

CHAPTER 1 : OVERVIEW OF ECONOMIC PERFORMANCE

Summary

- *The Hong Kong economy picked up slightly to a 1.9% growth in real terms in the third quarter of 2016 over a year earlier, following a 1.7% growth in the preceding quarter. Domestic demand gathered further pace, while external demand also saw relative improvements.*
- *Global economic growth remained modest in the third quarter, though with the acute risks waning somewhat of late. The US maintained its gradualist approach to monetary policy normalisation and kept interest rates unchanged in the quarter. The contagion effect of Brexit on the global economy also stayed largely contained. With Asia's exports generally stabilising after a weak start earlier this year, Hong Kong's total exports of goods made further growth in the third quarter. Meanwhile, exports of services staged a visible improvement and the year-on-year decline continued to taper, thanks to the stabilisation in regional trade and cargo flows and a revival in initial public offering (IPO) activities. Indeed, on a seasonally adjusted quarter-to-quarter basis, services exports rebounded notably after declining for five consecutive quarters.*
- *Domestic demand strengthened visibly in tandem. Private consumption expenditure regained some momentum in the third quarter, supported by further employment growth and sustained increases in labour earnings. Investment expenditure rebounded strongly, having declined successively for four quarters. Machinery and equipment acquisition reverted to notable growth in the quarter, and overall building and construction works expanded steadily further.*
- *The labour market exhibited much resilience and remained in a state of full employment. The seasonally adjusted unemployment rate stayed low at 3.4% in the third quarter, and household income and earnings sustained gains. Total employment grew further in the third quarter, though with still-weak demand in the trade- and consumption-related sectors.*
- *The local stock market was largely buoyant during the third quarter alongside the rally in major overseas markets. Market sentiment was supported by such developments as the smaller-than-expected contagion effect of Brexit, delays in US interest rate hikes, and the approval of the Shenzhen-Hong Kong Stock Connect implementation plan. The Hang Seng Index rallied to this year's highest level in early September and closed the quarter 12% higher than at end-June. Likewise, the residential property market turned more active in the third quarter, marked by*

increases in both flat prices and trading activities.

- *Inflation pressures remained contained in the third quarter, reflecting moderate domestic cost pressures and the lack of imported inflation. Looking ahead, consumer price inflation is expected to stay modest in the near term, barring renewed upward pressures from a notable rebound in international food and energy prices amid an unsteady global monetary environment.*

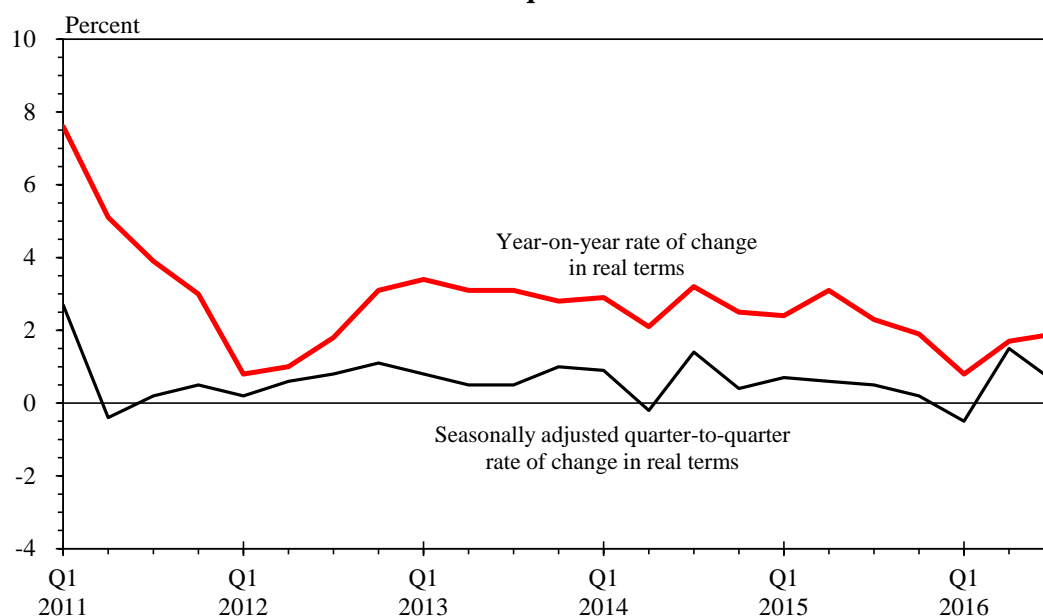
Overall situation

1.1 The Hong Kong economy grew modestly in the third quarter of 2016, underpinned by a strengthening in domestic demand and a relative improvement in the external sector. Global economic growth stayed modest. The US economy grew slightly faster than expected in the third quarter, after the weak performance in the first half of the year. The euro area remained on a modest growth track, as the contagion effect of Brexit has been largely contained so far and it is still highly uncertain whether the UK's formal exit process could be triggered next year. In Asia, the economic recovery in Japan remained fragile, which prompted its central bank to introduce a new monetary policy framework to fend off deflation risks and to consider additional easing moves. But the Mainland economy showed further signs of stabilisation and expanded steadily in the third quarter, on track to attain the official annual growth target. On balance, external headwinds seemed to have abated somewhat during the quarter, though the uncertainties arising from a possible US interest rate hike and the monetary policy divergence among major central banks, together with heightened geopolitical tensions in various regions, will continue to cloud the global economic outlook.

1.2 With global demand staging some modest recovery after a weak start earlier this year, Hong Kong's exports of goods made further growth in the third quarter. Services exports likewise improved upon the stabilisation in regional trade and cargo flows and a revival in IPO activities, though inbound tourism continued to pose a drag. Domestic demand strengthened visibly in the third quarter, with private consumption expenditure regaining some momentum and investment spending bouncing back strongly. Labour market remained in a state of full employment. Underlying inflation eased further, thanks to tame external price pressures.

1.3 In the third quarter of 2016, *Gross Domestic Product* (GDP)⁽¹⁾ grew slightly faster by 1.9% in real terms over a year earlier, after the 1.7% growth in the preceding quarter (same as the earlier estimate). On a seasonally adjusted quarter-to-quarter comparison⁽²⁾, real GDP grew further by 0.6% in the third quarter, following the 1.5% growth in the preceding quarter (revised from the earlier estimate of 1.6%).

Diagram 1.1 : The Hong Kong economy picked up slightly further in the third quarter of 2016



The external sector

1.4 *Total exports of goods* compiled under the GDP accounting framework grew mildly further by 1.9% year-on-year in real terms in the third quarter, broadly similar to that in the preceding quarter. Many markets showed improvements of varying degrees. Exports to the US resumed growth, while those to Japan recorded a much slower decline. Exports to the EU slackened and fell marginally. Yet, the decline in the third quarter was mainly dragged by a further drop in exports to the UK after the Brexit vote. Excluding the UK market, exports to the rest of EU as a whole still registered modest growth. Meanwhile, exports to the Mainland continued to pick up and those to some other Asian markets, including India, Taiwan, Korea and Singapore, registered notable growth. On a seasonally adjusted quarter-to-quarter basis, exports of goods rose further by 0.4% in real terms in the third quarter.

1.5 In tandem with the modest recovery in external demand, *exports of services* likewise improved and the year-on-year decline tapered further to 1.8% in real terms in the third quarter, much narrowed from the 4.6% drop in the preceding quarter. Amid the stabilisation of regional trade and cargo flows, exports of trade-related services grew slightly faster and exports of transportation services rebounded modestly. Meanwhile, exports of financial and other business services saw a much smaller drop, as IPO activities picked up during the quarter. On the other hand, exports of travel services remained the weakest link, still dampened by declines in visitor arrivals. On a seasonally adjusted quarter-to-quarter basis, the improvement was more notable, with exports of services bouncing back strongly by 1.8% in real terms in the third quarter, ending five consecutive quarters of decline.

**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> [#]	<u>Q3</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)	0.5 (0.8)	1.2 (0.7)
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)	3.5 (0.9)	3.3 (0.3)
Gross domestic fixed capital formation	-0.1	-2.0	5.6	3.9	-6.2	-9.4	-9.6	-5.0	6.0
<i>of which :</i>									
Building and construction	9.3	2.9	-3.9	14.1	4.2	-0.9	0.2	3.5	3.4
Machinery, equipment and intellectual property products	-8.6	-5.8	10.4	-4.7	-10.7	-12.9	-11.9	-11.2	6.1
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)	1.9 (0.4)
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)	2.4 (1.3)
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)	-1.8 (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)	4.9 (1.4)	1.6 (-1.5)	1.7 (0.4)
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 (1.5)	1.9 (0.6)
<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)	2.1 (0.7)	1.5 (-0.2)
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) [@]	3.1 [@] (0.4) [@]
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) [@]	2.1 [@] (0.4) [@]
<i>Change in nominal GDP (%)</i>	5.6	6.2	6.8	7.5	5.8	4.8	3.1	3.7	3.4

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 Domestic demand strengthened visibly in the third quarter. Thanks to further employment growth and sustained increases in labour earnings under a broadly stable labour market, *private consumption expenditure* picked up slightly, registering a 1.2% year-on-year growth in real terms in the third quarter, up from the 0.5% growth in the preceding quarter. Over the same period, *government consumption expenditure* maintained a steady year-on-year growth of 3.3% in real terms.

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

		<i>Of which :</i>							
		Total consumer spending in the domestic market ^(a)	Food	Durables	Non- durables	Services	Residents' expenditure abroad	Visitor spending	Private consumption expenditure ^(b)
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	0.6	-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	2.7	-18.1	-1.5	0.8	2.2	-9.7	0.5
	Q3	-0.9	0.3	-11.4	-3.7	1.8	5.2	-9.0	1.2

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 expenditure rose at a slightly faster pace

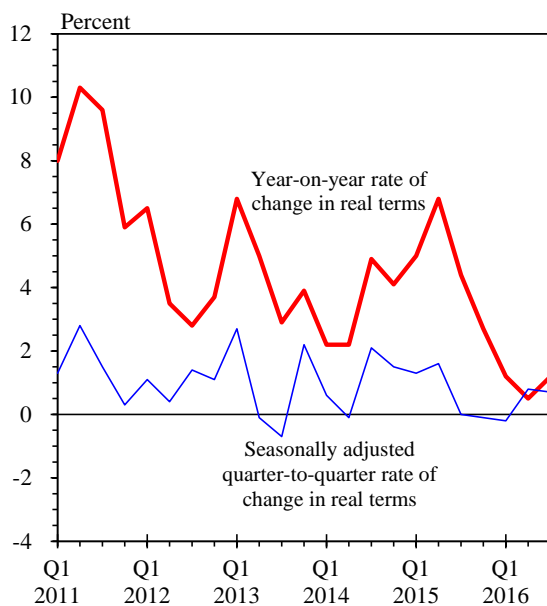
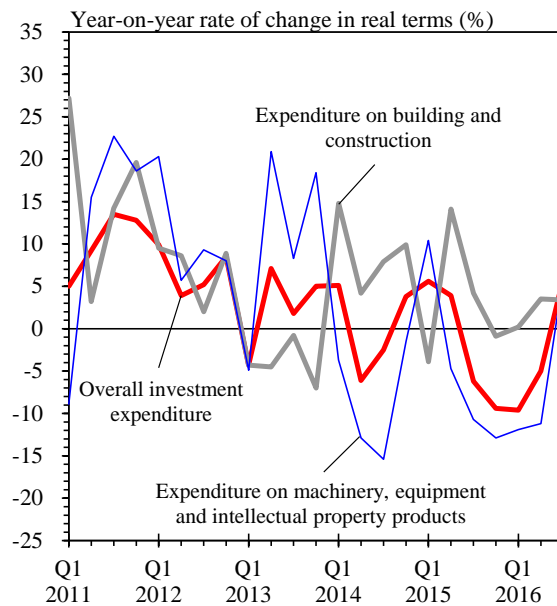


Diagram 1.3 : Investment spending rebounded strongly



1.7 Overall investment spending in terms of *gross domestic fixed capital formation* rebounded strongly by 6.0% year-on-year in real terms in the third quarter, ending the declines in the preceding four quarters. Within this, private sector machinery and equipment acquisition bounced back to an impressive year-on-year growth of 6.7%. Business sentiment seemed to have turned more positive in recent months, as indicated by the results of the latest Quarterly Business Tendency Survey and the diffusion indices on small and medium-sized enterprises (SMEs) (see **Box 1.1** for details of the consultation on SMEs). Overall building and construction expenditure rose steadily by 3.4% year-on-year, as private sector building and construction activity expanded moderately further, while public infrastructure works only dropped marginally.

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 400 SMEs. This note provides a further update of the results reported in *Box 1.2* in the *Half-yearly 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 enterprises surveyed generally remained cautious about the outlook, but with some relative improvement in recent months (*Table 1*). The overall index, albeit still below the boom-bust threshold of 50.0, rose successively from 43.6 in July to 46.6 in September, before moving down marginally to 46.3 in October. Specifically, both the diffusion indices for the import/export trade and logistics generally increased over the past three months, plausibly mirroring signs of improvement in the external trading environment. In regard to the local segments, their performances were mixed, among which the retail trade and business services sectors showed more discernible relative improvements in October as compared to July. As to the employment situation, the feedback from SMEs suggested an overall broadly stable development in recent months (*Table 2*).

For the import/export trade sector in particular, SMEs' views on new export orders were sought separately to help gauge the likely export performance in the near term. The diffusion index on new export orders moved up from 44.9 in July to 47.4 in October, amid the stabilisation in regional trade flows in recent periods (*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. The overall credit situation remained highly accommodative in recent months. In October, 9.2% of SMEs reported current need for credit, and only 0.7% reported tight access to credit. Apart from the generally accommodative monetary conditions, the Government's continued efforts to support SMEs through various loan guarantee schemes also helped (*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 1.1 (Cont'd)

Table 1 : Diffusion indices[^] on business receipts

	<u>2015</u>			<u>2016</u>									
	<u>Oct</u>	<u>Nov</u>	<u>Dec</u>	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>	<u>May</u>	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>
<i>Local segments</i>													
Restaurants	42.5	43.3	48.3	41.5	45.7	46.6	44.0	41.4	40.2	49.2	45.0	47.5	44.1
Real estate	41.4	36.2	43.1	41.4	50.0	55.2	46.6	53.4	43.8	50.0	47.4	55.3	42.1
Retail trade	47.7	41.9	44.7	42.2	48.5	41.9	38.8	44.2	37.2	39.7	43.3	45.3	47.9
Wholesale trade	41.7	50.0	47.2	38.9	44.4	32.4	32.4	35.3	38.9	41.7	50.0	47.2	41.7
Business services	50.0	48.4	48.4	45.2	51.7	51.7	50.0	51.8	48.5	45.6	48.5	47.1	47.2
<i>External segments</i>													
Import/export trade	46.0	46.0	46.9	46.4	45.0	49.1	50.9	46.3	41.4	44.0	45.2	45.2	46.9
Logistics	46.9	50.0	50.0	50.0	50.0	46.7	46.7	46.4	37.5	39.5	47.4	50.0	47.1
All the above sectors*	46.1	45.0	46.5	44.2	47.2	46.8	45.7	45.9	41.0	43.6	45.7	46.6	46.3

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>Oct</u>	<u>Nov</u>	<u>Dec</u>	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>	<u>May</u>	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>
<i>Local segments</i>													
Restaurants	49.2	49.2	50.8	50.0	47.4	50.0	50.9	48.3	45.9	50.0	51.7	48.3	51.7
Real estate	51.7	46.6	46.6	43.1	50.0	51.7	50.0	50.0	50.0	46.1	50.0	51.3	51.3
Retail trade	50.0	50.0	50.0	51.0	48.5	50.0	47.4	49.5	48.7	48.3	49.6	49.6	49.6
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	48.4	54.8	48.4	48.3	50.0	50.0	50.0	48.5	48.5	48.5	48.6	50.0
<i>External segments</i>													
Import/export trade	50.0	48.2	49.1	49.1	48.2	49.5	50.5	49.5	48.8	48.7	49.1	48.2	48.2
Logistics	50.0	50.0	50.0	50.0	50.0	46.7	43.3	50.0	50.0	44.7	50.0	44.4	47.1
All the above sectors*	50.1	48.8	50.1	49.2	48.6	49.8	49.4	49.6	48.8	48.4	49.5	48.8	49.3

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>Oct</u>	<u>Nov</u>	<u>Dec</u>	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>	<u>May</u>	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>
Import/export trade	46.9	47.3	49.1	46.8	46.8	49.5	48.6	47.7	41.4	44.9	46.9	46.5	47.4

Table 4 : Percentage of SMEs with current credit need and reporting tight credit access[&]

	<u>2016</u>				
	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>
All selected sectors*					
With current credit need	13.0	8.9	8.4	9.3	9.2
Reported tight access to credit	1.2	0.8	0.3	0.9	0.7

Notes : (&) The questions on access to credit have been enhanced for better understanding of the current credit need and credit access situation of SMEs. 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”. 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 displayed much resilience and remained in a state of full employment in recent periods, marked by sustained growth in household income and earnings. The *seasonally adjusted unemployment rate* stayed at a low level of 3.4% in the third quarter. Over the same period, the *underemployment rate* also held steady at 1.4%. Total employment grew moderately further over a year earlier. Employment growth was seen in most of the major sectors, though with still-weak demand in the trade- and consumption-related sectors.

The asset markets

1.9 The *local stock market* trended largely upward during the third quarter, in tandem with the rallies in major overseas markets. Favourable factors, including the smaller-than-expected contagion effect of Brexit, delays in US interest rate hikes and the approval of the Shenzhen-Hong Kong Stock Connect implementation plan, propelled the Hang Seng Index to reach its highest level this year in early September, and closed the third quarter at 23 297, up by 12% from end-June. Average daily turnover rose to \$68.3 billion in the third quarter, from \$62.6 billion in the preceding quarter. Fund-raising activity also picked up during the quarter, with total equity fund raised up notably when compared with the preceding quarter. Indeed, taking the first three quarters of 2016 together, Hong Kong ranked first among the major stock exchanges in the world in terms of the amount of funds raised through IPO.

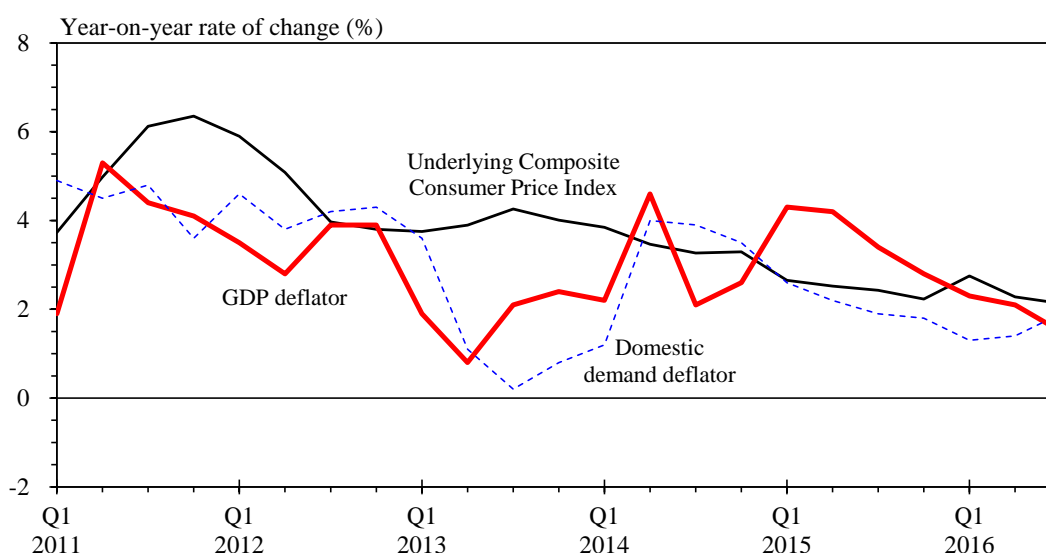
1.10 The *residential property market* put up a brisk performance during the third quarter, with a visible increase in trading activity. The number of residential property transactions rose to 17 890, up 31% over the preceding quarter and marked the highest level since the third quarter of 2014. Residential property prices rose by an accelerated 7% between June and September, and were only 3% lower than the peak in 2015. Overall flat prices in September exceeded the 1997 peak by 71% and the housing affordability ratio worsened again to around 59% in the third quarter. During the third quarter, flat and office rentals rose by 3% and 1% respectively, while shop rentals fell by 1%.

Inflation

1.11 Inflation pressures stayed on an easing trend in the third quarter. On the domestic front, the continued feed-through of earlier year-on-year declines in fresh-letting residential and shop rentals, coupled with steady increases in labour costs, helped contain domestic price pressures. On the external front, imported inflation was basically absent, amid still-low international food and commodity prices and subdued 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 consumer price inflation* eased slightly to 2.1% in the third quarter, from 2.3% in the preceding quarter. *Headline consumer price inflation* went up to 3.1% in the third quarter, from 2.6% in the preceding quarter, but the increase was mainly due to the temporary low base effect resulted from the Government's one-off payment of public housing rentals in August last year.

1.12 The year-on-year rate of increase in the *GDP deflator* slowed further to 1.5% in the third quarter. Within this, the domestic demand deflator rose at a pace broadly similar to underlying consumer price inflation, but the effect of which was more than offset by the concurrent mild decline in the terms of trade.

Diagram 1.4 : Underlying consumer price inflation eased slightly in the third 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 by 2.6% in real terms in the second quarter of 2016 over a year earlier, up from the 1.5% increase in the first quarter. Net output of import and export trade increased at a faster pace, while those of transportation and storage maintained steady growth. The decline in net output of the wholesale and retail trades tapered, while accommodation and food services reverted to modest growth, reflecting the reduced drag from the slowdown in inbound tourism in the quarter. Net output of real estate (mainly reflecting activity of private sector developers and property agencies) bounced back, on the back of a revival in property market activity. Professional and business services, and information and communications saw some acceleration in activity, while financing and insurance registered further moderate growth. As for the secondary sector, net manufacturing output remained on a secular downtrend, while activity in the construction sector showed a modest rebound in the quarter.

**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>	<u>Q2</u>
Manufacturing	-1.5	-1.5	-1.2	-2.1	-1.3	-0.3	-0.4
Construction	2.0	-5.3	14.8	3.0	-2.3	-1.4	2.7
Services ^(b)	1.9	2.3	1.6	1.9	1.9	1.5	2.6
Import/export, wholesale and retail trades	-1.1	*	-3.6	-0.5	-0.7	-2.1	0.5
Import and export trade	-0.8	0.1	-4.9	-0.1	0.8	0.3	2.5
Wholesale and retail trades	-2.2	-0.4	1.4	-2.5	-6.1	-10.7	-6.6
Accommodation ^(c) and food services	-0.9	-0.5	-1.1	-2.6	0.4	-0.7	1.2
Transportation, storage, postal and courier services	1.9	2.4	1.1	1.1	3.0	2.8	3.2
Transportation and storage	2.4	2.8	1.4	1.5	3.7	3.0	3.3
Postal and courier services	-6.0	-4.6	-4.7	-6.8	-7.6	-1.3	2.7
Information and communications	4.0	5.0	4.6	3.5	2.9	3.3	4.0
Financing and insurance	6.3	4.9	7.9	6.1	6.2	5.5	4.6
Real estate, professional and business services	2.2	4.3	2.1	1.7	1.0	1.1	3.4
Real estate	1.4	3.5	2.6	1.4	-1.8	-0.3	2.1
Professional and business services	3.0	5.1	1.7	1.9	3.3	2.5	4.6
Public administration, social and personal services	2.6	2.3	2.0	3.3	2.9	2.6	3.3

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 $\pm 0.05\%$.

Box 1.2

An analysis of the poverty situation of Hong Kong, 2009-2015

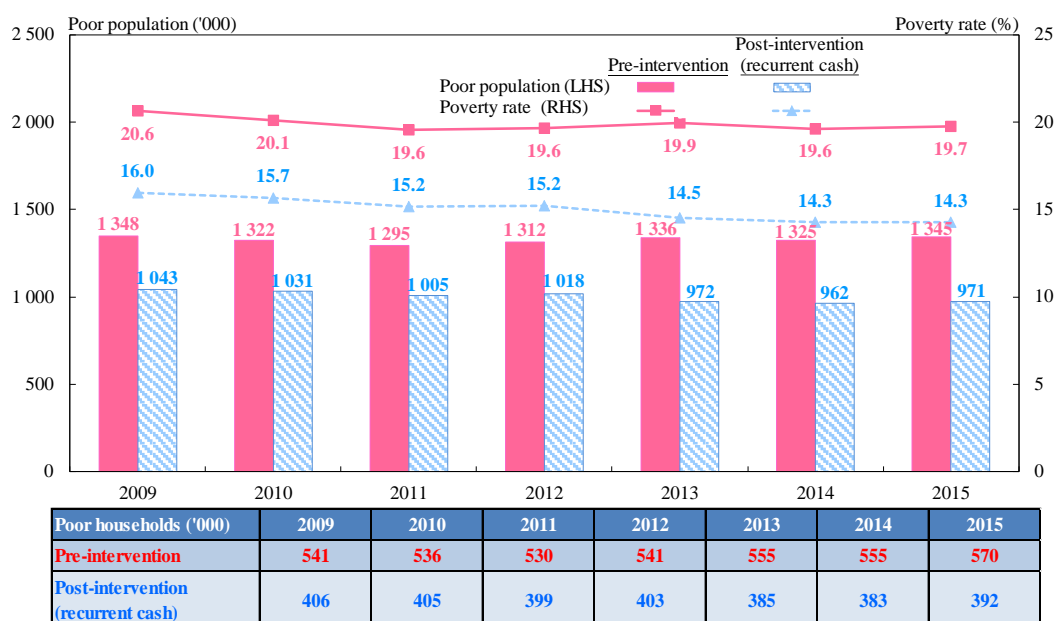
The current-term Government attaches great importance to the poverty issue. As an unprecedented move to demonstrate the Government's commitment to this priority policy area, the first official poverty line was announced by the reinstated Commission on Poverty (CoP) in September 2013, to analyse the poverty situation, assist policy formulation and assess policy effectiveness. Based on the official poverty statistics released annually, this box article analyses the trends in the poverty situation of Hong Kong from 2009 to 2015 with respect to the economic cycles, and discusses the challenges faced by the Government's poverty alleviation work in the future amid the structural trend of population ageing.

The poverty line framework set by CoP

In 2013, the first-term CoP agreed that the poverty line should be based on the concept of "relative poverty" and set at 50% of the median monthly household income before policy intervention (i.e. before taxation and social welfare transfer)⁽¹⁾. On top of the pre-intervention household income, deducting taxes and adding back all recurrent cash benefits gives the post-intervention household income. Households and persons living therein are classified as poor if their household incomes are below the poverty line for the corresponding household size. As such, there are two sets of poverty statistics: pre- and post-intervention; and a comparison of the two sets of poverty indicators facilitates the evaluation of the poverty alleviation impact of the Government's recurrent cash intervention.

Overall trends in the poverty situation of Hong Kong

Chart 1: Poor population and poverty rate, 2009-2015



On the whole, the poverty situation saw improvements between 2009 and 2015, with both the pre- and post-intervention poverty rates⁽²⁾ following general downward trends during the period (*Chart 1*). In 2015, before policy intervention, the size of the poor population and

(1) The poverty line thresholds are set on the basis of household income before policy intervention, so as to avoid distortion by the Government's policy measures, which is in cognisance with one important function of the poverty line, i.e. to assess policy effectiveness. For details of the poverty line and its analytical framework, please refer to **Appendix 1** of the *Hong Kong Poverty Situation Report 2015*.

(2) Poverty rate is the share of the poor population to the total population living in domestic households.

Box 1.2 (Cont'd)

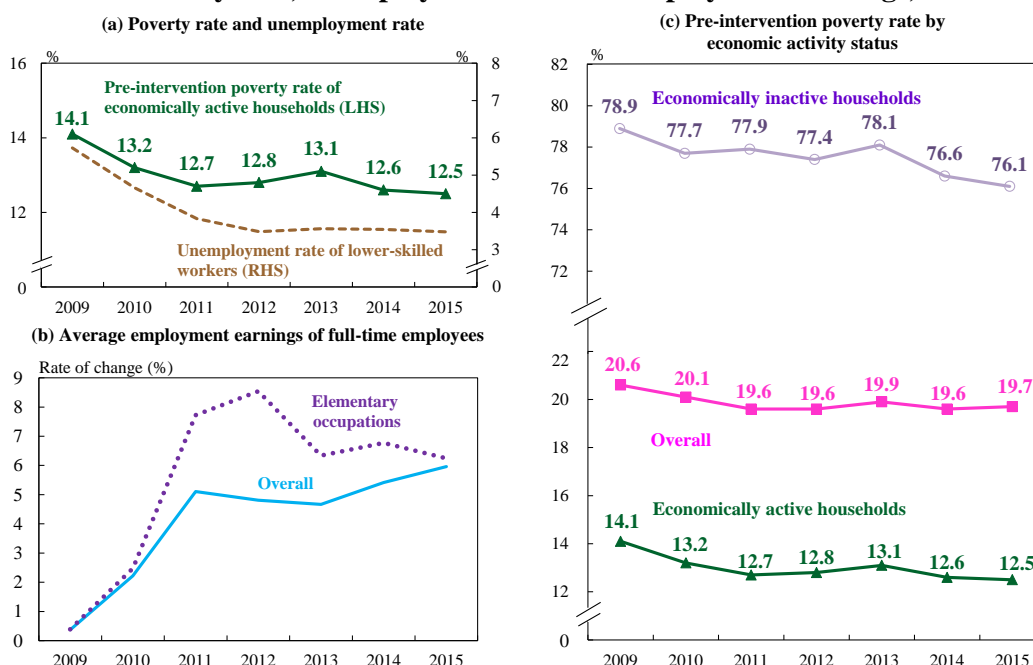
the poverty rate were 1 345 000 and 19.7% respectively. The corresponding poverty figures after policy intervention were 971 400 (the third consecutive year below the one million mark) and a seven-year low of 14.3%, down from 1 043 400 and 16.0% respectively in 2009.

Relationship between poverty and economic cycle

The improvement in the pre-intervention poverty situation is mainly attributable to economic growth and more favourable labour market conditions. The relationship between poverty situation and economic cycle is more discernible when we focus on the poverty rate of economically active households⁽³⁾. With improved economic conditions, these households can conceivably more directly benefit from more job opportunities and sustained income growth, resulting in lower poverty risk.

After the shock of the Global Financial Crisis in 2008, the Hong Kong economy has experienced a speedy recovery since 2010, with an average annual growth rate of 3.6% in real terms. In parallel, the unemployment rate in overall terms and that of lower-skilled workers fell to a low level from 2012 onwards, signifying a state of full employment. This, coupled with the implementation of Statutory Minimum Wage since May 2011 and the upratings in 2013 and 2015, led to notable increase in the employment earnings of grassroots workers. As a result, the pre-intervention poverty rate of economically active households also improved when the unemployment rate and employment earnings had more substantial improvements (*Charts 2a and b*), and it trended down to 12.5% in 2015, at a seven-year low. Specifically, the size of the poor population residing in unemployed and working poor households before policy intervention fell significantly by 53 700 and 20 500 respectively from 2009.

Chart 2: Poverty rate, unemployment rate and employment earnings, 2009-2015



While the overall poverty rate also exhibited decline over the same period, its magnitude of change was smaller due to dilution by poverty statistics of economically inactive households. As the latter do not engage in economic activities, their poverty situation appears to have little direct linkage to the macroeconomic and labour market conditions. With no

(3) Economically active households include working households (households with working member(s)) and unemployed households (households with all members in the labour force being unemployed).

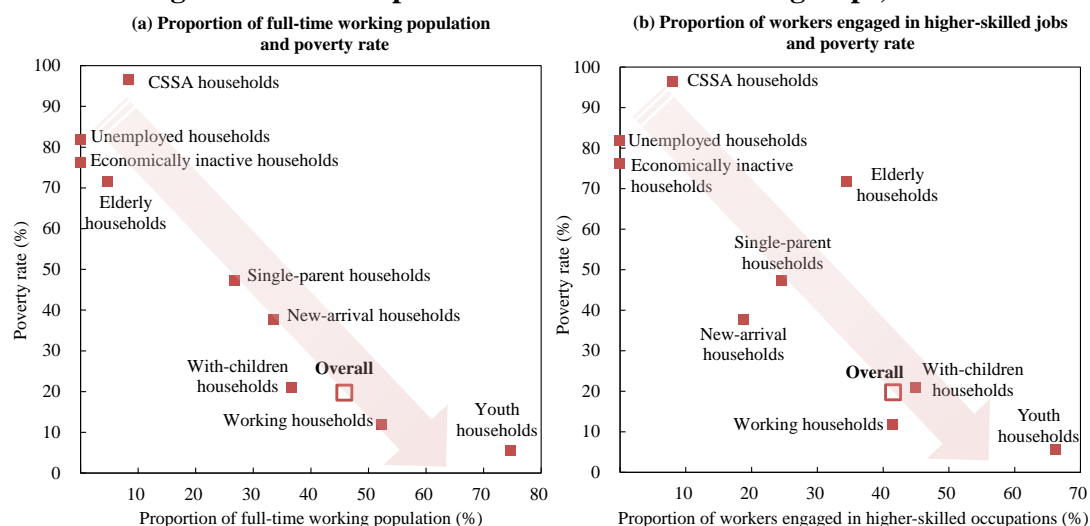
Box 1.2 (Cont'd)

employment earnings, their poverty rate is also far higher than that of their economically active counterparts (*Chart 2c*). Furthermore, measuring poverty solely based on income, the poverty statistics would unavoidably include some “asset-rich, income-poor” persons, especially retired elders, which is a main limitation of the existing poverty line framework that should be borne in mind.

Employment is the best route out of poverty

Further analyses comparing the characteristics among various socio-economic groups reveal that employment is the key to stay away from poverty for those who are available for employment. Taking the 2015 situation for illustration, *Chart 3a* shows that the poverty risk is generally lower for household groups with higher proportions of full-time working population. Also, higher proportions of workers engaged in higher-skilled occupations are associated with lower poverty rates (*Chart 3b*). These demonstrate the importance of employment and skills upgrading to poverty prevention and alleviation.

Chart 3: Proportion of full-time working population / working members engaged in higher-skilled occupations of different household groups, 2015



Note: Poverty rates refer to statistics before recurrent cash intervention.

Increasing Government's poverty alleviation efforts

The Government provides assistance to help those who cannot provide for themselves through the social security system on a reasonable and sustainable basis. Indeed, the recurrent government expenditure on social welfare has risen by nearly 50% between financial years 2009/10 and 2015/16. Taking into account the recurrent cash measures of the Government, the observed post-intervention poverty rate declined by 1.7 percentage points between 2009 and 2015, with its level falling visibly below 15% since 2013, when the Old Age Living Allowance was fully implemented to provide targeted assistance to needy elders.

Indeed, the “actual” extent of poverty reduction during 2009-2015 would be even larger if not masked by changes in demographic factors⁽⁴⁾ over the same period. A decomposition

(4) It should be noted that the change in demographic structure is also a key factor influencing poverty statistics since most elders are retirees with no employment earnings, living alone or with their spouse only. Elderly households take up a substantial (58% in 2015) and rising share of the overall economically inactive households, which feature a poverty rate far higher than that of their economically active counterparts.

Box 1.2 (Cont'd)

analysis of the changes in poverty rate between 2009 and 2015⁽⁵⁾ indicates that the post-intervention poverty rate would have been lowered by 2.51 percentage points due to economic growth, improvement in employment conditions, stronger Government's poverty alleviation efforts, etc., but nearly one-third of the potential poverty reduction was counteracted by the opposite effects brought about by the changes in age structure and the trend toward smaller household size amid population ageing over the past six years (*Table 1*).

Table 1: Decomposition of changes in the poverty rate between 2009 and 2015

Post-intervention poverty rate in 2009	16.0%
Decomposition of changes in the poverty rate between 2009 and 2015	
a. Age structure (Ageing → overall poverty rate↑)	+0.51 % point
b. Household size (Smaller household size↑ → overall poverty rate↑)	+0.29 % point
<i>Sub-total (a + b)</i>	<i>+0.80 % point (-32%)</i>
c. Other factors (including economic performance, the Government's poverty alleviation efforts, etc.)	-2.51 % points
Post-intervention poverty rate in 2015	14.3%

Note: () Figures in parentheses denote the offsetting ratio, i.e. (a + b) / c.

More difficult for poverty rate to decline continuously against a fast ageing trend

The above analyses illustrate that the observed poverty statistics are influenced by a dynamic interplay of factors such as economic cycle, demographic changes and Government measures. Looking forward, the issue of population ageing is set to become more acute, as the proportion of elders is expected to increase from 16% in 2015 to 30% in 2034, thereby posing further upward pressure on the overall poverty statistics, and entailing increasing difficulty for a continuous decline in the future poverty rate.

Concluding remarks

The analyses demonstrate the importance of economic growth, employment and skills upgrading to poverty prevention and alleviation at source. These affirm the direction of the Government's policy to provide more quality jobs by propelling economic development along with reduction in skills mismatch through manpower training, and to encourage employable persons to become self-reliant through employment, while assisting needy persons through social security system. Accordingly, the Government implemented the Low-income Working Family Allowance since May 2016 to relieve the financial burden of working families in need (especially those with children and youths) and encourage active employment. Thanks to economic development with job creation, and the achievements of the current-term Government's efforts in poverty alleviation, the overall post-intervention poverty rate stayed at a seven-year low in 2015. However, persistent population ageing will continue to have a lifting impact on the income-based poverty indicators. The Government is tackling challenges from population ageing on various fronts, and will continue to monitor the poverty situation in Hong Kong, as well as provide appropriate support to the most needy groups.

(5) For details, please see **Box 2.5** of the *Hong Kong Poverty Situation Report 2015*.

Other economic developments

1.14 Hong Kong was again ranked as the world's freest economy by the Fraser Institute in September. In particular, Hong Kong retained the top ranking in terms of the size of government and regulation, and came second in terms of freedom to trade internationally. The Government's steadfast commitment to upholding economic freedom and maintaining an open and free trade and business environment, a small and efficient government, and the rule of law and independent judiciary, are the cornerstones of Hong Kong's economic success and have contributed to enhancing Hong Kong's international competitiveness.

1.15 On consolidating Hong Kong's competitive edge, the Economic Development Commission held its 11th meeting in July, providing insights on possible enhancements to the work of the Government in respect of the key areas mentioned in the chapter dedicated to Hong Kong and Macao in the National 13th Five-Year Plan. Separately, in August, the Government announced its plan to launch a new HK\$200 million Professional Services Advancement Support Scheme in the fourth quarter, to facilitate exchanges and co-operation of the professional services sector with their counterparts in overseas markets and enhance the sector's professional standards and external competitiveness.

1.16 On deepening financial linkages with the Mainland, the Shenzhen-Hong Kong Stock Connect implementation plan was announced in August under the support of the Central Government. It would take about four months to complete the preparations for its formal launch. Exchange-traded funds will be included as eligible securities under the mutual stock market access scheme. These initiatives will consolidate Hong Kong's position as an international financial centre and a premier offshore RMB hub, while facilitating the two-way opening-up of the Mainland's capital markets.

1.17 Regarding innovation and technology, the 11th meeting of the Mainland-Hong Kong Science and Technology Co-operation Committee took place in August to enhance co-operation and encourage entrepreneurship in both places. The 15th Meeting of the Guangdong-Hong Kong Expert Group on Protection of Intellectual Property Rights was held in the same month to strengthen intellectual property (IP) trading and reinforce cross-boundary protection of IP. Separately, in July, the Government announced its plan to launch a HK\$2 billion Innovation and Technology Venture Fund early next year. The Fund will help stimulate private investments in local innovation and technology start-ups.

1.18 On enhancing co-operation with the Pan-Pearl River Delta region, the Government jointly held a business networking luncheon with the provincial governments of Guangdong and Fujian and the Macao SAR Government during the 11th Pan-Pearl River Delta Regional Co-operation and Development Forum and Trade Fair in August, with a view to opening up more business and investment opportunities brought about by Pilot Free Trade Zones. In addition, the Ninth Hong Kong-Macao Co-operation High Level Meeting was held in July. A Working Group on Enhancing Hong Kong-Macao Economic Co-operation will be set up to strengthen co-operation in areas such as trade, professional services and tourism, as well as to promote 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.