion in October (*Chart 6*). Taking the first three quarters of 2016 together, Hong Kong ranked first among the major stock exchanges in the world in terms of the amount of funds raised through IPO.

Chart 6 : Local stock market generally rose during the third quarter, though consolidated subsequently

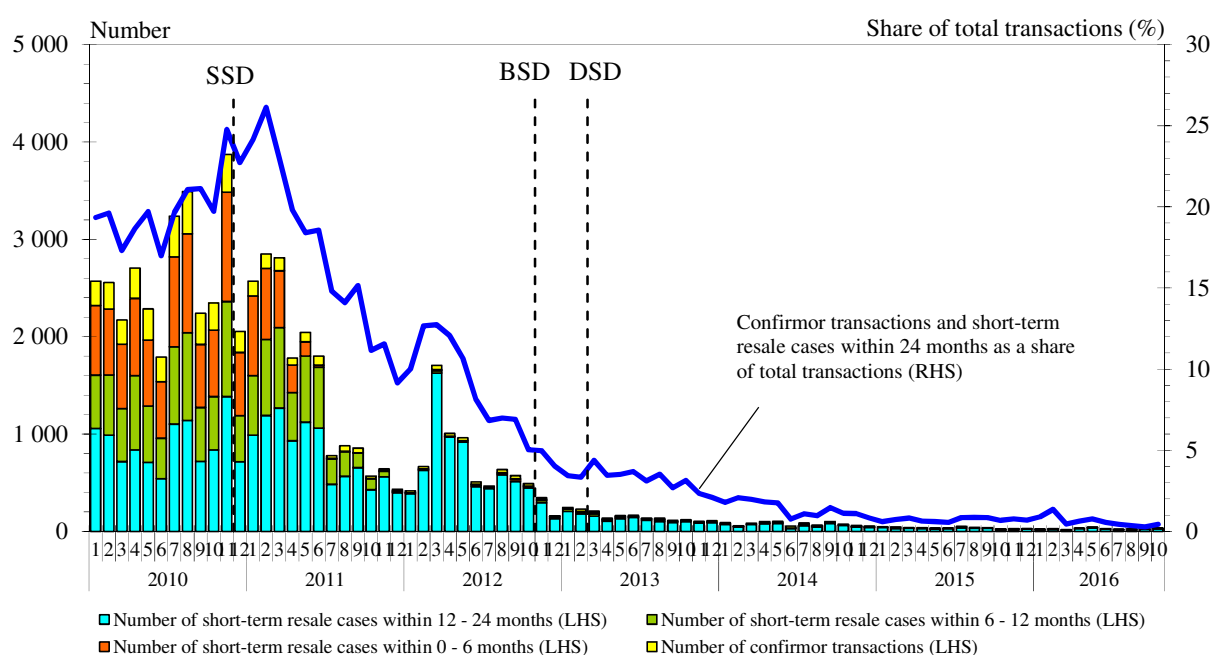


14. Raising flat supply through increasing land supply is the Government's top policy priority in ensuring the healthy and stable developments of the property market. As announced in September 2016, in the fourth quarter of 2016 the Government will put up for sale a total of five residential sites which are capable of providing about 2 800 flats. The private housing land supply (including Government land sale, railway property development projects, the Urban Renewal Authority's projects, and private re-development/development projects) in the first three quarters of 2016-17 has an estimated capacity of providing about 15 700 units, representing 87% of the 2016-17 private housing supply target of 18 000 units.

Reflecting the Government’s sustained efforts in raising land supply, 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) remained at a record high of 93 000 units as estimated at end-September.

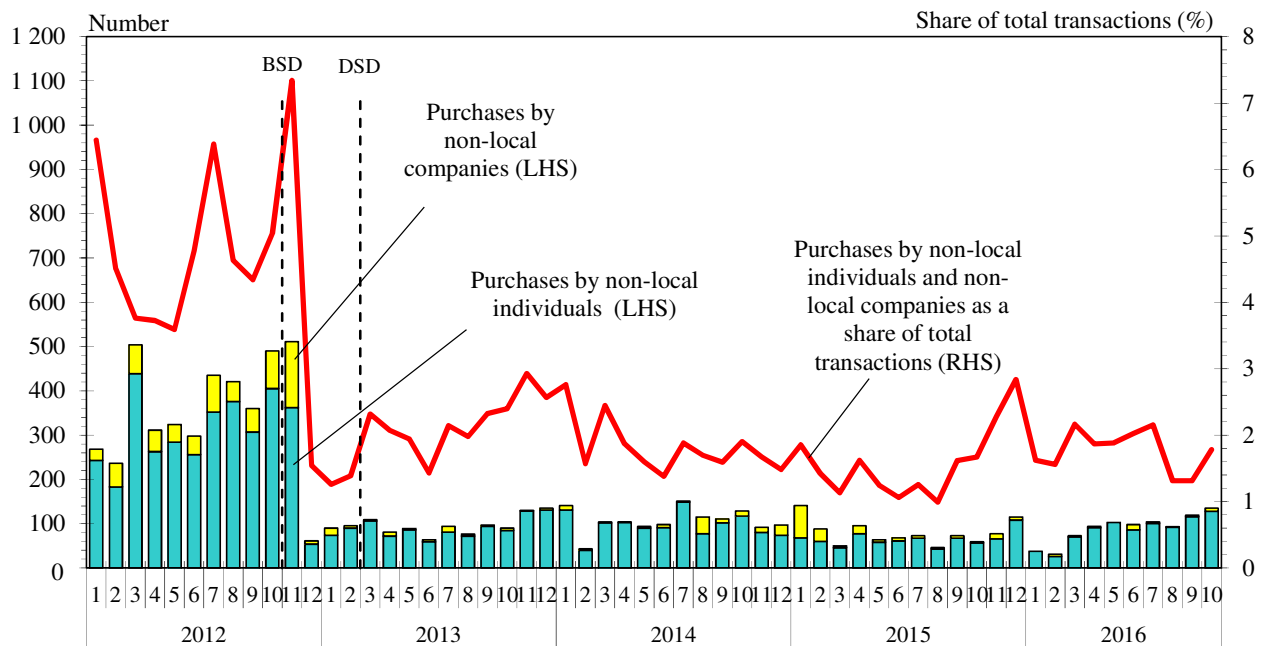
15. At the same time, the Government has introduced a series of measures in the past several years to manage demand and reduce the possible risks to financial stability arising from an exuberant property market. These measures have achieved the intended results. On speculative activities, the number of short-term resale (comprising confirmor transactions and resale within 24 months after assignment) remained subdued at an average of 27 cases per month or 0.5% of total transactions in the first ten 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 7*). Reflecting the effects of the Buyer’s Stamp Duty, purchases by non-local individuals and non-local companies stayed low at an average of 89 cases per month or 1.7% of total transactions in the first ten months of 2016, much lower than the monthly average of 365 cases or 4.5% in January to October 2012 (*Chart 8*). As to mortgage lending, the average loan-to-value ratio of new mortgages was 52% in the first nine months of 2016, considerably 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 7 : Short-term speculative activities stayed subdued



Note : Confirmor transactions refer to resale before assignment.

Chart 8 : Purchases by non-local buyers remained low

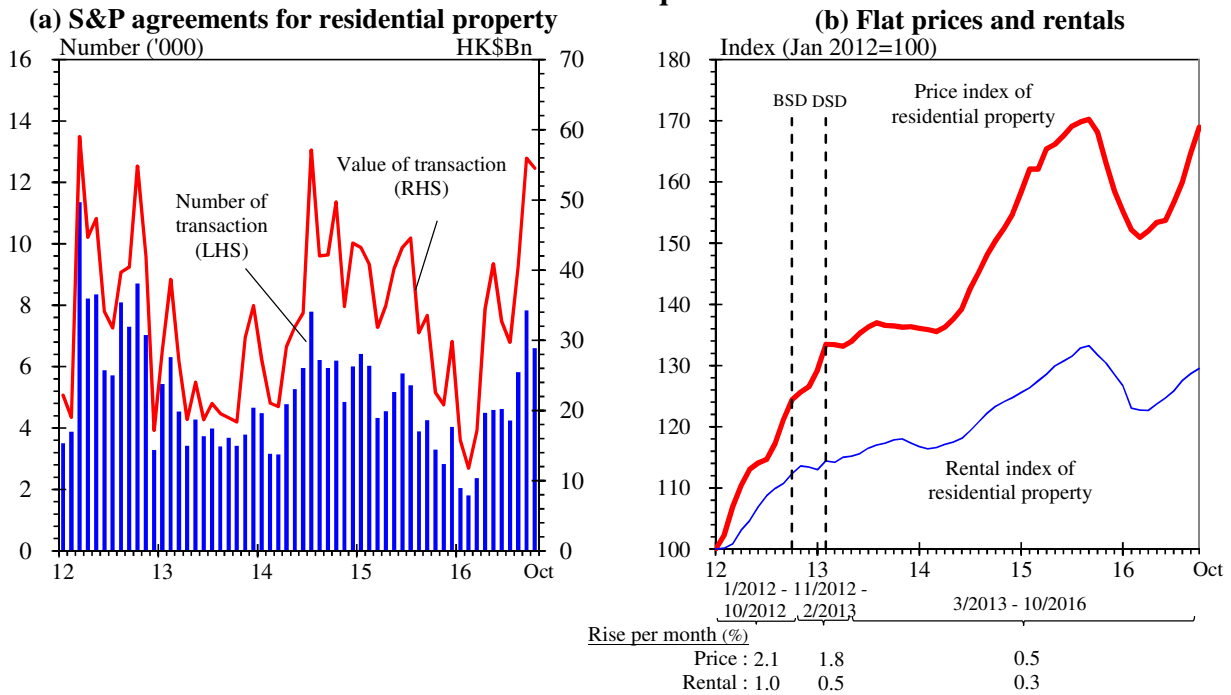


16. However, amid an ongoing demand-supply imbalance and repeated delays in the interest rate hike in the US, the residential property market showed renewed signs of exuberance in the third quarter, marked by visible increases in both flat prices and trading activities. The increase in flat prices was led by mass market flats. Meanwhile, the housing affordability ratio worsened.

17. The number of sale and purchase agreements for residential property received by the Land Registry increased by 34% from the second quarter to a monthly average of 6 100 in July to October 2016, above the monthly average of 3 300 cases in the first half of 2016 (*Chart 9(a)*).

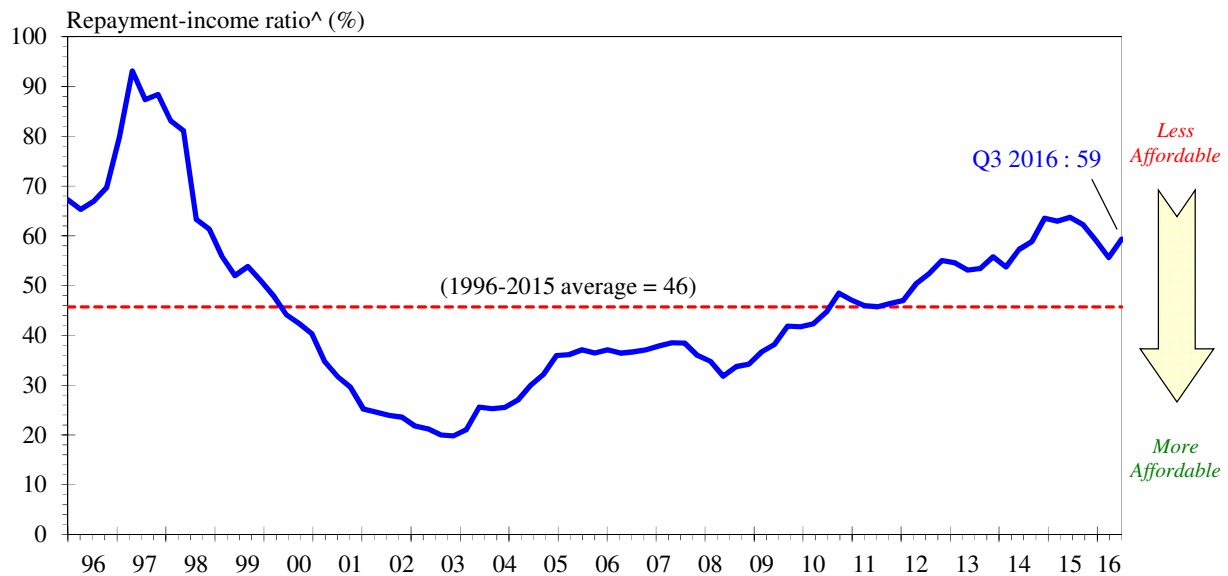
18. Overall flat prices rebounded by a cumulative 11.9% between March and October 2016, mainly led by a 12.4% increase among mass market flats (less than 70 square metres). The month-to-month increases in flat prices accelerated successively in the third quarter. In particular, flat prices in September rose by 3.0%, the largest monthly gain since February 2013 (*Chart 9(b)*).

Chart 9 : Residential property market showed renewed signs of exuberance in the third quarter



19. Overall flat prices in October 2016 were only 0.8% lower than the peak in September 2015, and have exceeded the peak in 1997 by a cumulative 76%. With the increase in flat prices exceeding income growth, the home purchase affordability index (i.e. the ratio of mortgage payment for a 45-square metre flat to median income of households, excluding those living in public housing) rose again to 59% in the third quarter. Should interest rates rise by three percentage points to a more normal level, the ratio would rise further to 77%, far exceeding the long-term average of 46% over 1996-2015 (*Chart 10*).

Chart 10 : The mortgage payment to income ratio rose again

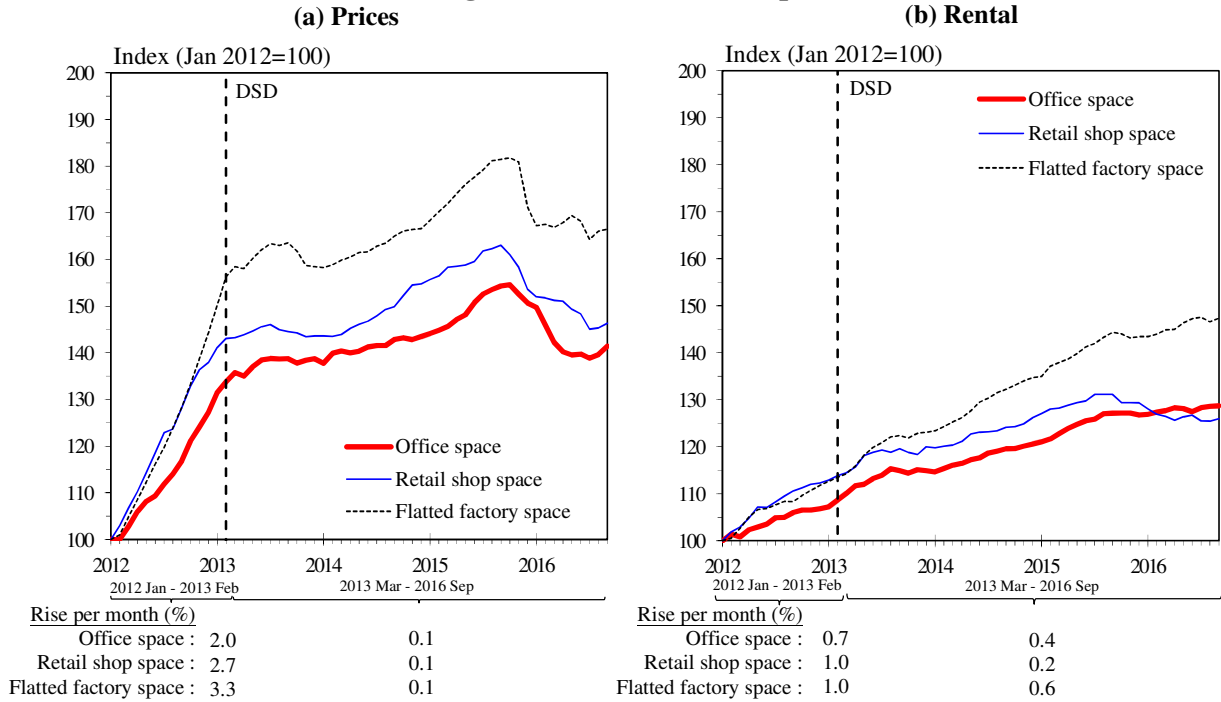


Note : (^) The ratio of mortgage payment for a flat with saleable area of 45 sq m (assuming 70% loan-to-value ratio and tenor of 20 years) to median income of households (excluding those living in public housing). This ratio is different from the debt servicing ratio published by the HKMA, which is the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

20. To forestall further build-up of housing bubble risk and safeguard the macroeconomic and financial sector stability, the Government announced the latest round of demand-side management measures on 4 November 2016, raising the ad valorem stamp duty rate on residential property transactions to a flat rate of 15%. Exemption is granted to Hong Kong Permanent Residents who do not own any other residential property in Hong Kong. Market intelligence suggested that after the Government announced the latest round of measure, the property market has shown signs of cooling down. Trading activities quietened down, and the uptrend in prices also slowed.

21. The commercial and industrial property markets were relatively quiet as compared with the residential segment in the second and third quarters of 2016, and showed no apparent sign of overheating. Overall sale prices of office space edged down by 1% between March and September. During the same period, sale prices of retail shop space fell by 3%, while those of flatted factory space stayed little changed (*Chart 11*). Trading activities were also relatively quiet by historical standards.

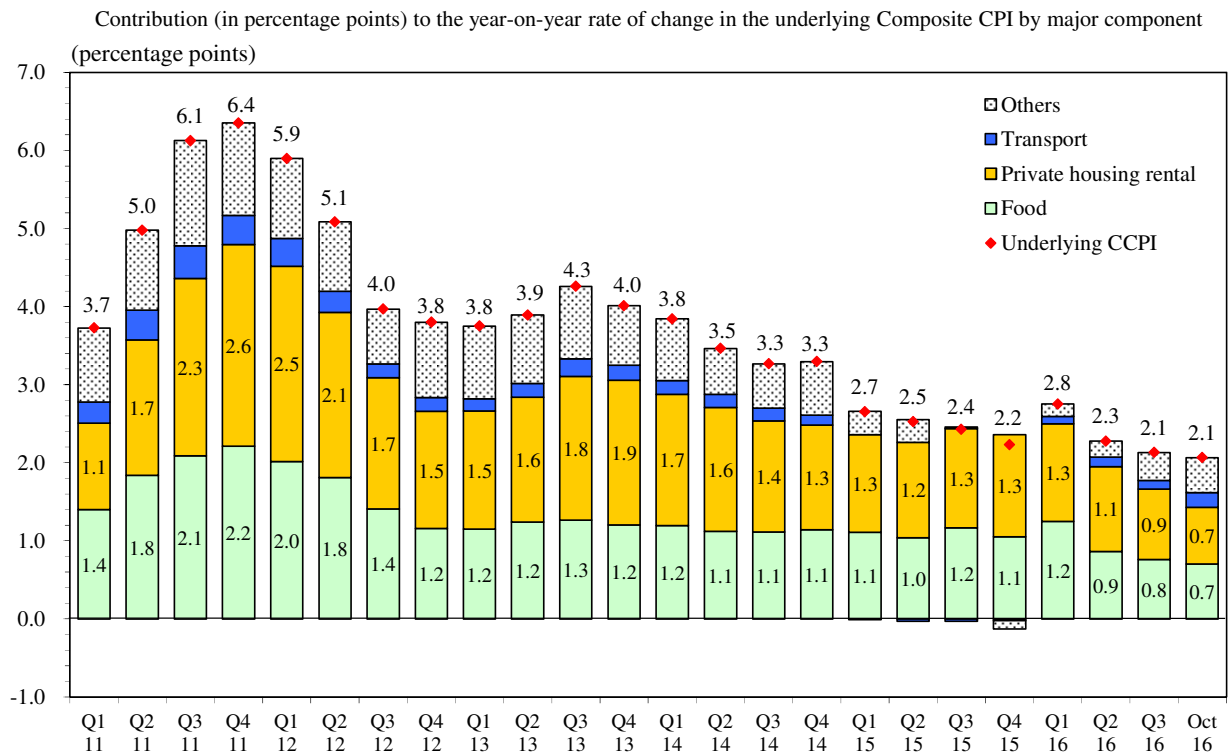
Chart 11 : Non-residential property markets were relatively quiet during the second and third quarters



Inflation

22. Inflation pressures were benign given contained domestic price pressures and muted imported inflation. Netting out the effects of the Government’s one-off relief measures to more accurately reflect the underlying inflation trend, underlying consumer price inflation eased further to 2.1% in the third quarter of 2016, and held at a modest level of 2.1% in October, averaging 2.4% in the first ten months, down from the annual average of 2.5% in 2015 (*Chart 12*).

Chart 12 : Underlying consumer price inflation pressures were benign



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.

23. Price pressures of many major components of the underlying Composite Consumer Price Index (Composite CPI) remained benign (*Table 2*). On the two largest components by weight, food inflation (including cost of dining out), after temporarily rising to 4.6% in the first quarter amid bad weather conditions, eased successively to 3.2% and 2.8% respectively in the second and third quarters, alongside the still-soft global food prices and moderate food inflation in the Mainland. Food inflation remained moderate at 2.6% in October. The year-on-year increase in private housing rental component eased successively from 4.2% in the first quarter to 3.0% in the third quarter, and further to 2.4% in October, as the impacts of the earlier softening in fresh-letting rentals continued to feed through. Price pressures of other components in the CPI were generally benign.

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

<u>Expenditure component</u>	<u>Weighting (%)</u>	<u>2015</u>					<u>2016</u>			
		<u>2015</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Oct</u>
Food	27.29	4.0 ^(b)	4.0	3.7	4.2	3.9	4.6	3.2	2.8	2.6
<i>Meals bought away from home</i>	17.74	4.2 ^(b)	4.4	4.3	4.3	4.0	3.7	3.3	3.1	3.0
<i>Other foodstuffs</i>	9.55	3.4 ^(b)	3.3	2.8	4.0	3.7	6.3	3.1	2.1	1.7
Housing ^(a)	34.29	4.5 ^(b) (5.1) ^(b)	4.7 (8.2)	4.7 (4.2)	4.5 (4.1)	4.1 (4.1)	4.0 (4.0)	3.5 (4.6)	3.1 (6.0)	2.9 (0.5)
<i>Private dwellings</i>	29.92	4.3 ^(b) (4.7) ^(b)	4.3 (6.8)	4.2 (3.8)	4.3 (3.9)	4.4 (4.4)	4.2 (4.2)	3.6 (4.8)	3.0 (4.1)	2.4 (0.7)
<i>Public dwellings</i>	1.94	6.2 ^(b) (10.9) ^(b)	9.8 (29.0)	9.4 (10.0)	6.1 (6.4)	* (*)	* (*)	0.4 (0.5)	3.6 (51.3)	10.0 (-5.6)
Electricity, gas and water	2.67	-2.6 ^(b) (8.4) ^(b)	-1.4 (21.5)	-0.7 (22.8)	-6.1 (-4.6)	-2.2 (-1.1)	-1.1 (*)	-1.6 (-1.1)	4.0 (4.1)	4.9 (4.9)
Alcoholic drinks and tobacco	0.54	1.3 ^(b)	4.3	-0.1	0.3	1.0	0.3	1.2	2.4	1.9
Clothing and footwear	3.21	-1.8 ^(b)	-0.8	-2.7	-1.9	-1.6	-3.3	-2.8	-4.5	-2.4
Durable goods	4.65	-5.6 ^(b)	-5.5	-5.7	-5.6	-5.8	-5.7	-5.4	-5.3	-4.9
Miscellaneous goods	3.56	0.9 ^(b)	1.2	1.3	0.6	0.5	0.5	1.3	2.3	1.8
Transport	7.98	-0.3 ^(b)	-0.1	-0.4	-0.4	-0.3	1.2	1.5	1.4	2.4
Miscellaneous services	15.81	1.1 ^(b) (1.1) ^(b)	0.8 (0.8)	1.4 (1.4)	1.1 (1.1)	1.2 (1.2)	2.7 (2.7)	2.1 (2.1)	2.5 (2.5)	1.6 (1.6)
All items	100.00	2.5 ^(b) (3.0) ^(b)	2.7 (4.4)	2.5 (3.0)	2.4 (2.3)	2.2 (2.3)	2.8 (2.8)	2.3 (2.6)	2.1 (3.1)	2.1 (1.2)

Notes : (a) 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.

(b) The year-on-year rates of change of the 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. Splicing has been applied to the indices in order to obtain better estimates of the rates of change for the year 2015.

() Figures in brackets represent the headline rates of change before netting out the effect of Government's one-off relief measures.

(*) Change within $\pm 0.05\%$.

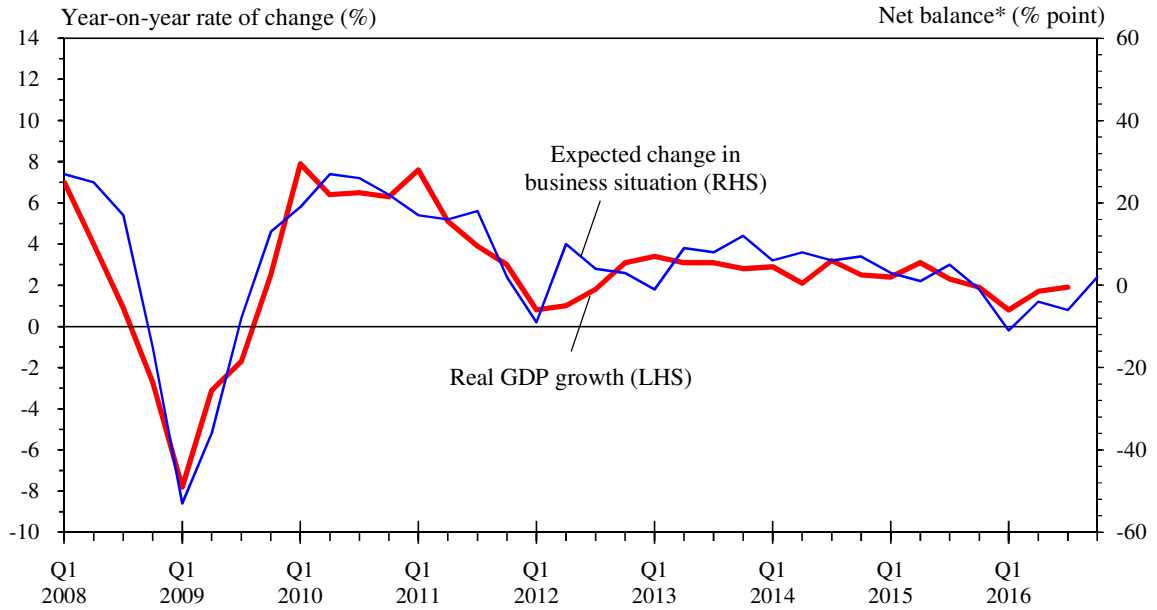
Updated short-term economic forecasts for 2016

24. As for the outlook for the rest of this year, the global economy, having stabilised somewhat from the acute start of the year, is expected to remain on a modest growth track in the near term. The relative stabilisation in global demand should render some support to Asia's trade and Hong Kong's exports. Services exports would also benefit in tandem. If inbound tourism continues to show improvement, the recovery in services exports would hopefully be on an even firmer footing. Yet, given the looming interest rate hike in the US, monetary policy divergence among major central banks, concerns about whether the US economic situation and policies would stage significant changes after the election, the referendum in Italy in early December, and with the Brexit event still unfolding and geopolitical tensions remaining elevated in various regions, the external environment will continue to face uncertainties in the period ahead. We need to stay alert to these developments and their possible repercussions on the global financial and economic situation.

25. Domestic demand has remained resilient thus far and should continue to provide support to economic growth in the rest of the year. Full employment and favourable income conditions would provide the key positive factors underpinning consumption growth. Meanwhile, the ongoing hectic infrastructure works, coupled with solid growth in private construction activity, should also render impetus to overall economic growth. Moreover, the latest Quarterly Business Tendency Survey indicated that overall business sentiment among large enterprises has improved somewhat of late (*Chart 13*).

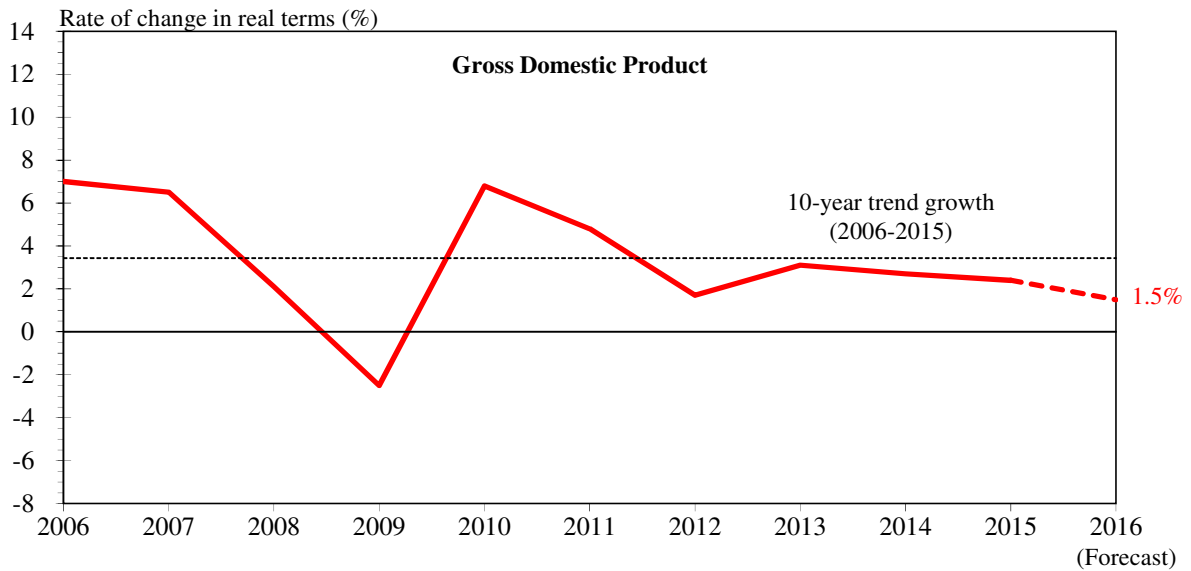
26. With the actual GDP growth outturn of 1.4% in the first three quarters in line with the forecast range of 1-2% announced in August, and in cognizance of a likely further modest growth in the fourth quarter, real GDP growth for 2016 as a whole is forecast at 1.5% (*Chart 14*). For reference, the forecasts by private sector analysts for the real GDP growth this year mostly range from 1.0% to 1.8%, averaging around 1.3%.

Chart 13 : Overall business sentiment among large enterprises slightly improved of late



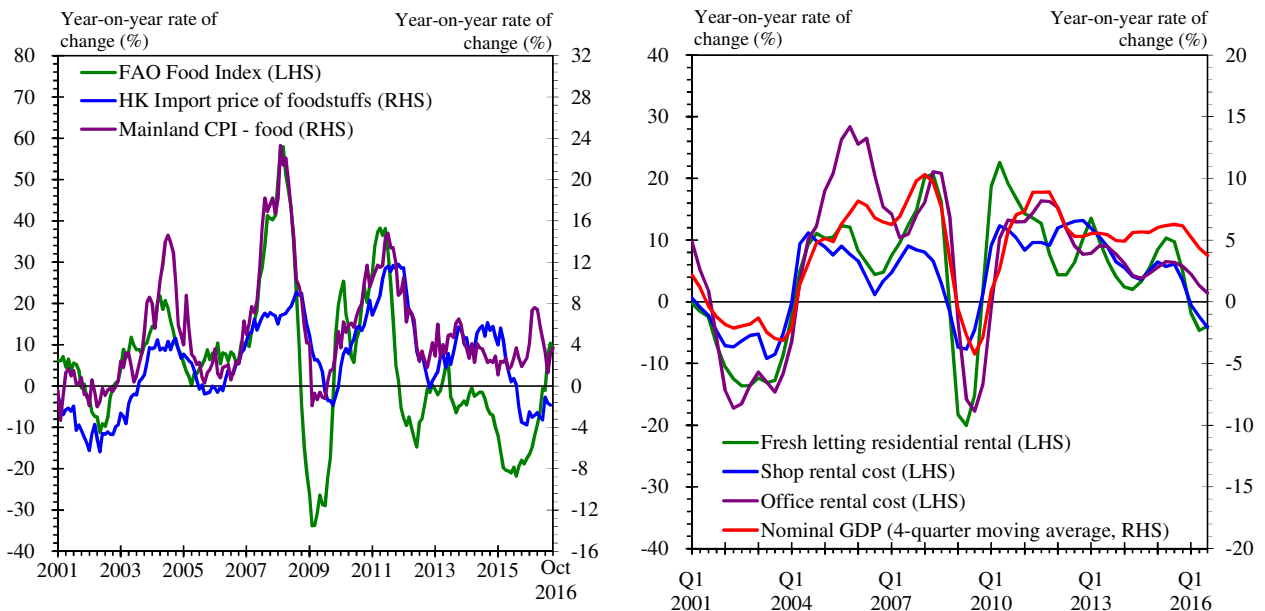
Note : (*) Net balance indicates the direction of expected change in business situation versus preceding quarter. It refers to the difference in percentage points between the proportion of establishments choosing "better" over that choosing "worse". A positive sign indicates a likely upward trend while a negative sign, a likely downward trend.

Chart 14 : Economic growth for 2016 as a whole is forecast at 1.5%



27. On inflation, imported inflation pressure is still muted. The continued feed-through of softer fresh-letting residential rentals in earlier periods and the modest pace of economic expansion should also keep local cost pressures in check (*Chart 15*). The underlying and headline inflation rates in the first ten months averaged 2.4% and 2.7% respectively. The forecast rates of underlying and headline consumer price inflation for 2016 as a whole are 2.3% and 2.4% respectively. For reference, the forecasts by private sector analysts for the headline consumer price inflation rate in 2016 mostly range from 2.2% to 2.9%, averaging around 2.5%.

Chart 15 : Imported inflation pressure is still muted and the modest pace of economic expansion should also keep local cost pressures in check



Economic outlook for 2017

28. Global economic growth has remained modest and uneven so far this year. In October, the International Monetary Fund forecast global economic growth to improve slightly to 3.4% in 2017, from 3.1% in 2016. Yet, the global economic outlook is still subject to many uncertainties, which may lead to unsteadiness in the external environment.

29. Among the advanced economies, the US economy, having experienced a soft start of the year, gathered growth momentum in the third quarter of this year (**Chart 16**). Labour market continued to improve and private consumption also expanded solidly. Given a relatively firmer footing, the US economy should hopefully see further expansion next year. However, headwinds associated with a strong US dollar continued to mount. Also, whether the US economic situation as well as the policy directions of the new administration after the election would stage significant changes has emerged as a new source of uncertainty. The US is the largest economy in the world. The US policy directions, if changed significantly, would have notable ramifications on the global economic recovery, financial markets as well as economic performance of Hong Kong. The Government will continue to closely monitor the US economic situation, as well as the developments on the trade policy front under the new US administration.

Chart 16 : The US economy picked up in growth momentum recently, but uncertainties for the outlook remain

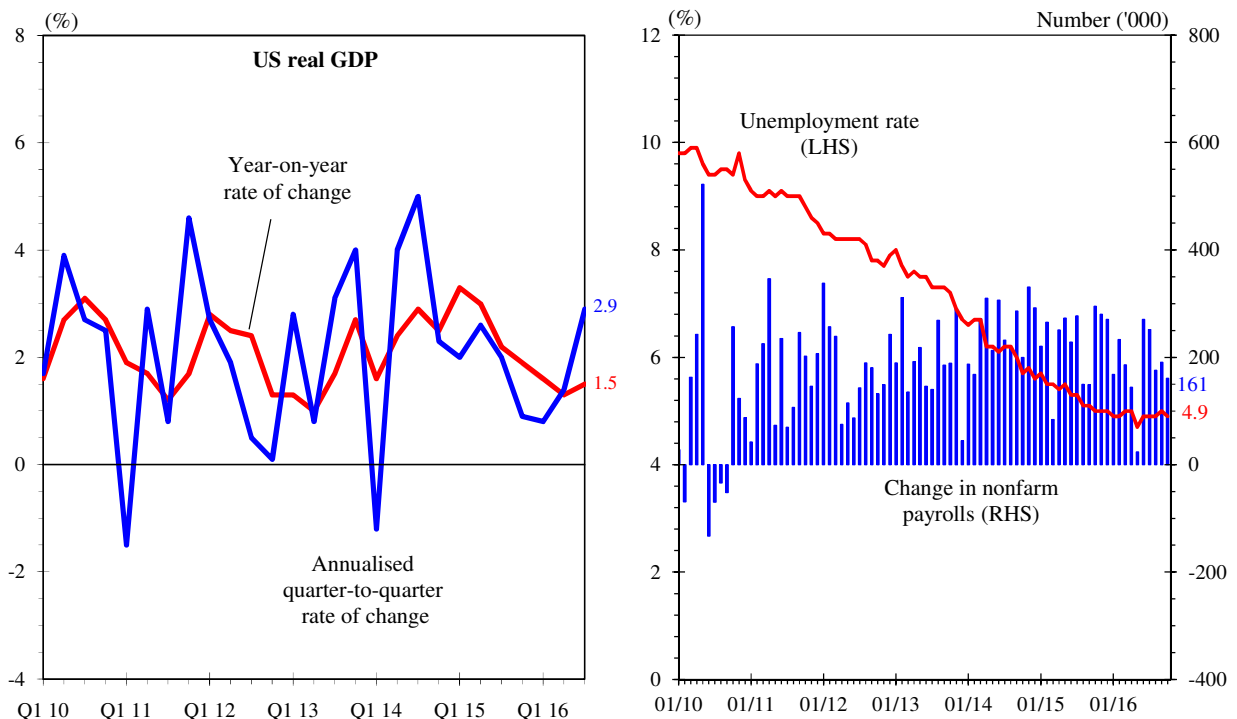


Chart 17 : The euro area economy continued to grow modestly, but its outlook continues to face challenges

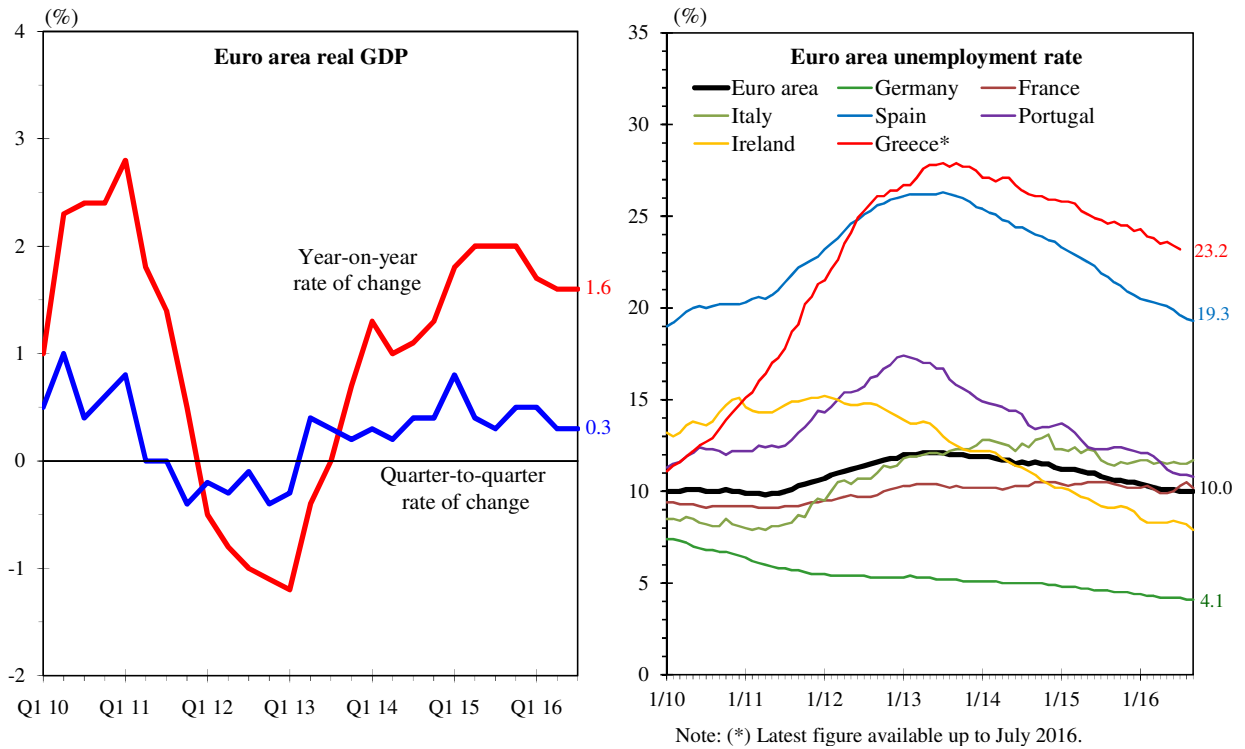
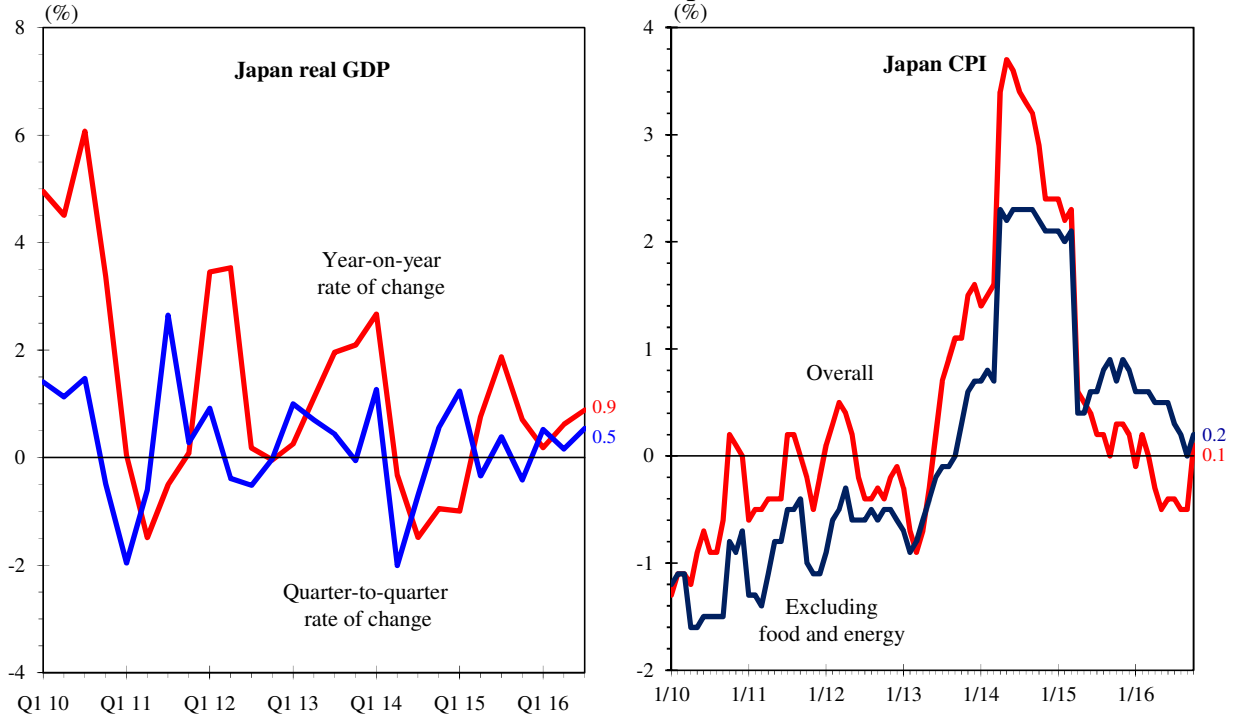


Chart 18 : Japan's economic performance remained subdued and deflation risks prevail

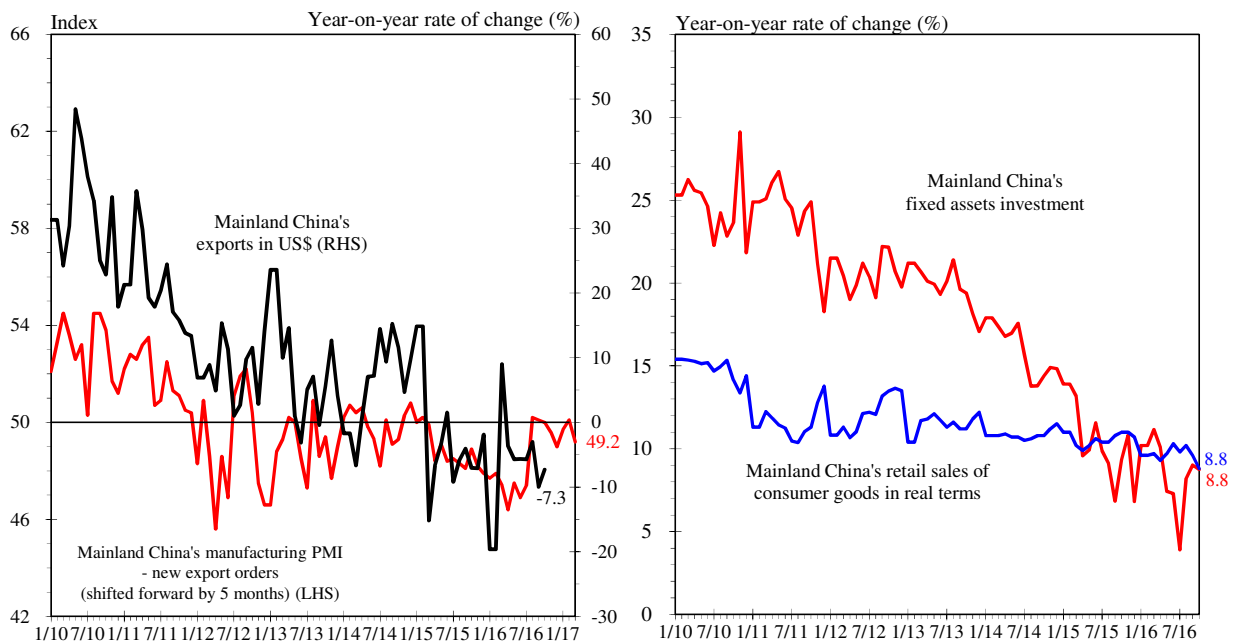


30. The euro area economy grew by 1.6% in the third quarter over a year earlier, broadly similar to the modest growth picture in the first half of the year (*Chart 17*), but its economic outlook continues to face challenges. The Brexit event is still unfolding, and the future negotiations between the EU and UK could be bumpy, with possible wider repercussions on the global economic and financial environment. Apart from the Brexit event, deep-seated structural impediments, such as the overhang of debt and high unemployment rate, as well as risks stemming from non-economic factors, such as heightened geopolitical tensions, the mass influx of migrants and terrorist attacks, add uncertainties over the region's growth prospects.

31. Japan's economic performance remained subdued (*Chart 18*), marked by sluggish private consumption. In view of this, Japan's government had postponed the plan for consumption tax hike from 2017 to 2019 and set forth a new package of fiscal stimulus. The effects of these measures remain to be seen, given the sustained structural issues.

32. Emerging Asian economies generally have relatively sound fundamentals, and the Mainland will continue to be a key pillar in propelling global economic growth. The Mainland economy grew by 6.7% in the first three quarters from a year earlier on the back of solid domestic demand expansion, and the official annual growth target of 6.5-7% in 2016 should not be difficult to attain (*Chart 19*). In the near term, the economic situation in the Mainland may still be affected by the external uncertainties, as well as the ongoing economic restructuring. Yet, the Mainland authorities have ample policy room to keep economic growth at a medium-to-high pace.

Chart 19 : The Mainland economy grew steadily in the first three quarters, amid solid domestic demand expansion



33. On monetary environment, the market generally expects the US to raise interest rates in December. The broad direction of interest rate normalisation in the US is expected to continue, but its pace still hinges on such factors as the future US economic performance and fiscal policy stance under the new administration as well as the global financial market conditions, which are still subject to uncertainties. In contrast, the European Central Bank and the Bank of Japan (BOJ) have already set their short-term interest rate targets below zero, and continued to signal the possibility of further monetary easing if necessary. The BOJ even set the 10-year government bond yield target at around zero. Uncertainties arising from monetary policy divergence among major central banks and the possible side-effects of negative interest rate policies could interact with other economic and non-economic factors, resulting in sudden reversals in capital flows, and thereby triggering volatility in the global financial markets.

34. In sum, the global economy still faces challenges, including the uncertainties associated with US interest rate normalisation, the monetary policy divergence among central banks, the policy stance under the new US administration, the uncertain developments of Brexit, fragile economic recovery in the euro area and Japan as well as heightened geopolitical tensions in various parts of the world. As such, the performance for Asian trade and our exports may also feel the pinch.

35. On the domestic front, the favourable job and income conditions have been vital factors underpinning the resilience of domestic demand, which has been a key growth impetus for the economy in the past period. The improvement of inbound tourism, if continued, would also help stabilise retail sales business.

36. In view of various external uncertainties, we need to stay alert to the potential risks of abrupt gyrations in global financial markets and their ramifications on local economic sentiment. To provide support to the tourism industry and enhance the attractiveness and competitiveness of Hong Kong, a series of short, medium and long-term measures were introduced in the 2016-17 Budget. The Government will strive to facilitate the tourism industry to move towards diversified and high value-added services, with a view to attracting more high-spending overnight visitors to Hong Kong.

37. The Government will closely monitor the developments on the domestic and external fronts, take into account the relevant factors, and announce the economic forecasts for 2017 along with the 2017-18 Budget in February next year. For reference, the economic growth forecast for Hong Kong in 2017 by private sector analysts mostly range from 1.1% to 2.0%, averaging around 1.5%.

38. The inflation outlook of Hong Kong in 2017 will continue to hinge on a host of factors, including the global economic growth, exchange rate, international commodity price trends, inflation in our major imported sources and local costs. Externally, import prices have remained soft recently amid a still-modest global inflation and a stronger US dollar. Coupled with generally benign local inflation pressures, the upward pressures on inflation are limited in the near term. The Government will monitor the various external and domestic factors shaping inflation developments, including property market developments after the latest round of demand-side management measures, as well as the effects of the volatile international energy and food prices. For reference, the 2017 headline consumer price inflation forecasts by private sector analysts averaged around 2.0%.

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 household income and employment earnings

2. The labour market held largely stable in overall terms in 2016 so far, and remained at a state of full employment. On a year-on-year comparison, total employment in August – October 2016 increased by 1.0%, while the seasonally adjusted unemployment rate stayed at 3.4% for eight consecutive periods. Median household income, a reflection of the overall income, increased by 3.7% year-on-year in the third quarter of 2016, or 0.6% in real terms after adjusting for inflation.

3. Wages and earnings sustained steady growth. The average employment earnings of full-time employees (excluding bonus) increased by 5.2% year-on-year in the third quarter of 2016, or 2.0% in real terms. Meanwhile, the average employment earnings of full-time unskilled employees grew by 5.3% year-on-year. After netting out inflation, there was a real improvement of 0.8%. For higher-skilled staff, in June 2016, the Salary Index for Managerial and Professional Employees indicates that employees in the same company and occupation enjoyed nominal and real salaries growth of 5.2% and 2.9% 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 household income / employment earnings indicators
(year-on-year rate of change (%))**

Period		Median monthly household income		Overall employment earnings of employees*		Employment earnings of unskilled employees [^]		Salaries of managerial and professional employees [~]	
2013	Q1	6.4	(2.6)	3.2	(-0.4)	6.2	(2.0)		
	Q2	7.8	(3.7)	3.2	(-0.7)	7.2	(2.5)	6.0	(2.2)
	Q3	10.2	(4.7)	5.4	(@)	5.7	(-1.6)		
	Q4	6.7	(2.3)	4.8	(0.4)	7.4	(2.9)		
2014	Q1	4.5	(0.4)	4.6	(0.4)	7.1	(2.7)		
	Q2	2.3	(-1.3)	6.3	(2.5)	6.0	(2.1)	5.3	(1.8)
	Q3	4.0	(-0.9)	6.1	(1.2)	6.7	(-0.5)		
	Q4	5.8	(0.7)	5.6	(0.5)	6.9	(@)		
2015	Q1	6.5	(2.1)	5.9	(1.5)	5.3	(-0.8)		
	Q2	7.1	(4.1)	4.1	(1.2)	6.4	(2.1)	5.7	(3.8)
	Q3	6.4	(3.8)	6.4	(3.7)	8.0	(4.6)		
	Q4	3.3	(1.0)	7.0	(4.6)	6.5	(3.9)		
2016	Q1	2.0	(-0.7)	3.5	(0.7)	6.1	(2.9)		
	Q2	3.7	(1.1)	3.7	(1.1)	5.1	(2.3)	5.2	(2.9)
	Q3	3.7	(0.6)	5.2	(2.0)	5.3	(0.8)		

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%.

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

4. In the third 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 59 500. The corresponding proportion in total domestic households was 2.4%⁽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 4.9% in the third quarter of 2003 to 3.4% in 2008 over the same period. After the outbreak of the global financial tsunami in late 2008, the corresponding proportion rose back to 3.9% in the third 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 2.4% in the third quarter of

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

2016, which was slightly higher than a year ago (by 0.1 percentage point), 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>
Q3 2003	3 000 (0.1)	102 000 (4.8)	105 000 (4.9)	125 600 [3.8]
Q3 2008	2 400 (0.1)	75 300 (3.3)	77 700 (3.4)	87 000 [2.5]
Q3 2009	1 700 (0.1)	89 000 (3.9)	90 800 (3.9)	104 300 [3.0]
Q3 2010	1 500 (0.1)	68 700 (2.9)	70 200 (3.0)	79 300 [2.3]
Q3 2011	3 500 (0.1)	52 900 (2.2)	56 400 (2.4)	62 900 [1.8]
Q3 2012	3 400 (0.1)	58 100 (2.4)	61 500 (2.6)	66 500 [1.9]
Q3 2013	4 200 (0.2)	62 800 (2.6)	67 100 (2.8)	74 000 [2.1]
Q3 2014	5 800 (0.2)	53 800 (2.2)	59 600 (2.4)	64 900 [1.8]
Q3 2015	3 600 (0.1)	52 500 (2.1)	56 100 (2.3)	62 800 [1.7]
Q3 2016	6 500 (0.3)	53 100 (2.1)	59 500 (2.4)	65 400 [1.8]

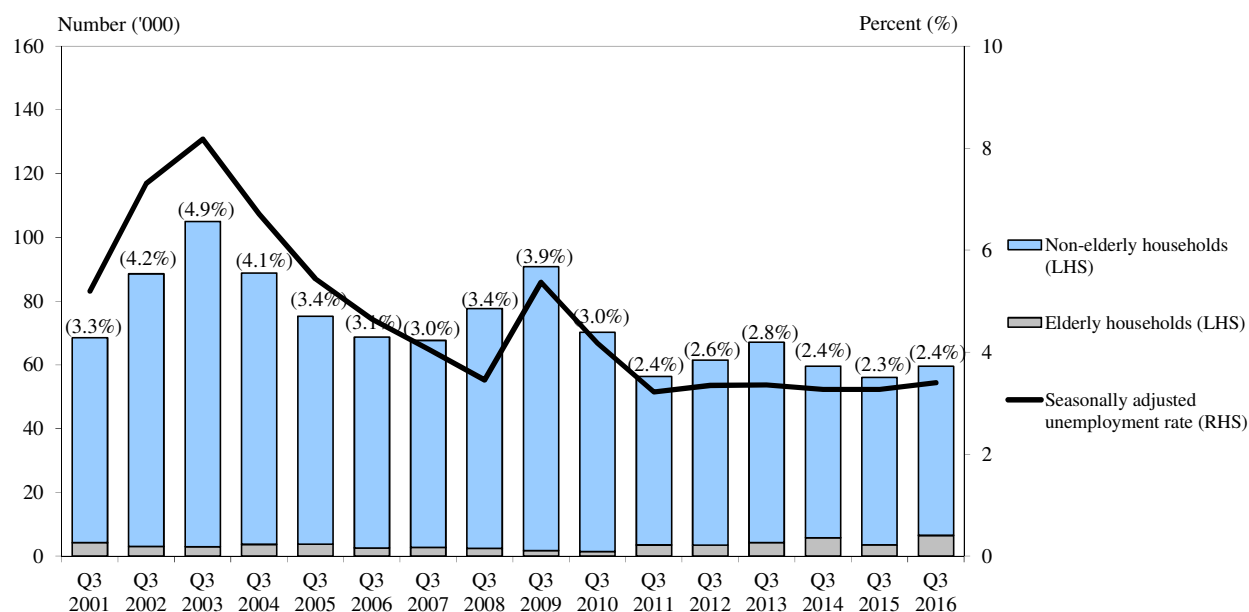
Notes : (*) Low-income households refer to households with monthly household income less than \$7,600 at constant Q2 2015 prices. This does not include households with all members being economically inactive.

(#) 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(*)



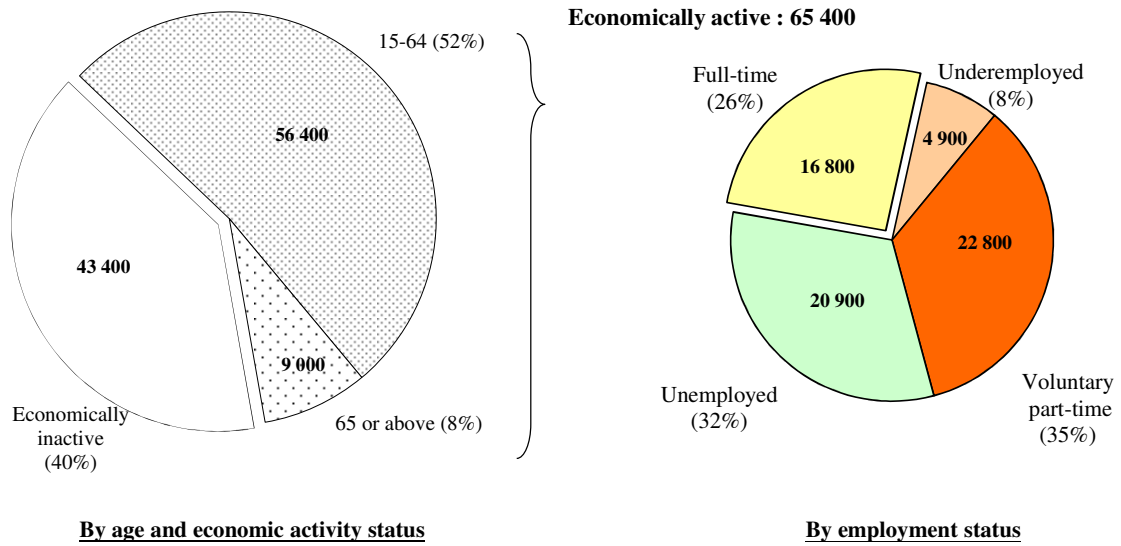
Notes : (*) Low-income households refer to households with monthly household income less than \$7,600 at constant Q2 2015 prices. This does not include households with all members being economically inactive. Figures in brackets are the proportions of low-income households in all domestic households.

Socio-economic characteristics of low-income households

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

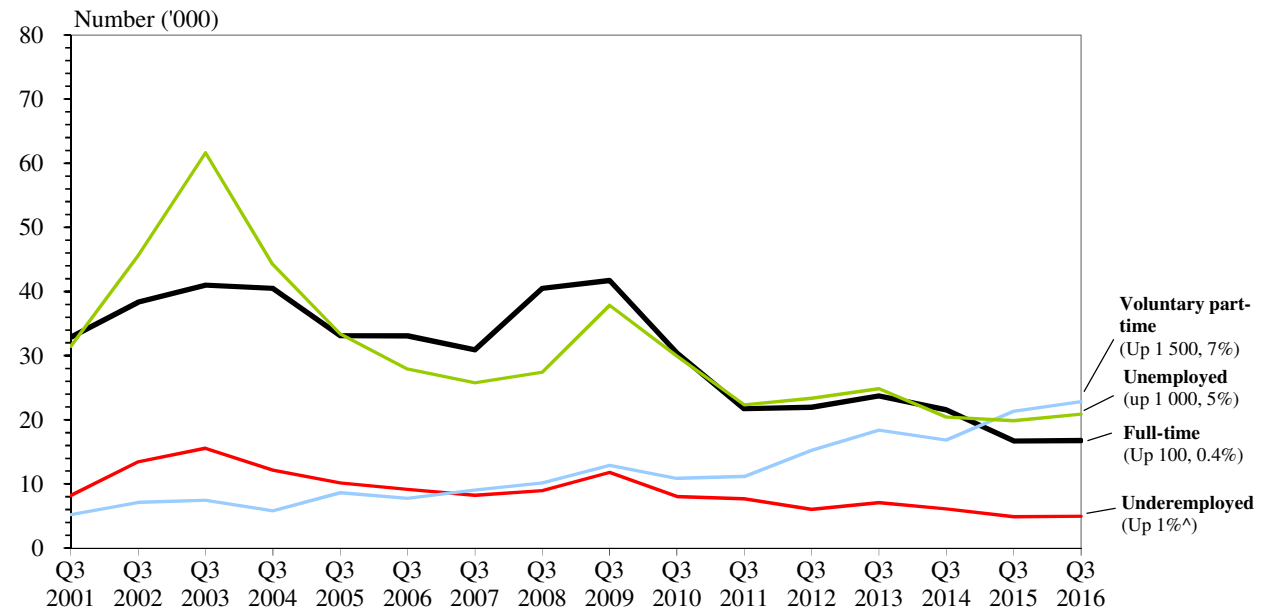
- 108 800 persons were residing in the households in question, among whom 65 400 were economically active. Most of these individuals (56 400 or 86%) were persons aged 15-64, with the majority within the age group of 40-64 (41 900 or 64%), whilst those aged 65 or above amounted to 9 000 (14%).
- The remaining 43 400 persons were economically inactive. 19 500 of them (45%) 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 65 400 economically active persons, 26% were full-time workers, while the respective proportions for voluntary part-timers, unemployed and underemployed were 35%, 32% and 8% (**Chart 2**). Among these, the number of voluntary part-timers rose by 7% over a year ago (**Chart 3**).

Chart 2 : Persons living in low-income households* by age and economic activity status, Q3 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.

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 Q3 2016.

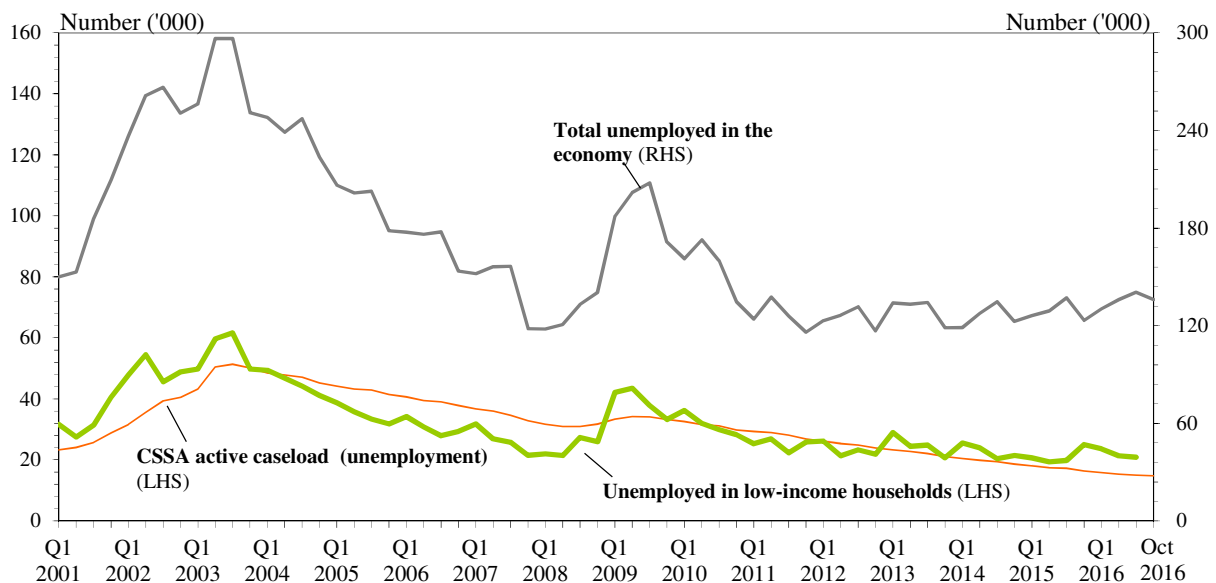
(^*) Increases or decreases in the number of persons less than 50. Such statistics are not shown.

- Analysed by occupation, the majority of the employed persons living in low-income households (87%) were lower-skilled workers (among whom 40% were elementary workers, and 28% 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 (12 000 or 27%), followed by repair, laundry, domestic and other personal service activities (4 900 or 11%).

The number of CSSA cases

7. The lower-skilled unemployment rate in August – October 2016 remained at 3.4%, the same level as a year ago. Meanwhile, the number of overall CSSA caseload declined for the 67th consecutive month, by 7 256 (or 2.9%) to 238 836 in October 2016 as compared to a year earlier. The decrease in unemployment cases was even more distinct, down by 2 166 (or 12.7%) to 14 825 over the same period (*Chart 4*), decreasing for 86 consecutive months. This indicates that some grassroots workers were 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 to job-seekers, and assist needy persons who cannot provide for themselves through the social security system on a reasonable and sustainable basis. 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. Amid a largely stable labour market, the prevailing unemployment rate is still at a relatively low level, and increases in earnings at varied paces have been observed for citizens from different segments. 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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Financial Secretary’s Office
28 November 2016