

Press Release

(embargoed until 4:15 p.m. on 17 August 2007)

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

The Government released today (Friday) the Half-yearly Economic Report 2007, together with the preliminary figures on Gross Domestic Product for the second quarter of 2007.

The Government Economist, Mr K C Kwok, described the economic situation in the second quarter of 2007 and provided the latest GDP and price forecasts for the year.

MAIN POINTS

- * The Hong Kong economy expanded briskly in the second quarter of 2007, with GDP accelerating to a 6.9% growth in real terms over a year earlier, up from a revised 5.7% in the first quarter. The economic upturn continued to be broad-based and distinctly above trend.
- * Externally, merchandise exports sustained another quarter of strong performance, growing by 11.3% in real terms in the second quarter. While exports to the Mainland stayed vibrant on the back of a buoyant economy, those to the EU and Japan also showed faster growth, thereby offsetting the softness of the US market. Further weakening of the US dollar also helped.
- * Financial services recorded spectacular performance while many business and professional services held up well. Meanwhile, exports of services continued to show distinct growth, rising by 10.9% in real terms in the second quarter, underpinned by the surge in offshore trade, buoyant financial market activities and sustained expansion of inbound tourism.
- * Domestically, private consumption expenditure rose markedly further by 6.6% in real terms in the second quarter, supported by rising income, better job prospects and improved financial positions of households. Overall investment spending picked up to a strong 11.1% growth in real terms in the second quarter. Investment in equipment and machinery re-accelerated to double-digit growth amidst the strong business confidence, while construction and building activity saw a notable rebound albeit from a low base.
- * The labour market improved further in the second quarter, with the seasonally adjusted unemployment rate edging down to 4.2% in the second quarter, the lowest since mid-1998. Wages and earnings continued to rise, while job vacancies surged to a post-1997 high in March 2007.
- * The global economic environment is still largely positive. However, the weakness of the US economy arising from a prolonged correction in the housing

market and the turmoil arising from the sub-prime mortgages will remain a concern. This, coupled with the tightening in credit conditions in many financial markets, will constitute the key source of uncertainty going forward. The external environment will also be affected by the movements of exchange rates as well as the macroeconomic adjustment measures in the Mainland. Yet there are also a number of favourable developments, including the continued vibrant growth of the Mainland and other emerging economies, the sustained economic expansion in Europe and Japan, as well as the fairly strong performance of other Asian economies.

- * Domestic demand has gathered strong momentum in recent quarters and assumed an important role in driving the economy forward. An improving labour market and strong consumer confidence should continue to support private consumption spending. Investment spending should also hold up well, in the face of the brisk pace of business expansion, sustained corporate profit growth, and new business opportunities emanating from the economic integration between Hong Kong and the Mainland.
- * Taking into account the better-than-expected outturn of a 6.3% GDP growth in the first half of 2007 and also the range of uncertainties prevailing in the external environment, the forecast GDP growth for 2007 as a whole is revised upward from 4.5-5.5% to 5-6%. Indeed, barring any abrupt adverse changes in the external environment, the economy is set for further solid growth in the second half of the year.
- * As to the inflation outlook, higher food prices, the renminbi appreciation and recent weakness of the US dollar would continue to exert cost pressure from the external front. Nevertheless, the sustained rapid increase in labour productivity and continued expansion in productive capacity on the supply side would provide an offset. Moreover, various one-off factors including the rates concession for two quarters, the recent public housing rental cut, and the implementation of the Pre-primary Education Voucher Scheme would also help keep the headline inflation at a moderate level in the rest of the year. With the actual outturn of consumer price inflation so far largely in line with expectations (1.5% for the first half of 2007), the forecast rate of increase in the Composite CPI for 2007 as a whole is 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 rose by 6.9% in real terms in the second quarter of 2007 over a year earlier, marking the 15th consecutive quarter of distinctly above-trend growth. This was also faster than the revised 5.7% growth in the preceding quarter. Growth remained broad-based, with external trade gathering strong momentum and domestic demand continuing to display strength. On a seasonally adjusted quarter-to-quarter comparison, GDP accelerated to a 2.0% growth in real terms in the second quarter of 2007 (*Chart*).

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

External trade

3. Merchandise exports registered robust growth in the second quarter of 2007, with broad-based expansion across different markets. The Mainland market continued to be the key growth driver, given its own vibrant trade flows and strong domestic demand. Exports to the EU and Japan also showed faster growth, thereby offsetting the softness of the US market. Further weakening of the US dollar also contributed to export competitiveness. *Total exports of goods* went up strongly by 11.3% in real terms in the second quarter over a year earlier. On a seasonally adjusted quarter-to-quarter comparison, total exports of goods expanded by 2.0% in real terms in the second quarter of 2007.

4. *Exports of services* grew distinctly, by 10.9% in real terms in the second quarter of 2007 over a year earlier, mainly propelled by service exports relating to offshore trade as well as by exports of financial services given the buoyant financial market activities. Service exports relating to inbound tourism also saw further notable growth along with the pick-up in the number of incoming visitors in the quarter. On a seasonally adjusted quarter-to-quarter comparison, exports of services rose notably by 3.9% in the second quarter of 2007.

Domestic sector

5. The robust external trade was well matched by the fairly strong performance of domestic demand. Local consumer sentiment was upbeat in the second quarter, backed by rising labour income, better job prospects and buoyancy of the stock market. *Private consumption expenditure (PCE)* accelerated to a strong 6.6% growth in real terms in the second quarter of 2007 over a year earlier. On a seasonally adjusted quarter-to-quarter comparison, private consumption expenditure likewise increased distinctly, by 2.8% in real terms in the second quarter.

6. *Overall investment spending* picked up to a strong 11.1% growth in real terms in the second quarter of 2007. Machinery and equipment investment continued to be a major driving force of overall investment growth, while stronger private sector construction activities led to a rebound in overall building and construction expenditure, albeit from a low base. Meanwhile, the results of the latest Quarterly Business Tendency Survey continued to indicate strong business confidence.

The labour sector

7. The labour market continued to improve in the second quarter of 2007. Total employment hit record high, and in tandem the *seasonally adjusted unemployment rate* edged down further to 4.2% in the second quarter, the lowest since mid-1998. The total number of job vacancies in the corporate sector surged to a post-1997 high in March 2007, while wages and earnings continued to rise.

Prices

8. Consumer price inflation remained mild. The year-on-year rate of increase in *Composite Consumer Price Index (CCPI)* eased to 1.3% in the second quarter of 2007, down from the 1.7% rise in the first quarter. This was mainly attributable to the rates concession for two quarters, which would last until September this year. Discounting the effect of the rates concession, the underlying inflation rate was still moderate, at 2.4% year-on-year in the second quarter. This was notwithstanding the increased imported inflation particularly in foodstuffs in addition to the exchange rate effect as a result of the weakness of the Hong Kong dollar and the appreciation of the renminbi. The *GDP deflator* continued to increase slightly, by 0.7% in the second quarter, along with the improvement in terms of trade.

Latest GDP and price forecasts for 2007

9. The global economic environment is still largely positive. However, the weakness of the US economy is expected to continue in the coming quarters, given the prolonged correction in its housing market and the recent financial market turmoil arising from the sub-prime mortgages. Uncertainties arising from the tightening in credit conditions in many financial markets and the increase in financial market risks will continue for some time. The external environment will also be affected by the movements of exchange rates as well as the macroeconomic adjustment measures in the Mainland. Yet there are also a number of favourable developments, including the continued vibrant growth of the Mainland and other emerging economies, the sustained economic expansion in Europe and Japan, as well as the fairly strong performance of other Asian economies.

10. Domestic demand has gathered strong momentum in recent quarters and assumed an important role in driving the economy forward. An improving labour market and strong consumer confidence should continue to support private consumption spending. Investment spending should also hold up well, in the face of the brisk pace of business expansion, sustained corporate profit growth, and new business opportunities emanating from the economic integration between Hong Kong and the Mainland.

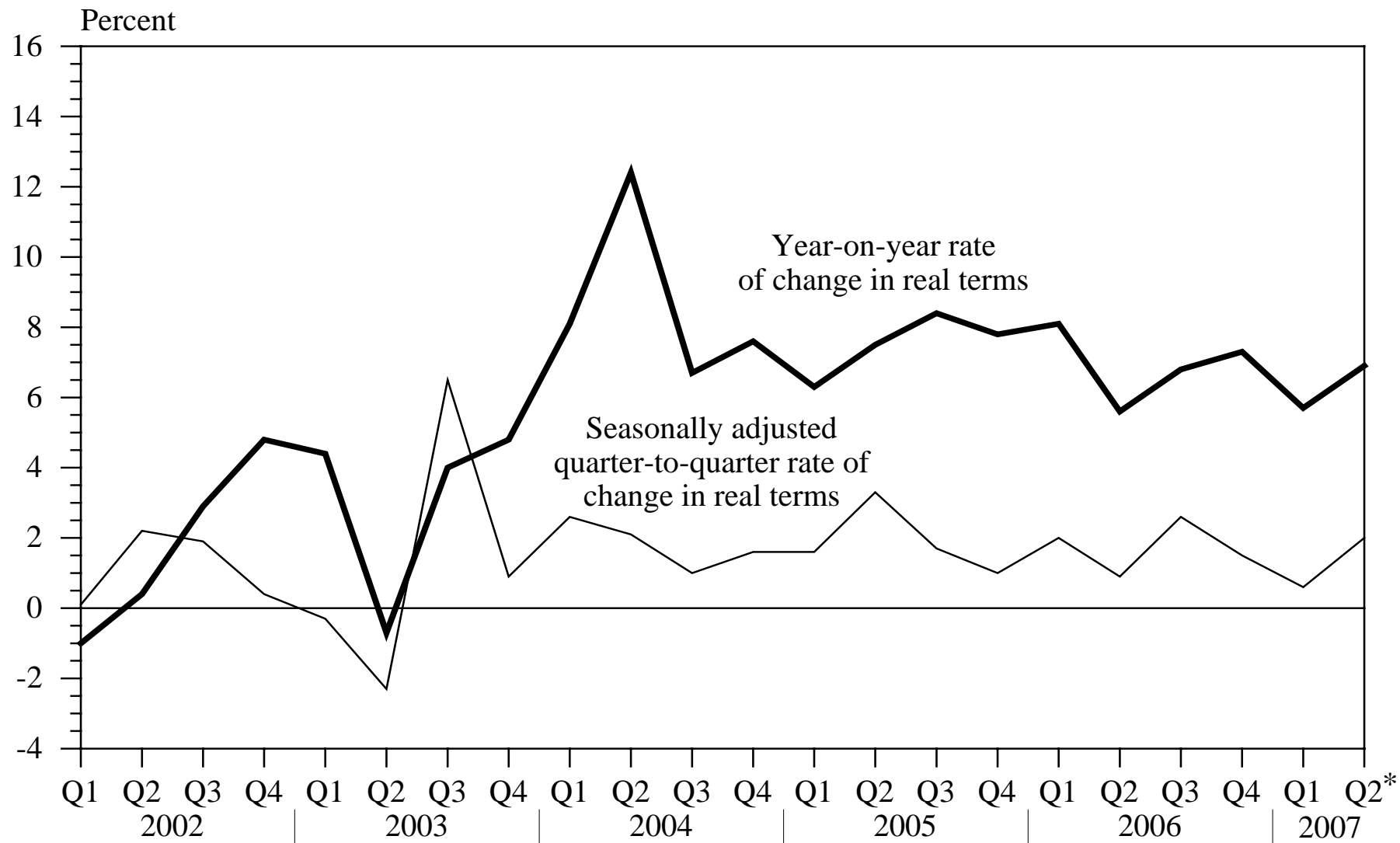
11. Taking into account the better-than-expected outturn of a 6.3% GDP growth in the first half of 2007 and also the range of uncertainties prevailing in the external environment, the forecast GDP growth for 2007 as a whole is revised upward from 4.5-5.5% to 5-6%. Indeed, barring any abrupt adverse changes in the external environment, the economy is set for further solid growth in the second half of the year (*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*.

12. As to the inflation outlook, higher food prices, the renminbi appreciation and recent weakness of the US dollar would continue to exert cost pressure from the external front. Nevertheless, the sustained rapid increase in labour productivity and continued expansion in productive capacity on the supply side would provide an offset. Moreover, various one-off factors including the rates concession for two quarters, the recent public housing rental cut, and the implementation of the Pre-primary Education Voucher Scheme would also help keep the headline inflation at a moderate level in the rest of the year. With the actual outturn of consumer price inflation so far largely in line with expectations, the forecast rate of increase in the Composite CPI for 2007 as a whole is maintained at 1.5%. As to the GDP deflator, in view of its recent mild rebound along with the improvement in terms of trade, the forecast rate of increase for 2007 as a whole is revised slightly upward from -0.5% to 0.5%.

(The Half-yearly 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 \$69 per copy (15% discount offered if purchased on-line), with a postage charge.)

(The GDP figures up to the second quarter of 2007 are published in the Report of the Gross Domestic Product, Second 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>	<u>Q2⁺</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)	5.3 (1.8)	6.6 (2.8)
Government consumption expenditure	-3.1	0.2	1.1 (2.9)	-1.5 (-2.3)	-1.1 (0.3)	2.3 (1.4)	2.4 (3.0)	2.8 (-1.8)
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)	4.7 (N.A)	11.1 (N.A)
<i>of which :</i>								
Building and construction	-8.4	-7.3	-11.4	-4.1	-10.1	-2.8	-2.6	5.3
Machinery, equipment and computer software	12.9	17.2	22.4	11.9	20.4	14.9	6.8	13.1
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)	11.3 (2.0)
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)	12.9 (3.5)
Exports of services	11.3	8.9	8.5 (0.6)	8.9 (2.6)	8.9 (3.2)	9.0 (2.5)	8.9 (0.5)	10.9 (3.9)
Imports of services	7.4	6.4	5.0 (-0.3)	9.1 (5.4)	5.2 (-0.9)	6.5 (2.0)	4.1 (-2.3)	8.0 (9.2)
Gross Domestic Product	7.5	6.9	8.1 (2.0)	5.6 (0.9)	6.8 (2.6)	7.3 (1.5)	5.7 (0.6)	6.9 (2.0)
<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)	0.7 (-0.3)
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 (*)	1.3 (0.4)
<u>Change in nominal GDP (%)</u>	7.1	6.6	8.0	5.3	6.3	6.9	6.7	7.7

(#) 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 on 18.5.2007 (%)	Latest forecasts for 2007 on 17.8.2007 (%)
Gross Domestic Product (GDP)		
<i>Real GDP</i>	4.5 to 5.5	5 to 6
<i>Nominal GDP</i>	4 to 5	5.5 to 6.5
Composite Consumer Price Index	1.5	1.5
GDP deflator	-0.5	0.5

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.
	Apr 2007	5.3	--	--	--	--	--	East Asia and Pacific Update, Apr 2007.
PECC	Nov 2006	5.1	1.7	--	--	--	2.5	State of the Region 2006-2007, Nov 2006.
	May 2007	5.3	--	--	7.4	--	2.2	State of the Region First Quarter Economic Outlook, 2007.
United Nations	Jan 2007	6.2	--	--	--	--	1.7	World Economic Situation and Prospects 2007, Jan 2007.
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.
	Jul 2007	5.4	3.5	8	--	--	1.8	Macro Currencies, July 2007.
Hang Seng Bank	Feb 2007	5.6	--	--	--	--	2.5	Economic Bulletin, February 2007.
	May 2007	5.6	--	--	8	--	2	Economic Bulletin, May 2007.
	Jul 2007	5.6	--	--	8	--	2	Economic Bulletin, Jul 2007.
Standard Chartered Bank	Feb 2007	5	--	--	--	--	2	Asia Focus, 14 Feb 2007.
	May 2007	5.5	--	--	--	--	2	Asia Focus, 16 May 2007.
	Aug 2007	5.5	--	--	--	--	1.8	Asia Focus, 8 Aug 2007.
Bank of China (HK)	Dec 2006	5	3.8	4.8	7.5	7	2.5	Bank of China (HK) Research, Dec 2006.
	Jun 2007	5	3.8	4.8	7.5	7	2	BOC Economic Review Monthly, Jun 2007.
Bank of East Asia	Jan 2007	5	5.5	4.5	7.4	7	2.7	Economic Analysis, Jan 2007.
	Aug 2007	6	--	--	--	--	2	Bank of East Asia, 13 Aug 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 capital formation in real	Total exports of goods terms (%)	Exports of services	Rate of change in consumer prices (%)	Reference source
ABN Amro Bank	Jan 2007	4	3.6	6	--	--	3	Asia Vision, 10 Jan 2007.
	May 2007	4.8	--	--	--	--	--	Asia Vision, 30 May 2007.
	Jul 2007	5.5	--	--	--	--	2.1	Macro forecast, Jul 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.
	Jul 2007	6	--	--	--	--	1.8	Hong Kong Economics, 2 Jul 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.
	Aug 2007	5.3	--	--	--	--	1.6	JP Morgan Chase, 13 Aug 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.
	Aug 2007	6	--	--	--	--	2.9	Goldman Sachs Asia, 13 Aug 2007.
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.
	May 2007	5	4.5	6	--	--	2.5	Hong Kong Economics, 21 May 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.
	Jun 2007	5	5.5	6.5	--	--	2	Emerging Markets Quarterly, 20 Jun 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.
	Aug 2007	6.5	--	--	--	--	1.5	Global Weekly Economic Monitor, 10 Aug 2007.

Table 3 (cont'd)

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>
<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.
	Jul 2007	5.7	5.5	6.5	--	--	2	Country Forecast, Jul 2007.
	Aug 2007	5.9	5.8	6.5	--	--	1.9	Country Forecast, Aug 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.
	Jul 2007	5.2	--	--	--	--	--	APEC Study Center, HKU 4 Jul 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 5-6%, averaging at 5.5%.