

Outlook for the Hong Kong economy in 2017

2.21 Given the small and highly externally-oriented nature of our economy, Hong Kong’s economic outlook for 2017 will continue to depend predominantly on how global economic and financial conditions will evolve. After a rather weak start in early 2016, Hong Kong’s economic growth picked up steadily as the year progressed, alongside a generally stabilising external environment. Regional trade flows have continued to revive amid the relative improvement in external demand, and in tandem, our merchandise export growth staged a visible rebound in the fourth quarter of 2016. Should this positive trend extend into 2017 and barring abrupt negative shocks to the global economic, financial and trading environment, Hong Kong’s *exports of goods* will likely see a stronger performance this year, especially if the demand recovery in the advanced markets can gain further traction, rendering firmer support to Asia’s production and trading activities. However, a downside factor to watch out is the possibility of a distinct strengthening of the US dollar, which could pose a cap to the upside potential of the current export recovery.

Diagram 2.5 : The outlook for Hong Kong’s goods exports should hopefully improve in 2017

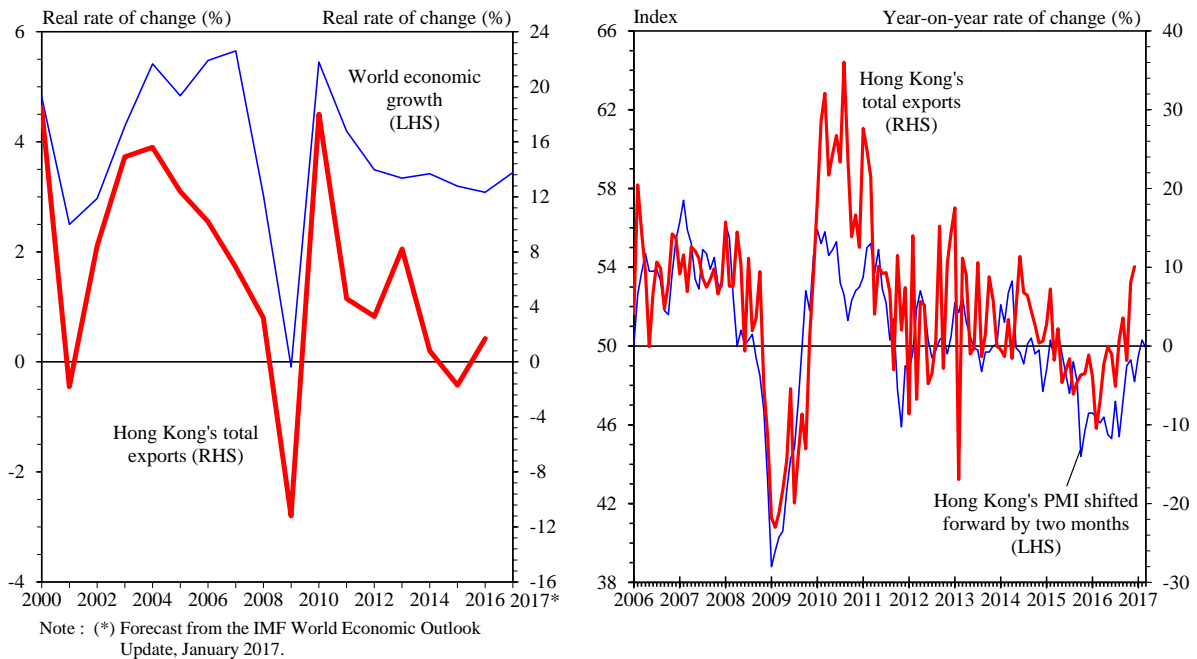
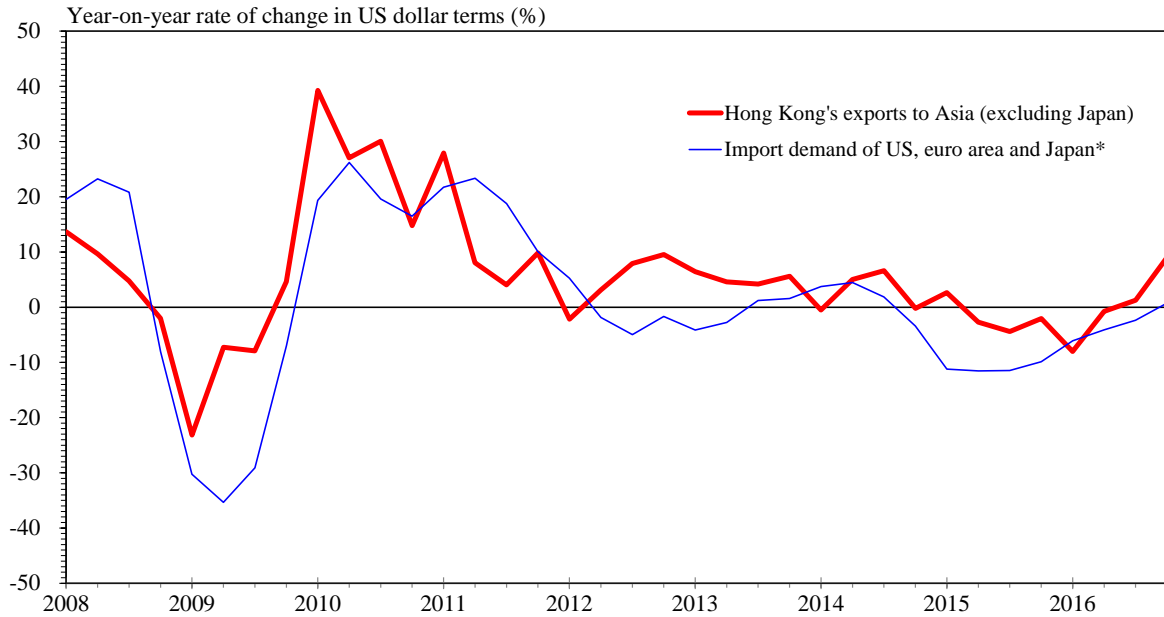


Diagram 2.6 : Regional trade picked up amid the recent recovery in external demand

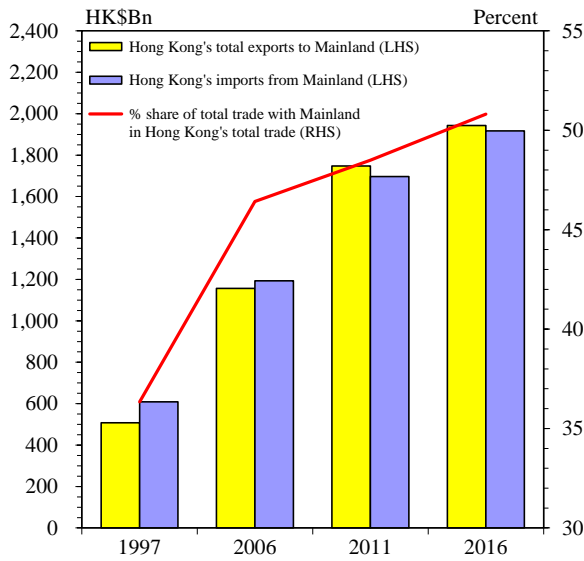


Note : (*) The latest figure refers to October-November 2016 combined.

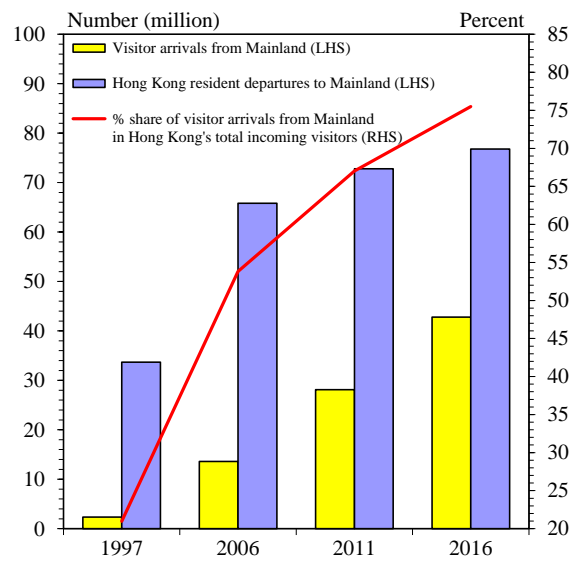
2.22 Amid a gradually improving trading environment and lesser drag from inbound tourism over the course of the year, *exports of services* also strengthened up gradually during 2016. By the fourth quarter, services exports returned to a mild year-on-year growth, ending four consecutive quarters of decline. Looking ahead, overall services exports should hopefully improve further this year. The recent rebound in visitor arrivals, if continues, will be one positive factor. On top of this, exports of transport services look set to ride on the expected recovery of regional trade and cargo flows, and more so if the various external uncertainties subside further over the course of 2017. Also, exports of financial services and business and other services will likely benefit from cross-border financing and fund-raising activities, which have great potential to flourish.

Diagram 2.7 : Economic links with the Mainland are important for Hong Kong

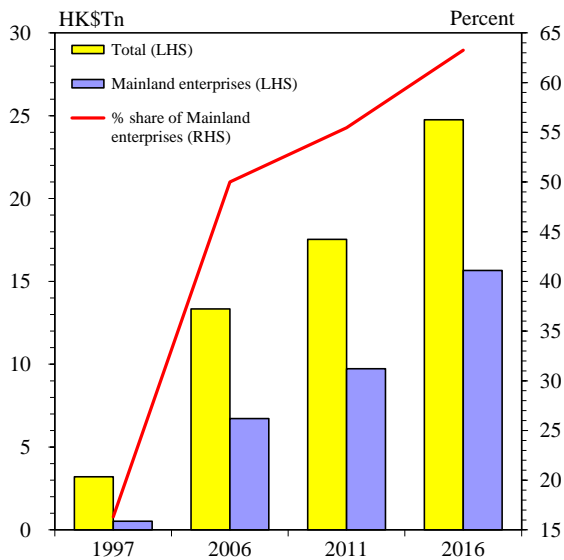
(a) Merchandise trade



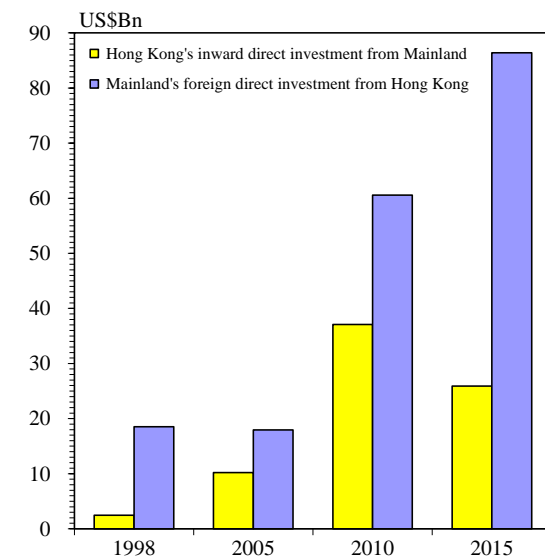
(b) Visitor arrivals from Mainland and Hong Kong resident departures to Mainland



(c) Market capitalisation of Mainland enterprises in the Hong Kong stock market (end-year figures)



(d) Hong Kong's inward direct investment from Mainland and Mainland's foreign direct investment from Hong Kong



2.23 Hong Kong's *domestic demand* continued to exhibit much resilience in 2016. Looking ahead, barring any significant negative shocks from the external front, domestic demand should be able to hold up well this year. A stable labour market in a virtually full-employment situation, coupled with steady household income growth, is expected to remain a solid anchor to private consumption expenditure this year, and even more so if asset market conditions are to remain broadly supportive. Investment expenditure is generally sensitive to the vicissitudes of the external environment and the ups and downs of the business cycle. On this, it should be noted that business sentiments of large enterprises have tended to remain stable of late. Ongoing building and construction works are likely to provide a more stable growth impetus to overall investment this year, with expenditure on such activities at a multi-year high last year.

2.24 Local borrowing costs have increased subsequent to the US interest rate hike in December 2016, albeit still at very low levels by historical standards. Given that Hong Kong is not a highly leveraged economy and assuming a gradual normalisation of interest rates by the Fed, the increases in local interest rates in the coming year should be manageable without impinging heavily on the growth momentum of the local economy. That said, various external uncertainties could swing market sentiment. The potential repercussions on asset market conditions and economic sentiment will need to be closely monitored.

Diagram 2.8 : Private consumption looks set to attain further growth in 2017

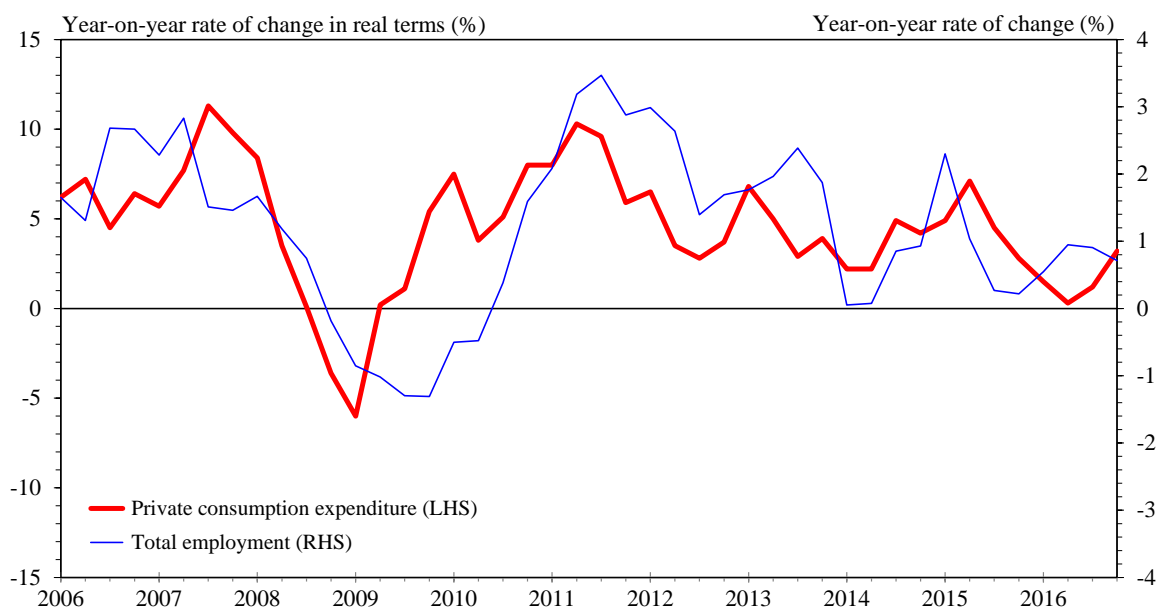


Diagram 2.9 : Consumer sentiment should hold up if asset market conditions remain broadly supportive

(a) Housing wealth

(b) Equity wealth

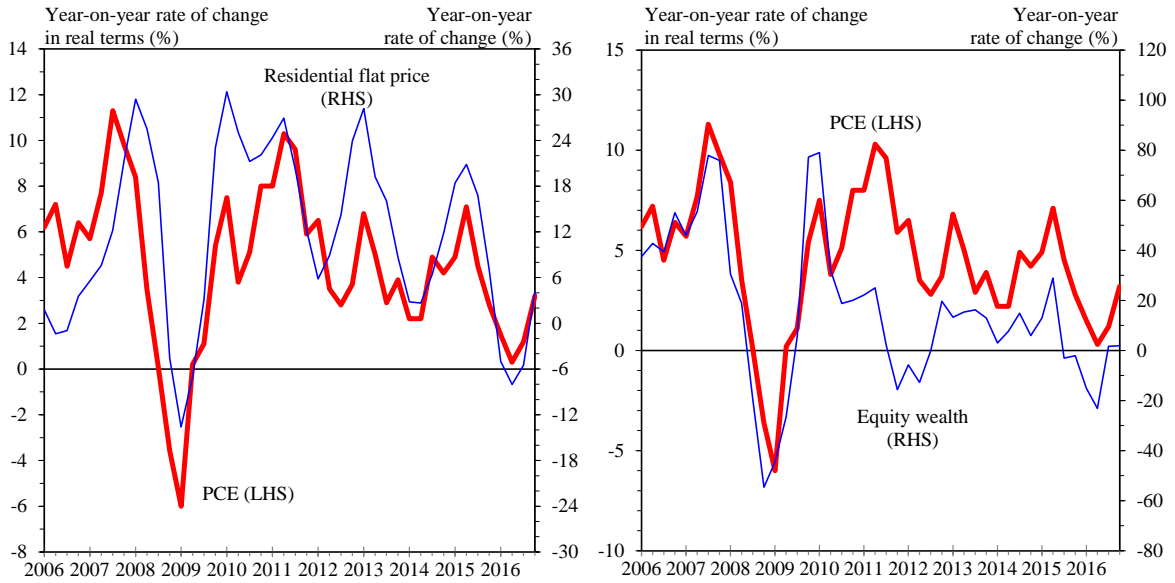
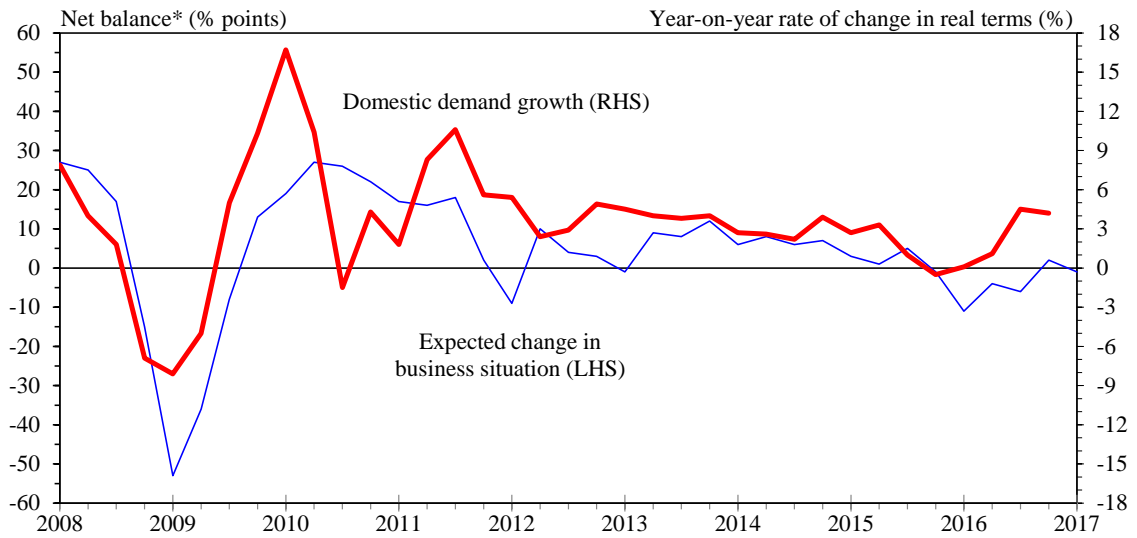
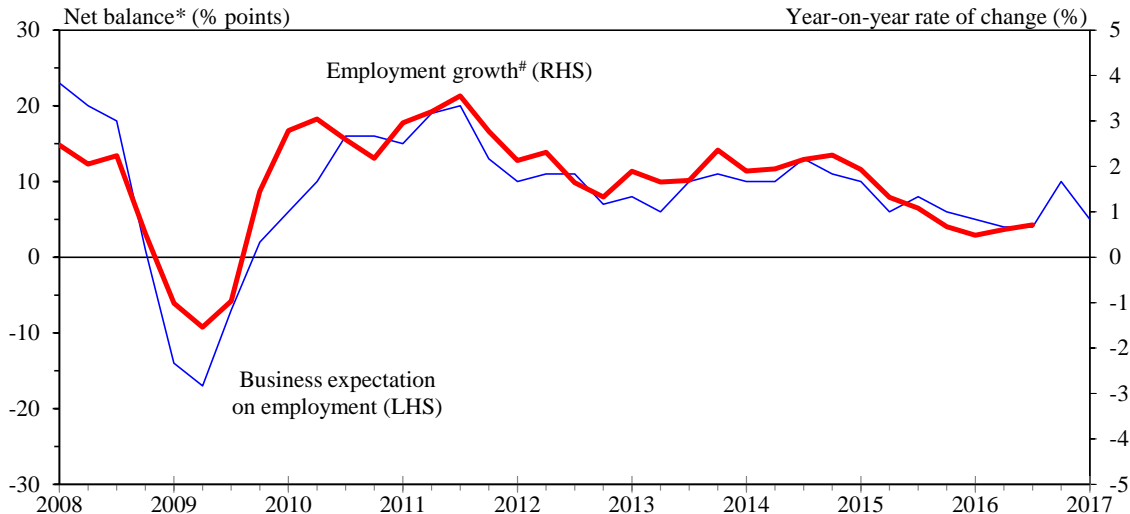


Diagram 2.10 : Business sentiments of large enterprises have tended to remain stable of late



Note : (*) Net balance indicates the direction of expected change in business situation versus the 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.

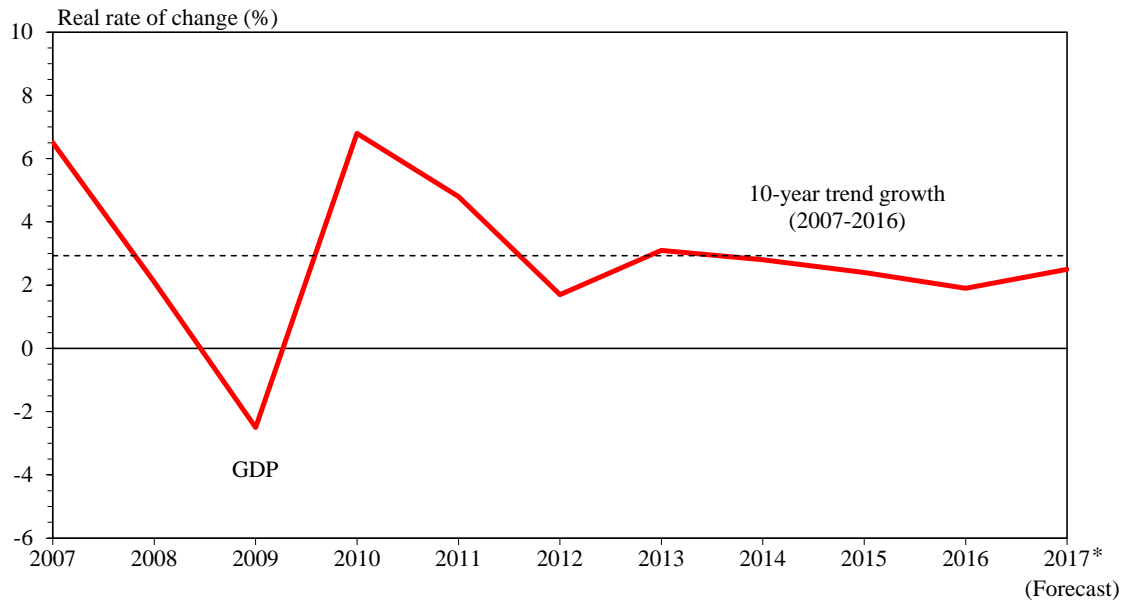
Diagram 2.11 : Hiring sentiment held broadly stable



Notes : (*) Net balance indicates the direction of expected change in number of persons engaged versus the preceding quarter. It refers to the difference in percentage points between the proportion of establishments choosing "up" over that choosing "down". A positive sign indicates a likely upward trend while a negative sign, a likely downward trend.
 (#) Employment in the private sector.

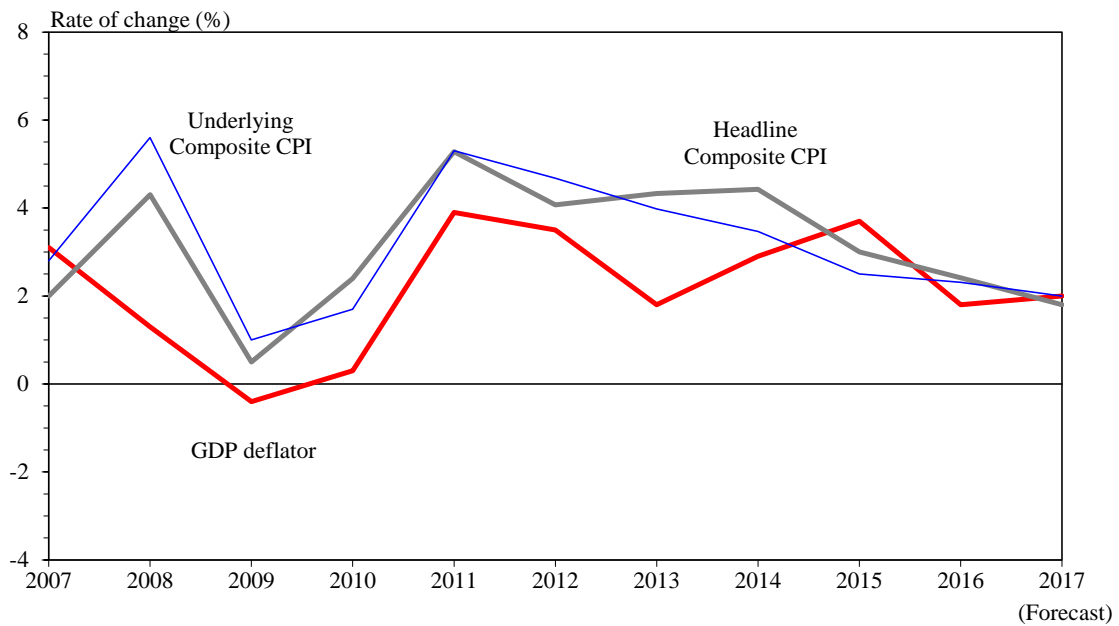
2.25 Taking into account a likely further improvement in export performance and continued growth in domestic demand, the Hong Kong economy is projected to grow by 2-3% in 2017, after the 1.9% growth in 2016 and compared to the average annual growth of 2.9% in the past ten years. The forecast is predicated on a slightly faster economic expansion in the US amid a gradual interest rate normalisation by the Fed, modest economic recovery in Europe, no significant disruptions to the global financial environment arising from developments on economic and political fronts, and steady economic performance in the Mainland and other Asian emerging market economies. For comparison, the latest forecasts by private sector analysts for Hong Kong's economic growth in 2017 mostly fall within the range of 1.1-2.1%, averaging around 1.6%, and that by the IMF is 1.9%. Yet, there are downside risks to the forecast if the global economic recovery were to stall again. Abrupt changes in global economic and financial conditions could heighten risk aversion and bring about sudden reversals of capital flows and sharp corrections in asset prices, which would hurt sentiment and derail the current global economic recovery path. On the other hand, there may be some upside potential to the forecast if global economic growth can gain more traction, providing a more favourable support for regional trade flows, to the benefit of Hong Kong. Domestic demand will fare better than expected if financial markets can be more stable and if economic sentiment holds up.

Diagram 2.12 : Hong Kong economy is expected to fare better in 2017, but uncertainties prevail



2.26 Underlying inflation in Hong Kong edged down from 2.5% in 2015 to 2.3% in 2016, marking the fifth consecutive year of easing. On the external front, slow growth in the advanced economies and the still-tame inflation outlook for Hong Kong’s major trading partners should ease some of the upward pressures from commodity prices and help keep imported inflation in check. On the domestic front, local cost pressures should remain at bay, considering the likely moderate economic growth and the continued feed-through of the earlier softening in rentals. The *underlying Composite CPI* is forecast to increase by 2% for 2017 as a whole, compared to the 2.3% increase in 2016. Taking into account the effects of the Government’s one-off measures, the *headline Composite CPI* is forecast to increase by 1.8% in 2017, compared to 2.4% in 2016. The *GDP deflator* is forecast to rise by 2%, in light of the anticipated mild price pressures from both the local and external fronts.

Diagram 2.13 : Inflation will likely remain moderate in 2017



Forecast rate of change in 2017 (%)

Gross Domestic Product (GDP)

<i>Real GDP</i>	2 to 3
<i>Nominal GDP</i>	4 to 5
<i>Per capita GDP in real terms</i>	1.2 to 2.2
<i>Per capita GDP at current market prices</i>	HK\$349,700 – 353,000 (US\$44,800 – 45,300)

Composite Consumer Price Index

<i>Underlying</i>	2
<i>Headline</i>	1.8

GDP Deflator **2**

**Forecast on Hong Kong’s real GDP growth in 2017
recently made by other selected parties**

	(%)
The University of Hong Kong	1.5 to 2.5
Average forecast by private sector analysts [#]	1.6

Note : (#) Real GDP growth forecasts by private sector analysts mostly fall between 1.1% and 2.1%.

ECONOMIC PERFORMANCE IN 2016

1. Rates of change in the Gross Domestic Product and its expenditure components and in the main price indicators in 2016 ^(Note 1):

	(%)
(a) Growth rates in real terms of:	
Private consumption expenditure	1.6
Government consumption expenditure	3.3
Gross domestic fixed capital formation	-0.5
<i>of which :</i>	
Building and construction	3.6
Machinery, equipment and intellectual property products	-4.6
Total exports of goods	1.7
Imports of goods	1.0
Exports of services	-3.1
Imports of services	1.9
Gross Domestic Product (GDP)	1.9
<i>Per capita GDP in real terms</i>	1.4
<i>Per capita GDP at current market prices</i>	HK\$338,800 (US\$43,600)
(b) Rates of change in:	
Underlying Composite Consumer Price Index	2.3
GDP Deflator	1.8
Government Consumption Expenditure Deflator	3.8
(c) Growth rate of nominal GDP	3.8

2. Annual rates of change in real terms of re-exports, domestic exports and total exports based on external trade quantum index numbers:

	<i>Re-exports</i> (%)	<i>Domestic exports</i> (%)	<i>Total exports</i> (%)
2014	1	3	2
2015	-2	-13	-2
2016	2	-7	1
<i>Share in the value of total exports of goods in 2016</i>	99	1	100

3. Annual rates of change in real terms of total exports by major market based on external trade quantum index numbers:

	<i>Total exports</i>					
	<i>Total</i> (%)	<i>The Mainland</i> (%)	<i>US</i> (%)	<i>EU</i> (%)	<i>Japan</i> (%)	<i>India</i> (%)
2014	2	-1	3	1	-4	16
2015	-2	-2	1	-4	-4	8
2016	1	2	-2	-1	-2	18

4. Annual rates of change in real terms of imports and retained imports based on external trade quantum index numbers:

	<i>Imports</i> (%)	<i>Retained imports</i> (%)
2014	2	4
2015	-3	-7
2016	1	-1

5. Annual rates of change in real terms of exports of services by type:

	<i>Exports of services</i>				
	<i>Total</i> (%)	<i>Transport services</i> (%)	<i>Travel services</i> (%)	<i>Financial services</i> (%)	<i>Other services</i> (%)
2014	2	3	-2	6	1
2015	0	1	-4	9	-1
2016 <i>(Note 1)</i>	-3	2	-9	-3	0

6. Hong Kong's goods and services trade balance in 2016 reckoned on GDP basis *(Note 1)*:

	(HK\$ billion)
Total exports of goods	3,900.2
Imports of goods	4,036.2
<i>Goods trade balance</i>	-136.0
Exports of services	764.0
Imports of services	578.0
<i>Services trade balance</i>	186.1
<i>Combined goods and services trade balance</i>	50.1

Note 1 Preliminary figures.

7. Annual averages of the unemployment and underemployment rates and growth in labour force and total employment:

	<i>Unemployment rate (%)</i>	<i>Underemployment rate (%)</i>	<i>Growth in labour force (%)</i>	<i>Growth in total employment (%)</i>
2014	3.3	1.5	0.5	0.6
2015	3.3	1.4	0.9	0.8
2016	3.4	1.4	0.9	0.8

8. Annual rates of change in the Consumer Price Indices:

	<i>Composite CPI</i>		<i>CPI(A)</i>	<i>CPI(B)</i>	<i>CPI(C)</i>
	<i>Underlying (%)</i>	<i>Headline (%)</i>	<i>(%)</i>	<i>(%)</i>	<i>(%)</i>
2014	3.5	4.4	5.6	4.2	3.5
2015	2.5	3.0	4.0	2.9	2.1
2016	2.3	2.4	2.8	2.3	2.1

ECONOMIC PROSPECTS FOR 2017

Forecast rates of change in the Gross Domestic Product and prices in 2017:

	(%)
Gross Domestic Product (GDP)	
<i>Real GDP</i>	2 to 3
<i>Nominal GDP</i>	4 to 5
<i>Per capita GDP in real terms</i>	1.2 to 2.2
<i>Per capita GDP at current market prices</i>	HK\$349,700-353,000 (US\$44,800-45,300)
Composite Consumer Price Index	
<i>Underlying Composite Consumer Price Index</i>	2
<i>Headline Composite Consumer Price Index</i>	1.8
GDP Deflator	2
Government Consumption Expenditure Deflator	3.3