CHAPTER 1 : OVERVIEW OF ECONOMIC PERFORMANCE

Summary

- *As a small open economy, Hong Kong has been hard hit by the global financial crisis and the ensuing severe recession which is the worst in more than sixty years. Following a contraction of 2.6% in the fourth quarter of 2008, GDP registered a sharp decline of 7.8% in the first quarter of 2009 over a year earlier.*

- *The shocks on Hong Kong were inflicted mainly through the trade and financial channels via the collapse in world trade, negative wealth effects, and heightened cautiousness in local consumer and investment spending. On the trade front, Hong Kong's merchandise exports faced the double blow from sharp plunge in global demand and from an acute fall-off in intra-regional exports which were closely linked to demand in advanced economies. Many export-dependent Asian economies were hit in a similar way, and their ensuing recession also added to Hong Kong's already weak export performance.*

- *Exports of services likewise deteriorated even more in the first quarter, as offshore trade lost momentum and demand for freight transport dwindled. Exports of financial services remained sluggish as market activities were way below the levels before the financial tsunami. Inbound tourism nevertheless held fairly firm, thanks to continued growth in Mainland visitors, partly helped by the further liberalisation measures under the Individual Visit Scheme.*

- *In such a difficult and uncertain global economic climate, local sentiments were naturally affected. Consumption weakened in the first quarter, but the situation would have been worse if not for the relative improvements in the local stock and property markets during the quarter, and also the stimulus from the several rounds of packages announced last year and in the 2009/10 Budget this year. Investment demand, however, remained much in a depressed state.*

- *The unemployment rate rose to a 38-month high of 5.2% in the first quarter, with increasing downward pressures on wages and earnings. Yet the pace of uptrend in unemployment rate tapered somewhat in the more recent months.*

- *Consumer price inflation continued to trend down, in tandem with the notable easing in both local and external price pressures consequential to*

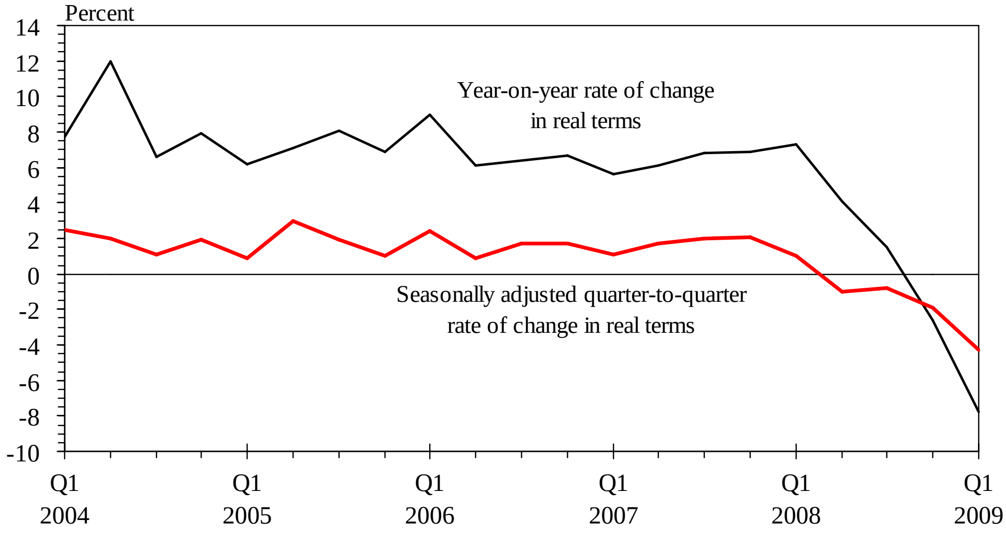
the distinct deceleration in economic activities.

Overall situation

1.1 The Hong Kong economy was badly hit by the worst global recession in more than sixty years. The impact on external trade from the shrinkage in world trade due to the deepening global recession became increasingly severe. Domestic demand also experienced a visible decline. The grim global economic outlook led to notable curtailments in business investment plans, while consumption spending fell further along with the worsening labour market conditions. Nevertheless, consumer sentiment was to some extent supported by the improved performance of the stock and property markets in the quarter, and also by the stimulus measures put out by the Government over the past year or so (see **Box 1.1** for details). Inflation came down notably further in the first quarter, reflecting the process of cost and price adjustments in the local economy to weather the severe shocks from global financial crisis and recession.

1.2 In the first quarter of 2009, the *Gross Domestic Product (GDP)*[(1)] fell sharply by 7.8% in real terms over a year earlier. This represented a further deterioration from the growth of 2.4% (revised from the earlier estimate of 2.5%) in 2008 as a whole and the contraction of 2.6% (revised from the earlier estimate of -2.5%) in the fourth quarter of last year. On a seasonally adjusted quarter-to-quarter comparison[(2)], GDP fell by 4.3% in real terms in the first quarter, the fourth consecutive quarter of contraction, after the 1.9% decline in the previous quarter.

Diagram 1.1 : Economy showed a steep contraction in the first quarter



Box 1.1

Counter-cyclical fiscal measures

A counter-cyclical fiscal strategy refers to the efforts of a government to suppress or alleviate economic overheating or recession through fiscal measures or other means. Specifically, in times of an economic contraction, an increase in expenditure and a reduction in revenue is a counter-cyclical fiscal measure by a government.

Apart from taking all-out efforts to address the problems of the financial system and credit market, major economies are also pursuing an expansionary fiscal policy to revive their economies. This is because the transmission of monetary policies has been greatly weakened amid the global financial crisis where credit flow has yet to return to normal. As a result, compared with accommodative monetary policies, the adoption of expansionary fiscal policies is more effective and practicable as an economic stimulant. Given the severity of the current economic downturn, it is essential to take fiscal measures to stimulate the economy in the short term. However, governments must consider whether their public finances are sustainable in the longer term.

In light of such exceptional times of our economy, the Government has stated clearly in the 2009-10 Budget that it will continue to adopt counter-cyclical measures to ease the pressure of economic contraction, boost domestic demand and increase employment opportunities. The expansionary strength of the Budget can be analysed on three fronts.

Stimulating effect of the Budget on the economy

First, public expenditure is estimated to be $319.4 billion for this year, equivalent to 19.4% of the GDP. In comparing this figure with that of 2008-09, it should be noted that some items of public expenditure for that year involved fund transfers and had no immediate effect on the Hong Hong economy or GDP. These include the $21.6 billion endowment to the West Kowloon Cultural District Authority, the establishment of an $18 billion Research Endowment Fund, injections of $8.6 billion into the Mandatory Provident Fund and $6 billion into the fund for Sichuan Reconstruction. As such, these items should not be taken into account in considering the effects of government expenditure on the economy. Excluding these special items, the provisional figures of the Government Account shows that last year's public expenditure was about 16.5% of the GDP. The public expenditure's share in GDP has risen significantly from 16.5% last year to 19.4% this year as indicated in the Budget. This illustrates that the 2009-10 Budget has an expansionary effect on the economy.

Box 1.1 (Cont'd)

Second, with respect to government revenue, the total estimated revenue for 2009-10 is $261.7 billion, which is $54.8 billion less than the provisional amount for 2008-09 and $96.7 billion less than the actual revenue for 2007-08. This partly reflects the concessions to be provided by the Government this year, such as the waiving of rates for the first two quarters of 2009-10 which involves $4.2 billion. As a result of a decrease in government revenue and an increase in expenditure, the fiscal deficit for 2009-10 is estimated to be $39.9 billion, equivalent to 2.4% of the GDP, while the fiscal position was broadly balanced for 2008-09. That the fiscal balance will turn into a deficit also shows that the effect of the 2009-10 Budget is basically expansionary in nature and will help stimulate the economy and counter the recession.

Third, the fiscal stimulus measures that the Hong Kong Government has proposed since last year compare favourably in intensity with those of other economies. The Government announced a series of relief measures in the 2008-09 Budget and in last July. The 2009-10 Budget also proposed additional expenditures on various concessions, expedition of minor works and creation of employment. The total expenditure on all these economic stimulus measures exceeds $70 billion, representing about 4% of the GDP. According to the report published by the International Monetary Fund (IMF) in March, the average cumulative expenditure of the G-20 nations on economic stimulus measures for countering the financial crisis in 2008 and 2009 accounts for just 2.3% of their GDP. It is evident that the fiscal measures in Hong Kong are stronger in intensity than those of many other economies. It is roughly estimated that the discretionary fiscal measures implemented by the Government since last financial year, taking into account the import content of the various expenditure items and the multiplier effect, can increase the GDP by about 1.5% in 2009 alone. In other words, in the absence of these measures, the Hong Kong economy will contract by a larger margin this year.

Maintaining financial health in the medium and long term

According to the report published by the IMF in March, while adopting stimulus measures to boost demand in addressing the current crisis, governments around the world must also ensure a healthy financial position in the long term. The IMF therefore suggested that stimulus measures should not have long-term implications on fiscal deficit. Governments should also formulate medium-term strategies expressing the intention of revising their financial commitments when economic conditions improve. Given that this economic recession will be longer and deeper, the IMF also recommended that governments should employ public works and infrastructure projects as the major means to stimulate the economy because they would bring more lasting impact on economic activities and greater economic benefits compared with tax concessions and other short-term measures.

Box 1.1 (Cont'd)

The main themes of the economic stimulus measures proposed in this year's Budget are to create ample job opportunities specifically for the construction industry where unemployment is most serious by enhancing medium-sized and minor works projects and expediting infrastructure projects; to provide internship opportunities for young people; while ensuring that the Government is capable of dealing with the risks of future economic uncertainties.

Regarding the medium range forecast, the Government will adhere to the principle of prudent financial management. Although this year's Budget forecasts a deficit in the Operating Account for the next three years, it will be followed by a return to surplus in 2012-13. Besides, with the infrastructure projects entering their construction stage, annual capital works expenditure will be at a very high level over the next few years, and may reach $50 billion. These infrastructure projects will be able to provide great impetus to an economic recovery even when the external environment has not totally returned to normal. In summary, the Government will also take care of the long-term public finances and social needs when countering the financial tsunami.

1.3 Recessionary forces continued to intensify around the globe in the first quarter of 2009. According to the International Monetary Fund (IMF), world GDP would contract by 1.3% in 2009, representing the most severe recession during the post-war period. Even granting that governments of major economies would step up efforts to heal the financial sector while continuing to support demand through monetary and fiscal easing, IMF believed that a slow recovery would only begin to take hold in 2010.

1.4 Many export-dependent Asian economies were also heavily battered by the severe global recession, posting a further drag on Hong Kong’s exports on top of shrinking demand in the advanced economies. Total exports of goods fell by 22.7% in real terms in the first quarter of 2009, markedly down from the 4.9% decline in the fourth quarter of 2008. The decline was across the board in almost all markets. Not only exports to US and Europe fell off markedly, so did exports to the Asian markets, as production activities along the supply chains in the region were cut back significantly in the face of the dwindling demand in the advanced economies. The sharp decline in Hong Kong’s exports was thus part of a region-wide phenomenon. In fact, in comparison, the extent of decline in exports in Hong Kong was similar to that in the Mainland, but less severe than in many other Asian economies.

1.5 Exports of services also deteriorated further, down 8.2% in the first quarter as compared to the marginal 0.4% growth in the fourth quarter of last year. The collapse in world trade weighed heavily on exports of trade-related services (mainly offshore trade) as well as exports of transportation services. Exports of financial services and other business services were also much affected, as financial market and commercial activities were notably below the levels before the eruption of the financial tsunami last year. On the other hand, inbound tourism held fairly firm, thanks to still rising Mainland visitors, partly supported by the further liberalisation measures under the Individual Visit Scheme.

Table 1.1 : Gross Domestic Product and its main expenditure components and the main price indicators (year-on-year rate of change (%))

	2007#	2008#	2008 Q1#	2008 Q2#	2008 Q3#	2008 Q4#	2009 Q1+
Change in real terms of GDP and its main expenditure components (%)							
Private consumption expenditure	8.5	1.5	8.0 (*)	3.0 (-1.3)	-0.2 (-0.6)	-4.1 (-2.2)	-5.5 (-1.5)
Government consumption expenditure	3.0	1.7	0.6 (-0.3)	3.1 (1.6)	1.6 (-0.5)	1.8 (0.8)	1.5 (-0.3)
Gross domestic fixed capital formation	3.4	-0.5	9.9	5.1	2.9	-17.8	-12.6
of which :							
Building and construction	-0.3	1.6	9.1	-0.1	-2.8	0.1	-8.2
Machinery, equipment and computer software	3.0	-0.3	4.3	7.4	10.7	-21.1	-6.6
Total exports of goods	7.0	1.9	8.3 (0.9)	4.4 (0.1)	1.3 (-1.8)	-4.9 (-4.3)	-22.7 (-16.8)
Imports of goods	8.8	1.8	8.4 (-1.7)	4.8 (1.9)	2.0 (-1.2)	-6.4 (-5.6)	-21.4 (-15.9)
Exports of services	14.1	5.7	10.1 (1.5)	8.4 (0.3)	4.8 (0.1)	0.4 (-1.3)	-8.2 (-7.5)
Imports of services	12.1	3.3	11.2 (1.3)	3.8 (-2.6)	2.2 (-0.1)	-3.4 (-1.8)	-10.9 (-6.8)
Gross Domestic Product	**6.4**	**2.4**	**7.3** **(1.0)**	**4.1** **(-1.0)**	**1.5** **(-0.8)**	**-2.6** **(-1.9)**	**-7.8** **(-4.3)**
Change in the main price indicators (%)							
GDP deflator	**2.9**	**1.4**	**2.3** **(-1.5)**	**1.9** **(0.6)**	**2.0** **(0.9)**	**-0.2** **(-0.2)**	**0.5** **(-0.7)**
Composite CPI							
Headline	**2.0**	**4.3**	**4.6** **(0.9)**	**5.7** **(1.5)**	**4.6** **(-0.2)**	**2.3** **(0.1)**	**1.7** **(0.3)**
Underlying^	**2.8**	**5.6**	**4.9** **(2.0)**	**5.7** **(1.5)**	**6.3** **(1.3)**	**5.4** **(0.4)**	**3.1** **(-0.2)**
Change in **nominal GDP** *(%)*	**9.5**	**3.8**	**9.7**	**6.1**	**3.5**	**-2.8**	**-7.3**

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.
(*) Change of less than 0.05%.
(^) After netting out effects of Government's one-off relief measures.

1.6 Domestic demand was also down. *Private consumption expenditure (PCE)* fell further by 5.5% in real terms year-on-year in the first quarter, after the 4.1% fall in the fourth quarter last year. The further rise in unemployment and the ensuing downward pressures on wages and earnings put a drag on private consumption. Nevertheless, consumer sentiment was supported to some extent by the stabilisation in the local stock and property markets in the quarter as well as by the relief measures put out by the Government over the past year or so. *Government consumption expenditure* continued to increase steadily in the first quarter, providing some mild cushioning effect to the fall in aggregate demand.

Table 1.2 : Consumer spending by major components[(a)]
(year-on-year rate of change in real terms (%))

		Total consumer spending in the domestic market[(a)]	*Of which :* Food	Durables	Non-durables	Services	Residents' expenditure abroad	Visitor spending	Private consumption expenditure[(b)]
2008	Annual	2.2	0.8	10.6	4.8	0.4	-1.1	6.1	1.5
	Q1	7.6	3.4	18.8	11.4	5.6	10.7	7.2	8.0
	Q2	4.3	1.6	13.8	8.4	2.2	-6.7	7.6	3.0
	Q3	0.8	0.4	13.5	3.1	-1.8	-1.5	7.3	-0.2
	Q4	-3.1	-1.8	-1.1	-2.1	-3.9	-6.1	3.0	-4.1
2009	Q1	-4.4	-3.7	-5.8	-5.7	-3.9	-6.4	3.9	-5.5

Notes : (a) Consumer spending in the domestic market comprises both local consumer and visitor spending, which are not separable from the survey data.

(b) Private consumption expenditure is obtained by deducting visitor spending from the total consumer spending in the domestic market, and adding back residents' expenditure abroad.

Diagram 1.2 : Private consumption expenditure fell further in the first quarter

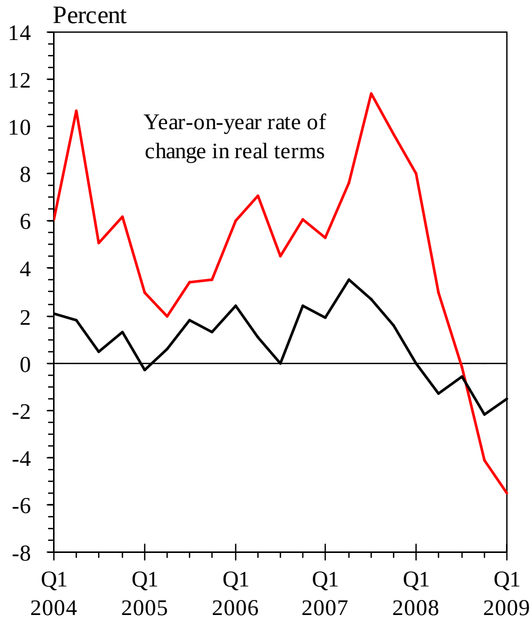
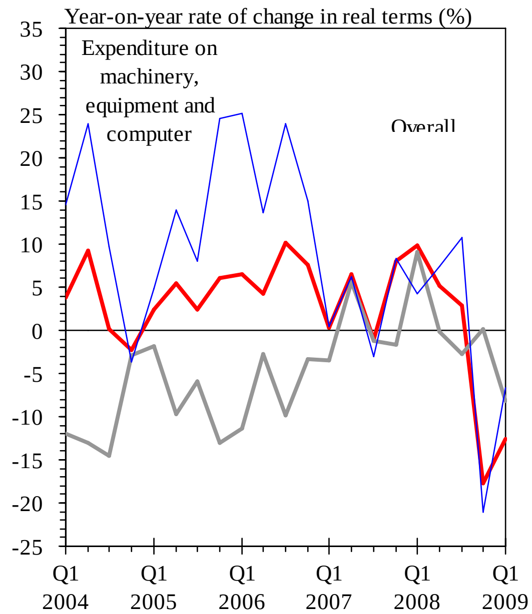


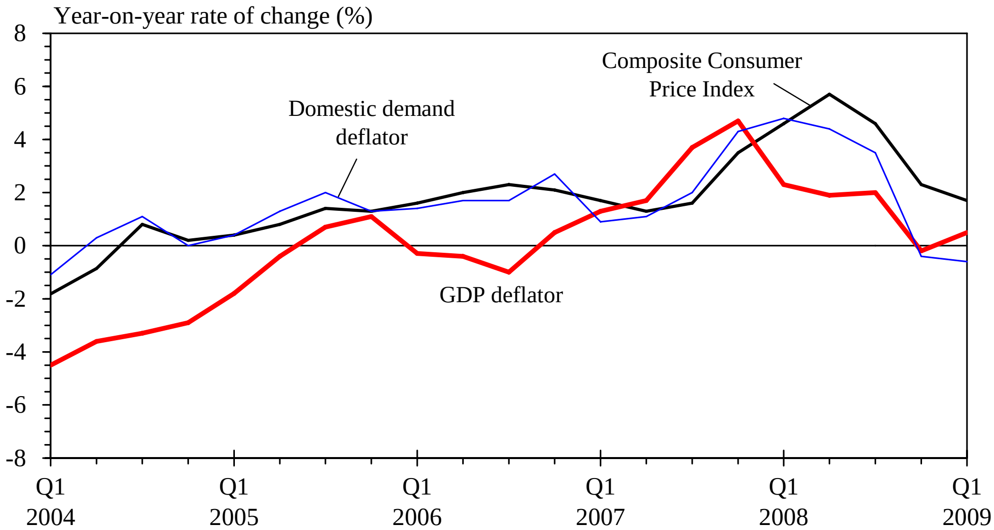
Diagram 1.3 : Overall investment remained weak due to the grim economic outlook



1.7 Overall investment spending in terms of *gross domestic fixed capital formation* remained much in a depressed mode, down by 12.6% in the first quarter over a year earlier, after the contraction of 17.8% in the preceding quarter. Machinery and equipment investment fell by 6.6% in the first quarter, as businesses curtailed investment plans in view of the grim global economic outlook. The results of latest Quarterly Business Tendency Survey conducted by the Census and Statistics Department in March and early April indicated that large companies remained rather pessimistic about the near-term business situation, but the extent of pessimism seemed to have lessened somewhat compared with the survey results obtained three months earlier. Expenditure on building and construction fell notably, by 8.2% in the first quarter, due mainly to a notable decline in private sector construction activity. As to public sector construction work, there was a moderate decline in the first quarter. Nevertheless, the efforts to accelerate public sector projects should begin to pay off in the coming quarters.

1.8 Inflationary pressure eased notably further in the first quarter on the back of receding local and external price pressures. *Underlying consumer price inflation* came down to 3.1% in the first quarter, partly helped by the lower food price inflation and recent easing in private housing rentals. *Headline consumer price inflation*, being affected by the relevant one-off relief measures, was lower at 1.7%, due mainly to the electricity subsidy that began to take effect since September last year. As to the *GDP deflator*, an increase of 0.5% was recorded in the first quarter, due to a more favourable terms of trade offsetting the decline in domestic demand deflator.

Diagram 1.4 : Inflationary pressure eased notably further in the first quarter



Box 1.2

Impact of financial tsunami on small and medium-sized enterprises (An update)

The abrupt escalation of the financial turbulence in September 2008 has led to a deepening synchronized global economic downturn. It is one of the priorities of the Government to support enterprises, especially the small and medium-sized enterprises (SMEs)[1]. To attain a better understanding on the impact of the financial tsunami on the business receipts, employment and credit access situations of the SMEs, an ad-hoc weekly consultation exercise has been conducted by the Census and Statistics Department on behalf of the Economic Analysis and Business Facilitation Unit since late November 2008 on a sample panel of around 500 SMEs to solicit their relevant feedback information. This note provides an update of the results reported in Box 1.1 in the 2008 Economic Background and 2009 Prospects.

The results of the weekly consultation covering the period from December 2008 to April 2009 indicate that SMEs' business situation in overall terms was significantly hit by the financial tsunami from December to March, with the overall reading successively down during this four-month period ***(Table 1)***. However, some relative improvement was spotted in around the third week of March and this trend sustained into April, especially so for sectors which were related to local demand in the economy. Specifically, business situation in the retail trade and restaurants showed more discernible improvements after around mid-March ***(Chart 1a)***, thanks to relatively stable inbound tourism and some revival in property market activities. On the other hand, business situation for SMEs in import/export trades and financing institutions remained much depressed with no sign of improvement. The situation in the logistics sector was especially difficult ***(Chart 1b).*** As explained in the Highlights section of this chapter, the main shocks on Hong Kong economy were inflicted through the trade and financial channels, and the findings of the SME consultation exercise were largely in line with this assessment. Clearly, given the coverage and nature of the consultation exercise, the consultation findings should be interpreted with considerable caution, yet they generally can serve as rough indicator to enable high frequency monitoring of SMEs' situation.

Concerning the employment situation, the results of the consultation indicated that as a result of the financial tsunami, employment had declined by 1-2%. Among the various sectors, employment in real estate and construction, business services, logistics, financing institutions, and restaurants had been affected the most (***Table 2***). But the pressures for retrenchment and downsizing in staffing amongst the SMEs surveyed seemed to have tapered somewhat in the recent weeks, and whether this can be sustained needs to be further monitored.

(1) Manufacturing enterprises with fewer than 100 employees and non-manufacturing enterprises with fewer than 50 employees are regarded as SMEs in Hong Kong.

Box 1.2 (Cont'd)

Chart 1 Impact of Financial Tsunami on SMEs' Business Receipts (BR)

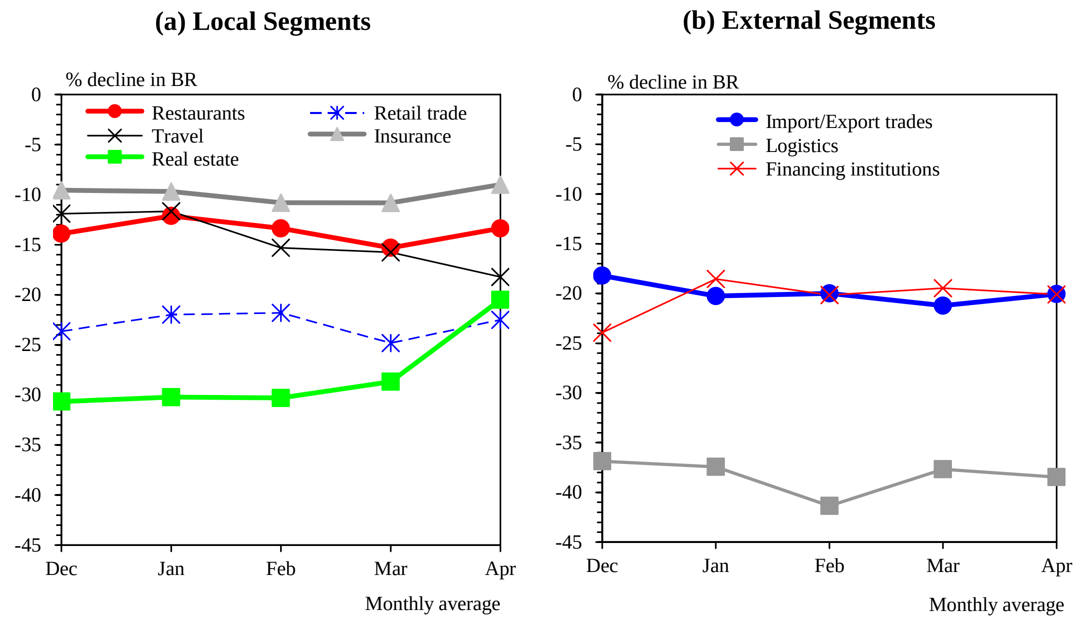


Table 1 Impact on business receipts as compared with normal situation

	% decline as compared with normal situation (Monthly average)				
SMEs by sectors	Dec	Jan	Feb	Mar	Apr
Wholesale trade	-16.3	-8.3	-9.3	-16.2	-18.7
Retail trade	-23.6	-22.0	-21.8	-24.8	-22.5
Import and export trades	-18.2	-20.3	-20.0	-21.2	-20.1
Restaurants	-13.9	-12.1	-13.4	-15.3	-13.4
Logistics	-36.9	-37.4	-41.4	-37.7	-38.5
Travel agents	-11.9	-11.7	-15.3	-15.8	-18.2
Financing institutions	-23.9	-18.6	-20.2	-19.5	-20.1
Insurance agents and brokers	-9.6	-9.7	-10.8	-10.8	-9.0
Real estate and construction	-30.7	-30.2	-30.3	-28.7	-20.5
Business services	-9.0	-10.6	-14.2	-14.8	-15.1
All the above sectors	-18.3	-19.3	-19.4	-20.9	-20.0

Note: The monthly figures refer to the averages of declines reported weekly by the SMEs in the month concerned.

Box 1.2 (Cont'd)

Table 2 Impact on employment as compared with normal situation

SMEs by sectors	% change as compared with normal situation (Monthly average)				
	Dec	Jan	Feb	Mar	Apr
Wholesale trade	0.0	0.0	0.0	0.0	0.0
Retail trade	-0.5	-0.5	-0.6	-0.4	-0.2
Import and export trades	-1.1	-0.9	-1.0	-0.6	-0.9
Restaurants	-3.1	-3.2	-3.7	-2.6	-1.7
Logistics	-6.5	-3.7	-3.0	-3.2	-3.4
Travel agents	0.2	-0.1	0.1	0.2	0.2
Financing institutions	-0.9	-0.7	-1.4	-1.6	-2.3
Insurance agents and brokers	0.0	0.0	0.0	0.0	0.0
Real estate and construction	-7.3	-8.2	-8.0	-8.0	-8.0
Business services	-3.0	-3.0	-3.7	-3.8	-3.8
All the above sectors	-1.8	-1.6	-1.8	-1.5	-1.5

One encouraging development is the improving trend in credit access situation on entering 2009. This is clear from the progressive fall in the proportion of SMEs reporting very tight/tighter than usual credit access, from above 12% in late November last year to around 8-9% in the more recent weeks (***Table 3*** and ***Chart 2***). Amongst the sectors covered in the consultation, SMEs in restaurants, retail trade and wholesale trade saw more discernible improvements. SMEs in import and export trades also reported mild improvement in credit access situation. It appears that the measures taken by the Government to support enterprises, including the Special Loan Guarantee Scheme, have helped to ease the credit access situations facing the SMEs. Nevertheless, SMEs in some harder-hit sectors, especially logistics, continued to face notably tighter access to credit than other sectors.

Box 1.2 (Cont'd)

Table 3 Impact on access to credit as compared with normal situation

SMEs by sectors	Nov	Dec	Jan	Feb	Mar	Apr
	% SMEs reporting very tight/tighter credit access					
Wholesale trade	12.0	10.0	5.3	0.0	0.0	0.0
Retail trade	10.0	8.8	6.5	6.6	4.6	3.5
Import and export trades	17.1	17.0	15.7	14.0	14.5	13.7
Restaurants	19.0	10.7	11.8	11.8	8.6	7.1
Logistics	0.0	11.8	17.6	12.5	26.3	16.7
Travel agents	3.3	3.8	3.7	3.6	3.7	3.7
Financing institutions	12.5	10.8	7.9	7.7	8.3	7.9
Insurance agents and brokers	15.0	10.0	5.6	10.0	10.5	10.0
Real estate and construction	11.4	5.9	5.7	6.1	8.8	8.8
Business services	5.7	6.1	0.0	0.0	2.9	3.1
All the above sectors	12.5	11.9	10.2	9.0	9.7	8.5

Chart 2 Access to credit showed some gradual improvement

Impact on Access to Credit

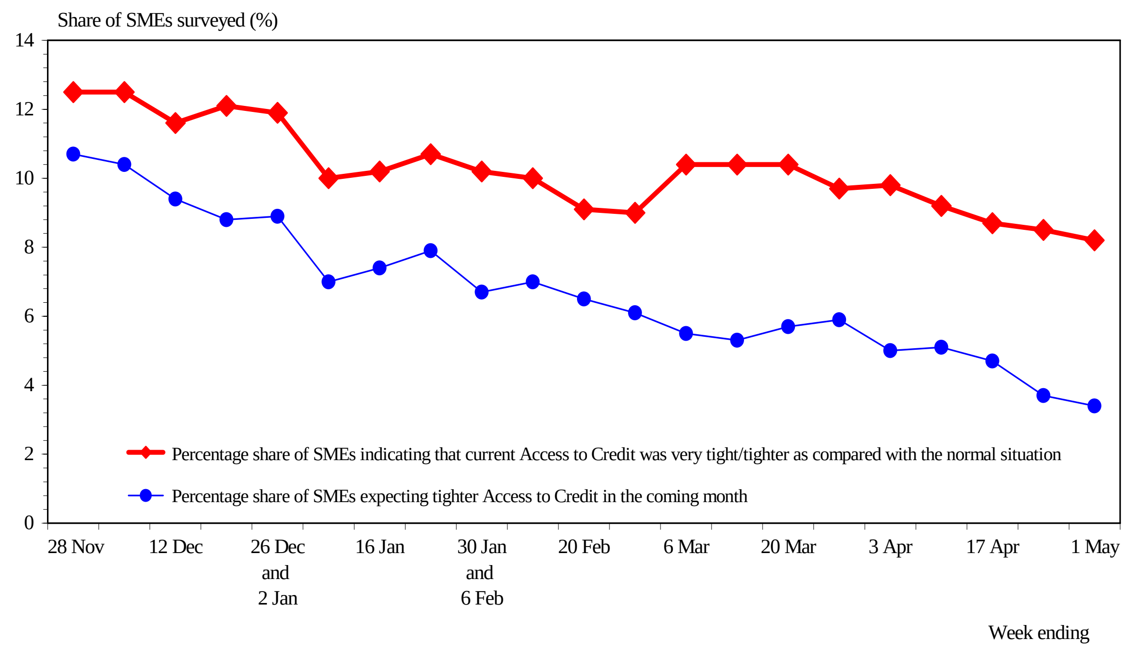


Table 1.3 : GDP by economic activity[(a)]
(year-on-year rate of change in real terms (%))

			2007				2008			
	2007	2008	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Manufacturing	-1.5	-6.6	-1.5	-2.3	-2.1	-0.3	-4.4	-4.1	-6.7	-10.4
Construction	-1.1	2.7	-5.7	4.6	-1.4	-1.4	9.2	-0.3	-1.5	2.8
Services[(b)]	7.0	2.4	6.1	7.2	6.8	7.8	7.1	4.0	1.7	-2.3
Wholesale, retail and import and export trades, restaurants and hotels	6.6	4.1	5.1	6.7	6.5	7.9	9.0	7.2	4.2	-2.1
Import and export trade	6.0	4.6	4.6	6.4	5.7	7.1	9.7	8.0	4.9	-1.9
Wholesale and retail trades	6.8	2.9	4.0	4.8	7.7	10.0	9.1	6.0	2.2	-3.6
Restaurants and hotels	11.0	2.1	7.9	9.6	13.9	12.5	4.4	3.7	1.8	-1.2
Transport, storage and communications	5.1	2.2	3.6	4.6	5.8	6.4	7.6	3.9	2.0	-4.3
Transport and storage	5.1	1.9	3.1	4.0	6.1	7.0	8.3	3.8	1.5	-5.4
Communications	5.3	3.5	6.0	7.0	4.5	3.9	4.4	4.6	4.3	0.8
Financing, insurance, real estate and business services	13.5	1.6	11.7	13.4	13.7	15.0	10.0	2.8	-0.5	-4.9
Financing and insurance services	17.6	1.4	14.9	16.7	19.8	18.9	11.1	2.2	-0.5	-6.1
Real estate and business services	6.4	2.1	6.2	6.6	4.5	8.3	7.9	3.6	-0.1	-2.4
Community, social and personal services	1.7	1.4	2.1	1.4	1.7	1.7	1.5	1.7	1.7	0.7

Notes : Figures are subject to revision later on as more data become available.

(a) The GDP figures shown in this table are compiled from the production approach, in parallel with those shown in Table 1.1 which are compiled from the expenditure approach. For details, see Note (1) to this chapter.

(b) In the context of value-added contribution to GDP, the service sectors include ownership of premises as well, which is analytically a service activity.

GDP by major economic sector

1.9 The global financial tsunami had a widespread dampening impact across different sectors of the economy since the latter part of last year. Latest available figures indicate that net output of the services sector grew by 2.4% in real terms for 2008 as a whole, representing a notable deceleration from 7.0% in 2007. The manufacturing sector continued to contract, while the construction sector showed a small expansion after years of contraction. In the fourth quarter of 2008, the services sector as a whole registered a decline of 2.3% in net output. Financing and insurance showed the largest decrease, followed by transport and storage, wholesale and retail trades, and real estate and business services. While the net output of import and export trades, and restaurants and hotels decreased modestly, that of community, social and personal services increased slightly. Manufacturing output fell markedly in the quarter, while construction output showed an increase.

Some highlights of economic policy

1.10 After the Third Meeting of the Task Force on Economic Challenges (TFEC) in January, the Chief Executive announced a series of measures to create employment, internship and training opportunities to cope with the expected wave of staff layoffs and to assist school leavers who will be entering the labour market in the middle of this year. The Government would also re-consider the introduction of a corporate rescue procedure, to provide an opportunity for companies in short-term financial difficulties but with viable long-term business prospects to turn around or restructure.

1.11 The "Outline of the Plan for the Reform and Development of the Pearl River Delta" ("Outline Plan for PRD") issued by the National Reform and Development Commission in early January 2009 marked a major milestone for closer cooperation among Hong Kong, Guangdong and Macau on all fronts so as to set directions and targets that are most beneficial to the long-term development of the region. Following its release, a liaison and co-ordinating meeting was held in February among the three jurisdictions to forward the implementation of the plan. A consensus was reached on the establishment of a liaison and coordinating mechanism, and the three governments also agreed to take forward major cooperation initiatives in such areas as tourism, environmental protection, infrastructural and transport arrangements, regional development and town planning. The three governments will also ask the Central Government to consider including the concept of developing the region into a green and quality living area in the 12th five-year national plan.

1.12 The 2009-10 Budget was announced on 25 February. In response to the economic recession and rising unemployment, the Government has given priority to measures that are effective in creating jobs. Government spending would exceed $300 billion in the 2009-10 financial year to help combat the economic downturn. The Budget has put forward short term strategies to cushion the impact of global financial crisis on the economy; has set out the directions for development and prospects; and also provides resources for building a caring community. Highlights as follows:-

(i) *Short-term strategies:* the objective is to preserve and create jobs. The Government will adopt counter-cyclical measures (see **Box 1.1** for details), and will implement targeted measures to create around 62 000 employment and internship opportunities in the next three years. Also, a number of relief measures were announced, including a one-off tax reduction of 50% of salaries tax and tax under personal assessment for 2008-09 (subject to a ceiling of $6,000), rates concession for the first two quarters of 2009-10 (subject to a ceiling of $1,500 per quarter for each rateable tenement), 20% rental reduction for most government properties and short term tenancies of government land for three months, and an extended freeze on government fees and charges related to people's livelihood till 31 March 2010.

(ii) *Directions for development and prospects:* the key strategic direction is to foster Mainland-Hong Kong economic relations, particularly to promote Hong Kong-Guangdong economic co-operation in the context of the Outline Plan for PRD, in keeping with the Greater PRD's efforts to upgrade its industries. In addition, measures were also put forward to enhance existing pillar industries and develop new economic initiatives. The Government will continue to put substantial resources in developing human capital and key infrastructure.

(iii) *To develop a caring community:* The Government will strive to strengthen the community and improve the quality of life, through a series of medical, health and welfare measures.

1.13 The 2009/10 Budget, whilst unveiling measures to ease the pressure of economic contraction, boost domestic demand and increase employment opportunities, has placed considerable emphasis in longer term development of the economy, highlighting in particular the growth potential from technology-based, creative and green economy. Subsequently, after the Fourth Meeting of the TFEC in early April, the Task Force further identified six sectors(3) with good potential and would explore the possibility of creating an environment that could be more favourable to the development of these sectors.

1.14 Further to the 14 supportive measures announced by the Central Government in December last year, the Premier indicated in mid-April further measures(4) to support Hong Kong to weather the financial tsunami. These new measures will enhance the role of Hong Kong as an international financial centre, help to promote Hong Kong's tourism industry and assist the Hong Kong companies operating in the Mainland. All in all, significant efforts have been made by the Government in tackling the crisis. All these should have helped to mitigate the adverse impact of the global crisis on the local economy and pave the way for a swift recovery once the external environment improves.

Notes :

(1) The Gross Domestic Product (GDP) is an overall measure of net output produced within an economy in a specified period, such as a calendar year or a quarter, before deducting the consumption of fixed capital. In accordance with the expenditure approach to its estimation, GDP is compiled as total final expenditures on goods and services (including private consumption expenditure, government consumption expenditure, gross domestic fixed capital formation, changes in inventories, and exports of goods and services), less imports of goods and services.

(2) The seasonally adjusted quarter-to-quarter GDP series, by removing the variations that occur at about the same time and in about the same magnitude each year, provides another perspective for discerning the trend, particularly in regard to turning points. A detailed examination reveals the presence of seasonality in the overall GDP and in some of its main components, including private consumption expenditure, government consumption expenditure, exports of goods, imports of goods, exports of services, and imports of services. However, due to the presence of considerable short-term fluctuations, no clear seasonal pattern is found in gross domestic fixed capital formation. Therefore, the seasonally adjusted series of GDP is compiled separately at the overall level, rather than summing up from its main components.

(3) The six sectors are: (1) testing and certification; (2) medical services; (3) innovation and technology; (4) cultural and creative industries; (5) environmental industry; and (6) educational services.

(4) The measures indicated by Premier Wen included: (1) Mainland's financial institutions will be encouraged to issue renminbi bonds in Hong Kong, and the Ministry of Finance will study whether it can issue bonds in the city; (2) The Central Government will help Hong Kong companies to use their assets located in Hong Kong to secure loans from the Hong Kong-backed banks in Guangdong and Shanghai; (3) The Central Government will also assist companies in the processing industry to promote their Mainland sales; (4) Mainland tourists will be allowed to travel to Taiwan via Hong Kong on Hong Kong-based cruisers; (5) Supplement VI to CEPA , to be signed in May, will further open the Mainland market to the city's service industries. Moreover, to implement fully the recommendations in the "Outline of the Plan for the Reform and Development of the Pearl River Delta", the Pearl River Delta Region will further open its market to Hong Kong's education, training and accounting services etc..