

CHAPTER 1 : OVERVIEW OF ECONOMIC PERFORMANCE

Summary

- *The Hong Kong economy slowed further in the first quarter of 2016, growing meagrely by 0.8% over a year earlier. This compared to the 1.9% growth in the preceding quarter. The external environment deteriorated during the quarter, characterised by subdued global growth and sharp gyrations in global financial and monetary conditions, leading to a deeper setback in both goods and services trade. The domestic sector also lost some momentum, as the weak global outlook with rising downside risks hurt local economic sentiment.*
- *Strong headwinds in the external environment persisted in the first quarter, weighing heavily on global trade flows. Many advanced economies were still in a fragile state and their persistently sluggish import demand took a heavy toll on Asia's production and trading activities. Heightened financial market volatility and the uncertainty arising from the monetary policy actions by major central banks also added downward pressures. Against this background, Hong Kong's total exports of goods deteriorated further in the first quarter. Exports of services remained in the doldrums, inflicted by a sharper drop in visitor arrivals and weaker visitor spending, and by sluggish cargo and trade flows.*
- *While the domestic segment exhibited remarkable resilience last year, the prolonged weakness in the external sector, austere global economic environment, and recent asset market corrections, all sapped economic sentiment, pulling in the reins on domestic demand. Private consumption expenditure slowed visibly from the preceding quarter, growing only mildly year-on-year in the first quarter. This, together with the continued slowdown in inbound tourism, posed a severe drag on retail sales, which saw the largest year-on-year decline since the Asian financial crisis in 1998. Meanwhile, investment expenditure extended the decline, mainly dragged by the large fall in machinery and equipment acquisition.*
- *The labour market stayed largely stable in the first quarter, notwithstanding the slowdown in the overall economy, with the seasonally adjusted unemployment rate edging up to a still-low level of 3.4%. Wages and earnings sustained moderate growth. However, total employment grew only slowly and labour demand saw signs of further weakening, particularly in the trade- and tourism-related sectors.*
- *The local stock market underwent another correction at the start of the year, in tandem with many overseas stock markets, reflecting increased risk aversion upon the bleaker global outlook and intensified divergence in*

monetary policy stances among major central banks. Stock prices nevertheless stabilised somewhat in March. The residential property market remained quiet, with flat prices still on the decline alongside a visible slowdown in trading activities.

- *Inflationary pressures remained contained in the first quarter, alongside the weakening of overall economic growth. Looking ahead, the upside risks to inflation should be limited in the near term, given the soft import prices and diminished rental cost pressures.*

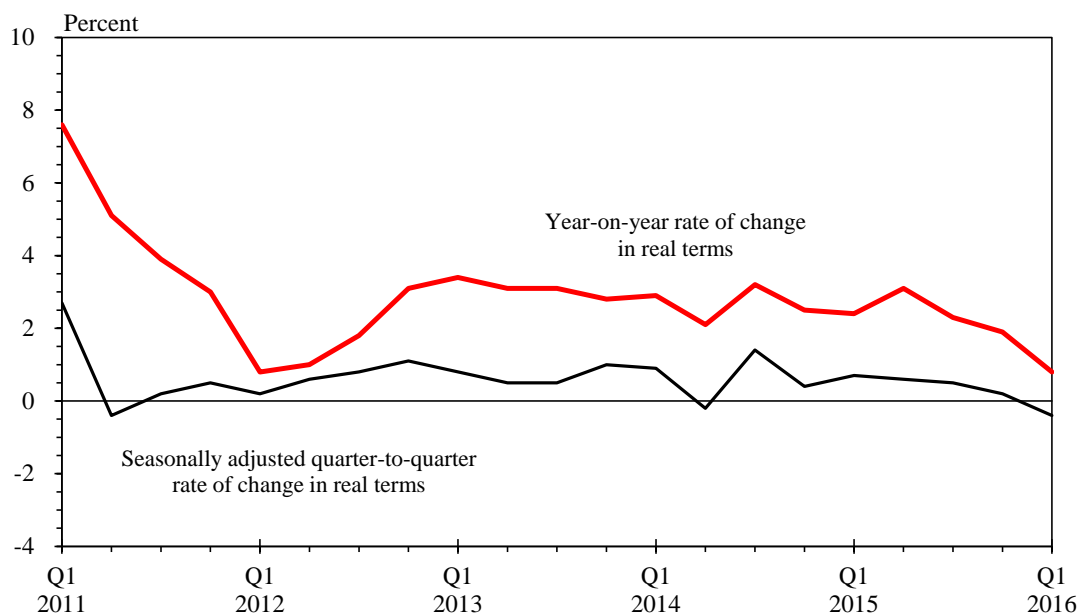
Overall situation

1.1 Hong Kong's economic growth slowed further in the first quarter of 2016, in the face of the intensified drag from an austere external environment. The global economy was stuck in low gear, as many advanced economies were still struggling to gather pace and as many emerging market and commodity-exporting economies slackened further. The global monetary environment also turned more volatile, given the bleaker global outlook, uncertainty about the US Federal Reserve's second interest rate hike, increasing monetary policy divergence among major central banks, and heightened geopolitical tensions. The central banks in Europe and Japan indeed rolled out additional monetary stimulus in the first quarter, underscoring the fragile economic conditions in both places. The weak global demand continued to hit production and trading activities in Asia. Against such a challenging backdrop, the fall in Hong Kong's exports of goods enlarged in the first quarter. Exports of services likewise worsened, attributable to the sharp decline in tourist arrivals along with weaker tourist spending, and to the setback in trade and cargo flows. The notable slowdown in inbound tourism also led to a marked deterioration in retail sales in the first quarter, which saw the largest year-on-year decline since the Asian financial crisis in 1998.

1.2 The weakened global outlook, coupled with the unsteady global monetary environment, heightened investors' risk aversion and triggered massive sell-offs in local and overseas stock markets early this year. Meanwhile, local property prices continued its downward adjustment in the first quarter. The economic uncertainties and asset market corrections apparently also weighed on local consumption and investment sentiments. Thus, the domestic sector lost steam in the first quarter. Nonetheless, the labour market was still broadly stable during the quarter, although the demand for labour showed further signs of weakening, particularly in the trade- and tourism-related sectors. Alongside the slowdown in the global and local economy, external and domestic price pressures largely remained in check.

1.3 In the first quarter of 2016, *Gross Domestic Product* (GDP)⁽¹⁾ grew tepidly by 0.8% in real terms over a year earlier, slower than the 1.9% growth in the preceding quarter (unchanged from the earlier estimate). On a seasonally adjusted quarter-to-quarter comparison⁽²⁾, real GDP fell by 0.4% in the first quarter, after the 0.2% growth in the preceding quarter (unchanged from the earlier estimate).

Diagram 1.1 : The Hong Kong economy slowed further in the first quarter of 2016



The external sector

1.4 *Total exports of goods* compiled under the GDP accounting framework registered a larger year-on-year decline of 3.6% in real terms in the first quarter, after falling by 0.5% in the preceding quarter and 1.9% for 2015 as a whole. The weakness of export performance was actually part of a regional phenomenon, as exports of Asian economies were hard hit by the protracted sluggishness of global demand. Exports to the advanced markets dived further in the first quarter given their fragile economic conditions, while exports to many Asian markets were curbed by subdued intra-regional trade flows. The Indian market was among the few exceptions that still registered notable growth.

1.5 *Exports of services* suffered another setback in the first quarter, down visibly by 4.9% in real terms over a year earlier, after the 2.7% decline in the preceding quarter and the 0.2% fall for 2015 as a whole. Exports of travel services posed a severe drag, amid markedly lower visitor arrivals and weaker visitor spending. Exports of trade-related and transportation services remained

battered by subdued trade and cargo flows. Exports of financial and other business services also weakened to decline slightly, as the more volatile global financial and monetary conditions dampened cross-border financial and commercial activities in the quarter.

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

	<u>2014[#]</u>	<u>2015[#]</u>	<u>2015</u>				<u>2016</u>
			<u>Q1[#]</u>	<u>Q2[#]</u>	<u>Q3[#]</u>	<u>Q4[#]</u>	<u>Q1⁺</u>
<i>Change in real terms of GDP and its main expenditure components (%)</i>							
Private consumption							
Expenditure	3.3	4.7	5.0 (1.3)	6.8 (1.6)	4.4 (*)	2.7 (-0.1)	1.1 (-0.4)
Government consumption							
Expenditure	3.0	3.4	3.9 (1.0)	3.6 (0.8)	2.8 (0.5)	3.3 (1.0)	3.2 (0.9)
Gross domestic fixed capital formation	-0.1	-2.0	5.6	3.9	-6.2	-9.4	-10.1
<i>of which :</i>							
Building and construction	9.3	2.9	-3.9	14.1	4.2	-0.9	-0.8
Machinery, equipment and intellectual property products	-8.6	-5.8	10.4	-4.7	-10.7	-12.9	-11.9
Total exports of goods	0.8	-1.9	0.2 (-1.9)	-3.8 (-2.4)	-3.1 (0.5)	-0.5 (2.3)	-3.6 (-3.9)
Imports of goods	0.9	-2.7	-0.2 (-2.6)	-3.3 (-2.4)	-4.2 (-0.8)	-2.8 (2.0)	-5.4 (-4.2)
Exports of services	1.1	-0.2	0.7 (0.6)	1.6 (-0.8)	-0.2 (-1.1)	-2.7 (-1.4)	-4.9 (-1.8)
Imports of services	1.8	5.7	6.7 (1.8)	5.1 (1.9)	5.5 (0.2)	5.4 (1.4)	3.8 (0.3)
Gross Domestic Product	2.7	2.4	2.4 (0.7)	3.1 (0.6)	2.3 (0.5)	1.9 (0.2)	0.8 (-0.4)
<i>Change in the main price indicators (%)</i>							
GDP deflator	2.9	3.6	4.3 (1.2)	4.2 (1.0)	3.4 (0.1)	2.8 (0.4)	2.3 (0.7)
Composite CPI							
Headline	4.4	3.0[@]	4.4 (0.3)[@]	3.0 (-0.6)[@]	2.3 (-0.1)[@]	2.3[@] (2.7)[@]	2.8[@] (0.7)[@]
Underlying[^]	3.5	2.5[@]	2.7 (0.3)[@]	2.5 (0.6)[@]	2.4 (0.5)[@]	2.2[@] (0.9)[@]	2.8[@] (0.7)[@]
Change in nominal GDP (%)	5.6	6.2	6.8	7.5	5.8	4.8	3.1

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 $\pm 0.05\%$.

(@) By reference to the new 2014/15-based CPI series.

The domestic sector

1.6 The domestic sector lost some momentum in the first quarter, as the uncertain global economic outlook apparently dented local economic sentiment. The asset market consolidation amid the volatile financial environment also added woes to local consumption demand, partly offsetting the support from the broadly stable labour market conditions. *Private consumption expenditure* continued to moderate in the first quarter, growing only mildly by 1.1% in real terms over a year earlier, down from the 2.7% growth in the preceding quarter. *Government consumption expenditure*, on the other hand, grew steadily by 3.2% in the first quarter, providing some cushion to domestic demand.

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

	Total consumer spending in the domestic market ^(a)	<i>Of which :</i>						
		Food	Durables	Non- durables	Services	Residents' expenditure abroad	Visitor spending	Private consumption expenditure ^(b)
2015 Annual	2.5	2.4	8.8	-1.0	2.8	13.1	-3.8	4.7
H1	3.9	3.3	14.5	*	3.7	12.5	-2.1	5.9
H2	1.1	1.4	3.8	-2.0	1.9	13.6	-5.3	3.5
Q1	2.8	4.0	9.5	-0.3	2.6	11.6	-3.3	5.0
Q2	5.0	2.7	22.0	0.3	4.7	13.4	-0.8	6.8
Q3	2.1	1.4	7.6	-0.7	2.2	14.8	-3.8	4.4
Q4	0.2	1.3	1.1	-3.2	1.6	12.4	-6.7	2.7
2016 Q1	-2.6	-1.5	-18.7	-3.5	1.4	14.3	-13.3	1.1

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 continued to moderate

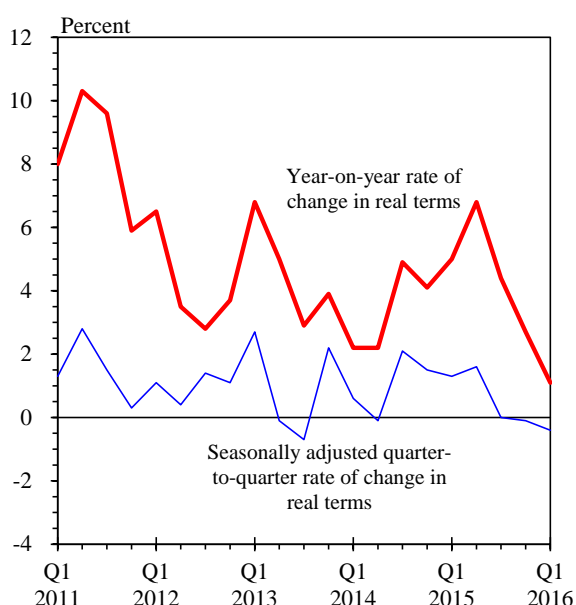
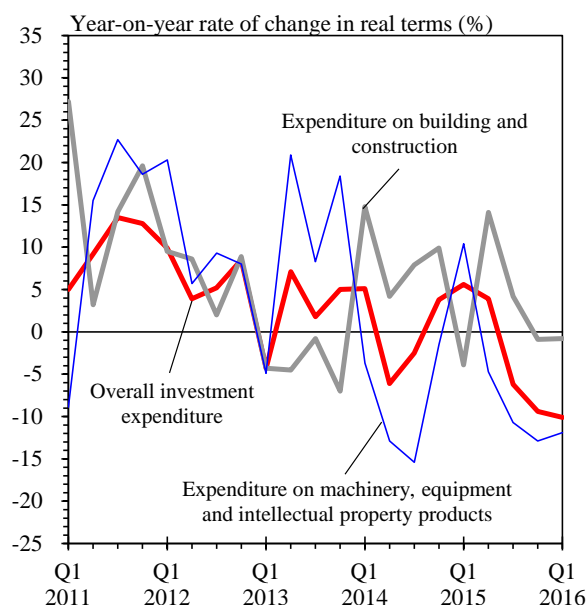


Diagram 1.3 : Investment spending declined further



1.7 Overall investment spending in terms of *gross domestic fixed capital formation* remained on the downtrend, falling by 10.1% year-on-year in real terms in the first quarter, after the 9.4% plunge in the preceding quarter. Machinery and equipment acquisition was a key drag, plummeting by 11.9% over a year earlier, conceivably reflecting the scaling back of investment plans amid growing pessimism over the global economic outlook. Indeed, the results of the latest Quarterly Business Tendency Survey and the diffusion indices on small and medium-sized enterprises (SMEs) (see **Box 1.1** for details of the consultation on SMEs) suggested that business sentiment in many economic sectors remained weak in regard to the near-term business prospects. Overall building and construction activity registered a modest decline, as public infrastructure works decelerated from their peak last year, even though private sector building works still expanded solidly.

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 1.1* in the *2015 Economic Background and 2016 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 remained weak in recent months and enterprises surveyed in both local and external segments generally stayed cautious about the outlook (*Table 1*). After a mild relative improvement in February, the overall index moved lower to 45.7 in April, with most sectors registering readings below the boom-bust mark of 50.0. Specifically, the readings for the wholesale and retail sectors deteriorated notably since February, reflecting weaker local consumption spending and the drag from the slowdown in inbound tourism. The reading for real estate also weakened in April along with the property market consolidation, while that for business services fared better, hovering within the range of 50.0 – 51.7 in recent months. As regards the more externally-oriented sectors, the reading for logistics remained sluggish in recent months, mirroring the unsteady external environment. Yet, the reading for import/export trade showed some relative improvement, moving slightly above 50.0 in April. As to the employment situation, the feedback from SMEs suggested a broadly stable development in recent months in most selected sectors. However, the readings for such sectors as retail trade and logistics fell visibly in April, suggesting weaker demand for labour in these sectors (*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 stayed below the boom-bust mark of 50.0, at 48.6 in April, partly reflecting the still-subdued external demand conditions.

The proportion of SMEs reporting tight credit access stood unchanged at a low level of 0.2% in April, 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 1.1 (Cont'd)**Table 1 : Diffusion indices[^] on business receipts**

	<u>2015</u>								<u>2016</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	48.4	47.6	48.4	49.2	46.8	46.7	42.5	43.3	48.3	41.5	45.7	46.6	44.0
Real estate	45.5	53.2	50.0	50.0	38.3	33.3	41.4	36.2	43.1	41.4	50.0	55.2	46.6
Retail trade	43.9	45.6	46.0	44.1	45.0	43.9	47.7	41.9	44.7	42.2	48.5	41.9	38.8
Wholesale trade	41.7	47.2	50.0	38.9	41.7	38.9	41.7	50.0	47.2	38.9	44.4	32.4	32.4
Business services	48.4	53.2	51.6	46.8	46.8	56.5	50.0	48.4	48.4	45.2	51.7	51.7	50.0
<i>External segments</i>													
Import/export trade	49.6	46.2	50.4	49.6	46.9	47.3	46.0	46.0	46.9	46.4	45.0	49.1	50.9
Logistics	52.8	50.0	52.9	44.1	40.6	46.9	46.9	50.0	50.0	50.0	50.0	46.7	46.7
All the above sectors*	47.3	47.7	49.4	46.9	45.3	46.1	46.1	45.0	46.5	44.2	47.2	46.8	45.7

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>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	49.2	50.0	49.2	50.0	50.0	50.0	49.2	49.2	50.8	50.0	47.4	50.0	50.9
Real estate	47.0	46.8	50.0	48.3	51.7	45.0	51.7	46.6	46.6	43.1	50.0	51.7	50.0
Retail trade	50.0	49.6	50.4	48.6	49.5	50.0	50.0	50.0	50.0	51.0	48.5	50.0	47.4
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	48.4	50.0	48.4	51.6	51.6	51.6	50.0	48.4	54.8	48.4	48.3	50.0	50.0
<i>External segments</i>													
Import/export trade	50.4	49.2	50.0	49.6	48.2	50.0	50.0	48.2	49.1	49.1	48.2	49.5	50.5
Logistics	50.0	50.0	50.0	52.9	50.0	50.0	50.0	50.0	50.0	50.0	50.0	46.7	43.3
All the above sectors*	49.7	49.4	49.9	49.7	49.5	49.9	50.1	48.8	50.1	49.2	48.6	49.8	49.4

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>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	48.7	45.3	48.7	48.7	47.4	47.3	46.9	47.3	49.1	46.8	46.8	49.5	48.6

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

	<u>2015</u>								<u>2016</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*	0.7	0.9	0.2	0.2	0.2	0.2	0.2	1.0	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 was largely stable, with the *seasonally adjusted unemployment rate* edging up by 0.1 percentage point from the preceding quarter to 3.4% in the first quarter. The *underemployment rate* stayed unchanged at 1.4%. Wages and earnings remained on the rise. However, total employment saw slower growth in the first quarter. Moreover, there were further signs of slackening in labour demand, particularly in the trade- and tourism-related sectors, reflecting the lustreless external trade, the protracted slowdown in inbound tourism and the growth moderation in private consumption.

The asset markets

1.9 The *local stock market* underwent another correction at the start of 2016, as increasing worries over a slowing global economy and wider monetary policy divergence heightened risk aversion, triggering a new round of global stock market rout and massive sell-offs. The Hang Seng Index came under pressure before stabilising somewhat in March, closing the first quarter at 20 777, 5.2% lower than at end-2015. Average daily turnover of the stock market edged up to \$72.7 billion in the first quarter, from \$71.9 billion in the preceding quarter. Fund-raising activity slowed markedly compared with the preceding quarter. Yet, the amount of funds raised through initial public offering in Hong Kong was still ranked third among the world's stock markets.

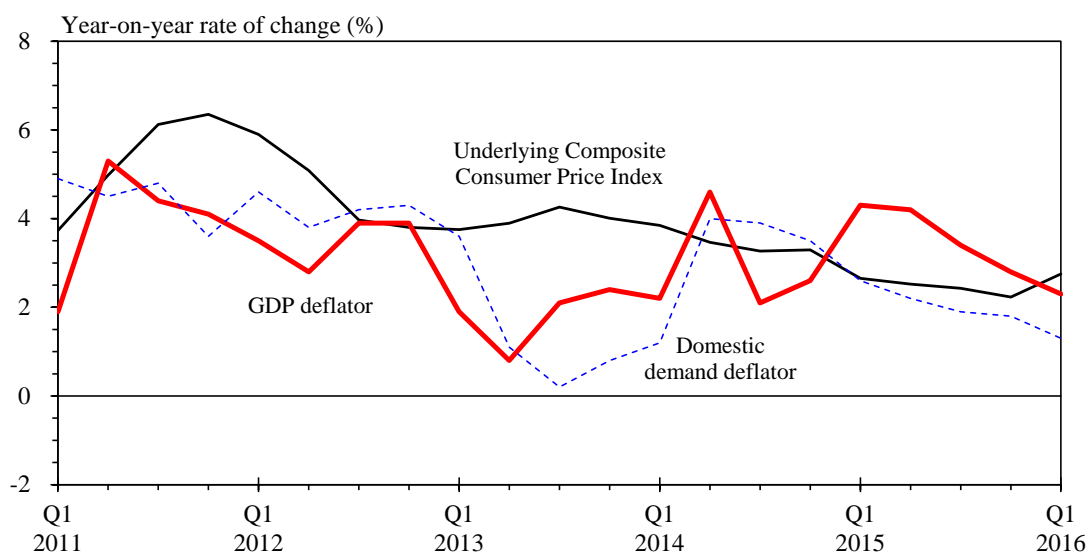
1.10 The *residential property market* remained in the consolidation mode in the first quarter. Trading volume tumbled by 39% from the preceding quarter. Residential property prices shed another 5% between December 2015 and March 2016, cumulating to a 12% decline from the peak in 2015. Notwithstanding the recent correction, overall flat prices in March 2016 still exceeded the 1997 peak by 56%, and the housing affordability ratio remained elevated at around 59% in the first quarter. Similarly, flat and shop rentals went lower by 5% and 2% respectively during the first quarter, while office rentals were little changed.

Inflation

1.11 Consumer price inflation stayed moderate alongside the continued subpar performance of the overall economy. By reference to the new 2014/15-based series and netting out the effects of the Government's one-off relief measures, *underlying consumer price inflation* went up slightly to 2.8% in the first quarter, from 2.2% in the preceding quarter (or from 2.4% to 2.9% by reference to the old 2009/10-based series). The slight pick-up in the underlying inflation in the first quarter was mainly driven by the surge in basic food prices amid bad weather conditions. This factor aside, domestic price pressures generally remained in check, given the weaker consumption demand and the easing rental inflation in tandem with the property market consolidation. Meanwhile, external price pressures were muted, thanks to the rather benign inflation in Hong Kong's major import partners and the still-low international commodity prices. *Headline consumer price inflation* also went up modestly to 2.8% in the first quarter, from 2.3% in the preceding quarter (or from 2.4% to 2.9% by reference to the old 2009/10-based series).

1.12 The year-on-year rate of increase in the *GDP deflator* slowed to 2.3% in the first quarter. Within this, the increase in domestic demand deflator continued its moderating trend, while the terms of trade improved mildly further.

Diagram 1.4 : Consumer price inflation remained moderate in the first quarter



Note : The year-on-year rates of change of the Composite Consumer Price Index from the fourth quarter of 2015 onwards are computed from the new 2014/15-based series, and those before are from the old 2009/10-based series.

GDP by major economic sector

1.13 Net output of the services sector as a whole moderated to grow by 1.9% in real terms in 2015, down from the 2.4% growth in 2014, mirroring the slowdown in overall economic growth amid the difficult external environment. Economic activities related to external trade and inbound tourism decelerated visibly. Net output of import and export trade slackened to a decline in 2015, while transportation and storage also saw moderation in growth, in tandem with the sluggish global trade flows. Wholesale and retail trades, as well as accommodation and food services, were dampened by the protracted slowdown in inbound tourism. Net output of financing and insurance grew solidly in 2015, on the back of buoyant cross-border financial and fund-raising activities. Professional and business services picked up slightly in growth in 2015. The net output of real estate activity, which mainly reflects activity of private sector developers and property agency, slipped in the fourth quarter of 2015, alongside the consolidation of the property market, but still expanded modestly for 2015 as a whole. As for the secondary sector, activity in the manufacturing sector declined for the second consecutive year. Meanwhile, the construction sector posted a mild growth in 2015, notwithstanding an exceptionally high base of comparison, amid intensive large-scale infrastructure works and continued expansion in private sector building activity.

**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</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>
Manufacturing	-0.4	-1.5	2.1	2.2	-1.7	-3.6	-1.5	-1.2	-2.1	-1.3
Construction	13.0	2.0	17.3	8.3	11.2	14.5	-5.3	14.8	3.0	-2.3
Services ^(b)	2.4	1.9	2.2	2.0	2.9	2.4	2.3	1.6	1.9	1.9
Import/export, wholesale and retail trades	1.2	-1.1	0.5	0.9	2.6	0.8	*	-3.6	-0.5	-0.7
Import and export trade	1.3	-0.8	-0.8	2.5	2.9	0.4	0.1	-4.9	-0.1	0.8
Wholesale and retail trades	1.2	-2.2	5.0	-4.8	1.7	2.4	-0.4	1.4	-2.5	-6.1
Accommodation ^(c) and food services	2.2	-0.9	3.9	1.6	3.7	-0.1	-0.5	-1.1	-2.6	0.4
Transportation, storage, postal and courier services	2.9	1.9	4.3	4.8	1.4	1.3	2.4	1.1	1.1	3.0
Transportation and storage	3.0	2.4	4.0	4.7	2.3	1.2	2.8	1.4	1.5	3.7
Postal and courier services	1.2	-6.0	12.8	6.5	-14.8	2.6	-4.6	-4.7	-6.8	-7.6
Information and communications	3.9	4.0	3.0	5.6	3.3	3.8	5.0	4.6	3.5	2.9
Financing and insurance	4.8	6.3	3.9	1.3	6.4	7.6	4.9	7.9	6.1	6.2
Real estate, professional and business services	1.9	2.2	1.1	2.4	2.1	2.2	4.3	2.1	1.7	1.0
Real estate	1.2	1.4	-0.1	1.8	1.6	1.7	3.5	2.6	1.4	-1.8
Professional and business services	2.6	3.0	2.2	3.0	2.5	2.5	5.1	1.7	1.9	3.3
Public administration, social and personal services	2.5	2.6	2.9	2.6	2.3	2.2	2.3	2.0	3.3	2.9

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.

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

Other economic developments

1.14 In view of the unsteady global economic climate with increasing downside risks, the economic environment facing Hong Kong on both the domestic and external fronts will remain highly challenging in 2016. Against this backdrop, the 2016-17 Budget (the Budget) proposed a series of relief measures to help alleviate the financial burden of the public, stimulate local consumption, preserve economic stability and safeguard employment. The package of relief measures, amounting to some \$38.8 billion, together with other Budget initiatives, are estimated to have a stimulus effect of boosting GDP by 1.1 percent. The Budget also laid out measures to support SMEs and promote tourism.

1.15 Strategies were proposed in the Budget for Hong Kong to sustain its competitiveness in the global arena under the “new economic order”, characterised by the shifting of global economic gravity towards the East and breakthroughs in information technology development. In the aspect of nurturing innovation, the Government will promote the application of smart production technologies, such as robotics; develop financial technologies; and support business start-ups and creative industries. In the aspect of expanding trade ties with new and emerging markets, the Government will explore co-operation opportunities and the unique role of Hong Kong arising from the Belt and Road Initiative by capitalising on Hong Kong’s strength as the world’s largest offshore Renminbi (RMB) business hub and a major asset management centre and investment platform in the Asia-Pacific region. Also, the Government will continue to actively pursue trade and investment agreements to facilitate Hong Kong enterprises in tapping overseas markets. At the same time, the Government will strengthen commercial connectivity and facilitate e-commerce through upgrading transport and logistic services as well as enhancing our airport’s capacity, while promoting Hong Kong to become the region’s intellectual property trading hub.

1.16 The Budget also provided measures to facilitate Hong Kong’s long-term economic development, through investment in human capital and increasing land supply. To ensure fiscal health, the Government will strive to contain expenditure growth, preserve the revenue base and set aside fiscal reserves to the Future Fund for long-term investments, in preparation for the long-term needs of Hong Kong amid an ageing population and the future pressure on public finances. For the benefit of Hong Kong’s sustainable development, the Economic Development Commission held its tenth meeting in March 2016, providing views on how to balance economic development with social aspirations while ensuring sufficient land supply.

1.17 On economic integration with the Mainland, the National 13th Five-Year Plan (the 13-5 Plan) was promulgated in March (see **Box 1.2** for details). A chapter of the 13-5 Plan is again dedicated to Hong Kong and Macao, acknowledging their significant functions and positioning in the overall development of the country. In addition to consolidating its position as an international financial, transportation and trade centre, Hong Kong will continue to promote its pillar industries towards high-end and high value-added developments (see **Box 1.3** for reference). Furthermore, Hong Kong will continue to develop the innovation and technology industry, nurture emerging industries, and establish itself as a centre for international legal and dispute resolution services in the Asia-Pacific region. The Government's Steering Committee on Co-operation with the Mainland will continue to formulate policies and measures based on the 13-5 Plan. Separately, the sixth working meeting of Hong Kong-Shanghai Financial Co-operation took place in March. Ways to enhance co-operation in the areas of cross-border RMB business, reinsurance business and the securities and futures industry were discussed.

1.18 Hong Kong was ranked by the Heritage Foundation as the world's freest economy for the 22nd year in a row. Free market principles have been the cornerstones of Hong Kong's sustained economic development and prosperity. The Government will continue to enhance Hong Kong's global competitiveness, by providing a favourable business environment, ensuring fair competition and free trade, maintaining a simple tax regime with low tax rates and keeping an efficient public sector, while upholding free market principles and the rule of law.

1.19 On enhancing economic co-operation with overseas markets, a comprehensive agreement for the avoidance of double taxation between Hong Kong and Russia was signed in January 2016. This should offer added incentives for Russian companies to do business and invest in Hong Kong. Separately, an Investment Promotion and Protection Agreement was signed between Hong Kong and Canada in February, which will help strengthen bilateral economic and trade ties and expand investment flows between the two places.

Box 1.2

The “13th Five-Year Plan” and Hong Kong’s economic development

The “Outline of the 13th Five-Year Plan for the National Economic and Social Development of the People’s Republic of China” (the 13-5 Plan) was endorsed in the fourth session of the 12th National People’s Congress in March this year. The 13-5 Plan outlines the blueprint for national economic and social development in the next five years (2016-2020), with specific goals and major missions. A chapter is again dedicated to Hong Kong and Macao (the Dedicated Chapter), which acknowledges the significant functions and positioning of Hong Kong in the national development, as well as the scope and opportunities for development in a number of key areas.

With the primary goal of “building a moderately prosperous society in all respects”, the 13-5 Plan unveils five tenets of development, namely “innovation”, “co-ordination”, “green development”, “opening up” and “sharing”. It aims to maintain a medium-high pace of economic growth at an average annual rate of over 6.5% during the period covered by the 13-5 Plan, having regard to balanced, inclusive and sustainable development.

- (1) “Innovation” is the primary driving force for development, which encompasses theoretical innovation, institutional innovation, technological innovation, cultural innovation, etc., in support of economic development as well as upgrading and restructuring of the economy.
- (2) “Co-ordination” is an inherent requisite for sustained and sound development, with focus on progressing towards balanced development between urban and rural areas and in socio-economic spheres, aiming for greater coherence in development.
- (3) “Green development” is a requisite for sustainable development, stressing the nation’s strong commitment to the policies of resources conservation and environmental protection.
- (4) “Opening up” fosters the nation’s deeper economic integration with the global economy, with emphasis on striving a balance between domestic and external demand, between importing and exporting, and between “attracting foreign investment” and “going global”, in order to facilitate the development of a more sophisticated open economy.
- (5) “Sharing” ensures that the fruits of development are shared by the people, establishing a stronger sense of ownership among them in the course of co-development, and providing impetus to further development.

The Dedicated Chapter: Support Hong Kong’s development for maintaining its long-term prosperity and stability

The Dedicated Chapter of the 13-5 Plan expresses clear support for Hong Kong in leveraging its unique advantages to enhance its role and functions in the nation’s economic development and opening up. Support is also pledged to Hong Kong in enhancing its economic competitiveness, including consolidating and enhancing Hong Kong’s status as an international financial, transportation and trade centre, strengthening its status as a global offshore Renminbi (RMB) business hub and an international asset management centre, and promoting financing services, business and commerce, logistics and professional services, etc. towards high-end and high value-added developments. In addition, the Dedicated Chapter highlights the support for Hong Kong in developing the innovation and technology industry, nurturing emerging industries as well as establishing itself as a centre for international legal and dispute resolution services in the Asia-Pacific region.

Box 1.2 (Cont'd)

To deepen co-operation between the Mainland and Hong Kong, the Dedicated Chapter expresses support for Hong Kong in participating in the nation's two-way opening up and in the Belt and Road Initiative. It also spells out the Mainland's stepped-up efforts to further open up its markets to Hong Kong and Macao, and promotes the upgrading of the closer economic partnership arrangements with Hong Kong and Macao. Financial co-operation between the Mainland and Hong Kong will be strengthened, facilitating mutual access to the markets of both places. In addition, the Dedicated Chapter proposes the promotion of deeper exchanges and co-operation between Hong Kong and the Mainland in various aspects, in particular pushing ahead co-operation in innovation and technology, and supporting small, medium and micro-enterprises as well as young people of Hong Kong in starting and developing businesses in the Mainland. On regional co-operation, the Dedicated Chapter lays out support for expediting development of Guangdong-Hong Kong-Macao co-operation platform with particular regard to Qianhai, Nansha and Hengqin. It also supports Hong Kong in playing an important role in the Pan-Pearl River Delta (PPRD) Region co-operation, and promotes the development of the Guangdong-Hong Kong-Macao Big Bay Area as well as major co-operation platforms among provinces and regions, with a view to opening up more opportunities for co-operation between Hong Kong and the Mainland.

The Dedicated Chapter not only reaffirms the strong support of the Central Authorities for Hong Kong in maintaining long-term prosperity and stability, but also provides a solid foundation and sound platform for further co-operation between Hong Kong and the Mainland. Over the past five years, with the support of the 12-5 Plan, Hong Kong has made remarkable achievements in fostering economic integration and consolidating its competitiveness. On the trade front, the Government signed the Agreement on Trade in Services with the Ministry of Commerce under the framework of the Mainland and Hong Kong Closer Economic Partnership Arrangement to achieve basic liberalisation of trade in services between the two places. On the financial front, Hong Kong has become a leading international offshore RMB centre. Arrangements such as the Shanghai-Hong Kong Stock Connect and the Mainland-Hong Kong Mutual Recognition of Funds have further enhanced capital market connectivity between Hong Kong and the Mainland. On entering the period covered by the 13-5 Plan, the nation will proceed with the two-way opening up and the Belt and Road Initiative, inducing active inward and outward flows of goods, services, investments and other factors of production. This will in turn drive up the derived demand for financial, logistics, legal and other professional services. Take the offshore RMB business as an example. With the orderly realisation of RMB capital account convertibility and the steady progress of RMB internationalisation, there will be a wider use of RMB in the global arena. This will further expand the respective offshore market and push up the demand for relevant wealth management products and services, bringing substantial development opportunities for related industries in Hong Kong.

The 13-5 Plan holds far-reaching significance for the development of Hong Kong's innovation and technology industry. Along with the nation's on-going efforts in actively promoting innovation as a new economic driver, Hong Kong, with its excellent research and development (R&D) institutes and talent as well as world-class information technology facilities, can work closely with the Mainland in areas such as scientific and technological exchange and R&D results commercialisation, achieving mutual and complementary development. Meanwhile, Hong Kong may act as the "super-connector" in the arena of innovation and technology, serving as a bridge for Mainland enterprises of innovation and technology to enter the international markets.

Box 1.2 (Cont'd)

Regional development serves as an important platform for achieving “co-ordinated development” as stated in the 13-5 Plan, and Hong Kong has a crucial role to play in this aspect. The governments of PPRD provinces/regions, including Hong Kong, signed the “Joint Declaration on Deepening PPRD Regional Co-operation (2015-2025)” to pursue co-operation in areas including infrastructure, commerce and trade, financial services, technology and environmental protection, with a view to bringing the regional comparative advantages into fuller play. At the Plenary of the Hong Kong/Guangdong Co-operation Joint Conference held last year, the two sides reached consensus on the key areas for further co-operation in 2016, which included the Belt and Road Initiative, liberalisation of trade in services, innovation and technology as well as financial services. The Government will continue to maintain close liaison and co-operation with various provinces in pressing ahead with the major initiatives.

With unique advantages under “one country, two systems”, the Government will give full play to its role as the “super-connector” for the nation, in line with the policy of “what the country needs, what Hong Kong is good at”, thereby enabling Hong Kong to capitalise on the new opportunities arising from the 13-5 Plan.

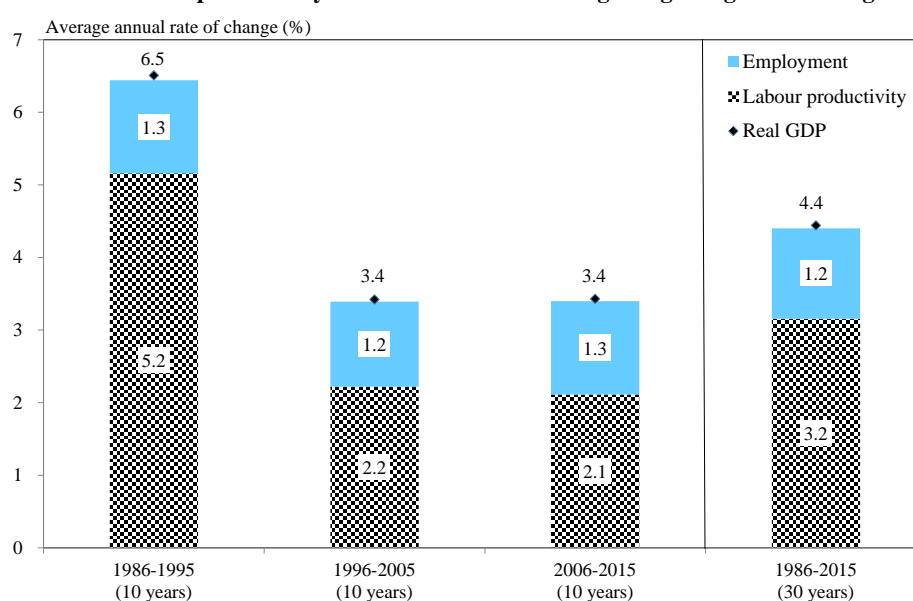
Box 1.3

Labour productivity growth in Hong Kong: a structural perspective

While the short-term growth of an economy is usually subject to cyclical fluctuations from the demand-side, supply-side factors are more crucial in determining its medium and long-term growth trend. Among the supply-side factors, labour productivity⁽¹⁾ has always been the key growth driver of the Hong Kong economy over time. This note attempts to discuss briefly, from a structural perspective, the key elements driving productivity growth.

Over the past three decades, despite undergoing several episodes of ups and downs, the Hong Kong economy grew by 4.4% per annum on average. While employment growth, steady at around an average of 1.2-1.3% per annum in the past decades, made its contribution, a more notable contribution came from labour productivity growth, which averaged 5.2%, 2.2% and 2.1% per annum during 1986-1995, 1996-2005 and 2006-2015 respectively (*Chart 1*).

Chart 1: Labour productivity has been crucial in driving Hong Kong's economic growth



The relatively fast growth in labour productivity over the past three decades was related to the structural transformation of Hong Kong economy, which gradually repositioned itself from a manufacturing hub to an international financial, trading and business centre, focusing more on higher value-added services. The contribution of the services sector to GDP rose from 71% in 1986 to 93% in 2014. Likewise, the share of services employment to total employment climbed up from 55% in 1986 to 88% in 2015. The structural transformation of the Hong Kong economy was particularly rapid during 1986-1995 among the three 10-year periods under study.

The tapering of the transformation pace in the recent past is not surprising as the services sector has already accounted for over 90% of GDP since 2004. Besides the structural shifts among economic sectors, productivity growth could be driven by the skill upgrades of individual sectors. The latter is reflected by the steadily rising proportion of higher-skilled employment in the services sector from around 30% in 1998 to 40% in 2015. This is also a manifestation of the further metamorphosis of Hong Kong into a knowledge-based economy under keen competition in the new era of globalisation and technological advancement.

(1) Labour productivity in this box is defined as the real GDP per employment, which does not account for working hours due to data limitation.

Box 1.3 (Cont'd)

To analyse these effects in more detail, labour productivity growth of Hong Kong during 1986-2015 is further decomposed quantitatively into the two aforementioned components⁽²⁾, i.e. economic restructuring and sectoral upgrading. As shown in **Table 1**, economic restructuring contributed a relatively larger proportion to productivity growth during 1986-1995, i.e. 1.5 percentage points out of the 5.2% average annual growth. Such contribution then narrowed notably, to 0.3 percentage point and 0.1 percentage point respectively during 1996-2005 and 2006-2015. On the other hand, sectoral upgrading has always been the key contributor to productivity growth over the reference period. Notwithstanding its moderation from 3.8 percentage points in 1986-1995 to 2.0 percentage points over the last two decades, it became virtually the sole engine of the overall productivity growth of Hong Kong over the past 10 years.

Table 1: Breakdown of average annual labour productivity growth (%)

	1986-1995	1996-2005	2006-2015
Labour productivity growth	5.2	2.2	2.1
<i>of which due to:</i>			
<i>Economic restructuring</i>	1.5	0.3	0.1
<i>Sectoral upgrading</i>	3.8	1.9	2.0

Note: Figures may not add up due to rounding and/or statistical discrepancy.

Looking ahead, from the supply-side perspective, skills upgrading will remain the key source of Hong Kong's future economic growth. This is particularly so under the threat of population ageing with the labour force being projected to dwindle after 2018, thereby further constraining the economic growth potential originating from demographic dividend.

To enhance labour productivity growth, the Government has strongly committed to investing heavily in human capital and technology and to exploring potential growth areas. In this regard, the 2016-17 Budget has proposed comprehensive measures on nurturing innovation, promoting technology and fostering talent. All in all, the continual improvement in productivity would help build a solid foundation for a more sustainable growth in the future.

On the demand side, the Government will continue to explore new markets and further deepen the economic linkage with the Mainland. The continuous economic reform in the Mainland, its Belt and Road Initiative, and its rebalancing of growth towards services and consumption will unleash massive opportunities for Hong Kong in the decades to come, supporting our move towards a high value-added, knowledge-based economy.

(2) The decomposition formula is:

$$G_t = \sum_i \left[\frac{P_{i,t}}{P_{t-1}} \times (S_{i,t}^L - S_{i,t-1}^L) \right] + \sum_i (S_{i,t-1}^Y \times G_{i,t})$$

where P_t and $P_{i,t}$ denote the labour productivity of the overall economy and sector i in period t respectively, G_t and $G_{i,t}$ denote their respective growth, and $S_{i,t}^Y$ and $S_{i,t}^L$ denote the share of value added and employment of sector i . The first summation on the right hand side represents the productivity growth due to economic restructuring, while the second summation represents the productivity growth due to sectoral upgrading.

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.