

CHAPTER 1 : OVERVIEW OF ECONOMIC PERFORMANCE IN 2009

Summary

- *The Hong Kong economy exhibited much resilience in countering the global financial tsunami and the ensuing global recession. Although the economy contracted severely in the first quarter of 2009 amid the global-wide plunge in trade, it quickly rebounded in the second quarter and continued to improve in the rest of the year, along with other Asian economies, particularly the Mainland, which took the lead in the global recovery process. The momentum picked up further in the fourth quarter, marked by a distinct acceleration in GDP growth on a quarter-to-quarter basis, leading to the return to positive year-on-year growth at 2.6%. For 2009 as a whole, the economy contracted by 2.7%, the first annual recession since 1998.*
- *Merchandise trade was the most severely hit segment and the key drag on the economy for most of the year, with improvement only emerging towards the year-end. Trade in services fared persistently better, particularly in the second half, thanks to the distinct bounce-back in financial market activities and inbound tourism.*
- *The local segment quickly stabilized after a weak start in 2009, thereby rendering the cushion against the setback in external trade through the year. In particular, consumer confidence progressively recovered after a dismal first quarter, and business sentiment likewise turned up distinctly in the latter half of the year following the rebound in economic activity and henceforth an improved outlook.*
- *The Government's strategy of "stabilizing the financial sector, supporting enterprises and preserving employment" has played an instrumental role in cushioning the economy from what would have been a more severe recession. Of particular note were the faster-than-expected improvements in the labour market. The seasonally adjusted unemployment rate, having deteriorated notably in early 2009 and peaked at 5.4% in the second quarter, came down gradually to 4.9% in the fourth quarter. Downward pressures on labour earnings also abated over the course of the year.*
- *The local stock market at the start of the year was much overshadowed by the onset of the deepest global downturn in recent history, but rebounded since March on first signs of green shoots in the global economy. The property market, after a period of heavy fall-off in late 2008, staged a strong rebound in 2009. There was an uninterrupted increase through the year, though prices turned slightly steadier in the fourth quarter following*

the extended rally earlier on and upon the authorities' measures to stabilise the market. For 2009 as a whole, there was a cumulative rise of 27%.

- *With the economic downturn and soft import prices, inflation came down successively and turned slightly negative from July to November. Then, as the local economic recovery gathered pace, consumer price inflation returned to slight positive in December.*

Overall situation

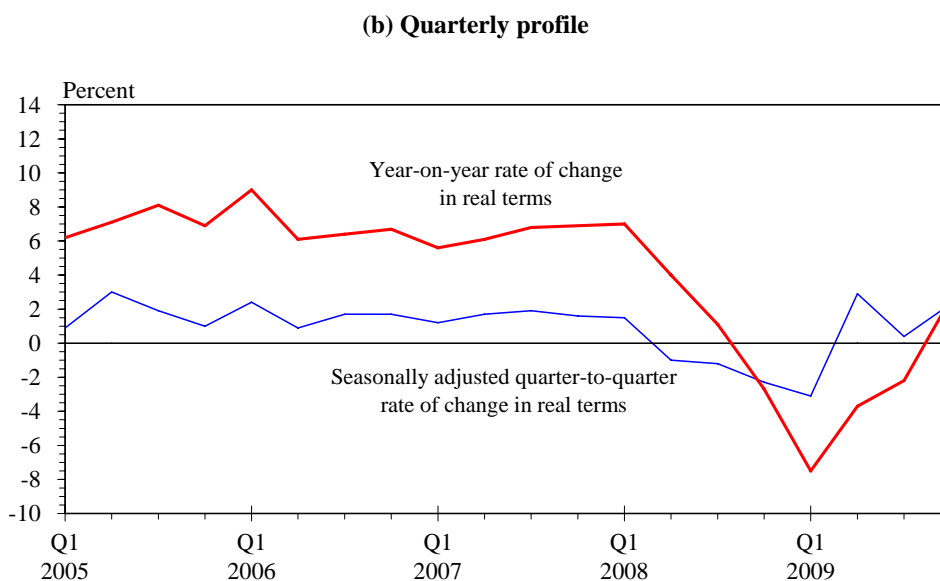
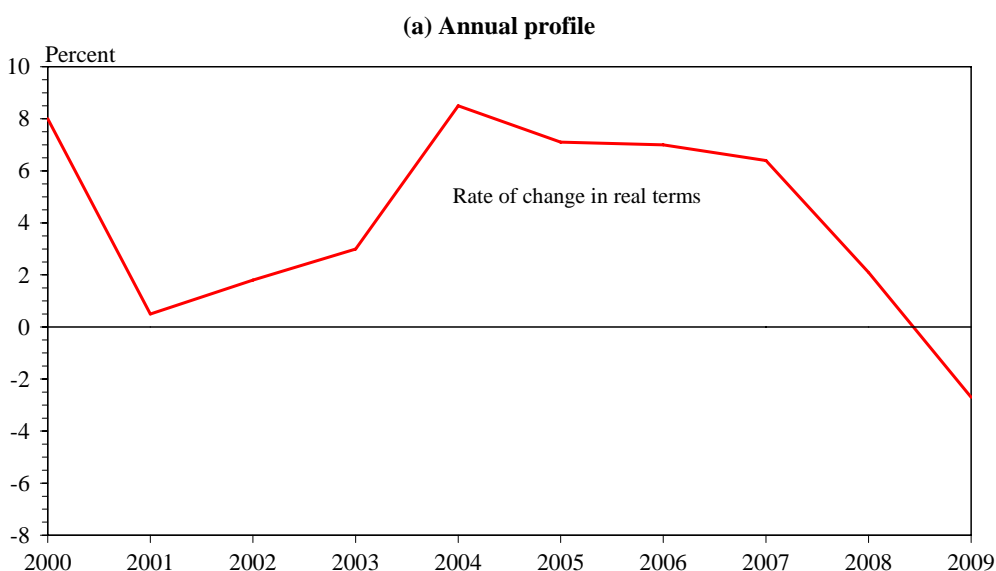
1.1 2009 was a year of exceptional gyrations for the Hong Kong economy. The economy suffered a heavy blow in the early part of the year as the global financial tsunami mutated into the most severe global recession since the Second World War. Then, with Mainland taking the lead in the economic recovery, Hong Kong also staged a notable rebound during the second quarter, and improved further in the rest of the year. But for most of the year, merchandise exports were on a significant decline under the drag of sluggish global trade flows, only reverting to growth towards the year-end. Exports of services, though also affected by the global recession, showed more resilience, thanks to the bounce-back in financial market activities and inbound tourism in the second half. Consumption demand was likewise held back by falling income and cautious sentiment in early 2009, but also saw progressive improvement during the year as the labour market stabilized, the Government's relief measures yielded results, and the asset markets rebounded. Business sentiment similarly recovered as outlook gradually improved (**Box 1.1**), leading to a distinct strengthening in investment demand later in the year. As the recovery continued in the year, unemployment rate came down successively after the mid-year, and the mild deflation that emerged after July finally gave way to slight inflation in December.

1.2 For 2009 as a whole, the *Gross Domestic Product (GDP)*⁽¹⁾ contracted by 2.7% in real terms, the first annual recession since 1998. This followed a 2.1% growth in 2008, and represented the second year of sub-par growth. Indicating the exceptional shocks from the global crisis in early 2009 and the subsequent recovery, GDP went sharply down by 3.1% in real terms in the first quarter on a seasonally adjusted quarter-to-quarter comparison⁽²⁾, rebounded notably by 2.9% in the second quarter, and grew further by 0.4% and 2.3% respectively in the third and fourth quarters. The progressive improvements were more visible from the year-on-year profile, with the rate of decline in GDP narrowing notably from 7.5% in the first quarter to 3.7% and 2.2% respectively in the second and third quarters, followed by the return to

positive growth at 2.6% in the fourth quarter.

1.3 Although the global financial crisis of 2008-2009 was of a much larger scale than the Asian financial crisis of 1997-1998, the recession experienced by Hong Kong had lasted for four quarters in the current crisis, one quarter less than that in the previous crisis. The labour market also showed more resilience this time, with significantly less job loss than during the Asian financial crisis. All these have much to do with the sounder fundamentals and hence greater resilience of the Hong Kong economy in countering external shocks.

Diagram 1.1 : Economic recovery gathered pace since the second quarter of 2009



Box 1.1

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

To attain a better understanding on the impact of the financial tsunami on the business receipts, employment and credit access situations of the small and medium-sized enterprises (SMEs)⁽¹⁾, an ad-hoc 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 1.2 in the Third Quarter Economic Report 2009.

The results of the consultation exercise available up to January 2010 indicated that the overall situation in business receipts had been improving successively since July 2009, and markedly more towards the end of 2009 and early 2010. Analysed by sectors, SMEs in retail trade and restaurants saw some notable improvement in business receipts, supported by the strengthening of local consumer sentiment as well as inbound tourism, and so did the travel agents. Business receipts in real estate turned markedly better more recently after the pullback in October 2009, while those in insurance remained stable for some months before improving distinctly in January 2010 (*Chart 1a*). Business situation in financing institutions continued to improve notably in recent months, thanks to the increasing financial market activities. The decline in business receipts for SMEs in import/export trades narrowed substantially in tandem with the relative improvement in merchandise exports. Nevertheless, the decline in business receipts in the logistics sector remained substantial (*Chart 1b*). It should be noted that given the coverage and nature of the consultation exercise, the consultation findings should be interpreted with considerable caution. They nevertheless can serve as rough indicator to enable high frequency monitoring of SMEs' situation.

On the employment front, the results of the consultation indicated that SMEs' employment situation held stable in overall terms in recent months. Among the various sectors, employment in real estate and construction, financing institutions, travel agents and import/export trade reported more discernible improvements than the others.

Credit access situation improved notably further in the recent months. The proportion of SMEs reporting tighter-than-normal credit access went down distinctly to only 5.2% in January 2010 from above 12% in late November 2008, also the lowest since the consultation exercise started (*Chart 2*). The supplementary information provided by SMEs surveyed indicated that credit pricing continued to hold broadly stable over the past few months, reflecting the improved financial conditions as well as the effectiveness of the Government's efforts to help to ease credit strains facing SMEs, especially those under the enhanced and special loan guarantee schemes. As at end-January, some 16 600 companies benefited under these schemes, involving approved loan amount of 72.4 billion. This also indirectly helped to secure the jobs for those employed by these companies, totaling over 280 000.

(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 1.1 (Cont'd)

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

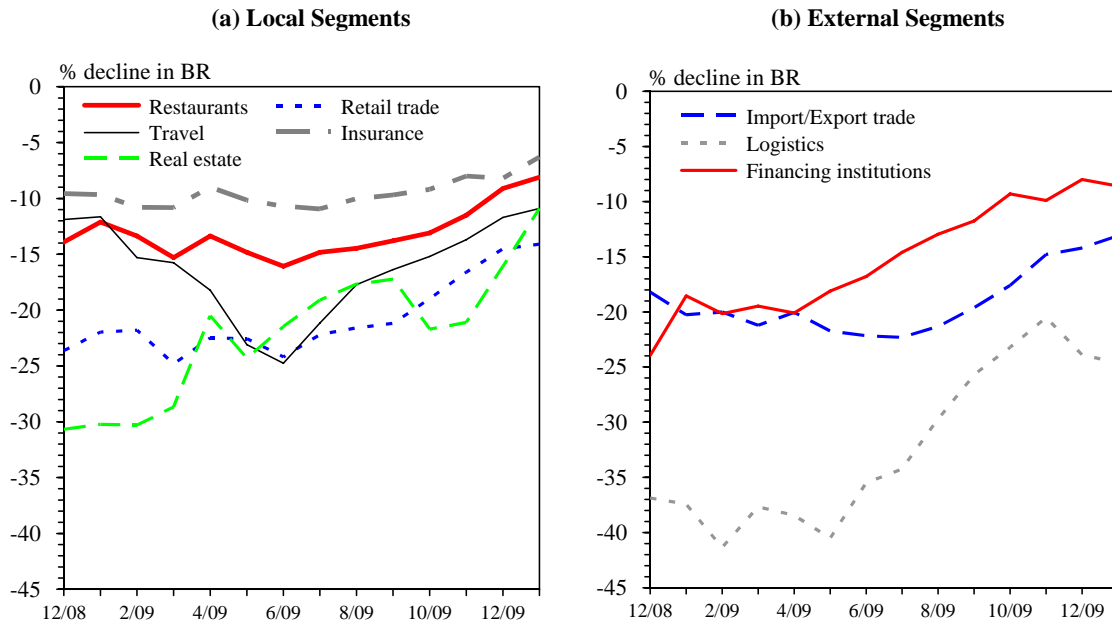
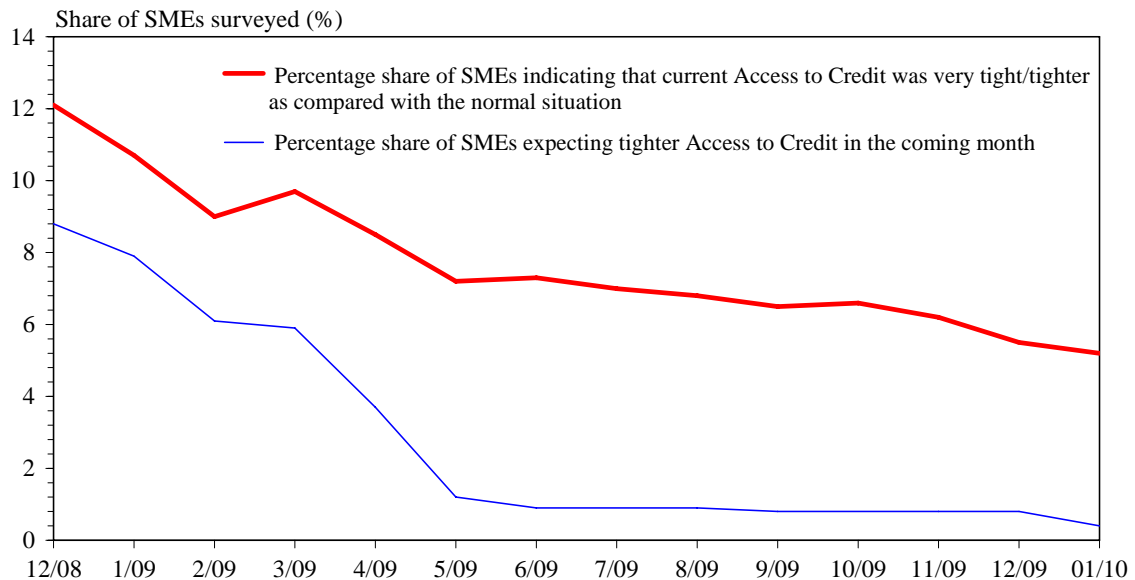


Chart 2: Access to credit continued to improve



The external sector

1.4 The setback in merchandise exports during most of 2009 posed a significant drag to Hong Kong's economic growth. Merchandise exports suffered the steepest drop since 1954 in the first quarter of the year amidst the collapse in demand from the advanced economies and its knock-on effect on intraregional trade. Merchandise exports then saw improvement in the following quarters, initially on the recovery in the Asian region led by the return to rapid growth in the Mainland economy since the second quarter, then on the gradual bottoming out in demand from the advanced economies following the resumption of growth since the third quarter. The improvement was more notable towards the end of the year, with merchandise exports resuming year-on-year growth in November and December, reflecting some normalization of global trade after a period of exceptionally large fall-off. For 2009 as a whole, *total exports of goods* still fell significantly by 12.6% in real terms, following only modest growth at 1.9% in 2008. In 2009, many other Asian economies saw even larger declines in their exports.

1.5 In comparison, exports of services fared persistently better in 2009. Indeed, all the major categories of exports of services reverted to year-on-year growth in real terms by the fourth quarter of the year. Inbound tourism showed solid growth during most of the year, except for a brief setback around mid-2009 due to the concern about the spread of human swine flu. Exports of financial and other business services plummeted in the first half of the year in the aftermath of the global financial tsunami, but showed a visible turnaround in the rest of the year as financial market activities revived and business activities gradually recovered. Merchanting and other trade-related services (mainly offshore trade), and to some extent exports of transportation services, were sluggish during most of 2009, reflecting the plunge in global trade flows in early 2009 and their subsequent slow recovery. Overall, *exports of services* contracted by 0.7% in real terms in 2009, after the 5.0% growth in 2008.

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

	2008 [#]	2009 ⁺	2008				2009			
			Q1 [#]	Q2 [#]	Q3 [#]	Q4 [#]	Q1 [#]	Q2 [#]	Q3 [#]	Q4 ⁺
<i>Change in real terms of GDP and its main expenditure components (%)</i>										
Private consumption expenditure	2.3	-0.3	8.7 (1.0)	4.0 (-1.4)	0.7 (-0.8)	-3.2 (-2.1)	-6.1 (-1.6)	-0.8 (3.8)	0.5 (0.6)	4.9 (2.1)
Government consumption expenditure	1.8	2.0	0.6 (0.1)	2.8 (1.0)	2.0 (-0.4)	2.1 (1.3)	1.6 (-0.3)	2.1 (1.4)	2.9 (0.6)	1.7 (-0.1)
Gross domestic fixed capital formation	0.8	-2.2	11.5	6.1	4.1	-16.7	-11.1	-12.3	2.6	14.7
<i>of which :</i>										
Building and construction	6.1	*	13.3	2.3	1.5	7.1	-5.6	-2.3	6.0	2.9
Machinery, equipment and computer software	-0.8	-3.6	4.3	7.7	10.3	-22.9	-5.8	-17.3	-3.5	16.2
Total exports of goods	1.9	-12.6	8.3 (4.3)	4.4 (-3.7)	1.3 (-0.8)	-4.9 (-5.3)	-22.7 (-12.7)	-12.4 (6.4)	-13.2 (-1.7)	-2.6 (7.5)
Imports of goods	1.8	-9.7	8.4 (2.2)	4.8 (-1.8)	2.0 (-1.7)	-6.4 (-5.9)	-21.4 (-11.0)	-12.7 (6.0)	-8.3 (2.6)	3.1 (7.0)
Exports of services	5.0	-0.7	9.2 (3.0)	7.7 (0.5)	4.0 (-0.9)	0.2 (-2.7)	-5.5 (-2.1)	-5.3 (1.0)	-0.5 (3.7)	7.7 (4.9)
Imports of services	6.3	-4.0	14.4 (6.0)	7.2 (-3.1)	5.1 (-0.7)	-0.6 (-2.7)	-9.5 (-3.4)	-5.5 (1.4)	-3.3 (1.5)	2.4 (2.9)
Gross Domestic Product	2.1	-2.7	7.0 (1.5)	4.0 (-1.0)	1.1 (-1.2)	-2.7 (-2.3)	-7.5 (-3.1)	-3.7 (2.9)	-2.2 (0.4)	2.6 (2.3)
<i>Change in the main price indicators (%)</i>										
GDP deflator	1.5	0.2	2.7 (-0.9)	2.2 (*)	2.1 (0.9)	-0.5 (-0.5)	-0.1 (-0.4)	0.6 (0.6)	-0.1 (0.1)	0.2 (-0.1)
Composite CPI										
Headline	4.3	0.5	4.6 (0.9)	5.7 (1.5)	4.6 (-0.2)	2.3 (0.1)	1.7 (0.3)	-0.1 (-0.2)	-0.9 (-1.1)	1.3 (2.2)
Underlying[^]	5.6	1.0	4.9 (2.0)	5.7 (1.5)	6.3 (1.3)	5.4 (0.4)	3.1 (-0.2)	1.2 (-0.3)	-0.3 (-0.1)	-0.1 (0.5)
Change in nominal GDP (%)	3.7	-2.5	9.8	6.3	3.2	-3.2	-7.6	-3.1	-2.3	2.8

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.

(*) Change of less than 0.05%.

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

The domestic sector

1.6 The Government's strategy of "stabilizing the financial sector, supporting enterprises and preserving employment" helped to cushion the economy from the aftershock of the financial tsunami and to maintain confidence. The stabilizing effect was particularly evident in the domestic sector. Apart from a more notable contraction in the first quarter, private consumption demand had actually strengthened notably since the second quarter, along with the improvement in labour market conditions and better economic outlook. For 2009 as a whole, *private consumption expenditure (PCE)* fell only modestly by 0.3% in real terms, after the 2.3% growth in 2008. *Government consumption expenditure* continued to play the role of automatic stabiliser, growing by 2.0% in real terms in 2009 following the 1.8% growth in 2008.

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

		<i>Of which :</i>							
		Total consumer spending in the domestic market ^(a)	Food	Durables	Non- durables	Services	Residents' expenditure abroad	Visitor spending	Private consumption expenditure ^(b)
2008	Annual	3.0	5.6	11.0	7.2	*	*	6.4	2.3
	H1	6.7	7.1	16.7	12.4	3.4	2.6	7.6	6.2
	H2	-0.5	4.1	6.2	2.6	-3.3	-2.5	5.3	-1.3
	Q1	8.3	8.5	19.1	14.0	5.0	11.2	7.5	8.7
	Q2	5.2	5.9	14.2	10.9	2.0	-5.5	7.9	4.0
	Q3	1.6	5.5	13.9	5.5	-2.3	-0.5	7.5	0.7
	Q4	-2.3	2.7	-0.8	0.1	-4.2	-4.6	3.3	-3.2
2009	Annual	0.4	-2.0	0.9	-0.1	1.0	1.6	8.0	-0.3
	H1	-2.7	-3.0	-6.6	-5.8	-1.1	1.5	6.8	-3.4
	H2	3.6	-1.0	7.8	5.6	3.1	1.7	9.0	2.7
	Q1	-4.0	-3.7	-5.5	-5.7	-3.3	-3.7	14.4	-6.1
	Q2	-1.5	-2.4	-7.9	-5.9	1.1	7.3	-1.5	-0.8
	Q3	0.8	-1.3	-2.3	-1.4	2.6	0.5	3.2	0.5
	Q4	6.2	-0.7	18.2	11.8	3.6	3.1	14.3	4.9

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.

(*) Change of less than 0.05%

Diagram 1.2 : Private consumption accelerated further in the fourth quarter

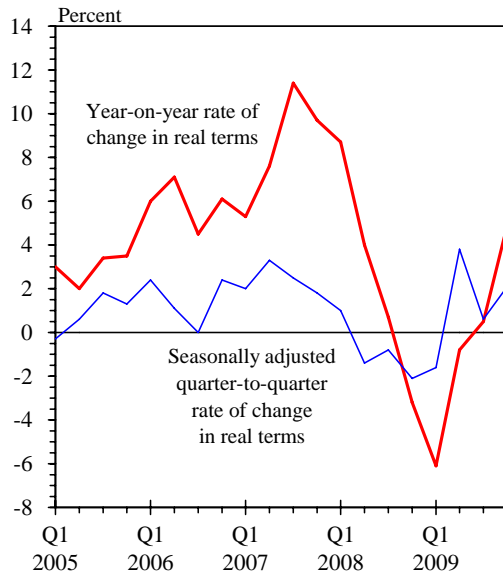
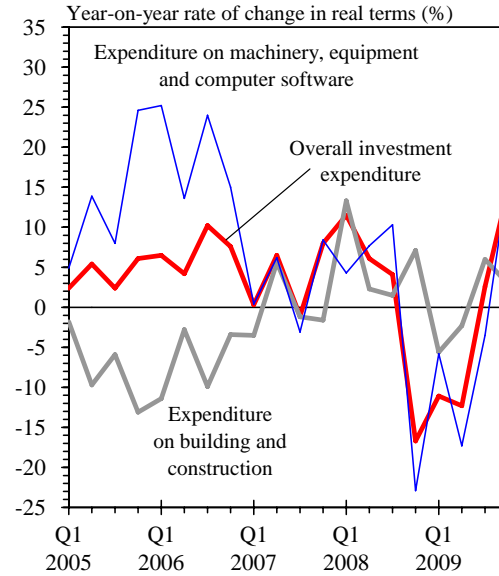


Diagram 1.3 : Overall investment rebounded visibly in the second half of 2009



1.7 Overall investment spending likewise showed a sharp improvement in the second half of 2009 after a dismal first half. Under the Government's commitment to expedite public sector projects to counter the financial tsunami, public sector building and construction works accelerated markedly during the year, while public sector investment in machinery and equipment also grew solidly. With the return of business confidence, private sector expenditures on building and construction as well as machinery and equipment both showed relative improvement in the second half of the year. Indeed, according to the Quarterly Business Tendency Survey conducted by the Census and Statistics Department, a larger proportion of large business establishments surveyed turned more optimistic about the outlook over the course of the year. The latest Survey, conducted during early December 2009 to early January 2010, showed that the improvement in business sentiment was broad-based, evident across all major economic sectors. Reflecting the broad-based improvements in private investment, *gross domestic fixed capital formation* resumed positive growth in the third quarter and picked up significantly further in the fourth quarter, trimming the annual decline to 2.2% in real terms for 2009 as a whole.

The labour sector

1.8 Local labour market showed much resilience during the global crisis. After a marked rise in the early part of 2009, the seasonally adjusted unemployment rate stabilized by around mid-year and came down successively to 4.9% in the fourth quarter. The total number of job loss was 43 000 at the worst time of the crisis, only one-third of the total job loss during the Asian financial crisis in 1997-1998. Towards the end of the year, there were signs that companies had turned more positive in hiring workers. Likewise, the downward pressure on labour earnings abated in the latter part of the year.

The asset markets

1.9 Local stock market was under much selling pressure in early 2009, with the Hang Seng Index (HSI) reaching the post-tsunami low of 11 345 on 9 March. It then staged a strong rebound alongside other Asian markets, reaching a high of 22 944 in mid-November. The abundance in liquidity amid the substantial monetary easing by central banks around the world, coupled with the relatively brighter prospect of the Asian region, led to a strong influx of funds into Hong Kong and other Asian economies. HSI closed the year at 21 873, 52% higher than at end-2008. Activities in the local stock market also revived over the course of the year, with the average daily turnover averaging at \$62.3 billion in 2009 as compared to \$50.8 billion in the fourth quarter of 2008. Fund-raising activities also showed a strong comeback in the second half of the year. For 2009 as a whole, there were altogether 73 IPO listings, raising a total capital of \$248.2 billion, the largest among all stock exchanges in the world.

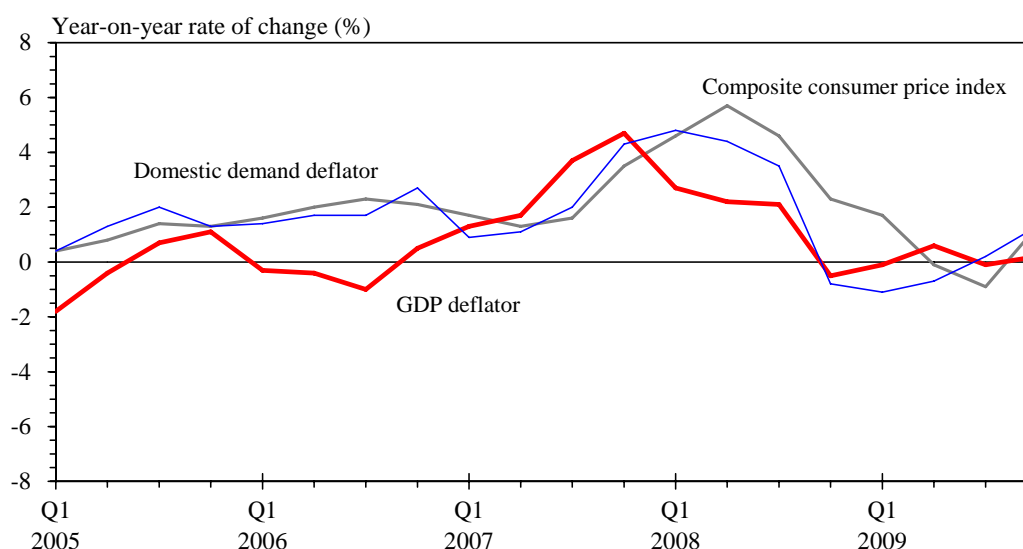
1.10 After a sharp correction immediately after the financial tsunami, the local property market likewise staged a notable rebound that began in early 2009. Trading activities picked up as buying interest re-emerged amid a more accommodative mortgage lending policy by local banks. With a view to maintaining banking stability and enhancing banks' risk management on mortgage lending, in October 2009 the HKMA advised banks to cap the loan-to-value ratio at 60% for residential properties valued at \$20 million or more and set the maximum loan amount at \$12 million for mortgages on properties valued at below \$20 million. The HKMA also reminded lenders to be prudent in valuating properties and calculating borrowers' debt servicing ratios. The Government also introduced guidelines for developers to follow, aiming to improve the transparency of the property market. Residential property prices, though turning slightly steadier in the fourth quarter, on average still rose by 27% during 2009, bringing the overall flat prices in December 2009 some 5% above their pre-crisis peak in mid-2008.

Inflation

1.11 Inflationary pressures quickly subsided over the course of 2009 as the global recession led to spare capacity around the world. Underlying consumer price inflation, in terms of the year-on-year rate of change of the *underlying Composite Consumer Price Index*, came down steadily during the first half, turning slightly negative from July to November. Yet, with economic recovery gathering pace, inflation reverted back to a slight positive at 0.3% in December. For 2009 as a whole, the underlying Composite Consumer Price Index rose by an average of 1.0%, down markedly from 5.6% in 2008. Headline inflation continued to be lower than its underlying counterpart, thanks to further one-off relief measures introduced by the Government in 2009. The *headline Composite Consumer Price Index* rose by 0.5% in 2009, compared with the increase of 4.3% in 2008.

1.12 The *GDP deflator* rose by 0.2% in 2009, likewise down from that of 1.5% in 2008. The year-on-year rate of change similarly reversed into increase in the fourth quarter, as the deflationary pressure within the economy receded.

Diagram 1.4 : Price pressures subsided during most of 2009, but picked up modestly towards year-end



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

	<u>2008</u>					<u>2009</u>		
	<u>2008</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>
Manufacturing	-6.6	-4.4	-4.1	-6.7	-10.4	-12.2	-10.8	-8.3
Construction	8.8	15.6	5.5	4.1	9.5	-3.4	-1.0	8.1
Services ^(b)	2.5	7.1	3.9	1.9	-2.0	-7.1	-3.6	-2.1
Wholesale, retail and import and export trades, restaurants and hotels	6.2	10.9	9.3	6.6	-0.1	-15.5	-11.2	-8.8
Wholesale and retail trades	4.2	10.2	7.3	3.6	-2.4	-10.0	-7.9	-3.7
Import and export trade	7.2	11.8	10.6	7.9	0.7	-18.1	-12.3	-10.1
Restaurants and hotels	1.9	5.6	3.5	0.9	-2.0	-5.4	-7.7	-4.1
Transport, storage and communications	2.4	7.8	4.1	2.2	-4.0	-8.8	-8.8	-6.9
Transport and storage	2.1	8.5	4.0	1.8	-5.1	-10.8	-10.7	-8.7
Communications	3.4	4.3	4.5	4.2	0.7	0.3	-0.4	1.3
Financing, insurance, real estate and business services	-0.4	8.1	0.3	-2.7	-6.5	-6.4	0.3	4.3
Financing and insurance	-1.3	8.8	-0.8	-3.6	-8.6	-8.5	0.3	5.1
Real estate	0.9	11.3	0.6	-2.6	-5.2	-3.8	1.9	5.8
Business services	1.9	2.8	3.8	0.9	0.3	-0.3	-1.5	0.2
Community, social and personal services	2.2	2.1	2.6	2.8	1.5	0.6	1.5	1.0

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.

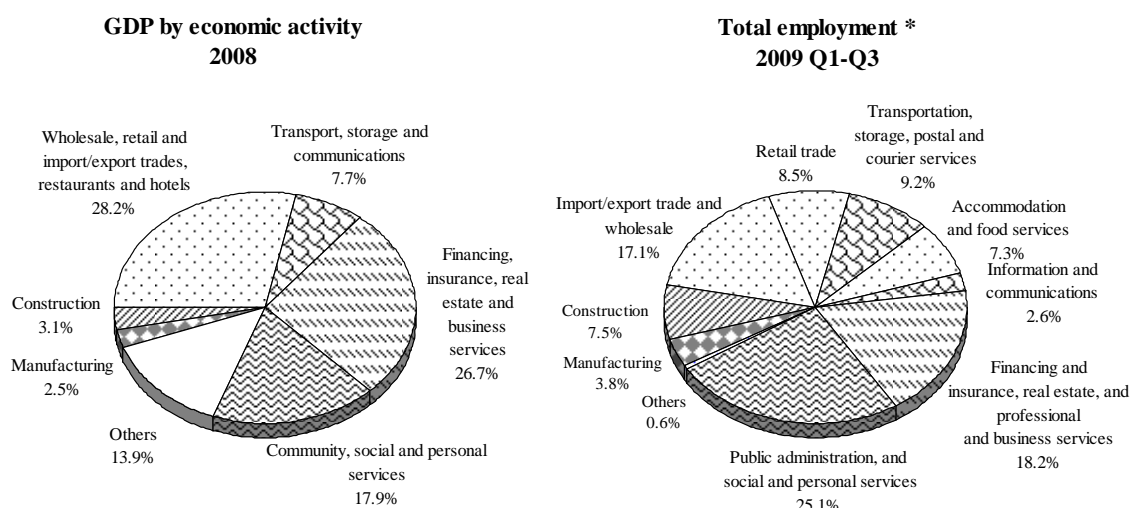
(b) In the context of value-added contribution to GDP, the service sectors include ownership of premises as well, which is analytically a service activity.

GDP by major economic sector

1.13 Most of the service sectors also showed further relative improvement in the third quarter, reflecting the upturn in domestic sector as well as the relative improvement in external sector. With the revival in financial market activities and a more active property market, net output in financing and insurance as well as real estate saw faster year-on-year growth in the third quarter. Business services also reverted to a modest expansion. The rates of decline of wholesale and retail trades, as well as restaurants and hotels, both tapered notably in the third quarter as consumer sentiment revived further and inbound tourism rebounded on the back of a pick-up in Mainland visitors. Transport and storage as well as import and export trade also saw some relative improvement in net output in the third quarter, but still recorded notable declines as global trade flows were only recovering slowly. For the services sector as a whole, the year-on-year decline in net output narrowed distinctly further to 2.1% in the third quarter, from 7.1% and 3.6% respectively in the first and second quarters. As to the industrial sectors, the rate of decline in manufacturing tapered further, while net construction output rebounded notably in the third quarter upon the acceleration in public works.

1.14 Services sector activity continued to feature prominently in the Hong Kong economy, accounting for 92.0% of GDP in 2008 and having a share of 88.0% of total employment in the first three quarters of 2009. The service-oriented structure of the economy allows Hong Kong to realize its comparative advantage, thereby driving growth through meeting the rising demand for high quality services from the Mainland economy and other parts of the world. The transformation of Hong Kong into a high value-added, knowledge-based economy has been supported by the increased availability of skilled workers. The proportion of the workforce with tertiary education attainment rose from 27.8% in 2004 to 31.4% in 2009.

Diagram 1.5 : Services sector continued to feature prominently



Note : (*) Figures refer to the Composite Employment Estimates, which are compiled based on results of the General Household Survey and the Quarterly Survey of Employment and Vacancies. Figures for 2009 are averages for the first three quarters of the year. Starting from the first quarter of 2009, industrial classification of employment has adopted the Hong Kong Standard Industrial Classification Version 2.0 while that of GDP by economic activity is based on Version 1.1.

Some highlights of economic policy

1.15 With the joint effort by the community, together with the Government's successive rounds of measures to stabilise the financial markets, ease credit conditions, support enterprises, accelerate public works, and create employment, the Hong Kong economy has weathered the aftershocks of the global financial tsunami and progressively emerged from the deep contraction in early 2009. The Government will continue with this strategy until economic recovery is on solid ground and employment resumes a visible improvement. To provide the favourable conditions for the economic recovery, the Government has decided to extend the loan guarantee schemes for another 6 months until June 2010. At the same time, public investment in infrastructure projects is expected to gather further momentum in 2010, and this should add impetus to Hong Kong's recovery process and provide a cushion against the expected weakness in the external sector.

1.16 The silver lining behind the current global crisis is that it has radically changed the landscape of the global economy. The Mainland has emerged as a prominent economic powerhouse. This, in turn, will present new opportunities for Hong Kong. The past year has seen a rapid expansion of the Reminbi (RMB) business in Hong Kong. Hong Kong became the first place outside the Mainland where cross-border trade may be settled using the RMB, and where the Central Government issued RMB bonds. Moreover, for the first time Mainland branches of Hong Kong banks are permitted to issue RMB bonds in Hong Kong. All these have strengthened Hong Kong's position as a global financial center, as well as its unique role in the internationalisation of the RMB.

1.17 The Supplement VI to the Closer Economic Partnership Arrangement, with effect from 1 October 2009, provides further liberalization measures covering a wide range of service sectors, further enhancement in financial co-operation and progress in mutual recognition of professional qualifications between the Mainland and Hong Kong. Also, as part of the regional co-operation, Hong Kong will participate in the development of Qianhai in Shenzhen, so as to promote and enhance Hong Kong's own service industries and to contribute to the development of service industries in the Mainland.

1.18 The Government is also making full use of opportunities generated by increasing integration between Hong Kong and the Pearl River Delta, a national strategy endorsed by the Central Government. Hong Kong and Guangdong are pushing ahead with co-operation on many fronts. In terms of hardware, construction of the Hong Kong-Zhuhai-Macao Bridge has just started and funding for the Hong Kong- Guangzhou Express Rail Link has just been approved. Both of these mega projects will enhance the efficient flow of people and goods and further deepen economic integration. Needless to say, Hong Kong has benefited and will continue to benefit significantly from the vibrant growth in Mainland in 2010 and in the years to come.

1.19 The significant improvement in cross-Strait relations in 2009, which has posed major challenges for Hong Kong in terms of reduced passenger and cargo traffic, has also brought new opportunities to develop deeper economic and cultural co-operation with Taiwan. The Government is working hard to enrich these links.

1.20 The global financial crisis also galvanised the Government's thinking on economic diversification. The Task Force on Economic Challenges has identified six promising industries where Hong Kong enjoys competitive advantages, including education services, medical services, testing and certification, environmental industries, innovation and technology, and cultural and creative industries. Taking the recommendations of the Task Force forward, the Government announced a series of measures in the 2009-10 Policy Address to promote the six new growth areas, including, among others, measures to release the potential of over 1000 old industrial buildings. The Government's role is to make flexible adjustments in response to market needs and remove the barriers so as to ensure the smooth running of the markets for the benefit of the public and society, under the principle of "Big Market, Small Government".

Box 1.2

Economic contribution of the six industries

Background

In response to the global financial tsunami, the Chief Executive established the Task Force on Economic Challenges (TFEC) in late 2008. With the experience and collective wisdom of its members from different sectors, the TFEC identified six industries where Hong Kong enjoys clear advantages for further development. The recommendation was made making reference to the findings of various studies and the views of the public and the industries, and considering factors such as whether the opportunities for co-operation with the Mainland and the Pearl River Delta region could be capitalised. The six industries are cultural and creative industries, testing and certification services, medical services, education services, environmental industries, and innovation and technology. The Government has accepted the TFEC recommendations and has been developing specific measures for promoting the six industries.

To track the performance of the six industries over time and to assess their impact on the economy, it will be useful to have statistics on their value added and employment size. Value added refers to the value of total output minus the value of goods and services used up in the course of production. The value added of an industry indicates how much it contributes to the Gross Domestic Product (GDP) while the employment size shows the employment opportunities created by the industry.

The six industries referred to in this article mainly cover the production activities of private corporations, including non-profit making or subsidised organisations.

The estimates given in this article only relate to the direct economic impact of the six industries. Their indirect economic impact, including spill-over effects on other industries (e.g. expansion in the cultural and creative industries may have a positive impact on tourism) as well as future benefits to Hong Kong (e.g. enhanced productivity and faster growth brought about by technological innovation activities and education services) are not taken into account.

Crude estimates on value added and employment

As the six industries are either relatively small at present, or not well defined industries in the current industrial classification, official statistics for these industries are not readily available. Moreover, some of the six industries such as innovation and technology are not exactly an industry in the traditional sense since innovation and technology activities can exist in any organisations and in any industries, but the term “industry” is still used to denote the aggregate of the economic activities concerned for the sake of simplicity and easy general understanding. This is similar to the use of the term “industry” for tourism and producer services which do not fall under the standard statistical classification of industries and hence are not industries in the traditional sense.

Box 1.2 (Cont'd)

There is also some overlapping of the coverage of activities in the six industries with the four traditional pillar industries (i.e. financial services, trading and logistics, tourism, and producer and professional services). For instance, advertising and software and computing are covered in both "cultural and creative industries" and "producer and professional services", and medical tourism is covered in both "medical services" and "tourism".

For a quick assessment on the economic contribution of the six industries, some ballpark figures had been worked out in 2009 by drawing reference to the best available information from various sources at that time. As released in the Chief Executive's Policy Address in October 2009, the private sector component of these six industries directly contributed around 7% to 8% of the GDP, and employed around 350 000 persons or about 10% of the total workforce. These ballpark figures had many limitations and were necessarily crude. Given these considerations, figures pertaining to individual industries were not released.

Effort has been made in the past few months to improve the data sources and the methodological framework for compiling estimates for the six industries. Some data gaps have been filled, industry coverage more specifically defined and some conceptual issues in the estimation process worked out. As a result, an updated set of crude estimates has been produced as refinements to the ballpark figures released earlier in the 2009-10 Policy Address. Moreover, though still subject to considerable limitations at this stage, estimates for each of the six industries are now made available, as given below.

Based on updated data and a better estimation framework, it is estimated that in 2008 the private sector component of the six industries contributed around 8% of the GDP and employed around 380 000 persons, accounting for some 11% of total employment.

Box 1.2 (Cont'd)

Direct contribution to GDP and employment in 2008

	<u>Value added</u> (HK\$Bn)	<u>Contribution</u> <u>to GDP</u>	<u>Number of</u> <u>persons engaged</u>	<u>Contribution to</u> <u>employment</u>
Cultural and creative industries	around 60	around 3.9%	around 176 000	around 5.0%
Medical services	around 25	around 1.6%	around 69 000	around 1.9%
Education services	around 21	around 1.3%	around 69 000	around 2.0%
Innovation and technology [#]	around 10	around 0.6%	around 22 000	around 0.6%
Testing and certification services	around 4-5	around 0.3%	around 13 000	around 0.4%
Environmental industries	around 3	around 0.2%	around 35 000	around 1.0%
Total	around 120	around 8%	Around 380 000	around 11%

Note: (#) For innovation and technology, persons engaged refer to the number of research and development personnel in full-time equivalent terms.

Way forward

The estimates given above are compiled by the Economic Analysis and Business Facilitation Unit in collaboration with the Census and Statistics Department (C&SD) based on best available information and in consultation with relevant policy bureaux/departments.

C&SD is stepping up its existing data collection framework, with a view to compiling a set of official estimates on the employment size and value added for the six industries. Relevant economic surveys have been enhanced and sample sizes in respect of the targeted industries enlarged for collecting more comprehensive data. Relevant administrative data are also being collated to provide inputs to the estimation framework. Some basic figures for the testing and certification services will be available later this year from an ad hoc survey carried out from end 2009 to early 2010, while data for other industries are being collected. It is expected that the official estimates showing the situation of the six industries in 2009 will become available in early 2011.

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.