

CHAPTER 1 : OVERVIEW OF ECONOMIC PERFORMANCE IN 2011

Summary

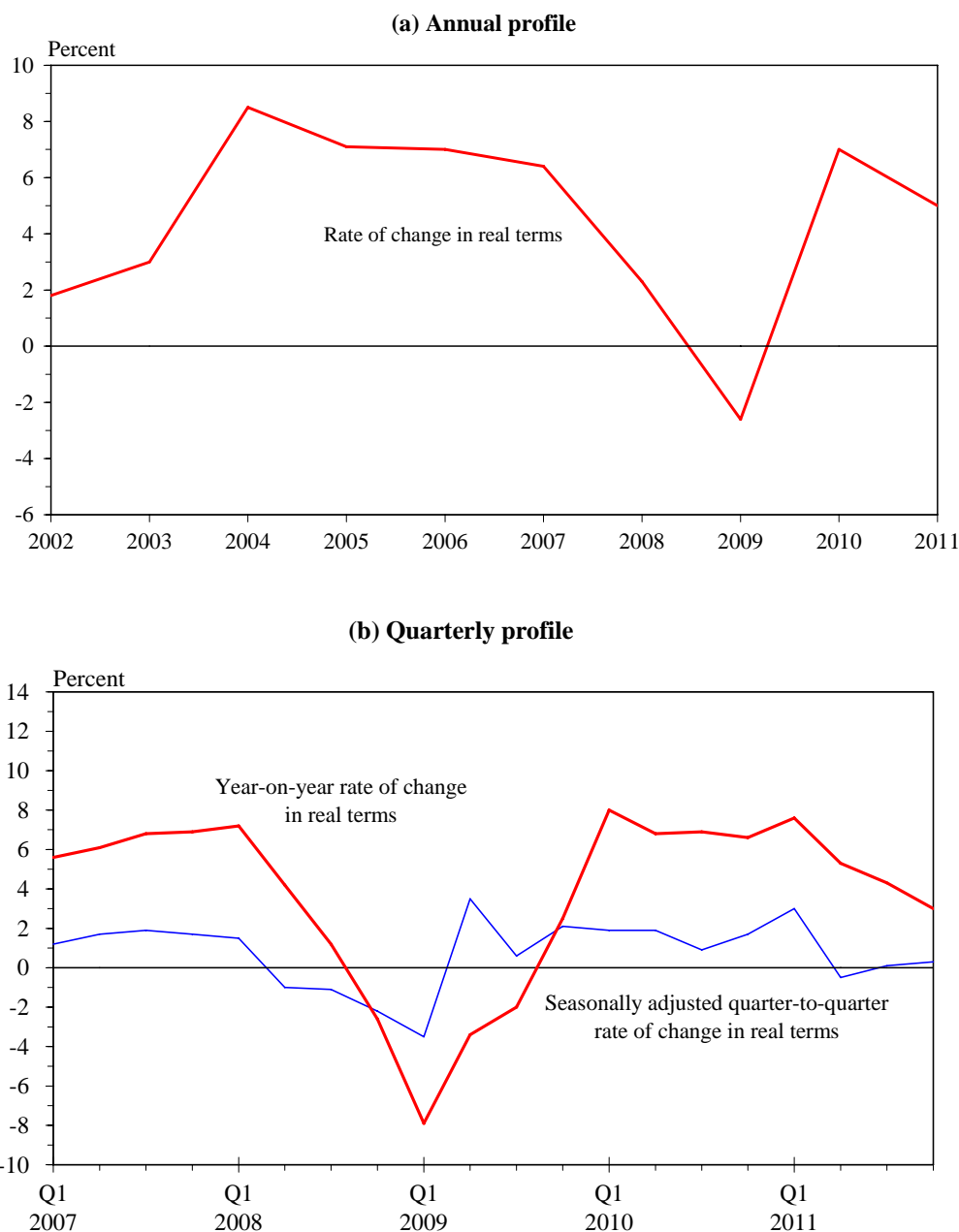
- *The Hong Kong economy sustained strong momentum on entering 2011. However, economic growth moderated progressively since the second quarter, as the external environment was increasingly plagued by the re-emergence of the eurozone sovereign debt crisis and faltering demand in the advanced economies. Yet, the domestic sector stayed resilient throughout the year, partially offsetting the drag from the weaker performance of merchandise exports. For 2011 as a whole, the economy still registered a notable 5.0% expansion, after a 7.0% growth in 2010.*
- *Total exports of goods re-accelerated strongly in the first quarter of 2011, but moderated markedly in the second quarter, partly exaggerated by the disruptions to supply chains caused by the Japan earthquake in March, and stayed sluggish in the second half of the year, due mainly to slackening demand in the advanced markets, notably the US and the EU. In addition, the second round impact of weaker demand in the advanced markets was also increasingly evident in some Asian markets.*
- *Exports of services fared rather strongly for 2011 as a whole, although growth also moderated visibly towards the year-end. Vibrant inbound tourism and buoyant cross-border commercial and financial activities provided the key drivers, but exports of trade-related and transportation services were more affected by the slowdown in merchandise trade flows.*
- *The domestic sector performed remarkably well in 2011. Private consumption expenditure grew robustly throughout the year, thanks to the notable job and income growth in the past year or so. Investment strengthened after the first quarter and held firm to the year-end on hectic machinery and equipment acquisition and intensive public sector works, despite more cautious business sentiments in the latter part of the year.*
- *The labour market was in a state of full employment. Job vacancies surged across many sectors amid the economic expansion, pushing total employment to successive new highs. The seasonally adjusted unemployment rate fell to a 13-year low of 3.2% in the third quarter, before edging up to 3.3% in the fourth quarter. Both wages and earnings recorded their largest increases since the mid-1990s, thanks to the buoyant labour market conditions, and an additional boost from the implementation of statutory minimum wage (SMW) since 1 May 2011.*

- *Local stock prices underwent sharp gyrations and drifted markedly lower during the year amid the global financial market turmoil induced by the deepening euro debt crisis. Local property market continued its uptrend in the first half of 2011, before turning much quieter in the second half amid a more uncertain global economic outlook and tighter mortgage loan terms.*
- *As part of a region-wide phenomenon, inflation went up visibly during most of 2011, driven by the feed-through of domestic cost pressures as well as higher imported inflation. Yet with the ease-back of global food and commodity prices since early 2011 and slower local economic growth, inflation stabilised towards the year-end. In 2011, underlying inflation averaged at 5.3%, up from 1.7% in 2010.*

Overall situation

1.1 Following the full-fledged upturn in 2010, the Hong Kong economy saw another year of above-trend growth in 2011, thanks largely to the spectacular performance in the early part of the year. However, successive moderation in growth momentum was seen after the first quarter of 2011, as the increasingly difficult global economic environment led to a marked slowdown in merchandise exports. Total exports of goods to the US, EU and Japan relapsed to declines since the second quarter, although exports of services held up relatively better on the back of thriving inbound tourism and vibrant cross-border commercial and financial activities. In contrast, domestic demand was the bright spot and sustained notable growth throughout the year, underpinned by strong consumption demand and hectic expansion of public sector construction works. The sanguine business sentiment during most of the year also contributed to a notable increase in investment in machinery and equipment. In line with the experience of many Asian economies, inflation went up uninterruptedly during most of the year, and then stabilised towards the year-end.

Diagram 1.1 : Economic growth moderated over the course of 2011, but still registered above-trend growth for the year as a whole



1.2 For 2011 as a whole, the *Gross Domestic Product (GDP)*⁽¹⁾ expanded by 5.0% in real terms, following a strong growth of 7.0% in 2010. In terms of the quarterly profile, real GDP surged by 7.6% in the first quarter over a year earlier, before moderating progressively to 5.3%, 4.3% and 3.0% year-on-year growth in the second, third and fourth quarters respectively amid increasing headwinds in the external environment. On a seasonally adjusted quarter-to-quarter comparison⁽²⁾, real GDP expanded strongly by 3.0% in the first quarter, but relapsed to a 0.5% decline in the second quarter, then grew only mildly by 0.1% in the third quarter, and by 0.3% in the fourth quarter.

The external sector

1.3 *Total exports of goods* slackened markedly to a modest growth of 3.6% in real terms in 2011, from the strong rebound of 17.3% in 2010. After a double-digit year-on-year growth of 16.8% in the first quarter of 2011, mainly driven by the vibrant Asian markets, total exports of goods decelerated sharply to virtually zero growth in the second quarter, partly dragged by temporary disruptions to regional supply chains arising from the March earthquake in Japan, and also partly by slower demand growth in many export markets. Import demand in the advanced economies was notably hampered by their fragile fiscal conditions and weak fundamentals in the ensuing quarters, as reflected by the further sharp plunges in exports to the US and enlarged declines in those to the EU. The spillover effect of waning final demand in these markets was also increasingly felt across Asia, as manifested by the region-wide deceleration in production and export activities. As a result, Hong Kong's merchandise exports to some Asian markets, including India, Korea and Singapore, slowed visibly in the second half of 2011. Total exports of goods registered a modest year-on-year decline of 2.2% in the third quarter, before rebounding by 2.2% in the fourth quarter over a year earlier. On a seasonally adjusted quarter-to-quarter comparison, merchandise exports grew strongly in the first quarter, fell back notably in the second quarter, held flat in the third, only edging up slightly in the fourth quarter.

1.4 *Exports of services* fared better, with a growth of 6.3% in real terms for 2011 as a whole, though markedly slower than the 14.6% growth in 2010. With trade-related and transportation services significantly curtailed by the worsening global environment and slowdown in merchandise trade flows, the pace of growth in exports of services tapered over the course of the year, from a strong 9.1% year-on-year growth in the first quarter to only a moderate expansion of 3.5% in the fourth quarter. Yet exports of travel services stayed vibrant with very strong growth throughout the year, thanks to the rapid increase in visitor arrivals, especially those from the Mainland. Exports of financial and business services were likewise resilient during most of the year, on the back of buoyant cross-border financing, fund raising and other commercial activities. These two components provided a strong cushion against the slack in the trade-related components and helped underpin the still solid performance of exports of services in 2011.

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

	<u>2010[#]</u>	<u>2011⁺</u>	<u>2010</u>				<u>2011</u>			
			<u>Q1[#]</u>	<u>Q2[#]</u>	<u>Q3[#]</u>	<u>Q4[#]</u>	<u>Q1[#]</u>	<u>Q2[#]</u>	<u>Q3[#]</u>	<u>Q4⁺</u>
<i>Change in real terms of GDP and its main expenditure components (%)</i>										
Private consumption expenditure	6.7	8.4	7.9 (0.9)	4.6 (1.6)	5.8 (1.9)	8.6 (3.7)	7.9 (0.6)	9.7 (3.1)	9.8 (2.1)	6.4 (0.4)
Government consumption expenditure	2.8	1.8	3.4 (1.0)	2.9 (0.8)	3.3 (0.8)	1.7 (-0.8)	2.5 (1.7)	1.0 (-0.8)	1.4 (1.1)	2.0 (0.1)
Gross domestic fixed capital formation	7.7	7.3	8.0	15.7	-0.4	8.5	0.8	7.7	11.2	9.0
<i>of which :</i>										
Building and construction	5.6	N.A.	-7.6	12.3	8.2	10.2	17.8	-4.2	1.8	N.A.
Machinery, equipment and computer software	6.4	N.A.	11.5	16.4	-6.6	7.1	-11.2	17.8	26.7	N.A.
Total exports of goods	17.3	3.6	21.6 (6.2)	20.2 (3.9)	20.8 (1.8)	8.2 (-3.5)	16.8 (13.8)	0.3 (-11.1)	-2.2 (*)	2.2 (0.9)
Imports of goods	18.1	4.8	28.3 (7.5)	23.4 (3.3)	16.7 (-0.6)	7.5 (-2.3)	12.6 (11.7)	2.6 (-5.9)	1.4 (-1.0)	3.9 (-0.5)
Exports of services	14.6	6.3	17.9 (3.8)	17.0 (2.1)	15.4 (2.4)	9.4 (0.7)	9.1 (3.5)	7.5 (0.6)	5.5 (0.5)	3.5 (-1.1)
Imports of services	10.7	3.0	11.6 (2.1)	12.2 (2.6)	11.2 (1.0)	8.1 (2.0)	5.3 (-0.6)	2.9 (0.5)	2.3 (0.3)	1.9 (1.5)
Gross Domestic Product	7.0	5.0	8.0 (1.9)	6.8 (1.9)	6.9 (0.9)	6.6 (1.7)	7.6 (3.0)	5.3 (-0.5)	4.3 (0.1)	3.0 (0.3)
<i>Change in the main price indicators (%)</i>										
GDP deflator	0.3	3.4	0.7 (0.9)	-2.2 (-2.4)	1.8 (2.4)	0.7 (-0.1)	1.4 (1.3)	4.9 (1.4)	4.7 (1.9)	2.8 (-1.7)
Composite CPI										
Headline	2.4[@]	5.3[@]	1.9 (0.8)[@]	2.6 (0.5)[@]	2.3 (-2.2)[@]	2.7[@] (3.7)[@]	3.8[@] (1.8)[@]	5.2[@] (1.8)[@]	6.4[@] (-0.9)[@]	5.7[@] (3.0)[@]
Underlying[^]	1.7[@]	5.3[@]	0.8 (0.5)[@]	1.5 (0.5)[@]	2.0 (0.4)[@]	2.4[@] (1.0)[@]	3.7[@] (1.8)[@]	5.0[@] (1.7)[@]	6.1[@] (1.5)[@]	6.4[@] (1.2)[@]
Change in nominal GDP (%)	7.3	8.6	8.7	4.4	8.9	7.3	9.1	10.5	9.2	5.9

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.

(+) Figures for Q4 2011 and year 2011 are advance preliminary estimates compiled in accordance with an advanced schedule. As the estimates are compiled based on limited data, only figures for major expenditure aggregates are available. More detailed data will be released on 22 Feb 2012 in the report *Gross Domestic Product, Fourth Quarter 2011*, which can be downloaded from the website of the Census and Statistics Department.

([@]) By reference to the new 2009/10-based CPI series.

() 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.

N.A. Not yet available. An advance schedule has been adopted in compiling the GDP figures for Q4 2011 and year 2011. Due to insufficient data, figures of sub-components are not available.

The domestic sector

1.5 The domestic sector fared remarkably well in 2011, rendering the key impetus to overall economic growth. Local consumer sentiments were buoyed by the broad-based income and job growth over the past year or so. *Private consumption expenditure* (PCE) grew robustly in real terms in all four quarters of 2011. For 2011 as a whole, PCE grew by 8.4%, further to the already strong growth of 6.7% in 2010. On a seasonally adjusted quarter-to-quarter comparison, PCE stayed on an uptrend throughout 2011. Meanwhile, *government consumption expenditure* expanded steadily further in 2011, by 1.8% in real terms, following the 2.8% growth in 2010.

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

Of which :

		Total consumer spending in the domestic market ^(a)	Food	Durables	Non- durables	Services	Residents' expenditure abroad	Visitor spending	Private consumption expenditure ^(b)
2010	Annual	9.2	5.0	28.8	13.7	5.5	5.2	25.7	6.7
	H1	8.8	4.5	28.7	12.8	5.7	3.9	26.9	6.2
	H2	9.6	5.5	28.8	14.5	5.3	6.5	24.7	7.3
	Q1	9.8	5.1	30.3	13.8	6.4	4.5	19.1	7.9
	Q2	7.9	4.0	27.0	11.8	5.1	3.4	36.9	4.6
	Q3	9.4	5.3	28.1	14.1	5.8	10.0	39.4	5.8
	Q4	9.7	5.7	29.5	14.9	4.8	3.0	12.8	8.6
2011	Annual	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	8.4
	H1	10.0	1.1	34.1	22.2	3.6	2.3	13.0	8.8
	H2	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	8.0
	Q1	8.9	3.6	24.1	19.2	3.5	1.9	10.6	7.9
	Q2	11.0	-0.9	45.5	25.2	3.8	2.8	15.6	9.7
	Q3	10.7	0.3	38.2	21.8	3.7	-0.2	9.4	9.8
	Q4	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	6.4

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.

N.A. Not yet available. An advance schedule has been adopted in compiling the GDP figures for Q4 2011 and year 2011. Due to insufficient data, figures of sub-components are not available.

Diagram 1.2 : Private consumption expenditure sustained strong growth in 2011

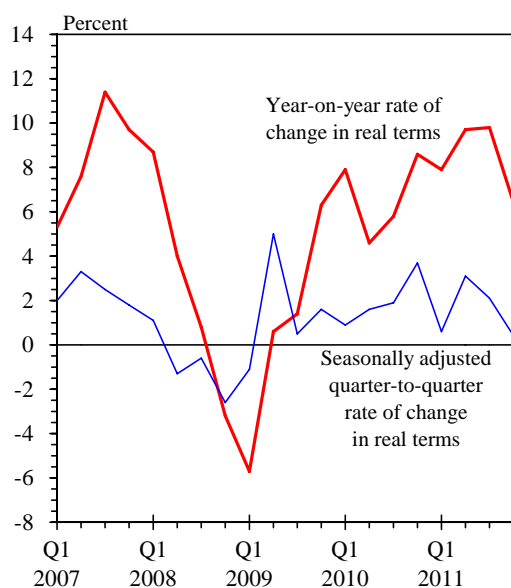
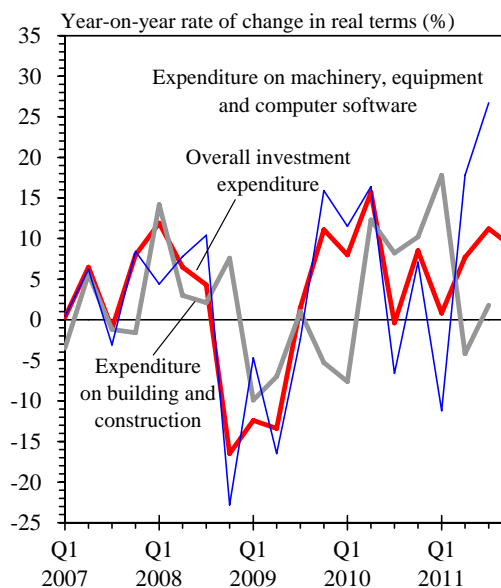


Diagram 1.3 : Investment spending was more volatile during 2011



1.6 Overall investment spending in terms of *gross domestic fixed capital formation* posted a notable 7.3% growth in real terms in 2011, following the 7.7% expansion in 2010. Machinery and equipment acquisition, which tends to be rather volatile, displayed fluctuations during the year, relapsing to a year-on-year decline in the first quarter before rebounding to double-digit growth in the second and third quarters. Preliminary indication from retained imports of capital goods suggests that private machinery and equipment investment stayed vibrant in the fourth quarter. Meanwhile, public sector construction works continued apace throughout the year, offsetting the slack in private sector building activity, thereby rendering another important growth driver of domestic demand, and in turn, the overall economy. However, with increasing headwinds in the external environment upon the deepening euro debt crisis, business sentiments saw some deterioration in the latter part of the year, as suggested by results of the Quarterly Business Tendency Survey on large enterprises and diffusion indices on small and medium-sized enterprises (SMEs) (See **Box 1.1** for details of the consultation on SMEs).

Box 1.1

Diffusion indices on small and medium-sized enterprises (an update)

To gain a better understanding of the current situation of business receipts, employment and credit access for 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 feedback. This note provides a further update of the results reported in *Box 1.1* in the *Third Quarter Economic Report 2011*.

From June 2011 onwards, the industry coverage and questionnaire design for the exercise have been modified. Specifically, three sectors (viz. travel agents, financing institutions, and insurance agents and brokers) are dropped from the exercise, while questions on access to credit have been modified to gauge SMEs' views as to whether the current and expected credit access situation are "easy", "fair" or "tight", rather than in respect of a comparison with the normal times. The sample size of the panel is consequently reduced to around 410.

A set of diffusion indices is compiled to indicate the general directions of change in the respondents' views on business receipts and employment versus the preceding month. Given the changes in questions and sample, the results regarding their views on business receipts and employment since the June 2011 round onwards are not strictly comparable with those in the preceding rounds. The findings should also be interpreted with considerable caution given the coverage and nature of the consultation exercise. Nevertheless, they can serve as a rough indicator to enable high frequency monitoring of SMEs' situation.

Business receipts of the SMEs surveyed, as depicted by the set of diffusion indices, showed that the overall situation deteriorated further towards the end of 2011 (*Table 1*). In November and December 2011, a larger proportion of SMEs in almost all of the seven sectors surveyed reported some deterioration in business receipts. More notable declines were seen in the real estate sector alongside a quieter property market, and logistics amid the slowdown in merchandise trade. On the other hand, the domestically-oriented sectors such as restaurants and retail trade held up relatively better, reflecting the still vibrant domestic demand, although the latter saw some worsening in December. Separately, the feedback from SMEs indicated that their employment situation remained largely stable in recent months (*Table 2*).

Specifically for import and export trading firms, their views on new export orders were sought separately to gauge the export performance. The diffusion index on new export orders dropped to a record low of 43.1 in November 2011, before climbing back somewhat to 45.7 in December. This reflects a rather grim near-term outlook for exports due to faltering demand from the advanced economies and its increasingly evident second-round effects on the Asian markets.

(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)

Credit access situation remained favourable in recent months, with only 1.2% of SMEs reporting tight current access to credit from October 2011 to December 2011, thanks to the generally accommodative monetary conditions and the Government's continued efforts to support SMEs through various loan guarantee schemes.

Table 1 : Diffusion indices[^] on business receipts

	<u>2011</u>											
	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>	<u>May</u>	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>	<u>Nov</u>	<u>Dec</u>
<i>Local segments</i>												
Restaurants	50.0	50.0	49.1	50.0	50.0	48.3	50.0	48.3	45.6	47.4	49.1	50.0
Travel	48.3	48.3	48.3	50.0	51.7	--	--	--	--	--	--	--
Real estate	60.6	52.9	48.5	45.6	41.2	33.8	42.9	45.7	35.7	41.4	42.6	39.7
Retail trade	50.0	48.3	50.4	50.0	49.5	45.1	49.1	48.7	46.9	49.1	48.6	46.8
Wholesale trade	50.0	50.0	52.8	50.0	50.0	50.0	45.0	47.5	50.0	42.5	42.5	47.5
Insurance	60.5	57.9	57.9	50.0	52.8	--	--	--	--	--	--	--
Business services	51.6	48.5	47.0	48.5	50.0	46.8	43.3	45.5	47.0	50.0	46.9	45.3
<i>External segments</i>												
Import/export trades	49.2	50.0	50.0	50.0	49.1	46.1	47.9	49.6	45.3	45.7	43.1	47.4
Logistics	50.0	52.8	50.0	50.0	50.0	47.4	47.5	45.0	42.5	45.0	42.5	36.1
Financing institutions	50.0	48.7	52.6	52.6	47.4	--	--	--	--	--	--	--
All the above sectors*	50.4	49.8	50.0	49.7	49.1	45.7	47.4	48.3	45.6	46.6	45.1	46.3

Notes: (^) The diffusion index is computed by adding the percentage of SMEs reporting "up" to one half of the percentage of SMEs reporting "same." A diffusion index reading above 50 indicates that the business condition is generally favourable, whereas an index below 50 indicates otherwise. Respondents were requested to exclude seasonal effects in reporting their views.

(--) Not applicable.

(*) Weighted average using total number of SMEs in individual sectors as weights.

Table 2 : Diffusion indices on employment situation

	<u>2011</u>											
	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>	<u>May</u>	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>	<u>Nov</u>	<u>Dec</u>
<i>Local segments</i>												
Restaurants	50.0	50.0	50.0	50.0	50.0	50.0	50.0	49.1	50.0	50.0	50.0	49.1
Travel	50.0	50.0	50.0	50.0	51.7	--	--	--	--	--	--	--
Real estate	50.0	50.0	50.0	48.5	50.0	50.0	54.3	51.4	50.0	50.0	51.5	48.5
Retail trade	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	49.1
Wholesale trade	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0
Insurance	55.3	52.6	52.6	50.0	50.0	--	--	--	--	--	--	--
Business services	50.0	50.0	50.0	51.5	51.5	50.0	50.0	51.5	48.5	50.0	50.0	50.0
<i>External segments</i>												
Import/export trades	50.0	50.0	50.0	50.0	50.0	49.6	49.6	50.0	49.6	49.6	48.7	50.0
Logistics	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0
Financing institutions	52.6	53.8	52.6	51.3	50.0	--	--	--	--	--	--	--
All the above sectors*	50.1	50.1	50.1	50.1	50.1	49.8	50.1	50.2	49.7	49.8	49.5	49.6

Notes: (--) Not applicable.

(*) Weighted average using total number of SMEs in individual sectors as weights.

Box 1.1 (Cont'd)

Table 3 : Diffusion index on current new export orders

	<u>2011</u>											
	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>	<u>May</u>	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>	<u>Nov</u>	<u>Dec</u>
Import and export trades	49.2	50.0	50.0	50.0	49.1	47.8	48.7	49.2	45.7	45.7	43.1	45.7

Table 4 : Percentage of SMEs reporting tight current access to credit

	<u>2011</u>											
	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>	<u>May</u> [#]	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>	<u>Nov</u>	<u>Dec</u>
All selected sectors*	2.8	2.8	3.2	3.2	3.2	1.6	1.6	1.6	1.6	1.2	1.2	1.2

Notes: (*) Weighted average using total number of SMEs in individual sectors as weights.

(#) Prior to June 2011, the question posed to the SMEs was framed in relation to the normal situation.

The labour sector

1.7 The labour market saw further notable and broad-based tightening in 2011. Total employment was on a strong uptrend throughout the year, reaching a new record high of 3 661 900 in the fourth quarter. Along with this, the *seasonally adjusted unemployment rate* fell successively to a 13-year low of 3.2% in the third quarter, only rising back slightly to 3.3% in the fourth quarter, a level that still signified full employment. The *underemployment rate* also declined steadily, to 1.4% in the fourth quarter. On the back of a vibrant domestic sector, labour demand stayed buoyant throughout the year with an upsurge in job vacancies, although hiring sentiments appeared to turn somewhat more cautious in the latter part of the year amid a highly uncertain external environment. In tandem, labour wages and earnings rose significantly across many sectors, especially for the lower decile groups, thanks in part to the additional boost from SMW implementation in May 2011.

The asset markets

1.8 The *local stock market* underwent sharp volatilities and drifted markedly lower during 2011. The correction was mainly induced by market worries over the worsening debt situation in Europe since the second quarter as well as the increasingly bleak global economic outlook. With the sharp intensification of the euro debt crisis and heightened contagion risks in the ensuing months, the Hang Seng Index (HSI) hit a low of 16 250 on 4 October 2011, the level last seen in May 2009. Though with some subsequent rebound upon the coordinated efforts taken by the European governments and major central banks to tackle the crisis and stabilise the global financial situation, the HSI closed the year at 18 434, still 20% lower than at end-2010. Against the market corrections worldwide and shifting market sentiments, fund-raising activities turned visibly quieter in the second half of the year. For 2011 as a whole, total IPO funds raised amounted to \$258.9 billion, 42% down from 2010. Yet Hong Kong still ranked as the world's top IPO centre in 2011, the third year in a row.

1.9 After an almost uninterrupted uptrend over the past two years or so, *residential property market* turned quieter in the second half of 2011, amid a more uncertain global economic outlook and tighter mortgage loan terms. Following the 21% increase during 2010, residential property prices rose further by a cumulative 15% during the first half of 2011, before retreating somewhat in the ensuing months. Nevertheless, overall flat prices in December 2011 were still 9% and 3% respectively higher than the level at end-2010 and the 1997 peak. Transaction volume fell visibly by 38% in 2011, as a combined result of the implementation of Special Stamp Duty (SSD) since November 2010 and the increasingly cautious market sentiment. Housing affordability ratio stood at 45% in the fourth quarter of 2011, on par with that a year earlier, though somewhat lower than the long-term average of 50% over 1991-2010. Rentals generally softened along with the property market correction in the latter part of the year, though for 2011 as a whole, flat rentals still rose by 7%. Rentals for offices and shops likewise softened towards the year-end. The increases were 15% and 9% respectively during the first eleven months of 2011.

Inflation

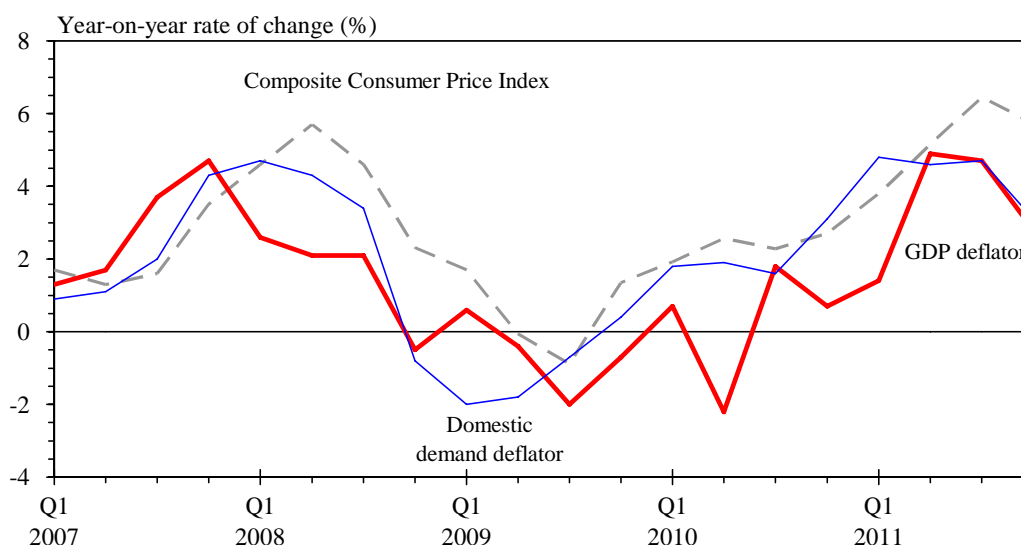
1.10 Inflation was on a notable uptrend during most of 2011 under the influence of both external and domestic factors. On the external front, the notable increases in import prices, driven by the surges of global food and commodity prices from late 2010 through early 2011, played a significant role in driving up local inflation. Domestically, the strong economic upswing in

2010 and early 2011, coupled with the one-off effect from the implementation of SMW in May 2011, resulted in higher local business costs and added further inflationary pressures. Nevertheless, with global food and commodity prices generally easing back after the first quarter and with the moderation in local economic growth over the course of the year, inflation stabilised on entering the fourth quarter.

1.11 The *Composite Consumer Price Index* (Composite CPI) rose by an average of 5.3% in 2011, faster than the 2.4% increase in 2010. Netting out the effects of the Government's one-off measures to give a more accurate indicator of the inflation trend, underlying Composite CPI also rose by 5.3% for 2011 as a whole, compared with the 1.7% increase in 2010. In terms of the quarterly profile, underlying consumer price inflation went up visibly from 3.7% year-on-year in the first quarter of 2011 to 5.0% and 6.1% respectively in the second and third quarters, and slightly further to 6.4% in the fourth quarter. On a seasonally adjusted quarter-to-quarter comparison, underlying inflation recorded increases of 1.8% and 1.7% in the first two quarters, followed by 1.5% and 1.2% in the third and fourth quarters, reflecting the progressive tapering in price pressures towards the year-end.

1.12 The *GDP deflator* rose by 3.4% in 2011, further to the 0.3% increase in 2010, in tandem with the pick-up in domestic prices in the year.

Diagram 1.4 : Inflation went up progressively in 2011 under the influence of both local and external factors



GDP by major economic sector

1.13 The services sector grew solidly in the first three quarters of 2011, albeit tapering in momentum through the quarters. Net output in real terms expanded by 7.4%, 5.1% and 3.9% respectively in the first three quarters of 2011 over a year earlier. Among the major sectors, import and export trade saw the most visible deceleration along with the slowdown in global and regional trade flows. Concurrently, the transportation and storage sector also saw less rapid growth in the second and third quarters than in the first quarter. Financing and insurance, which grew robustly at double-digit rates in the first two quarters, moderated somewhat in the third quarter on the back of a worsening global financial environment. On the other hand, the professional and business services sector sustained solid growth through the three quarters, underpinned by vibrant commercial activities, while accommodation and food services even picked up somewhat in the third quarter, thanks to buoyant local consumption and inbound tourism. Yet real estate activity, mainly reflecting the net output of private sector developers and property agency activity, declined in all three quarters. Meanwhile, output in the manufacturing sector saw only meagre growth, while the construction sector decelerated markedly in the second and third quarters, largely dragged by the slack in private building and construction activity.

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

	<u>2010</u>	<u>2010</u>				<u>2011</u>		
		<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>
Manufacturing	3.5	0.4	2.2	5.4	5.7	3.5	2.0	0.2
Construction	15.4	2.1	20.9	19.6	19.5	23.4	-0.3	1.2
Services ^(b)	7.0	8.1	6.2	7.2	6.4	7.4	5.1	3.9
Import/export, wholesale and retail trades	16.7	22.3	19.3	17.5	10.5	15.4	7.1	4.9
Import and export trade	16.6	23.3	20.0	17.4	9.3	15.1	5.0	2.9
Wholesale and retail trades	17.0	18.1	16.1	17.3	16.5	16.8	17.7	15.7
Accommodation and food services	9.5	10.8	12.7	9.6	5.3	0.9	0.9	2.1
Transportation, storage, postal and courier services	6.1	4.6	9.4	6.4	4.3	9.2	4.5	6.0
Transportation and storage	5.5	4.0	8.9	5.9	3.5	9.0	4.0	6.1
Postal and courier services	17.8	19.1	20.0	17.1	15.6	13.7	13.3	4.4
Information and communications	1.5	1.7	1.5	2.1	0.8	2.0	1.5	0.8
Financing and insurance	7.3	8.8	1.3	5.5	13.3	12.2	12.9	8.3
Real estate, professional and business services	2.3	2.7	1.4	0.9	4.3	2.3	1.3	0.9
Real estate	-1.4	-1.2	-2.7	-3.1	1.3	-0.6	-3.1	-4.2
Professional and business services	6.1	7.1	5.5	4.8	6.9	5.1	5.5	5.5
Public administration, social and personal services	1.8	2.7	1.5	2.5	0.7	2.3	2.4	2.5

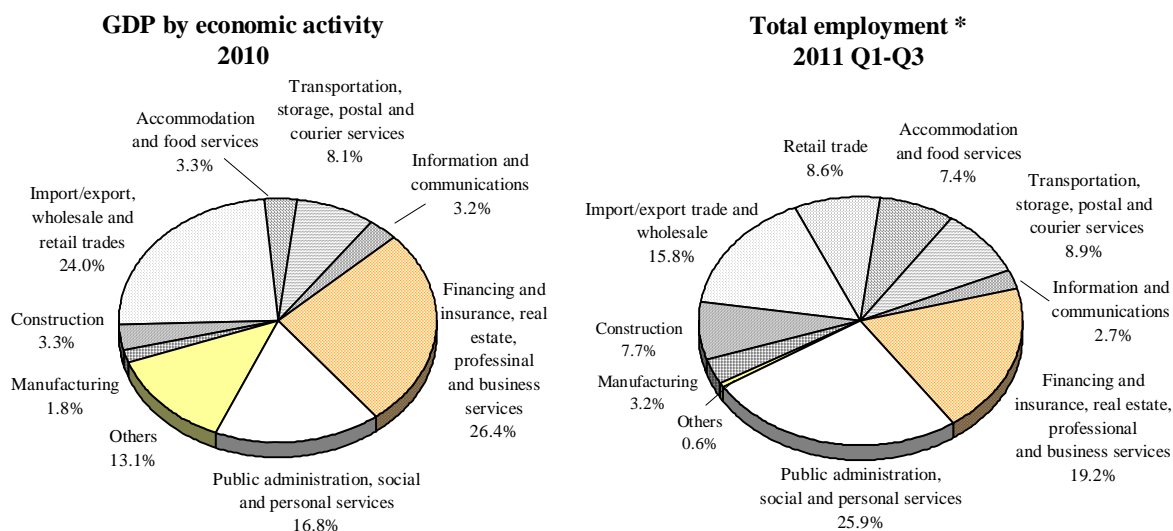
Notes : Figures are subject to revision later on as more data become available.

(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.

1.14 The services sector is the mainstay of Hong Kong's economy, accounting for 92.9% of GDP in 2010 and 88.5% of total employment in the first three quarters of 2011. Being the key driver of overall economic growth, the services sector is where Hong Kong's competitive advantage lies, and plays an increasing role in the deepening integration with the Mainland and strategic development of the nation. Hong Kong will continue to strengthen its position as a global financial centre and regional business hub, by increasing the competitiveness of the four pillar industries, developing further the six industries where it enjoys clear advantages⁽³⁾ (See **Box 1.2** for the latest statistics on the six industries in 2010), and by the continued upgrading of its infrastructure and human capital. On the latter, it is worth noting that the proportion of the local workforce with tertiary education attainment increased steadily from 30.3% in 2006 to 33.8% in 2011.

Diagram 1.5 : Services sector remains the key driver of the economy



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 2011 are averages for the first three quarters of the year.

Box 1.2

Economic contribution of the Six Industries (an update)

In 2009, the Government accepted the recommendations of the Task Force on Economic Challenges for the development of Six Industries where Hong Kong enjoys clear advantage. They are cultural and creative industries, medical services, education services, innovation and technology, testing and certification services, and environmental industries. To track the performance of the Six Industries, statistics on their value added and employment size will be useful. Since the Six Industries straddle different industries as defined by the current industrial classification⁽¹⁾, the Census and Statistics Department (C&SD) has developed a statistical framework specifically for measuring the economic contribution and employment of the Six Industries, by taking into account relevant policy objectives, international guidelines and feedback from stakeholders. This article provides a further update to **Box 1.2** of the *2010 Economic Background and 2011 Prospects* and summarises the latest statistics released by the C&SD on the direct economic contribution (in terms of value added) and employment in respect of the Six Industries for 2010.

The value added of the Six Industries grew notably further in 2010, by 15.6% over 2009 to \$143.8 billion, alongside the global economic rebound and the full-fledged local economic upturn in that year (**Table 1**). Notably, this is way above the already very strong growth of 9.8% in nominal terms for the overall Hong Kong economy in 2010⁽²⁾. As a result, they outperformed the overall economy by a clear margin with their combined direct contribution to GDP rising further to 8.4% in 2010 from 8.0% in 2009, a manifestation of their strong relative competitiveness.

As for employment, the Six Industries together employed 407 750 persons in 2010, representing an appreciable increase of 3.0% from 395 760 persons in 2009 (**Table 2**), also far outstripping the 0.5% employment growth for the overall economy. As a result, the contribution of the Six Industries to total employment increased from 11.3% in 2009 to 11.6% in 2010.

Among the Six Industries, the value added of cultural and creative industries posted the biggest growth in 2010, in contrast to the zero growth in 2009, backed by broad-based increases across the component industries, in particular software, computer games and interactive media; advertising; art, antiques and crafts; television and radio. Environmental industries continued to see double-digit growth in its value added, attributable to increased businesses in waste management and environmental engineering. The value added of innovation and technology likewise picked up notably, thanks to increased business spending on product innovation as well as higher education research and development activity. Growth in the value added of medical services and education services also grew markedly in 2010. The value added of testing and certification recorded a modest growth on continued demand for medical testing as well as other testing services amid tighter regulatory requirements in overseas markets.

(1) The Hong Kong Standard Industrial Classification (HSIC) Version 2.0.

(2) To facilitate comparison of contribution of the Six Industries in the private sector as percentage of nominal GDP, GDP in terms of total gross value added is used. This is slightly different from the GDP figure commonly used, which is compiled at market price basis.

Box 1.2 (Cont'd)

In terms of employment, environmental industries expanded the most in 2010, followed by education services, innovation and technology, medical services, and cultural and creative industries. Testing and certification services however saw a small decline, although their share in total employment remained stable.

Table 1: Value Added of the Six Industries ^{(a) (b)}

<u>Value added at current prices</u>	2008	2009	2010	% change of	
	<u>\$Mn</u>	<u>\$Mn</u>	<u>\$Mn</u>	<u>2009 over 2008</u>	<u>2010 over 2009</u>
1. Cultural and creative industries	63,275 (4.0%)	63,266 (4.1%)	77,683 (4.6%)	*	+22.8
2. Medical services	22,185 (1.4%)	24,156 (1.6%)	26,040 (1.5%)	+8.9	+7.8
3. Education services	15,809 (1.0%)	16,517 (1.1%)	17,542 (1.0%)	+4.5	+6.2
4. Innovation and technology	10,283 (0.6%)	10,733 (0.7%)	11,783 (0.7%)	+4.4	+9.8
5. Testing and certification services	4,499 (0.3%)	5,081 (0.3%)	5,157 (0.3%)	+12.9	+1.5
6. Environmental industries	4,178 (0.3%)	4,697 (0.3%)	5,603 (0.3%)	+12.4	+19.3
Six Industries^(c)	120,229 (7.5%)	124,450 (8.0%)	143,808 (8.4%)	+3.5	+15.6
GDP^(d)	1,592,897	1,550,851	1,702,966	-2.6	+9.8

Notes : Figures in brackets refer to percentages to GDP (see note (d)).

- (a) This set of estimates reflects the direct economic contribution of the Six Industries in private sector.
 - (b) Strictly speaking, some of the Six Industries are service domains straddling different industries rather than individual industries. For example, innovation and technology 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.
 - (c) The above total for the Six Industries in the private sector is only a simple summation of the figures for individual industries. Users should note that there is some overlapping among the Six Industries.
 - (d) To facilitate comparison of contribution of the Six Industries in the private sector as percentage of nominal GDP, GDP in terms of total gross value added is used. This is slightly different from the GDP figure commonly used, which is compiled at market price basis.
- (*) Change of less than 0.05%.

Main data sources: GDP by economic activity at detailed level, Annual Survey of Economic Activities, Survey of Innovation Activities, 2009 Survey of Testing and Certification Activities, Hong Kong’s Domestic Health Accounts compiled by the Food and Health Bureau.

Box 1.2 (Cont'd)**Table 2: Employment in the Six Industries^{(a)(b)}**

<u>Employment</u>	<u>2008 Number</u>	<u>2009 Number</u>	<u>2010 Number</u>	<u>% change of</u>	
				<u>2009 over 2008</u>	<u>2010 over 2009</u>
1. Cultural and creative industries	191 260 (5.4%)	188 250 (5.4%)	189 430 (5.4%)	-1.6	+0.6
2. Medical services	71 040 (2.0%)	72 750 (2.1%)	74 450 (2.1%)	+2.4	+2.3
3. Education services	56 840 (1.6%)	62 200 (1.8%)	66 540 (1.9%)	+9.4	+7.0
4. Innovation and technology ^(c)	26 090 (0.7%)	27 470 (0.8%)	28 860 (0.8%)	+5.3	+5.1
5. Testing and certification services ^(d)	12 420 (0.4%)	12 680 (0.4%)	12 390 (0.4%)	+2.1	-2.3
6. Environmental industries	31 270 (0.9%)	32 410 (0.9%)	36 080 (1.0%)	+3.6	+11.3
Six Industries^(e)	388 920 (11.0%)	395 760 (11.3%)	407 750 (11.6%)	+1.8	+3.0
Total employment^(f)	3 521 400	3 486 900	3 503 000	-1.0	+0.5

Notes : Figures in brackets refer to percentage shares to total employment (see note (f)).

(a) This set of estimates reflects the direct contribution of the Six Industries in private sector to employment.

(b) Strictly speaking, some of the Six Industries are service domains straddling different industries rather than individual industries. For example, innovation and technology 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.

(c) Since innovation and technology involves significant non-routine activities, persons engaged in these activities are measured by the volume of labour input to innovation and technology in full-time equivalent terms (in terms of man-years).

(d) Figures refer to the quarterly averages of employment in the years concerned, which differ from the figures at a particular time point in the *Report on the 2009 Survey of Testing and Certification Activities* published in February 2010.

(e) The above total for the Six Industries in the private sector is only a simple summation of the figures for individual industries. Users should note that there is some overlapping among the Six Industries.

(f) Figures for total employment refer to Composite Employment Estimates.

Main data sources: Quarterly Survey of Employment and Vacancies, Survey of Innovation Activities, 2009 Survey of Testing and Certification Activities, Annual Survey of Economic Activities.

It should be noted that, as figures on the Six Industries are available for only three years at present, a longer time series on the performance of the industries would be needed to have a clearer picture on their long term growth trend. The Government will closely monitor the development of the Six Industries. Indeed, various measures to promote the development of these industries are being implemented by the Government, as part of the efforts to diversify Hong Kong’s growth engines and move towards a high value-added and knowledge-based economy.

Some highlights of economic policy

1.15 Following the strong economic upturn in 2010 and given the challenges as perceived in early 2011, the macroeconomic policy focus over the past year had been fighting inflation and containing asset market bubble risk. On fighting inflation, a series of relief measures were unveiled in the 2011-12 Budget and the 2011-12 Policy Address with a view to alleviating the impact of rising inflation on the lower-income people. The Government also strived to ease the domestically generated price pressure by forestalling asset market exuberance, preventing excessive credit growth, and pursuing a prudent fiscal policy.

1.16 Specifically on ensuring the stable development of the property market and maintaining macroeconomic stability, the Government stepped up efforts in increasing land supply and implementing macro-prudential measures. The Hong Kong Monetary Authority enhanced its monitoring of banks' business plans and funding strategies, and tightened on mortgage lending in order to strengthen risk management and safeguard the stability of the local banking system. This would build in a sufficiently large buffer should the global financial conditions reverse.

1.17 The global economic environment had turned more uncertain over the course of 2011. In face of this challenging environment, achieving long-term and sustainable growth is all the more important. The Government has adopted a multi-pronged strategy to strengthen and diversify our growth engines, viz. continuing to develop the traditional four pillar industries and six industries where we enjoy clear advantages, deepening integration with the Mainland and further developing the renminbi (RMB) business, fostering and broadening our economic ties with emerging and new markets, and investing in infrastructure and human capital to enhance Hong Kong's productive capacity and long-term competitiveness. Some of the specific measures and developments are summarised below:

- On economic integration with the Mainland, the National 12th Five-Year Plan was promulgated in March 2011, with a chapter dedicated to Hong Kong's positioning in the national development strategy. In addition to consolidating its position as an international financial, trade and shipping centre, Hong Kong will continue to nurture emerging industries and develop the six industries where it enjoys clear advantages. Subsequently, cooperation with the Mainland was further strengthened with the signing of Supplement VIII to the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) on 13 December 2011. The new

supplement brought the total number of covered service sectors up to 47.

- On the development of RMB business, Vice-Premier Li Keqiang unveiled a package of measures to boost Hong Kong's role as an RMB offshore centre and global financial centre during his visit in August. These include, among others, launching exchange-traded funds for Mainlanders to invest in Hong Kong stocks, allowing the repatriation of yuan via RMB qualified foreign institutional investors (RQFIIs) and foreign direct investment (FDI), and expanding RMB-denominated bond issuance in Hong Kong. The measures will broaden the scope of the offshore RMB market in Hong Kong and expand the channels for the flow and circulation of RMB funds between Hong Kong and the Mainland. The RMB business continued to grow at a rapid pace. Total RMB deposits in Hong Kong amounted to RMB627.3 billion at end-November, almost double the level at end-2010. Total RMB remittance for cross-border trade settlement handled by banks in Hong Kong likewise surged to RMB1,675.9 billion in the first eleven months of 2011, 4.5 times the level recorded for 2010 as a whole, a manifestation of the rapid development of Hong Kong as the premier offshore RMB business centre for the Mainland.
- On regional integration and developing overseas markets, Hong Kong strengthened economic relations with Shenzhen to raise the productivity of the twin cities as a whole. The Qianhai project entered the implementation stage in September with the establishment of the Inter-ministries Joint Conference on the Development of Qianhai Area in Shenzhen. Agreements were signed to enhance collaborations on various fronts, including legal services and developing of the Lok Ma Chau Loop. In addition, the Hong Kong Economic, Trade and Cultural Office was established in Taiwan on 20 December 2011. As for overseas markets, a free trade agreement was signed with the European Free Trade Association (FTA) in June, the first FTA with European economies. Linkages with emerging markets continued to deepen, with the value of Hong Kong's merchandise exports to India, Brazil and Russia surging by 26%, 23% and 18% respectively in 2011.

1.18 In sum, the Government will continue to provide the most favourable conditions for market forces to propel the economy forward. These include nurturing talents, building on infrastructure, maintaining our sound institutions as well as financial and macroeconomic stability, in addition to expanding our opportunities through broadening the industry base and exploring new markets. The strategy has served us well in navigating through the short-term challenges and positioning for long-term growth, as confirmed by

Hong Kong's ranking as the world's most competitive economy by the Institute for Management Development (IMD) in Switzerland, side by side with the US. While economic development is the way to raise people's standard of living, the Government is also committed to improving people's quality of living, specifically through spending on education, health, the environment, and social welfare. Indeed, the 2011-12 Policy Address laid out specific measures to tackle the social issues of housing, the wealth gap and the ageing population, with a view to enhancing social development.

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 four traditional pillar industries refer to financial services, tourism, trading and logistics, and producer and professional services. The six industries where Hong Kong enjoys clear advantages refer to medical services, education services, environmental industries, testing and certification, innovation and technology, and cultural and creative industries.