

CHAPTER 1 : OVERVIEW OF ECONOMIC PERFORMANCE

Summary

- *The Hong Kong economy regained some momentum in the second quarter of 2016, growing modestly by 1.7% in real terms over a year earlier, up from 0.8% in the preceding quarter. This was largely underpinned by a pick-up in goods exports. On a seasonally adjusted quarter-to-quarter basis, real GDP rebounded distinctly by 1.6% in the second quarter, reversing the 0.5% decline in the preceding quarter.*
- *Global economic growth was still slow in the second quarter, yet reflected some relative improvement from the disappointing start of the year. Regional trade flows also showed initial signs of stabilisation. The UK vote in late June in favour of leaving the EU caused a temporary large sell-off in the global financial markets and worsened the already subdued global outlook, but had little impact on the wider European and global economy in so far as the second quarter is concerned. Against this background, Hong Kong's total exports of goods resumed modest growth in the second quarter, after declining for four consecutive quarters. Meanwhile, exports of services also saw a slightly narrower decline, reflecting reduced drag from the slowdown in inbound tourism and regional trade and cargo flows.*
- *On the domestic front, private consumption expenditure still grew slightly in the second quarter. Meanwhile, the decline in investment expenditure narrowed notably, thanks to the pick-up in overall building and construction works, though private sector machinery and equipment acquisition was still subdued.*
- *The labour market remained remarkably resilient. The seasonally adjusted unemployment rate held unchanged at 3.4% in the second quarter. Wages and earnings sustained further growth. Total employment grew modestly, but signs of slackening labour demand in the trade- and consumption-related sectors continued to be a cause for concern.*
- *The local stock market remained rather volatile in the second quarter, but the range of fluctuation narrowed compared to the preceding quarter. While the UK vote in favour of leaving the EU surprised global financial markets in late June, equity markets stabilised quickly after a brief jittery period. Residential property market activity also rebounded during the second quarter from its low, with prices showing a small increase.*

- *Underlying inflation eased back in the second quarter, thanks to largely moderate local cost pressure and the absence of imported inflation. Looking ahead, barring any unforeseen fluctuations in international energy and food prices, consumer price inflation is expected to remain benign in the near term.*

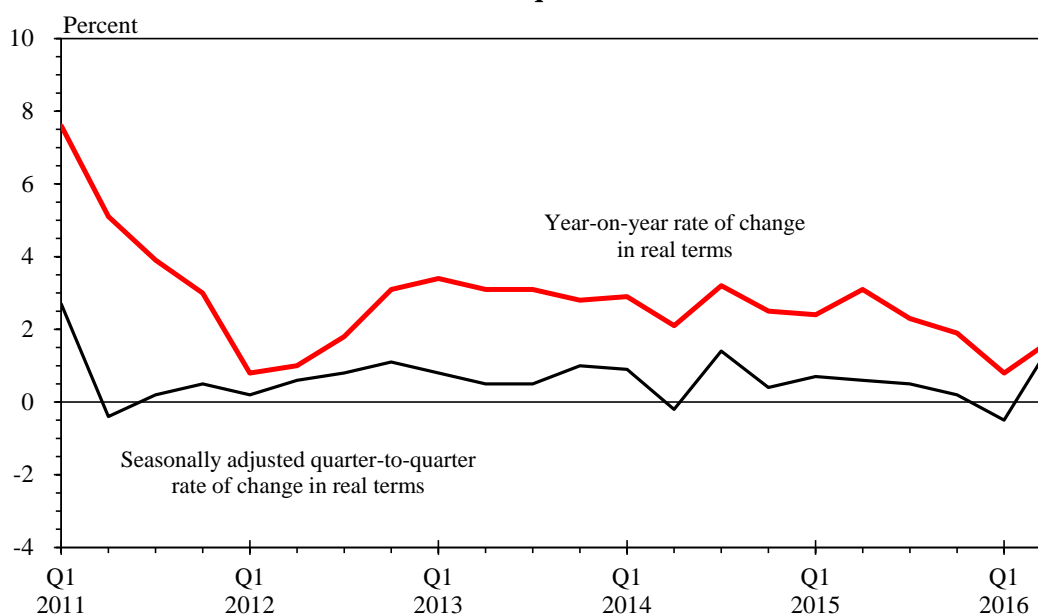
Overall situation

1.1 The Hong Kong economy regained some momentum in the second quarter of 2016, improving from its sluggish performance in the preceding quarter. Global economic activities picked up somewhat relative to the first quarter, notwithstanding the lingering uncertainties associated with the US interest rate normalisation, monetary policy divergence of major central banks, and geopolitical tensions in various parts of the world. The US economy grew slightly faster in the second quarter after a slow start to the year, while the euro area economy expanded moderately. Meanwhile, the Mainland economy sustained steady growth in the second quarter, underpinned by solid domestic demand expansion. The downward pressures on production and trading activities in Asia therefore lessened. Yet, the outcome of the UK vote in favour of leaving the EU in late June surprised global financial markets, causing a brief period of financial jitters. The unexpected event has cast a shadow over the already subdued global outlook, but its impact on the global economy has so far been limited.

1.2 Against this backdrop, Hong Kong's goods exports rebounded modestly in real terms in the second quarter, after experiencing four consecutive quarters of year-on-year decline. Services exports also saw a slightly narrower year-on-year decline, mainly reflecting the stabilisation of regional trade and cargo flows and reduced drag from the slowdown in inbound tourism. Locally, private consumption expenditure still grew slightly notwithstanding relatively cautious economic sentiment, while the decline in investment spending narrowed notably. Labour market conditions also held broadly stable in overall terms, with the unemployment rate staying at a relatively low level. Underlying consumer price inflation eased, alongside modest local cost pressure and the absence of external price pressure.

1.3 In the second quarter of 2016, *Gross Domestic Product (GDP)*⁽¹⁾ grew by 1.7% in real terms over a year earlier, up from the 0.8% growth in the preceding quarter (unchanged from the earlier estimate). For the first half of 2016 as a whole, real GDP expanded by 1.2% year-on-year, following the 2.4% growth in 2015. On a seasonally adjusted quarter-to-quarter basis⁽²⁾, real GDP rebounded more distinctly by 1.6% in the second quarter of 2016, reversing the 0.5% decline in the preceding quarter (revised from the earlier estimate of 0.4%).

Diagram 1.1 : The Hong Kong economy regained some momentum in the second quarter of 2016



The external sector

1.4 *Total exports of goods* compiled under the GDP accounting framework reverted to 2.0% growth in real terms in the second quarter over a year earlier, in contrast to the 3.6% decline in the preceding quarter. Among the advanced markets, exports to the EU rebounded, partly offsetting the continued declines in exports to the US and Japan. Exports to the Mainland reverted to modest growth. Exports to some higher-income Asian economies such as Taiwan and Korea picked up, and those to India registered further double-digit growth. On a seasonally adjusted basis, exports of goods bounced back strongly by 3.3% in real terms in the second quarter over the preceding quarter.

1.5 *Exports of services* extended their decline in the second quarter, but fell at a slightly smaller year-on-year rate of 4.6% in real terms, after a 5.0% drop in the preceding quarter. Exports of travel services saw a narrower decline, reflecting a milder drop in visitor arrivals. Meanwhile, exports of trade-related services staged a slight rebound, and exports of transportation services declined at a softer pace, mirroring some relative improvement in regional trade and cargo flows. On the other hand, exports of financial and other business services registered a larger year-on-year decline, affected by the slowdown in cross-border financial and fund-raising activities and the high base of comparison created by the strong double-digit growth in the second quarter of last year. On a seasonally adjusted quarter-to-quarter basis, exports of services recorded a much narrower decline of 0.2% in real terms in the second 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> [#]	<u>Q2</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)	1.2 (-0.2)	0.6 (0.9)
Government consumption expenditure	3.0	3.4	3.9 (1.0)	3.6 (0.8)	2.8 (0.5)	3.3 (1.0)	3.3 (1.0)	3.4 (0.8)
Gross domestic fixed capital formation	-0.1	-2.0	5.6	3.9	-6.2	-9.4	-9.6	-4.9
<i>of which :</i>								
Building and construction	9.3	2.9	-3.9	14.1	4.2	-0.9	0.2	3.9
Machinery, equipment and intellectual property products	-8.6	-5.8	10.4	-4.7	-10.7	-12.9	-11.9	-11.3
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)	2.0 (3.3)
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)	0.2 (3.5)
Exports of services	1.1	-0.2	0.7 (0.6)	1.6 (-0.8)	-0.2 (-1.1)	-2.7 (-1.4)	-5.0 (-1.9)	-4.6 (-0.2)
Imports of services	1.8	5.7	6.7 (1.8)	5.1 (1.9)	5.5 (0.2)	5.4 (1.4)	4.9 (1.4)	1.1 (-2.0)
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 (-0.5)	1.7 (1.6)
<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)	2.0 (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) [@]	2.6 [@] (-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) [@]	2.3 [@] (0.2) [@]
Change in nominal GDP (%)	5.6	6.2	6.8	7.5	5.8	4.8	3.1	3.8

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.

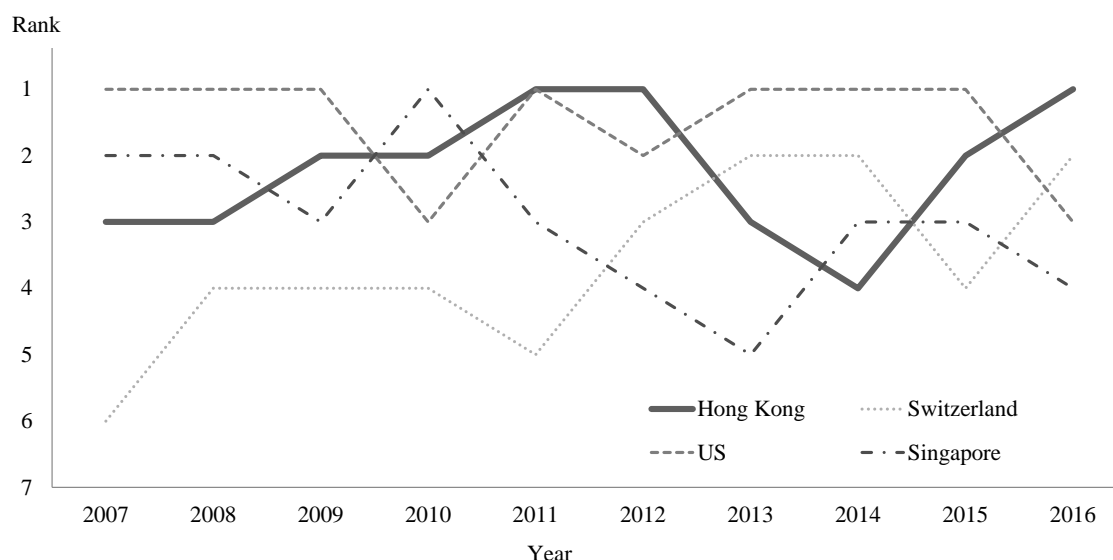
Box 1.1

Competitiveness of the Hong Kong economy

On 30 May, the International Institute for Management Development (IMD) published the World Competitiveness Yearbook (WCY) 2016, assessing the competitiveness of 61 economies worldwide. In the report, Hong Kong is again ranked as the world's most competitive economy⁽¹⁾, improving from the fourth place two years ago. Taking advantage of the release of IMD WCY, this article attempts to briefly analyse Hong Kong's competitiveness in the context of the global economy.

Competitiveness can cover many aspects with studies having different foci, but in the broadest sense it is generally considered as the economy's ability to generate prosperity in a sustainable manner. The competitiveness of an economy depends on the interplay of a wide spectrum of factors, including such structural factors as the economy's natural endowment, physical infrastructure, and regulatory regime. Data on actual economic performance such as trade flows and inflation also reflect the competitiveness situation, though the data for individual years could be affected by many cyclical factors. It is hence a natural consequence that, barring some extreme shocks, the competitiveness of an economy should show a steady trend over time, but with some fluctuations in the short term. The performance of the top four economies in IMD WCY 2016 over the past decade is a useful showcase (*Chart 1*). Although the ups and downs in business cycles may have affected these economies' rankings year-to-year, all of them have managed to stay in the top tier over an extended period of time.

Chart 1 : Rankings of selected economies in the past decade in IMD WCY



Source: IMD World Competitiveness Yearbook (2007-2016).

Studying the underlying components of IMD WCY reveals that each of these highly competitive economies has its own receipt to prosperity (*Table 1*). IMD WCY measures four competitiveness factors and each of them in turn consists of five sub-factors, measuring competitiveness in a total of 20 specific areas. Among the four competitiveness factors, Hong Kong fares exceptionally well in “Government efficiency” and “Business efficiency”, thanks mainly to our steadfast adherence to fiscal discipline and persistent effort in building a favourable business environment with robust financial system. Switzerland and Singapore, being small open economies like Hong Kong, likewise feature “Government efficiency” and

(1) Hong Kong was ranked top for the first time in 2011 and 2012, see *Chart 1*.

Box 1.1 (Cont'd)

“Business efficiency” as their comparative advantages, but also show some strengths in innovation and technology. On the other hand, the US counts more on the sheer size of its economy as well as its unparalleled edge in scientific infrastructure. Indeed, given the different backgrounds and natural constraints, each of these economies pursues its unique route of economic development, and hence has developed its own distinctive strengths.

Table 1 : Detailed rankings of selected economies in IMD WCY 2016

	<u>Hong Kong</u>	<u>Switzerland</u>	<u>US</u>	<u>Singapore</u>
Overall	1	2	3	4
Economic Performance	5	10	1	4
● <i>Domestic Economy</i>	19	9	1	13
● <i>International Trade</i>	2	17	12	1
● <i>International Investment</i>	2	4	1	5
● <i>Employment</i>	13	17	10	4
● <i>Prices</i>	60	51	35	52
Government Efficiency	1	2	25	3
● <i>Public Finance</i>	1	5	49	4
● <i>Fiscal Policy</i>	2	7	29	8
● <i>Institutional Framework</i>	6	1	22	2
● <i>Business Legislation</i>	1	14	13	3
● <i>Societal Framework</i>	25	5	27	19
Business Efficiency	1	3	7	5
● <i>Productivity & Efficiency</i>	7	5	4	10
● <i>Labour Market</i>	1	16	25	8
● <i>Finance</i>	1	3	2	6
● <i>Management Practices</i>	2	3	14	17
● <i>Attitudes and Values</i>	1	8	21	4
Infrastructure	21	3	1	8
● <i>Basic Infrastructure</i>	14	8	5	9
● <i>Technological Infrastructure</i>	14	9	3	1
● <i>Scientific Infrastructure</i>	26	4	1	13
● <i>Health and Environment</i>	17	4	16	25
● <i>Education</i>	13	9	24	4

Note: Each of the sub-factors carries the same weight (i.e. 5%) in the overall results.

Source: IMD World Competitiveness Yearbook 2016.

Box 1.1 (Cont'd)

With the various routes to prosperity, the exact ranking results of different competitiveness league tables could vary due to the differences in emphasis and methodology. For instance, the latest Global Competitiveness Report (GCR) published by the World Economic Forum (WEF) gives a similar assessment that Hong Kong's strengths are the flexible goods and labour markets as well as robust financial system. However, as WEF GCR puts greater emphasis on innovation when measuring competitiveness of the developed economies, Hong Kong only ranked 7th in its overall ranking, while Switzerland, Singapore and the US took the first three spots. As a separate matter, the Chinese Academy of Social Sciences has been conducting an annual study that compares the various aspects of competitiveness across Chinese cities for years. In its latest issue, Hong Kong is ranked first in terms of sustainability and second in terms of general economic competitiveness, as the latter focuses on the size and growth pace of economic activities in the cities.

While each of these competitiveness rankings has its own assessment framework and hence different ranking results, reading across these rankings could serve as a first step to understand the strengths and weaknesses of the Hong Kong economy relative to other advanced economies, and in turn provide insights for policy formulation. To this end, the Government would strive to uphold Hong Kong's prevailing competitive edges that have been earned through conscientious efforts over the years, including simple tax regime with low tax rates, free and open markets, rule of law and clean society, as well as a business-friendly environment. Also, in recent years, the Government has already rolled out a series of measures to cultivate a favourable ecosystem for innovative activities and startups to flourish, including the provision of the necessary financial and land resources. In fact, according to figures released by InvestHK, there were 1 558 local startups as of August 2015, representing an increase of 46% over a year ago.

Enhancing competitiveness is always an ongoing task, a part and parcel of the Government's effort in promoting economic development. In the midst of keen competition in an era of globalisation, we must step up our effort to broaden economic base and move our industries up the value chain, so as to maintain Hong Kong's competitiveness in the global arena and our leading position as a key metropolitan city in the world.

The domestic sector

1.6 The domestic sector saw some improvement in the second quarter. *Private consumption expenditure* grew slightly by 0.6% in real terms in the second quarter over a year earlier, as compared to the 1.2% growth in the preceding quarter. The slower growth mainly reflected the difference in the timing of the Easter holidays between this year and last year, which resulted in a notable deceleration in residents' expenditure abroad in the second quarter. Although consumption sentiment was affected by various economic uncertainties, the broadly stable labour market continued to render support. On a seasonally adjusted basis, private consumption expenditure actually bounced back by 0.9% in the second quarter over the preceding quarter. *Government consumption expenditure* maintained steady growth at 3.4% year-on-year in real terms in the second quarter.

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								
H1	-2.0	0.8	-18.5	-2.5	1.0	9.0	-11.9	0.9
Q1	-2.8	-1.8	-18.7	-3.5	1.2	16.3	-13.9	1.2
Q2	-1.2	2.9	-18.2	-1.5	0.8	2.2	-9.7	0.6

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 : Cautious sentiment still weighed on private consumption expenditure

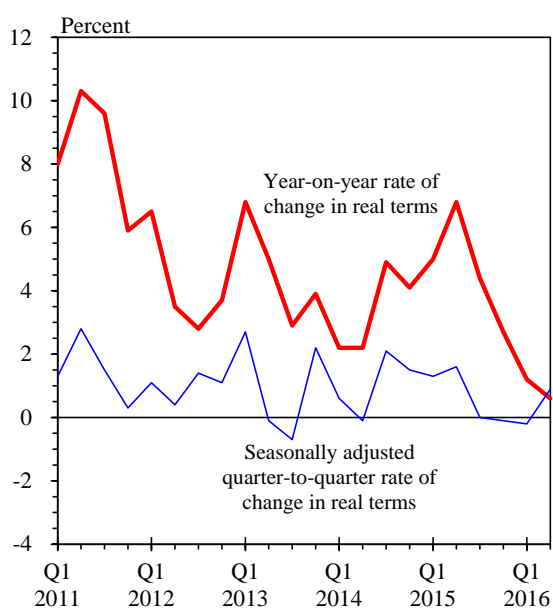
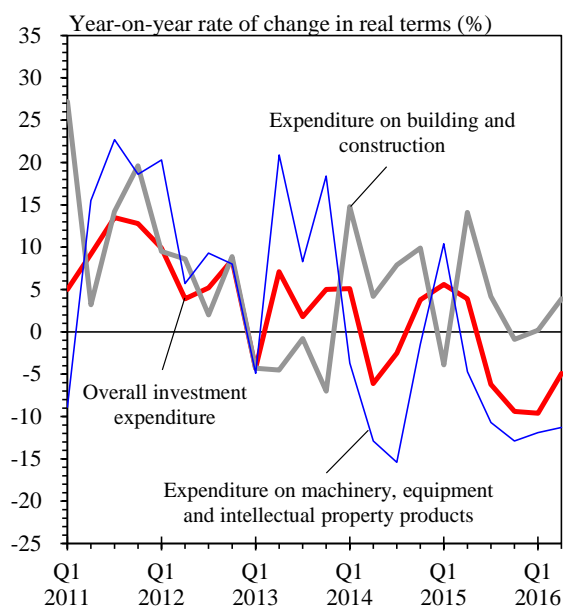


Diagram 1.3 : Investment spending saw a narrower decline



1.7 Overall investment spending in terms of *gross domestic fixed capital formation* declined by a lesser extent, at 4.9% year-on-year in real terms in the second quarter, representing a visible relative improvement after two quarters of near double-digit decline. This was mainly due to a pick-up in overall building and construction expenditure, which grew by 3.9% year-on-year, as public infrastructure works fell at a notably decelerated pace, while private sector building works sustained visible growth. In contrast, private sector machinery and equipment acquisition remained on the downtrend, plunging by 13.1%, reflecting cautious business sentiment amid subdued global economic outlook. Indeed, the latest Quarterly Business Tendency Survey and the consultation on small and medium-sized enterprises (SMEs) (see **Box 1.2** for details of the consultation on SMEs) both indicated that business sentiment in many economic sectors weakened recently.

Box 1.2

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

To gain a better understanding of the current situation of business receipts, employment and credit access for small and medium-sized enterprises (SMEs)⁽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 400 SMEs. This note provides a further update of the results reported in *Box 1.1* in the *First Quarter Economic Report 2016*.

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. From the June 2016 round onwards, SMEs are asked to report whether they have credit need, in addition to whether the access to credit is tight. 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 weakened visibly in recent months and enterprises surveyed generally turned more cautious about the outlook (*Table 1*), conceivably reflecting dimmer global economic prospects after the UK vote in favour of leaving the EU in late June. The overall index fell distinctly from 45.9 in May to 41.0 in June, the lowest level since October 2014, before moving up slightly to 43.6 in July. Most sectors registered readings below the boom-bust mark of 50.0. Specifically, the diffusion indices for the import/export trade and logistics sectors declined visibly since April, before stabilising somewhat in July. Meanwhile, the readings for the retail and wholesale trades remained subdued. The reading for real estate displayed large fluctuations in recent months, but bounced back to the 50.0 neutral mark in July, alongside some rebound in property market activity during the second quarter. As to the employment situation, the feedback from SMEs suggested slightly weaker demand for labour in recent months, which warrants close monitoring (*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 deteriorated distinctly from 47.7 in May to 41.4 in June, before moving somewhat higher to 44.9 in July, partly reflecting the increased uncertainties in the external environment after the UK vote and the still-sluggish external demand conditions (*Table 3*).

Starting in June, as mentioned above, the questions on access to credit have been enhanced for better understanding of the current credit need and credit access situation of SMEs. It is observed that 8.9% of SMEs reported current need for credit in July, among which 69.8% reported easy to fair access to credit, thanks mainly to the generally accommodative monetary conditions and the Government's continued efforts to support SMEs through various loan guarantee schemes. Meanwhile, 9.2% of those SMEs having a credit need reported tight credit access, and 20.9% did not apply for credit (*Table 4*).

(1) Manufacturing enterprises with fewer than 100 employees and non-manufacturing enterprises with fewer than 50 employees are regarded as SMEs in Hong Kong.

Box 1.2 (Cont'd)

Table 1 : Diffusion indices[^] on business receipts

	2015						2016						
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
<i>Local segments</i>													
Restaurants	49.2	46.8	46.7	42.5	43.3	48.3	41.5	45.7	46.6	44.0	41.4	40.2	49.2
Real estate	50.0	38.3	33.3	41.4	36.2	43.1	41.4	50.0	55.2	46.6	53.4	43.8	50.0
Retail trade	44.1	45.0	43.9	47.7	41.9	44.7	42.2	48.5	41.9	38.8	44.2	37.2	39.7
Wholesale trade	38.9	41.7	38.9	41.7	50.0	47.2	38.9	44.4	32.4	32.4	35.3	38.9	41.7
Business services	46.8	46.8	56.5	50.0	48.4	48.4	45.2	51.7	51.7	50.0	51.8	48.5	45.6
<i>External segments</i>													
Import/export trade	49.6	46.9	47.3	46.0	46.0	46.9	46.4	45.0	49.1	50.9	46.3	41.4	44.0
Logistics	44.1	40.6	46.9	46.9	50.0	50.0	50.0	50.0	46.7	46.7	46.4	37.5	39.5
All the above sectors*	46.9	45.3	46.1	46.1	45.0	46.5	44.2	47.2	46.8	45.7	45.9	41.0	43.6

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

	2015						2016						
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
<i>Local segments</i>													
Restaurants	50.0	50.0	50.0	49.2	49.2	50.8	50.0	47.4	50.0	50.9	48.3	45.9	50.0
Real estate	48.3	51.7	45.0	51.7	46.6	46.6	43.1	50.0	51.7	50.0	50.0	50.0	46.1
Retail trade	48.6	49.5	50.0	50.0	50.0	50.0	51.0	48.5	50.0	47.4	49.5	48.7	48.3
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	51.6	51.6	51.6	50.0	48.4	54.8	48.4	48.3	50.0	50.0	50.0	48.5	48.5
<i>External segments</i>													
Import/export trade	49.6	48.2	50.0	50.0	48.2	49.1	49.1	48.2	49.5	50.5	49.5	48.8	48.7
Logistics	52.9	50.0	50.0	50.0	50.0	50.0	50.0	50.0	46.7	43.3	50.0	50.0	44.7
All the above sectors*	49.7	49.5	49.9	50.1	48.8	50.1	49.2	48.6	49.8	49.4	49.6	48.8	48.4

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

Table 3 : Diffusion index on current new export orders

	2015						2016						
	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul
Import/export trade	48.7	47.4	47.3	46.9	47.3	49.1	46.8	46.8	49.5	48.6	47.7	41.4	44.9

Table 4 : Percentage of SMEs with current credit need and their views on credit access[&]

	2016	
	Jun	Jul
All selected sectors* with current credit need	13.0	8.9
<i>Of which:</i>		
Reported easy access to credit	28.0	31.4
Reported fair access to credit	39.7	38.4
Reported tight access to credit	9.6	9.2
Did not apply for credit	22.8	20.9

Notes : (&) The questions on access to credit have been enhanced for better understanding of the current credit need and credit access situation of SMEs. Hence, the results presented in this table are not comparable to those presented in previous reports. It should be noted that the assessment of credit access situation might display great fluctuations from month to month given the small number of SMEs involved, as a great majority of SMEs reported “no credit need” and some did not apply for credit despite having such need; thus the results should be interpreted with caution.

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

The labour sector

1.8 The labour market remained largely stable in overall terms, with the *seasonally adjusted unemployment rate* unchanged at 3.4% in the second quarter. The *underemployment rate* also held steady at 1.4%. Wages and earnings remained on the rise. Total employment sustained a modest year-on-year growth in the second quarter. Yet, the labour demand in the trade- and consumption-related sectors showed further signs of slackening, mirroring the lack of growth in external trade, weakness in inbound tourism and softer local consumer spending.

The asset markets

1.9 The *local stock market* was still rather volatile in the second quarter, but the range of fluctuation was narrower than in the first quarter. In tandem with many overseas stock markets, it saw larger swings immediately after the unexpected outcome of the UK vote in late June. Yet the Hang Seng Index stabilised quickly thereafter and closed the second quarter at 20 794, 0.1% higher than at end-March. Average daily turnover went down to \$62.6 billion in the second quarter, from \$72.7 billion in the preceding quarter. Total equity funds raised also slowed further compared with the preceding quarter amid generally cautious investment sentiment. Nevertheless, Hong Kong still ranked first among the major stock exchanges in the world in terms of the amount of funds raised through initial public offering in the first half of 2016.

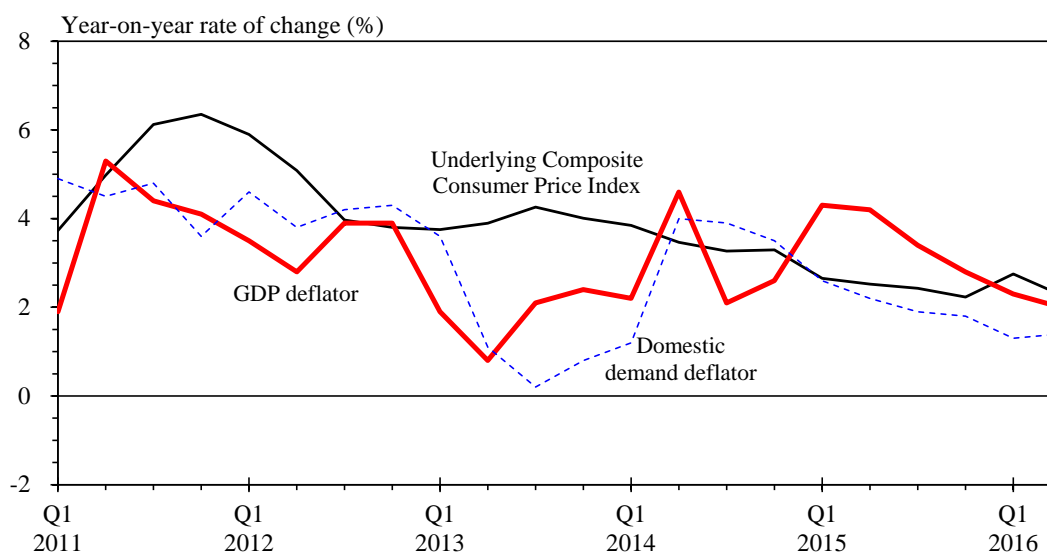
1.10 The *residential property market* rebounded somewhat in the second quarter, especially in terms of trading activity, after undergoing a period of consolidation since the fourth quarter of 2015. Trading turned more active in the second quarter but remained low by historical standards, with the number of residential property transactions at 13 700, up from a low of 6 221 in the preceding quarter. Residential property prices rebounded slightly by 2% between March and June, but were still down by 10% from the peak in 2015. Nonetheless, overall flat prices in June still surpassed the 1997 peak by 59% and the housing affordability ratio stayed elevated at around 56% in the second quarter. During the second quarter, flat rentals went up by 1%, while shop and office rentals showed little change.

Inflation

1.11 Consumer price inflation eased back in the second quarter. Domestic price pressures were kept at bay amid subpar local economic performance. The private housing rental component of the underlying Composite Consumer Price Index and prices of basic foodstuffs registered milder year-on-year increases. Meanwhile, imported inflation was basically absent, thanks to still-low international food and commodity prices and muted inflation in Hong Kong's major import partners. Netting out the effects of the Government's one-off relief measures to more accurately reflect the underlying inflation trend, *underlying composite consumer price inflation* eased from 2.8% in the first quarter to 2.3% in the second quarter. For the first half of 2016 as a whole, underlying inflation averaged 2.5%, similar to that in 2015. *Headline consumer price inflation* also edged lower to 2.6% in the second quarter, from 2.8% in the preceding quarter. Headline inflation averaged 2.7% in the first half of 2016, moderating further from 3.0% in 2015.

1.12 The year-on-year rate of increase in the *GDP deflator* also slowed, to 2.0% in the second quarter. Broken down into components, the domestic demand deflator rose modestly, while the terms of trade improved only marginally.

Diagram 1.4 : Consumer price inflation eased in the second 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 expanded in real terms at a slower year-on-year pace of 1.5% in the first quarter of 2016, after the 1.9% growth in the fourth quarter of 2015, largely mirroring the slowdown in the overall economy. Net output of wholesale and retail trades weakened distinctly, while accommodation and food services relapsed to a decline, alongside the protracted slowdown in inbound tourism and weakening local consumption. Import and export trade, as well as transportation and storage, saw moderation in growth in the first quarter, as the external environment deteriorated. Net output of real estate, which mainly reflects activity of private sector developers and property agencies, continued to fall alongside property market consolidation in the first quarter. Financing and insurance, and professional and business services registered slower growth, while information and communications picked up in activity in the first quarter. As for the secondary sector, net manufacturing output remained on the downtrend. Meanwhile, activity in the construction sector fell further in the quarter, amid a notable drop in expenditure on large-scale public infrastructure works.

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

	<u>2015</u>	<u>2015</u>				<u>2016</u>
		<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>
Manufacturing	-1.5	-1.5	-1.2	-2.1	-1.3	-0.3
Construction	2.0	-5.3	14.8	3.0	-2.3	-1.4
Services ^(b)	1.9	2.3	1.6	1.9	1.9	1.5
Import/export, wholesale and retail trades	-1.1	*	-3.6	-0.5	-0.7	-2.1
Import and export trade	-0.8	0.1	-4.9	-0.1	0.8	0.3
Wholesale and retail trades	-2.2	-0.4	1.4	-2.5	-6.1	-10.7
Accommodation ^(c) and food services	-0.9	-0.5	-1.1	-2.6	0.4	-0.7
Transportation, storage, postal and courier services	1.9	2.4	1.1	1.1	3.0	2.8
Transportation and storage	2.4	2.8	1.4	1.5	3.7	3.0
Postal and courier services	-6.0	-4.6	-4.7	-6.8	-7.6	-1.3
Information and communications	4.0	5.0	4.6	3.5	2.9	3.3
Financing and insurance	6.3	4.9	7.9	6.1	6.2	5.5
Real estate, professional and business services	2.2	4.3	2.1	1.7	1.0	1.1
Real estate	1.4	3.5	2.6	1.4	-1.8	-0.3
Professional and business services	3.0	5.1	1.7	1.9	3.3	2.5
Public administration, social and personal services	2.6	2.3	2.0	3.3	2.9	2.6

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 Hong Kong was ranked as the world's most competitive economy in the International Institute for Management Development World Competitiveness Yearbook 2016, moving up from the second place last year. In particular, Hong Kong continued to rank first in terms of government efficiency and business efficiency, recognising the Government's commitment to upholding a favourable business environment, encouraging innovation through low and simple taxation, and maintaining the free flow of capital. Separately, Hong Kong was ranked second globally for the second consecutive year in terms of foreign direct investment inflows, according to the United Nations Conference on Trade and Development World Investment Report 2016, affirming Hong Kong's role as an international business hub for foreign and Mainland companies.

1.15 In regard to expanding trade ties with new markets along the Belt and Road, the inaugural Belt and Road Summit, jointly organised by the Government and Hong Kong Trade Development Council, was held in Hong Kong in May. Insights into the opportunities brought about by the Belt and Road Initiative were shared. Hong Kong's unique advantages in the areas of professional services and financial services, and its pivotal role in people-to-people exchanges and co-operation with the Mainland in tapping markets were highlighted. In June, the Government announced that a steering committee will be set up to formulate strategies and policies for Hong Kong's participation in the Belt and Road Initiative. A Belt and Road Office will also be established to take forward related studies and co-ordinate work among the Government and other organisations. Besides, the Hong Kong Monetary Authority launched the Infrastructure Financing Facilitation Office (IFFO) in early July, with a view to providing a platform for pooling the efforts of investors, banks and the financial sector to offer comprehensive financial services and facilitate investment in infrastructure projects in countries along the Belt and Road.

1.16 The Government also continued to actively forge economic ties with other overseas markets. In April, Hong Kong and Latvia signed a comprehensive agreement for the avoidance of double taxation. This should offer added incentives for Latvian companies to do business and invest in Hong Kong. In May, the Government announced that Hong Kong will soon commence separate free trade agreement negotiations with Georgia and the Maldives, which will facilitate the tapping of emerging markets with growth potential by Hong Kong companies. A Memorandum of Understanding (MOU) pledging mutual co-operation in investment promotion exchanges and best practices was signed between Hong Kong and Indonesia in the same month, which will help strengthen bilateral economic and trade ties and expand investment flows between the two places. An MOU was also signed with Austria to enhance co-operation in technology start-ups ecosystems.

1.17 On financial development, the Mainland's Ministry of Finance announced in June its plans to issue sovereign bonds totalling RMB28 billion in Hong Kong this year, reinforcing Hong Kong's status as the global RMB offshore business hub. The first batch of RMB14 billion was issued to institutional investors in late June, while the remaining RMB14 billion will be issued in the second half of the year. Separately, the Financial Services Development Council released a report in May, providing recommendations for Hong Kong to consolidate its position as a leading hub for the provision of green finance and investment.

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.