

CHAPTER 1 : OVERVIEW OF ECONOMIC PERFORMANCE IN 2016

Summary

- *The Hong Kong economy expanded at a slower pace in 2016 as global economic growth pace weakened to its lowest level since 2009. Yet, after a notable slackening in the first quarter of 2016, the economy regained momentum, picking up successively in growth to 3.1% in the fourth quarter, riding on the improvement in external economic environment. For 2016 as a whole, the economy grew by 1.9%, somewhat slower than the 2.4% growth in 2015.*
- *The economic performance during 2016 was characterised by resilience in domestic demand and a low start in external demand with a subsequent visible rebound. The labour market was in a state of full employment all through 2016, while inflation eased for the fifth consecutive year.*
- *The external trading environment was particularly difficult in early 2016, but staged some improvement subsequently, led by stronger US demand and steady growth in the Mainland economy. The UK vote in June to leave the EU caught the markets by surprise, but the contagion impact remained largely contained till end 2016. Along with the general recuperation of Asia's trade flows, Hong Kong's total exports of goods revived after a distinct fall-off in the first quarter, with a particularly impressive growth in the fourth quarter, yielding a modest growth for 2016 as a whole.*
- *Exports of services slackened in 2016, posting the first annual decline since 1998, dragged mainly by notable fall-off in inbound tourism. Yet, as the global economic environment turned more benign and as visitor arrivals bottomed out, exports of services generally improved during the year, reverting to growth by the fourth quarter. Amongst the key components, the fall in exports of travel services posed a significant drag, being affected by subpar regional growth, strong currency and the effect of the "one trip per week" Individual Visit Endorsements. Exports of financial services and exports of business and other services were likewise sluggish, though faring better towards the year-end. Exports of transport services were the brighter spot, benefitting from improved regional trade flows during the year.*
- *The domestic sector stayed resilient in 2016 despite the various external uncertainties. Private consumption expenditure registered further growth, buttressed by continued favourable employment and labour income conditions. Investment expenditure fell off consequential to the economic slowdown in early 2016, but rose again in the second half on the back of the*

economic growth pick-up. For 2016 as a whole, investment expenditure still registered a slight decline.

- The labour market was in a state of full employment throughout the year, notwithstanding the slowdown in inbound tourism and weakness in retail sales. Total employment for 2016 as a whole rose to a new annual high. The seasonally adjusted unemployment rate edged down to 3.3% in the fourth quarter of 2016. Against this background, wages and earnings attained another year of real improvements.*
- The local stock market remained volatile in 2016. Local stock prices came under pressure at the beginning of the year, but rallied during the second and third quarters, supported by such developments as the smaller-than-expected contagion effect of Brexit, delays in US interest rate hikes and the approval of Shenzhen-Hong Kong Stock Connect implementation plan. Towards the end of the year, the Hang Seng Index again consolidated, finishing 2016 almost flat from a year earlier, amid renewed market wary over imminent US interest rate hikes. Residential property market activity rebounded after the second quarter, but cooled off notably towards the year end after the Government's introduction of another round of demand-side management measure in early November and US interest rate hike in December.*
- Inflation eased slightly further in 2016, thanks to the generally soft domestic and external price pressures. For 2016 as a whole, underlying inflation edged down to 2.3% from 2.5% in 2015, marking the fifth consecutive year of easing.*

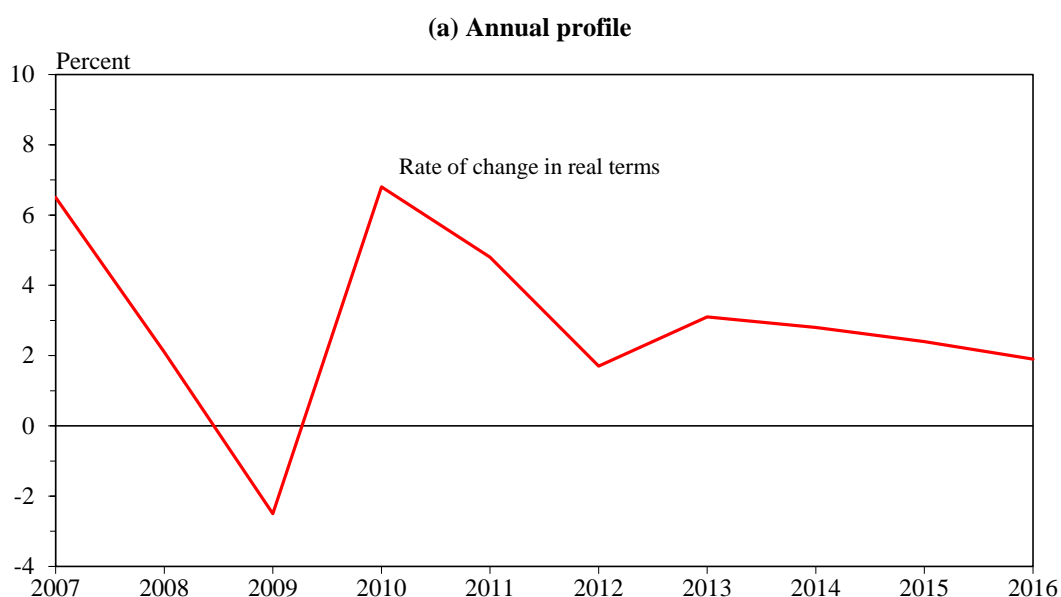
Overall situation

1.1 The Hong Kong economy made only moderate growth in 2016, mainly dragged by the external headwinds from a slowly growing global economy. Yet, the growth pace picked up successively after the first quarter alongside the relative stabilisation in the external environment. The US economy strengthened in the second half, bolstering confidence for the Federal Reserve to hike rates in December. Moreover, the solid expansion of the Mainland economy continued throughout the year. The impact of the Brexit vote as well as political developments in the major advanced economies towards the end of the year was contained insofar as 2016 was concerned, although the associated uncertainties lingered on. In tandem with the stabilisation in regional trade flows, Hong Kong's exports of goods rebounded after the first quarter and picked up further to attain a modest growth in real terms in 2016 as a whole. Exports of services weakened and registered a

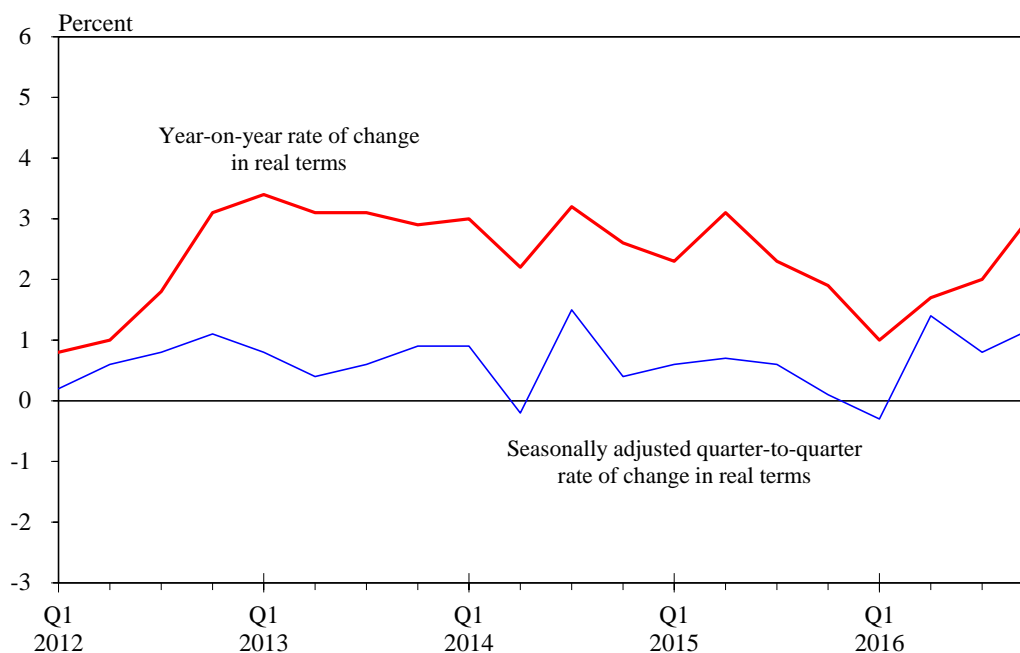
decline, dragged mainly by the subdued inbound tourism, though also seeing a recovery in the fourth quarter. The domestic sector showed remarkable resilience. Favourable employment and labour income conditions supported further private consumption growth, while investment spending also bounced back strongly in the second half. The underlying inflation rate eased slightly, marking the fifth consecutive year of declines.

1.2 For 2016 as a whole, *Gross Domestic Product* (GDP)⁽¹⁾ grew moderately by 1.9% in real terms, slower than the 2.4% growth in 2015. In terms of the quarterly profile, the year-on-year growth rate of real GDP picked up from 1.0% in the first quarter to 1.7% and 2.0% respectively in the second and third quarters, and reached 3.1% in the fourth quarter on the back of improving external sector and strengthening domestic demand. On a seasonally adjusted quarter-to-quarter comparison⁽²⁾, real GDP fell by 0.3% in the first quarter, and then rebounded markedly by 1.4% in the second quarter, before growing further by 0.8% and 1.2% respectively in third and fourth quarters.

Diagram 1.1 : The Hong Kong economy continued to grow moderately in 2016



(b) Quarterly profile



The external sector

1.3 *Total exports of goods*, compiled under the GDP accounting framework based on the change of ownership principle (see **Box 1.1** for details), rose modestly by 1.7% in real terms in 2016, after a slight decline of 1.7% in 2015. The movements of total exports of goods under the GDP accounting framework are broadly similar to those compiled under the external merchandise trade statistics. In terms of quarterly profile, total exports of goods declined by 3.5% year-on-year in real terms in the first quarter, and rebounded by 2.3% in the second quarter, with growth picking up notably from 2.4% in the third quarter to 5.1% in the fourth quarter, in tandem with the improvement in regional trade flows. On a seasonally adjusted quarter-to-quarter comparison, after falling visibly in the first quarter, total exports of goods rebounded in the second quarter, rose slightly in the third quarter and picked up notably in the fourth quarter.

1.4 Analysed by major market, by reference to external merchandise trade statistics, exports to Asian markets generally picked up over the course of 2016, as the relative stabilisation in global demand during the year led to increased intake of raw materials and semi-manufactures in the region. For 2016 as a whole, exports to the Mainland rebounded modestly, with performance strengthening progressively to a visible growth in the fourth quarter. Furthermore, exports to Taiwan surged; those to Singapore grew solidly, while exports to Korea reverted to a slight growth. The Indian market displayed notable growth for the fourth consecutive year. In stark contrast, exports to the major advanced economies remained subdued in 2016. Exports

to the US slackened distinctly in the first quarter, and though with some subsequent relative improvement, for 2016 as a whole, the US market still saw a slight decline. Exports to the EU were held back by persistent weak demand there, with the weakness exacerbated by the continued fall-off in the UK market after the Brexit vote. Exports to Japan were still sluggish for most of 2016, with only some marginal improvements in the fourth quarter.

1.5 *Exports of services* slackened to a 3.1% decline in real terms in 2016, marking the first annual decline since 1998. After a rather weak start, the performance turned better in the second half, staging a slight year-on-year growth in the fourth quarter, thanks to the more benign global economic environment and bottoming out of visitor arrivals. In 2016, exports of travel services fell more notably to pose an even bigger drag, under a host of factors from subpar regional growth, strong US dollar and the effect of “one trip per week” Individual Visit Endorsements. Exports of financial services also worsened, while exports of business and other services were mostly sluggish, both held down by the difficult global economic environment. A relatively brighter spot was exports of transport services, which saw a notable pick-up in the second half of the year, benefitting from the recovery of regional trade and cargo flows.

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

	<u>2015[#]</u>	<u>2016⁺</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>	<u>Q4⁺</u>
<i>Change in real terms of GDP and its main expenditure components (%)</i>										
Private consumption expenditure	4.8	1.6	4.9 (1.4)	7.1 (1.8)	4.5 (*)	2.8 (-0.4)	1.5 (0.2)	0.3 (0.6)	1.2 (0.9)	3.2 (1.5)
Government consumption expenditure	3.5	3.3	4.0 (1.1)	3.7 (0.7)	2.8 (0.6)	3.3 (0.9)	3.2 (0.9)	3.4 (0.9)	3.3 (0.5)	3.3 (1.0)
Gross domestic fixed capital formation	-3.2	-0.5	4.5	3.0	-7.3	-10.9	-8.7	-5.0	6.7	5.2
<i>of which :</i>										
Building and construction	2.2	3.6	-4.6	13.7	3.2	-1.4	1.4	2.5	3.5	6.9
Machinery, equipment and intellectual property products	-7.7	-4.6	8.7	-6.3	-12.1	-15.6	-10.9	-10.3	7.6	-4.2
Total exports of goods ^{&}	-1.7	1.7	0.6 (-0.1)	-4.0 (-3.0)	-3.0 (0.7)	-0.4 (1.6)	-3.5 (-2.4)	2.3 (2.8)	2.4 (0.7)	5.1 (3.9)
Imports of goods ^{&}	-2.7	1.0	0.2 (-1.7)	-3.5 (-2.8)	-4.2 (-0.6)	-2.9 (1.8)	-5.5 (-3.7)	0.6 (3.5)	3.1 (1.8)	5.5 (4.0)
Exports of services ^{&}	0.3	-3.1	1.3 (1.1)	2.8 (-0.1)	0.7 (-1.9)	-3.4 (-2.5)	-5.6 (-1.1)	-5.8 (-0.3)	-2.4 (1.6)	1.4 (1.2)
Imports of services ^{&}	5.1	1.9	6.1 (2.4)	4.7 (1.8)	4.6 (-0.1)	4.9 (0.6)	4.0 (1.5)	1.1 (-1.0)	0.7 (-0.3)	1.8 (1.6)
Gross Domestic Product	2.4	1.9	2.3 (0.6)	3.1 (0.7)	2.3 (0.6)	1.9 (0.1)	1.0 (-0.3)	1.7 (1.4)	2.0 (0.8)	3.1 (1.2)
<i>Change in the main price indicators (%)</i>										
GDP deflator	3.7	1.8	4.3 (1.2)	4.3 (1.0)	3.4 (0.3)	2.8 (0.4)	2.1 (0.5)	1.9 (0.6)	1.5 (0.1)	1.6 (0.5)
Composite CPI										
Headline	3.0[@]	2.4[@]	4.4 (0.2)[@]	3.0 (-0.5)[@]	2.3 (-0.1)[@]	2.3[@] (2.7)[@]	2.8[@] (0.7)[@]	2.6[@] (-0.6)[@]	3.1[@] (0.4)[@]	1.2[@] (0.7)[@]
Underlying[^]	2.5[@]	2.3[@]	2.7 (0.2)[@]	2.5 (0.7)[@]	2.4 (0.5)[@]	2.2[@] (0.9)[@]	2.8[@] (0.7)[@]	2.3[@] (0.2)[@]	2.1[@] (0.5)[@]	2.1[@] (0.7)[@]
<i>Change in nominal GDP (%)</i>	6.1	3.8	6.8	7.5	5.8	4.7	3.1	3.6	3.5	4.8

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.

(&) Figures are compiled based on the change of ownership principle in recording goods sent abroad for processing and merchandising under the standards stipulated in the *System of National Accounts 2008*.

(#) 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 new 2014/15-based CPI series.

Box 1.1

Change in dissemination of the Hong Kong's gross domestic product (GDP) statistics

Starting from February 2017, the Census and Statistics Department (C&SD) will present the statistics on trade in goods and services compiled based on the change of ownership principle in the main statistical tables of C&SD's regular report on Hong Kong's Gross Domestic Product (GDP). These trade statistics were previously presented in the supplementary tables of C&SD's reports on GDP. The adoption of the change of ownership principle in compiling trade statistics within the GDP framework follows closely the prevailing international standards given in the *System of National Accounts 2008*, which is the latest version of the international statistical manual on the compilation of national accounts statistics. This short article attempts to recap the key features of the trade statistics based on the change of ownership principle. More details can be found in C&SD's *Special Report on Gross Domestic Product – September 2012*.

Simply put, the adoption of the change of ownership principle is a technical amendment to the ways of recording trade in goods (TIG) and services (TIS) related to (i) goods sent abroad for processing (outward processing); and (ii) merchanting⁽¹⁾. Following this principle, goods sent abroad for processing and subsequently returned to Hong Kong will no longer be recorded as TIG. Instead, the fees paid to the processing units will be recorded as imports of services. Meanwhile, merchanting will be re-classified as TIG, instead of TIS⁽²⁾.

Adopting the change of ownership principle can better reflect the latest trend in globalisation and the genuine trade flows irrespective of the goods' physical movements and locations. This is particularly relevant since outward processing and merchanting activities feature prominently in Hong Kong's trade structure with our traders' extensive trading network of buyers and sellers in the global market.

Based on the above re-classification, the trade deficit in goods would be smaller, due to the exclusion of trade in goods for processing and the inclusion of the net value of goods under merchanting. Similarly, the trade surplus in services would likewise be smaller, after the exclusion of exports of merchanting services and the inclusion of imports of manufacturing services (**Charts 1 and 2**). The ratio of total trade to GDP compiled according to the change of ownership principle is also slightly lower than before. For instance, such a ratio in 2016 was 372.8%, compared to 382.2% compiled according to the previous standards.

Chart 1 : Balance of trade in goods

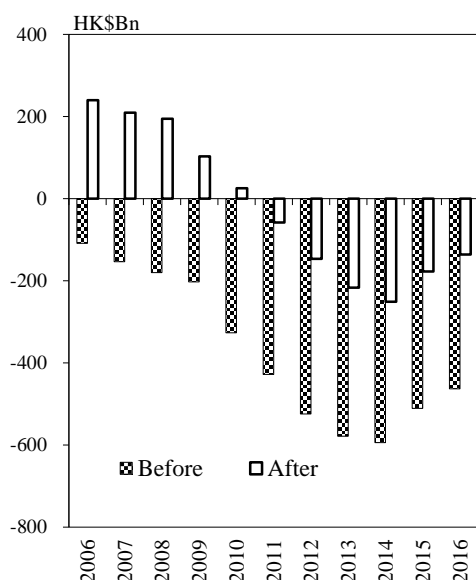
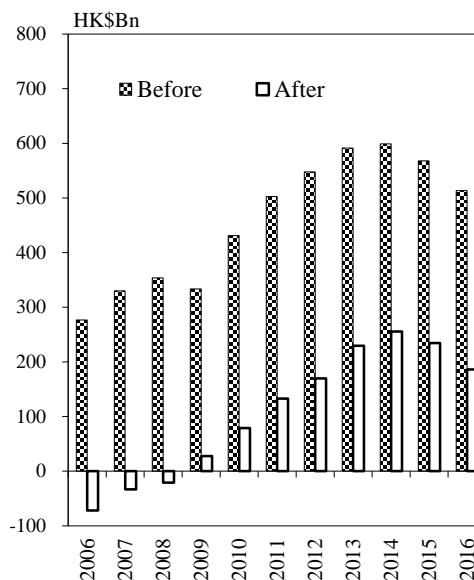


Chart 2 : Balance of trade in services



Box 1.1 (Cont'd)

Nevertheless, as the adoption of the change of ownership principle only involves re-classification of components in TIG and TIS, **the overall trade balance of goods and services remains unchanged. The level and the growth rate of overall GDP are also unaffected.** Regarding the past trends of the trade-related variables, it can be observed that the year-on-year rates of changes in exports of goods and services compiled based on adopting the change of ownership principle are broadly similar to those based on the previous standards (*Charts 3 and 4*), and so is the case for imports of goods and services.

Chart 3 : Exports of goods

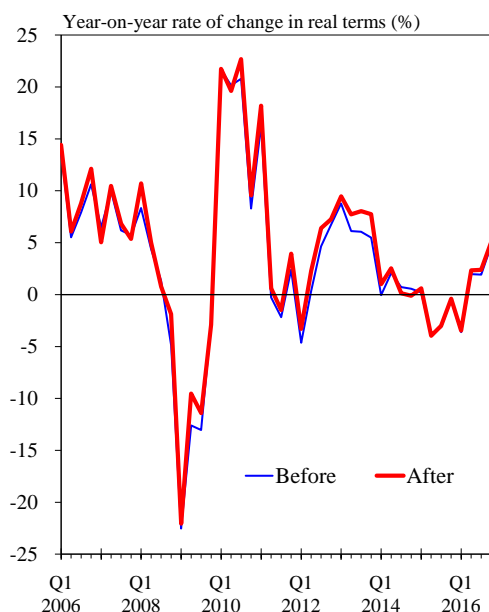
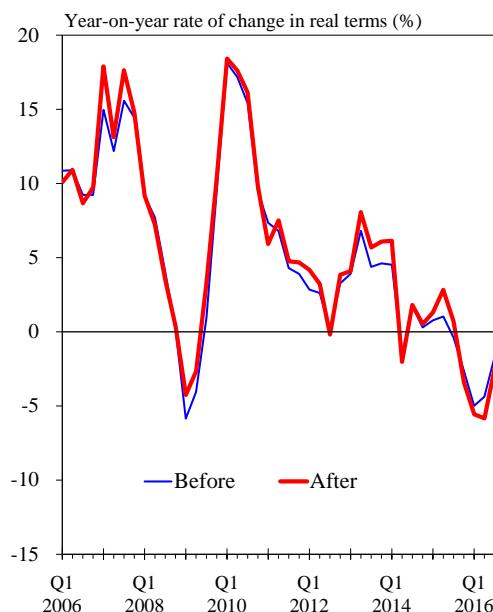


Chart 4 : Exports of services



Given that the statistics adopting the change of ownership principle were first released back in 2012, sufficient time should have been allowed since then for users to understand the new series. Also, as an increasing number of statistically advanced economies, such as the UK, Australia, the US and Singapore, have gradually adopted the change of ownership principle, the present switch by C&SD in the presentation of trade statistics in the context of GDP follows closely this international statistical development. The original set of statistics not adopting the change of ownership principle will still be presented in the supplementary tables in the routine publications for readers' reference.

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- (1) Item (i) refers to the arrangement by a Hong Kong company to send raw materials or semi-manufactures abroad for processing, with the processed goods later returned to Hong Kong for local consumption or re-exporting. The goods sent abroad for processing and the processed goods subsequently returned to Hong Kong remained to be owned by the Hong Kong company. Offshore trade activities involving outward processing are also included. Item (ii) refers the purchase of goods by a Hong Kong trader from a non-resident and subsequent resale of the goods to another non-resident without the goods entering or leaving Hong Kong.
 - (2) According to the old principle, TIG statistics records imports and exports of goods at the time they cross Hong Kong's borders. Hence, the materials sent abroad for processing are recorded as exports and the returned goods as imports. For now, these goods are not recorded as TIG as they do not involve actual buying and selling (i.e. no change of ownership is involved). Similarly, as a change of ownership is involved in goods traded under merchanting, the value of goods sold is recorded as exports of goods while the value of goods acquired for resale as negative exports of goods.

The domestic sector

1.6 Domestic demand displayed much resilience in 2016, marked also by a progressive strengthening during the year. *Private consumption expenditure* was a key growth driver, expanding by 1.6% in real terms in 2016, after the 4.8% growth in 2015. Private consumption turned stronger gradually in the latter half of the year, as sustained rises in employment and labour earnings supported local consumption sentiment. Meanwhile, *government consumption expenditure* sustained steady growth of 3.3% in real terms in 2016, similar to those in the preceding years.

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

Of which :

		Total consumer spending in the domestic market ^(a)	Food	Durables	Non- durables	Services	Residents' expenditure abroad	Visitor spending	Private consumption expenditure ^(b)
2015	Annual	2.7	1.9	5.9	0.7	3.1	13.1	-3.2	4.8
	H1	4.1	3.1	11.7	1.7	3.9	12.5	-1.5	6.0
	H2	1.3	0.6	0.7	-0.2	2.3	13.6	-4.7	3.6
	Q1	2.9	3.7	7.1	1.3	2.7	11.6	-2.7	4.9
	Q2	5.4	2.7	18.7	2.1	5.1	13.4	-0.2	7.1
	Q3	2.2	0.7	5.0	0.8	2.5	14.8	-3.2	4.5
	Q4	0.4	0.6	-2.4	-1.2	2.1	12.4	-6.1	2.8
2016	Annual	-0.6	0.9	-15.3	-0.7	2.1	6.9	-8.5	1.6
	H1	-1.8	0.6	-18.5	-2.5	1.2	9.0	-11.1	0.9
	H2	0.6	1.2	-12.1	1.0	2.9	4.8	-5.8	2.2
	Q1	-2.4	-1.8	-18.7	-3.4	1.9	16.3	-13.2	1.5
	Q2	-1.3	2.7	-18.1	-1.5	0.6	2.2	-8.8	0.3
	Q3	-0.6	0.3	-11.4	-3.7	2.4	3.9	-7.9	1.2
	Q4	1.8	2.0	-12.6	5.2	3.5	5.8	-3.8	3.2

Notes : (a) Consumer spending in the domestic market comprises both local consumer and visitor spending, which are not separable from the survey data.

(b) Private consumption expenditure is obtained by deducting visitor spending from the total consumer spending in the domestic market, and adding back residents' expenditure abroad.

Diagram 1.2 : Private consumption held firm

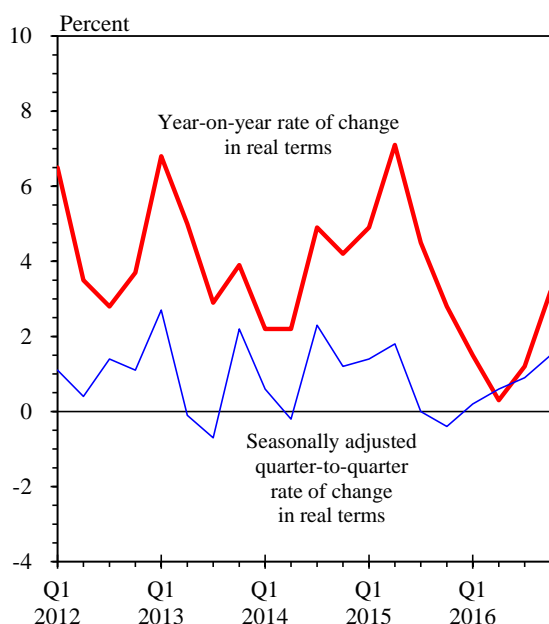
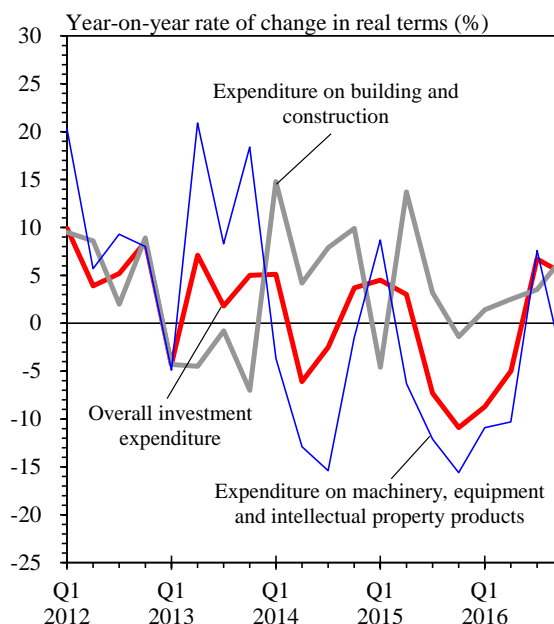


Diagram 1.3 : Investment spending bounced back visibly in the latter half of the year



1.7 Overall investment spending in terms of *gross domestic fixed capital formation* showed a slight decline of 0.5% in real terms in 2016, after the 3.2% fall in 2015. It is worthy to note the visible rebound in the second half of the year as the overall economy regained momentum. Overall building and construction gathered pace over the course of the year, up 3.6% in real terms in 2016. Within this, private sector building and construction activity sustained solid expansion all through, while public sector building and construction works made slight growth to reach a multi-year high. On the other hand, machinery and equipment acquisition, a typically volatile component, fell visibly in the first half of 2016 amid wary over the bleak global economic outlook. While the performance quickly improved as the more acute risks in the global economy waned, for 2016 as a whole, machinery and equipment still registered a decline of 4.6% in real terms. Compared to the early part of 2016, business sentiment of large enterprises turned somewhat better in the second half, as indicated by the results of the Quarterly Business Tendency Survey. However, the diffusion indices on small and medium-sized enterprises (SMEs) still painted a generally cautious picture (see **Box 1.2** for details of the consultation on SMEs).

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 over 500 SMEs. This note provides a further update of the results reported in **Box 1.1** in the *Third 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 generally remained stable, but enterprises surveyed were still cautious about the outlook (**Table 1**). The overall index hovered below the boom-bust threshold of 50.0, dipping from 46.4 in November 2016 to 45.2 in December, before improving slightly to 46.0 in January 2017. Analysed by sector, the readings for retail and wholesale trades and restaurants showed some relative improvements in January 2017 from the preceding month amid the recent recovery in inbound tourism. The diffusion index for real estate stabilised somewhat in January 2017, after some visible deterioration in late 2016 conceivably due to the introduction of the latest round of demand-side management measures in November last year. Meanwhile, the business services sector fared better, with its reading staying steadily above the 50.0 boom-bust line in the past three months. As for the external segments, the diffusion indices for the import/export trade and logistics sectors were still rather weak, notwithstanding the recent improvements in global and regional trade flows. As to the employment situation, the feedback from SMEs suggested a broadly steady development in recent months in most 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 moved slightly lower from 48.6 in November 2016 to 47.3 in January 2017, plausibly affected by the lingering uncertainties in the external environment (**Table 3**).

The overall credit situation remained highly accommodative in recent months. In January 2017, 8.4% of SMEs reported current need for credit, and only 0.2% reported tight access to credit, thanks to the generally accommodative monetary conditions and the Government's continued efforts to support SMEs through various loan guarantee schemes (**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

	<u>2016</u>												<u>2017</u>
	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>	<u>May</u>	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>	<u>Nov</u>	<u>Dec</u>	<u>Jan</u>
<i>Local segments</i>													
Restaurants	41.5	45.7	46.6	44.0	41.4	40.2	49.2	45.0	47.5	44.1	41.9	42.4	45.1
Real estate	41.4	50.0	55.2	46.6	53.4	43.8	50.0	47.4	55.3	42.1	33.3	40.4	45.2
Retail trade	42.2	48.5	41.9	38.8	44.2	37.2	39.7	43.3	45.3	47.9	47.1	43.2	45.2
Wholesale trade	38.9	44.4	32.4	32.4	35.3	38.9	41.7	50.0	47.2	41.7	48.1	41.1	46.4
Business services	45.2	51.7	51.7	50.0	51.8	48.5	45.6	48.5	47.1	47.2	51.2	51.1	51.1
<i>External segments</i>													
Import/export trade	46.4	45.0	49.1	50.9	46.3	41.4	44.0	45.2	45.2	46.9	47.2	47.2	45.2
Logistics	50.0	50.0	46.7	46.7	46.4	37.5	39.5	47.4	50.0	47.1	45.7	38.3	43.5
All the above sectors*	44.2	47.2	46.8	45.7	45.9	41.0	43.6	45.7	46.6	46.3	46.4	45.2	46.0

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>2016</u>												<u>2017</u>
	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>	<u>May</u>	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>	<u>Nov</u>	<u>Dec</u>	<u>Jan</u>
<i>Local segments</i>													
Restaurants	50.0	47.4	50.0	50.9	48.3	45.9	50.0	51.7	48.3	51.7	46.3	48.2	50.0
Real estate	43.1	50.0	51.7	50.0	50.0	50.0	46.1	50.0	51.3	51.3	44.8	47.1	47.1
Retail trade	51.0	48.5	50.0	47.4	49.5	48.7	48.3	49.6	49.6	49.6	50.0	49.1	49.4
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	48.3	50.0	50.0	50.0	48.5	48.5	48.5	48.6	50.0	50.0	50.0	50.0
<i>External segments</i>													
Import/export trade	49.1	48.2	49.5	50.5	49.5	48.8	48.7	49.1	48.2	48.2	50.7	49.1	50.0
Logistics	50.0	50.0	46.7	43.3	50.0	50.0	44.7	50.0	44.4	47.1	52.2	51.7	51.6
All the above sectors*	49.2	48.6	49.8	49.4	49.6	48.8	48.4	49.5	48.8	49.3	49.8	49.2	49.7

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

Table 3 : Diffusion index on current new export orders

	<u>2016</u>												<u>2017</u>
	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>	<u>May</u>	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>	<u>Nov</u>	<u>Dec</u>	<u>Jan</u>
Import/export trade	46.8	46.8	49.5	48.6	47.7	41.4	44.9	46.9	46.5	47.4	48.6	48.1	47.3

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

	<u>2016</u>							<u>2017</u>
	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>	<u>Nov</u>	<u>Dec</u>	<u>Jan</u>
All selected sectors*								
With current credit need	13.0	8.9	8.4	9.3	9.2	9.4	9.8	8.4
Reported tight access to credit	1.2	0.8	0.3	0.9	0.7	0.6	0.5	0.2

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 in overall terms remained remarkably resilient in 2016, sustaining full employment all through, notwithstanding a slowdown in inbound tourism and the weak retail sales performance. The *seasonally adjusted unemployment rate* edged down to 3.3% in the fourth quarter, while the *underemployment rate* stayed low at 1.4%. Both total employment and the labour force sustained further growth to new annual highs. Against this background, nominal wages and earnings sustained broad-based increases in 2016.

The asset markets

1.9 The *local stock market* remained volatile in 2016. In tandem with overseas markets, the Hang Seng Index (HSI) extended declines in the early part of the year and fell to a four-year low of 18 320 on 12 February, due to increasing risk aversion amid concerns about the bleak global economic outlook. Subsequently, favourable developments such as slower-than-expected US interest rate hikes, and the approval of Shenzhen-Hong Kong Stock Connect implementation plan helped revive market sentiment, sending the HSI to the year-high level of 24 100 on 9 September. The surprise result of UK referendum in June only spurred short-lived jitters, and the local stock market followed the overseas counterparts to bounce back swiftly. Yet, as US interest rate hike fears returned towards the end of the year, HSI lost some ground again, closing the year at 22 001, only 0.4% higher than at end-2015. The average daily turnover fell to \$66.9 billion in 2016. Nevertheless, fund-raising activity stayed relatively buoyant in 2016. The amount of total initial public offering (IPO) funds raised, at \$195.3 billion in 2016, though lower than the high level of \$263.1 billion in 2015, still made Hong Kong as the world's largest IPO centre for the second consecutive year.

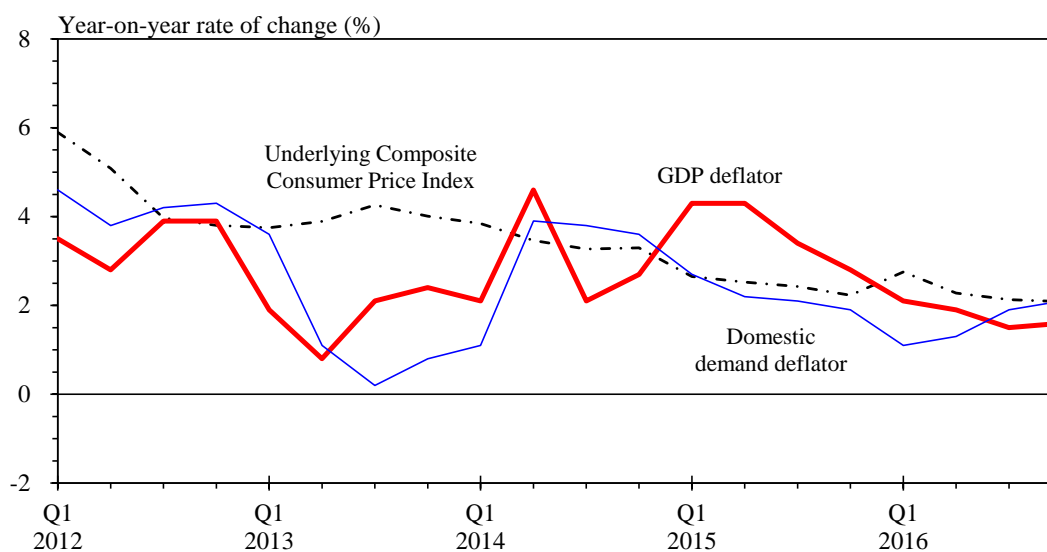
1.10 Amid a still tight demand-supply balance, the residential property market showed renewed signs of exuberance during the year, only cooled off notably after the Government's introduction of a further round of demand-side management measure in early November 2016 and US interest rate hike in December 2016. However, given the increases cumulated earlier, overall flat prices in December 2016 were still 8% higher than a year earlier and exceeded the 1997 peak by 77%. The housing affordability ratio worsened to around 63% in the fourth quarter of 2016, well above the long-term average of 46% over 1996 to 2015. Flat rentals were somewhat more stable, with a cumulative gain of 1% during 2016. As regards commercial property, shop rentals retreated by 2% during 2016, amid a weak retail market. On the other hand, office rentals edged up by 3% during 2016.

Inflation

1.11 Consumer price inflation eased further in 2016, as domestic price pressures remained benign and imported inflation was largely absent. External price pressures were muted, thanks to the relatively low inflation of Hong Kong's major import sources and to some extent the persisted strength of the US dollar. Food inflation, despite a temporary surge in the first quarter under bad weather, was moderate for the year as a whole. Locally, the moderate expansion of the local economy kept rises in domestic costs at bay. Rental inflation eased further. The price-setting power of the retailers was also constrained by the slowdown in inbound tourism as well as the slower growth in local consumption. *Headline consumer price inflation* moderated to 2.4% in 2016 from 3.0% in 2015. Netting out the effects of the Government's one-off relief measures, *underlying consumer price inflation* eased to 2.3% in 2016 from 2.5% in 2015, marking the lowest since 2010.

1.12 The *GDP deflator* increased by 1.8% in 2016, down from the 3.7% increase in 2015, mainly reflecting further moderation in domestic demand deflator, mirroring the trend in consumer price inflation. Meanwhile, the terms of trade was almost flat, with both import and export prices showing modest falls.

Diagram 1.4 : Underlying consumer price inflation eased further in 2016



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 The services sector grew modestly in the first three quarters of 2016, in line with the overall economic performance. Net output of the services sector grew in real terms by 1.5%, 2.7% and 2.3% respectively in the first three quarters of 2016 over a year earlier.

1.14 Among the major services sectors, net output of wholesale and retail trades was the worst performer, falling distinctly in the first three quarters of 2016 combined amid the slowdown in inbound tourism. Net output of accommodation and food services was virtually unchanged over a year earlier. Net output of other service sectors registered varying degrees of growth in the first three quarters of 2016. Net output of import/export trade rose modestly while those of transportation, storage, postal and courier services expanded steadily further, mirroring the improving regional trade flows. Financing and insurance grew at a more visible pace comparatively in the first three quarters. Professional and business services, information and communications, as well as public administration, social and personal services continued to grow moderately. Net output of real estate (mainly reflecting activity of private sector developers and property agency) rebounded in the first three quarters, led by more active property market over the period. As for the secondary sector, net output in the manufacturing sector fell slightly in the first three quarters of 2016, while that in the construction sector grew further.

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

	<u>2015</u>	<u>2016</u>	<u>2015</u>				<u>2016</u>		
		<u>Q1-Q3</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>
Manufacturing	-1.5	-0.2	-1.5	-1.2	-2.1	-1.3	-0.3	-0.4	-0.1
Construction	5.4	0.7	-2.2	18.9	6.2	1.2	-1.3	0.9	2.4
Services ^(b)	1.7	2.2	2.1	1.4	1.7	1.8	1.5	2.7	2.3
Import/export, wholesale and retail trades	-1.1	-0.2	-0.1	-3.9	-0.5	-0.2	-2.2	0.8	0.7
Import and export trade	-0.9	1.7	0.1	-5.4	-0.3	1.0	0.1	2.7	2.3
Wholesale and retail trades	-1.6	-7.4	-0.8	1.7	-1.5	-4.8	-10.0	-6.0	-6.1
Accommodation ^(c) and food services	-1.9	*	-1.3	-1.7	-4.0	-0.6	-1.1	0.9	0.3
Transportation, storage, postal and courier services	3.3	3.2	3.5	2.6	2.7	4.5	2.8	3.3	3.5
Transportation and storage	4.0	3.2	4.1	3.1	3.2	5.3	3.0	3.3	3.4
Postal and courier services	-8.2	2.2	-6.6	-7.1	-9.2	-9.7	-1.4	2.7	5.8
Information and communications	4.0	3.8	5.0	4.7	3.6	3.0	3.5	4.3	3.5
Financing and insurance	6.1	4.8	4.8	8.0	5.8	5.7	5.2	4.5	4.8
Real estate, professional and business services	0.7	2.8	2.9	0.6	0.1	-0.7	1.7	3.7	3.1
Real estate	-2.3	2.8	0.6	-1.4	-2.5	-5.7	0.6	2.7	5.4
Professional and business services	3.2	2.8	5.2	2.2	2.1	3.4	2.7	4.5	1.3
Public administration, social and personal services	2.6	2.8	2.1	1.9	3.3	3.0	2.6	3.3	2.4

Notes : Figures are subject to revision later on as more data become available.

(a) The GDP figures shown in this table are compiled from the production approach, in parallel with those shown in Table 1.1 which are compiled from the expenditure approach. For details, see Note (1) to this chapter.

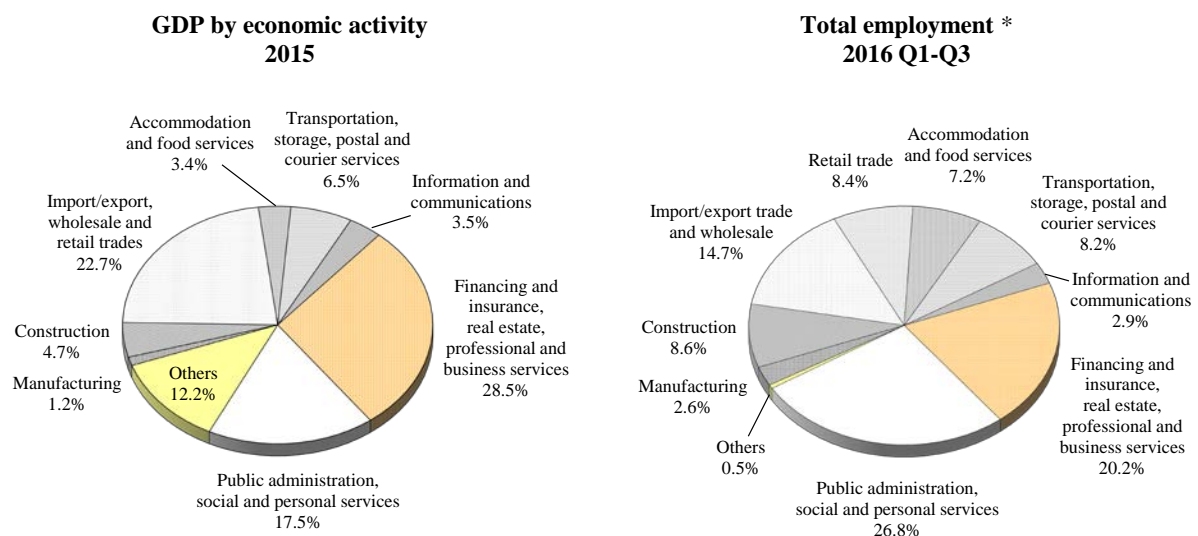
(b) In the context of value-added contribution to GDP, the services sectors include ownership of premises as well, which is analytically a service activity.

(c) Accommodation services cover hotels, guesthouses, boarding houses and other establishments providing short-term accommodation.

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

1.15 The services sector is the mainstay of the Hong Kong economy, accounting for 92.6% of GDP in 2015 and providing 88.3% of total employment in the first three quarters of 2016. Given the Mainland's further opening-up and deepening reforms and its continued rebalancing of the economy to services and consumption, Hong Kong's services sector should be able to leverage on our competitive strengths to contribute to the nation's economic development. Moreover, the promising market potential of Asian and other emerging economies along the Belt and Road, with vast population and ever-growing purchasing power, will also provide significant opportunities. Hong Kong will continue to keep up its leading position as an international financial and business hub, by consolidating the strength of the traditional pillar industries, developing new industries with growth potential, encouraging innovation and technology, and investing heavily in education, training and infrastructure to nurture talents and improve connectivity. It is worth noting that the proportion of the local workforce with tertiary education attainment increased steadily from 33.4% in 2011 to 38.0% in 2016.

Diagram 1.5 : The services sector remains the key driver of the economy



Note : (*) Figures refer to the Composite Employment Estimates, which are compiled based on results of the General Household Survey and the Quarterly Survey of Employment and Vacancies. Figures for 2016 are averages for the first three quarters of the year.

Other economic developments

1.16 The Hong Kong economy faced considerable challenges on both external and domestic fronts in 2016. In anticipation of an unsteady global economic environment, the Government introduced a package of relief measures amounting to some \$39 billion in the 2016-17 Budget, which help alleviate the financial burden of the public, stimulate local consumption, preserve economic stability and safeguard employment.

1.17 The Government attaches great importance to sustain macroeconomic stability and promote economic development. On economic integration with the Mainland, the National 13th Five-Year Plan was promulgated officially in March 2016. A chapter continues to be dedicated to Hong Kong and Macao (the Dedicated Chapter), acknowledging their significant functions and positioning in the national development. The Dedicated Chapter expressed clear support for Hong Kong in consolidating and enhancing our status as international financial, transportation and trade centres, and in participating in our country's two-way opening up and in Belt and Road Initiative. In September 2016, the 19th Plenary of Hong Kong/Guangdong Co-operation Joint Conference was held, in which both sides exchanged views on areas where Hong Kong-Guangdong co-operation could be strengthened as set out in the Dedicated Chapter.

1.18 The Government continued to strengthen and broaden economic ties with overseas markets. Hong Kong signed comprehensive agreements for the avoidance of double taxation with Russia and Latvia in January and April 2016 respectively. In May 2016, the Government signed a Memorandum of Understanding (MoU) pledging mutual co-operation on investment promotion exchanges and best practices with Indonesia. Moreover, investment agreement with Canada entered into force in September 2016, and investment agreement with Chile was signed in November 2016 to increase confidence of investors and expand investment flows.

1.19 The Belt and Road Initiative offers huge opportunities to Hong Kong given the vast market potential of the economies it covers. In July 2016, the Hong Kong Monetary Authority launched the Infrastructure Financing Facilitation Office to promote development of Hong Kong as an infrastructure financing hub, helping facilitate investment in infrastructure projects in countries along the Belt and Road. A Belt and Road Office was established in August 2016 to capitalise on the opportunities brought to Hong Kong and liaise with government departments and various sectors of the community.

1.20 On deepening financial linkages with the Mainland, under the support of the Central Government, the Shenzhen-Hong Kong Stock Connect was officially launched in December 2016 with no aggregate quota. The Shanghai-Hong Kong Stock Connect was also enhanced through the abolishment of the aggregate quota in August 2016. These initiatives reinforced Hong Kong's position as an international financial centre and a premier RMB offshore hub, and deepened mutual access of capital markets in Hong Kong and the Mainland.

1.21 On innovation and technology, a MoU with Austria was signed to strengthen bilateral co-operation in technology start-up ecosystems in May 2016. To stimulate private investments in local innovation and technology start-ups and to increase deal flows, the Government announced in July 2016 to launch a HK\$2 billion Innovation and Technology Venture Fund (ITVF). The ITVF should help fill the funding gap encountered by local start-ups in the growth stage. In January 2017, a MoU with Shenzhen was signed on development of a Hong Kong/Shenzhen Innovation and Technology Park in the Lok Ma Chau Loop in Hong Kong.

1.22 Hong Kong's institutional strength continues to be well recognised, ranking as the world's freest economy by the Heritage Foundation for 22 years in a row. Also, Hong Kong was ranked as the world's most competitive economy by the International Institute for Management Development World Competitiveness Yearbook 2016, moving up from the second place in the preceding year. Moreover, Hong Kong's ranking by the World Bank in ease of doing business also rose one place to the fourth position, a recognition of our continuous efforts in enhancing the business-friendly environment. Separately, according to the United Nations Conference on Trade and Development World Investment Report 2016, Hong Kong was ranked the world's second largest recipient of foreign direct investment flows, the second year in a row, reflecting our prominent position as an international business hub.

1.23 To forestall a further build-up in housing market bubble risks, the Government introduced a new round of demand-side management measure in November 2016, while continuing its efforts in increasing land supply. The measure was necessary to safeguard macroeconomic and financial sector stability. Along with the US interest rate hike in December 2016, the property market cooled off visibly towards the end of the year.

1.24 The Chief Executive delivered the 2017 Policy Address on 18 January 2017, outlining plan to develop the economy and improve people's livelihood. The more salient points are highlighted below.

- On economic development, the Government will make the best use of opportunities rendered by the National 13th Five-Year Plan and the Belt and Road Initiative. The Government is exploring further with the Mainland the expansion and enhancement of the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) in the areas of investment, economic and technical co-operation, etc. and will seize new opportunities through Guangdong-Hong Kong-Macao co-operation platform.
- On financial development, the Government will actively consider the recommendations by the Financial Services Development Council, and take forward the feasible measures. The Government will also strive to complete by mid-2017 the procedures for Hong Kong to join the Asian Infrastructure Investment Bank, while taking advantage of the demand arising from the Belt and Road Initiative and the Mainland-Hong Kong Mutual Recognition of Funds Arrangement to further expand Hong Kong's RMB business.
- On innovation and technology, the Government will continue its efforts in promoting re-industrialisation, encouraging universities to conduct impactful and translational research projects to meet Hong Kong's needs, and supporting start-ups. Apart from supply of hardware, the Government will consider policy support measures such as offering tax and financial concessions to attract innovation and technology enterprises from Hong Kong, the Mainland and overseas.
- On housing, the Government will continue to adopt a multi-pronged approach to increase land and housing supply, in the short-, medium- and long-term.
- A raft of measures to help the elderly, enhance retirement protection and improve healthcare services are announced, while the support to education and youth development will continue. The Old Age Living Allowance scheme and the Elderly Health Care Vouchers will be enhanced. Moreover, the Government proposed to progressively abolish the "offsetting" of severance payments or long service payments with Mandatory Provident Fund contributions. Additional recurrent funding will be provided to the Hospital Authority in 2017-18 to meet increasing service demand.

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.