

CHAPTER 1 : OVERVIEW OF ECONOMIC PERFORMANCE IN 2015

Summary

- *The Hong Kong economy grew modestly by 2.4% in 2015, slightly slower than the 2.6% growth in 2014. The global economy, which experienced the slowest growth since 2009 amid heightened financial volatility, posed a severe drag on global trade, thereby dampening Hong Kong's exports. The slowdown in inbound tourism also added pressures. Domestic demand remained the key force propelling economic growth to keep labour market in full employment through the year. As external headwinds grew stronger, domestic demand softened in tandem, causing the economy to ease in the latter part of 2015.*
- *As with other Asian economies, Hong Kong's total exports of goods suffered a setback in 2015, similarly affected by the protracted sluggishness in demand from the advanced markets and its spillovers on Asia's trade flows and production activity.*
- *Exports of services also slackened further to show a marginal decline in 2015. The decline in exports of travel services saw an enlarged fall in the second half of the year, as visitor arrivals weakened distinctly and tourist spending on big-ticket items shrank further. Added to this was the sluggishness in exports of both trade-related and transportation services alongside the lacklustre cargo and trade flows. Partially offsetting these developments, exports of financial and other business services grew solidly, thanks to hectic fund-raising and cross-border financial activities.*
- *The domestic sector expanded further in 2015. However, the growth momentum also eased back somewhat in the second half, following increasing expectation of an imminent interest rate hike and heightened financial market volatility. Private consumption expenditure still grew solidly for 2015 as a whole, underpinned by the broadly stable job and income conditions. Yet, investment expenditure dropped for the second consecutive year, reflecting more cautious investment sentiment during the year.*
- *The labour market remained largely stable, with the unemployment rate staying low at 3.3% in 2015. Wages and earnings attained real improvements. Thanks to the upward adjustment of the Statutory Minimum Wage (SMW) rate since May 2015, low-paid workers enjoyed more appreciable wage growth.*
- *Local stock prices went on a global roller-coaster ride, showing sharp fluctuations during 2015. The Hang Seng Index climbed up to reach a seven-year high in April. Upon the spike in Greek debt crisis, trepidation*

about the negative spillovers of US interest rate hikes and dimmer global economic outlook, it lost ground subsequently, finishing the year somewhat lower from a year earlier. The local property market was rather active in early 2015, but came under pressure in the latter part of the year, with both trading volume and flat prices coming down in the fourth quarter.

- *Inflation subsided further, thanks to softer import prices and tamed domestic cost pressures. For 2015 as a whole, underlying inflation averaged 2.5%, marking the fourth consecutive year of easing.*

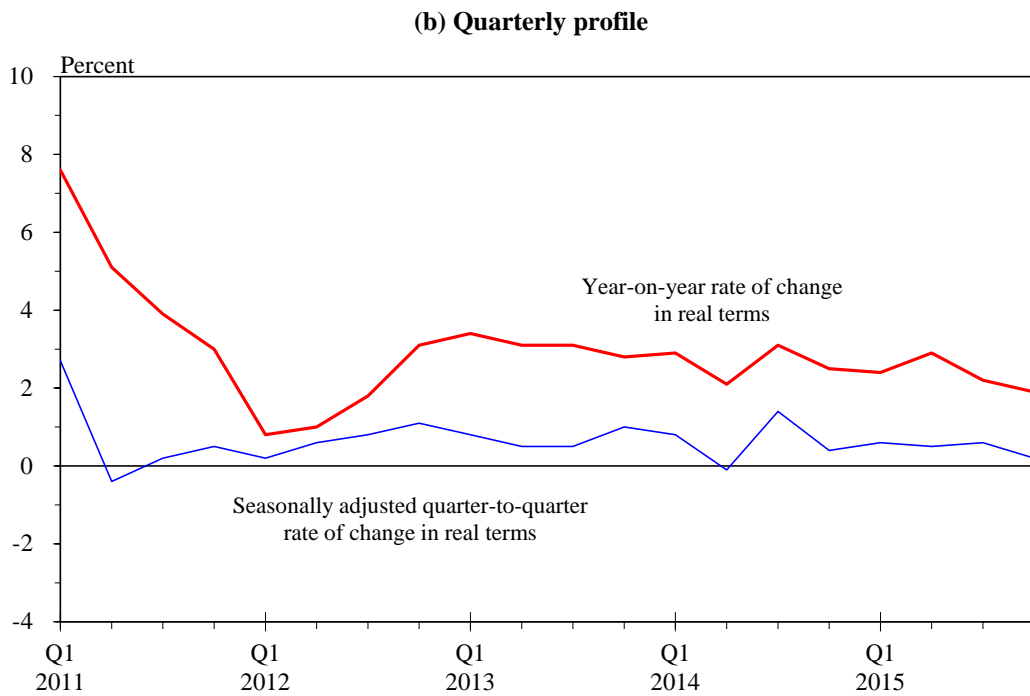
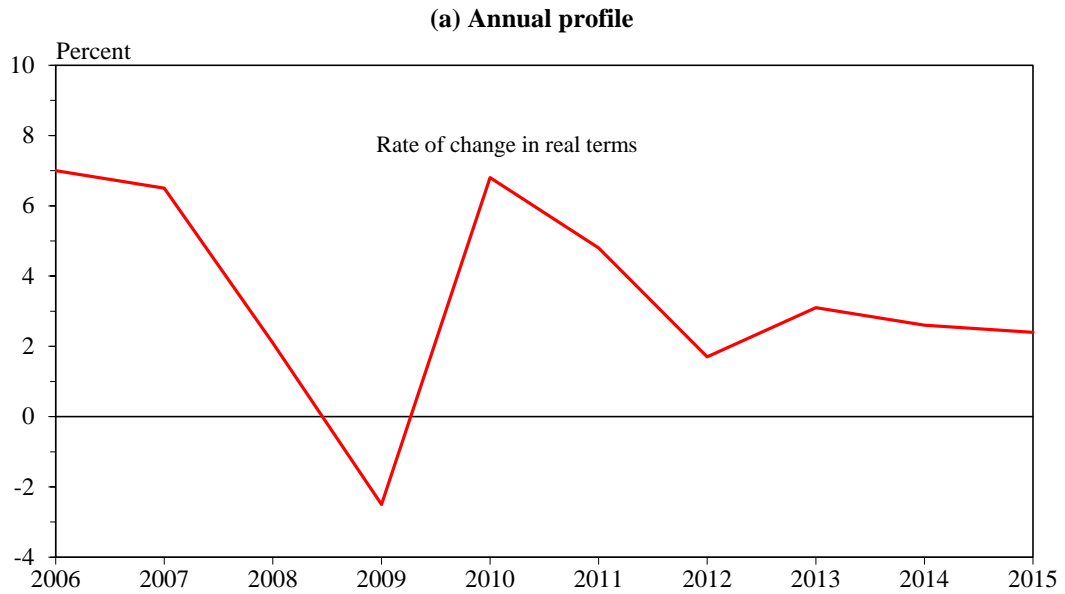
Overall situation

1.1 The Hong Kong economy remained on a modest growth path in 2015, mainly confined by the austere external environment. The global economy decelerated during the year and grew at its slowest pace since the Global Financial Crisis, featured by the slow and uneven recovery of advanced economies, notable downward pressures on emerging market economies and sharp declines in commodity prices. Of particular note were the highly volatile global financial conditions. Following the spike of the Greek debt crisis in the middle of the year, shifting expectations about the timing of US interest rate lift-off amid a subdued global economic picture sparked gyrations in financial and foreign exchange markets in the third quarter, with notable strains on some emerging markets. All these further weighed on global trade flows. Asia's exports generally took a hit in the face of lethargic global demand, with some suffering the worst falls since 2009. Hong Kong's goods exports also weakened in 2015. Likewise, exports of services slackened to decline slightly, dragged mainly by the downdraft in inbound tourism and subdued regional trade and cargo flows. On the other hand, amid stable job and income conditions and sustained rise in private building and construction activity, domestic demand grew further in 2015 and remained the key growth engine, but its momentum also slowed somewhat in the second half of the year due to lingering economic uncertainties. Price pressures receded further on a broad front, with underlying inflation easing in 2015 for the fourth consecutive year.

1.2 For 2015 as a whole, *Gross Domestic Product (GDP)*⁽¹⁾ expanded by 2.4% in real terms, following the 2.6% growth in 2014, representing the fourth consecutive year of sub-par growth. In terms of the quarterly profile, the year-on-year growth rate of real GDP picked up from 2.4% in the first quarter to 2.9% in the second quarter, before moderating to 2.2% and 1.9% respectively in the third and fourth quarters. On a seasonally adjusted quarter-to-quarter

comparison⁽²⁾, real GDP grew by 0.6%, 0.5% and 0.6% in the first, second and third quarters respectively, but weakened to a marginal increase of 0.2% in the fourth quarter.

Diagram 1.1 : The Hong Kong economy continued to expand modestly in 2015



The external sector

1.3 *Total exports of goods* compiled under the GDP accounting framework slackened visibly, falling by 1.7% in real terms in 2015, after a scant growth of 0.8% in 2014. This was the first annual decline since 2009. The performance of major advanced markets remained subdued. Exports to Japan and the EU were on the decline, alongside the subdued economic activity in both places. The continued feed-through of earlier euro and yen depreciations against the US dollar had to some extent also dampened the import appetite in these markets. Exports to the US, though faring better, registered only a meagre growth for 2015 as a whole, as the market weakened in the second half of the year amid softer economic growth and sagging industrial production. Amid the sluggish global demand, the performance of most other Asian markets also worsened. Apart from the plunge in capital goods intake caused by faltering production activities in Asia, the concurrent economic slowdown and currency depreciations in the region also severely curtailed their import appetite. Exports to higher-income newly industrialised economies (Korea, Taiwan and Singapore combined) saw particularly sharp declines. Exports to the Mainland went down in tandem, and those to some ASEAN emerging markets also lost stream. The exceptions were the Indian and Vietnamese markets, which held up well for the year as a whole despite large quarterly fluctuations for the former.

1.4 In terms of quarterly profile, total exports of goods registered a meagre year-on-year growth of 0.4% in real terms in the first quarter and relapsed to fall in the following quarters, by 3.6%, 3.2% and 0.3% respectively. On a seasonally adjusted quarter-to-quarter comparison, goods exports declined in the first and second quarters, yet resumed growth in the third and fourth quarters.

1.5 *Exports of services* fell slightly by 0.6% in real terms in 2015, marking the first yearly decline since 1998. The key drag stemmed from the enlarged decline in exports of travel services, as visitor arrivals weakened to show the first annual decline since 2003 and as the slack in tourist spending on big-ticket items continued. Meanwhile, exports of trade-related and transportation services were both subdued, dampened by the sluggish regional trade and cargo flows. On the other hand, exports of financial and other business services showed solid growth, supported by hectic fund-raising and cross-border financial activities. In 2015, Hong Kong again resumed the top position as the largest IPO centre in the world.

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

	<u>2014</u> [#]	<u>2015</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> [#]	<u>Q4</u> ⁺
<i>Change in real terms of GDP and its main expenditure components (%)</i>										
Private consumption expenditure	3.3	4.8	2.2 (0.5)	2.2 (0.3)	4.9 (2.0)	4.1 (1.4)	5.4 (1.5)	6.2 (1.2)	4.3 (0.2)	3.2 (0.3)
Government consumption expenditure	3.0	3.4	2.5 (0.7)	2.6 (1.2)	3.6 (1.2)	3.5 (0.4)	3.9 (1.1)	3.6 (0.7)	2.8 (0.5)	3.5 (1.1)
Gross domestic fixed capital formation	-0.1	-2.2	5.1	-6.1	-2.5	3.8	5.3	3.9	-6.4	-9.7
<i>of which :</i>										
Building and construction	9.3	2.8	14.8	4.2	7.9	9.9	-3.8	14.2	4.1	-1.5
Machinery, equipment and intellectual property products	-8.6	-5.8	-3.6	-12.8	-15.3	-1.4	10.4	-4.8	-10.7	-13.0
Total exports of goods	0.8	-1.7	-0.1 (-1.6)	2.1 (1.0)	0.7 (0.1)	0.6 (0.9)	0.4 (-1.8)	-3.6 (-2.4)	-3.2 (0.4)	-0.3 (2.7)
Imports of goods	0.9	-2.5	1.0 (-1.3)	1.2 (0.1)	0.3 (0.2)	1.1 (2.0)	0.1 (-2.4)	-3.2 (-2.5)	-4.1 (-0.8)	-2.6 (2.3)
Exports of services	1.1	-0.6	4.4 (0.4)	-1.8 (-1.8)	1.6 (0.7)	0.1 (0.9)	0.4 (0.4)	1.0 (-1.0)	-0.9 (-1.2)	-2.7 (-0.9)
Imports of services	2.0	5.1	0.1 (-4.0)	5.4 (3.9)	2.2 (-0.6)	0.4 (1.3)	6.3 (1.6)	3.9 (1.5)	4.7 (0.4)	5.4 (1.8)
Gross Domestic Product	2.6	2.4	2.9 (0.8)	2.1 (-0.1)	3.1 (1.4)	2.5 (0.4)	2.4 (0.6)	2.9 (0.5)	2.2 (0.6)	1.9 (0.2)
<i>Change in the main price indicators (%)</i>										
GDP deflator	2.9	3.9	2.2 (-0.5)	4.7 (1.3)	2.2 (0.8)	2.6 (1.1)	4.5 (1.4)	4.6 (1.1)	3.7 (0.1)	3.0 (0.4)
Composite CPI										
Headline	4.4	3.0	4.2 (1.0)	3.6 (0.8)	4.8 (0.4)	5.1 (2.8)	4.4 (0.4)	3.0 (-0.6)	2.3 (-0.2)	2.4 (2.9)
Underlying[^]	3.5	2.5	3.8 (1.0)	3.5 (0.8)	3.3 (0.6)	3.3 (0.8)	2.7 (0.4)	2.5 (0.7)	2.4 (0.6)	2.4 (0.8)
Change in nominal GDP (%)	5.6	6.4	5.2	6.9	5.4	5.2	7.1	7.7	6.0	5.0

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.

The domestic sector

1.6 Domestic demand grew further in 2015, rendering the key impetus to overall economic growth. Supported by the stable labour market conditions, *private consumption expenditure* (PCE) grew solidly by 4.8% in real terms in 2015, after the 3.3% growth in 2014. Yet, growth momentum eased back somewhat in the second half of 2015, conceivably reflecting the negative repercussions on local consumer sentiment from local asset price corrections and increased uncertainties over the economic outlook. The deceleration in PCE growth in the second half was more visible on a seasonally adjusted quarter-to-quarter comparison. Meanwhile, *government consumption expenditure* grew steadily by 3.4% in real terms in 2015, slightly faster than the 3.0% growth in 2014.

**Table 1.2 : Consumer spending by major component^(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)
2014	Annual	2.4	3.5	4.8	-0.5	2.9	3.9	-1.6	3.3
	H1	1.6	5.1	-0.4	-1.3	2.5	5.1	0.4	2.2
	H2	3.0	1.9	9.9	0.2	3.3	2.8	-3.4	4.5
	Q1	3.9	4.8	3.6	6.9	2.6	0.7	10.7	2.2
	Q2	-0.6	5.3	-5.8	-8.5	2.5	9.6	-9.5	2.2
	Q3	3.3	3.4	3.3	2.0	3.7	2.8	-4.1	4.9
	Q4	2.8	0.4	15.1	-1.3	2.8	2.9	-2.8	4.1
2015	Annual	2.4	2.4	8.8	-1.0	2.6	11.4	-5.0	4.8
	H1	3.8	3.3	14.5	*	3.4	11.2	-2.7	5.8
	H2	1.1	1.4	3.8	-2.0	1.8	11.7	-7.2	3.8
	Q1	3.1	4.0	9.5	-0.3	2.8	12.1	-3.7	5.4
	Q2	4.6	2.7	22.0	0.3	4.1	10.3	-1.5	6.2
	Q3	1.9	1.4	7.6	-0.7	2.2	12.3	-5.0	4.3
	Q4	0.3	1.5	1.1	-3.1	1.4	11.0	-9.1	3.2

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 grew solidly in 2015

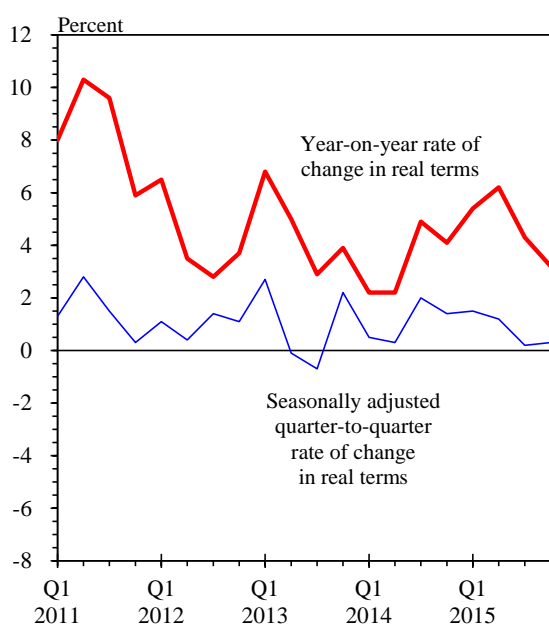
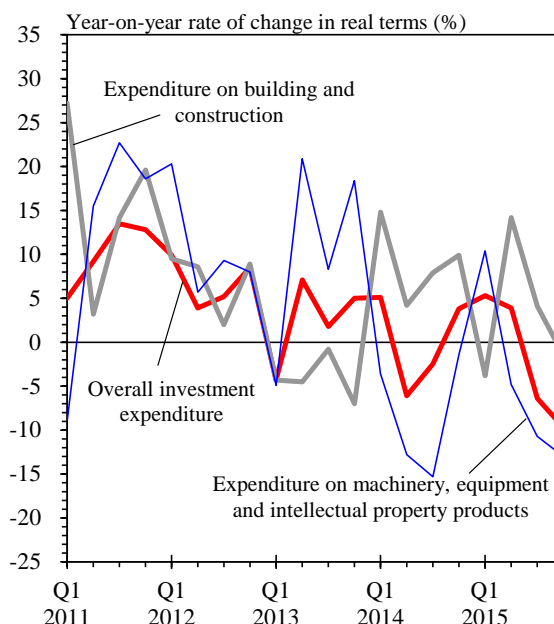


Diagram 1.3 : Investment spending remained weak in 2015



1.7 Overall investment spending in terms of *gross domestic fixed capital formation* remained weak, down 2.2% in real terms in 2015, representing the second year of decline after the 0.1% dip in 2014. Machinery and equipment acquisition was the key drag, down further by 5.8% in 2015, with more visible declines in the second half of the year, conceivably reflecting increasing worry over the dimmer global economic outlook and impending interest rate lift-off. Indeed, business sentiment turned visibly more cautious, as indicated by the latest Quarterly Business Tendency Survey as well as the diffusion indices on small and medium-sized enterprises (SMEs) (see **Box 1.1** for details of the consultation on SMEs). On the other hand, overall building and construction expenditure posted moderate growth of 2.8%, driven by the steady expansion of private sector building and construction activity.

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. In the recent past, the exercise has been conducted on a sample panel of around 350 SMEs. This note provides a further update of the results reported in *Box 1.3* in the *Third Quarter 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 surveyed companies continued to take a more cautious view on business situation, with the overall diffusion index falling to 44.2 in January 2016, well below the boom-bust threshold of 50 (*Table 1*). After reaching a recent high of 49.4 in June 2015, the diffusion index has become more lacklustre in the second half of 2015, and the situation deteriorated further recently. Analysing the sectoral breakdown shows that, apart from the logistics sector, all other sectors registered readings below 50 in January 2016. In particular, the retail trade and restaurant sectors reported worsening business situation amid the sustained weakness in inbound tourism. The recent local asset market corrections may also have dampened consumption sentiment. Business situation of wholesale trade also deteriorated visibly. Moreover, the reading of the real estate sector hovered at low levels, as the local property market consolidated and turned quiet in the recent past. Meanwhile, the reading for import/export trade was still rather sluggish, reflecting the weak external demand conditions and slow regional trade flows. As regards the employment situation, the feedback from SMEs suggested a broadly stable development in recent months across most selected sectors, except that the real estate sector saw a visible slackening (*Table 2*).

Specifically for the import/export trade sector, 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 fell further below the neutral mark of 50, to 46.8 in January 2016, indicating that external demand remained rather lacklustre.

The proportion of SMEs reporting tight credit access still hovered at very low levels, at 0.2% in January 2016, thanks mainly to the continued 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 1.1 (Cont'd)**Table 1 : Diffusion indices[^] on business receipts**

	<u>2015</u>												<u>2016</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>	<u>Jan</u>
<i>Local segments</i>													
Restaurants	50.0	47.7	47.7	48.4	47.6	48.4	49.2	46.8	46.7	42.5	43.3	48.3	41.5
Real estate	48.5	47.1	51.5	45.5	53.2	50.0	50.0	38.3	33.3	41.4	36.2	43.1	41.4
Retail trade	47.5	47.9	44.4	43.9	45.6	46.0	44.1	45.0	43.9	47.7	41.9	44.7	42.2
Wholesale trade	50.0	44.4	44.4	41.7	47.2	50.0	38.9	41.7	38.9	41.7	50.0	47.2	38.9
Business services	45.6	50.0	47.0	48.4	53.2	51.6	46.8	46.8	56.5	50.0	48.4	48.4	45.2
<i>External segments</i>													
Import/export trade	50.0	47.5	49.6	49.6	46.2	50.4	49.6	46.9	47.3	46.0	46.0	46.9	46.4
Logistics	50.0	50.0	44.7	52.8	50.0	52.9	44.1	40.6	46.9	46.9	50.0	50.0	50.0
All the above sectors*	48.8	47.8	47.4	47.3	47.7	49.4	46.9	45.3	46.1	46.1	45.0	46.5	44.2

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>2015</u>												<u>2016</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>	<u>Jan</u>
<i>Local segments</i>													
Restaurants	49.2	48.5	50.0	49.2	50.0	49.2	50.0	50.0	50.0	49.2	49.2	50.8	50.0
Real estate	48.5	50.0	51.5	47.0	46.8	50.0	48.3	51.7	45.0	51.7	46.6	46.6	43.1
Retail trade	49.6	50.0	50.0	50.0	49.6	50.4	48.6	49.5	50.0	50.0	50.0	50.0	51.0
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	50.0	50.0	50.0	48.4	50.0	48.4	51.6	51.6	51.6	50.0	48.4	54.8	48.4
<i>External segments</i>													
Import/export trade	50.0	49.2	50.8	50.4	49.2	50.0	49.6	48.2	50.0	50.0	48.2	49.1	49.1
Logistics	47.1	47.1	47.4	50.0	50.0	50.0	52.9	50.0	50.0	50.0	50.0	50.0	50.0
All the above sectors*	49.6	49.5	50.3	49.7	49.4	49.9	49.7	49.5	49.9	50.1	48.8	50.1	49.2

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

Table 3 : Diffusion index on current new export orders

	<u>2015</u>												<u>2016</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>	<u>Jan</u>
Import/export trade	50.0	48.3	48.3	48.7	45.3	48.7	48.7	47.4	47.3	46.9	47.3	49.1	46.8

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

	<u>2015</u>												<u>2016</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>	<u>Jan</u>
All selected sectors*	0.8	0.7	0.7	0.7	0.9	0.2	0.2	0.2	0.2	0.2	1.0	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 in 2015. Supported by further expansion of domestic demand, the *seasonally adjusted unemployment rate* hovered at a low level of 3.2-3.3% during the year. The *underemployment rate* likewise stayed low throughout the year, averaging at 1.4% for the year as a whole, the lowest since 1997. Total employment grew moderately by 1.3% in 2015, though with visible signs of slowdown in tourism-related and trade sectors. With the labour market staying in full employment, wages and earnings attained real improvements. In particular, thanks to the upward adjustment of the SMW rate since May 2015, employment earnings of low-paid workers enjoyed more appreciable rises.

The asset markets

1.9 The *local stock market* fluctuated with sharp swings over the course of 2015. The Hang Seng Index went successively higher in the first few months of the year alongside Mainland and other major markets worldwide upon improved investment sentiment, reaching a seven-year high of 28 443 on 28 April 2015. The Hang Seng Index then slipped towards the end of the second quarter in tandem with the global stock market rout, unnerved by the escalation of the Greek debt crisis, concerns over US interest rate hikes and dimmer global economic outlook. It fell to a low of 20 557 on 29 September 2015, down by over 7 000 points from the peak in April, before recovering some lost ground to finish the year at 21 914, 7% lower than at end-2014. Average daily turnover rose markedly to \$105.6 billion in 2015, from \$69.5 billion in 2014. Despite escalated financial market volatility, total IPO funds raised still reached \$261.3 billion in 2015, up from \$232.5 billion in 2014. With such stellar performance, Hong Kong regained its position as the world's largest IPO centre in 2015, having ranked second in the preceding two years.

1.10 The *residential property market* cooled down with thinner trading volume after the seventh round of macro-prudential measures on tightening mortgage loans in late February 2015. Overall flat prices increased at a moderated pace in subsequent months. Then as concerns about US interest rate normalisation grew, overall flat prices finally turned south and shed 7% between September and December 2015. Transaction volume fell back by 12% in 2015. However, given the earlier rises, overall flat prices in December 2015 were still 2% higher than a year earlier and exceeded the 1997 peak by 65%. The housing affordability ratio stayed elevated at around 62% in the fourth quarter of 2015, well above the long-term average of 46% over 1995 to 2014. Likewise, flat rentals also reversed the moderate uptrend during the first

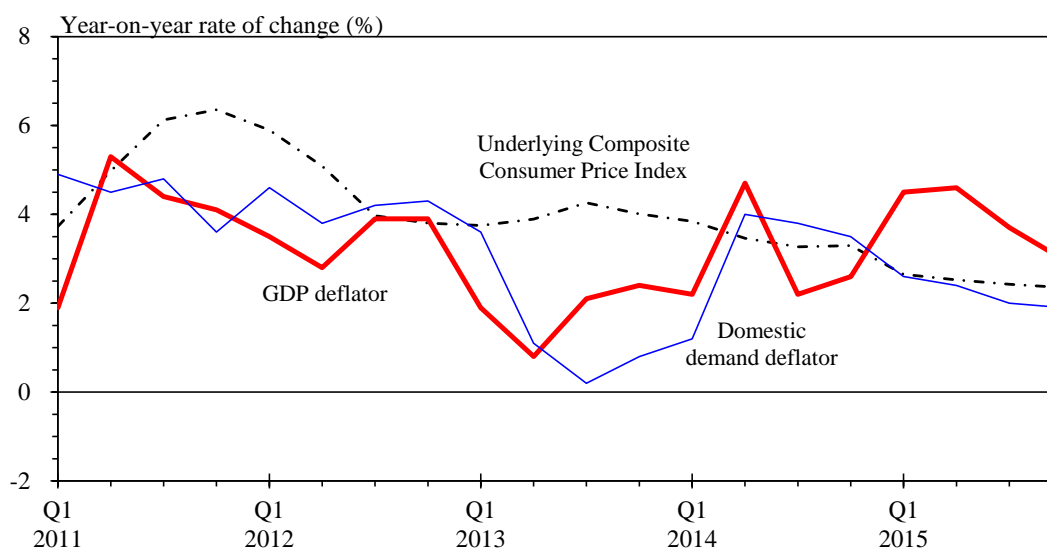
three quarters of the year and fell during the fourth quarter, leading to a cumulative gain of 3% during 2015. As regards commercial property, both shop and office rentals dropped in the fourth quarter after rising continuously in the first three quarters, in tandem with the weakening retail market, concluding 2015 with increases of 1% and 5% respectively.

Inflation

1.11 Consumer price inflation receded further in 2015. Netting out the effects of the Government's one-off relief measures, *underlying consumer price inflation* retreated to 2.5% in 2015 from 3.5% in 2014, marking the fourth consecutive year of falling underlying inflation. The easing trend was attributed to the further moderation in imported inflation, thanks to the still-weak international food and commodity prices as well as the strength of the US dollar. Domestic cost pressures also remained moderate in the midst of economic slowdown. The rises in labour costs were broadly steady. Rental inflation held generally stable during most of 2015 amid continued feed-through of a slower increase in fresh-letting rentals in 2014, with some easing towards the end of the year given the setback in retail market and the concurrent consolidation of the property market. The weakness in retail sales, largely impaired by the slowdown of inbound tourism, also restrained the pricing power of retailers and other related businesses. *Headline consumer price inflation*, which is under the influence of the Government's one-off relief measures, likewise moderated to 3.0% in 2015 from 4.4% in 2014.

1.12 The *GDP deflator* increased by 3.9% in 2015, up from the 2.9% increase in 2014, mainly reflecting the notable improvement in the terms of trade as import prices benefitted from falling commodity prices and a strong US dollar. But the rise in domestic demand deflator actually moderated during the year, largely mirroring the trend in CPI inflation.

Diagram 1.4 : Underlying consumer price inflation followed an easing trend in 2015



GDP by major economic sector

1.13 The services sector grew modestly in the first three quarters of 2015, matching the modest overall economic performance during the period. Net output in real terms grew by 2.3%, 1.4% and 1.9% respectively in the first three quarters of 2015 over a year earlier.

1.14 Among the major services sectors, those related to external trade and inbound tourism generally weakened and posted declines in the first three quarters of 2015. In particular, net output of import/export showed year-on-year declines in the second and third quarters, after a slight growth in the first quarter. Wholesale and retail trades relapsed to a decline in the third quarter after a rebound in the second quarter, while the fall in accommodation and food services widened. Other major services sectors saw varying degrees of growth in the first three quarters of 2015. Financing and insurance showed rather solid growth, supported by buoyant stock market turnovers and hectic fund-raising activity. Information and communications grew solidly, while professional and business services and public administration, social and personal services also registered moderate growth. Transportation, storage, postal and courier services as a whole rose modestly. Real estate (mainly reflecting activity of private sector developers and property agency) grew only moderately, with easing growth pace in line with the cool-off of the property market during the year. As for the secondary sector, activity in the manufacturing sector continued to fall, alongside the weak trading and production activities in the region. Construction grew moderately for the first three quarters as a whole, but with fluctuating performance from quarter to quarter.

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

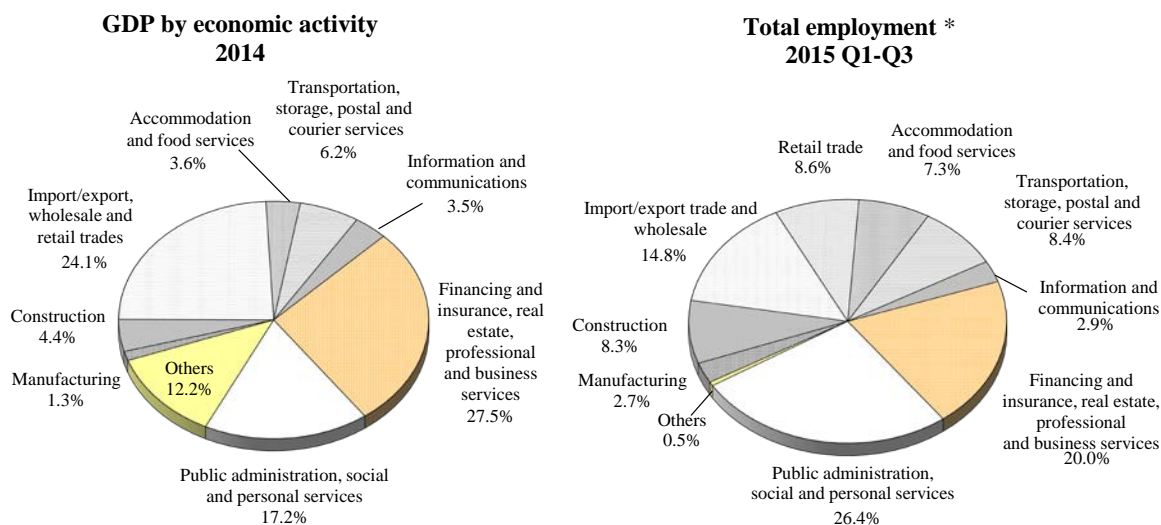
	<u>2014</u>	<u>2015</u>	<u>2014</u>				<u>2015</u>		
		<u>Q1-Q3</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>
Manufacturing	-0.4	-1.6	2.1	2.2	-1.7	-3.6	-1.5	-1.2	-2.1
Construction	13.0	3.5	17.3	8.3	11.2	14.5	-5.3	14.8	2.8
Services ^(b)	2.4	1.9	2.2	2.0	2.9	2.4	2.3	1.4	1.9
Import/export, wholesale and retail trades	1.2	-1.2	0.5	0.9	2.6	0.8	0.4	-3.3	-0.7
Import and export trade	1.3	-1.4	-0.8	2.5	2.9	0.4	0.5	-4.6	-0.2
Wholesale and retail trades	1.2	-0.5	5.0	-4.8	1.7	2.4	-0.2	1.5	-2.5
Accommodation ^(c) and food services	2.2	-1.4	3.9	1.6	3.7	-0.1	-0.7	-1.1	-2.5
Transportation, storage, postal and courier services	2.9	1.6	4.3	4.8	1.4	1.3	2.5	1.2	1.1
Transportation and storage	3.0	2.0	4.0	4.7	2.3	1.2	2.9	1.5	1.5
Postal and courier services	1.2	-5.3	12.8	6.5	-14.8	2.6	-4.6	-4.7	-6.8
Information and communications	3.9	4.5	3.0	5.6	3.3	3.8	5.5	3.8	4.2
Financing and insurance	4.8	6.0	3.9	1.3	6.4	7.6	4.6	7.3	6.0
Real estate, professional and business services	1.9	2.9	1.1	2.4	2.1	2.2	4.4	2.3	1.9
Real estate	1.2	2.9	-0.1	1.8	1.6	1.7	3.8	3.0	1.9
Professional and business services	2.6	2.9	2.2	3.0	2.5	2.5	5.1	1.7	1.9
Public administration, social and personal services	2.5	2.5	2.9	2.6	2.3	2.2	2.3	2.0	3.2

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 services 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.

1.15 The services sector remained the mainstay of the Hong Kong economy, accounting for 92.7% of GDP in 2014 and providing 88.4% of total employment in the first three quarters of 2015. In the midst of the growth rebalancing of Mainland’s economy towards consumption and services, further opening-up under the National 13th Five-Year Plan, and significant opportunities offered by the “Belt and Road” Initiative, Hong Kong’s services sector, with its competitive edge, should have plenty of room for growth and a vital role to play in contributing to the nation’s economic development. The expansion of commercial activity in the rest of Asia, which still outperforms many other parts of the world, will also give additional opportunities. Hong Kong will continue to enhance its competitiveness as an international financial and business hub, by consolidating strength of the traditional pillar industries, developing new industries and markets with promising potential, increasing land supply, and upgrading 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 32.0% in 2010 to 37.5% in 2015.

Diagram 1.5 : The 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 2015 are averages for the first three quarters of the year.

Other economic developments

1.16 In anticipation of the austere external environment in 2015, the Government included a package of relief measures amounting to some \$34 billion in the 2015-16 Budget. These measures helped stabilise the economy and rendered cushion to the overall economy against the external headwinds and the slowdown in inbound tourism.

1.17 In May 2015, a memorandum of regulatory co-operation related to the mutual recognition of funds arrangement was signed between the Hong Kong Securities and Futures Commission and the China Securities Regulatory Commission, marking Mainland's first mutual recognition of funds arrangement with a market outside. The arrangement took effect in July 2015, and the first batch of authorised funds was announced in December. The arrangement not only expands the distribution network for the industry, but also attracts more funds to domicile in Hong Kong, which help build up the city's fund manufacturing capabilities and develop it into a full-fledged fund service centre.

1.18 Strengthening the trading and investment relations with our economic partners is another important pillar of our economic development strategy. For example, in October 2015, the Government announced that Hong Kong and Macao would soon commence negotiations on the Hong Kong and Macao Closer Economic Partnership Arrangement. In November, the Agreement on Trade in Services (the Agreement) under the framework of the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) was signed. The implementation of the Agreement enables basic liberalisation of trade in services between the Mainland and Hong Kong and represents a new milestone after the continuous liberalisation of trade in services through CEPA over the years.

1.19 Indeed, our institutional advantages continue to win international recognitions. Hong Kong was ranked by the Heritage Foundation as the world's freest economy for 22 years in a row. Also, Hong Kong was ranked as the second most competitive economy in the world in the International Institute for Management Development World Competitiveness Yearbook 2015, up from the fourth place in the preceding year. In addition, according to the World Bank's Doing Business 2016 Report, Hong Kong remains one of the world's easiest places to do business, being ranked fifth in the report. According to the United Nations Conference on Trade and Development World Investment Report 2015, Hong Kong was the second largest recipient and provider of foreign direct investment flows in the world, underscoring the attractiveness of Hong Kong as an international business hub and our role as a key conduit for

investment flows.

1.20 To prepare for the long-term challenges from an ageing population and slower economic growth to public finance, the Government followed the recommendation by the Working Group on Long-Term Fiscal Planning and announced the establishment of the Future Fund in December 2015. The Future Fund, with an initial endowment of \$219.7 billion, is a long-term saving scheme. It will be established administratively and will remain an integral part of the fiscal reserves, but its withdrawal before 31 December 2025 is not allowed except in emergencies, with a view to bringing about higher returns through long-term investment. Also in December, a six-month public engagement exercise on retirement protection was launched, aiming at gauging public views on how to improve Hong Kong's retirement protection system.

1.21 The Chief Executive delivered the 2016 Policy Address in January 2016, putting forward a broad range of initiatives to develop the economy, support innovation and technology, enhance education and improve health care.

- The Government will continue to promote the development of financial services, transportation services and logistics industry, trade and professional services and tourism to move up the value chain. Hong Kong will consolidate and expand its role as an international financial centre, including infrastructure financing and risk management, and deepen Renminbi-related financial services and products. The city is well-positioned to leverage on its “One Country, Two Systems” advantages and serves as the “super-connector” to pursue the abundant opportunities brought by the National 13th Five-Year Plan.
- The “Belt and Road” Initiative raised by the Central Government is a promising area bringing significant opportunities to Hong Kong. The Government will set up a high-level steering committee, chaired by the Chief Executive, responsible for formulating strategies and policies for Hong Kong's participation in the “Belt and Road” Initiative. A “Belt and Road” Office will be set up to co-ordinate efforts between government departments and other organisations and liaise with the central ministries and authorities at provincial and municipal levels, as well as various sectors, professional bodies and community organisations in Hong Kong.
- To forge closer ties with major trading partners, six additional liaison offices will be set up on the Mainland, a new Economic and Trade Office (ETO) in Indonesia will be set up and another ETO in Korea is also forthcoming. The negotiation with ASEAN on a free-trade agreement will

continue in full swing and is expected to be concluded in 2016.

- Nearly \$5 billion in funding is set aside for various innovation and technology initiatives. The Government will allocate resources to encourage investment from venture capital funds in local innovation and technology start-ups, and to facilitate the commercialisation of research and encourage local universities to carry out more mid-stream applied research projects.

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.