

Press Release

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Economic Situation in the Second Quarter of 2016 and Latest GDP and Price Forecasts for 2016

The Government released today (12 August) the Half-yearly Economic Report 2016, together with the preliminary figures on Gross Domestic Product (GDP) for the second quarter of 2016.

The Acting Government Economist, Mr Andrew Au, described the economic situation in the second quarter of 2016 and provided the latest GDP and price forecasts for 2016.

Main points

- * The Hong Kong economy regained some momentum in the second quarter of 2016, growing modestly by 1.7% in real terms over a year earlier, up from 0.8% in the preceding quarter. This was largely underpinned by a pick-up in goods exports. On a seasonally adjusted quarter-to-quarter comparison, real GDP rebounded distinctly by 1.6% in the second quarter, reversing the 0.5% decline in the preceding quarter.
- * Global economic growth was still slow in the second quarter, yet reflected some relative improvement from the disappointing start of the year. Regional trade flows also showed initial signs of stabilisation. The UK vote in late June in favour of leaving the EU caused a temporary large sell-off in the global financial markets and worsened the already subdued global outlook, but had little impact on the wider European and global economy in so far as the second quarter is concerned. Against this background, Hong Kong's total exports of goods resumed a modest year-on-year growth of 2.0% in real terms in the second quarter, after declining for four consecutive quarters. Meanwhile, exports of services also saw a slightly narrower decline of 4.6%, reflecting reduced drag from the slowdown in inbound tourism and regional trade and cargo flows.
- * On the domestic front, private consumption expenditure grew slightly by 0.6% in real terms in the second quarter over a year earlier. Meanwhile, the decline in investment expenditure narrowed notably to 4.9%, thanks to the pick-up in overall building and construction works, though private sector machinery and equipment acquisition was still subdued.
- * The labour market remained remarkably resilient. The seasonally adjusted unemployment rate held unchanged at 3.4% in the second quarter. Wages and earnings sustained further growth. Total employment grew modestly, but signs of slackening labour demand in the trade- and consumption-related sectors continued to be a cause for concern.
- * The local stock market remained rather volatile in the second quarter, but the range of fluctuation narrowed compared to the preceding quarter. While the UK vote in favour of leaving the EU surprised global financial markets in late

June, equity markets stabilised quickly after a brief jittery period. Residential property market activity also rebounded during the second quarter from its low, with prices showing a small increase.

- * Looking ahead, the global economy will likely continue to expand at a modest pace in the rest of the year, with the US economy regaining some steam and many Asian economies showing signs of improvement. This should hopefully provide some support to Hong Kong's goods exports in the coming quarters. While the UK vote to leave the EU has added uncertainty, the pledges by major central banks to safeguard global financial stability and the quick stabilisation of global financial markets after the vote have mitigated the more acute risks. That said, the event of Brexit is still unfolding, and the possibility of further repercussions on the global economic and financial environment could not be ruled out. Moreover, various external downside risks still persist and warrant close monitoring. These include the uncertainty about US interest rate normalisation, monetary policy divergence among major central banks, fragile recoveries of the euro area and Japan, and heightened geopolitical tensions in various regions.
- * Latest visitor arrivals trend suggests that the drag from the slowdown of inbound tourism has been reducing. If continued, this may help to improve the performance of services exports and to gradually stabilise retail sales in the latter part of the year.
- * Domestically, private consumption expenditure will continue to be underpinned by the largely stable income and employment conditions. The package of relief measures in the 2016-17 Budget and the ongoing intensive building and construction works should also provide impetus to overall economic growth.
- * Taking into account the actual growth outturn of 1.2% in the first half and various external challenges, and barring abrupt negative shocks from the external environment, the real GDP growth forecast for 2016 as a whole is maintained at 1-2% in the current round of review. The Government will stay vigilant and monitor the local and external developments closely.
- * Inflation pressure remained moderate, with underlying inflation easing to 2.3% in the second quarter from 2.8% in the first quarter. Given the generally low global inflation, external price pressure should remain muted in the near term. Locally, the feed-through of the earlier softening in fresh-letting residential rentals will continue, while the below-trend economic growth will also contain the local cost pressure. With limited upside risks, inflation in Hong Kong will likely stay modest in the rest of the year. Having considered the actual outturn in the first half, the forecast rate of underlying consumer price inflation for 2016 as a whole is slightly revised upward to 2.2% in the current round of review, while the corresponding headline consumer price inflation rate is forecast at 2.3%.

Details

GDP

According to the preliminary data on the *Gross Domestic Product (GDP)* released today by the Census and Statistics Department, GDP grew by 1.7% in real terms in the second quarter of 2016 over a year earlier, picking up from the 0.8% growth in the preceding quarter (same as the earlier estimate). On a seasonally adjusted quarter-to-quarter comparison, real GDP rebounded distinctly by 1.6% in the second quarter, after the 0.5% decline in the preceding quarter (revised from the earlier estimate of -0.4%) (*Chart*).

2. The latest figures on GDP and its major expenditure components up to the second quarter of 2016 are presented in *Table 1*. Developments in different segments of the economy in the second quarter of 2016 are described below.

External trade

3. *Total exports of goods* reverted to 2.0% growth in real terms in the second quarter over a year earlier, in contrast to the 3.6% decline in the preceding quarter. Among the advanced markets, exports to the EU rebounded, partly offsetting the continued declines in exports to the US and Japan. Exports to the Mainland reverted to modest growth. Exports to some higher-income Asian economies such as Taiwan and Korea picked up, and those to India registered further double-digit growth. On a seasonally adjusted quarter-to-quarter basis, exports of goods bounced back strongly by 3.3% in real terms in the second quarter.

4. *Exports of services* extended the decline in the second quarter, but fell at a slightly smaller year-on-year rate of 4.6% in real terms, after a 5.0% drop in the preceding quarter. Exports of travel services saw a narrower decline, reflecting a milder drop in visitor arrivals. Meanwhile, exports of trade-related services staged a slight rebound, and exports of transportation services declined at a softer pace, mirroring some relative improvement in regional trade and cargo flows. On the other hand, exports of financial and other business services registered a larger year-on-year decline, affected by the slowdown in cross-border financial and fund-raising activities and the high base of comparison created by the strong double-digit growth in the second quarter of last year. On a seasonally adjusted quarter-to-quarter basis, exports of services recorded a much narrower decline of 0.2% in real terms in the second quarter.

Domestic sector

5. The domestic sector saw some improvement in the second quarter. *Private consumption expenditure* grew slightly by 0.6% in real terms in the second quarter over a year earlier. Although consumption sentiment was affected by various economic uncertainties, the broadly stable labour market continued to render support. On a seasonally adjusted quarter-to-quarter comparison, private consumption expenditure bounced back by 0.9% in the second quarter. *Government consumption expenditure* maintained steady growth at 3.4% year-on-year in real terms in the second quarter.

6. Overall investment spending in terms of *gross domestic fixed capital formation* declined by a lesser extent, at 4.9% year-on-year in real terms in the second quarter, representing a visible relative improvement after two quarters of near double-digit decline. This was mainly due to a pick-up in overall building and construction expenditure, which grew by 3.9% year-on-year, as public infrastructure works fell at a notably decelerated pace, while private sector building works sustained visible growth. In contrast, private sector machinery and equipment acquisition remained on the downtrend, plunging by 13.1% over a year earlier, reflecting cautious business sentiment amid subdued global economic outlook.

The labour sector

7. The labour market remained largely stable in overall terms, with the *seasonally adjusted unemployment rate* unchanged at 3.4% in the second quarter. The *underemployment rate* also held steady at 1.4%. Wages and earnings remained on the rise. Total employment sustained a modest year-on-year growth in the second quarter. Yet, the labour demand in the trade- and consumption-related sectors showed further signs of slackening, mirroring the lack of growth in external trade, weakness in inbound tourism and softer local consumer spending.

The asset markets

8. The *local stock market* was still rather volatile in the second quarter, but the range of fluctuation was narrower than in the first quarter. In tandem with many overseas stock markets, it saw larger swings immediately after the unexpected outcome of the UK vote in late June. Yet the Hang Seng Index stabilised quickly thereafter and rebounded subsequently to 22 581 on 11 August, 3.0% higher than at end-2015.

9. The *residential property market* rebounded somewhat in the second quarter of 2016, especially in terms of trading activity, after undergoing a period of consolidation since the fourth quarter of 2015. Trading turned more active in the second quarter but remained low by historical standards. Residential property prices rebounded slightly by 2% between March and June, but were still down by 10% from the peak in 2015. Nonetheless, overall flat prices in June still surpassed the 1997 peak by 59% and the housing affordability ratio stayed elevated at around

56% in the second quarter. During the second quarter, flat rentals went up by 1%, while shop and office rentals showed little change.

Prices

10. Consumer price inflation eased back in the second quarter. Domestic price pressures were kept at bay amid subpar local economic performance. The private housing rental component of the underlying Composite Consumer Price Index and prices of basic foodstuffs registered milder year-on-year increases. Meanwhile, imported inflation was basically absent, thanks to still-low international food and commodity prices and muted inflation in Hong Kong's major import partners. Netting out the effects of the Government's one-off relief measures to more accurately reflect the underlying inflation trend, *underlying consumer price inflation* eased from 2.8% in the first quarter to 2.3% in the second quarter. For the first half of 2016, underlying consumer price inflation averaged 2.5%, virtually the same as 2015 as a whole. *Headline consumer price inflation* also edged lower to 2.6% in the second quarter, from 2.8% in the preceding quarter. Headline consumer price inflation averaged 2.7% in the first half of 2016, moderating further from 3.0% in 2015.

Latest GDP and price forecasts for 2016

11. Looking ahead, the global economy will likely continue to expand at a modest pace in the rest of the year, with the US economy regaining some steam and many Asian economies showing signs of improvement. This should hopefully provide some support to Hong Kong's goods exports in the coming quarters. While the UK vote to leave the EU has added uncertainty, the pledges by major central banks to safeguard global financial stability and the quick stabilisation of global financial markets after the vote have mitigated the more acute risks. That said, the event of Brexit is still unfolding, and the possibility of further repercussions on the global economic and financial environment could not be ruled out. Moreover, various external downside risks still persist and warrant close monitoring. These include the uncertainty about US interest rate normalisation, monetary policy divergence among major central banks, fragile recoveries of the euro area and Japan, and heightened geopolitical tensions in various regions.

12. Latest visitor arrivals trend suggests that the drag from the slowdown of inbound tourism has been reducing. If continued, this may help to improve the performance of services exports and to gradually stabilise retail sales in the latter part of the year.

13. Domestically, private consumption expenditure will continue to be underpinned by the largely stable income and employment conditions. The package of relief measures in the 2016-17 Budget and the ongoing intensive building and construction works should also provide impetus to overall economic growth.

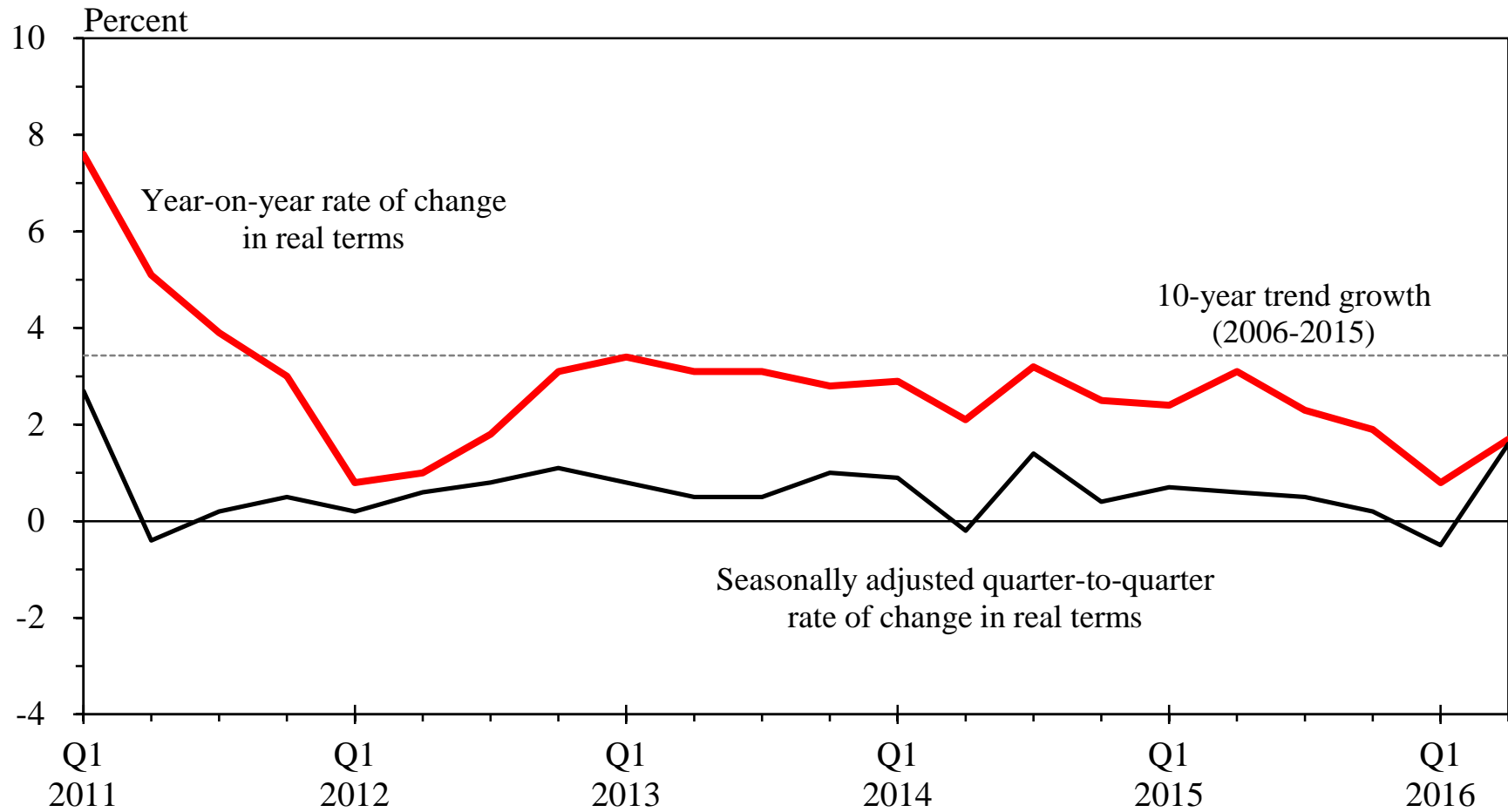
14. Taking into account the actual growth outturn of 1.2% in the first half

and various external challenges, and barring abrupt negative shocks from the external environment, the real GDP growth forecast for 2016 as a whole is maintained at 1-2% in the current round of review (*Table 2*). For reference, the latest forecasts by private sector analysts mostly range from 0.5-1.5%, averaging around 1.2%. The Government will stay vigilant and monitor the local and external developments closely.

15. On inflation outlook, given the generally low global inflation, external price pressure should remain muted in the near term. Locally, the feed-through of the earlier softening in fresh-letting residential rentals will continue, while the below-trend economic growth will also contain the local cost pressure. With limited upside risks, inflation in Hong Kong will likely stay modest in the rest of the year. Having considered the actual outturn in the first half, the forecast rate of underlying consumer price inflation for 2016 as a whole is slightly revised upward to 2.2% in the current round of review, while the corresponding headline inflation rate is forecast at 2.3% (*Table 2*).

(The Half-yearly Economic Report 2016 is now available for online download, free of charge at www.hkeconomy.gov.hk/en/reports/index.htm. The Report of the Gross Domestic Product, Second Quarter 2016, which contains the GDP figures up to the second quarter of 2016, is also available for online download, free of charge at the homepage of the Census and Statistics Department, www.censtatd.gov.hk.)

Hong Kong's Gross Domestic Product



Note : Figures for the second quarter of 2016 are preliminary estimates.

Table 1

**Gross Domestic Product, its main expenditure components
and the main price indicators
(year-on-year rate of change (%))**

| | <u>2014</u> | <u>2015</u> | <u>Q1</u> | <u>Q2</u> | <u>2015</u> <u>Q3</u> | <u>Q4</u> | <u>Q1</u> [#] | <u>2016</u> <u>Q2</u> ⁺ |
|--|-------------|-------------------------|---|--|--|--|--|---|
| <i>Change in real terms of GDP and its main expenditure components (%)</i> | | | | | | | | |
| Private consumption expenditure | 3.3 | 4.7 | 5.0 (1.3) | 6.8 (1.6) | 4.4 (*) | 2.7 (-0.1) | 1.2 (-0.2) | 0.6 (0.9) |
| Government consumption expenditure | 3.0 | 3.4 | 3.9 (1.0) | 3.6 (0.8) | 2.8 (0.5) | 3.3 (1.0) | 3.3 (1.0) | 3.4 (0.8) |
| Gross domestic fixed capital formation | -0.1 | -2.0 | 5.6 | 3.9 | -6.2 | -9.4 | -9.6 | -4.9 |
| <i>of which :</i> | | | | | | | | |
| Building and construction | 9.3 | 2.9 | -3.9 | 14.1 | 4.2 | -0.9 | 0.2 | 3.9 |
| Machinery, equipment and intellectual property products | -8.6 | -5.8 | 10.4 | -4.7 | -10.7 | -12.9 | -11.9 | -11.3 |
| Total exports of goods | 0.8 | -1.9 | 0.2 (-1.9) | -3.8 (-2.4) | -3.1 (0.5) | -0.5 (2.3) | -3.6 (-3.9) | 2.0 (3.3) |
| Imports of goods | 0.9 | -2.7 | -0.2 (-2.6) | -3.3 (-2.4) | -4.2 (-0.8) | -2.8 (2.0) | -5.4 (-4.2) | 0.2 (3.5) |
| Exports of services | 1.1 | -0.2 | 0.7 (0.6) | 1.6 (-0.8) | -0.2 (-1.1) | -2.7 (-1.4) | -5.0 (-1.9) | -4.6 (-0.2) |
| Imports of services | 1.8 | 5.7 | 6.7 (1.8) | 5.1 (1.9) | 5.5 (0.2) | 5.4 (1.4) | 4.9 (1.4) | 1.1 (-2.0) |
| Gross Domestic Product | 2.7 | 2.4 | 2.4 (0.7) | 3.1 (0.6) | 2.3 (0.5) | 1.9 (0.2) | 0.8 (-0.5) | 1.7 (1.6) |
| <i>Change in the main price indicators (%)</i> | | | | | | | | |
| GDP deflator | 2.9 | 3.6 | 4.3 (1.2) | 4.2 (1.0) | 3.4 (0.1) | 2.8 (0.4) | 2.3 (0.7) | 2.0 (0.7) |
| Composite CPI | | | | | | | | |
| Headline | 4.4 | 3.0 [@] | 4.4 (0.3) [@] | 3.0 (-0.6) [@] | 2.3 (-0.1) [@] | 2.3 [@] (2.7) [@] | 2.8 [@] (0.7) [@] | 2.6 [@] (-0.7) [@] |
| Underlying [^] | 3.5 | 2.5 [@] | 2.7 (0.3) [@] | 2.5 (0.6) [@] | 2.4 (0.5) [@] | 2.2 [@] (0.9) [@] | 2.8 [@] (0.7) [@] | 2.3 [@] (0.2) [@] |
| <i>Change in nominal GDP (%)</i> | 5.6 | 6.2 | 6.8 | 7.5 | 5.8 | 4.8 | 3.1 | 3.8 |

Notes : Figures are subject to revision later on as more data become available. Seasonally adjusted quarter-to-quarter rate of change is not applicable to gross domestic fixed capital formation, as no clear seasonal pattern is found for the category due to the presence of considerable short term fluctuations.

(#) Revised figures.

(+) Preliminary figures.

() Seasonally adjusted quarter-to-quarter rate of change.

(^) After netting out the effects of Government's one-off relief measures.

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

(@) By reference to the new 2014/15-based CPI series.

Table 2**Economic forecasts for 2016
(rate of change (%))**

| | <u>Forecasts as released on 13.5.2016</u> (%) | <u>Latest forecasts on 12.8.2016</u> (%) |
|--|--|---|
| Real Gross Domestic Product (GDP) | 1 to 2 | <i>1 to 2</i> |
| Composite Consumer Price Index (CCPI) | | |
| <i>Underlying CCPI</i> | 2 | 2.2 |
| <i>Headline CCPI</i> | 2.3 | 2.3 |