

CHAPTER 1 : OVERVIEW OF ECONOMIC PERFORMANCE

Summary

- *Hong Kong's economic growth slowed to 2.3% year-on-year in the third quarter of 2015, from 2.8% in the second quarter. The growth slowdown was part of a region-wide phenomenon amid a lacklustre global economy, and reflected the intensified drag on the economy from weaker external demand. The domestic segment, while staying relatively stable, also expanded at a slower pace.*
- *The global economic environment was highly unsteady in the third quarter, with downside risks on the rise. Recovery in many advanced markets remained fragile, and emerging market economies also generally came under pressure. Amid concerns about the global outlook and rising expectations for an interest rate lift-off in the US, and the ensuing bout of capital outflows from the emerging markets, global financial market volatility heightened notably during the quarter. Against this backdrop, global trade flows were in the doldrums. As a result, Hong Kong's total exports of goods extended the decline in the third quarter. Meanwhile, exports of services also relapsed to a decline, due to continued contraction of inbound tourism and subdued trade and cargo flows.*
- *Domestic demand expanded further in the third quarter, albeit at a slower pace. Private consumption expenditure still increased solidly, thanks to broadly stable job and income conditions in recent quarters. Nevertheless, investment expenditure slackened distinctly to a decline, amid a rather austere external environment. Machinery and equipment acquisition saw a notable fall-off, though building and construction works registered further growth.*
- *The labour market held largely steady. The seasonally adjusted unemployment rate stayed at a low level of 3.3% in the third quarter, following 3.2% in the second quarter. Total employment remained near its record level and labour earnings continued to rise in real terms.*
- *The local stock market underwent a sharp correction during the quarter, alongside the plunge in many stock markets across the globe, being weighed down by the worsening global economic outlook and lingering market worry over the impending US interest rate hike. The Hang Seng Index closed the quarter at its lowest level since June 2013, significantly down by 21% from end-June 2015. The residential property market also turned quieter in the third quarter, with softer increases in flat prices and a plunge in transactions.*

- *Inflation eased slightly further in the third quarter, as local cost pressures remained at bay and imported inflation continued to recede. Looking ahead, the upside risks to inflation should remain well contained in the near term.*

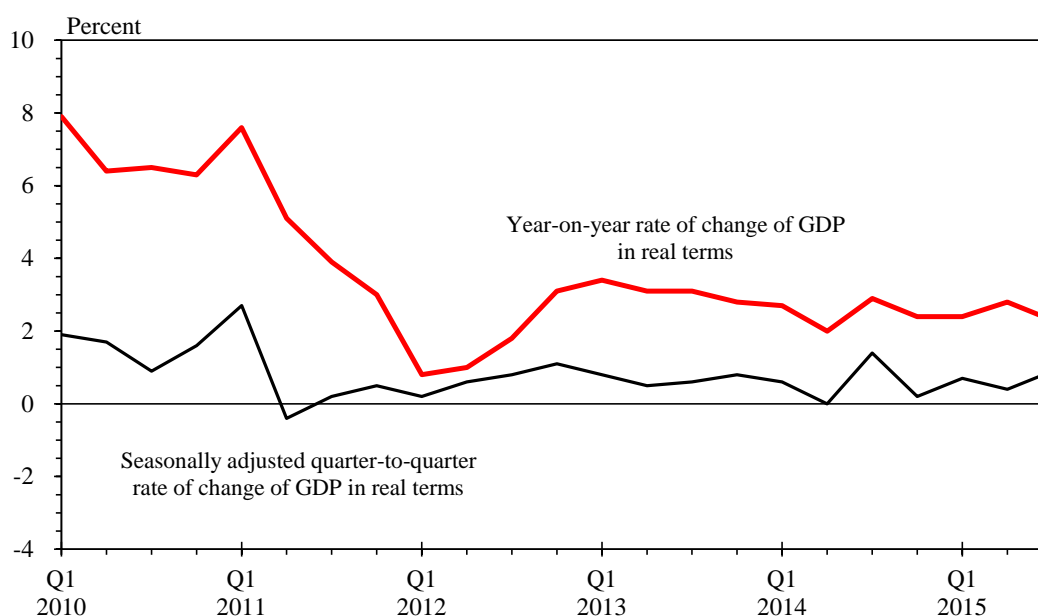
Overall situation

1.1 The Hong Kong economy grew modestly in the third quarter of 2015, continuing to stay below its long-term growth trend. The external sector weakened further, as the global economy was in a fragile state, growing at its slowest pace since the 2008-09 Global Financial Crisis. The US economy lost some momentum in the third quarter, after a notable rebound in the preceding quarter. The economic recovery in the eurozone and Japan remained disappointing and deflation risks re-emerged. Many emerging market economies experienced varying degrees of growth slowdown and increased capital outflows. Shifting market expectations about the timing of the Federal Reserve's interest rate lift-off and increased downside risks to the global economic outlook also instigated sharp stock market corrections and currency depreciations during the quarter. All these unfavourable developments weighed on regional trade flows and production activities.

1.2 As part of a region-wide phenomenon, Hong Kong's external sector worsened in the third quarter. Exports of goods remained on the downtrend. Services exports likewise relapsed to a decline, mainly dragged by the protracted weakness in inbound tourism and the negative impacts on trade-related and transportation services from the anaemic regional trade flows. On the other hand, domestic demand was more stable, and the labour market was still virtually in a state of full employment, both helping to cushion the Hong Kong economy against such an austere external environment. Meanwhile, underlying inflation eased further, amid modest local and external price pressures.

1.3 In the third quarter of 2015, *Gross Domestic Product* (GDP)⁽¹⁾ grew by 2.3% in real terms over a year earlier, slightly moderated from the 2.8% growth in the preceding quarter (unchanged from the earlier estimate). On a seasonally adjusted quarter-to-quarter comparison⁽²⁾, real GDP grew by 0.9% in the third quarter, following the 0.4% growth in the preceding quarter (unchanged from the earlier estimate).

Diagram 1.1 : The Hong Kong economy grew modestly in the third quarter of 2015



The external sector

1.4 *Total exports of goods* compiled under the GDP accounting framework contracted for the second consecutive quarter, down by 3.2% year-on-year in real terms in the third quarter, further to a 3.6% decline in the preceding quarter. Among the advanced markets, exports to the US slackened to a modest decline, while exports to the EU and Japan trended lower. Exports to major Asian economies, including Taiwan, Korea, Singapore and the Mainland, fell notably. The declines in exports of raw materials and semi-manufactures as well as capital goods reflected the slack in regional production activities in the face of the subdued global demand conditions.

1.5 *Exports of services* slackened again to a decline, falling by 1.3% in real terms in the third quarter over a year earlier. Exports of travel services saw an enlarged decline, marked by a visible drop in visitor arrivals. Likewise, exports of trade-related services and transportation services saw further declines, dragged by the much weaker regional trade and cargo flows under an increasingly difficult external trading environment. The more volatile financial conditions during the quarter also affected cross-border financial and fund-raising activities, leading to a concurrent slowdown in exports of financial and other business services.

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

	<u>2013</u>	<u>2014</u>	<u>2014</u>				<u>2015</u>		
			<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2[#]</u>	<u>Q3⁺</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)	5.3 (1.8)	6.1 (1.3)	4.3 (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)	3.4 (0.8)	3.3 (1.1)	2.6 (0.2)
Gross domestic fixed capital formation	2.6	-0.2	3.9	-6.0	-1.7	3.4	7.5	5.2	-6.5
<i>of which :</i>									
Building and construction	-4.3	6.5	11.1	2.2	4.5	7.6	-3.3	13.4	4.2
Machinery, equipment and intellectual property products	11.3	-6.5	-2.0	-11.4	-11.2	-0.4	14.4	-1.3	-10.5
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)	-3.6 (-3.2)	-3.2 (0.5)
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)	-3.2 (-3.1)	-4.1 (-0.9)
Exports of services	4.9	0.9	4.1 (0.6)	-1.5 (-1.7)	1.3 (0.2)	-0.3 (0.7)	* (0.9)	0.9 (-0.8)	-1.3 (-1.9)
Imports of services	1.5	1.9	-0.2 (-4.1)	4.9 (3.8)	2.0 (-0.8)	1.1 (2.1)	6.1 (0.8)	3.6 (1.5)	4.1 (-0.3)
Gross Domestic Product	3.1	2.5	2.7 (0.6)	2.0 (*)	2.9 (1.4)	2.4 (0.2)	2.4 (0.7)	2.8 (0.4)	2.3 (0.9)
<i>Change in the main price indicators (%)</i>									
GDP deflator	1.9	2.9	2.5 (0.1)	4.6 (1.2)	2.3 (0.4)	2.3 (0.6)	4.4 (2.3)	4.6 (1.3)	3.6 (-0.6)
Composite CPI									
Headline	4.3	4.4	4.2 (0.9)	3.6 (0.7)	4.8 (0.5)	5.1 (2.9)	4.4 (0.3)	3.0 (-0.6)	2.3 (-0.2)
Underlying[^]	4.0	3.5	3.8 (0.9)	3.5 (0.7)	3.3 (0.7)	3.3 (0.9)	2.7 (0.3)	2.5 (0.6)	2.4 (0.6)
Change in nominal GDP (%)	5.0	5.5	5.2	6.7	5.3	4.8	7.0	7.6	6.0

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.

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

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

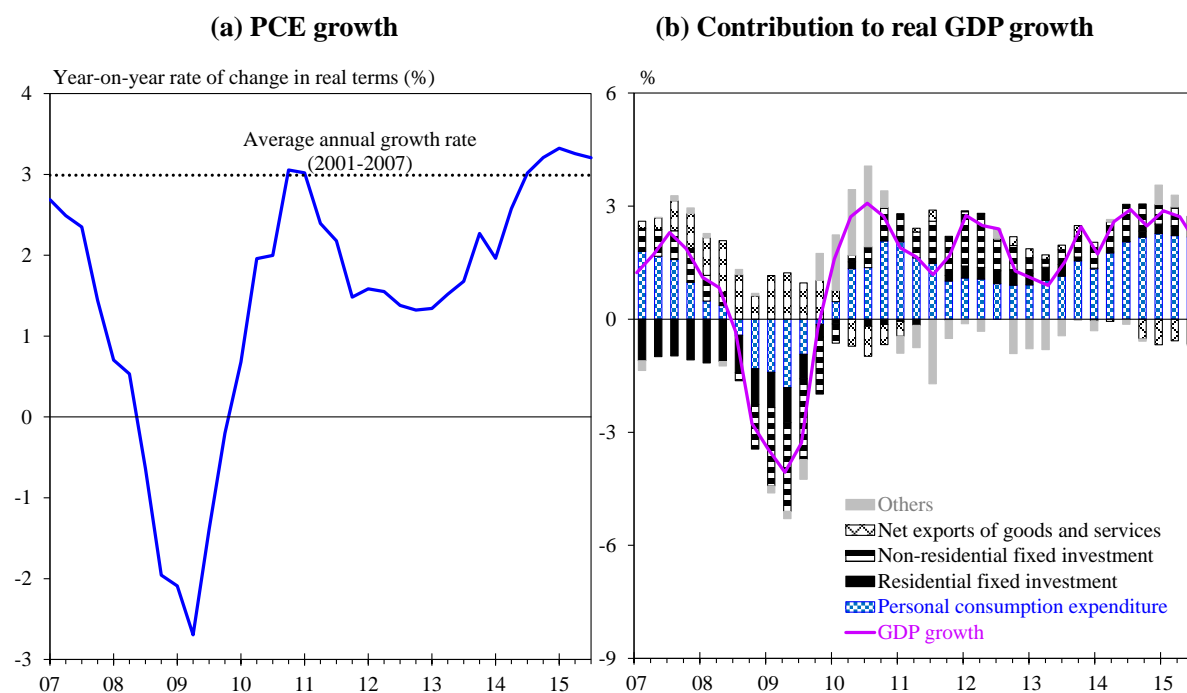
Box 1.1

Will personal consumption help sustain economic growth in the United States?

Personal consumption has been the key growth driver of the US economy in the recent past, with personal consumption expenditure (PCE) outpacing exports for four consecutive quarters, as the latter was dragged by the lacklustre international developments and the strength of the US dollar. This note briefly examines the recent personal consumption situation in the US, and how this may affect its near-term economic outlook.

The US economy expanded moderately further by 2.0% in the third quarter of 2015 over a year earlier, after a 2.7% growth in the second quarter. In the first three quarters of 2015, GDP grew by 2.5% year-on-year, slightly faster than the 2.4% growth in 2014. PCE grew notably by 3.3% over the same period, up from 2.7% in 2014, marking the fastest pace of expansion since the Global Financial Crisis (*Chart 1a*). In terms of contribution to the year-on-year GDP growth, PCE contributed 2.2 percentage points in the first three quarters of 2015, in contrast to the negative contribution from net exports (*Chart 1b*).

Chart 1 : Domestic consumption continued to be the key driver of the US economy



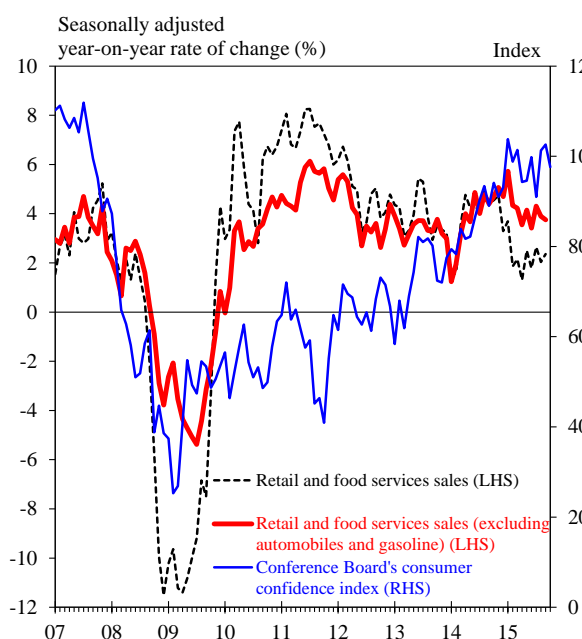
Personal consumption in the US was buoyed by the improving labour market. In the first nine months of 2015, job creation was solid, adding an average of some 198 000 new jobs per month, and the unemployment rate went down to 5.1% in September, falling within the central tendency range of the long-run normal level of 4.9-5.2% as estimated by the Federal Reserve's Federal Open Market Committee (FOMC) participants in September. The favourable effect of improving job and income conditions was also evidenced by the performance of retail and food services sales, which increased by 2.3% year-on-year in value terms in the first nine months of 2015. Excluding the volatile automobile and gasoline sales, the core measure rose even faster, at 4.1% (*Chart 2*).

Box 1.1 (Cont'd)

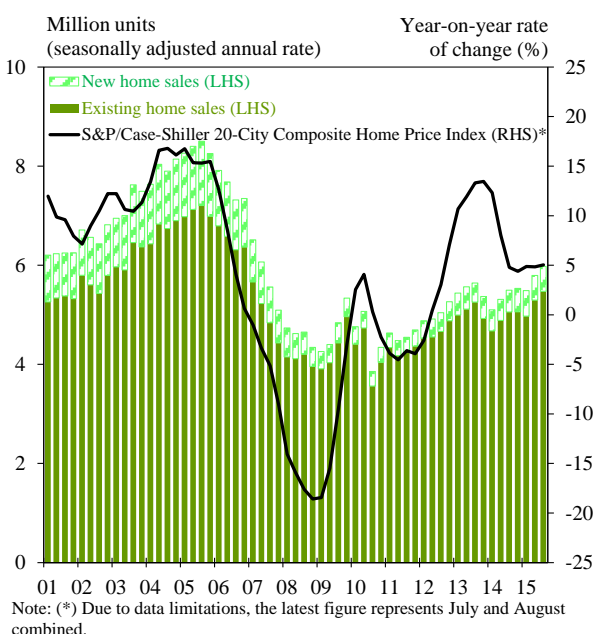
The progressive housing market recovery in the US also helped. Housing market activity not only directly contributed to US economic growth through higher residential investment and trading, but also indirectly bolstered consumption through the wealth channel. Amid a very low interest rate environment, total home sales, comprising existing and new home sales, rose to the highest level since 2008 in recent months, along with steady rises in house prices (*Chart 2*).

Chart 2 : Improved consumer sentiment and the progressive housing recovery both helped support personal consumption in the US

(a) Buoyant consumer sentiment also evidenced by steady core retail sales growth



(b) Home sales rose to a multi-year high, and prices increased moderately year-on-year



On current trends, personal consumption should continue to help support US economic growth in the rest of the year. Consumer confidence, as gauged by the Conference Board's index, trended up successively to reach a multi-year high before easing somewhat in October (*Chart 2*). Indeed, the central tendency of the GDP growth estimates made by the Fed's FOMC participants in September for the fourth quarter of 2015 was 2.0-2.3%, while the IMF in October projected US GDP growth in 2015 to be 2.6%.

Yet, uncertainties still prevail. The pace of job creation in August and September was notably slower than expected, conceivably reflecting the negative feedback from developments in the rest of the global economy. If continued, this could weaken consumer sentiment going forward. Another key source of uncertainty relates to the impending US interest rate lift-off, which would eventually lead to higher borrowing costs for individuals and businesses. How the housing market and business climate will react to higher interest rates could have a significant bearing on household wealth and income prospects and hence on personal consumption behaviour.

With the increased downside risks to the global economy, the volatile financial conditions of late, and the Fed's inclination to normalise monetary policy, a sustained strengthening of the US economy cannot be taken for granted. We have to monitor the situation closely, as this would inevitably impinge on the Hong Kong economy.

The domestic sector

1.6 Domestic demand expanded at a slower pace in the third quarter, but continued to render the major driver of the economy in the face of stronger external headwinds. *Private consumption expenditure* sustained a solid, albeit somewhat slower, year-on-year growth of 4.3% in real terms in the third quarter, supported by broadly stable job and income conditions. Meanwhile, *government consumption expenditure* also maintained a steady year-on-year growth of 2.6% in the third quarter.

Table 1.2 : Consumer spending by major component^(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)
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	H1	3.6	3.3	12.9	0.3	3.2	11.2	-3.1	5.7
	Q1	2.9	4.0	8.5	-0.3	2.6	12.1	-4.4	5.3
	Q2	4.4	2.7	19.6	1.0	3.9	10.3	-1.6	6.1
	Q3	1.7	1.4	5.3	-1.0	2.3	12.5	-5.6	4.3

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 $\pm 0.05\%$.

Box 1.2

An update on the recent performance of Hong Kong's retail sales

This note provides an update of *Box 1.1* in the *2014 Economic Background and 2015 Prospects* by examining the recent trends of retail sales and the related employment situation.

After registering a notable average annual growth of 12.8% in 2010-2013, retail sales slowed down to a meagre 0.6% growth in volume terms in 2014. Sales weakened to a 0.5% year-on-year decline in the third quarter of 2015, following a 1.7% growth in the first half of the year (*Chart 1*). The lacklustre performance of retail sales raised concerns about the outlook for the sector and the wider implications for the economy.

Chart 1 : Retail sales remained lacklustre in the first three quarters of 2015, dragged by continued slowdown in inbound tourism

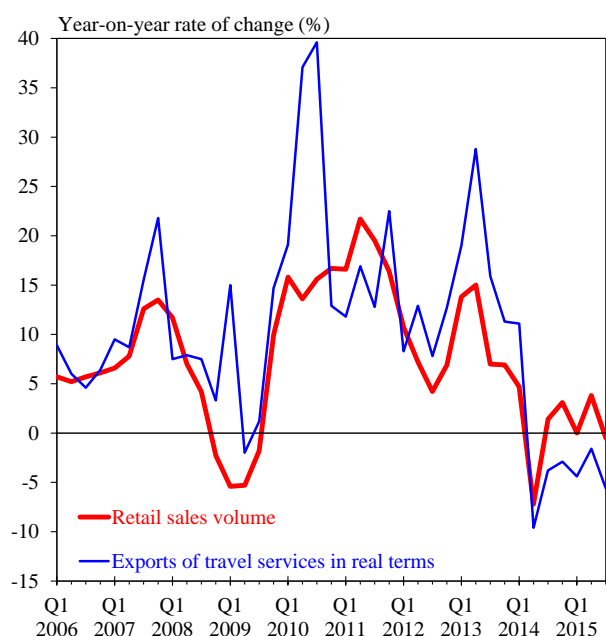
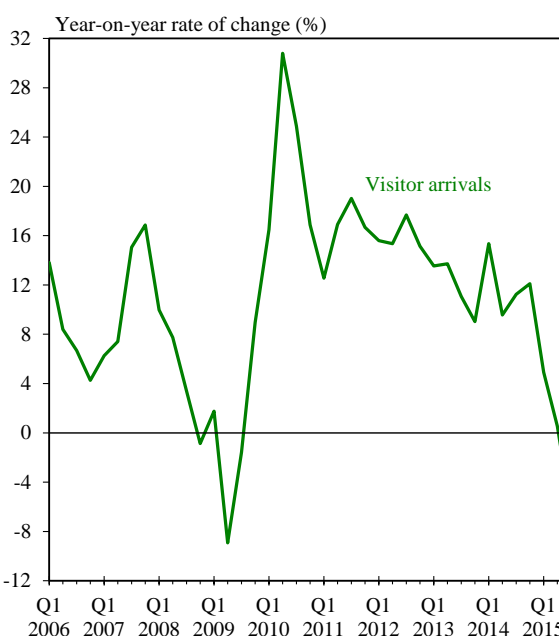


Chart 2 : Visitor arrivals recorded the first decline since the third quarter of 2009, adding downward pressure on the retail sector

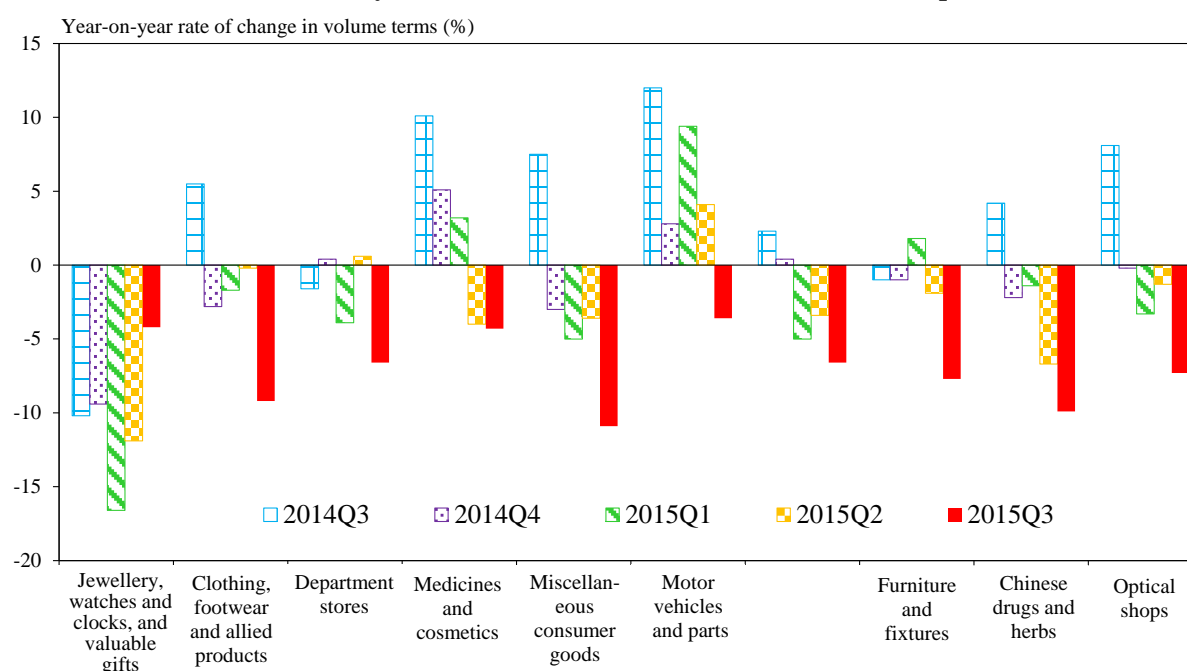


To analyse the possible reasons behind the recent weakness in retail sales, it would be useful to look at inbound tourism performance, as the share of tourists' shopping expenditure in retail sales value has been substantial (around 42% in 2014). The number of visitor arrivals slowed down markedly to a 6.4% year-on-year decline in the third quarter of 2015 (*Chart 2*). Exports of travel services (which cover visitors' spending on shopping, food and beverages, accommodation, entertainment, etc.), likewise slackened in tandem, down 5.6% in real terms in the third quarter. Against this backdrop, our retail sales performance was inevitably affected.

Chart 3 showed that the sales volume of those retail outlet types that are more related to tourist spending, such as "jewellery, watches and clocks, and valuable gifts", "department stores", "medicines and cosmetics" and "clothing, footwear and allied products", saw visible declines in the third quarter of 2015, mirroring continued contraction in inbound tourism. Meanwhile, retail outlets selling goods that are conceivably more local consumption related, including "books, newspapers, stationery and gifts" and durable goods such as "motor vehicles and parts" and "furniture and fixtures", also saw widened declines, as compared to previous quarters, suggesting that the stock market correction in the quarter, coupled with a more uncertain global economic outlook, have dented local consumer sentiment to some extent.

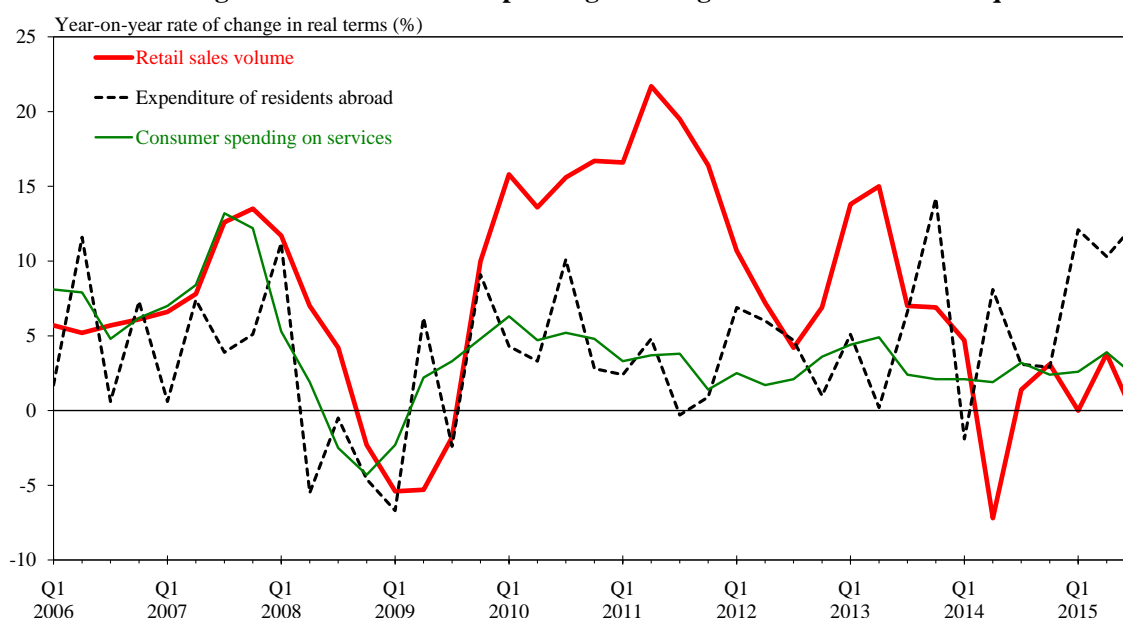
Box 1.2 (Cont'd)

Chart 3 : Sales of many retail outlets saw visible declines in the third quarter of 2015



It should be noted that private consumption expenditure continued to expand solidly in the third quarter, by 4.3% in real terms over a year earlier, underpinned by the further growth of spending on non-goods items, viz. services and outbound travel, which is not captured by the retail sales figures (*Chart 4*).

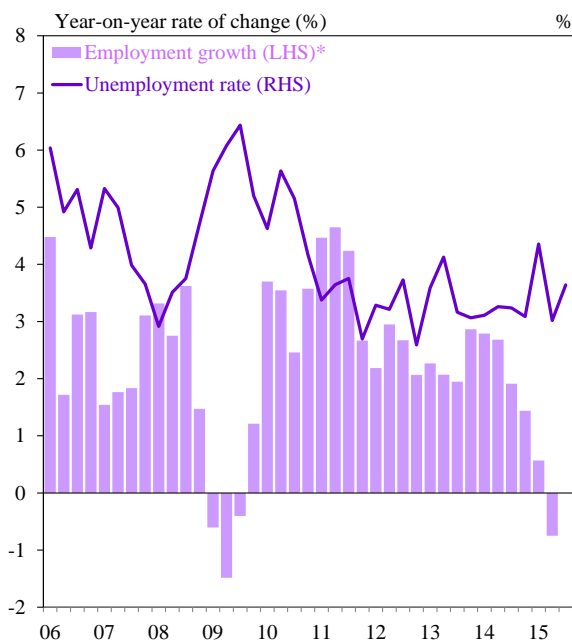
Chart 4 : Further growth was seen in the spending on non-goods items in the third quarter of 2015



Protracted slowdown in retail sales would have negative impacts on the labour market conditions in Hong Kong, as the retail sector directly contributed around 9% of total employment (i.e. around 330 000 jobs) in 2014. While the retail sector's unemployment rate continued to stay relatively low, employment actually fell in the second quarter of 2015 over a year earlier, marking the first decline since the 2008-09 Global Financial Crisis (*Chart 5*). Indeed, business sentiment among large enterprises and SMEs in the retail sector turned more cautious recently (*Chart 6*). Hiring intentions among large enterprises in the sector also deteriorated visibly.

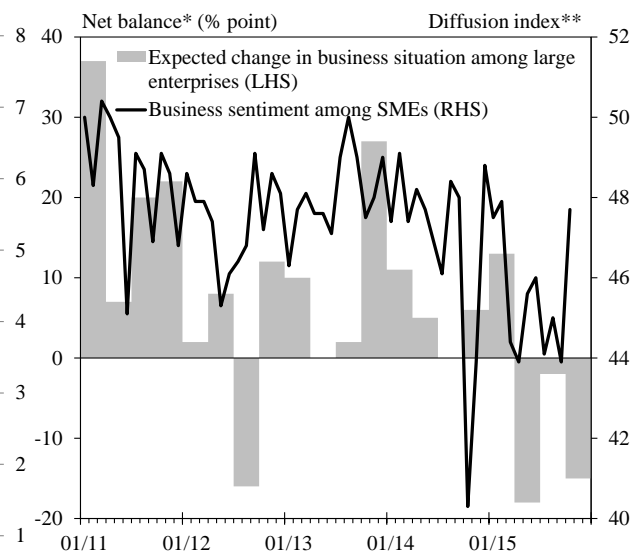
Box 1.2 (Cont'd)

**Chart 5 : Employment in the retail sector
slackened to a decline in the second quarter of
2015**



Note:
(*) According to the Quarterly Survey of Employment and Vacancies, the latest figure for employment in the retail sector is up to the second quarter of 2015.

**Chart 6 : Business sentiment in the retail sector
turned more cautious**



Notes:
(*) Net balance indicates the direction of expected change in business situation versus the preceding quarter. It refers to the difference in percentage points between the proportion of establishments choosing "better" over that choosing "worse". A positive sign indicates a likely upward trend, while a negative sign, a likely downward trend.
(**) A diffusion index reading above 50 indicates that the business condition is generally favourable, whereas an index below 50 indicates otherwise.

Looking ahead, the near-term outlook for the retail business hinges much on the inbound tourism performance and on how the external headwinds will affect the overall economy. Persistent weakness in inbound tourism will pose downward pressure on the retail business. Moreover, the difficult external environment, including weaker global growth and heightened financial market volatility amid the uncertainties associated with the US' interest rate lift-off, might also erode consumer confidence. The Government will continue to monitor closely the situation and its potential repercussions on the local economy and job creation.

Diagram 1.2 : Private consumption expenditure sustained further growth, thanks to stable job and income conditions

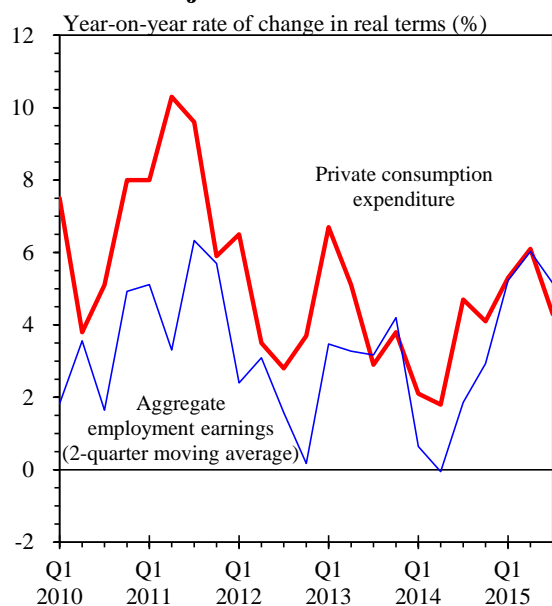
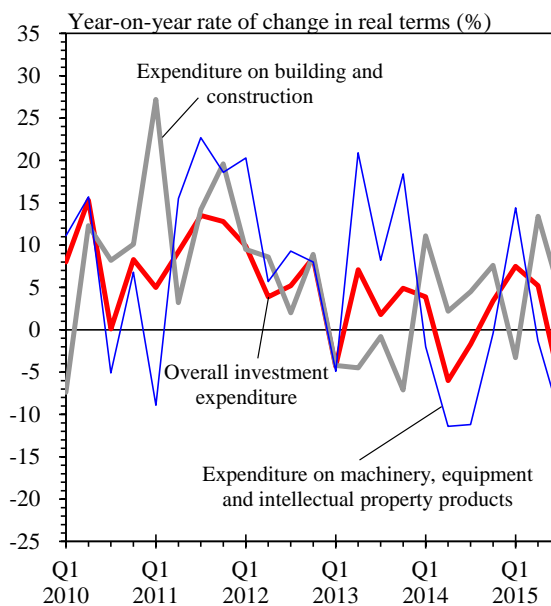


Diagram 1.3 : Investment spending slackened distinctly



1.7 Overall investment spending in terms of *gross domestic fixed capital formation* slackened distinctly to a year-on-year decline of 6.5% in real terms in the third quarter, after a 5.2% growth in the preceding quarter. The visible decline largely reflected the plunge in private sector machinery and equipment acquisition, by 13.1% year-on-year. While this GDP component is typically volatile, its weak performance is conceivably due to increasing concerns over business prospects, in the face of a dimmer global economic outlook and heightened financial market volatility during the quarter. Indeed, business sentiment turned more cautious in recent months, as indicated by the results of the latest Quarterly Business Tendency Survey and the diffusion indices on small and medium-sized enterprises (SMEs) (see **Box 1.3** for details of the consultation on SMEs). Overall building and construction expenditure, on the other hand, posted further growth, backed by the ongoing large-scale infrastructure works and the steady expansion of private sector building and construction activity.

Box 1.3

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. In the recent past, the exercise has been conducted on a sample panel of around 360 SMEs. This note provides a further update of the results reported in *Box 1.2* in the *Half-yearly Economic Report 2015*.

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 remained lacklustre in recent months and enterprises surveyed generally stayed cautious about the outlook (*Table 1*). After falling to 45.3 in August, the overall index stood at 46.1 in October, and was lower than the reading three months ago. With the exception of business services, all other sectors recorded readings below the boom-bust level of 50.0 in October. The diffusion index for real estate slackened quite visibly in recent months compared to July. The still-weak readings for the retail trade and restaurant sectors reflected continued contraction of inbound tourism. The readings for import/export trade and logistics remained subdued, given the drag from sluggish trade performance under the austere external environment. As to the employment situation, the feedback from SMEs suggested broadly stable conditions 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 weakened to 46.9 in October, conceivably reflecting the still-strong external headwinds amid the persistently weak global demand conditions.

The proportion of SMEs reporting tight credit access remained low, at 0.2% in October, thanks mainly to the generally accommodative monetary conditions and the Government's continued efforts to support SMEs through various loan guarantee schemes.

(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 1.3 (Cont'd)**Table 1 : Diffusion indices[^] on business receipts**

	<u>2014</u>			<u>2015</u>									
	<u>Oct</u>	<u>Nov</u>	<u>Dec</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>
<i>Local segments</i>													
Restaurants	38.2	46.1	52.0	50.0	47.7	47.7	48.4	47.6	48.4	49.2	46.8	46.7	42.5
Real estate	40.6	54.7	45.3	48.5	47.1	51.5	45.5	53.2	50.0	50.0	38.3	33.3	41.4
Retail trade	40.3	43.9	48.8	47.5	47.9	44.4	43.9	45.6	46.0	44.1	45.0	43.9	47.7
Wholesale trade	33.3	44.4	44.4	50.0	44.4	44.4	41.7	47.2	50.0	38.9	41.7	38.9	41.7
Business services	45.2	46.8	48.4	45.6	50.0	47.0	48.4	53.2	51.6	46.8	46.8	56.5	50.0
<i>External segments</i>													
Import/export trade	42.6	47.9	50.8	50.0	47.5	49.6	49.6	46.2	50.4	49.6	46.9	47.3	46.0
Logistics	36.1	41.7	41.7	50.0	50.0	44.7	52.8	50.0	52.9	44.1	40.6	46.9	46.9
All the above sectors*	41.0	46.7	48.9	48.8	47.8	47.4	47.3	47.7	49.4	46.9	45.3	46.1	46.1

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>Oct</u>	<u>Nov</u>	<u>Dec</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>
<i>Local segments</i>													
Restaurants	46.1	50.0	49.0	49.2	48.5	50.0	49.2	50.0	49.2	50.0	50.0	50.0	49.2
Real estate	50.0	51.6	50.0	48.5	50.0	51.5	47.0	46.8	50.0	48.3	51.7	45.0	51.7
Retail trade	49.2	50.8	49.6	49.6	50.0	50.0	50.0	49.6	50.4	48.6	49.5	50.0	50.0
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	50.0
Business services	46.8	50.0	50.0	50.0	50.0	50.0	48.4	50.0	48.4	51.6	51.6	51.6	50.0
<i>External segments</i>													
Import/export trade	49.2	50.0	50.0	50.0	49.2	50.8	50.4	49.2	50.0	49.6	48.2	50.0	50.0
Logistics	50.0	47.2	50.0	47.1	47.1	47.4	50.0	50.0	50.0	52.9	50.0	50.0	50.0
All the above sectors*	48.9	50.2	49.8	49.6	49.5	50.3	49.7	49.4	49.9	49.7	49.5	49.9	50.1

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>Oct</u>	<u>Nov</u>	<u>Dec</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>
Import/export trade	44.7	46.7	51.3	50.0	48.3	48.3	48.7	45.3	48.7	48.7	47.4	47.3	46.9

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

	<u>2014</u>			<u>2015</u>									
	<u>Oct</u>	<u>Nov</u>	<u>Dec</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>
All selected sectors*	0.8	0.8	1.0	0.8	0.7	0.7	0.7	0.9	0.2	0.2	0.2	0.2	0.2

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

The labour sector

1.8 The labour market held broadly stable during the quarter. The *seasonally adjusted unemployment rate* stayed at a low level of 3.3% in the third quarter, only marginally up from 3.2% in the second quarter. Meanwhile, the *underemployment rate* stood at 1.4%. Total employment stayed near its record level in the third quarter and private sector job vacancies remained high in June, both pointing to the still-tight overall labour demand conditions. Labour incomes sustained further growth in the third quarter, with the median monthly household income (excluding foreign domestic helpers) growing by 4.0% year-on-year in real terms.

The asset markets

1.9 After a marked downward adjustment towards the end of June, the *local stock market* underwent another sharp correction in August and remained under pressure in September. Such a phenomenon was widespread in equity markets across the globe, as investor sentiment was dented by worries over the global economic outlook and the uncertainties associated with the timing of the US interest rate lift-off. The Hang Seng Index closed the third quarter at 20 846, notably down by 21% from three months earlier, marking the lowest level since June 2013. Average daily turnover went down to \$101.5 billion in the third quarter of 2015 and total equity fund raised was distinctly lower when compared with the preceding quarter.

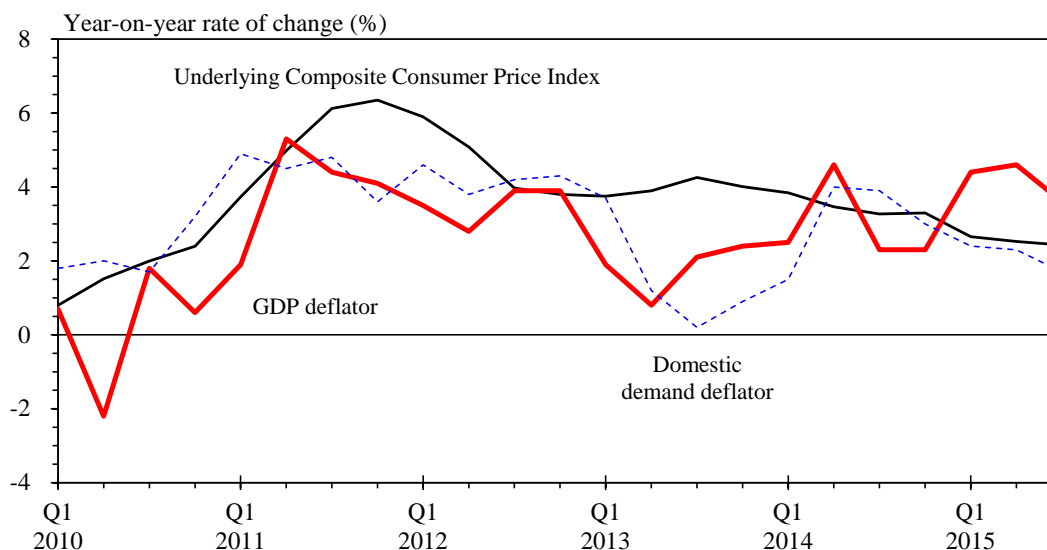
1.10 The *residential property market* turned quieter during the third quarter. Trading volume plunged by 13% over the preceding quarter. Residential property prices rose at a slower pace of 2% during the third quarter. Yet, overall flat prices in September still exceeded the 1997 peak by 77% and the housing affordability ratio stayed elevated at around 64% in the third quarter, indicating that the risks of a housing market bubble remain prominent. During the third quarter, flat rentals rose moderately by 2%, and so did office and shop rentals, both by 1%.

Inflation

1.11 Underlying consumer price inflation continued to ease in the third quarter. Locally, the growth in labour costs remained steady and the feed-through of the faster year-on-year increases in fresh-letting residential and commercial rentals earlier this year was still initial and gradual. All these helped keep domestic cost pressures contained. Meanwhile, external price pressures continued to recede, on the back of declining international food and commodity prices, lower inflation in Hong Kong's major import partners, and the strength of the US dollar. Netting out the effects of the Government's one-off relief measures to more accurately reflect the underlying inflation trend, *underlying composite consumer price inflation* edged down to 2.4% in the third quarter, from 2.5% in the second quarter. *Headline consumer price inflation* eased to 2.3% in the third quarter, from 3.0% in the preceding quarter.

1.12 The *GDP deflator* rose by 3.6% in the third quarter over a year earlier, further to a 4.5% increase in the first half of 2015. Within this, the terms of trade continued to improve modestly amid the strength of the US dollar, while the rise in domestic demand deflator moderated somewhat.

Diagram 1.4 : Consumer price inflation continued to ease in the third quarter



GDP by major economic sector

1.13 Net output of the services sector as a whole grew by 1.5% in real terms in the second quarter of 2015, slower than the 2.4% increase in the first quarter. Many individual sectors saw varying degrees of growth slowdown. The drag from the sluggish external environment on import and export trade was particularly distinct. Net output of transportation and storage also stayed subdued in tandem. Professional and business services saw moderation in growth, so did information and communications and real estate (mainly reflecting activity of private sector developers and property agency), but to a lesser extent. Accommodation and food services remained on the decline, affected by the further slowdown in inbound tourism. Net output of wholesale and retail trades, on the other hand, reverted to a modest growth, amid an exceptionally low base of comparison in the same period last year. Financing and insurance picked up visibly, conceivably reflecting the rally in the local stock market during the early part of the second quarter and the remarkably strong fund-raising activity. As for the secondary sector, manufacturing activity declined mildly further. Meanwhile, activity in the construction sector rebounded notably, on the back of intensive large-scale public infrastructure works in the quarter.

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

	<u>2014</u>	<u>2014</u>				<u>2015</u>	
		<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>
Manufacturing	-0.4	2.1	2.2	-1.7	-3.6	-1.5	-1.2
Construction	8.3	12.2	4.9	5.4	10.1	-5.1	13.6
Services ^(b)	2.4	2.3	2.1	2.9	2.5	2.4	1.5
Import/export, wholesale and retail trades	0.9	0.3	0.5	2.2	0.7	0.4	-3.3
Import and export trade	1.2	-0.7	2.3	2.7	0.6	0.6	-4.6
Wholesale and retail trades	-0.1	3.9	-6.1	0.3	1.3	-0.1	1.6
Accommodation ^(c) and food services	2.6	4.5	2.4	3.6	0.2	-0.7	-1.1
Transportation, storage, postal and courier services	5.2	6.6	7.3	3.9	3.3	2.4	1.2
Transportation and storage	5.4	6.3	7.3	4.9	3.2	2.8	1.5
Postal and courier services	2.0	13.6	7.5	-14.1	3.4	-4.6	-4.7
Information and communications	3.9	3.0	5.7	3.3	3.7	5.9	4.0
Financing and insurance	4.0	3.1	0.6	5.5	6.8	4.5	7.5
Real estate, professional and business services	3.2	1.9	3.7	3.5	3.7	4.6	2.4
Real estate	2.7	0.8	3.0	3.2	4.0	4.2	3.2
Professional and business services	3.6	3.0	4.3	3.7	3.4	5.1	1.7
Public administration, social and personal services	2.3	2.9	2.4	2.0	2.0	2.8	2.1

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 Hong Kong was ranked again as the world's freest economy by the Fraser Institute in September. In particular, Hong Kong attained the top rank in terms of the size of government, freedom to trade internationally and regulation, recognising the Government's steadfast commitment to upholding free market principles and maintaining a free and open business and trade environment.

1.15 The Government constantly strives to enhance the competitive environment of the economy. The Competition Ordinance, which was enacted in June 2012, will become fully operative in December. The full commencement of the Competition Ordinance will help promote sustainable competition and enhance economic efficiency in Hong Kong. Separately, in view of the continued slowdown in inbound tourism in the recent quarters, the Government will allocate an additional HK\$10 million to enhance overseas promotion and support the tourism sector.

1.16 To maintain our competitiveness in the global arena, the Government continues to proactively strengthen economic ties with our economic partners. On deepening our economic integration with the Mainland, the 18th Plenary of the Hong Kong/Guangdong Co-operation Joint Conference was held in September and five co-operation agreements were signed, covering such areas as intellectual property protection and cross-boundary e-commerce enhancement. Directions were set out for future co-operation in various aspects, including trade in services liberalisation, financial co-operation, professional services and innovation and technology. Both sides also exchanged ideas on the "Belt and Road" initiative and the development of the Guangdong Free Trade Zone. Separately, the Government announced in October that Hong Kong and Macao will soon commence negotiations on a Hong Kong and Macao Closer Economic Partnership Arrangement. The free trade agreement, when established, would enhance economic ties between the two places and could provide a platform to advance further liberalisation of trade and investment flows in the Greater China region.

1.17 On strengthening economic ties with overseas markets, Hong Kong and Mexico will launch negotiations on an Investment Promotion and Protection Agreement, which are expected to commence in 2016. Separately, Hong Kong and the Philippines signed a Memorandum of Intent on investment promotion co-operation. These arrangements would facilitate and promote economic and investment relations between Hong Kong and these two economic partners.

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.