

Press Release

(embargoed until 4:15 p.m. on 18 May 2007)

Economic Situation in the First Quarter of 2007 and Latest GDP and Price Forecasts for 2007

The Government released today (Friday) the First Quarter Economic Report 2007, together with the preliminary figures on Gross Domestic Product for the first quarter of 2007.

The Acting Government Economist, Mrs Helen Chan, described the economic situation in the first quarter of 2007 and provided the latest GDP and price forecasts for the year.

MAIN POINTS

- * The Hong Kong economy continued to show broad-based expansion in the first quarter of 2007, with GDP growing solidly by 5.6 % in real terms over a year earlier. Since the upturn in mid-2003, the economy has been growing at above-trend pace for 14 quarters in a row.
- * Externally, merchandise exports recorded a further notable growth at 8.2% in real terms in the first quarter, even when set against an exceptionally high base a year earlier. Trade flows involving the Mainland remained vibrant, thereby largely cushioning overall export performance against the weakness in the US market. Exports of services leaped by 8.4% in real terms in the first quarter, led by the surge in exports of financial and business services and the brisk expansion of both offshore trade and inbound tourism.
- * Domestically, private consumption expenditure continued to display strength, picking up to a 5.6% notable growth in the first quarter, on the back of rising income, improving job market and generally buoyant stock market activity. On the other hand, overall investment spending grew moderately further, by 3.9% in the first quarter, after several quarters of notable growth. Business sentiment still held up well, as suggested by the results of the latest Quarterly Business Tendency Survey.
- * The economic upturn continued to give rise to a stronger demand for labour, pushing the seasonally adjusted unemployment rate lower to 4.3% in the first quarter (and staying at this level in the three months ending April), the lowest in more than 8 1/2 years. A total of nearly 300 000 net additional jobs have been created since the trough in 2003. Labour incomes picked up more noticeably towards end-2006. Job openings continued to rise.

- * Although the global economy is able to sustain rather strong growth momentum up till now, there are uncertainties down the road that warrant a close watch over. The most notable downside risk is the possibility of a sharper-than-expected US downturn, for its ramifications to the rest of the world. Along with an uncertain US outlook, there may also come bigger volatility in the global financial markets, especially given the lingering structural problem of global imbalances.
- * Against these uncertainties, there are also a number of positive factors. The continuous economic expansion in Europe and Japan is a much welcomed development for the global economy to fill the gap from a slowing US economy. The Mainland's economy has remained vibrant, and continues to be a plus factor for Hong Kong. Even though there is concern about further macro tightening measures, these measures are intended to forestall the risk of overheating and steer the Mainland economy towards a steady and more sustainable high growth track. Also, the weakness of the US dollar should generally bode well for Hong Kong's export competitiveness. The still abundant liquidity in the local banking sector is another positive factor which should support continued business expansion.
- * Moreover, locally, domestic demand is expected to hold firm and take up a bigger role as a growth contributor, at a time when the trade prospects are subject to more uncertainties. Improving employment incomes and the positive economic prospects would continue to render support to private consumption. Vibrant business activity and the prevailing upbeat business sentiment should augur well for continued investment growth in the coming quarters.
- * Overall, with the actual GDP outturn of a 5.6% growth in the first quarter of 2007 largely in line with expectations, the GDP forecast at 4.5-5.5% for 2007 announced in the Budget round in late February is kept unchanged.
- * As to the inflation outlook, tighter labour market conditions, weakness of the US dollar and renminbi appreciation would see cost pressure creeping up further. Yet the upturn in CCPI is likely to proceed still at a rather modest pace, being cushioned by a concurrent notable growth in labour productivity. Moreover, various one-off factors including the rates waiver for two quarters, the public housing rental cut to be implemented later this year, and the implementation of the Pre-primary Education Voucher Scheme would also bring down the CCPI level. With the actual outturn of consumer price inflation so far in line with expectations, the forecast rate of increase in the CCPI for 2007 is thus maintained at 1.5%.

DETAIL

GDP

According to the preliminary figure on the *Gross Domestic Product (GDP)* released today by the Census and Statistics Department, GDP grew notably further by 5.6 % in real terms in the first quarter of 2007 over a year earlier, signifying the 14th consecutive quarter of distinctly above-trend growth. Growth remained broad-based in the first quarter, with domestic demand sustaining strong momentum and export performance staying resilient. On a seasonally adjusted quarter-to-quarter comparison, GDP also expanded further, by 0.5% in real terms in the first quarter of 2007 (*Chart*).

2. The latest figures on GDP and its major expenditure components up to the first quarter of 2007 are presented in *Table 1*. Developments in different segments of the economy in the first quarter of 2007 are described below.

External trade

3. External trade still fared rather well in the first quarter, as the Mainland's thriving trade flows and strong domestic demand cushioned in large part the continued slack in the US market. *Total exports of goods* went up quite appreciably by 8.2% in real terms in the first quarter over a year earlier, even when set against a very high base of comparison in the first quarter of 2006. On a seasonally adjusted quarter-to-quarter comparison, total exports of goods expanded further by 1.4% in real terms in the first quarter of 2007.

4. *Exports of services* continued to grow briskly, by 8.4% in real terms in the first quarter of 2007 over a year earlier. Bolstered by the active financial markets, exports of financial services continued to grow distinctly, indicating the prominent role of Hong Kong as an international financial and business centre. Exports of trade-related services continued to surge, again benefiting from the Mainland's buoyant trade flows. There was also a further expansion of exports of travel services on the back of a notable growth in visitor arrivals. On a seasonally adjusted quarter-to-quarter comparison, exports of services showed virtually no change in the first quarter of 2007.

Domestic sector

5. Consumption demand continued to display strength. With rising labour income and the wealth effect stemming from the buoyant performance of the stock market during most of the first quarter, *private consumption expenditure (PCE)* leaped by 5.6% in real terms in the first quarter of 2007 over a year earlier, extending the strong growth momentum in the latter part of 2006. On a seasonally adjusted quarter-to-quarter comparison, private consumption expenditure likewise increased distinctly, by 2.2% in real terms in the first quarter.

6. *Overall investment spending* grew further by 3.9% in real terms in the first quarter of 2007 over a year earlier. The somewhat more moderate growth in overall investment in the first quarter was caused by the less rapid increase in expenditure on machinery and equipment. It has to be noted, however, that investment expenditures can be volatile at times, especially after a rather long period of continuous upsurge. The results of the latest Quarterly Business Tendency Survey conducted by the Census and Statistics Department actually indicated that large business establishments were still optimistic on business outlook. Meanwhile, building and construction activity was still slack, owing to the continued fall-off in public sector construction. Yet construction activity in the private sector held largely stable.

The labour sector

7. As demand for labour continued to rise in tandem with the economic upturn, the number of unemployment fell further, bringing the *seasonally adjusted unemployment rate* down to 4.3% in the first quarter (and staying unchanged in the three months ending April), the lowest in more than 8½ years. Since the trough in mid-2003, a total of nearly 300 000 net additional jobs have been created. Workers at the lower segment of the labour market have continued to benefit from the general economic upturn, with their number of unemployment down by around half. The total number of job vacancies in the private sector continued to rise, while wages and earnings also picked up more notably in the fourth quarter of 2006.

Prices

8. Consumer price inflation stayed moderate. The year-on-year rate of increase in *Composite Consumer Price Index* (CCPI) averaged at only 1.7% in the first quarter of 2007. This was down from the 2.1% rise in the fourth quarter of 2006, due to the waiving of public housing rentals in February. Excluding the influence of this one-off measure, the underlying inflationary pressures actually crept up, yet only slightly, mainly reflecting the feed-through of higher imported inflation due to the depreciation of the Hong Kong dollar along with the US dollar, as well as the gradual appreciation of the renminbi. The *GDP deflator* bounced back to a positive increase at 0.9% in the first quarter, as terms of trade turned around after many quarters of decline.

Latest GDP and price forecasts for 2007

9. The near-term outlook is affected by a number of uncertainties arising from the external front. Although the global economy remained largely resilient so far this year, the evolving development of the US housing market and related issues of sub-prime mortgages and fall-off in construction investment continue to attract considerable concern, in particular whether the housing segment problems will eventually filter through to the wider segments of the economy and lead to a sharper-than-expected US economic slow-down, with negative spill-overs to the rest

of the global economy. Along with an uncertain US outlook, there may also come more volatility in global financial markets, especially given the lingering structural weakness of global imbalances.

10. Yet there are also a number of positive factors which should render support to the Hong Kong economy. The European and Japan economies have finally embarked on a sustainable growth path, a much welcomed development for the global economy, at a time when the US economy is slowing. The Mainland's economy has remained vibrant, and continues to be a plus factor for Hong Kong. Even though there is concern about further macro tightening measures, these measures are intended to forestall the risk of overheating and steer the Mainland economy towards a steady and more sustainable high growth track. On the exchange rate front, the weakness of the dollar particularly against the Asian currencies would continue to aid our export competitiveness. Abundant liquidity in our banking system is another positive factor for business expansion. Moreover, after the distinct upturn over the past few years, the Hong Kong economy is now on a sounder footing to cope with external shocks.

11. Moreover, locally, domestic demand is expected to hold firm and take up a bigger role as a growth contributor, at a time when the trade prospects are subject to more uncertainties. Improving employment incomes and the positive economic prospects would continue to render support to private consumption. Vibrant business activity and the prevailing upbeat business sentiment should augur well for continued investment growth in the coming quarters.

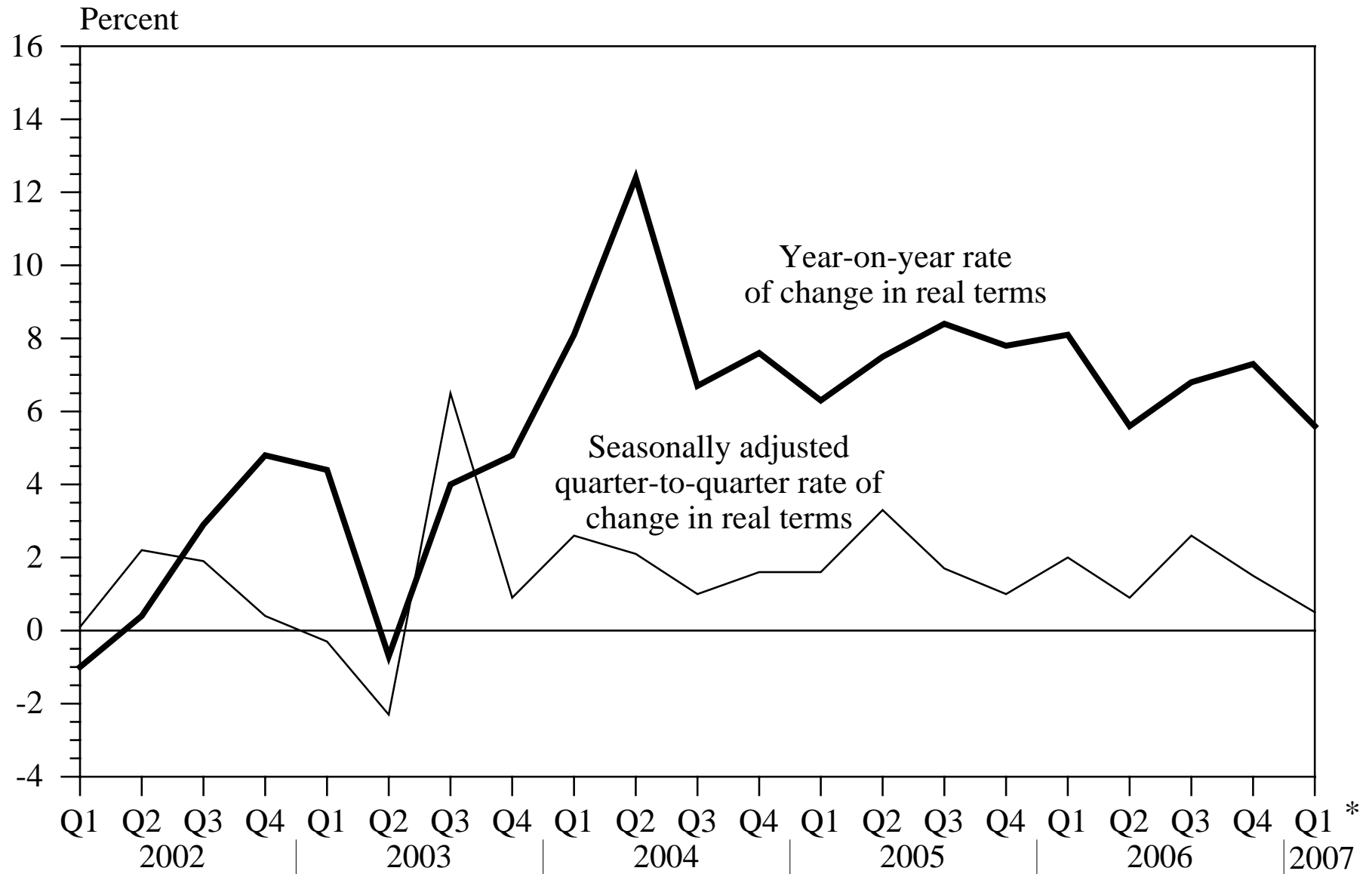
12. With the actual GDP outturn of a 5.6% growth in the first quarter of 2007 largely in line with expectations, the GDP forecast for 2007 is maintained at 4.5-5.5%, same as that put out in the Budget round in late February (*Table 2*). For comparison, the forecasts of Hong Kong's GDP growth by a selection of international organisations and local analysts are summarised in *Table 3*.

13. As to the inflation outlook, tighter labour market, weakness of the US dollar and renminbi appreciation would see cost pressure creeping up further. Yet the upturn in CCPI is likely to proceed still at a rather modest pace, being cushioned by a concurrent notable growth in labour productivity. Moreover, various one-off factors including the rates waiver for two quarters, the public housing rental cut to be implemented later this year, and the implementation of the Pre-primary Education Voucher Scheme would also bring down the CCPI level. With the actual outturn of consumer price inflation so far also in line with expectations, the forecast rate of increase in the CCPI for 2007 is maintained at 1.5%.

(The First Quarter Economic Report 2007 is now available. Users can download the publication free of charge at <http://www.statisticalbookstore.gov.hk> or <http://www.info.gov.hk/hkecon/report>. Print version of the report can also be purchased on-line, or by calling the Publications Sales Unit of ISD at 2537 1910. The hard copy of the report is available for sale at \$70 per copy (15% discount offered if purchased on-line), with a postage charge.)

(The GDP figures up to the first quarter of 2007 are published in the Report of the Gross Domestic Product, First Quarter 2007. Users can download the publication free of charge at <http://www.statisticalbookstore.gov.hk>. Print version of the report can also be purchased on-line, or by calling the Publications Sales Unit of ISD at 2537 1910. The hard copy of the report is available for sale at \$47 per copy (15% discount offered if purchased on-line), with a postage charge.)

Hong Kong's Gross Domestic Product



Note : (*) Preliminary figures.

Table 1

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

	<u>2005[#]</u>	<u>2006[#]</u>	<u>2006</u>				<u>2007</u>
			<u>Q1[#]</u>	<u>Q2[#]</u>	<u>Q3[#]</u>	<u>Q4[#]</u>	<u>Q1⁺</u>
<i>Change in real terms of GDP and its main expenditure components (%)</i>							
Private consumption expenditure	3.3	5.2	5.1 (1.9)	5.8 (1.4)	4.6 (0.9)	5.4 (1.0)	5.6 (2.2)
Government consumption expenditure	-3.1	0.2	1.1 (2.9)	-1.5 (-2.3)	-1.1 (0.3)	2.3 (1.4)	2.3 (2.9)
Gross domestic fixed capital formation	4.6	7.9	7.3 (N.A.)	4.5 (N.A.)	10.3 (N.A.)	9.4 (N.A.)	3.9 (N.A.)
<i>of which :</i>							
Building and construction	-8.4	-7.3	-11.4	-4.1	-10.1	-2.8	-5.4
Machinery, equipment and computer software	12.9	17.2	22.4	11.9	20.4	14.9	6.8
Total exports of goods	11.2	10.2	14.4 (3.2)	6.4 (0.1)	8.9 (4.1)	11.7 (3.3)	8.2 (1.4)
Imports of goods	8.6	10.0	14.0 (2.7)	6.7 (-0.2)	8.5 (4.2)	11.4 (3.8)	8.6 (1.0)
Exports of services	11.3	8.9	8.5 (0.6)	8.9 (2.6)	8.9 (3.2)	9.0 (2.5)	8.4 (*)
Imports of services	7.4	6.4	5.0 (-0.3)	9.1 (5.4)	5.2 (-0.9)	6.5 (2.0)	3.9 (-2.4)
Gross Domestic Product	7.5	6.9	8.1 (2.0)	5.6 (0.9)	6.8 (2.6)	7.3 (1.5)	5.6 (0.5)
<i>Change in the main price indicators (%)</i>							
GDP deflator	-0.4	-0.4	-0.1 (-0.2)	-0.2 (-0.1)	-0.4 (*)	-0.4 (*)	0.9 (1.1)
Composite Consumer Price Index	1.0	2.0	1.6 (0.4)	2.0 (0.7)	2.3 (0.6)	2.1 (0.4)	1.7 (*)
<u>Change in nominal GDP (%)</u>	7.1	6.6	8.0	5.3	6.3	6.9	6.6

Notes : (#) Revised figures.

(+) Preliminary figures.

() Seasonally adjusted quarter-to-quarter rate of change.

N.A. Not applicable, as no clear seasonal pattern is found in gross domestic fixed capital formation, due to the presence of considerable short-term fluctuations.

(*) Change of less than 0.05%.

Table 2**Economic forecasts for 2007
(year-on-year rate of change (%))**

	Forecasts for 2007 as released <u>on 28.2.2007</u> (%)	Latest forecasts for 2007 <u>on 18.5.2007</u> (%)
Gross Domestic Product (GDP)		
<i>Real GDP</i>	4.5 to 5.5	<i>4.5 to 5.5</i>
<i>Nominal GDP</i>	4 to 5	<i>4 to 5</i>
Composite Consumer Price Index	1.5	<i>1.5</i>
GDP deflator	-0.5	<i>-0.5</i>

Table 3

2007 GDP and price forecasts for Hong Kong put out by selected international organisations and private sector analysts

	<u>Date of release</u>	<u>GDP</u>	<u>Private consumption expenditure</u> (growth rate	<u>Gross domestic fixed capital Formation</u> in real	<u>Total exports of goods</u> terms (%))	<u>Exports of services</u>	<u>Rate of change in consumer prices</u> (%)	<u>Reference source</u>
International organisations:								
IMF	Apr 2007	5.5	--	--	--	--	1.5	World Economic Outlook, Apr 2007.
ADB	Mar 2007	5.4	--	--	--	--	1.6	Asian Development Outlook 2007, Mar 2007.
World Bank	Nov 2006	4.9	--	--	--	--	--	East Asia Update, Nov 2006.
PECC	Nov 2006	5.1	1.7	--	--	--	2.5	State of the Region 2006-2007, Nov 2006.
Private sector analysts:								
<i>(a) Major local banks</i>								
HSBC	Feb 2007	5.3	3.3	8.2	--	--	3	Macro Currencies, February 2007.
	May 2007	5.3	3.5	8	--	--	1.8	Macro Currencies, May 2007.
Hang Seng Bank	Feb 2007	5.6	--	--	--	--	2.5	Economic Bulletin, February 2007.
	May 2007	5.6	--	--	8	--	2	Economic Bulletin, May 2007.
Standard Chartered Bank	Feb 2007	5	--	--	--	--	2	Asia Focus, 14 Feb 2007.
	May 2007	5.5	--	--	--	--	2	Asia Focus, 16 May 2007.
Bank of China (HK)	Dec 2006	5	3.8	4.8	7.5	7	2.5	Bank of China (HK) Research, Dec 2006.
Bank of East Asia	Jan 2007	5	5.5	4.5	7.4	7	2.7	Economic Analysis, Jan 2007.
	May 2007	6	--	--	--	--	2	Bank of East Asia, 15 May 2007.
ABN Amro Bank	Jan 2007	4	3.6	6	--	--	3	Asia Vision, 10 Jan 2007.
Citigroup	Jan 2007	6	4.3	5.8	--	--	2.6	Asia Economic Outlook and Strategy, 26 Jan 2007.
	Apr 2007	6	4.8	5.9	--	--	1.8	Asia Economic Outlook and Strategy, 27 Apr 2007.
<i>(b) Investment bank</i>								
JP Morgan Chase	Feb 2007	5	--	--	--	--	2.5	Global Data Watch, 16 Feb 2007.
	May 2007	5.5	--	--	--	--	1.8	JP Morgan Chase, 14 May 2007.
Goldman Sachs Asia	Feb 2007	5.5	--	--	--	--	3.1	Goldman Sachs Asia, 26 Feb 2007.
	May 2007	5.5	--	--	--	--	3.1	Goldman Sachs Asia, 15 May 2007.

Table 3 (cont'd)

2007 GDP and price forecasts for Hong Kong put out by selected international organisations and private sector analysts

	Date of release	GDP	Private consumption expenditure (growth rate)	Gross domestic fixed capital formation in real	Total exports of goods terms (%)	Exports of services (%)	Rate of change in consumer prices (%)	Reference source
Morgan Stanley Asia	Nov 2006	5	4.2	6.4	--	--	2.5	Morgan Stanley Research, 21 Nov 2006.
	Feb 2007	5	4.2	5.8	10	7	2.5	Morgan Stanley Research, 28 Feb 2007.
Merrill Lynch	Apr 2007	4.6	--	--	--	--	2.3	The Asian Market Economist, 16 Apr 2007.
Credit Suisse	Dec 2006	4.5	--	--	--	--	3-5	Hong Kong Economics Times, 22 Dec 2006.
	Mar 2007	5	4.5	8.5	--	--	2.2	Emerging Markets Quarterly, 14 Mar 2007.
Lehman Brothers	Feb 2007	5.5	--	--	--	--	2.5	Global Weekly Economic Monitor, 16 Feb 2007.
	May 2007	5.5	--	--	--	--	2.5	Global Weekly Economic Monitor, 11 May 2007.
<i>(c) Others</i>								
Economist Intelligence Unit	Mar 2007	4.6	4.9	7.5	--	--	2.5	Country Forecast, Mar 2007.
	Apr 2007	5.7	5.7	8.1	--	--	2.5	Country Forecast, Apr 2007.
	May 2007	5.4	5.2	8.1	--	--	2.6	Country Forecast, May 2007.
Hong Kong General Chamber of Commerce	Feb 2007	5	--	--	--	--	2.5	HKGCC, 24 Feb 2007.
University of Hong Kong	Apr 2007	5-6	--	--	--	--	2.2	APEC Study Center, HKU 11 Apr 2007.
Federation of Hong Kong Industries	Jan 2007	5.5-6	--	--	--	--	--	Press release, 18 Jan 2007.

Observation :

The forecasts of GDP growth in real terms for 2007 from the private sector analysts listed above are mostly in the range of 5% to 5.5%, averaging at 5.3%.