

## CHAPTER 1 : OVERVIEW OF ECONOMIC PERFORMANCE

### *Summary*

- *The Hong Kong economy grew modestly in the first quarter of 2015, by 2.1% in real terms over a year earlier, slightly slower than the 2.4% growth in the preceding quarter. Domestic demand remained the key source of growth. External demand was still lacklustre, with goods exports expanding only marginally and with services exports, being dragged by the slowdown in inbound tourism, slackening further.*
- *The external environment remained unsteady and continued to weigh on Hong Kong's export performance. Total exports of goods increased only slightly in the first quarter, as the sluggishness of the advanced markets damped global trade growth. The performance of exports of services was also disappointing, mainly held down by the enlarged decline in exports of travel services amid a visibly slower growth in tourist arrivals and weaker tourist spending.*
- *Domestic demand fared relatively better, and remained the key source of economic growth. Private consumption expenditure grew steadily, on the back of stable labour market conditions in recent quarters. Investment expenditure picked up notably, mainly supported by the marked rebound in machinery and equipment acquisition.*
- *The labour market was broadly stable. The seasonally adjusted unemployment rate stayed low at 3.3% in the first quarter, signifying continued full employment situation. Wages and earnings sustained further steady growth.*
- *The local stock market generally trended upward during the quarter, despite some fluctuations in March on concerns about the prospective US interest rate increases, Greece's debt negotiations and the geopolitical risks surrounding Eastern Europe and the Middle East. The residential property market saw further signs of exuberance in early 2015, marked by accelerated price increases and rather active trading activities. Yet, the market cooled down somewhat after the Hong Kong Monetary Authority introduced the seventh round of macro-prudential measures in late February.*
- *Inflation eased further, reflecting softer international commodity and energy prices, low global inflation and steady local cost pressures. The upside risks to inflation should be limited in the near term.*

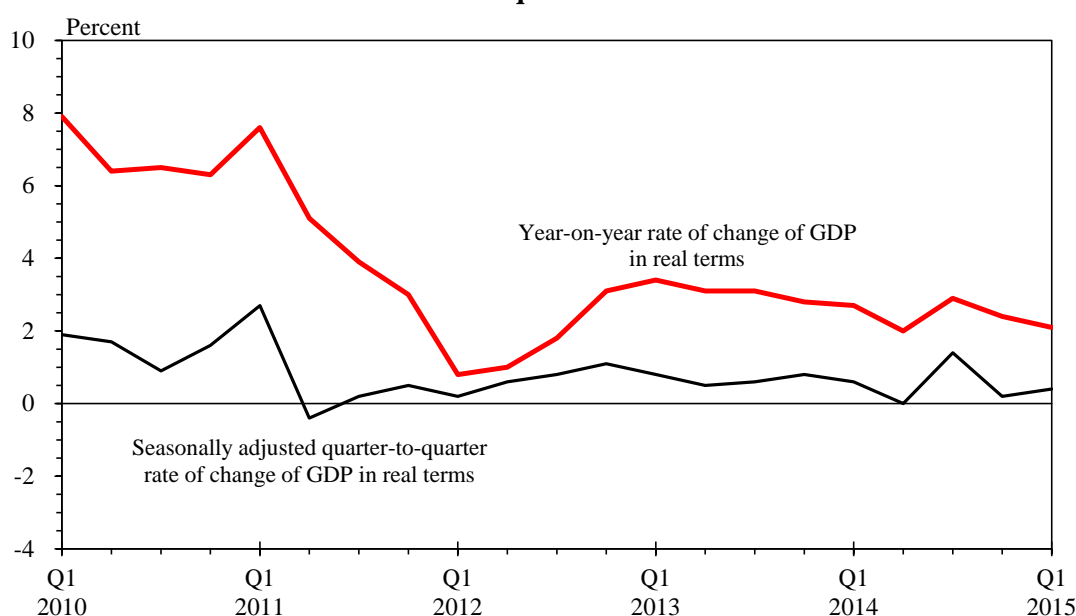
## Overall situation

1.1 The Hong Kong economy only maintained slow growth in the first quarter of 2015 over a year earlier, amid a still-unsteady external environment. The US economy grew much slower than expected, due partly to the unusually harsh weather and partly to the stronger US dollar. This also complicated the outlook for the Federal Reserve (Fed)'s first interest rate hike. Meanwhile, the situation in the eurozone improved somewhat along with the launch of new quantitative easing measures, but its import demand remained weak and the Greek debt problem re-emerged in the quarter. The Japanese economy still lacked growth momentum, although having emerged slowly from the recession induced by the sales tax hike in April 2014. The Mainland economy and other Asian economies also faced varying degrees of growth slowdown. In contrast to the Fed's inclination to normalise monetary policy, many other central banks, including the People's Bank of China, eased their policies in the first quarter. The diverging monetary policy stances, coupled with the elevated geopolitical tensions in various parts of the world and fluctuations in commodity prices, increased global financial market volatility. The uncertainties surrounding the global economic outlook also added headwinds to the trading environment.

1.2 In face of the uneven and moderate global economic expansion, anaemic regional trade flows and a stronger US dollar, Hong Kong's merchandise exports only managed to grow marginally in the first quarter over a year earlier. Exports of services, on the other hand, remained on the decline, mainly dragged by the further slowdown in inbound tourism amid the slower tourist arrivals growth and weaker tourist spending. On the other hand, domestic demand fared relatively better, providing solid support to the overall economic growth. The labour market remained in a state of full employment in the first quarter. Meanwhile, underlying consumer price inflation continued to ease.

1.3 In the first quarter of 2015, *Gross Domestic Product* (GDP)<sup>(1)</sup> grew by 2.1% in real terms over a year earlier, slightly slower than the 2.4% growth in the preceding quarter (revised from the earlier estimate of 2.2%). On a seasonally adjusted quarter-to-quarter comparison<sup>(2)</sup>, real GDP grew slightly by 0.4% in the first quarter, after the 0.2% growth in the preceding quarter (revised from the earlier estimate of 0.4%).

**Diagram 1.1 : The Hong Kong economy continued to maintain slow growth in the first quarter of 2015**



## The external sector

1.4 *Total exports of goods* compiled under the GDP accounting framework grew mildly by 0.4% year-on-year in real terms in the first quarter, slightly down from the 0.6% rise in the preceding quarter. The overall picture remained lacklustre. Among the advanced markets, exports to the US continued to grow, while exports to the EU and Japan slid further. Exports to the Mainland and such higher-income Asian markets as Korea and Taiwan also registered declines of varying degrees, weighed down by the sluggish recovery of import demand in the advanced economies. On the other hand, some Asian markets, including India and a number of ASEAN economies, grew notably further.

1.5 *Exports of services* extended the decline in the first quarter, falling by 0.6% in real terms over a year earlier, after the 0.3% drop in the preceding quarter. This was mainly dragged by the setback in exports of travel services, being marked by weaker per capita visitor spending and the visible slowdown in the growth of tourist arrivals to a low single-digit level in the first quarter. Alongside subdued trade and cargo flows, exports of transportation services only registered mild growth, while exports of trade-related services declined slightly. Yet, exports of financial and other business services grew further, thereby rendering some cushion to overall services exports, thanks to the expansion of cross-border financial and fund-raising activities.

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

	<u>2013<sup>#</sup></u>	<u>2014<sup>#</sup></u>	<u>2014</u>				<u>2015</u>
			<u>Q1<sup>#</sup></u>	<u>Q2<sup>#</sup></u>	<u>Q3<sup>#</sup></u>	<u>Q4<sup>#</sup></u>	<u>Q1<sup>+</sup></u>
<i>Change in real terms of GDP and its main expenditure components (%)</i>							
Private consumption Expenditure	4.6	3.2	2.1 (0.7)	1.8 (0.3)	4.7 (1.9)	4.1 (1.0)	3.5 (0.1)
Government consumption Expenditure	3.0	3.0	2.7 (0.7)	2.6 (1.3)	3.6 (1.0)	3.3 (0.4)	3.5 (0.8)
Gross domestic fixed capital formation	2.6	-0.2	3.9	-6.0	-1.7	3.4	7.3
<i>of which :</i>							
Building and construction	-4.3	6.5	11.1	2.2	4.5	7.6	-3.3
Machinery, equipment and intellectual property products	11.3	-6.5	-2.0	-11.4	-11.2	-0.4	14.2
Total exports of goods	6.5	0.8	-0.1 (-1.6)	2.1 (1.0)	0.7 (0.1)	0.6 (0.9)	0.4 (-1.4)
Imports of goods	7.2	0.9	1.0 (-1.3)	1.2 (0.1)	0.3 (0.2)	1.1 (2.0)	0.1 (-2.1)
Exports of services	4.9	0.9	4.1 (0.6)	-1.5 (-1.7)	1.3 (0.2)	-0.3 (0.7)	-0.6 (0.3)
Imports of services	1.5	1.9	-0.2 (-4.1)	4.9 (3.8)	2.0 (-0.8)	1.1 (2.1)	4.3 (-0.9)
<b>Gross Domestic Product</b>	<b>3.1</b>	<b>2.5</b>	<b>2.7</b> <b>(0.6)</b>	<b>2.0</b> <b>(*)</b>	<b>2.9</b> <b>(1.4)</b>	<b>2.4</b> <b>(0.2)</b>	<b>2.1</b> <b>(0.4)</b>
<i>Change in the main price indicators (%)</i>							
<b>GDP deflator</b>	<b>1.9</b>	<b>2.9</b>	<b>2.5</b> <b>(0.1)</b>	<b>4.6</b> <b>(1.2)</b>	<b>2.3</b> <b>(0.4)</b>	<b>2.3</b> <b>(0.6)</b>	<b>4.6</b> <b>(2.4)</b>
<b>Composite CPI</b>							
<b>Headline</b>	<b>4.3</b>	<b>4.4</b>	<b>4.2</b> <b>(0.9)</b>	<b>3.6</b> <b>(0.7)</b>	<b>4.8</b> <b>(0.5)</b>	<b>5.1</b> <b>(2.9)</b>	<b>4.4</b> <b>(0.3)</b>
<b>Underlying<sup>^</sup></b>	<b>4.0</b>	<b>3.5</b>	<b>3.8</b> <b>(0.9)</b>	<b>3.5</b> <b>(0.7)</b>	<b>3.3</b> <b>(0.7)</b>	<b>3.3</b> <b>(0.9)</b>	<b>2.7</b> <b>(0.3)</b>
<b>Change in nominal GDP (%)</b>	<b>5.0</b>	<b>5.5</b>	<b>5.2</b>	<b>6.7</b>	<b>5.3</b>	<b>4.8</b>	<b>6.7</b>

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.

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

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

## Box 1.1

### The Chinese New Year effects on Hong Kong's retail sales and merchandise exports

The Chinese New Year (CNY) holidays, which are based on the Lunar calendar, fall in either January or February of the “Western calendar” (or Gregorian calendar), thereby causing notable additional seasonal fluctuations to economic indicators for January and February, which are reported according to the “Western calendar”. This note attempts to illustrate how CNY could distort the movements of certain monthly economic indicators, by taking Hong Kong's retail sales and merchandise exports as examples. Nevertheless, CNY does not have any notable effect on quarterly economic data, as it always falls in the first quarter.

#### Distortions to year-on-year comparisons caused by shifting CNY holidays

Year-on-year comparisons are frequently used to analyse the underlying trend of economic variables, as they are a simple and handy way of removing fixed seasonality, viz. seasonal factors that occur at fixed time points. However, directly comparing such rates of change in January and February could be rather misleading, particularly when the CNY holidays of the two years under comparison fall in different months (i.e. one falling in January but another in February).

Take 2015 as an example. The CNY took place in mid-February, whereas in 2014, it fell in late January. Thus, retail sales volume underwent huge fluctuations in these two months. It declined markedly by 13.8% year-on-year in January, but rose back significantly by 18.1% in February. The same applied to merchandise exports, which grew modestly by 0.9% year-on-year in volume terms in January, but increased by 6.6% in February. These year-on-year rates of change are distorted by the difference in timing of the CNY in 2014 and 2015.

#### Components of retail sales and merchandise exports that are more affected by the CNY

To better understand the issue, it is useful to examine the components of retail sales and merchandise exports that are more likely influenced by the CNY effect. For retail sales, the sales volume is generally higher in the weeks immediately before or during the CNY amid stronger consumption for celebrating this important festival. When analysed by retail outlet, items which are more related to the festive spending include “food, alcoholic drinks, and tobacco”, “supermarkets”, “clothing and footwear” and “commodities in department stores”.

As for merchandise exports, which comprise mainly re-exports, they are usually affected by the week-long CNY holidays in the Mainland, as almost 90% of Hong Kong's re-exports involve our hinterland. Exports to the Mainland generally pick up in the weeks preceding the CNY as firms rush through their export orders before the holidays kick-off and fall afterwards since production activity comes to a halt during the holidays.

**Table : Selected items of Hong Kong's retail sales and merchandise exports in recent years**

	Share in 2014 total (%)	Year-on-year rate of change in volume terms (%)							
		2012		2013		2014		2015	
		Jan*	Feb	Jan	Feb*	Jan*	Feb	Jan	Feb*
Sales of festive-related items <sup>^</sup>	39%	6.1	2.3	-2.9	21.6	14.6	-4.0	-13.1	19.0
Exports to the Mainland	54%	-18.4	10.8	31.2	-21.7	-8.2	3.7	6.9	-11.2

Notes: In 2011, CNY fell in February. Distortions occurred in all the year-on-year changes for January and February in the years from 2012 to 2015.

(\*) Denotes the CNY month.

(<sup>^</sup>) Festive-related items include “food, alcoholic drinks, and tobacco”, “supermarkets”, “clothing and footwear” and “commodities in department stores”.

The above *Table* clearly shows that the year-on-year rates of change of the selected components were notably affected by the shifts in CNY timing in 2012-2015.

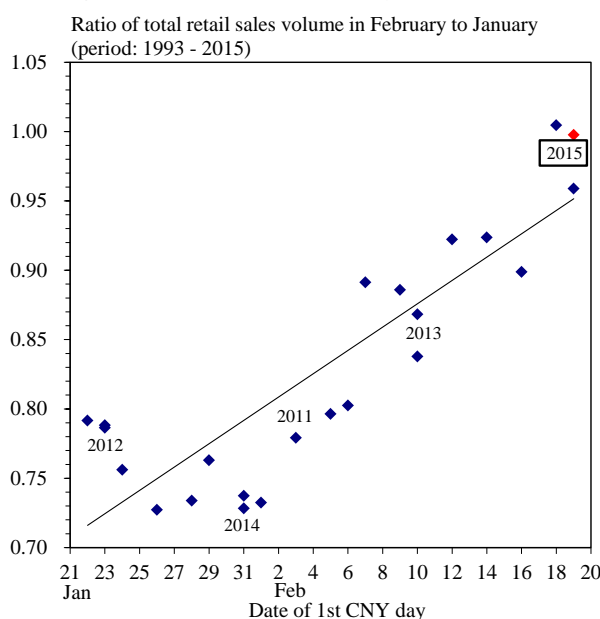
### Box 1.1 (Cont'd)

For retail sales, it is observed that the CNY has a boosting impact on the sales of festive-related items during the month in which this festive season took place. On the contrary, the CNY has a dampening effect on exports to the Mainland in the CNY month. Since the sales of festive-related items and exports to the Mainland take up significant shares in total retail sales and overall merchandise exports (at 39% and 54% respectively in 2014), the distortions caused by the CNY on these two economic variables should not be taken lightly.

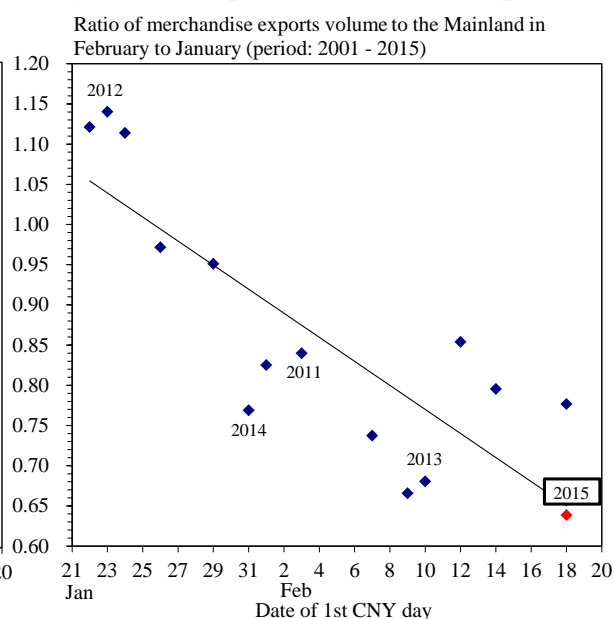
### Correlations between the magnitude of distortion and the exact CNY timing

When taking a deeper look at the exact dates on which the CNY took place, it is interesting to observe that the augmenting effect of the CNY on February's retail sales tends to be stronger when the CNY holidays fall entirely in latter part of February, evident in the positive relationship shown in *Chart 1*. Again, the negative impact of the CNY on February's exports volume would be stronger when the CNY holidays fall closer to late February, which is particularly notable in our exports to the Mainland (*Chart 2*). Since the CNY of this year fell on 19<sup>th</sup> February, which was the nearest to end-February in nearly 20 years, this explains why the year-on-year rates of change in retail sales and merchandise exports fluctuated distinctly in January and February of 2015. By identifying such relationships, the CNY impacts on economic statistics for January and February of a particular year with known CNY timing can be more reliably assessed.

**Chart 1 : The later the CNY timing, the stronger the boost to February's retail sales**



**Chart 2 : The later the CNY timing, the more negative the impact on February's exports**



Note: Hong Kong's exports to the Mainland were used for the scatter plot in *Chart 2* in order to illustrate the more pronounced relationship between the volume of exports and the CNY timing.

### Concluding remarks

In sum, Hong Kong's retail sales and merchandise exports, which give important indications of the overall economic performance of Hong Kong, are both visibly affected by this festive season. Caution is therefore needed when interpreting the economic indicators in January and February. For the purpose of examining their underlying trends, it would be more appropriate to analyse the economic indicators in the first two months combined, in order to neutralise the distortions caused by the difference in the timing of the CNY.

## The domestic sector

1.6 Domestic demand performance was relatively steady. *Private consumption expenditure* expanded moderately further in the first quarter of 2015, by 3.5% in real terms over a year earlier. Consumption sentiment was somewhat unsteady at the beginning of the year, but the stable income and job conditions continued to provide support. *Government consumption expenditure* maintained stable growth, also at 3.5% in the first quarter.

**Table 1.2 : Consumer spending by major component<sup>(a)</sup>  
(year-on-year rate of change in real terms (%))**

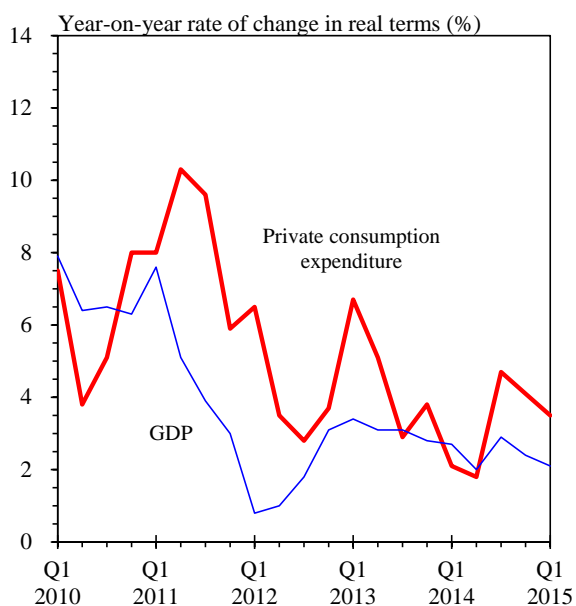
	Total consumer spending in the domestic market <sup>(a)</sup>	<i>Of which :</i>						
		Food	Durables	Non- durables	Services	Residents' expenditure abroad	Visitor spending	Private consumption expenditure <sup>(b)</sup>
2014 Annual	2.3	3.6	6.7	-0.6	2.4	3.0	-1.5	3.2
H1	1.6	5.1	1.5	-1.1	2.0	3.0	0.5	2.0
H2	3.0	2.0	11.9	*	2.8	3.0	-3.3	4.4
Q1	4.1	4.8	5.4	7.8	2.1	-1.9	11.0	2.1
Q2	-0.8	5.4	-3.8	-9.0	1.9	8.1	-9.6	1.8
Q3	3.2	3.5	6.0	1.3	3.2	3.1	-3.8	4.7
Q4	2.8	0.6	16.5	-1.1	2.4	2.9	-2.9	4.1
2015 Q1	1.6	1.7	8.0	-3.7	2.4	8.2	-4.4	3.5

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

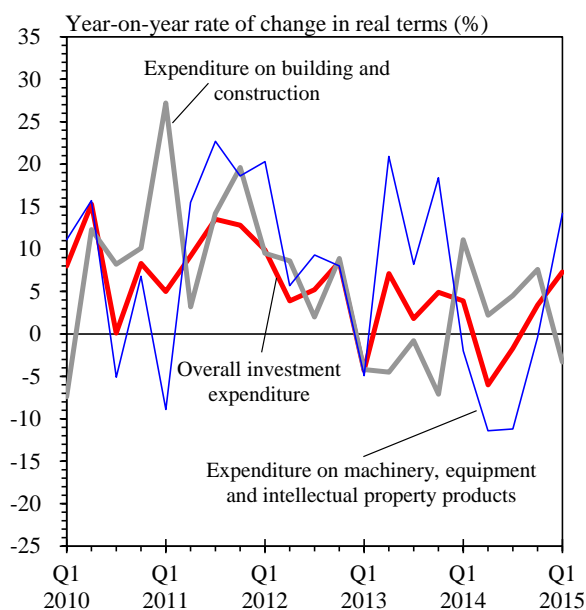
(b) Private consumption expenditure is obtained by deducting visitor spending from the total consumer spending in the domestic market, and adding back residents' expenditure abroad.

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

**Diagram 1.2 : Private consumption expenditure expanded moderately**



**Diagram 1.3 : Investment spending picked up visibly**



1.7 Overall investment spending in terms of *gross domestic fixed capital formation* picked up visibly by 7.3% year-on-year in real terms in the first quarter, following the 3.4% growth in the preceding quarter. Within this, large-scale infrastructure works slackened visibly to a decline, partly due to an exceptionally high base of comparison a year earlier, while private sector building and construction activity attained further moderate growth. On the other hand, machinery and equipment acquisition rebounded markedly by 14.2%. Yet, the results of the latest Quarterly Business Tendency Survey and the diffusion indices on small and medium-sized enterprises (SMEs) (see **Box 1.2** for details of the consultation on SMEs) suggested that business sentiment in general turned more cautious in recent months, in view of the uncertain business outlook under a challenging external environment.



## Box 1.2

### 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)<sup>(1)</sup>, 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. In the recent past, the exercise has been conducted on a sample panel of around 400 SMEs. This note provides a further update of the results reported in *Box 1.2* in the *2014 Economic Background and 2015 Prospects*.

A set of diffusion indices is compiled to indicate the general directions of change in the respondents' views on business receipts, employment and new export orders versus the preceding month. The percentage of SMEs reporting tight access to credit is also reported. While the findings should be interpreted with considerable caution given the coverage and nature of the consultation exercise, they can serve as a rough indicator to enable high frequency monitoring of SMEs' situation.

Business receipts of the SMEs consulted, as measured by the set of diffusion indices, suggested that the overall situation stayed sluggish in recent months and enterprises surveyed in both local and external segments were still cautious about the outlook (*Table 1*). The overall index weakened again after the rebound in December 2014, falling to 47.3 in April 2015. Sectoral breakdown shows that all selected local sectors recorded readings below the neutral level of 50.0. Among them, the wholesale and retail sectors recorded the lowest readings, in line with the fall in retail sales in the first quarter amid weaker inbound tourism. Besides, the diffusion index for real estate also declined visibly to a relatively low level after the Hong Kong Monetary Authority introduced the new round of macro-prudential measures in late February. As regards the externally-oriented sectors, the readings for import/export trade and logistics fluctuated and hovered around the boom-bust mark of 50.0 in the more recent months, in tandem with the unsteady external environment. As to the employment situation, the feedback from SMEs suggested a broadly stable development in recent months (*Table 2*).

For the import/export trade sector in particular, SMEs' views on new export orders were sought separately to help gauge the likely export performance in the near term. The diffusion index on new export orders has eased since end-2014 and drifted successively to 48.7 in April, partly reflecting the sluggish external demand conditions.

The proportion of SMEs reporting tight credit access continued to fall, reaching a low level of 0.7% in April 2015, thanks mainly to the generally accommodative monetary conditions and the Government's continued efforts to support SMEs through various loan guarantee schemes.

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(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)****Table 1 : Diffusion indices<sup>^</sup> on business receipts**

	<u>2014</u>									<u>2015</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>	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>
<i>Local segments</i>													
Restaurants	46.3	47.2	45.3	47.1	48.1	47.1	38.2	46.1	52.0	50.0	47.7	47.7	48.4
Real estate	48.5	48.5	43.9	47.0	47.0	46.9	40.6	54.7	45.3	48.5	47.1	51.5	45.5
Retail trade	48.2	47.7	46.9	46.1	48.4	48.0	40.3	43.9	48.8	47.5	47.9	44.4	43.9
Wholesale trade	50.0	44.7	39.5	36.8	44.4	41.7	33.3	44.4	44.4	50.0	44.4	44.4	41.7
Business services	53.1	50.0	46.9	48.4	48.4	45.3	45.2	46.8	48.4	45.6	50.0	47.0	48.4
<i>External segments</i>													
Import/export trade	49.6	48.4	49.2	48.8	49.6	49.2	42.6	47.9	50.8	50.0	47.5	49.6	49.6
Logistics	47.2	47.2	47.2	47.2	44.4	47.2	36.1	41.7	41.7	50.0	50.0	44.7	52.8
<b>All the above sectors*</b>	<b>49.3</b>	<b>48.0</b>	<b>47.0</b>	<b>47.0</b>	<b>48.3</b>	<b>47.6</b>	<b>41.0</b>	<b>46.7</b>	<b>48.9</b>	<b>48.8</b>	<b>47.8</b>	<b>47.4</b>	<b>47.3</b>

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.

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

**Table 2 : Diffusion indices on employment situation**

	<u>2014</u>									<u>2015</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>	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>
<i>Local segments</i>													
Restaurants	49.1	49.1	48.1	49.0	50.0	48.0	46.1	50.0	49.0	49.2	48.5	50.0	49.2
Real estate	48.5	47.0	48.5	50.0	50.0	50.0	50.0	51.6	50.0	48.5	50.0	51.5	47.0
Retail trade	50.5	49.6	49.6	49.6	50.4	50.0	49.2	50.8	49.6	49.6	50.0	50.0	50.0
Wholesale trade	52.6	47.4	47.4	47.4	52.8	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0
Business services	50.0	48.4	50.0	50.0	53.1	50.0	46.8	50.0	50.0	50.0	50.0	50.0	48.4
<i>External segments</i>													
Import/export trade	50.4	48.4	50.4	49.2	50.0	50.0	49.2	50.0	50.0	50.0	49.2	50.8	50.4
Logistics	50.0	50.0	52.8	50.0	50.0	47.2	50.0	47.2	50.0	47.1	47.1	47.4	50.0
<b>All the above sectors*</b>	<b>50.3</b>	<b>48.6</b>	<b>49.8</b>	<b>49.3</b>	<b>50.6</b>	<b>49.8</b>	<b>48.9</b>	<b>50.2</b>	<b>49.8</b>	<b>49.6</b>	<b>49.5</b>	<b>50.3</b>	<b>49.7</b>

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

**Table 3 : Diffusion index on current new export orders**

	<u>2014</u>									<u>2015</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>	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>
Import/export trade	50.0	49.6	49.2	49.6	50.4	50.0	44.7	46.7	51.3	50.0	48.3	48.3	48.7

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

	<u>2014</u>									<u>2015</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>	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>
All selected sectors*	0.9	1.1	1.1	0.8	0.8	0.8	0.8	0.8	1.0	0.8	0.7	0.7	0.7

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

## **The labour sector**

1.8 The labour market held broadly stable and remained in a state of full employment. The *seasonally adjusted unemployment rate* stayed low at 3.3% in the first quarter of 2015, while the *underemployment rate* edged down to 1.4%. Labour demand remained tight, as job vacancies bounced back in December 2014, and total employment posted further growth in the first quarter of 2015. Wages and earnings sustained moderate rises in the fourth quarter of 2014.

## **The asset markets**

1.9 The *local stock market* trended upward on entering 2015 alongside other major markets worldwide, but came under pressure in the first half of March amid shifting sentiment on concerns about the US Fed's monetary policy direction, Greece's debt problem and intensified geopolitical tensions in Eastern Europe and the Middle East. It recovered lost ground subsequent to the Fed's clearer indications that its interest rate hikes would still be data dependent and stay gradual. The Hang Seng Index closed the first quarter at 24 901, 5.5% higher than at end-2014. Average daily turnover of the stock market rose to \$86.4 billion in the first quarter, while fund-raising activity retreated markedly compared with the preceding quarter.

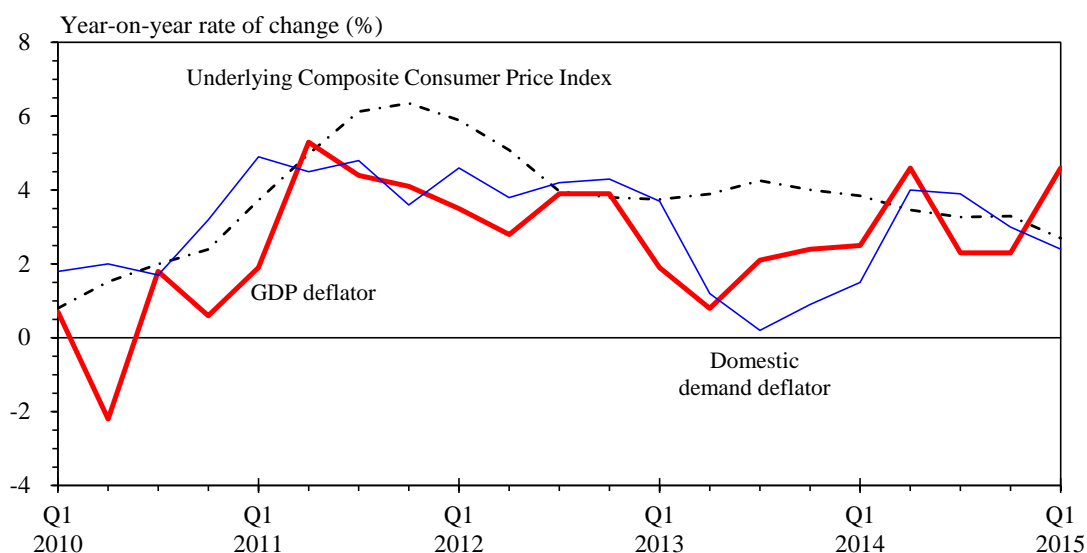
1.10 The *residential property market* saw further signs of exuberance in the first two months of 2015, but cooled down somewhat after the Hong Kong Monetary Authority introduced the seventh round of macro-prudential measures on tightening mortgage loans in late February. Trading volume in the first quarter edged down by 2% from the preceding quarter. Residential property prices turned from showing notable increases in January and February to moving sideways in March, though still up by 5% during the first quarter. Overall flat prices in March exceeded the 1997 peak by 69%, and the housing affordability ratio worsened further to around 64% in the first quarter. The renewed exuberance of the property market underscores that the risks of housing market bubble remain prominent. Flat rentals rose by 2% during the first quarter. Meanwhile, office and shop rentals went up by 1% and 2% respectively.

## Inflation

1.11 Consumer price inflation remained on an easing trend in the first quarter of 2015. Locally, the increase in private housing rental component moderated further as the milder increases in the fresh-letting rentals in earlier quarters continued to feed through. The single-digit year-on-year rises in commercial rentals and the steady growth in labour costs all helped keep local cost pressures contained. Externally, imported inflation remained tame, on the back of softer international food and commodity prices and easing inflationary pressures in Hong Kong's major import partners. Netting out the effects of the Government's one-off relief measures to more accurately reflect the underlying inflation trend, *underlying consumer price inflation* lowered to 2.7% in the first quarter of 2015, from 3.3% in the preceding quarter. *Headline consumer price inflation* was 4.4% in the first quarter of 2015, down from 5.1% in the fourth quarter of 2014.

1.12 The *GDP deflator* rose by 4.6% in the first quarter. Within this, domestic demand deflator saw a moderated increase, while the terms of trade improved over the same period.

**Diagram 1.4 : Consumer price inflation eased further in the first quarter**



## **GDP by major economic sector**

1.13 Mainly reflecting the unsteady global economic environment, net output of the services sector as a whole moderated to a 2.4% growth in real terms in 2014, from the 2.7% growth in 2013. Nevertheless, the performance varied across individual sectors. Net output of financing and insurance accelerated in growth since the third quarter of 2014 amid improved market sentiment. Professional and business services, information and communications, and transportation and storage showed solid growth in 2014. The net output of real estate activity, which mainly reflects activity of private sector developers and property agency, rebounded in 2014 alongside the pick-up in property market activity since the second quarter. On the other hand, the growth of the net output of import and export trade slowed, reflecting the sluggish trading environment in 2014. Accommodation and food services also saw some slowdown in growth. Net output of wholesale and retail trade fell marginally in 2014, in line with the lacklustre retail sales performance amid weaker tourist spending. As for the secondary sector, activity in the manufacturing sector slackened to a decline since the third quarter, giving a marginal fall for 2014 as a whole. In contrast, the construction sector gained momentum to show strong growth in 2014 amid hectic large-scale infrastructure works and moderate expansion in private sector construction activity.

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

	<u>2013</u>	<u>2014</u>	<u>2013</u>				<u>2014</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>
Manufacturing	0.1	-0.4	0.5	0.3	-0.9	0.5	2.1	2.2	-1.7	-3.6
Construction	4.2	8.3	2.3	6.0	11.8	-1.6	12.2	4.9	5.4	10.1
Services <sup>(b)</sup>	2.7	2.4	2.6	3.6	2.3	2.5	2.3	2.1	2.9	2.5
Import/export, wholesale and retail trades	3.2	0.9	5.0	4.7	1.5	2.4	0.3	0.5	2.2	0.7
Import and export trade	1.9	1.2	3.4	2.7	0.5	1.4	-0.7	2.3	2.7	0.6
Wholesale and retail trades	8.7	-0.1	11.4	12.4	6.0	6.0	3.9	-6.1	0.3	1.3
Accommodation <sup>(c)</sup> and food services	3.6	2.6	3.5	4.1	3.4	3.4	4.5	2.4	3.6	0.2
Transportation, storage, postal and courier services	4.1	5.2	1.2	4.5	4.1	6.8	6.6	7.3	3.9	3.3
Transportation and storage	4.1	5.4	1.2	4.8	3.5	7.0	6.3	7.3	4.9	3.2
Postal and courier services	4.6	2.0	0.9	-1.8	17.5	2.3	13.6	7.5	-14.1	3.4
Information and communications	4.0	3.9	6.4	2.8	4.1	2.8	3.0	5.7	3.3	3.7
Financing and insurance	7.6	4.0	5.3	9.8	9.3	6.1	3.1	0.6	5.5	6.8
Real estate, professional and business services	-4.0	3.2	-4.0	-5.2	-5.0	-2.1	1.9	3.7	3.5	3.7
Real estate	-10.7	2.7	-8.7	-13.8	-12.2	-8.4	0.8	3.0	3.2	4.0
Professional and business services	2.7	3.6	1.1	3.5	2.2	4.0	3.0	4.3	3.7	3.4
Public administration, social and personal services	2.5	2.3	2.0	3.7	2.1	2.0	2.9	2.4	2.0	2.0

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.
- (c) Accommodation services cover hotels, guesthouses, boarding houses and other establishments providing short term accommodation.

## **Other economic developments**

1.14 Given the moderate and uneven global economic growth, which is further complicated by the conflicting monetary policy stances of major central banks, the external environment facing Hong Kong is likely to remain challenging in 2015. Against this background, and also taking into account the healthy fiscal positions of the Government over the medium term, the 2015-16 Budget proposed a series of relief measures to help alleviate the financial burden of the public, stimulate consumption, stabilise the economy and preserve employment. The package of relief measures, amounted to some \$34 billion, together with other Budget initiatives, are estimated to have a stimulus effect of boosting GDP by one percentage point. The Budget also laid out measures to support SMEs, enhance the international image of Hong Kong and restore investors' and tourists' confidence in Hong Kong.

1.15 As for Hong Kong's long-term economic development, the Budget set out strategies and unveiled a series of measures to promote diversified development of our economy and augment the competitiveness of our pillar industries, alongside the ongoing capital works. The Government will continue to support business start-ups and create an enabling environment for innovation and technology, and cultural and creative industries. The Budget proposed a two-pronged approach to consolidate our pillar industries. On the one hand, the Government will utilise Hong Kong's position as an international financial, trading and business hub to capitalise on the new opportunities created by the Mainland's "One Belt One Road" initiative. On the other hand, measures are laid out to facilitate industries in moving up the value chain. In the aspect of financial development, to strengthen our connection with the Mainland market, the Government will review and discuss with the relevant Mainland authorities on the launch of the Shenzhen-Hong Kong Stock Connect and the enhancement of the Shanghai-Hong Kong Stock Connect.

1.16 The Budget also provided measures to address the constraints to Hong Kong's future economic growth, which include improving the quality of manpower to steer the development of our economy towards high value-added activities, increasing land supply and addressing the challenge of an ageing population. To save for the future in view of the expected surge in number of elderly and hence public expenditure on various key policy areas, the Government will collaborate with the Hong Kong Monetary Authority to work out specific details and arrangements of the establishment of the Future Fund. The savings scheme is expected to be in place within this year.

1.17 Human capital is crucial to driving Hong Kong's future economic vibrancy. The Financial Services Development Council in January 2015 made recommendations on developing human capital for the sustainable development of Hong Kong as an international financial centre. The Economic Development Commission held its seventh meeting in March 2015 and provided views on how to enhance workforce productivity and training in response to the Government's population policy initiatives.

1.18 In response to the pick-up in property market activity in the second half of 2014 amid a prolonged period of low interest rate environment, the Hong Kong Monetary Authority rolled out the seventh round of macro-prudential measures on tightening mortgage loans in late February 2015, which included lowering the maximum loan-to-value ratio and the maximum debt-servicing ratio of mortgage loans for both residential and non-residential properties.

1.19 Hong Kong was ranked by the Heritage Foundation as the world's freest economy for the 21<sup>st</sup> year in a row. The Government will continue to uphold free market principles and will maintain an open and flexible environment conducive to businesses and investment. The Inland Revenue Ordinance was amended in February 2015 to allow private equity funds to enjoy the profits tax exemption that is available to offshore funds. This will help attract more private equity fund managers to set up or expand their businesses in Hong Kong and is beneficial to Hong Kong's development as a premier asset management hub. Separately, the second protocol to the agreement for the avoidance of double taxation and prevention of income tax evasion between Hong Kong and Vietnam came into force in January 2015. This should offer added incentives for Vietnamese companies to do business and invest in Hong Kong.



## 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.