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

This paper analyses Hong Kong's overall economic development in the most recent period, and provides some preliminary analyses on the economic prospects for 2022.

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Introduction

This paper analyses the latest development of the Hong Kong economy and provides some preliminary analyses on the outlook for 2022.

Recent economic situation

2. The global economy continued to recover in the second half of 2021, though the growth was constrained by the evolving pandemic, supply bottlenecks and restrictions on international travel. The Mainland economy faced higher pressures in recent months but still remained stable in overall terms. The growth pace of the US economy slowed in the third quarter of 2021, but recent data pointed to continued expansion. The euro area economy grew steadily in the third quarter as a whole, but elevated energy prices, supply bottlenecks and the relapse of the epidemic have dented economic sentiment of late. As for other Asian economies, trading and production activities of most economies continued to expand. In October 2021, the International Monetary Fund (IMF) forecast that the global economy would rebound by 5.9% for 2021 as a whole. Yet, the IMF warned that disparities in vaccine access would exacerbate the imbalance of the global economic recovery and downside risks remained notable.

3. Hong Kong's economic recovery became more entrenched in the third quarter of 2021 alongside the further revival of global economic activity and stable local epidemic situation. Real Gross Domestic Product (GDP) grew by 5.4%(1) year-on-year, as compared to a 7.6% growth in the second quarter. The pace of expansion moderated somewhat mainly because of the stronger-than-expected growth in the first half of the year and the higher base effect. On a seasonally adjusted quarter-to-quarter comparison, real GDP rose slightly by 0.1% in the third quarter ***(Chart 1)***. For the first three quarters of 2021 as a whole, the economy grew by 7.0% over a year earlier. Recent indicators suggested that the Hong Kong economy sustained momentum in the fourth quarter of 2021.

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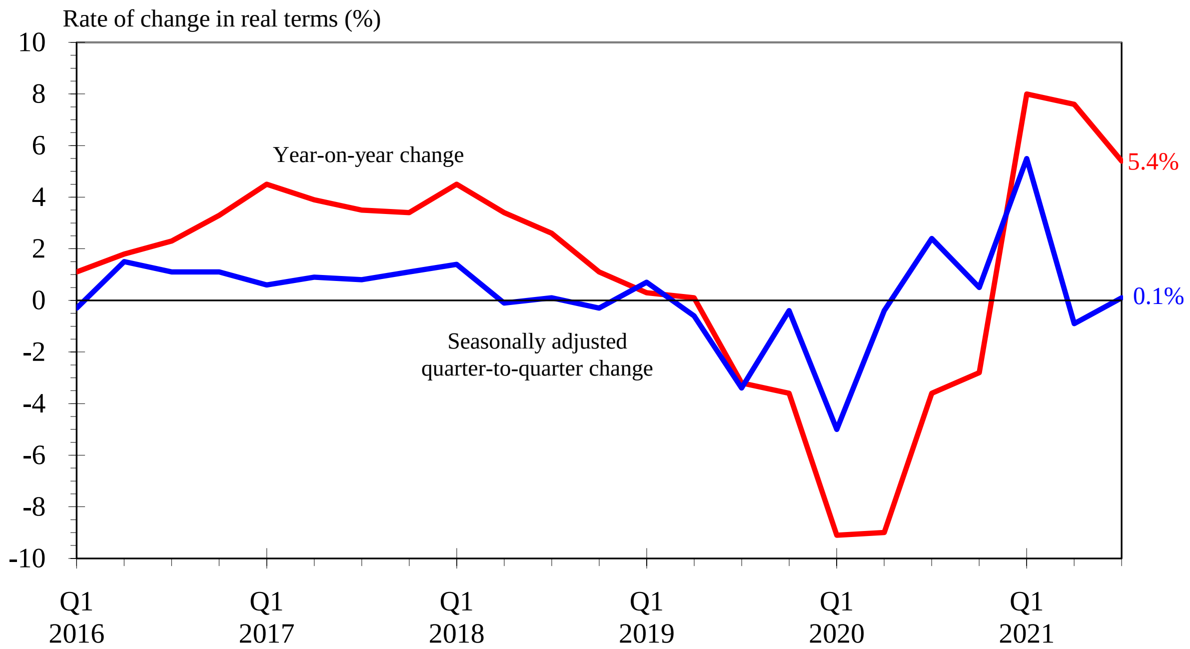
(1) Unless otherwise specified, all figures on changes in the recent economic situation, external trade and domestic sector sections of this paper are year-on-year changes in real terms.

Chart 1 : Real GDP rose further year-on-year in the third quarter of 2021



External trade

4. Hong Kong's total exports of goods grew notably by 14.2% year-on-year in the third quarter of 2021 ***(Chart 2(a))***, thanks to the continued revival of major economies and vibrant regional trade flows. Exports to the Mainland, the US and the EU continued to show double-digit growth. Exports to most of the other major markets in Asia also performed well. Entering the fourth quarter, the value of total merchandise exports in October and November continued to rise by over 20% year-on-year, which was better than expected.

5. Hong Kong's exports of services increased moderately by 4.2% year-on-year in the third quarter last year ***(Chart 2(b))***. As regional trade and cargo flows remained active, exports of transport services accelerated further despite subdued cross-boundary passenger transport. Exports of business and other services posted mild growth as the global economy recovered steadily. Exports of financial services continued to increase thanks to the pick-up in cross-border financial activities. Nonetheless, exports of travel services remained at a very low level as inbound tourism was virtually at a standstill.

Chart 2(a) : Total exports of goods grew notably in the third quarter

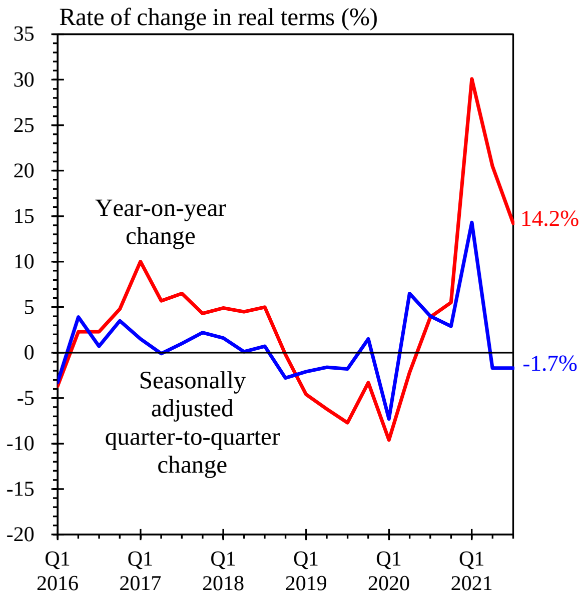
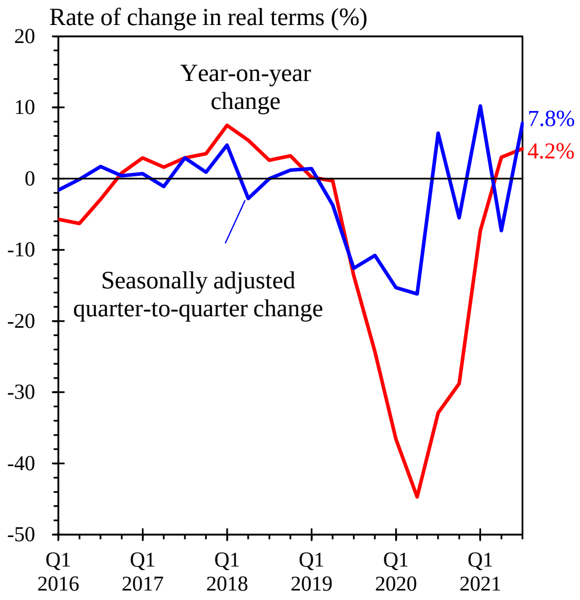


Chart 2(b) : Exports of services increased moderately



Domestic sector

6. The momentum of domestic demand continued to revive. Private consumption expenditure grew appreciably by 7.1% in the third quarter of 2021 ***(Chart 3(a))***. Thanks to the support from the stable local epidemic situation, improved labour market conditions and the Consumption Voucher Scheme, the value of total retail sales rose by 7.3% year-on-year in the third quarter, while total restaurant receipts increased sharply by 43.9% against a low base of comparison a year earlier. Stepping into the fourth quarter, the disbursement of the second batch of electronic consumption vouchers by the Government in early October continued to support consumption-related sectors. The value of total retail sales increased notably by 9.5% year-on-year in October and November combined.

7. Overall investment spending in terms of gross domestic fixed capital formation grew by 10.8% in the third quarter last year ***(Chart 3(b))***. Within the total, expenditure on acquisitions of machinery, equipment and intellectual property products surged by 19.6% thanks to the increasingly positive business outlook. Expenditure on building and construction increased marginally by 0.3% as private sector spending grew modestly while that of public sector stayed virtually unchanged. Meanwhile, the costs of ownership transfer continued to rise sharply, as property transactions were visibly higher than a year earlier.

Chart 3(a) : Private consumption expenditure grew appreciably

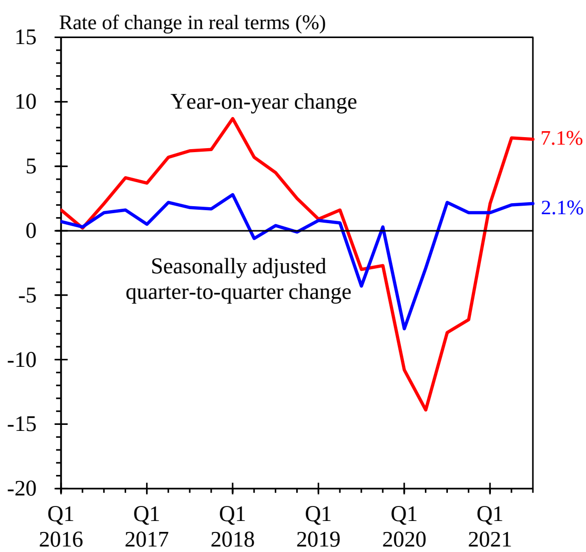
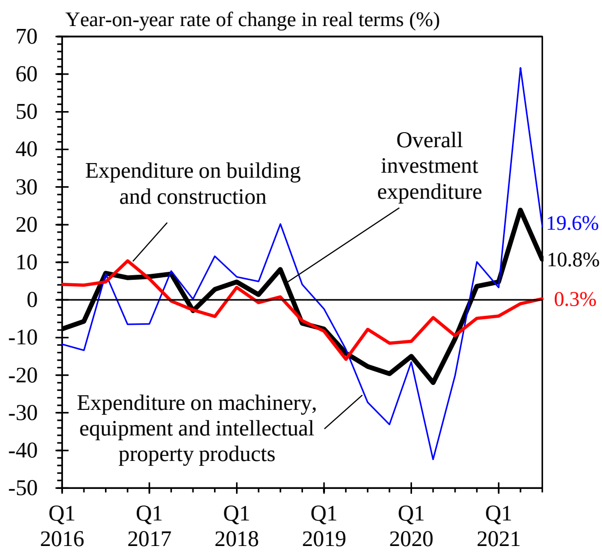


Chart 3(b) : Overall investment expenditure recorded double-digit growth



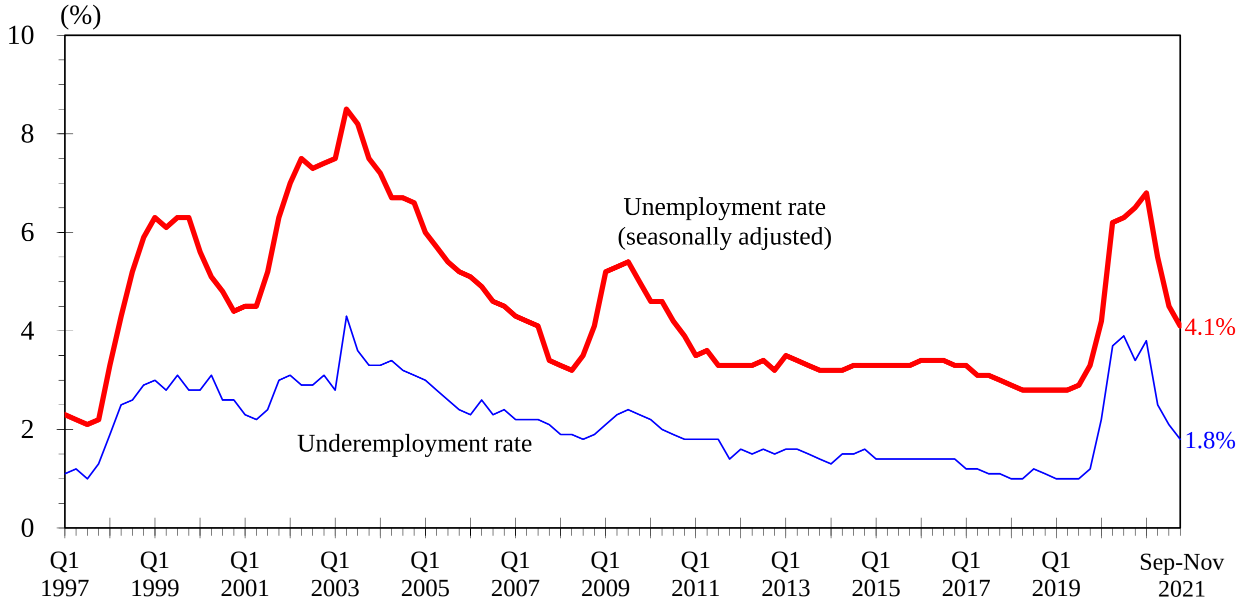
8. As for external direct investment (DI), the total stock of inward DI amounted to $16.6 trillion at end-September last year, equivalent to 5.9 times of GDP. According to the latest available figures analysed by source, at end-2020, the Mainland continued to be a major source of Hong Kong's inward DI, accounting for around 27% of the total stock. Separately, according to the survey results for 2021, the number of business operations in Hong Kong with parent companies either overseas or in the Mainland rose to 9 049, while the number of start-ups in Hong Kong increased by 68.5% to 3 755 when compared with 2017, both reaching record highs. This signifies fully that Hong Kong's business environment remains outstanding, and Hong Kong continues to be an ideal place for companies around the world to set up or expand their businesses.

Labour market

9. The labour market improved continuously since early 2021 amid the sustained economic recovery. The seasonally adjusted unemployment rate fell markedly from the peak (7.2%) in December 2020 – February 2021 to 4.1% in September – November 2021 (the latest period), and the underemployment rate also went down from the peak of 4.0% in December 2020 – February 2021 to 1.8% in the latest period ***(Chart 4)***. Over the same period, the number of unemployed persons decreased markedly by 39.6% from the peak of around 261 600 to around 158 000, and the number of underemployed persons also declined by 54.7% from a peak of around 154 600 to around 70 000.

10. Compared with the high levels in early last year, the unemployment rates of most major sectors already saw visible declines in the latest period. Among them, the unemployment rate of the consumption- and tourism-related sectors (viz. retail, accommodation and food services sectors) combined fell by 4.8 percentage points from the high level in early last year (December 2020 – February 2021) to 6.3% in the latest period. The unemployment rates of many other sectors, such as construction, transportation, and arts, entertainment and recreation, also registered notable declines from the high levels. Separately, overall labour demand strengthened alongside the continued economic recovery. Results of establishment surveys indicated that total private sector employment increased further in September last year over three months ago, and switched to a year-on-year increase of 0.3%, reversing the trend of successive periods of year-on-year declines since June 2019. Private sector vacancies also picked up strongly in September last year over three months earlier, and registered a 40.2% surge over the year-ago level. More recent statistics from the General Household Survey (“GHS”) showed that as compared with the low level early last year, total employment increased by 1.8% (or around 63 200) to around 3 673 300 in the latest period.

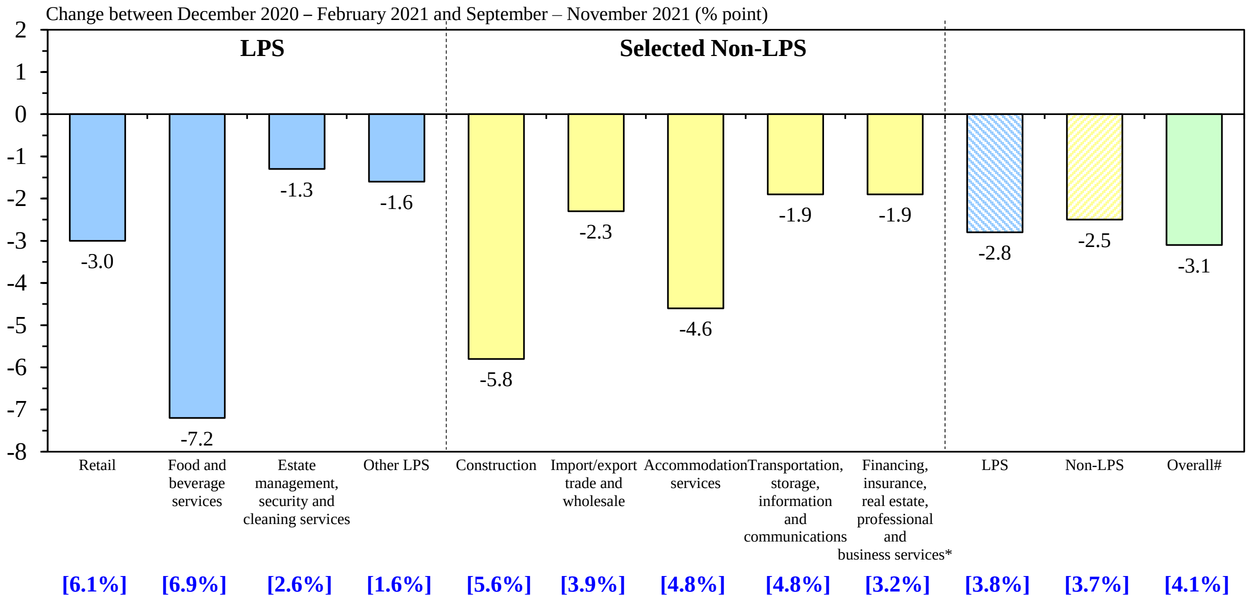
Chart 4 : The labour market improved continuously since early 2021 amid the sustained economic recovery



11. The unemployment rate of the low-paying sectors ("LPS")[(2)] as a whole likewise fell sharply from the peak of 6.6% in early last year to 3.8% in the latest period. Analysed by sector and compared with early last year, the unemployment rates of the food and beverage services and retail sectors fell sharply by 7.2 and 3.0 percentage points respectively to 6.9% and 6.1% in the latest period (***Chart 5***). The unemployment rates of the estate management, security and cleaning services sector and other LPS also fell by 1.3 and 1.6 percentage points respectively to 2.6% and 1.6%. At the same time, the unemployment rate of non-LPS decreased by 2.5 percentage points to 3.7%. Analysed by skill segment, the unemployment rate of the lower-skilled workers fell by 3.2 percentage points to 4.4%, but it was still visibly higher than that of the higher-skilled workers in the same period (2.7%).

(2) The fifth-term (2019-2021) Minimum Wage Commission identified LPS as (i) retail; (ii) food and beverage services; (iii) estate management, security and cleaning services; and (iv) other LPS, including elderly homes; laundry and dry cleaning services; hairdressing and other personal services; local courier services; and food processing and production.

Chart 5 : The unemployment rate of the low-paying sectors as a whole fell sharply from the peak in early 2021



Notes: Figures in square brackets refer to the unemployment rate for that sector in September – November 2021 (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.

12. Average nominal wages and labour earnings reversed the general trend of deceleration in their year-on-year rates of increase in the past two years or so. Average wage rates in nominal terms rose modestly by 1.3% in September 2021 over a year earlier, slightly faster than the corresponding increase of 1.1% in June. Labour earnings (as measured by the nominal index of payroll per person engaged) increased by 1.1% in the third quarter over a year earlier, the same as the corresponding increase in the second quarter. Most major sectors recorded year-on-year increases in wages and labour earnings in nominal terms. More recent statistics from the GHS suggested that employment earnings of low-income workers stayed on the rise. In August – October 2021, average monthly employment earnings of full-time employees (excluding foreign domestic helpers) of the lowest three decile groups combined increased by 3.9% year-on-year in nominal terms, faster than the headline and underlying (3) Consumer Price Index (A) inflation rates, which were at 2.0% and 1.1% respectively in the same three-month period. Meanwhile, as the employment situation improved, the median monthly household income (excluding foreign domestic helpers) rebounded from the low levels, and rose visibly by 5.4% year-on-year in August – October 2021, yet it was still 5.2% below the pre-recession level in the second quarter of 2019. Please refer to ***Annex*** for details on the recent situation of household income.

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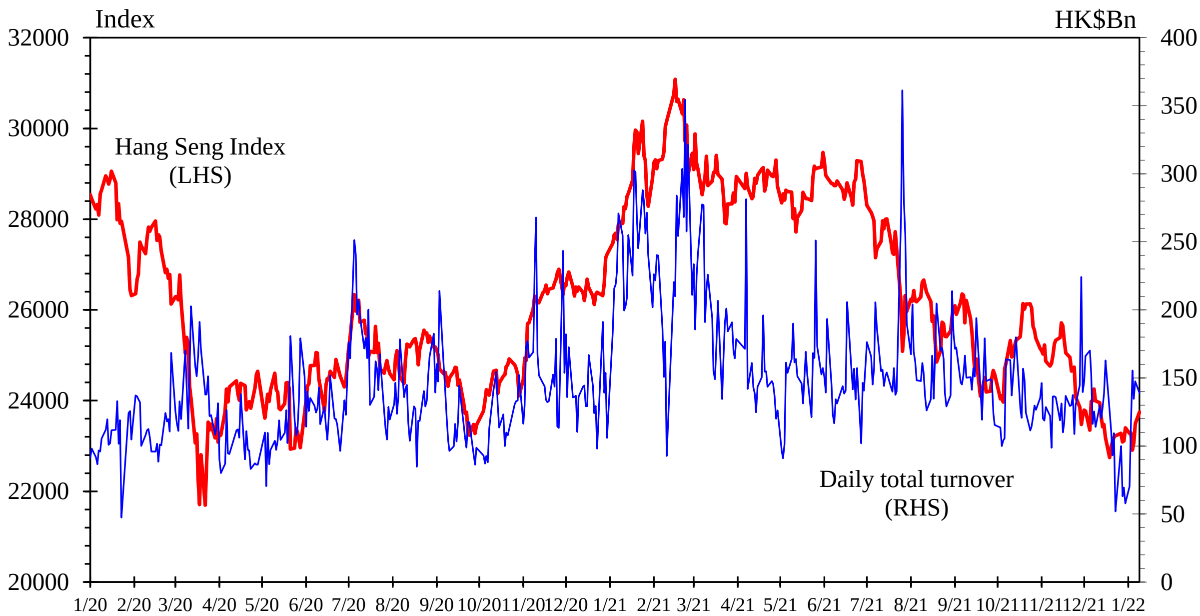
(3) The compilation has netted out the effects of the Government's one-off relief measures.

Asset markets

13. The local stock market underwent a sharp correction in second half of 2021, dampened by the monetary policy stance and direction in the US, the regulatory requirements in the Mainland, threat of COVID-19 variants, and uncertainty over the global economic outlook stemming from transportation and supply bottlenecks. The Hang Seng Index (HSI) closed at 23 398 at end-December, down by 18.8% from end-June ***(Chart 6)***, and closed at 23 747 on 10 Jan 2022. The daily turnover of the stock market in the second half of last year averaged $146.2 billion, a decrease of 22.3% from the first half of the year, but was 3.6% higher than its year-ago level. Affected by the deteriorating market sentiment, fund raising activities in the financial market turned quieter in the second half of the year.

Chart 6 : The local stock market underwent a sharp correction in second half of 2021

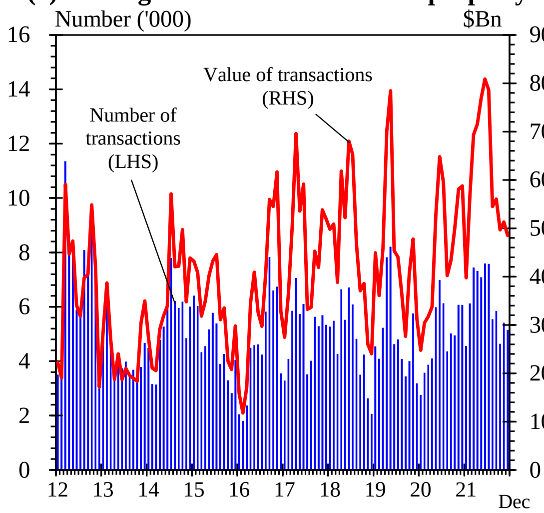


14. The residential property market remained generally active in the second half of 2021, despite quietening somewhat from the hectic level in the first half of the year. The low interest rate environment, firm end-user demand and the local economic recovery continued to render support to the market, though market sentiment weakened in the latter part of the year amid the local stock market correction and growing concerns over US interest rate hikes. The monthly average number of sale and purchase agreements for residential property received by the Land Registry declined to 5 694 in the second half of the year, 15% lower than the monthly average of 6 689 in the first half of the year, though still noticeably above the monthly average of 4 990 in 2020 ***(Chart 7(a))***.

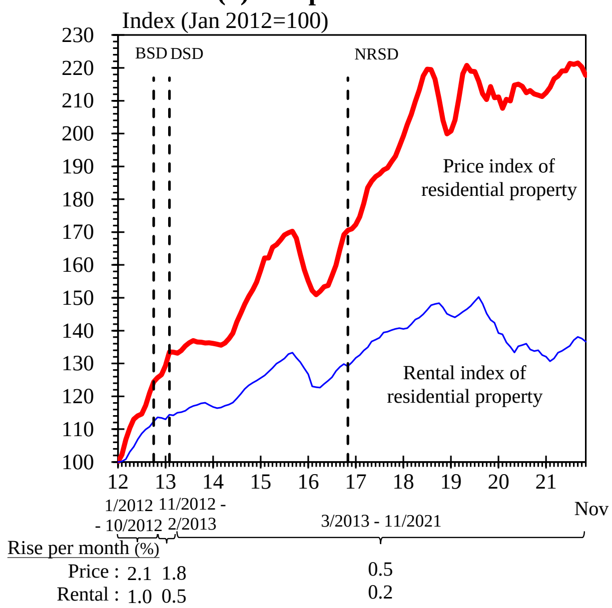
15. Flat prices increased by an average of 4% during the first half of 2021, and edged up further by 1% during the third quarter to a recent peak, before declining by 2% in October and November. Flat prices in November on average were 3% higher than in December 2020. Meanwhile, flat rentals rose by an average of 2% between June and November, but were still 9% below the peak in August 2019 ***(Chart 7(b))***.

Chart 7 : The residential property market remained generally active in the second half of 2021, despite quietening somewhat from the earlier hectic level

(a) S&P agreements for residential property

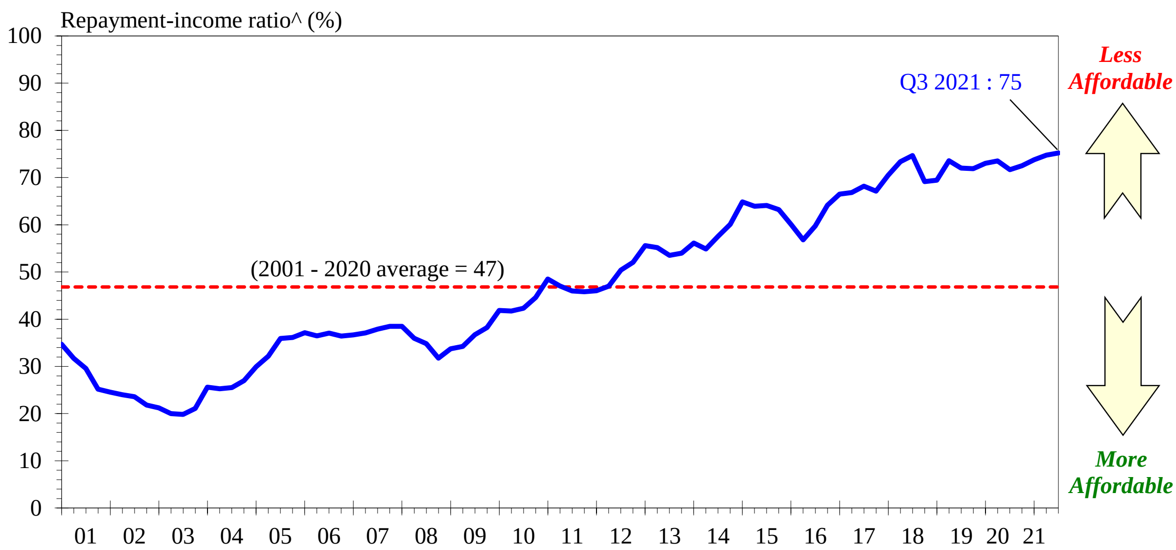


(b) Flat prices and rentals



16. 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 75% in the third quarter of 2021, significantly above the long-term average of 47% over 2001-2020 ***(Chart 8)***.

Chart 8 : The index of home purchase affordability remained elevated

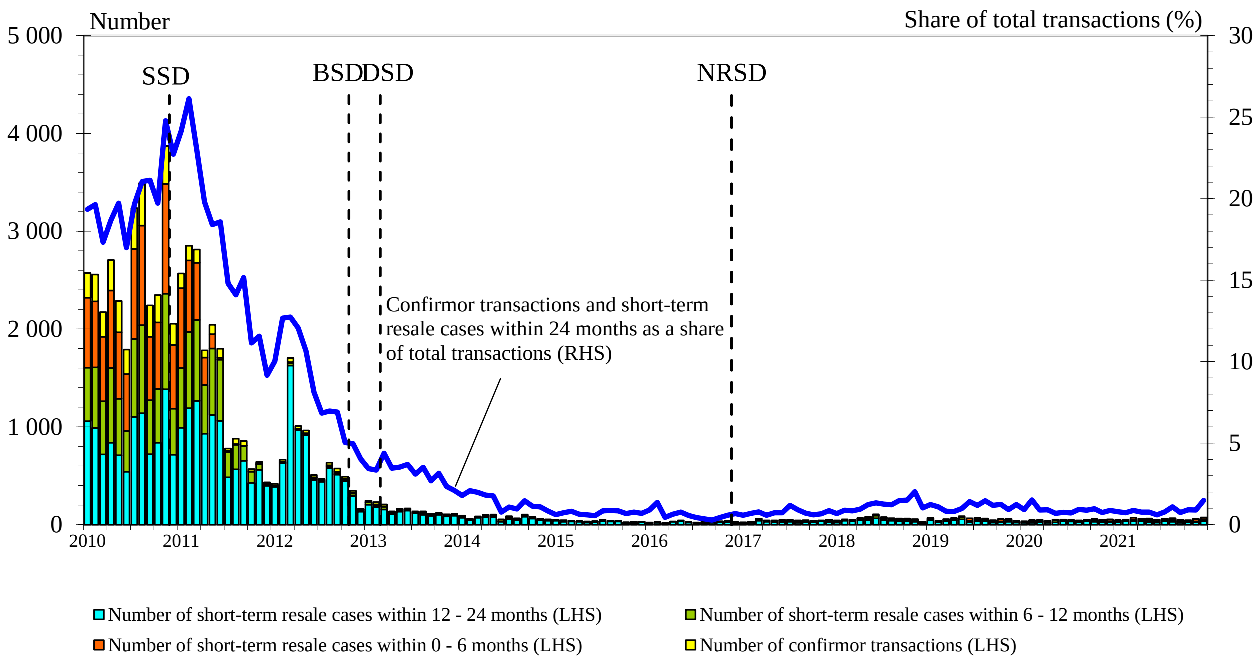


Note : (^) The ratio of the mortgage payment for a flat with saleable area of 45 sq m (assuming 70% loan-to-value ratio and tenor of 20 years) to the median income of households (excluding those living in public housing). This ratio is different from the debt servicing ratio published by the HKMA, which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

17. Raising flat supply through increasing land supply is the policy priority of the Government. As announced in December 2021, by 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 2021-22 is estimated to have a capacity to produce about 20 100 units, exceeding the private house supply target (i.e. 12 900 units) by 55%, a new high in recent years. The total supply of flats in the private sector 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) would stay at a high level of 94 000 units as estimated at end-September.

18. To dampen speculative, investment and non-local demand, and to reduce the possible risks to financial stability arising from an exuberant property market, the Government implemented various demand-side management and macro-prudential measures during 2009 to 2017, and these measures 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 57 cases per month or 0.8% of total transactions last year, well below the monthly average of 2 661 cases or 20.0% from January to November 2010 (i.e. the period before the introduction of the Special Stamp Duty) ***(Chart 9)***. Reflecting the effects of the Buyer's Stamp Duty, purchases by non-local individuals and non-local companies also stayed low at 25 cases per month or 0.4% of total transactions last year, much lower than the monthly average of 365 cases or 4.5% from January to October 2012 ***(Chart 10)***. As an indicator of investment activities, purchases subject to the New Residential Stamp Duty stayed at a modest level of 311 cases per month or 4.6% of total transactions last year, markedly lower than the monthly average of 1 412 cases subject to Doubled Ad Valorem Stamp Duty (DSD) or 26.5% from January to November 2016 ***(Chart 11)***. As to mortgage lending, the average loan-to-value ratio of new mortgages was 56% in the first eleven months of last year, likewise below the average of 64% from 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



Note : Confirmor transactions refer to resale before assignment.

Chart 10 : Purchases by non-local buyers remained low

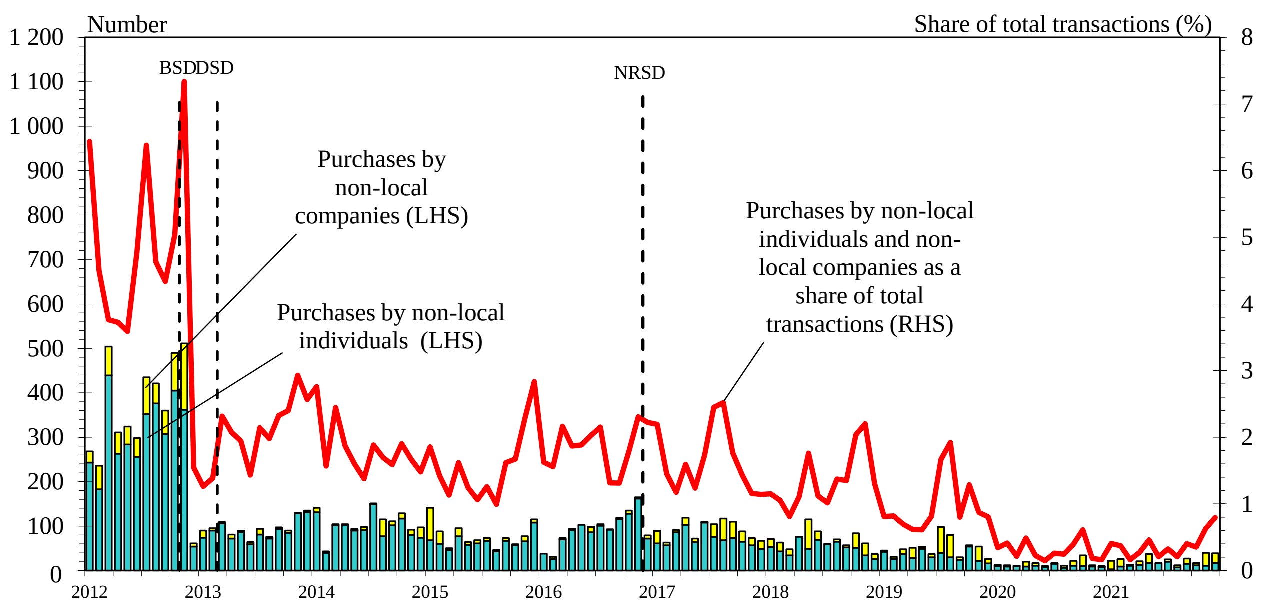
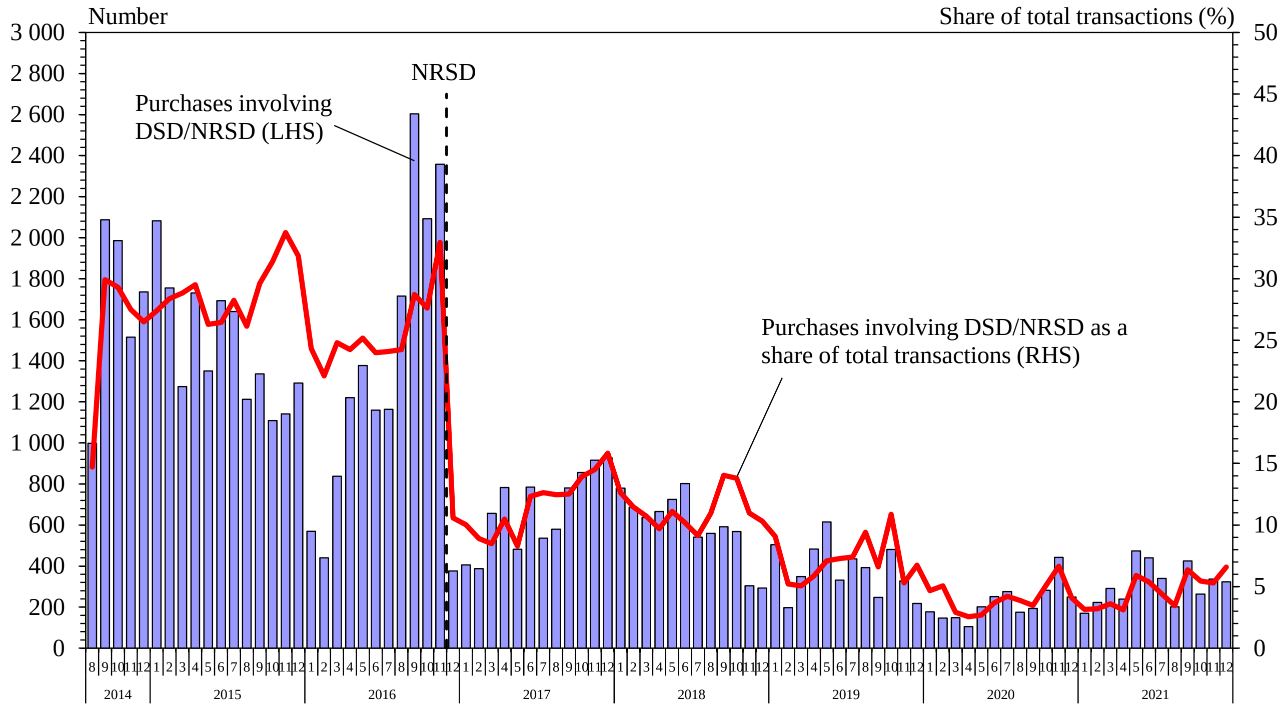


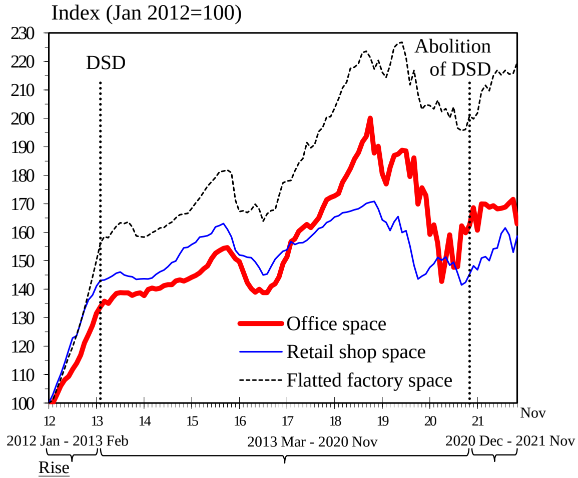
Chart 11 : Investment activities were modest



19. The commercial and industrial property markets showed some cool-off in the latter part of 2021. Trading activities in July to November retreated slightly from the first half of the year, but remained notably higher than the levels recorded a year earlier before the abolition of the DSD on non-residential property transactions. Prices of major market segments exhibited diverse movements, while rentals stayed firm. Prices of office space on average declined by 3% between June and November, while rentals on average were little changed. Prices and rentals of retail shop space both rose by 3% over the same period, while prices and rentals of flatted factory space increased by 1% and 4% respectively ***(Chart 12)***.

Chart 12 : Prices of non-residential properties exhibited diverse movements between June and November, while rentals stayed firm

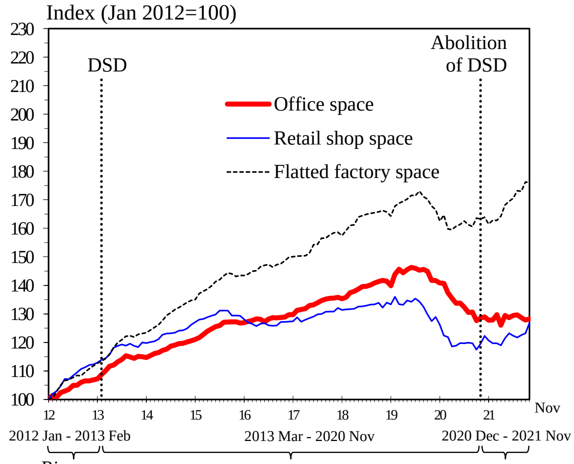
(a) Prices



Rise per month (%)	2012 Jan - 2013 Feb	2013 Mar - 2020 Nov	2020 Dec - 2021 Nov
Office space :	2.0	0.2	*
Retail shop space :	2.7	*	0.7
Flatted factory space :	3.3	0.3	0.8

Note : (*) Change of less than ±0.05%.

(b) Rentals



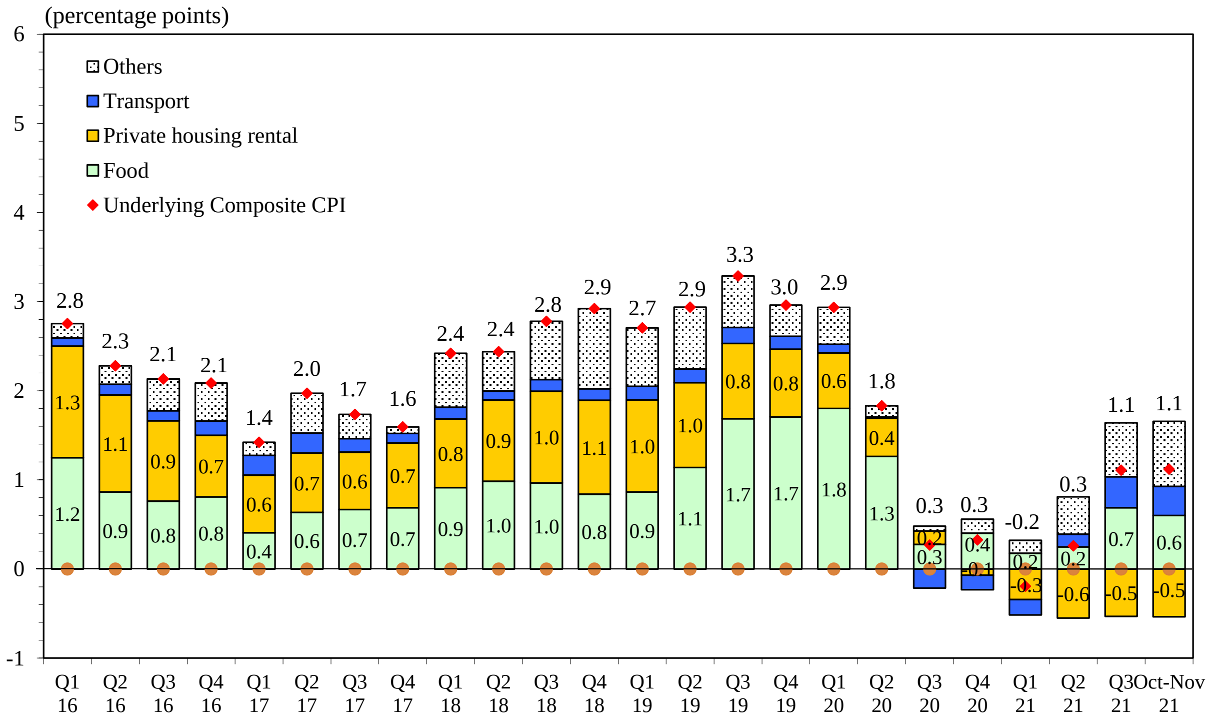
Rise per month (%)	2012 Jan - 2013 Feb	2013 Mar - 2020 Nov	2020 Dec - 2021 Nov
Office space :	0.7	0.2	*
Retail shop space :	1.0	0.1	0.5
Flatted factory space :	1.0	0.4	0.6

Inflation

20. Consumer price inflation went up in the second half of 2021 but remained moderate in overall terms. Some consumer price index (CPI) components saw larger year-on-year price increases amid the stabilised local epidemic situation and improved consumption demand. The year-on-year increase in prices of energy-related items also accelerated visibly. Nevertheless, price pressures on many other CPI components remained broadly in check. Netting out the effects of the Government's one-off relief measures to more accurately reflect the underlying inflation trend, underlying consumer price inflation rose from 0.3% in the second quarter last year to 1.1% in the third quarter, also averaged 1.1% during October – November, and averaged 0.5% in the first eleven months (***Chart 13***).

Chart 13 : Consumer price inflation went up in the second half of 2021

Contribution (in percentage points) to the year-on-year rate of change in the underlying Composite CPI by major component



21. Analysed by major component of the underlying Composite CPI ***(Table 1)***, and as compared to the first half of 2021, the year-on-year rate of increase in food prices, the component with the largest weight other than housing, widened in the third quarter and during October – November. Within food prices, the increase in prices of basic food was mild, while the increase in prices of meals out and takeaway food picked up, mainly attributable to a low base of comparison in the same period of 2020 during which the local epidemic and related social distancing measures severely disrupted the business of restaurants. The year-on-year decline in the private housing rental component narrowed slightly, as fresh-letting residential rentals resumed a year-on-year increase of late. Prices of transport rose at a visibly faster pace, mainly due to the low base of comparison in the second half of 2020 caused by the extra MTR fare discount. The increase in prices of electricity, gas and water accelerated notably due to the effect of rising international fuel prices. Against the backdrop of the stabilised local epidemic situation and improved consumption demand thanks to the support from the Consumption Voucher Scheme and better labour market conditions, prices of clothing and footwear, durable goods and miscellaneous services also registered faster increases. Meanwhile, prices of miscellaneous goods saw a narrowed decline.

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

Expenditure component	Weighting (%)	Annual[b]	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Oct-Nov
Food	27.41	3.3	6.4	4.5	1.0	1.5	0.7	0.9	2.6	2.2
Meals out and takeaway food	17.05	0.8	1.8	1.5	-0.6	0.5	*	1.0	3.6	2.4
Other foodstuffs	10.36	7.7	14.9	9.9	3.5	3.3	1.8	1.1	1.0	1.8
Housing[a]	40.25	1.3 (-0.1)	2.2 (0.7)	1.6 (1.6)	0.9 (-3.2)	0.6 (0.4)	-0.1 (1.7)	-0.7 (-0.7)	-0.9 (1.0)	-1.2 (-0.6)
Private housing rent	35.46	0.9 (1.1)	2.0 (2.7)	1.4 (1.4)	0.5 (0.5)	-0.2 (-0.3)	-1.0 (-1.0)	-1.6 (-1.6)	-1.5 (-1.6)	-1.5 (-0.8)
Public housing rent	1.87	3.3 (-21.0)	0.4 (-31.1)	0.2 (0.4)	3.3 (-61.7)	9.6 (8.3)	9.6 (59.2)	9.4 (11.0)	6.1 (100.3)	-0.1 (2.0)
Electricity, gas and water	2.82	0.6 (-20.6)	3.7 (-16.0)	0.8 (-19.0)	0.4 (-19.2)	-2.5 (-28.2)	* (25.4)	2.2 (26.0)	4.8 (20.5)	11.1 (29.6)
Alcoholic drinks and tobacco	0.49	0.5	-0.3	0.3	1.1	1.0	0.6	-0.1	-0.4	0.1
Clothing and footwear	2.42	-5.2	-4.2	-5.0	-6.4	-5.2	-1.5	2.1	5.4	6.3
Durable goods	4.00	-2.7	-2.5	-3.1	-3.5	-1.7	-0.5	0.7	2.1	1.9
Miscellaneous goods	3.32	3.1	3.8	2.8	2.3	3.5	-4.2	-4.1	-2.8	-1.3
Transport	6.17	-1.0	1.2	0.2	-2.8	-2.7	-2.8	2.4	5.9	5.5
Miscellaneous services	13.12	0.8 (0.8)	1.5 (1.5)	0.8 (0.8)	0.6 (0.6)	0.4 (0.4)	0.5 (0.5)	0.6 (0.6)	0.9 (0.8)	1.1 (1.0)
All items	100.00	1.3 (0.3)	2.9 (2.0)	1.8 (1.3)	0.3 (-1.7)	0.3 (-0.6)	-0.2 (1.2)	0.3 (0.8)	1.1 (2.3)	1.1 (1.8)

Notes : (a) The housing component covers rents, rates, Government rent, maintenance costs and other housing charges. Its sub-components on private and public housing rents as presented here, however, cover rents, rates and Government rent only. Hence, the combined weighting of private and public housing rents is slightly less than the weighting of the entire housing component.

(b) Splicing has been applied to the two sets of CPI series in order to obtain better estimates of the rates of change for the year 2020.

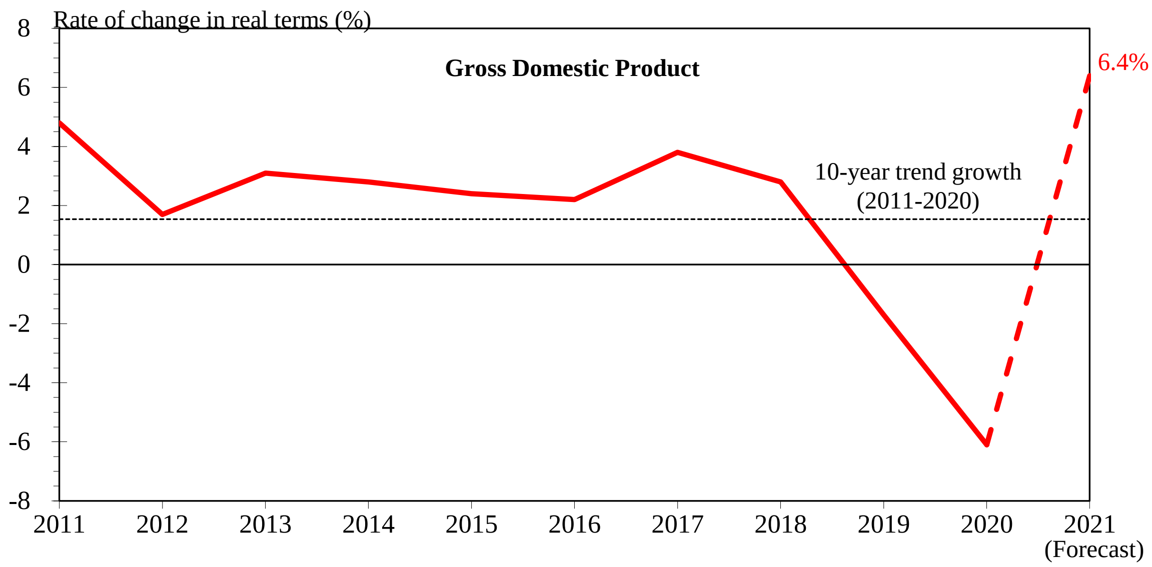
( ) Figures in brackets represent the headline rates of change before netting out the effects of Government's one-off relief measures.

(*) Change within ±0.05%.

Economic forecasts for 2021

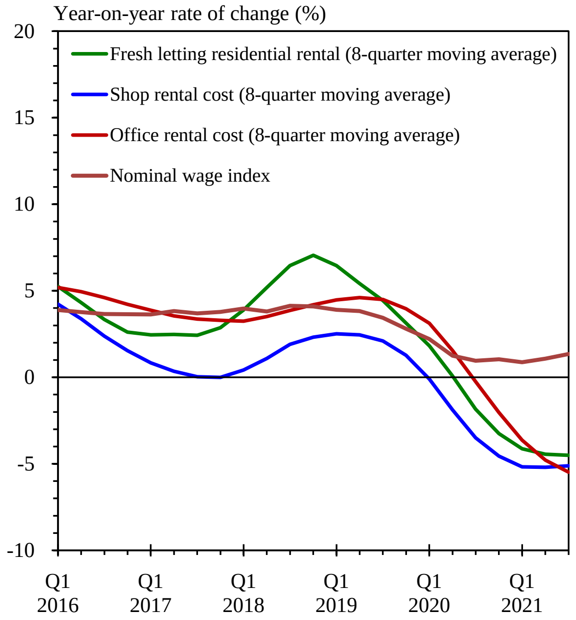
22. The economy expanded by 7.0% year-on-year for the first three quarters of 2021 as a whole. Recent indicators showed that the Hong Kong economy stayed on the recovery trend in the fourth quarter. Export performance in October and November remained strong, while the value of total retail sales also rose notably year-on-year in the same period. The Hong Kong economy should see a solid year-on-year growth in the fourth quarter last year, and is forecast to grow by 6.4% for the year as a whole, in line with the forecast as announced in November last year (***Chart 14***). For reference, the latest forecasts of Hong Kong's economic growth in 2021 by the IMF and private sector analysts ranged from 5.0% to 7.0%, averaging around 6.4%.

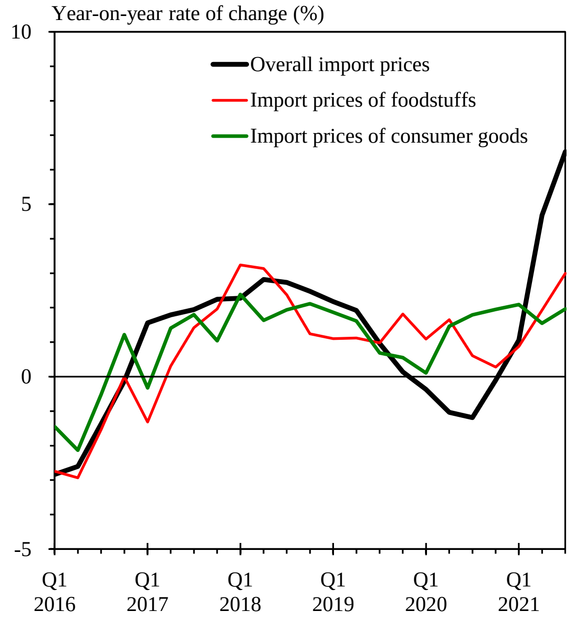
Chart 14 : Economic growth for 2021 as a whole is forecast at 6.4%



23. On inflation, the underlying and headline consumer price inflation rates for the first 11 months of 2021 averaged 0.5% and 1.5% respectively. Taking into account the recent inflation figures and developments, the average rate of underlying inflation for last year as a whole should be slightly lower than 0.7% as projected in the November last year. Inflationary pressure is likely to increase further in view of the notable rise in import prices and the on-going economic recovery. Nonetheless, as domestic cost pressures remain limited, the underlying inflation should stay largely contained in the near term ***(Chart 15)***.

Chart 15 : Domestic cost pressures remained limited; external price pressures increased further



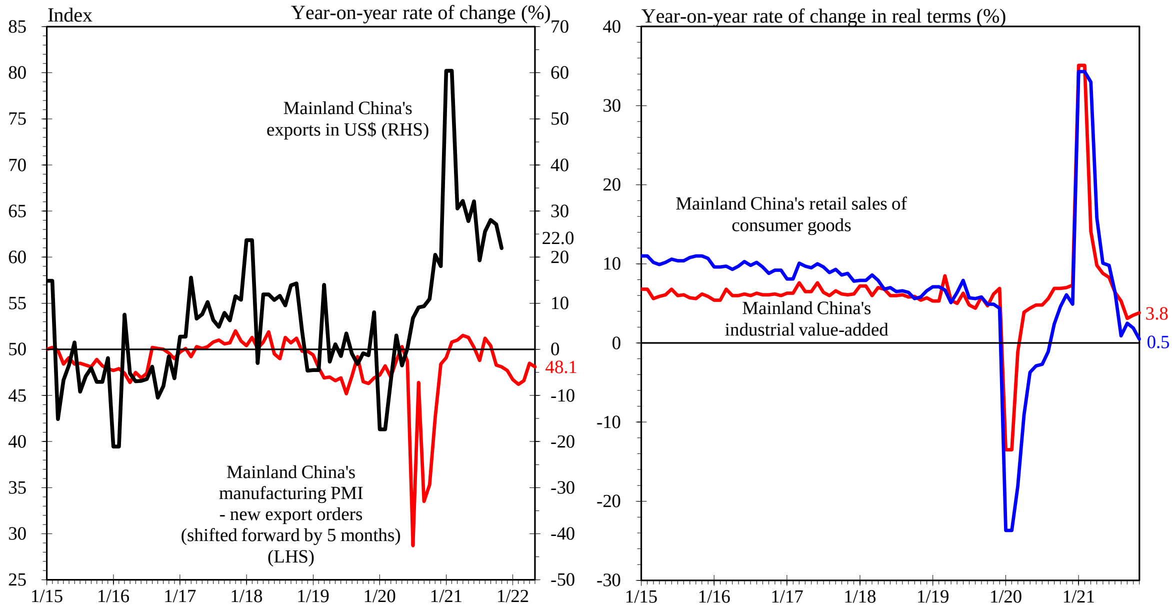


Economic outlook for 2022

24. The market generally expects the global economy to recover further in 2022. The International Monetary Fund (IMF) forecast in last October that the global economy would grow by 4.9% in 2022. In particular, the growth forecast for advanced economies was 4.5% (projected growth for 2021 was 5.2%), and that for emerging and developing Asia was 5.1% (projected growth for 2021 was 6.4%). Yet, the growth pace across economies is expected to be uneven and subject to high uncertainties. The evolving pandemic remains the biggest uncertainty. In fact, many governments have strengthened anti-epidemic measures and tightened travel restrictions in view of the rapid spread of the Omicron variant in many places since late 2021. The IMF in last December hinted at a downward revision of its global economic growth forecast. Separately, supply bottlenecks in various places may persist for a longer period of time. This, together with the upward pressure on energy and commodity prices, may hinder global production and push up global inflation. Major central banks have already begun to tighten their monetary policies amid rising inflation, and its impact on global financial market and capital flows warrants close attention.

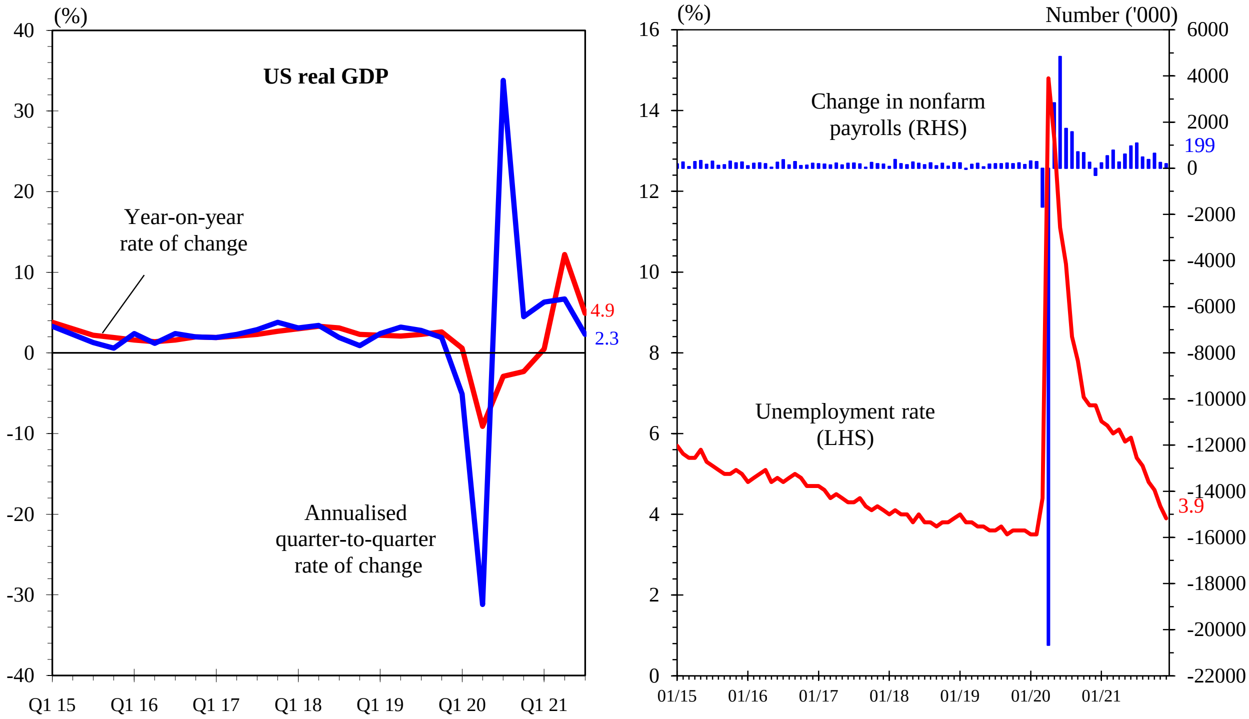
25. As the epidemic prevention and control in the Mainland has achieved remarkable results and the pandemic situation there has been far more stable than in other parts of the world, the Mainland economy continued to revive at a relatively faster pace in 2021, posting a notable year-on-year growth of 9.8% for the first three quarters combined. Yet, the pace of growth moderated somewhat within the year and stood at 4.9% in the third quarter, mainly due to the further dissipation of low base effect. Meanwhile, certain regions saw a resurgence of the epidemic or experienced flooding and power shortage, thereby also exerting downward pressures on the economy. This notwithstanding, the Mainland economy should stay on track for recovery in the fourth quarter on the back of strong export performance ***(Chart 16)***. As for the outlook, the economic development is subject to "triple pressures" stemming from demand contraction, supply shocks and weakening expectation. With that said, the fundamentals of the Mainland economy remain solid. A slew of reform measures under the 14th Five-Year Plan have also been rolled out to promote long-term economic development. These, together with the ample room for fiscal and monetary policy manoeuvring, would help alleviate the downward pressures facing the economy. The Mainland economy is expected to develop in a stable manner with progress in 2022, attain growth within a reasonable range, and continue to be the major driver of global economic growth.

Chart 16: The Mainland's export performance remained strong and the economy is expected to develop in a stable manner with progress this year



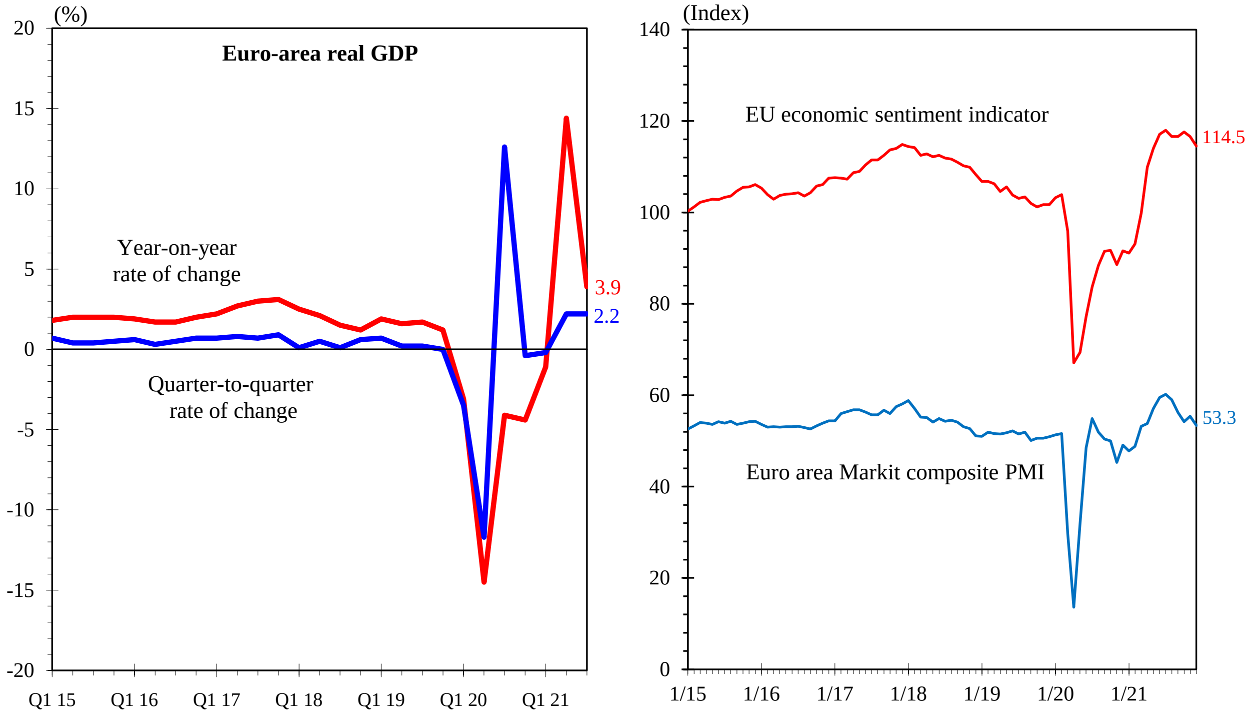
26. The US economy recovered further in 2021, but its quarter-to-quarter growth moderated in the third quarter ***(Chart 17)***, mainly due to the softening of private consumption after the strong growth in the first half of the year. The manufacturing and services Purchasing Managers' Indices remained visibly higher than the boom-bust divide in recent months, indicating sustained activity expansion. The labour market also continued to improve, though the labour force participation rate has yet to return to its pre-pandemic level. Nonetheless, the Federal Reserve (Fed) has already begun to reduce the size of its asset purchases, and hinted at rate hikes later in 2022. The fiscal policy support is also expected to diminish relative to last year. Inflation in the US continued to rise, with the core personal consumption expenditure deflator increasing by 4.7% in last November over a year earlier, notably higher than the Fed's target of 2%. If inflation remains elevated, the Fed may step up its pace of monetary policy tightening. Separately, the development of China-US relations down the road also continues to warrant attention.

Chart 17 : The US economy recovered further, while the labour market continued to improve



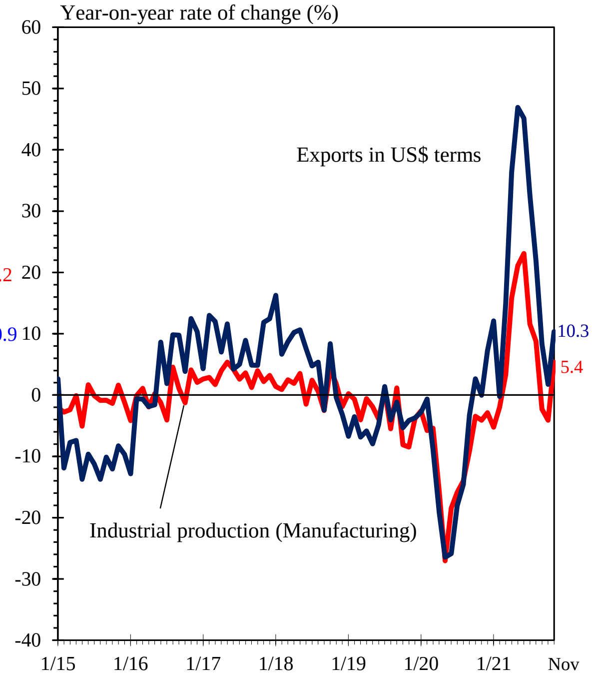
27. The euro area economy showed a steady recovery in the second and third quarters of 2021 ***(Chart 18)***. Yet, following the resurgence of the epidemic in many European countries in the fourth quarter, some of them have successively tightened their anti-epidemic measures, denting economic sentiments. This would likely weigh heavily on the growth pace. While the market expects the euro area economy to recover further in 2022, the evolving pandemic remains the biggest threat to economic outlook. In addition, supply bottlenecks and rising inflation are also major risk factors. In last December, the European Central Bank (ECB) forecast that inflation in the euro area would continue to rise in the near term, and whether it would further affect consumption and investment confidence there warrants attention.

Chart 18 : The euro area economy showed a steady recovery in the second and third quarters, but economic sentiment weakened recently



28. In Japan, the year-on-year growth of the economy moderated notably in the third quarter of 2021 alongside the surge in the number of newly confirmed COVID-19 cases ***(Figure 19)***. Yet, as the epidemic situation has stabilised since the fourth quarter, economic activities saw some improvement in recent months. If the epidemic situation in Japan remains stable, the accommodative monetary and fiscal policies of the authorities should continue to support the economy in 2022. Yet, structural issues such as population ageing and massive public debts would constrain Japan's economic growth potential. For other parts of Asia, most economies performed well in the second half of last year, with industrial production and merchandise exports sustaining growth in general. However, the growth prospects of these economies in 2022 still hinge on the development of the epidemic and restrictive measures by the governments.

Chart 19 : The year-on-year growth of the Japan's economy moderated notably in the third quarter



29. The monetary policies of major central banks remained relatively accommodative in general in view of the uncertainties facing the economic outlook. The People's Bank of China cut the reserve requirement ratios of financial institutions twice by a total of 1 percentage point in the second half of 2021, releasing over RMB 2 trillion worth of long-term liquidity to support the development of the real economy. Yet, some central banks have begun to tighten their policies amid rising inflation in their economies. In its meeting last December, the Fed decided to keep the federal funds rate at 0.00%-0.25%, but double the pace of monthly tapering of asset purchase from January 2022 onwards, suggesting that the asset purchase programme would end in mid-March this year. All participants of the Federal Open Market Committee (FOMC) expected rate hikes within this year, with over half of them anticipating a 75 basis point-increase in interest rate by the end of the year. Some participants even opined that it could be appropriate to begin to reduce the size of the Fed's balance sheet relatively soon after the first rate hike. In Europe, while the ECB continued to maintain its policy rates at historic lows and suggested that the rates are very likely to remain unchanged in 2022, it has announced to gradually reduce the size of its overall net asset purchases. As for Asia, the Bank of Japan kept its policy rate at record low, but some Asian economies (including Singapore and Korea) have already tightened their monetary policies. As to the emerging markets, the central banks of certain economies such as Brazil and Russia raised their policy rates amid rising inflation. On the fiscal front, US President Biden signed an infrastructure bill worth about US$1 trillion in November 2021, while the US$1.75 trillion social-spending package was still subject to the Senate's approval. The European Commission disbursed the payment under "Next Generation EU" to its member states to boost their economic

recovery.

30. Looking ahead into 2022, although the external environment is highly complicated, particularly with the threat of the Omicron variant, the market generally expects a further recovery across major economies. This is believed to be conducive to the vibrancy of regional trade flows as well as the performance of Hong Kong's exports of goods in 2022. Should the overall economic environment continue to turn better, exports of services can hopefully improve further, though the pace of recovery would still hinge on the resumption of cross-boundary travel. The Hong Kong economy would see faster and broader-based recovery if normal flow of people with the Mainland can be resumed in an orderly manner as soon as possible.

31. Domestic demand performance would hinge on the epidemic development. If the epidemic remains under control, employment and income conditions will likely continue to improve, which will help sustain a positive consumption sentiment. Meanwhile, a stable epidemic situation will be conducive to business sentiment. This, coupled with the Government's continued efforts in increasing housing supply, pursuing infrastructure investment projects and promoting innovation and technology, should render support to investment demand. Only the successful prevention and control of the epidemic will provide stable and sustainable conditions for economic recovery, and create favourable conditions for the gradual and orderly resumption of normal flow of people with other places, especially the Mainland with which Hong Kong has particularly close economic and trade ties. Therefore, the community must strive towards more widespread vaccination and abide by the anti-epidemic measures, working together to keep the local epidemic under control and strengthen the community's anti-epidemic capability.

32. Overall speaking, the prevention and control of epidemic remains the most critical task this year. The local epidemic situation has turned drastically recently due to the Omicron variant. The HKSAR Government has taken decisive measures by adhering to the principle of "preventing the importation of cases and the spreading of the virus in the community", hoping to cut the community transmission chains as soon as possible. Should we succeed in deterring a new wave of epidemic and keeping the local epidemic situation stable, and barring any abrupt deteriorations of the external environment, the Hong Kong economy should stay on a growth track in 2022. Nonetheless, the breadth, depth and pace of recovery are still subject to high uncertainties at this stage.

33. As to Hong Kong's inflation outlook, it will hinge on a host of factors, including overall economic performance, local cost pressures, inflation situation of Hong Kong's major import sources, international commodity prices, etc. Since it

takes time to resolve the supply bottlenecks in various places and the global economy is expected to recover further, external price pressures are likely to persist, especially in the first half of the year. With the further recovery of the Hong Kong economy, domestic cost pressures are likely to increase gradually. While the fresh letting residential rentals are already higher than a year earlier, their impact on consumer prices still take time to surface. As such, the underlying consumer price inflation is expected to remain at a moderate level in 2022.

34. The Government will closely monitor the developments on the domestic and external fronts and announce the economic growth and inflation forecasts for 2022 along with the 2022-23 Budget in February this year. For reference, the latest forecasts of Hong Kong's economic growth for 2022 by private sector analysts were in the range of 1.3% to 5.0%, while those of consumer price inflation were in the range of 0.6% to 2.8%.

Office of the Government Economist
Financial Secretary's Office
11 January 2022

Annex

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. The benchmark of monthly household income for low-income households is adjusted upward based on inflation[2] from $8,800 (at constant Q2 2019 prices) to $9,200 (at Q3 2021 prices), so as to reflect the latest circumstance.

Overall situation of household income and employment earnings

2. The labour market continued to improve in the third quarter of 2021, alongside the sustained revival of local economic activity. The seasonally adjusted unemployment rate went down from 5.5% in the second quarter to 4.5% in the third quarter, and fell further to 4.1% in September – November. The overall labour demand strengthened gradually, with the latest total employment up by 1.1% year-on-year.

3. Amid the continued improvement in employment situation, the median monthly household income, a reflection of the overall household income situation, increased by 1.7% in nominal terms in the third quarter of 2021 from a year earlier, while it went down slightly by 0.5% in real terms. Average employment earnings of full-time employees (excluding bonus) decreased by 2.3% and 4.4% in nominal and real terms respectively. Meanwhile, average employment earnings of unskilled employees went up by 3.3% over a year earlier in nominal terms, while it fell by 0.7% in real terms ***(Table 1)***. It should be noted that the differences between nominal and real year-on-year changes of the above indicators were partly because the headline inflation rate in the third quarter of 2021 was enlarged by the low base effect caused by the Government's one-off relief measures in 2020.

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(1) This annex was originally provided in response to a Member's request at the meeting of the Panel on Financial Affairs on 5 December 2005. It has since been updated regularly for Members' information. 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^	
2017		5.0	(3.5)	4.3	(2.8)	5.5	(3.9)
2018		6.7	(4.2)	5.5	(3.0)	4.9	(2.1)
2019		1.7	(-1.1)	3.2	(0.3)	3.5	(0.1)
2020	Q1	-4.0	(-5.8)	7.8	(5.8)	2.8	(2.0)
	Q2	-10.2	(-11.6)	6.0	(4.4)	4.5	(2.8)
	Q3	-9.0	(-7.3)	6.0	(7.9)	4.7	(9.4)
	Q4	-7.4	(-6.9)	3.3	(3.9)	5.3	(6.1)
2021	Q1	-7.9	(-9.0)	0.6	(-0.6)	3.7	(0.3)
	Q2	3.0	(2.2)	-0.7	(-1.5)	4.0	(2.3)
	Q3	1.7	(-0.5)	-2.3	(-4.4)	3.3	(-0.7)

Notes: (*) Average employment earnings of full-time employees (excluding bonus).
(^) Average employment earnings of full-time employees.
( ) Rate of change (%) in real terms.
Median monthly household income and overall employment earnings of employees in real terms are adjusted based on headline Composite Consumer Price Index, while employment earnings of unskilled employees in real terms is adjusted based on headline Consumer Price Index (A).

Economically active households with monthly household income below $9,200

4. Along with continued improvements in the labour market and household income situations in the third quarter of 2021, the number of economically active households with monthly household income below $9,200 (referred to as "low-income households" thereafter) came down to 104 400. Its proportion in total domestic households fell over a year earlier by 1.2 percentage points to 3.9%[(3)].

5. An analysis of the number and proportion of low-income households over the past two decades or so suggests that their changes generally followed economic cycles. During 2000 and 2008, when the economy sustained growth for most of the period, the proportion of low-income households fell successively from a peak of 5.5% in the third quarter of 2003 to 3.2% in the third quarter of 2007. After the onset of the global financial crisis in late 2008, the corresponding proportion rose back to 4.1% in the third quarter of 2009 and subsequently declined following economic recovery. In 2020, as the COVID-19 pandemic dealt heavy blows to economic activities and the labour market, the proportion of low-income households rose appreciably to 5.1% in the third quarter. Amid sustained revival of local economic activity, the number and proportion of low-income households came down to 104 400 and 3.9% respectively in the third quarter of 2021 ***(Table 2 and Chart 1)***.

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(3) All figures pertaining to low-income households in the third quarter of 2021 are provisional figures.

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

Period	Household type: Elderly households#	Household type: Non-elderly households	**Total**	Of which: Economically active persons therein
Q3 2003	3 000	113 400	**116 500**	140 600
	(0.1)	(5.3)	**(5.5)**	[4.3]
Q3 2007	2 700	70 500	**73 200**	80 600
	(0.1)	(3.1)	**(3.2)**	[2.4]
Q3 2008	2 700	79 100	**81 700**	91 200
	(0.1)	(3.5)	**(3.6)**	[2.7]
Q3 2009	1 700	91 800	**93 500**	107 600
	(0.1)	(4.0)	**(4.1)**	[3.1]
Q3 2011	3 800	55 600	**59 300**	66 000
	(0.2)	(2.3)	**(2.5)**	[1.9]
Q3 2013	4 400	67 600	**72 000**	79 300
	(0.2)	(2.8)	**(3.0)**	[2.2]
Q3 2015	3 900	56 200	**60 100**	67 400
	(0.2)	(2.3)	**(2.4)**	[1.9]
Q3 2017	7 000	65 400	**72 400**	79 800
	(0.3)	(2.6)	**(2.8)**	[2.2]
Q3 2019	6 200	62 400	**68 600**	73 600
	(0.2)	(2.4)	**(2.6)**	[2.0]
Q3 2020	9 600	125 300	**134 900**	156 300
	(0.4)	(4.7)	**(5.1)**	[4.4]
Q3 2021	10 100	94 300	**104 400**	117 700
	(0.4)	(3.5)	**(3.9)**	[3.4]

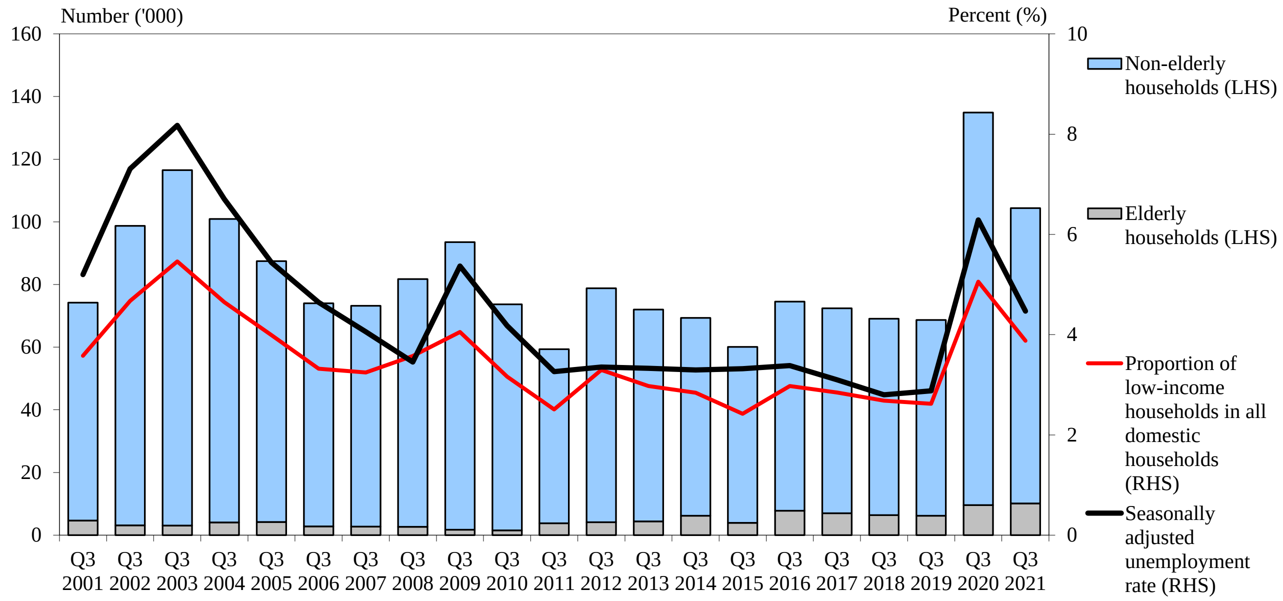
Notes :
(*) Low-income households refer to households with monthly household income less than $9,200 (Q3 2021 prices). This does not include households with all members being economically inactive.

(#) 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 and proportion of low-income households*



Note : (*) Low-income households refer to households with monthly household income less than $9,200 (Q3 2021 prices). This does not include households with all members being economically inactive.

Socio-economic characteristics of low-income households

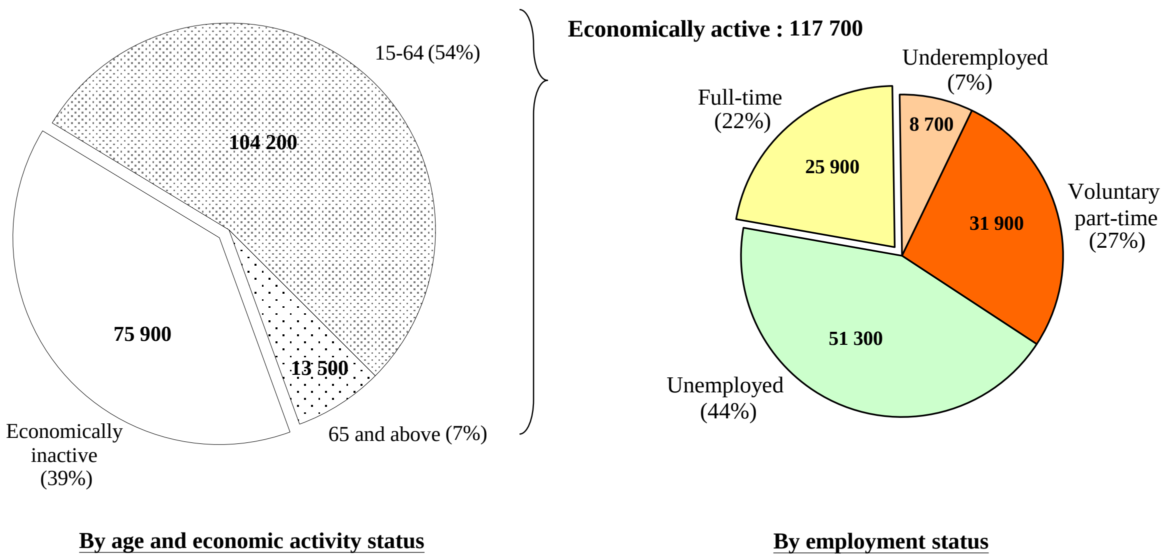
6. Further analysis of low-income households in the third quarter of 2021 reveals the following observations:

- There were 193 600 persons in these households, among whom 117 700 were economically active. Most of these economically active individuals (104 200 or 89%) were aged 15-64, with the majority of whom belonging to the older age group of 40-64 (73 100 or 70%); whilst 11% (13 500) were aged 65 and above.

- The remaining 75 900 persons were economically inactive, among whom 37 500 (49%) were either children aged below 15 or elders aged 65 and above.

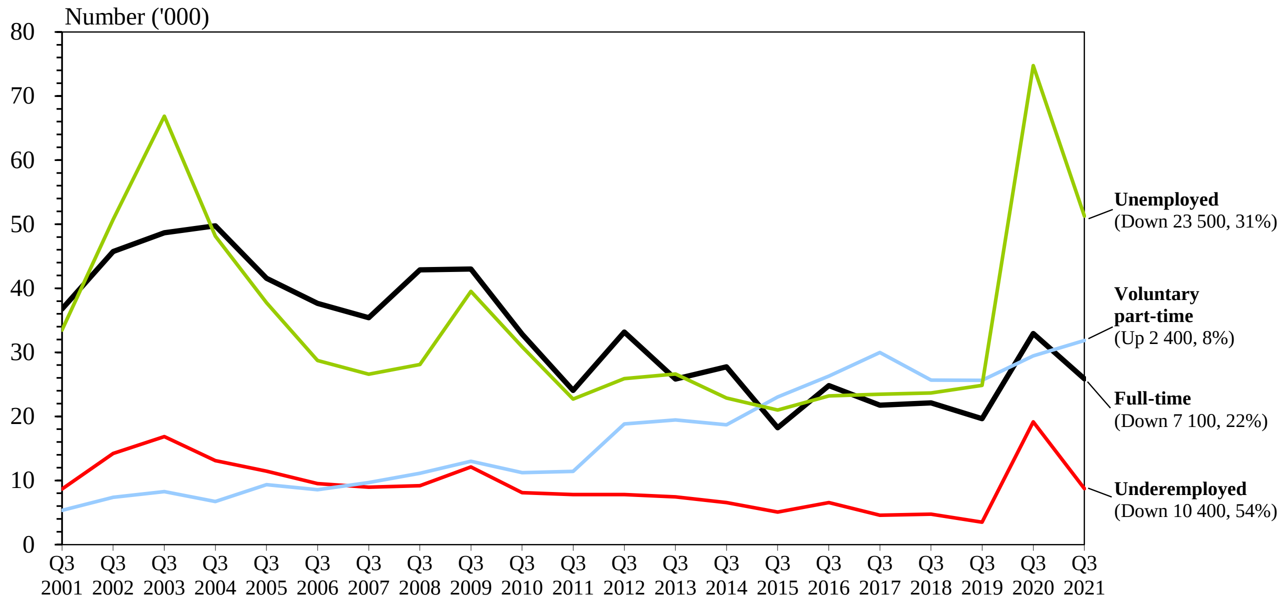
- Further analysis by employment status shows that among these 117 700 economically active persons, unemployed and underemployed persons accounted for 44% and 7% respectively, lower than the corresponding ratios of 48% and 12% in the same period in 2020, and the respective number of persons decreased to 51 300 and 8 700. The proportion of full-time workers was 22%, marginally higher than that of 21% from a year ago ***(Charts 2 and 3)***. All these reflected an improvement in the labour market as compared with a year earlier.

Chart 2 : Persons living in low-income households* by age and economic activity status, Q3 2021



Note : (*) Low-income households refer to households with monthly household income less than $9,200 (Q3 2021 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 $9,200 (Q3 2021 prices). This does not include households with all members being economically inactive.

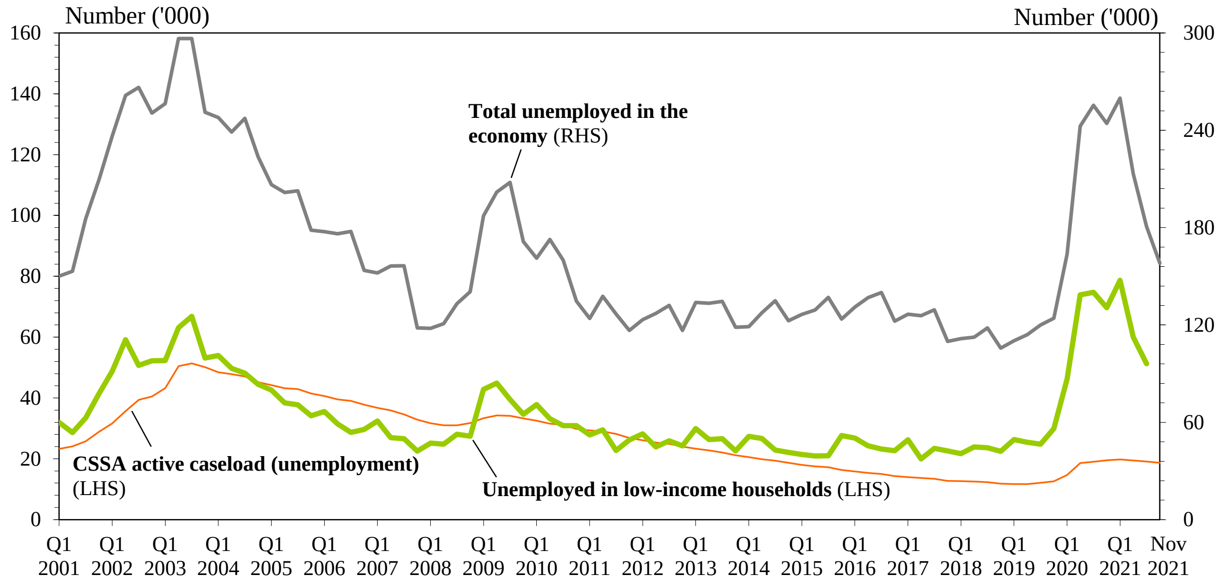
Figures in brackets are the year-on-year changes in number of economically active persons in Q3 2021.

- Analysed by occupation, the majority of the employed persons living in low-income households (76%) were lower-skilled workers (30% were elementary workers, and 26% 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 (14 900 or 22%), followed by repair, laundry, domestic and other personal service activities (6 600 or 10%).

The number of Comprehensive Social Security Assistance ("CSSA") cases

7. The unemployment rate of lower-skilled workers in September – November 2021 fell by 2.5 percentage points year-on-year to 4.4%. The number of CSSA unemployment cases declined by 409 or 2.1% over a year earlier to 18 670 in November 2021 ***(Chart 4)***. The number of overall CSSA caseload went down by 9 827 or 4.3% to 217 683 in November 2021 from its peak in April 2020 (227 510), and was also lower than the trough during the early stage of COVID-19 outbreak (219 677 in January 2020) by 1 994 or 0.9%.

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 $9,200 (Q3 2021 prices). This does not include households with all members being economically inactive.

(^) Monthly period-end figures.