

## Outlook for the Hong Kong economy in 2007

2.15 Having already experienced three years of robust economic expansion, the outlook for 2007 is for another year of balanced and solid growth. The closer integration with the Mainland economy, through the progressive implementation of the liberalisation measures under the CEPA framework and the strengthening of Pan-PRD cooperation, has contributed to a highly supportive business environment with more opportunities and greater dynamism.

2.16 Externally, the trade outlook still looks rather good this year, under the support of a thriving Mainland economy and its vibrant trade flows, sustained economic expansion in Europe and Japan, and also with the general weakness of the US dollar rendering a boost to Hong Kong's external competitiveness. The substantial ease-back in oil prices has removed a key element of uncertainty which has persistently overshadowed the global economy over the past few years. Lower oil prices would also help to alleviate global inflationary pressures, reduce production costs, and raise households' purchasing power thereby supporting overseas' consumer spending. Overall, granting a soft-landing scenario in the US, *total exports of goods* are likely to see further notable growth in 2007, though probably not as strong as the 10.2% growth in 2006.

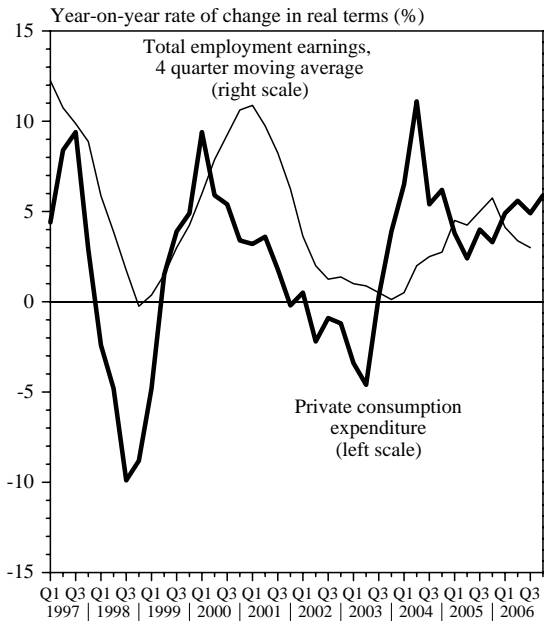
2.17 The outlook for *exports of services* is even more promising. Exports of finance, business and other services have been increasing at double-digit rates over the past year, and with the pace of economic and financial integration with the Mainland advancing further, the prospect for this year is likewise good. Exports of trade-related services are expected to remain on a strong surge, thanks again to vibrant trade flows of the Mainland and the regional trade boom. Exports of transportation services would then benefit in tandem. As to inbound tourism, the further extension of the Individual Visit Scheme in January 2007 and the expected further growth in visitors from overseas markets should lend support, although, judging from the recent trend, the momentum in visitor growth might not be as strong as in previous years.

2.18 Locally, the strong economic growth over the past three years has placed the economy on a much sounder footing. Economic fundamentals are much improved, while both consumer and investor confidence are on the rise. Domestic demand can thus be expected to render an important driving force of overall economic growth in 2007, at a time when external trade is subject to

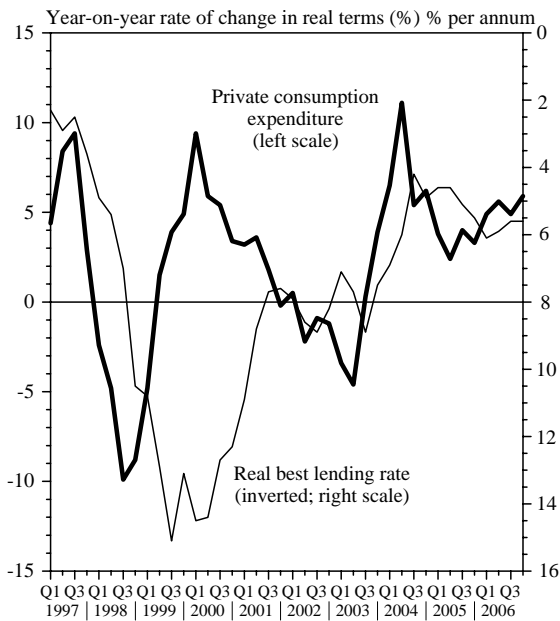
uncertainties from a slowing US economy. *Private consumption expenditure* is set to grow firmly further, under the support of improving employment conditions and steadily rising labour income. Movements of interest rates, which are likely to hold steady if not edging down later in the year, may help to sustain the prevailing upbeat consumer sentiment. There would be an added boost if asset market developments continue to be favourable.

**Diagram 2.6 : Private consumption set to grow firmly further**

**(a) Sustained improvement in employment conditions is a key factor underpinning consumer spending**

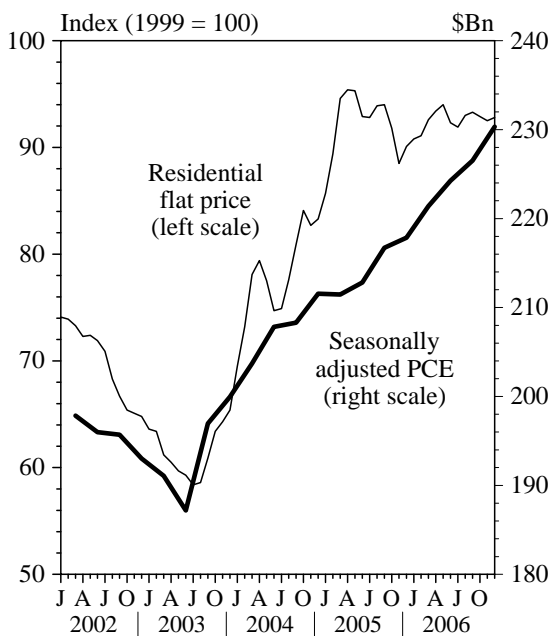


**(b) Pause in interest rate also helps**

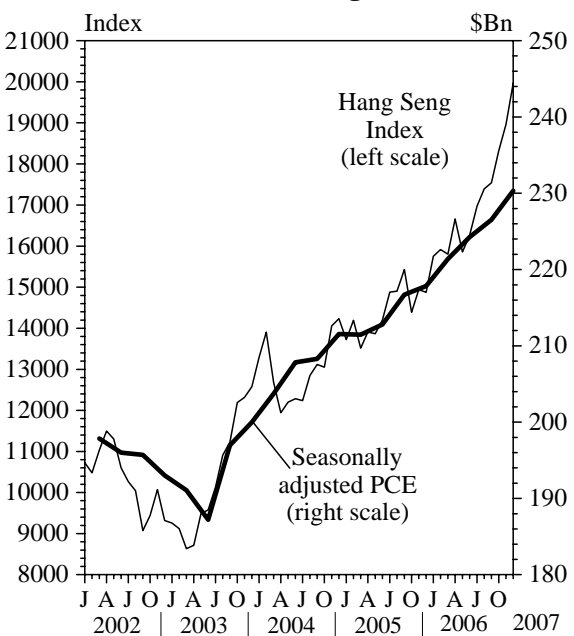


**Diagram 2.7 : Asset market developments also crucial in affecting local demand**

**(a) Residential flat price**

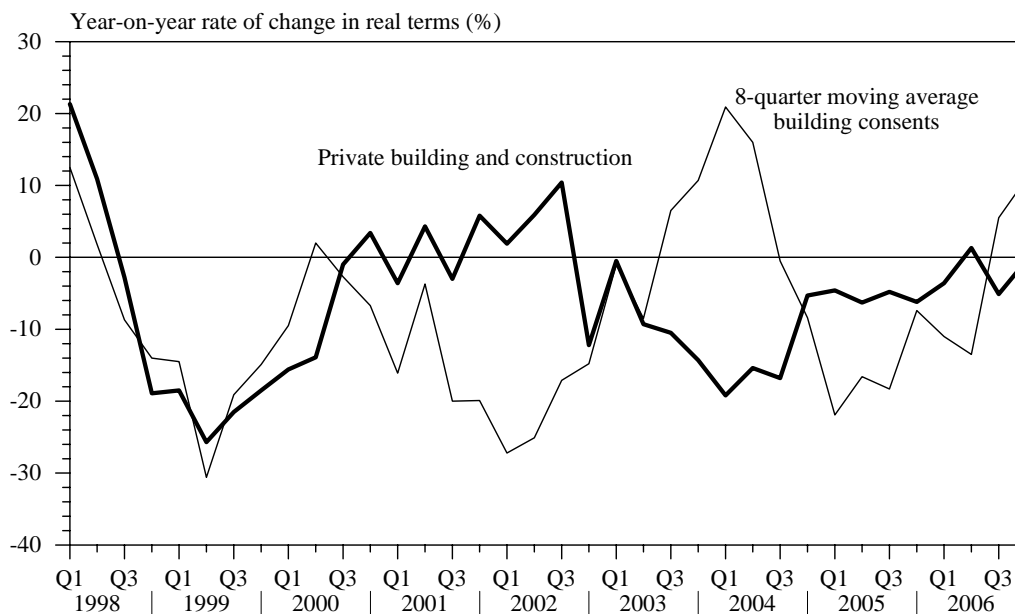


**(b) Hang Seng Index (month-end figures)**



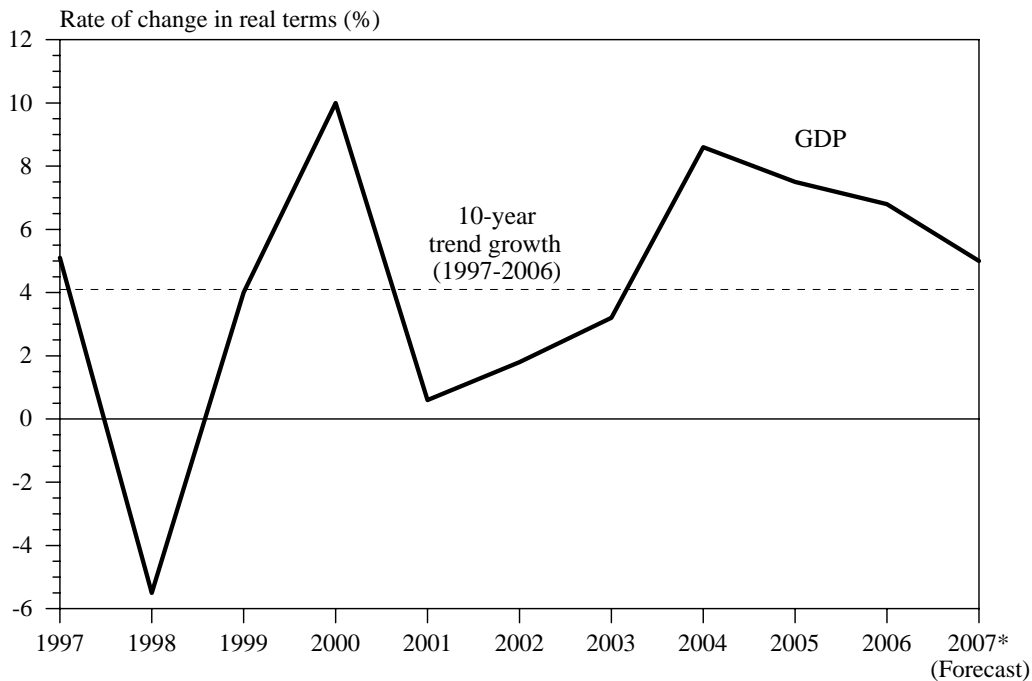
2.19 *Investment spending* in overall terms picked up distinctly over the past year, despite the continued slack in construction activity. Riding on the prevailing strength in business confidence and also on the business activity upturn, this trend is likely to extend into 2007. The major impetus to growth would again come from machinery and equipment acquisition, as many companies see increasing need to expand operation to meet the envisaged growth in activity. Indeed, the results of the latest Business Tendency Survey conducted by the Census and Statistics Department confirm that large companies surveyed remained optimistic about the near-term business outlook. On the other hand, overall construction activity might continue to be dragged by a lack of large-scale public sector infrastructure projects. Also, although the pick-up in building consents should point to some relative improvement in private sector building activity in 2007, the timing and extent of a turnaround remains subject to considerable uncertainty at this juncture.

**Diagram 2.8 : Although building consents have improved, the timing and extent of turnaround in private building activity remains uncertain**



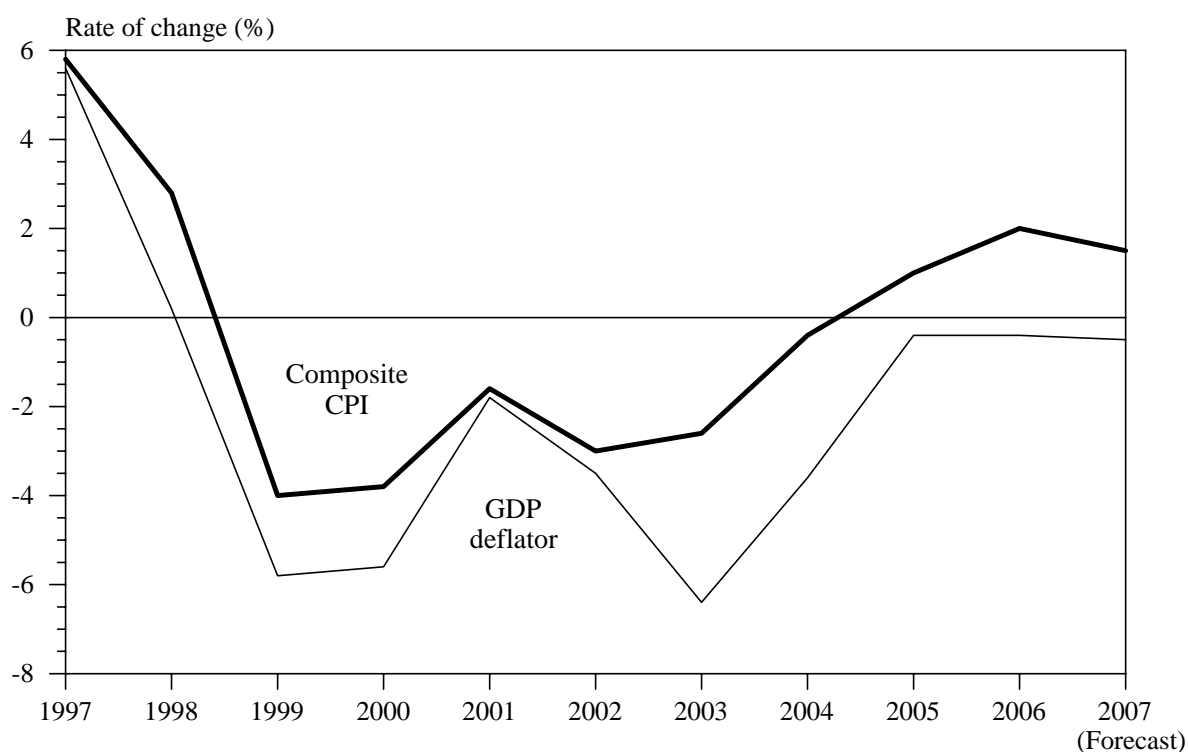
2.20 Overall, the Hong Kong economy is expected to attain solid and broad-based growth of 4.5 – 5.5% in real terms in 2007. This, if realised, would signify another year of above-trend growth when compared with the trend growth at 4.1% in the past ten years. The prevailing forecasts by the private sector are likewise upbeat about further expansion of Hong Kong economy at a solid pace, which are mostly in the range of 5 – 5.5 %.

**Diagram 2.9 : Economy set for another year of solid and balanced growth in 2007**



2.21 Consumer price inflation has been creeping up over the past two years amidst the sustained brisk expansion of the economy. Looking ahead, the underlying cost pressures are likely to build up slightly further in 2007, as continued economic expansion at above-trend pace is bound to add more pressure on local costs, and as a weak US dollar and renminbi appreciation would give rise to higher imported inflation. Yet with wages still showing a modest increase and well matched by notable productivity improvement, and with the pressures from rental increase also receding lately, the risk of a significant pick-up in consumer price inflation does not seem that high in 2007. The substantial ease-back in oil prices and the introduction of natural gas in town gas production will also bring down energy-related prices. Coupled with the various one-off factors, including the Budget measures announced for 2007/08, the one-month public housing rental waiver in February, the cut in public housing rentals and the granting of government subsidy in pre-primary education later this year, which would lower the Composite CPI level, for 2007 as a whole, the *Composite CPI* is forecast to increase by 1.5%. The *GDP deflator* is forecast to decline marginally by 0.5%, largely due to the expected further fall in terms of trade stemming from a weak US dollar.

**Diagram 2.10 : Inflation environment still benign in 2007**



**Forecast rate of change in 2007 (%)**

**Gross Domestic Product (GDP)**

<i>Real GDP</i>	<b>4.5-5.5</b>
<i>Nominal GDP</i>	4-5
<i>Per capita GDP, in real terms</i>	3.7-4.7
<i>Per capita GDP at current market prices</i>	HK\$221,500-223,700 (US\$28,400-28,700)

**Composite Consumer Price Index** **1.5**

**GDP Deflator** **-0.5**