



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

The Government released the Third Quarter Economic Report 2018 on 16 November 2018. The Economic Report, together with the press release containing the updated economic forecasts for the whole year of 2018, have been furnished to LegCo Members.

This paper analyses Hong Kong's overall economic development in the most recent period as well as outlook in the near term, and provides some preliminary analysis on the outlook for 2019.

Office of the Government Economist  
Financial Secretary's Office  
10 December 2018

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

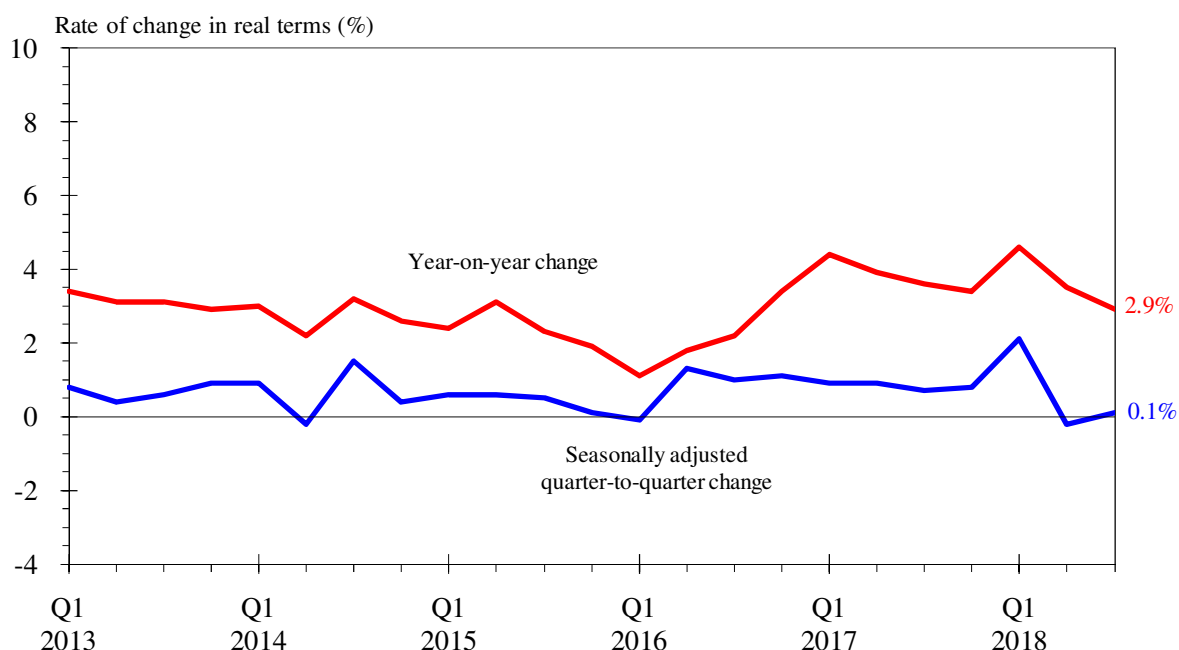
## Introduction

This paper analyses the recent development of the Hong Kong economy, and provides some preliminary analysis on the outlook for 2019.

## Recent economic situation

2. The Hong Kong economy expanded solidly by 2.9%<sup>(1)</sup> in the third quarter of 2018. While marking the eighth consecutive quarter of above-trend growth, it moderated from the 4.1% growth in the first half of the year. External demand continued to grow visibly for the third quarter as a whole alongside further expansion in the global economy. Domestic demand held firm. On a seasonally adjusted quarter-to-quarter comparison, real GDP grew by 0.1% in the third quarter (*Chart 1*). In the first three quarters of 2018 combined, the economy grew by 3.7% over a year earlier.

**Chart 1 : The Hong Kong economy expanded solidly in the third quarter of 2018**



(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 changes in real terms.

## External trade

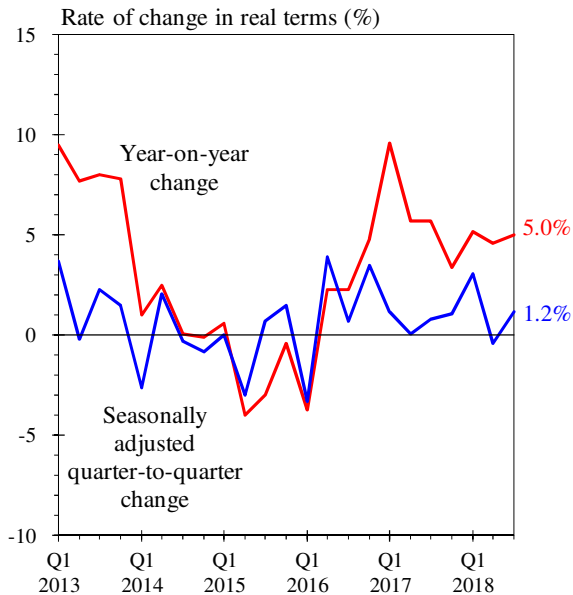
3. Global economic growth remained visible in the third quarter of 2018, but has lost some momentum as compared to the first half of the year. The US-Mainland trade conflicts have weighed on global economic sentiment and activities, as evidenced by corrections of the major stock markets and slower growth in the EU and many Asian economies. These, together with the continued normalisation of monetary policy in major advanced economies, particularly in the US, have led to a reversal in international capital flows and heightened global financial volatility, and exerted intense pressures on some emerging market economies with weak fundamentals such as Argentina and Turkey earlier this year. Against this backdrop, the International Monetary Fund (IMF) revised down its 2018 global economic growth forecast to 3.7% in October (as compared to 3.9% in July), and considered that there had been increased downside risks to global economic outlook .

4. Despite an increasingly challenging external environment, Hong Kong's total exports of goods continued to grow notably by 5.0% in the third quarter (*Chart 2(a)*). Exports to most major markets showed growth of varying degrees for the third quarter as a whole. Exports to the US grew visibly alongside strong economic expansion there. While those re-exports of Mainland origin to the US affected by the additional tariffs imposed in July and August saw notable deceleration in August and September, they constituted only about 15% of Hong Kong's total exports to the US. Exports to the EU also grew visibly amid sustained economic growth in the region. Meanwhile, exports to most Asian economies increased further. Specifically, exports to the Mainland, India, Vietnam and Korea grew visibly, while those to Singapore recorded solid growth. On the other hand, exports to Japan and Taiwan showed some declines. Entering the fourth quarter, the value of merchandise exports re-accelerated in growth in October after some slowdown in September. The direct impacts of the US-Mainland trade tensions on Hong Kong's overall export performance have been limited so far, but developments going forward are subject to many uncertainties, especially the progress of trade negotiations between China and the US.

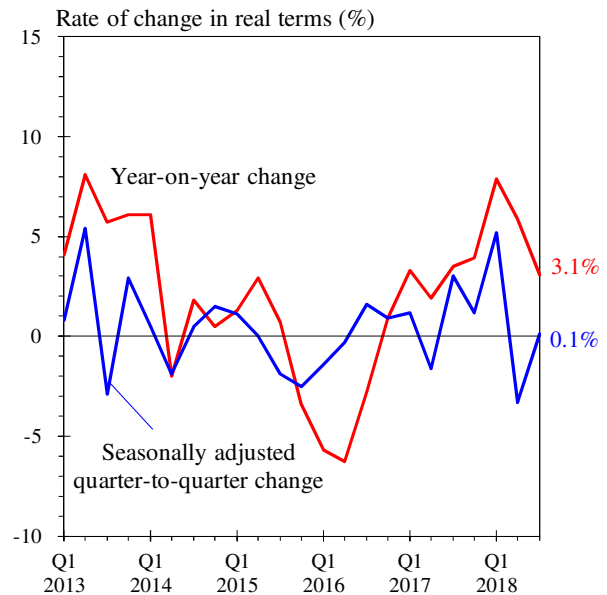
5. Exports of services expanded at a moderated pace of 3.1% in the third quarter, after a 5.9% growth in the preceding quarter (*Chart 2(b)*). Underpinned by visible expansion in inbound tourism, exports of travel services grew solidly, albeit at a moderated pace. Visitor arrivals in July – October increased by 9.2% on a year-on-year basis. Against a backdrop of heightened external uncertainties and slower momentum of cross-border financial activities, exports of financial services grew moderately, whereas exports of transport services and business and other

services recorded only modest increases.

**Chart 2(a) : Total exports of goods continued to grow notably**



**Chart 2(b) : Exports of services expanded at a moderated pace**

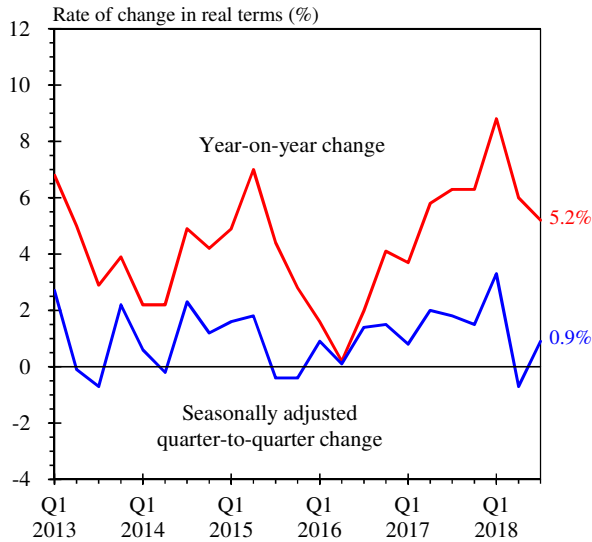


## Domestic sector

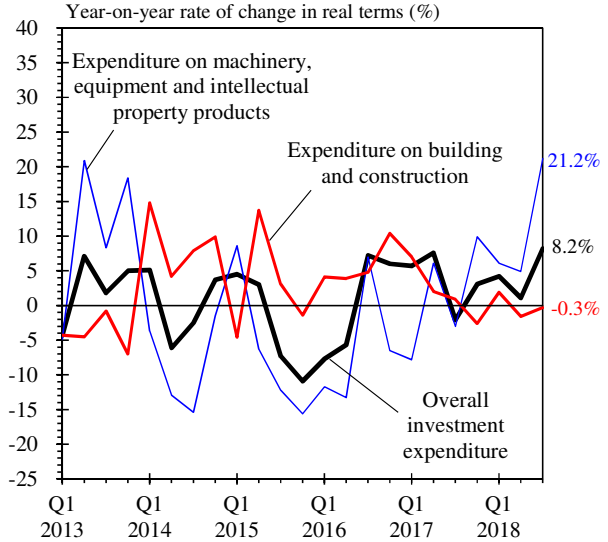
6. Domestic demand remained largely resilient in the third quarter of 2018. Private consumption expenditure grew notably by 5.2%, albeit moderating somewhat from the exceptionally strong growth of 7.4% in the first half of the year (**Chart 3(a)**). Local consumer sentiment continued to be buttressed by further solid growth in wages and earnings amid favourable labour market conditions, though the wealth effect had turned less supportive amid the stock market corrections.

7. Overall investment spending in terms of gross domestic fixed capital formation recorded a much faster growth of 8.2% in the third quarter, following the 1.1% increase in the preceding quarter (**Chart 3(b)**). Within the total, machinery and equipment acquisition, which is usually volatile, surged from a low base of comparison in the same quarter last year. Meanwhile, overall building and construction expenditure recorded a narrower decline. In the first three quarters of the year combined, gross domestic fixed capital formation grew by 4.5%.

**Chart 3(a) : Private consumption expenditure expanded notably**



**Chart 3(b) : Investment spending recorded a much faster growth**

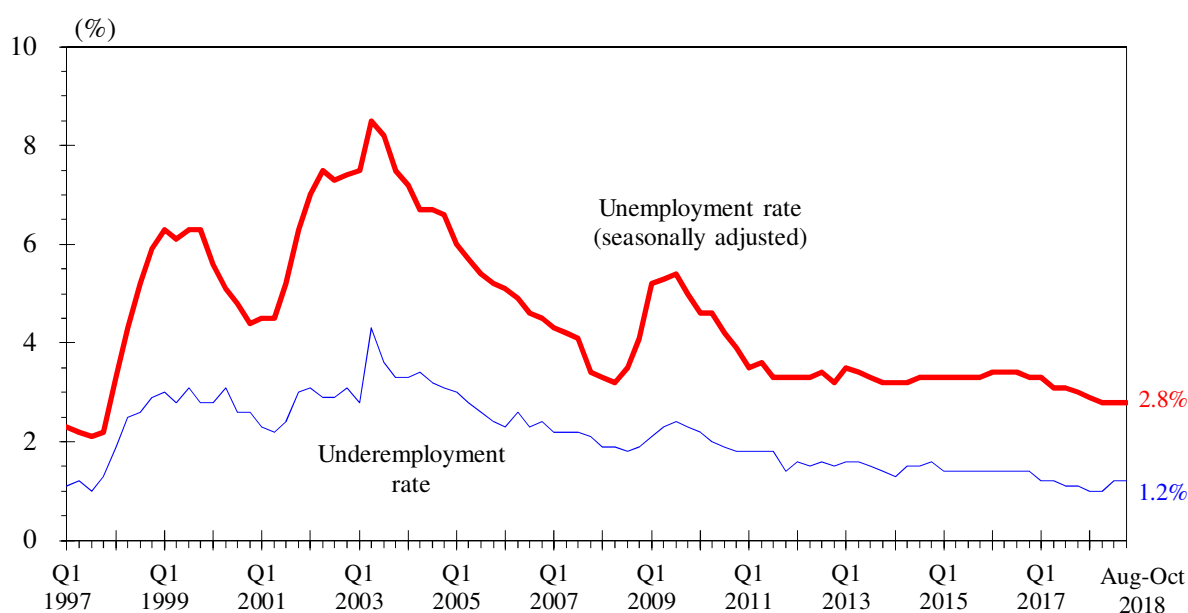


8. As for external direct investment (DI), the total position of external DI liabilities amounted to HK\$17.6 trillion at end-June 2018, equivalent to 6.3 times of GDP. According to latest available figures, at end-2017 the Mainland continued to be a major source of inward DI, accounting for around 25% of total position. Separately, the number of business operations in Hong Kong with parent companies either overseas or in the Mainland climbed to a new high of 8 754 as at 1 June according to the survey results for 2018, reflecting our business friendly environment as well as our prominent role as a conduit between the Mainland and the rest of the world. Hong Kong was ranked the world’s fourth easiest place to do business by the World Bank’s latest Doing Business Report.

## Labour Market

9. The labour market remained tight, with the seasonally adjusted unemployment rate staying at 2.8% in August – October 2018, the lowest level in 20 years. The underemployment rate also stayed low at 1.2% (**Chart 4**). Riding on the solid expansion of the local economy, total employment grew solidly and the number of private sector vacancies also increased further, reflecting that the labour demand stayed sturdy.

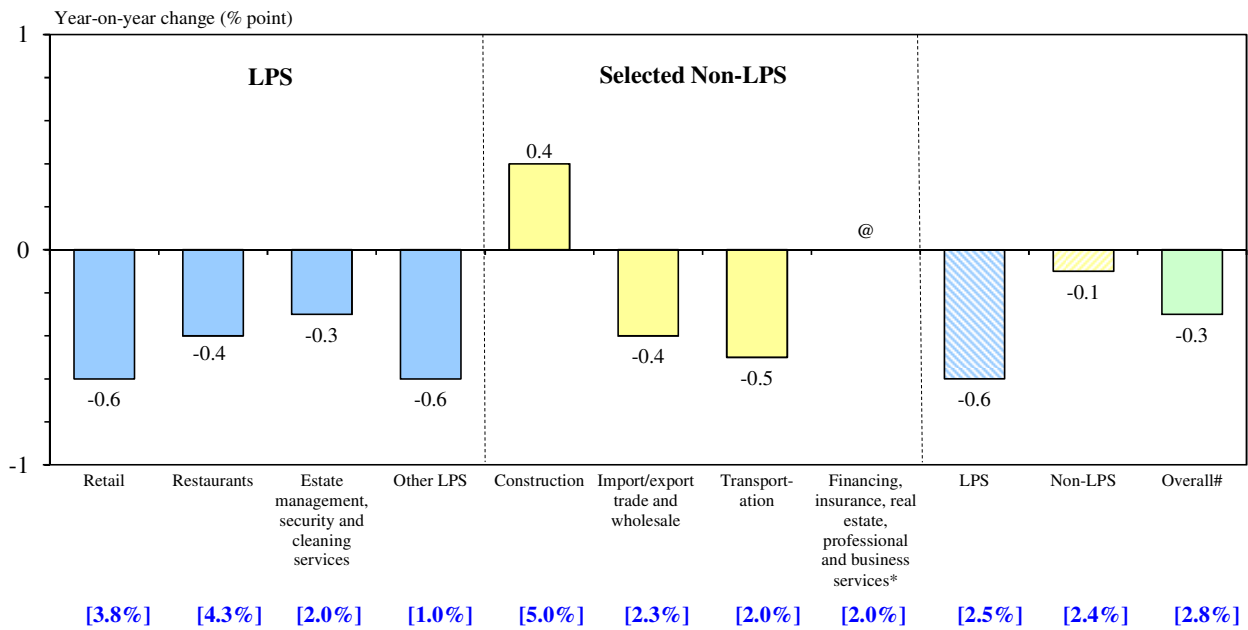
**Chart 4 : The labour market remained tight**



10. The Hong Kong economy has witnessed sustained expansion since the implementation of Statutory Minimum Wage (SMW), thereby relieving to a large extent the potential impact on the labour market brought about by SMW. In August – October 2018, the unemployment rate of the low paying sectors (LPS)<sup>(2)</sup> as a whole declined by 0.6 percentage point from a year earlier to 2.5%, and that of the non-LPS by 0.1 percentage point to 2.4% (**Chart 5**). Analysed by skill segment, the unemployment rate of the higher-skilled segment was at 1.8%, little changed from its year-ago level, while that of the lower-skilled segment, at 2.9%, was 0.4 percentage point lower than a year earlier.

(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 : Unemployment rates of most sectors declined from a year earlier**



Notes: Figures in square brackets refer to the unemployment rate for that sector in Aug-Oct 2018 (provisional figures).

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

(#) Seasonally adjusted, and including first-time job-seekers and re-entrants into the labour force.

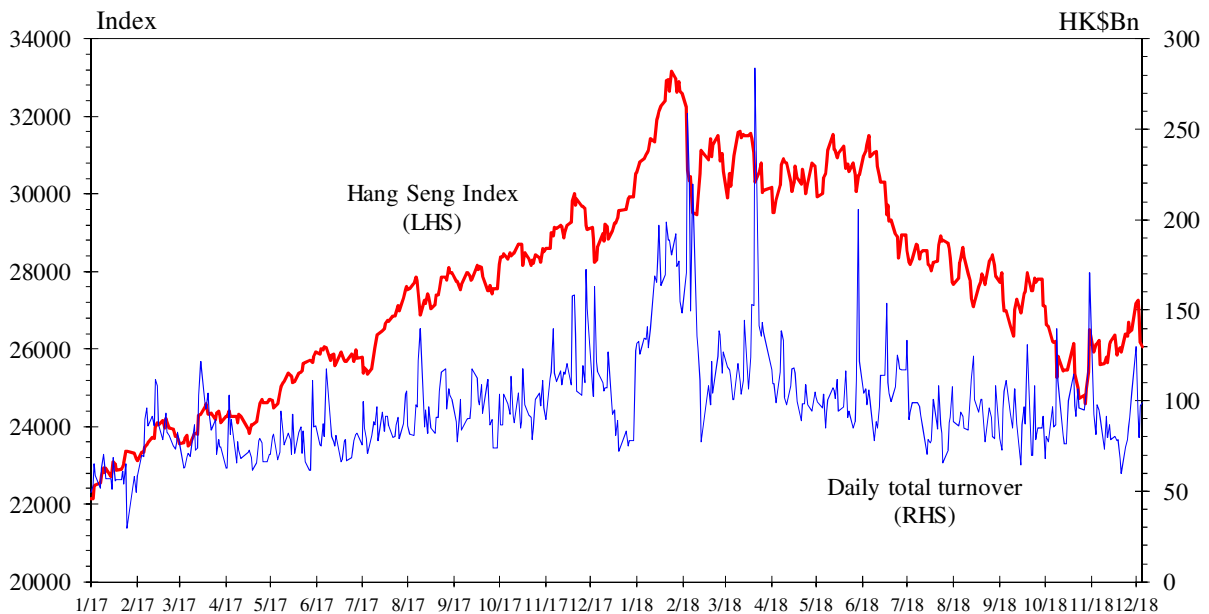
(@) Change less than 0.05 percentage point.

11. Wages and earnings registered further solid and broad-based increases amid favourable labour market conditions. Compared to a year earlier, both nominal wages in June and nominal payroll in the second quarter rose by 3.8%, translating into real increases of 1.2% and 1.6% respectively after netting out inflation. More recent data showed that income of lower-paid workers stayed on the rise, with the average monthly employment earnings of full-time employees (excluding foreign domestic helpers) in the lowest three income-decile groups combined rising by 4.2% in nominal terms or 1.3% in real terms in the third quarter. For the overall income situation, underpinned by the solid growth in employment and labour earnings, the median monthly household income (excluding foreign domestic helpers) increased markedly by 8.7% in nominal terms or 6.1% in real terms in the third quarter. (Please refer to *Annex* for details of the recent situation of household income.)

## Asset markets

12. The local stock market has been under pressure after reaching a record high in January 2018, as market sentiment was hit by rising external uncertainties. Despite stabilising somewhat in the past several weeks, the Hang Seng Index closed at 26 064 on 7 December, still down by 10.0% from end-June or 21.4% from its peak in late January. Average daily turnover fell from \$106.8 billion in the second quarter to \$91.9 billion in the third quarter, and was at \$91.8 billion in October and November combined (*Chart 6*).

**Chart 6 : Local stock market has come under pressure after reaching a record high in late January 2018**

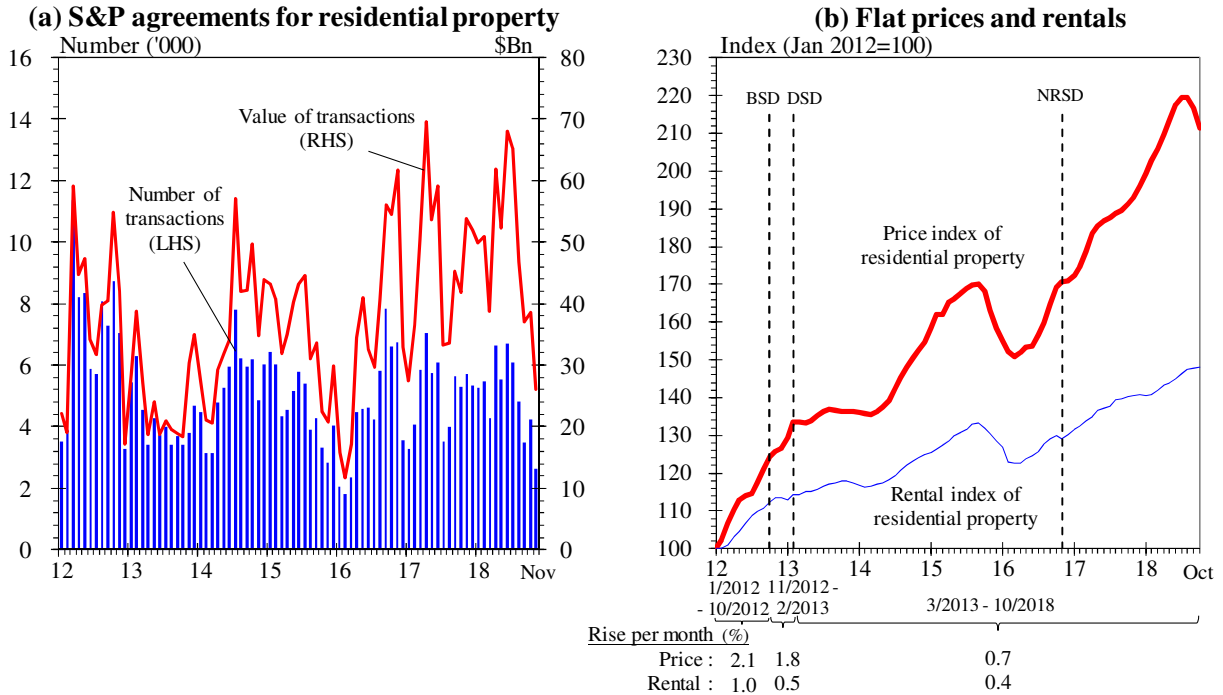


13. The residential property market has consolidated since August amid the escalating US-Mainland trade conflicts, global stock market corrections, rising local interest rate and other factors. The monthly average number of sale and purchase agreements for residential property received by the Land Registry declined to 3 800 in August to November, much below the monthly average of 5 712 in the first seven months (*Chart 7(a)*).

14. During the first ten months of 2018, flat prices and rentals rose cumulatively by 8% and 5% respectively. Yet, flat prices declined by a cumulative 4% between July and October. Over the same period, flat rentals edged up by 1% (*Chart 7(b)*).

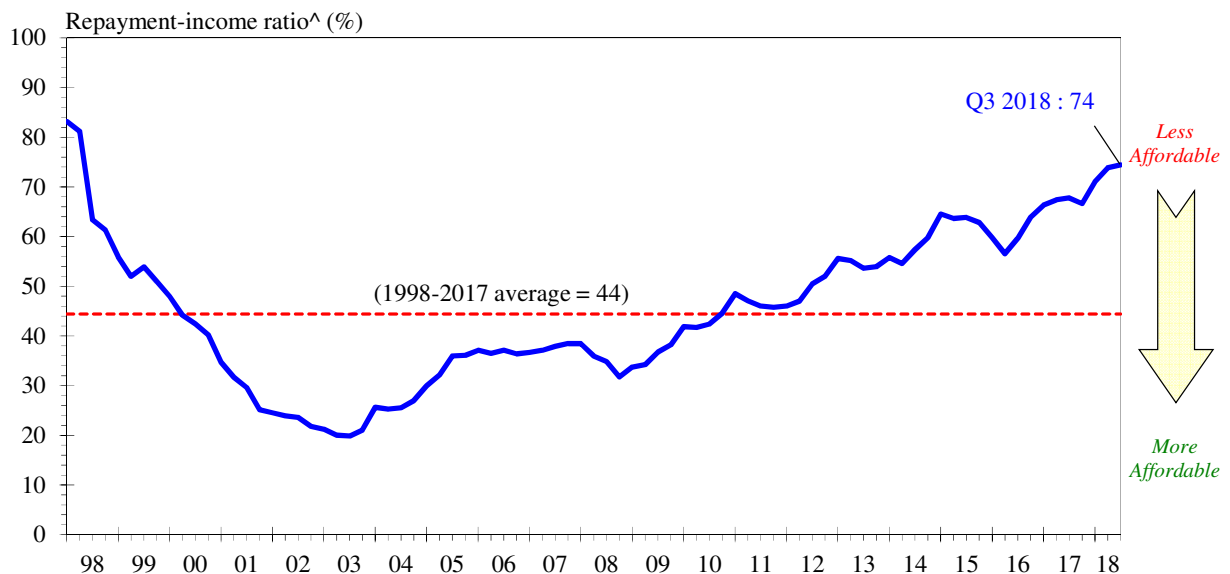


**Chart 7 : The residential property market has consolidated since August**



15. Notwithstanding some decline in recent months, flat prices in October 2018 still exceeded the 1997 peak by 120%. The index of 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) remained elevated at around 74% in the third quarter of 2018, significantly above the long-term average of 44% over 1998-2017 (*Chart 8*). Should local interest rates rise by three percentage points to a more normal level, the ratio would soar to 97%.

**Chart 8 : The index of home purchase affordability remained elevated**

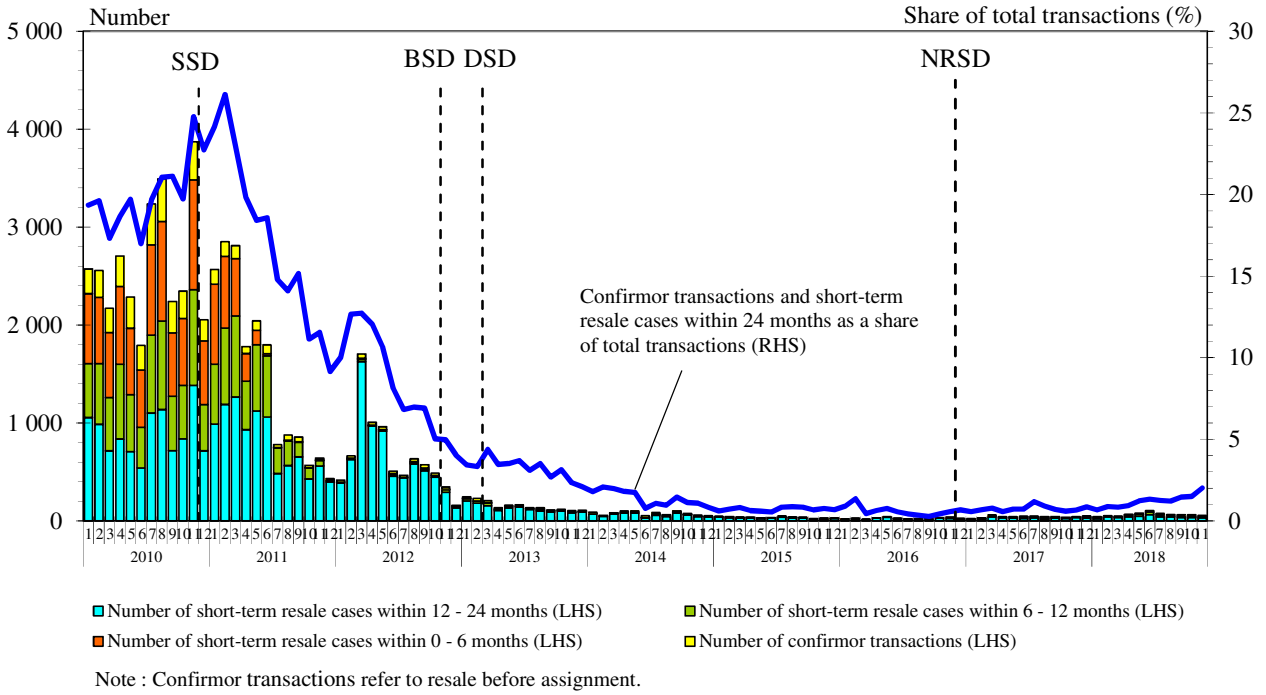


Note : (^) The ratio of mortgage payment for a flat with saleable area of 45 sq m (assuming 70% loan-to-value ratio and tenor of 20 years) to median income of households (excluding those living in public housing). This ratio is different from the debt servicing ratio published by the HKMA, which is the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

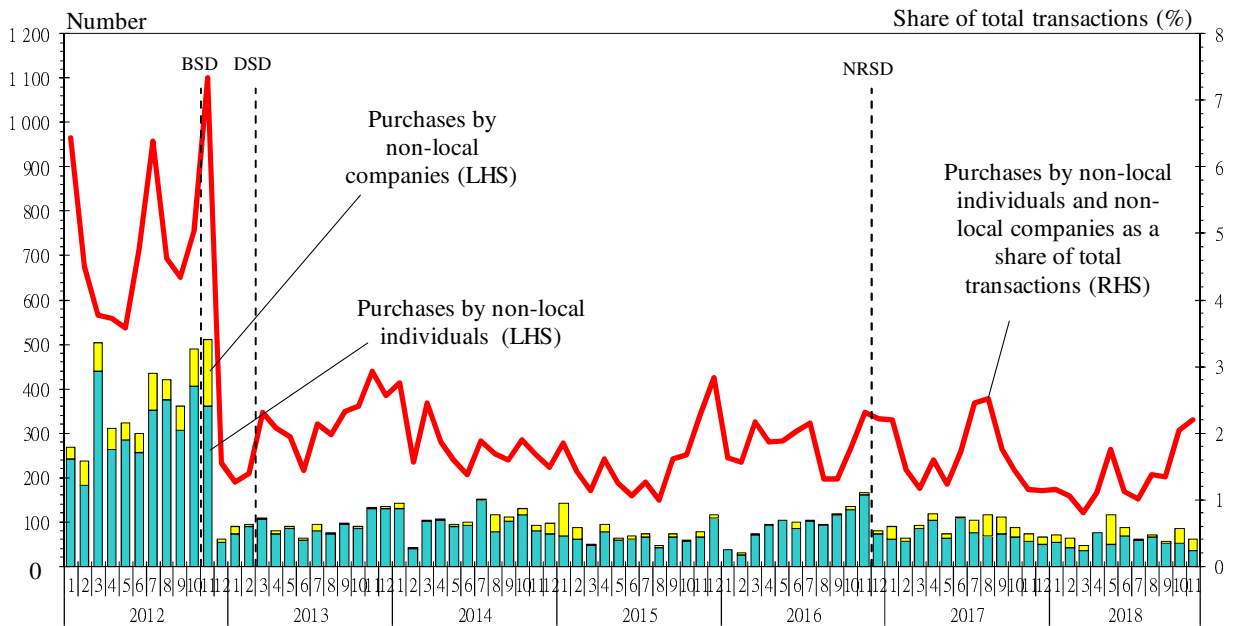
16. Raising flat supply through increasing land supply is a key policy of the Government. In September, the Government announced to put up four residential sites for sale in the fourth quarter of 2018, which are capable of providing a total of about 2 600 flats. Combining the various sources (including Government land sale, railway property development projects, the Urban Renewal Authority's projects, and private development and redevelopment projects), the total private housing land supply in the first three quarters of 2018-19 has an estimated capacity of providing about 9 600 units. 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) stayed at a high level of 93 000 units as estimated at end-September 2018. In October, the Chief Executive announced various measures and plans on housing and land supply in her Policy Address.

17. Over the past several years, the Government has also put forward demand-management measures to dampen investment and speculative demand, and to 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) remained low at 65 cases per month or 1.2% of total transactions in the first eleven months of 2018, 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 effect of the Buyer's Stamp Duty, purchases by non-local individuals and non-local companies also stayed low at 72 cases per month or 1.3% of total transactions in the first eleven months of 2018, much lower than the monthly average of 365 cases or 4.5% in January to October 2012 (*Chart 10*). As an indicator of investment activities, the number of purchases subject to the New Residential Stamp Duty was 624 cases per month or 11.2% of total transactions in the first eleven months of 2018, sharply below the monthly average of 1 412 cases subject to Double Stamp Duty or 26.5% in January to November 2016 (*Chart 11*). As to mortgage lending, the average LTV ratio of new mortgages was 45% in July - October 2018, likewise 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.

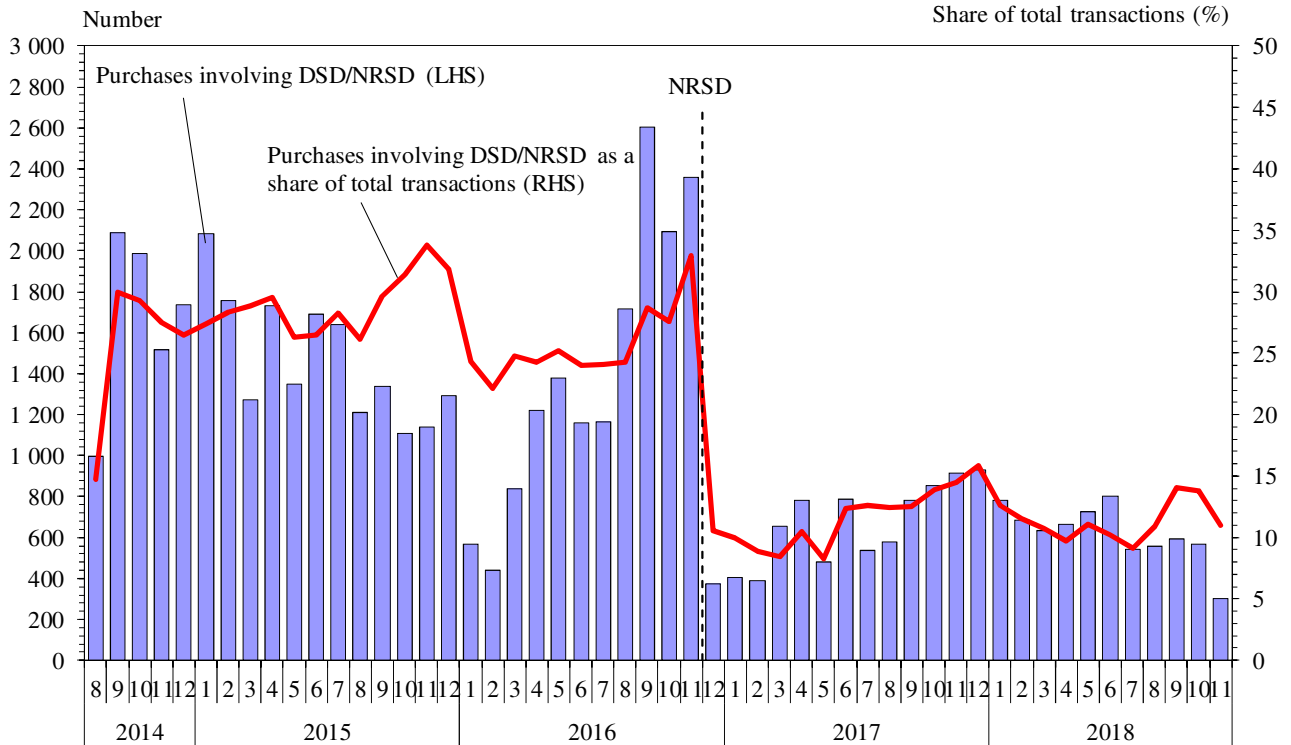
**Chart 9 : Short-term speculative activities stayed subdued**



**Chart 10 : Purchases by non-local buyers remained low**



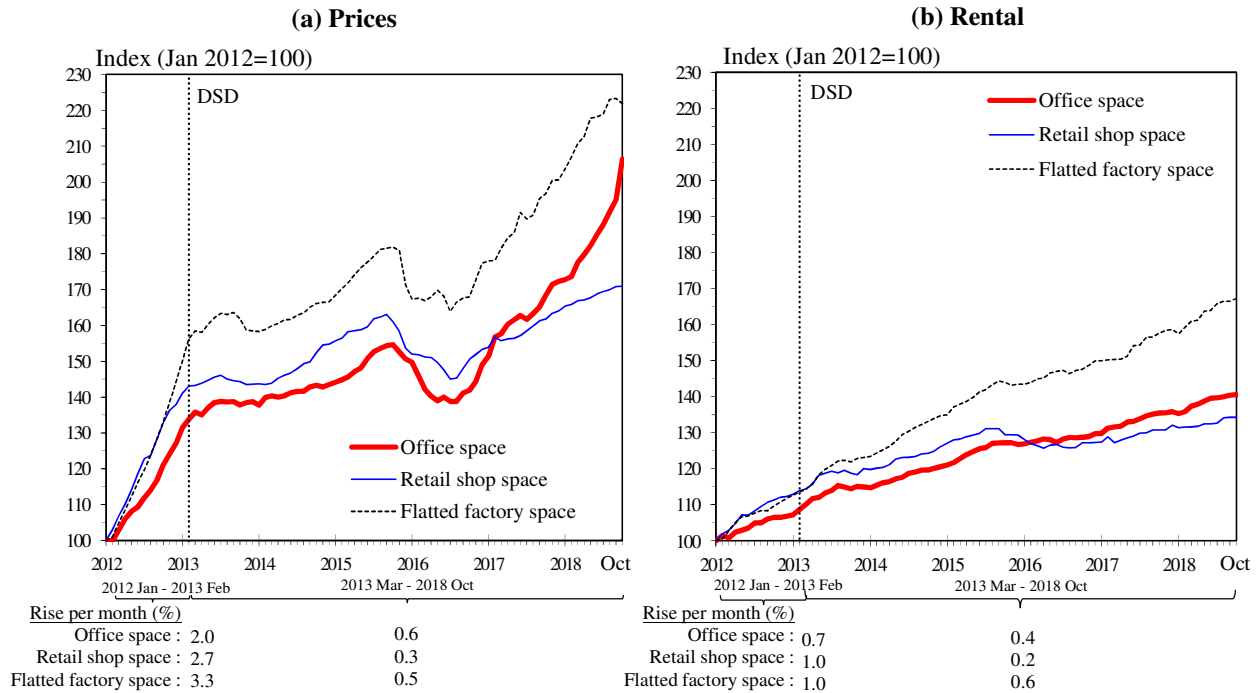
**Chart 11 : Investment activities were modest**



18. Looking ahead, the outlook for the local residential property market would hinge on the changing external and domestic factors. Firstly, the development of the trade conflicts between the US and the Mainland is still fluid for the time being. The global and local economic outlook are still subject to many uncertainties. Furthermore, as the US monetary policy normalisation process continues, local interest rates are bound to rise further under the Linked Exchange Rate System. In late September, shortly after the US Federal Reserve (Fed) raised the target range of its policy rate for the eighth time since late 2015, major commercial banks in Hong Kong raised their Best Lending Rates for the first time in 12 years. On demand-supply balance, the prevailing tight situation would ease over time given the expected increase in residential flat completions in the coming years.

19. On the other hand, the commercial and industrial property markets were rather buoyant in recent months. Sale prices of office space surged by 11% in overall terms between June and October 2018, while office rentals edged up by 1%. For retail shop space, sale prices and rentals both increased by 1% over the same period. As to flatted factory space, sale prices and rentals both rose by 2% (*Chart 12*). Yet, trading activities of these market segments in July to October all showed some retreat from the second quarter.

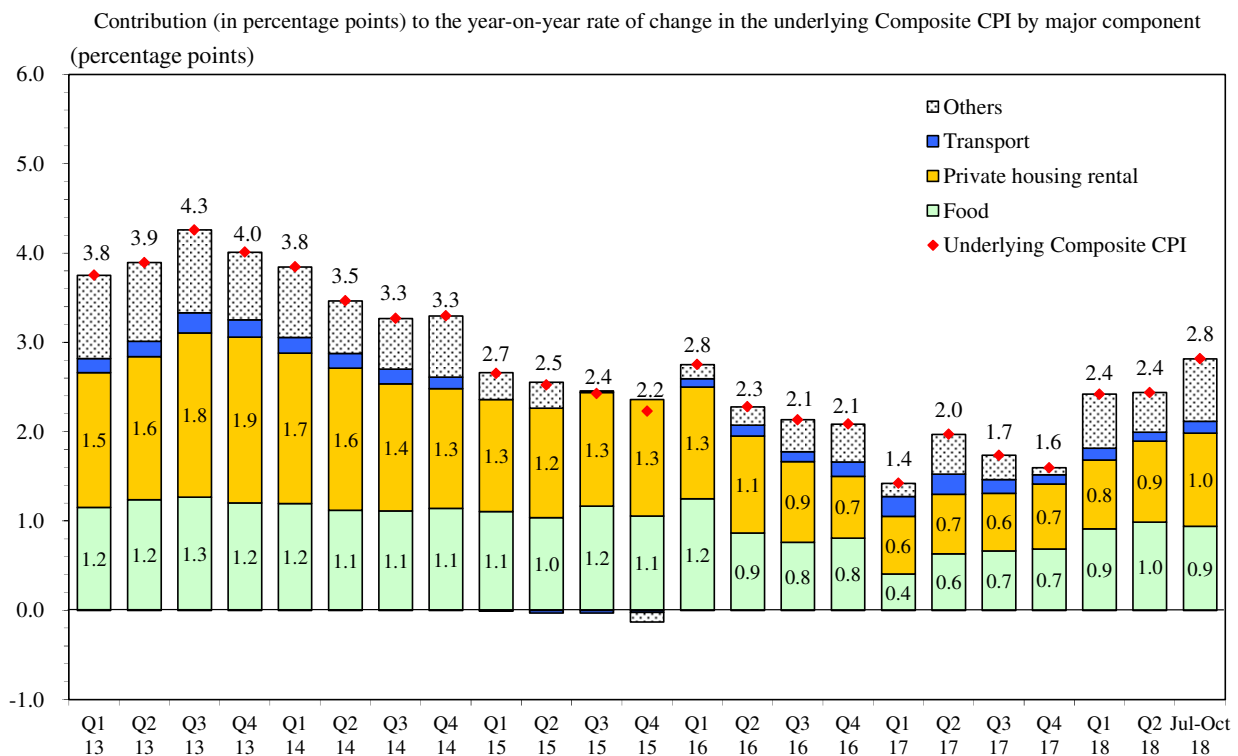
**Chart 12 : Prices and rentals of non-residential properties increased further between June and October**



## Inflation

20. Pressures on consumer prices continued to build up alongside sustained above-trend economic growth. Domestically, fresh-letting residential rentals over the past year or so continued to rise. Local cost pressures on factor inputs, while still largely contained, have turned more visible. Wages and earnings continued to register solid gains, and rental pressures faced by businesses also edged up against the broad uptrend in rentals of retail premises and offices. Meanwhile, external price pressures largely held steady. Against this backdrop, underlying consumer price inflation went up to 2.8% in July – October 2018, from 2.4% in the second quarter, and averaged 2.6% in the first ten months combined (*Chart 13*).

**Chart 13 : Pressures on consumer prices continued to build up**



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.

21. The further build-up of pressures on consumer prices were also reflected in the component-based analysis of the underlying Composite Consumer Price Index (Composite CPI) (*Table 1*). Private housing rent, the single component with the largest weighting in the Composite CPI, increased at a faster rate of 3.4% in July - October 2018 as the fresh-letting residential rentals in the past year or so continued to rise. Public housing rent also showed a larger increase of 5.2%, due to the upward adjustment in public housing rentals in September. Prices of food, the component with the largest weighting other than housing, continued to rise faster than the overall inflation rate in the same period, at 3.4%. The increase in prices of miscellaneous services accelerated to 2.3% in the same period, mainly due to the larger increase in charges for package tours and a reversion to increase in school fees in September 2018. Prices of clothing and footwear rose slightly faster in the same period, and so did prices of miscellaneous goods. On the other hand, prices of durable goods stayed on a downtrend.

**Table 1 : Underlying Composite Consumer Price Index by component  
(year-on-year rate of change (%))**

<u>Expenditure component</u>	<u>Weighting</u> (%)	<u>2017</u>					<u>2018</u>		<u>Jul- Oct</u>
		<u>Annual</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>	
Food	27.29	2.2	1.5	2.3	2.4	2.5	3.3	3.6	3.4
<i>Meals bought away from home</i>	17.74	2.7	2.8	2.7	2.7	2.7	3.0	3.0	2.8
<i>Other foodstuffs</i>	9.55	1.1	-1.1	1.4	2.0	2.2	3.8	4.9	4.5
Housing <sup>(a)</sup>	34.29	2.6	2.7	2.7	2.6	2.4	2.5	2.9	3.6
<i>Private housing rent</i>	29.92	(2.0)	(0.3)	(2.7)	(2.6)	(2.4)	(2.5)	(2.0)	(2.6)
<i>Public housing rent</i>	1.94	6.3	9.9	9.6	6.3	0.1	0.1	0.5	5.2
		(3.0)	(-5.6)	(11.5)	(7.5)	(0.4)	(0.4)	(0.4)	(6.0)
Electricity, gas and water	2.67	-1.7	-5.5	-1.0	-0.3	0.1	8.4	3.5	3.6
		(-1.7)	(-5.5)	(-1.0)	(-0.3)	(*)	(8.3)	(3.7)	(3.9)
Alcoholic drinks and tobacco	0.54	0.6	2.3	1.0	-0.2	-0.6	0.3	0.6	2.1
Clothing and footwear	3.21	-0.4	-1.9	-1.4	1.0	0.6	2.3	2.0	2.2
Durable goods	4.65	-3.2	-3.6	-3.6	-3.3	-2.3	-2.1	-2.1	-1.9
Miscellaneous goods	3.56	1.4	2.3	1.8	0.5	0.9	1.1	1.3	1.5
Transport	7.98	2.3	2.9	2.9	2.0	1.4	1.7	1.3	1.7
Miscellaneous services	15.81	0.9	0.6	2.2	0.9	-0.1	1.7	1.4	2.3
All items	100.00	1.7	1.4	2.0	1.7	1.6	2.4	2.4	2.8
		(1.5)	(0.5)	(2.0)	(1.8)	(1.6)	(2.4)	(2.1)	(2.5)

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.

( ) 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 economic forecasts for 2018

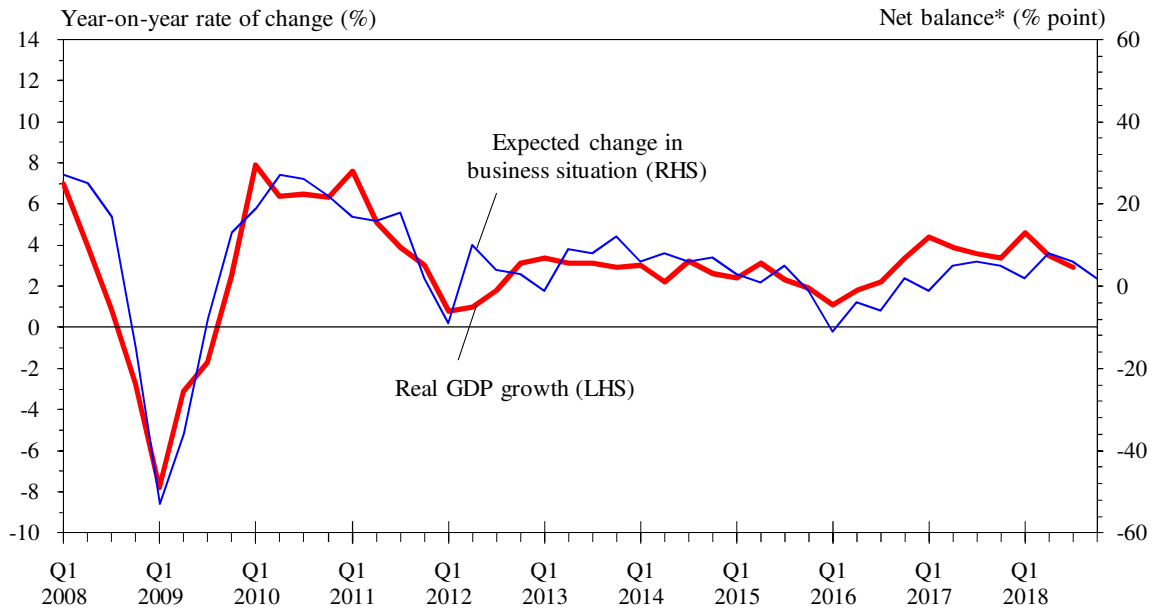
22. The impacts of various external headwinds (such as the US-Mainland trade conflicts, US rate hikes, and volatilities in the global financial markets) on the Hong Kong economy have begun to surface in the third quarter of 2018. After the presidents of China and the US met at the G20 Leaders' Summit in early December, an agreement was reached on temporarily holding off on raising tariffs further, and both sides agreed to continue to negotiate, thereby easing the tense sentiments in global economy and asset markets for the time being. Nevertheless, the moderating growth momentum in the global economy, the additional tariffs imposed by the US and China earlier on, together with many unfavourable factors prevailing in the external environment, could increasingly weigh on Hong Kong's external trade performance in the rest of the year.

23. Domestic demand will be subject to more pressure from the less favourable economic environment. Consumer sentiment, while still being supported by the favourable job and income conditions, could increasingly be affected by the external uncertainties and weaker asset markets. Various surveys also revealed that local business sentiment has become more cautious in recent months (*Chart 14*).

24. Taking into account the actual growth outturn of 3.7% in the first three quarters and the downside risks in the external environment, economic growth for 2018 as a whole is forecast at 3.2% (*Chart 15*), higher than the trend growth rate of 2.7% per annum in the past ten years for the second consecutive year. For reference, the latest forecasts for Hong Kong's economic growth in 2018 by the IMF and private sector analysts ranged from 3.0% to 4.0%.

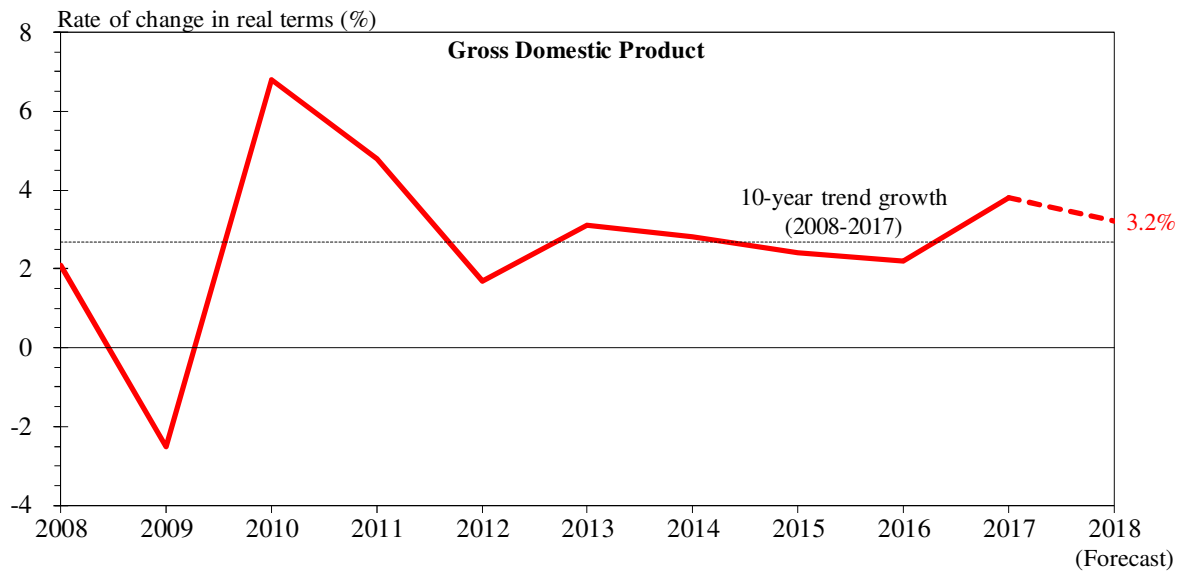


**Chart 14 : Local business sentiment has become more cautious**



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.

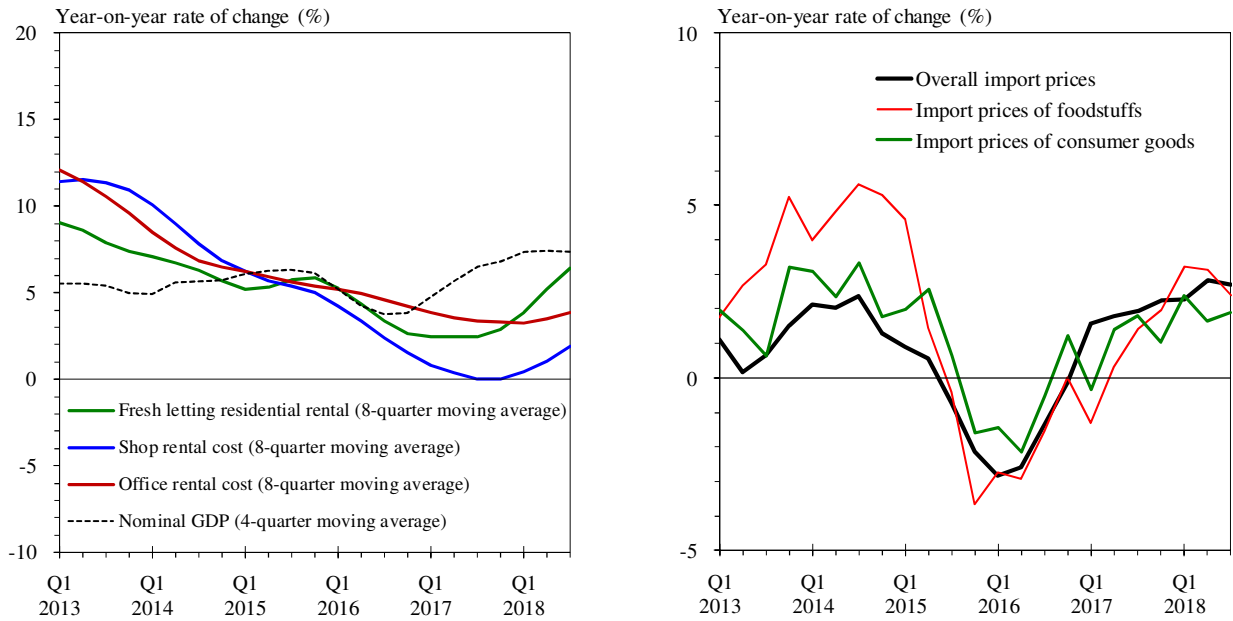
**Chart 15 : Economic growth for 2018 as a whole is forecast at 3.2%**



25. On inflation, the underlying and headline consumer price inflation rates for the first ten months of 2018 averaged 2.6% and 2.4% respectively. The inflation rates may still be subject to some mild upward pressure in the rest of the year, as local costs have increased along with sustained economic expansion, and as the earlier rises in fresh-letting residential rentals would continue to feed through (*Chart 16*). Taking into account the actual outturns so far this year, the underlying

and headline consumer price inflation for 2018 as a whole are forecast at 2.7% and 2.4% respectively. For reference, the forecasts for Hong Kong's consumer price inflation in 2018 by the IMF and private sector analysts ranged from 2.0% to 2.5%.

**Chart 16 : Local costs increased alongside sustained solid economic growth while external price pressures largely held steady**

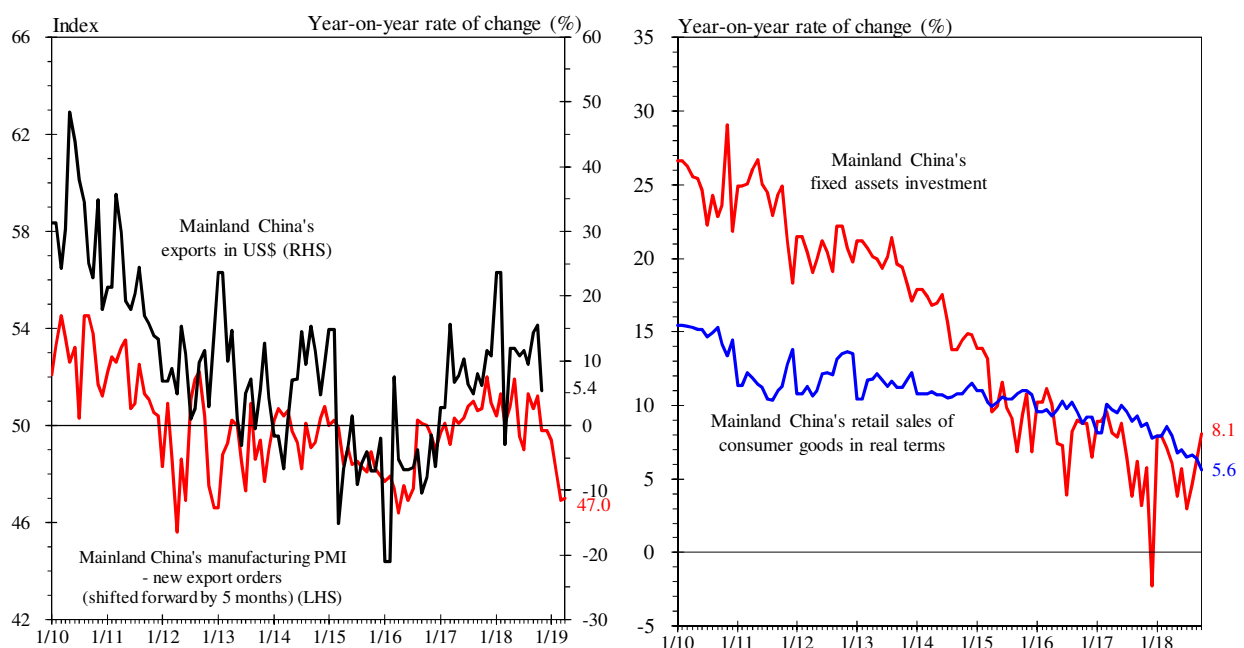


## Economic outlook for 2019

26. The market has turned cautious on the global economic outlook for 2019. In October 2018, the IMF marked down its global economic growth forecast for 2019 by 0.2 percentage point to 3.7%, on par with the forecast for 2018. In particular, the IMF projected that economic growth in the advanced economies as a whole would decelerate to 2.1% in 2019 (as compared to the projected 2.4% in 2018), and that of emerging and developing Asia to 6.3% (as compared to the projected 6.5% in 2018).

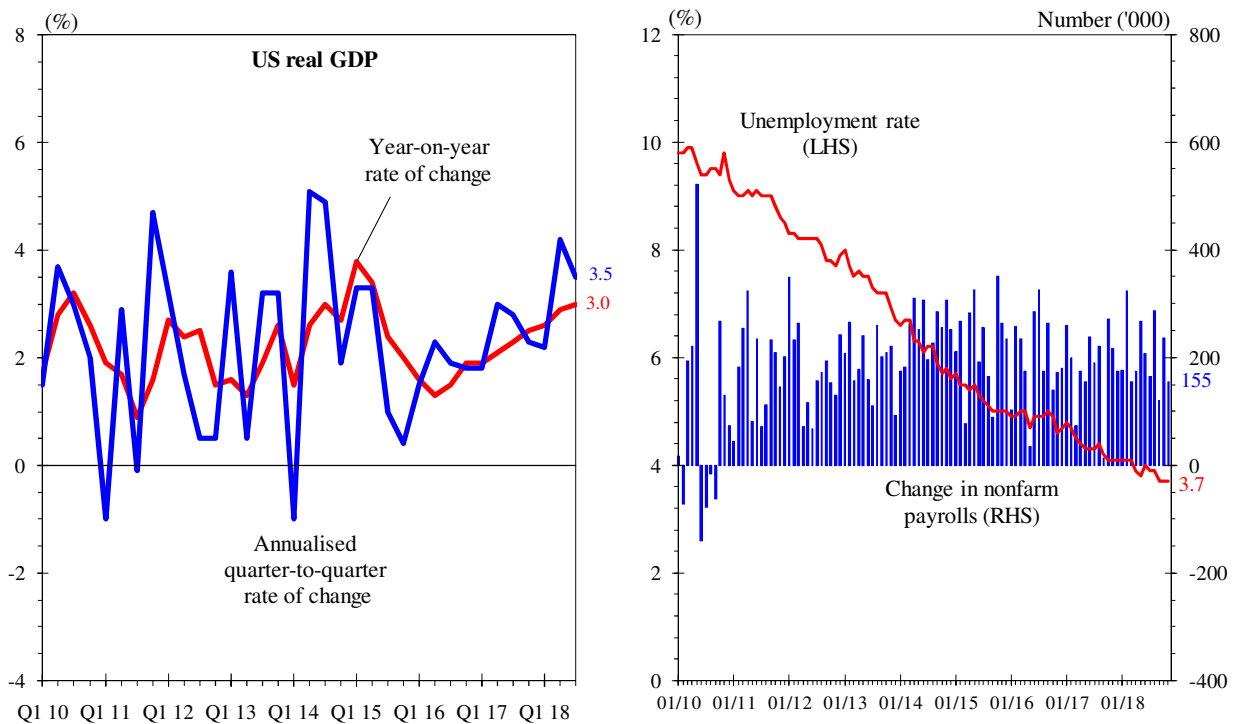
27. The Mainland economy grew by 6.7% over a year earlier in the first three quarters of 2018 (*Chart 17*), staying on track to attain the full-year official growth target of around 6.5%. The overall economic situation remained resilient, despite some moderation in growth in the third quarter. Retail sales and exports maintained the growth momentum in October, and investment also showed signs of stabilisation. The US-Mainland trade conflicts have eased temporarily of late, but there remain many uncertainties, which may affect the performance of exports of the Mainland next year. Nevertheless, the Mainland has reduced its reliance on external trade through structural transformation over the years. The Mainland authorities have also put forward a series of measures to maintain stability in employment, the financial sector, foreign trade, foreign investment, domestic investment and expectations. They have also implemented various mitigation measures, such as increasing export VAT rebates, lowering borrowing costs and reducing fees and charges, as well as improving the business environment for private enterprises, in order to support the stable development of the economy.

**Chart 17: The Mainland economy stays on track to attain the full-year official growth target in 2018**



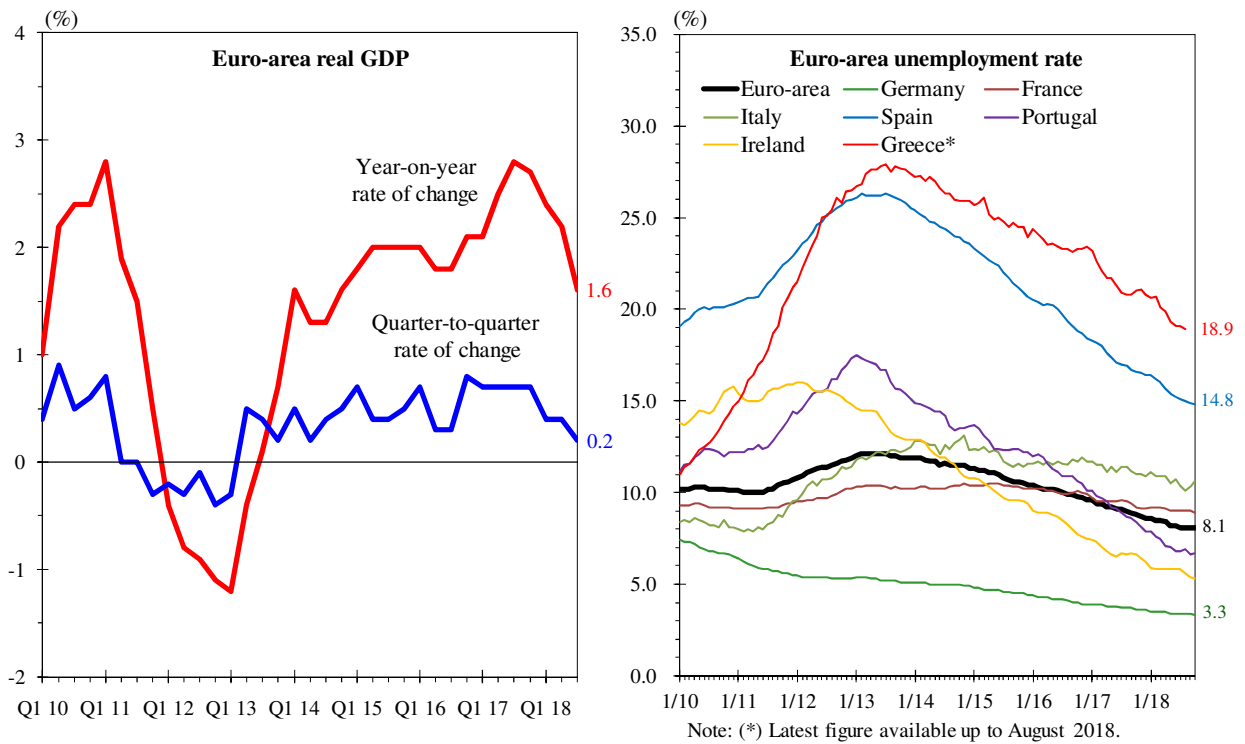
28. The US economy grew strongly (*Chart 18*) by 3.0% in the first three quarters of 2018, partly boosted by the expansionary fiscal policy. Labour market conditions were robust, and core CPI inflation and core PCE inflation both stayed close to the Fed’s target of around 2%. Looking ahead to 2019, the trade measures introduced by the US and the countermeasures by its trading partners, together with the waning of fiscal stimulus, are likely to result in some deceleration in growth.

**Chart 18 : The US economy grew strongly with robust labour market conditions**



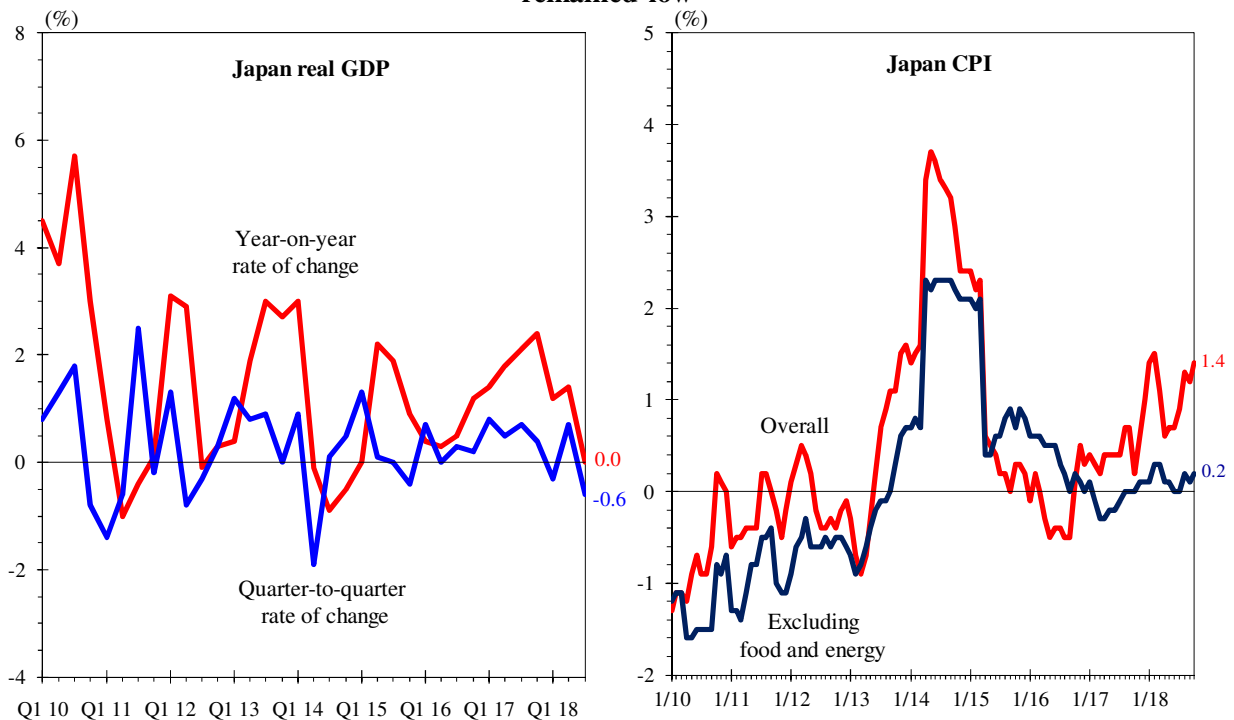
29. While the euro area continued to see broad-based economic expansion in 2018 with improved labour market conditions, real GDP growth decelerated over the course of 2018, from 2.3% in the first half to 1.6% in the third quarter (*Chart 19*). The ECB’s pledge to keep its interest rates at the present ultra-low levels at least through the summer of 2019 should provide some support to the economy, but growth is widely expected to moderate further. Although the draft agreement reached by the EU and UK in November marked a step forward in Brexit negotiations, it remains uncertain whether there would be a smooth separation at the end. Separately, the differences between the European Commission and the Italian government over the latter’s fiscal policy may also have implications for financial stability in the region.

**Chart 19 : Economic growth in the euro area decelerated through 2018**



30. Japan's economy slowed notably in the third quarter of 2018 with zero growth in real GDP (*Chart 20*), and core inflation was only marginally above zero. It is expected that growth potential would remain constrained by various structural issues such as elevated public debt and population ageing. If the sales tax hike proceeds as planned in October 2019, the growth pace would face extra downward pressure. As for the rest of Asia, many economies recorded solid but somewhat slower expansion in the third quarter, and their growth prospects in 2019 will unavoidably be affected by the rising headwinds in the global economic environment.

**Chart 20 : Japan's economy slowed visibly in the third quarter, while inflation still remained low**



31. Decelerating growth in many economies aside, the global economic outlook is subject to increasing downside risks. In particular, trade protectionism is the most worrying threat. The trade negotiations between the US and some economies remain clouded by uncertainty. Presidents of China and the US held a meeting earlier on. The two sides reached an agreement of not raising tariffs further for the time being, and agreed to continue to negotiate. Although the tense sentiments and worries caused by the trade conflicts have been eased for the time being, the outlook remains uncertain. In particular, trade conflicts are only one manifestation of the underlying tensions between China and the US, and there are some deep-seated structural differences that may not be resolved within a short period of time. Financial markets could turn volatile amid the fluctuating relations between the two sides, and we need to be vigilant to the risks involved. If the trade conflicts are to escalate, there would be significant repercussions on the global economy, international trade, investment and financial activities would be hit, and the impacts on the Hong Kong economy through both the direct and indirect channels would become more severe in 2019.

32. Further tightening of financial conditions across advanced economies, particularly in the US, is another risk factor that warrants attention. The Fed began scaling back its balance sheet in October 2017, and raised the federal funds rate three times so far this year. It is likely to give one more hike of 25 basis points before end-2018. If the US economy continues to grow solidly in 2019, the Fed would probably continue to raise interest rate, and the pace would depend on the incoming

economic data. In the euro area, the monthly net asset purchases of ECB were halved to €15 billion per month starting October 2018, and would be drawn to a close at end-2018. Furthermore, central banks in the UK and Canada further raised their benchmark interest rates in 2018. The further tightening of financial conditions across advanced economies could add to the volatility in the global financial and asset markets.

33. On the local front, the external environment facing the Hong Kong economy in 2019 is expected to be challenging, and the economic outlook is subject to considerable uncertainties. The expected moderation in economic growth of many of Hong Kong's key trading partners would weigh on Hong Kong's exports. While the risk of an imminent escalation of the US-Mainland trade conflicts has been reduced, the US announced that in case an agreement could not be reached within 90 days starting from 1 December this year, the rate of the additional tariffs on the US\$200 billion of goods from the Mainland would still be raised from the current 10% to 25%. If the US eventually decides to increase the tariff rate, or imposes additional tariffs on a wider range of Mainland products, the impacts on Hong Kong's external trade would become more visible.

34. The downside risks to domestic demand have increased in view of the recent deterioration in business sentiment and consolidation of local asset markets, though positive labour market conditions should continue to provide some support to local consumption in the near term. Should the external headwinds exacerbate the overall economic environment further, private consumption and investment could be subject to more pressure in 2019.

35. The inflation outlook of Hong Kong will hinge on a host of factors, including the overall economic growth, local cost pressures, inflation of our major import supply sources, international commodity prices, etc. The rising trend in private residential rentals over the past year or so will continue to feed through into consumer price inflation, at least in the earlier part of 2019. Meanwhile, the strong US dollar would help contain external price pressure.

36. The Government will closely monitor the developments on the domestic and external fronts, take into account the relevant factors, and announce the economic growth and inflation forecasts for 2019 along with the 2019-20 Budget in February 2019. For reference, the latest forecasts for economic growth of Hong Kong in 2019 by the IMF and private sector analysts were in the range of 2.3% to 3.0%, while those for Hong Kong's consumer price inflation in 2019 were in the range of 2.0% to 2.8%.

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Financial Secretary's Office  
10 December 2018



## **Recent situation of household income<sup>(1)</sup>**

### **Background**

This Annex provides a regular update on the latest trends of household income and employment earnings among various groups. The benchmark of monthly household income for low-income households is adjusted by inflation<sup>(2)</sup> to increase from \$8,100 (at constant Q2 2017 prices) to \$8,400 (at Q3 2018 prices), so as to reflect the latest circumstance.

### **Overall situation of household income and employment earnings**

2. The local labour market remained tight so far in 2018. Latest statistics show that the seasonally adjusted unemployment rate stayed at 2.8% in August – October, the lowest level in more than 20 years. Total employment registered a solid year-on-year growth of 1.3%. In the third quarter of 2018, median monthly household income, a reflection of the overall household income situation, saw an accelerated increase of 8.7% year-on-year in nominal terms or 6.1% in real terms after adjusting for inflation.

3. Overall wages and earnings went up further as labour demand continued to be robust on the back of sustained economic expansion. In the third quarter of 2018, the average employment earnings of full-time employees (excluding bonus) increased by 6.1% year-on-year in nominal terms or 3.6% in real terms after netting out inflation. For full-time unskilled employees, their average employment earnings also grew appreciably by 4.6% in nominal terms or 1.7% in real terms. For higher-skilled staff, the latest Salary Index for Managerial and Professional Employees indicates that employees in the same company and occupation enjoyed nominal and real year-on-year salaries growth of 4.8% and 2.6% respectively in June 2018 (*Table 1*).

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(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~		
2014	4.5	(0.1)	5.7	(1.2)	6.6	(0.9)	5.3	(1.8)	
2015	6.5	(3.4)	5.7	(2.6)	6.3	(2.2)	5.7	(3.8)	
2016	2.0	(-0.4)	6.1	(3.6)	5.7	(2.8)	5.2	(2.9)	
2017	Q1	4.0	(3.4)	3.9	(3.3)	5.1	(5.0)		
	Q2	2.5	(0.5)	5.1	(3.1)	6.0	(3.6)	4.9	(3.1)
	Q3	4.5	(2.7)	3.2	(1.3)	5.1	(2.9)		
	Q4	8.0	(6.3)	6.1	(4.4)	5.9	(4.2)		
2018	Q1	7.7	(5.1)	6.2	(3.7)	4.5	(1.8)		
	Q2	5.9	(3.7)	5.7	(3.5)	6.5	(4.0)	4.8	(2.6)
	Q3	8.7	(6.1)	6.1	(3.6)	4.6	(1.7)		

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.

### **Economically active households with monthly household income below \$8,400**

4. In the third quarter of 2018, the number of economically active households with monthly household income below \$8,400 (referred to as “low-income households” thereafter) fell to 64 200, down by 6 300 or 9.0% over a year earlier. This constituted 2.5% of total domestic households<sup>(3)</sup>.

5. An analysis of the number and proportion of low-income households over the past ten years or so suggests that their changes largely followed economic cycles. 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 5.0% in the third quarter of 2003 to 3.1% in the third quarter of 2007. After the outbreak of the global financial tsunami in late 2008, the corresponding proportion rose back to 4.0% in the third quarter of 2009 as the Hong Kong economy was mired in recession. With economic recovery taking hold afterwards, the figure declined in tandem. At 2.5% in the third quarter of 2018, the proportion was 0.3 percentage point lower than a year ago and 1.5 percentage points below the peak in the third quarter of 2009 (*Table 2 and Chart 1*).

(3) All figures pertaining to low-income households in the third quarter of 2018 are provisional figures.

**Table 2 : Number and proportion of low-income households\***

<u>Period</u>	Household type:			Of which:
	<u>Elderly households<sup>#</sup></u>	<u>Non-elderly households</u>	<u>Total</u>	<u>Economically active persons therein</u>
Q3 2003	3 000 (0.1)	103 900 (4.9)	<b>106 900</b> <b>(5.0)</b>	128 100 [3.9]
Q3 2007	2 700 (0.1)	68 300 (3.0)	<b>71 000</b> <b>(3.1)</b>	78 000 [2.3]
Q3 2008	2 600 (0.1)	76 300 (3.3)	<b>78 800</b> <b>(3.4)</b>	88 200 [2.6]
Q3 2009	1 700 (0.1)	89 500 (3.9)	<b>91 200</b> <b>(4.0)</b>	104 900 [3.0]
Q3 2011	3 500 (0.1)	54 400 (2.3)	<b>57 900</b> <b>(2.4)</b>	64 500 [1.9]
Q3 2013	4 300 (0.2)	66 900 (2.8)	<b>71 200</b> <b>(2.9)</b>	78 300 [2.2]
Q3 2015	3 800 (0.2)	54 000 (2.2)	<b>57 700</b> <b>(2.3)</b>	64 600 [1.8]
Q3 2017	6 700 (0.3)	63 800 (2.5)	<b>70 500</b> <b>(2.8)</b>	77 900 [2.1]
Q3 2018	5 900 (0.2)	58 300 (2.3)	<b>64 200</b> <b>(2.5)</b>	70 000 [1.9]

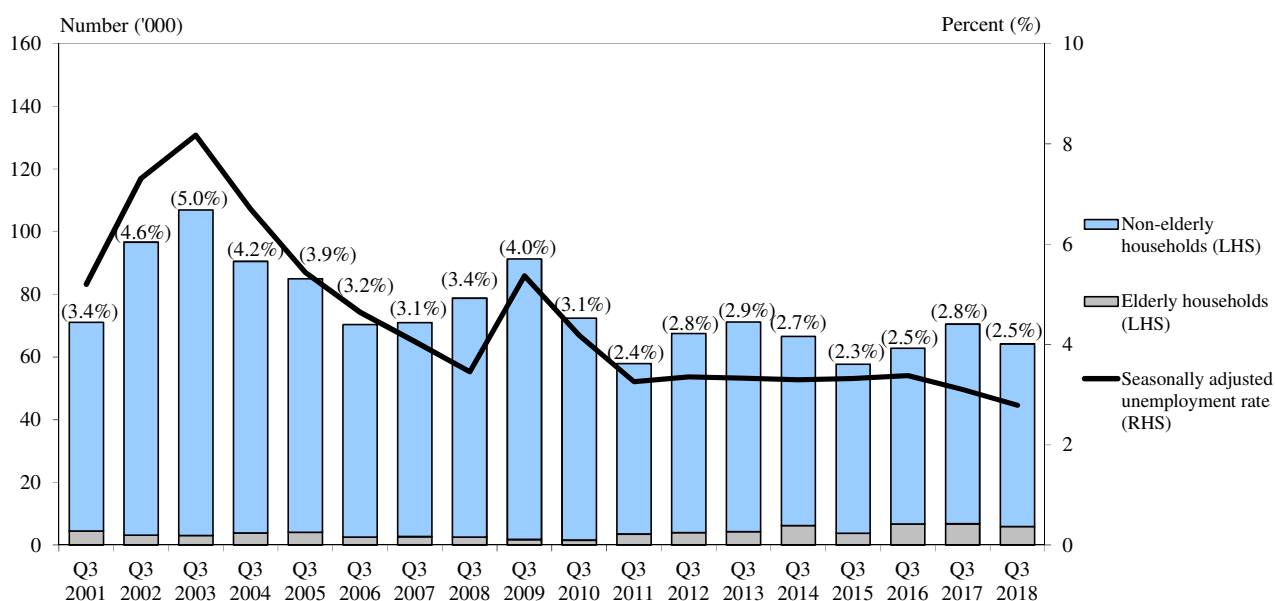
Notes : (\*) Low-income households refer to households with monthly household income less than \$8,400. This does not include households with all members being economically inactive.

(#) 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\***



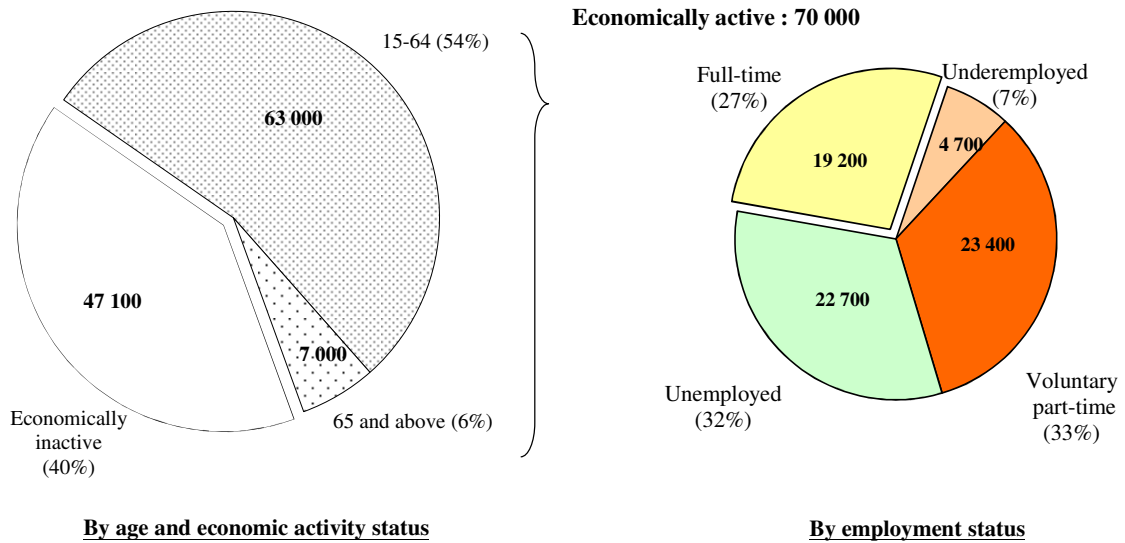
Notes : (\*) Low-income households refer to households with monthly household income less than \$8,400. This does not include households with all members being economically inactive. Figures in brackets are the proportions of low-income households in all domestic households.

## Socio-economic characteristics of low-income households

6. Further decomposition of low-income households in the third quarter of 2018 reveals the following observations:

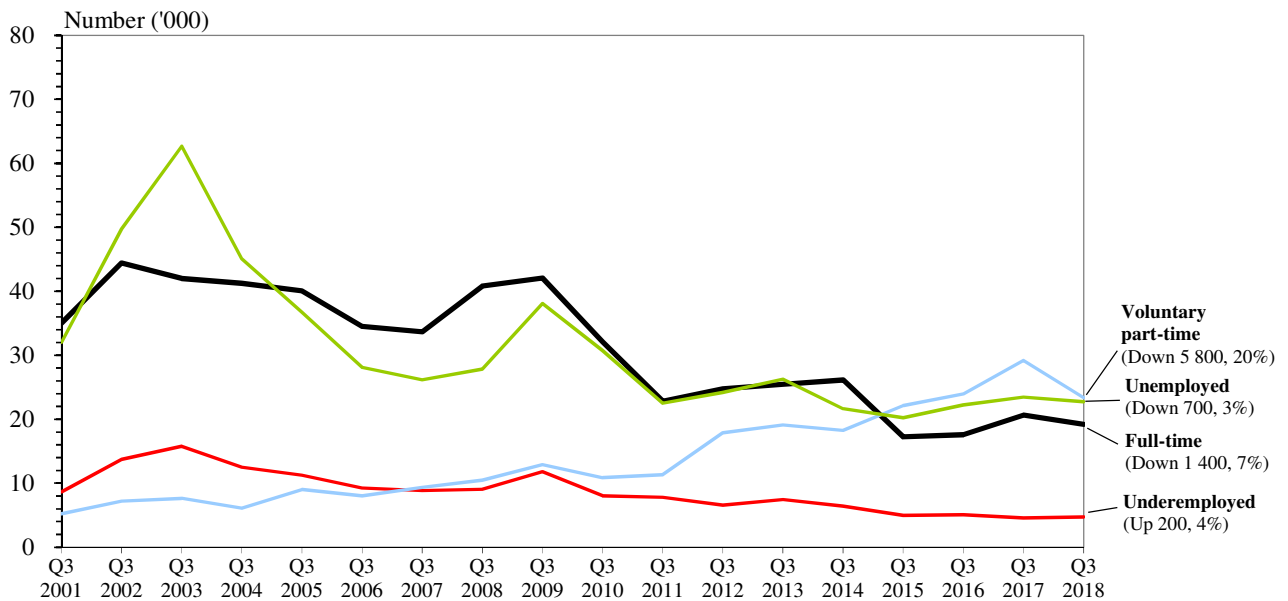
- There were 117 100 persons in the households in question, among whom 70 000 were economically active. Most of these economically active individuals (63 000 or 90%) were aged 15-64, with the majority within the age group of 40-64 (44 400 or 63%), whilst those aged 65 and above amounted to one-tenth (7 000).
- The remaining 47 100 persons were economically inactive. 21 500 of them (46%) were either children aged below 15 or elderly persons aged 65 and above.
- Further analysis by employment status shows that among these 70 000 economically active persons, voluntary part-timers, unemployed and underemployed persons accounted for 33%, 32% and 7% respectively, while the proportion of full-time workers was only 27% (**Chart 2**). Among these, the number of voluntary part-timers fell by two-tenths over a year ago (**Chart 3**).

**Chart 2 : Persons living in low-income households\* by age and economic activity status, Q3 2018**



Note : (\*) Low-income households refer to households with monthly household income less than \$8,400. 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 \$8,400. 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 2018.

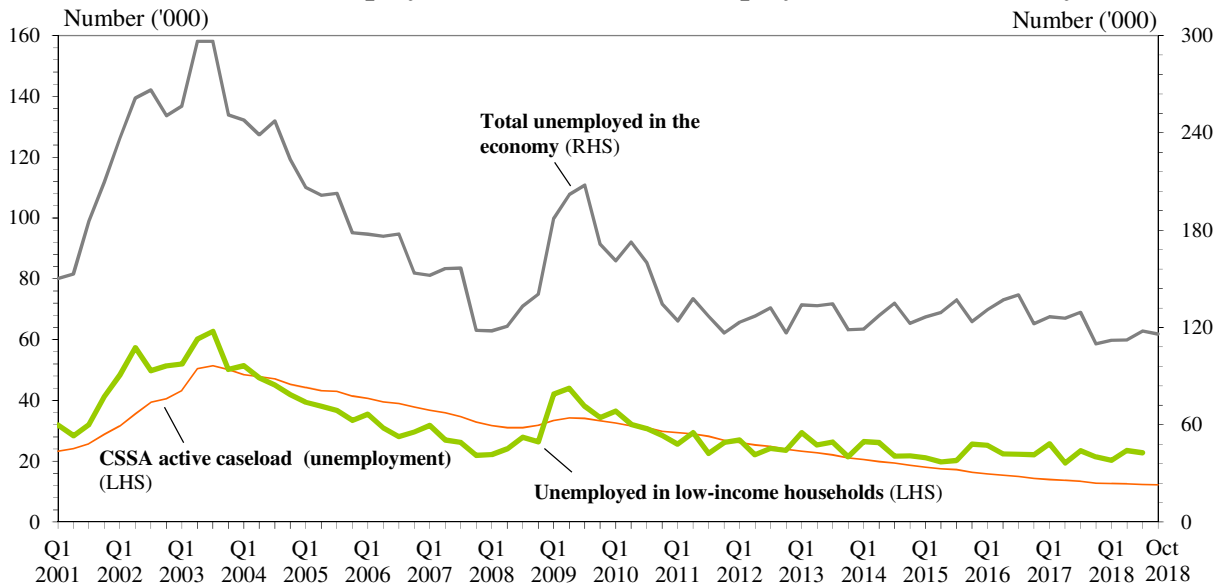
- Analysed by occupation, the majority of the employed persons living in low-income households (82%) were lower-skilled workers (33% were elementary workers, and 30% were service and sales workers). A breakdown by economic sector reveals that most of them were engaged in the retail, accommodation and food services sector (13 800 or 29%),

followed by the repair, laundry, domestic and other personal service activities sector (4 000 or 8%).

### The number of CSSA cases

7. The lower-skilled unemployment rate in August – October 2018 fell by 0.4 percentage point from a year earlier to 2.9%. Meanwhile, the number of overall CSSA caseload declined by 4 961 (or 2.1%) to 228 550 in October 2018 as compared to a year earlier. The decrease in unemployment cases was even more distinct, by 997 (or 7.6%) to 12 202 over the same period (**Chart 4**). This indicates that some grassroots workers were able to re-enter the labour market and leave the social security net amid tight 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 \$8,400. 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 in a knowledge-based society, increase social mobility, and reduce the child poverty risk and inter-generational poverty. To improve the livelihood of the grassroots, one fundamental solution is to promote overall economic growth so as to provide more employment and income opportunities.

9. The recent earnings situation of the grassroots was buttressed by the buoyant economic performance and robust labour demand. In April this year, the Government implemented a series of improvement measures to the Working Family Allowance scheme (previously named as the Low-income Working Family Allowance scheme) so as to benefit more working households, thereby encouraging self-reliance and easing inter-generational poverty.

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