

Press Release

(embargoed until 4:15 p.m. on 15 August 2008)

Economic Situation in the Second Quarter of 2008 and Latest GDP and Price Forecasts for 2008

The Government released today (Friday) the Half-yearly Economic Report 2008, together with the preliminary figures on Gross Domestic Product for the second quarter of 2008.

The Government Economist, Mr K C Kwok, described the economic situation in the second quarter of 2008 and provided the latest GDP and price forecasts for the year.

MAIN POINTS

- The Hong Kong economy grew moderately by 4.2% in the second quarter of 2008. This followed a strong 7.3% growth in the first quarter. The moderation after a prolonged period of robust economic expansion indicated that the headwinds from the slowing growth in the advanced economies and lingering financial market turbulence had increasingly posed a drag on the economic growth of the Asian region, including that of Hong Kong.
- Merchandise exports fell in June amidst the increasingly challenging external environment. But they grew moderately for the second quarter as a whole. Exports of services grew notably in the second quarter, yet the performance was not as sanguine as in the previous quarters. There was further expansion in offshore trade and inbound tourism, but the impact on financial service activities due to the ongoing turbulence in the global financial markets had become more evident.
- Domestic demand also showed a slower growth in the second quarter. The growth of consumption spending moderated after a long period of exceptionally strong performance. While the firm labour market remained a supportive factor, the stock market correction, rising inflation and dimmer global economic prospects had probably dented consumer sentiments. Investment spending expanded further despite the high base in the same quarter last year. The latest business survey results suggested that large business establishments were still generally positive about near-term business prospects.
- Labour market conditions remained firm in the second quarter. The seasonally adjusted unemployment rate stayed at 3.3%, the lowest in the past decade, and the underemployment rate was stable at 1.9%. Labour earnings and wages were on the rise.
- Inflationary pressure continued to trend upward in the second quarter, with headline consumer price inflation rising to 5.7%. The surge in food prices amidst the global food inflation contributed significantly to the recent pick-up in

consumer price inflation. Pressure from the demand side after a prolonged period of economic expansion was also reflected in the faster increases in private housing rentals and, to a lesser extent, prices for other goods and services. Meanwhile, underlying consumer price inflation, after netting out the effects of one-off policy measures, also stood at 5.7%, the same as its headline counterpart in the second quarter. This was because the alleviation effect of the rates concession in the second quarter this year was offset by the similar measure implemented in the same quarter last year.

- The external environment facing Hong Kong would become increasingly challenging going forward, owing to the expected moderation in global economic growth, the lingering global financial turbulence and the negative effect on demand in Hong Kong's major markets because of high commodity prices. Rising inflation among the Asian economies is also posing a greater threat to economic prospects in the region. The macroeconomic adjustment measures in the Mainland economy also need to be watched closely.
- Domestic demand should likewise experience a slower pace of expansion in the remaining months of the year, as the growth in the external sector recedes. Nevertheless, the firm labour market conditions should continue to provide support to local consumption. As business confidence remains generally positive, there should also be further growth in investment spending.
- On the whole, the Hong Kong economy is expected to grow moderately further in the rest of 2008, at a rate more in line with the trend growth rate over the past decade. Taking into account the notable growth of 5.8% of the economy in the first half of the year, the GDP forecast for the year of 2008 as a whole is kept unchanged at 4-5%.
- Global food prices and international oil prices, while showing some signs of stabilization lately, remain elevated. Thus inflationary pressure from the external front will continue to be felt in the coming months. The domestically generated inflationary pressure may also become more evident, especially in private housing rentals, after a prolonged period of rapid economic expansion. Yet the improvement in labour productivity and the expected moderation in the rate of economic growth in the period ahead should provide some alleviating effect. Taking into account the faster-than-expected increase in food prices in the first half of the year, the forecast rate of increase in the underlying Composite CPI for 2008 is revised upward from 4.5% in the May round to 5.5%. Nevertheless, the relief measures announced in the 2008-09 Budget and by the Chief Executive in mid-July would help to lower the headline inflation notably in the latter part of the year. The forecast headline inflation rate for 2008 is now put at 4.2%.

DETAIL

GDP

According to the preliminary figure on the *Gross Domestic Product (GDP)* released today by the Census and Statistics Department, GDP grew moderately by 4.2% in real terms in the second quarter of 2008 over a year earlier. This followed a strong 7.3% (upward revised from an earlier 7.1% estimate) growth in the first quarter. The moderation in growth reflected the strong headwinds from the slowing growth in the advanced economies and lingering financial market turbulence, which had increasingly posed a drag on the economic growth of the Asian region, including that of Hong Kong. On a seasonally adjusted quarter-to-quarter comparison, GDP fell by 1.4% in real terms in the second quarter. This was the first quarter-to-quarter decline since the second quarter of 2003. Yet this has to be viewed against the very strong performance in the first quarter. (*Chart*).

2. The latest figures on GDP and its major expenditure components up to the second quarter of 2008 are presented in *Table 1*. Developments in different segments of the economy in the second quarter of 2008 are described below.

External trade

3. *Total exports of goods* grew moderately in the second quarter as a whole, amidst an increasingly challenging external economic environment. Total exports of goods grew by 4.4% in real terms in the second quarter over a year earlier. The slowdown was concentrated in the month of June. The demand from the Mainland and other emerging economies, which held firm during most of the second quarter, as well as the continued expansion in the EU economy, provided the major support. The earlier weakness of the US dollar, and hence the Hong Kong dollar, against other major currencies also helped to sustain the price competitiveness of Hong Kong's exports to such markets as the EU and some emerging market economies. On a seasonally adjusted quarter-to-quarter comparison, total exports of goods expanded further by 1.0% in real terms in the second quarter of 2008.

4. *Exports of services* grew further at a less robust pace of 7.1% in real terms in the second quarter over a year earlier. There was further expansion in offshore trade and inbound tourism, but the impact on financial service activities due to the ongoing turbulence in the global financial markets had become more evident. Exports of financial services grew less rapidly than in the preceding quarters, albeit still at a double-digit pace. On a seasonally adjusted quarter-to-quarter comparison, exports of services fell by 0.3% in the second quarter of 2008.

Domestic sector

5. Domestic demand continued to contribute to overall economic growth in the second quarter despite showing a slower growth. The growth of consumer

spending moderated notably in the second quarter after a long period of exceptionally strong performance. While the firm labour market conditions constituted a supportive factor, the stock market correction, rising inflation, and dimmer global economic prospects began to weigh on consumer sentiments. *Private consumption expenditure* (PCE) rose by 3.1% in real terms in the second quarter over a year earlier. On a seasonally adjusted quarter-to-quarter comparison, private consumption expenditure fell by 1.6% in the second quarter.

6. *Overall investment spending* expanded further in the second quarter of 2008 despite the relative high base in the same quarter of last year. It rose by 4.3% in real terms in the second quarter over a year earlier. Machinery and equipment investment continued to rise solidly. Also, as suggested by the results of latest Quarterly Business Tendency Survey conducted by the Census and Statistics Department, large private sector business establishments in most economic sectors were still largely positive about the near-term economic prospects. However, building and construction activities in both private and public sectors reverted to declines in the second quarter. Taking altogether, overall expenditure on building and construction decreased by 1.7%.

The labour sector

7. Labour market conditions remained firm in the second quarter. The *seasonally adjusted unemployment rate* stayed at 3.3%, the lowest in the past decade, and the *underemployment rate* was stable at 1.9%. Labour earnings continued to register broad-based increase in the first quarter of 2008, though significant variations still existed across different economic sectors and occupations.

Prices

8. *Consumer price inflation*, in terms of the Composite CPI, rose further to an average of 5.7% in the second quarter. The sustained surge in food prices against the background of global food inflation was the main factor underlying the recent pick-up in the consumer price inflation. The pressure generated from the demand side, after several years of rapid expansion of the local economy, had also become increasingly visible. This is reflected in the faster increases in private housing rentals and, to a lesser extent, prices for other goods and services. The elevated energy prices, the gradual appreciation of the renminbi and the weak US dollar also added to the inflationary pressure. Meanwhile, underlying consumer price inflation, after netting out the effects of one-off policy measures, also stood at 5.7%, the same as its headline counterpart in the second quarter. This was because the alleviation effect of the rates concession in the second quarter this year was offset by the similar measure implemented in the same quarter last year. As to the GDP deflator, a smaller increase was recorded in the second quarter, largely reflecting the continued deterioration in the terms of trade.

Latest GDP and price forecasts for 2008

9. The external environment facing Hong Kong would become increasingly challenging going forward, owing to the expected moderation in global economic growth, the lingering global financial turbulence and the negative effect on demand in Hong Kong's major markets because of high commodity prices. Rising inflation among the Asian economies is also posing a greater threat to economic prospects in the region. The macroeconomic adjustment measures in the Mainland economy also need to be watched closely.

10. Domestic demand should likewise experience a slower pace of expansion in the remaining months of the year, as the growth in the external sector recedes. Nevertheless, the firm labour market conditions should continue to provide support to local consumption. As business confidence remains generally positive, there should also be further growth in investment spending.

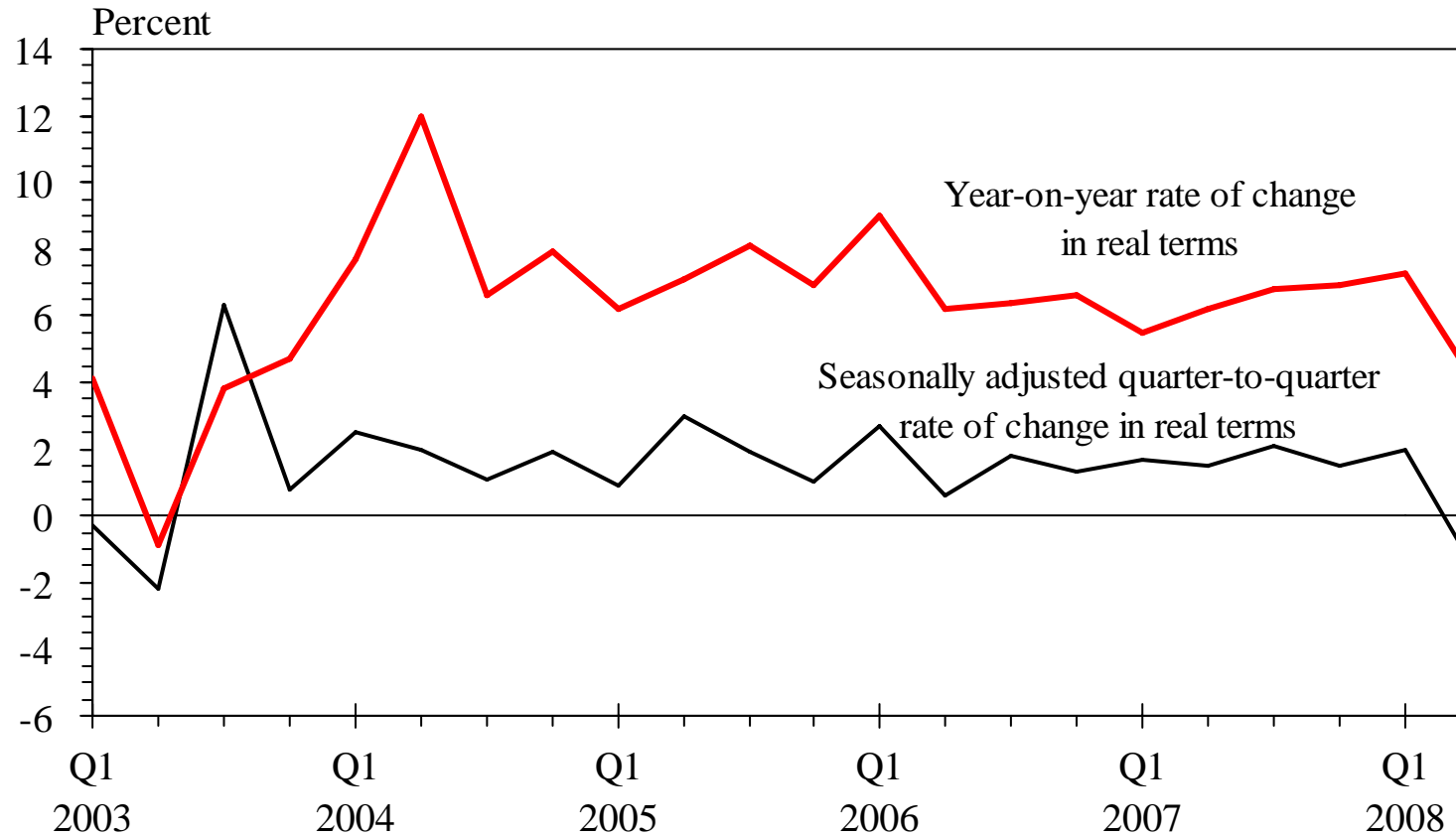
11. On the whole, the Hong Kong economy is expected to grow moderately further in the rest of 2008, at a rate more in line with the trend growth rate over the past decade. Taking into account the notable growth of 5.8% of the economy in the first half of the year, the GDP forecast for the year of 2008 as a whole is kept unchanged at 4-5%.

12. As for inflation outlook, global food prices and international oil prices, while showing some signs of stabilization lately, remain elevated. Thus inflationary pressure from the external front will continue to be felt in the coming months. The domestically generated inflationary pressure may also become more evident, especially in private housing rentals, after a prolonged period of rapid economic expansion. Yet the improvement in labour productivity and the expected moderation in the rate of economic growth in the period ahead should provide some alleviating effect. Taking into account the faster-than-expected increase in food prices in the first half of the year, the forecast rate of increase in the underlying Composite CPI for 2008 is revised upward from 4.5% in the May round to 5.5%. Nevertheless, the relief measures announced in the 2008-09 Budget and by the Chief Executive in mid-July would help to lower the headline inflation notably in the latter part of the year. The forecast headline inflation rate for 2008 as a whole is now put at 4.2%.

(The Half-yearly Economic Report 2008 is now available for online download, free of charge at <http://www.hkeconomy.gov.hk/en/reports/index.htm>. The Report of the Gross Domestic Product, Second Quarter 2008, which contains the GDP figures up to the second quarter of 2008, is also available for online download, free of charge at the homepage of the Census and Statistics Department (<http://www.censtatd.gov.hk>). Users can purchase the print version of these two publications online at the Government Bookstore at <http://www.bookstore.gov.hk>, or by calling the Publications Sales Unit of the Information Services Department at 2537 1910.

The print version of the two reports is available for sale at \$70 and \$47 per issue respectively (15% discount offered if purchased on-line), plus postage charge.)

Hong Kong's Gross Domestic Product



Note : Figures for the second quarter of 2008 are preliminary estimates.

Table 1

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

	<u>2006[#]</u>	<u>2007[#]</u>	<u>2007</u>				<u>2008</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	6.0	7.8	4.5 (1.5)	6.6 (3.0)	10.6 (3.2)	9.5 (1.6)	7.9 (-0.1)	3.1 (-1.6)
Government consumption expenditure	0.1	2.3	2.3 (1.6)	3.0 (-0.3)	1.5 (-0.3)	2.3 (1.2)	0.3 (-0.4)	3.5 (3.1)
Gross domestic fixed capital formation	7.0	4.2	0.8	8.1	-0.5	8.2	9.9	4.3
<i>of which :</i>								
Building and construction	-7.3	1.0	-1.9	7.3	-0.2	-1.2	8.2	-1.7
Machinery, equipment and computer software	19.1	3.5	0.3	7.8	-2.7	8.5	6.1	6.5
Total exports of goods	9.3	7.0	6.5 (0.3)	10.0 (3.0)	6.2 (0.2)	5.7 (1.8)	8.3 (1.4)	4.4 (1.0)
Imports of goods	9.2	8.8	7.1 (0.1)	11.5 (4.1)	8.1 (0.5)	8.5 (3.1)	8.4 (-1.1)	4.9 (2.4)
Exports of services	10.1	12.5	11.3 (3.5)	11.6 (2.8)	13.7 (4.2)	13.1 (2.2)	10.2 (0.6)	7.1 (-0.3)
Imports of services	8.1	8.5	6.6 (0.5)	8.9 (5.8)	8.7 (0.3)	9.7 (2.8)	10.1 (1.2)	2.6 (-2.1)
Gross Domestic Product	7.0	6.4	5.5 (1.7)	6.2 (1.5)	6.8 (2.1)	6.9 (1.5)	7.3 (2.0)	4.2 (-1.4)
<i>Change in the main price indicators (%)</i>								
GDP deflator	-0.3	3.0	1.4 (0.6)	2.0 (0.9)	3.2 (1.1)	4.9 (2.1)	2.3 (-1.7)	2.0 (0.6)
Composite Consumer Price Index	2.0	2.0	1.7 (*)	1.3 (0.3)	1.6 (0.8)	3.5 (2.2)	4.6 (1.1)	5.7 (1.5)
<u>Change in nominal GDP (%)</u>	6.7	9.5	7.0	8.4	10.2	12.1	9.8	6.3

Notes : Figures are subject to revision later on as more data become available. Seasonally adjusted quarter-to-quarter rate of change is not applicable to gross domestic fixed capital formation, as no clear seasonal pattern is found for the category due to the presence of considerable short term fluctuations.

(#) Revised figures.

(+) Preliminary figures.

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

(*) Change of less than 0.05%.

Table 2**Economic forecasts for 2008
(year-on-year rate of change (%))**

	Forecasts for 2008 as released on 16.5.2008 (%)	Latest forecasts for 2008 on 15.8.2008 (%)
Gross Domestic Product (GDP)		
<i>Real GDP</i>	4 to 5	4 to 5
<i>Nominal GDP</i>	6.5 to 7.5	6.5 to 7.5
Composite Consumer Price Index (CCPI)		
<i>Headline CCPI</i>	3.4	4.2
<i>Underlying CCPI</i>	4.5	5.5
GDP Deflator	2.5	2.5

Table 3

2008 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> (growth rate	<u>Private consumption expenditure</u> 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	Feb 2008	4.6	3.2	1.7	--	--	3.7	2007 Article IV Consultation -Staff Report, February 2008.
	Apr 2008	4.3	--	--	--	--	3.6	World Economic Outlook, Apr 2008.
ADB	Apr 2008	4.5	--	--	--	--	3.4	Asian Development Outlook 2008, Apr 2008.
	Jul 2008	4.9	--	--	--	--	4.7	Asian Development Outlook 2008, Jul 2008.
PECC	Dec 2007	6	--	--	--	--	2.87	State of the Region 2007-2008, 13 Dec 2007.
World Bank	Apr 2008	4.8	--	--	--	--	--	East Asia and Pacific Update, Apr 2008.
United Nations	Jan 2008	5.7	--	--	--	--	1.4	World Economic Situation and Prospects 2008, 9 Jan 2008.
United Nations, ESCAP	Mar 2008	5.7	--	--	--	--	3.4	Economic and Social Survey of Asia and the Pacific 2008, Mar 2008.
Private sector analysts:								
<i>(a) Major local banks</i>								
HSBC	Jan 2008	5	5.3	7.6	--	--	3.9	Macro Asia Economics Q1 2008, 8 Jan 2008.
	Mar 2008	5	7.6	7.6	--	--	3.9	Macro Asia Economics Q2 2008, 27 Mar 2008.
	Jul 2008	5	7.8	7.7	--	--	3.9	Macro Asian Economics, 10 Jul 2008.
Hang Seng Bank	Feb 2008	5	--	--	--	--	3.5	Hong Kong Economic Monitor, February 2008.
	May 2008	5	--	--	--	--	4	Hang Seng Bank, 13 May 2008.
	Aug 2008	5	--	--	--	--	5	Hang Seng Bank, 11 Aug 2008.
Standard Chartered Bank	Feb 2008	4.6	--	--	--	--	3.8	Standard Chartered Global Focus, 21 Feb 2008.
	May 2008	4.6	--	--	--	--	Headline: 4.1 Underlying: 5.2	Standard Chartered Bank, 13 May 2008.
	Aug 2008	4.6	--	--	--	--	Headline: 5 Underlying: 5.8	Standard Chartered Bank, 13 Aug 2008.
Bank of China (HK)	Dec 2007	5	5.5	4.5	7.6	9.8	3.5	Economic Review, Dec 2007.
	May 2008	5	5.5	4.5	7.6	9.8	4.5	Economic Review, May 2008.

Table 3 (Cont'd)

2008 GDP and price forecasts for Hong Kong put out by selected international organisations and private sector analysts

	Date of release	GDP (growth rate)	Private consumption expenditure rate	Gross domestic fixed capital formation		Total exports of goods terms	Exports of services (%)	Rate of change in consumer prices (%)	Reference source
				in	real				
Bank of East Asia	Jan 2008	5	7.5	4.5		6	8.5	3.5	Economic Analysis, Jan 2008.
	Mar 2008	4.5	6.5	--		7	--	3.5	Wen Wei Po, 20 Mar 2008.
	Aug 2008	4.5	--	--		--	--	4	Bank of East Asia, 11 Aug 2008.
Citigroup	Jan 2008	5.3	6	7.2		--	--	3.7	Asia Economic Outlook and strategy, 28 Jan 2008.
	Apr 2008	4.5	6.1	7		--	--	3.7	Asia Economic Outlook and strategy, 29 Apr 2008.
	Aug 2008	5	--	--		--	--	4.4	Citigroup, 12 Aug 2008.
<i>(b) Investment bank</i>									
Goldman Sachs Asia	Jan 2008	5.2	--	--		--	--	--	Apple Daily, 26 Jan 2008.
Morgan Stanley Asia	Feb 2008	5.5	--	--		--	--	4	Morgan Stanley Asia, 19 Feb 2008.
	Aug 2008	5.5	--	--		--	--	4.5	Morgan Stanley Asia, 11 Aug 2008.
JP Morgan Chase Bank	Feb 2008	5.3	--	--		--	--	3.5	JP Morgan Chase Bank 18 Feb 2008.
	May 2008	4.6	--	--		--	--	4.5	JP Morgan Chase Bank 13 May 2008.
	Aug 2008	4.8	--	--		--	--	4.5	JP Morgan Chase Bank 12 Aug 2008.
Merrill Lynch	Feb 2008	6	--	--		--	--	3.9	The Asian Macro Weekly, 15 Feb 2008.
	Aug 2008	6	--	--		--	--	3.9	The Asian Macro Weekly, 8 Aug 2008.
Credit Suisse	Dec 2007	4.6	6.5	4.9		--	--	5.1	Emerging Markets Quarterly, 6 Dec 2007.
	Mar 2008	3.9	5.6	8.6		--	--	4.9	Emerging Markets Quarterly, 12 Mar 2008.
	Aug 2008	3.9	5.4	6.9		--	--	6	Emerging Markets Economics Research, 22 July 2008.

Table 3 (Cont'd)

2008 GDP and price forecasts for Hong Kong put out by selected international organisations and private sector analysts

	Date of release	GDP (growth rate)	Private consumption expenditure (rate)	Gross domestic fixed capital formation		Total exports of goods in terms	Exports of services (%)	Rate of change in consumer prices (%)	Reference source
				in	real				
Lehman Brothers	Feb 2008	4.5	--	--	--	--	--	4.5	Global Weekly Economic Monitor, 15 Feb 2008.
	May 2008	4.3	--	--	--	--	--	5	Lehman Brothers, 13 May 2008.
	Aug 2008	4.5	--	--	--	--	--	5.7	Lehman Brothers, 11 Aug 2008.
<i>(c) Others</i>									
Economist Intelligence Unit	Mar 2008	4	5.1	4.5	--	--	--	4	Country Forecast, Mar 2008.
	May 2008	4.6	7.5	6.1	--	--	--	5.3	Country Forecast, May 2008.
	Jul 2008	4.7	7.1	6.4	--	--	--	5.3	Country Forecast, Jul 2008.
Hong Kong General Chamber of Commerce	Feb 2008	3.5	--	--	--	--	--	5	HKGCC, 20 Feb 2008.
Federation of Hong Kong Industries	Jan 2008	4.5	--	--	--	--	--	--	Press release, 10 Jan 2008.
University of Hong Kong	Jan 2008	5.6	--	--	--	--	--	--	Press release, 3 Jan 2008.
	Jul 2008	5.7	--	--	--	--	--	--	Press release, 3 Jul 2008.

Observation :

The forecasts of GDP growth in real terms for 2008 from the private sector analysts listed above are mostly in the range of 4.5% to 5.5%, averaging at 4.8%.