

Press Release

(embargoed until 4:30 p.m. on 14 November 2008)

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

The Government released today (Friday) the Third Quarter Economic Report 2008, together with the preliminary figures on Gross Domestic Product for the third quarter of 2008.

The Government Economist, Mrs Helen Chan, described the economic situation in the third quarter of 2008 and provided the latest GDP and price forecasts for the year.

MAIN POINTS

- The growth of the Hong Kong economy slowed notably further in the third quarter, as the external sector slackened amid the faltering global demand and as domestic demand towards the end of the quarter was severely hit by the outbreak of the global financial tsunami that caused significant jitters in the local asset markets. GDP for the third quarter as a whole grew by 1.7% year-on-year, down further from 4.2% in the second quarter.
- On the external front, merchandise exports slackened to only a modest growth in the third quarter, the worst performance since the first quarter of 2002. While the US market continued to pose the main drag, exports to other markets also saw different extents of slowdown as the impact of the global downturn increasingly set in.
- Hong Kong's service exports still recorded a solid growth in the third quarter, though likewise moderated from the second quarter. This was partly affected by a temporary fall-off in inbound tourism during the Olympic Games period. But more importantly, the slow-down was due to a further deceleration in exports of financial services amid the financial market distress on a globalwide basis.
- Consumption spending still held fairly firm in July and August, but slackened distinctly in September as the US financial turmoil escalated into a full-blown global financial tsunami causing the local stock market to plummet markedly. For the third quarter as a whole, consumer spending recorded only a marginal growth against an exceptionally high base a year ago when consumption grew by 10.6%.
- Overall investment spending still recorded a modest growth in the third quarter. Yet in the more recent period, companies have also turned more cautious in making new investments and in hiring new hands in the wake of a highly uncertain global financial and economic environment and as credit availability

was tightened amid the global credit crunch.

- Along with the economic slowdown, the seasonally adjusted unemployment rate rose marginally to a still relative low level of 3.4% in the third quarter. Job prospects have inevitably dimmed as the near term outlook was clouded by the unsettled global financial market situation.
- Headline consumer price inflation fell notably in the third quarter to 4.6%, mainly reflecting the favourable effects of the Government's one-off relief measures. Underlying inflation has tended to stabilize after July, as the tapering in food inflation offset the enlarged increase in private housing costs. CPI inflation notched down from 6.3% in both July and August to 6.1% in September, averaging at 6.3% in the third quarter.
- The financial turbulence, which began in August last year stemming from the US sub-prime mortgage problem, erupted into a full-blown global crisis causing significant clogs to financial markets around the world. The credit crunch that ensued has added woes to the already rapidly faltering global economy. Following a series of unprecedented measures taken by various governments and central banks in the advanced economies, there are signs that stability is gradually returning to the global financial markets. However, the credit markets remain unusually tight and would take time to return to more normal functioning. The risk of a more prolonged and protracted global economic downturn has increased.
- For many advanced economies, including the US and EU, a recession is already under way. The export-dependent economies in Asia would all be affected by different extents. Amid such an uncertain and difficult external environment, Hong Kong's export performance is likely to remain rather lacklustre in the near term.
- Domestic demand would likewise slow in the period ahead. The substantial fall-off in stock market triggered by the global-wide stock market crash and the spillover to the property market, coupled with the less promising job prospect, will continue to restrain consumers' propensity to spend. Businesses are also likely to turn more cautious in making machinery and equipment acquisitions.
- Taking into account the GDP growth of 4.3% in the first three quarters of the year, economic growth for the year of 2008 as a whole is forecast at 3-3.5%, revised down from the earlier range forecast of 4-5%. The economy in the rest of this year is likely to be rather subdued.
- With global commodity prices retreating, especially those of food and oil, and with the rebound in the US dollar since July, inflationary pressures from the external front are receding. The expected slowdown in the Hong Kong economy will also entail lesser pressures from the domestic economy. But the earlier surges in private residential rentals might continue to feed through to consumer price inflation in the coming months. With the favourable effects of the Government's relief measures continuing in the rest of the year, the forecast

headline consumer price inflation for 2008 as a whole remains unchanged at 4.2%. Netting out the effects of Government measures, the forecast underlying inflation rate for 2008 is also maintained at 5.5%.

DETAIL

GDP

According to the preliminary figures on the *Gross Domestic Product (GDP)* released today by the Census and Statistics Department, the GDP grew by 1.7% in real terms over a year earlier. This was a further moderation from the 4.2% growth in the second quarter. On a seasonally adjusted quarter-to-quarter comparison, GDP fell further by 0.5% in real terms in the third quarter, after a contraction of 1.4% in the second quarter (*Chart*).

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

External trade

3. *Total exports of goods* grew by 1.4% in real terms in the third quarter, representing a further deceleration from the second quarter and also the worst performance since the first quarter of 2002. Exports to the advanced economies, notably the US, were directly hit by the rapidly slowing demand in these economies. Intra-regional trade also slowed as a result, as reflected in different extents of moderation in Hong Kong's exports to many other economies in the Asian region. On a seasonally adjusted quarter-to-quarter comparison, total exports of goods fell by 2.6% in real terms in the third quarter of 2008.

4. *Exports of services*, while being affected by the worsening global economic climate, still registered a solid growth of 5.3% in the third quarter. The main drag was the further deceleration in exports of financial services amid the financial market distress and the notably slower pace of expansion in inbound tourism, the latter partly affected by the temporary fall-off in tourists during the Olympic Games period, with spillover to exports of transportation services. Yet offshore trade continued to grow notably, thanks to the Mainland's still vibrant trade flows. On a seasonally adjusted quarter-to-quarter comparison, exports of services rose by 1.8% in the third quarter of 2008.

Domestic sector

5. Consumer spending in July and August still held up relatively well. Yet the shock waves from the sudden outbreak of the global financial tsunami in early

September and the escalation of the crisis in the ensuing weeks sent the local stock market in a nose-dive, and the property market was also down. These financial market jitters coupled with increasing concern over the global outlook weighed heavily on the consumer sentiment towards the end of the quarter. For the third quarter as a whole, *private consumption expenditure* (PCE) grew by only 0.2% in real terms over a year earlier. On a seasonally adjusted quarter-to-quarter comparison, private consumption expenditure rose by 0.3% in the third quarter.

6. *Overall investment spending* saw some further growth of 3.0% in real terms in the third quarter over a year earlier. Machinery and equipment investment rose notably, but the overall expenditure on building and construction posted another moderate decrease. As the property market became quieter, ownership transfer activity also trended downward. The results of the latest Quarterly Business Tendency Survey conducted by the Census and Statistics Department indicated that the sentiments of large private sector business establishments in many economic sectors had turned rather negative on their near-term economic prospects.

The labour sector

7. Along with the economic slowdown, the *seasonally adjusted unemployment rate* rose marginally to a still relative low level of 3.4% in the third quarter. Job prospects have inevitably dimmed as the near term outlook was clouded by the unsettled global financial market situation.

Prices

8. *Headline consumer price inflation*, in terms of the year-on-year increase of the headline Composite CPI, halted its uptrend, easing to 4.6% in the third quarter from 5.7% in the second quarter. The fall-off was mostly due to the relief measures of the Government paying the public housing rentals on behalf of the lower-income families in August and September and the electricity subsidy that took effect in September. Netting out the effects of the one-off Government measures, *underlying consumer price inflation*, as measured by the year-on-year rate of increase in the underlying Composite CPI, rose further to 6.3% in the third quarter, from 5.7% in the second quarter. Nevertheless, on a monthly basis, underlying inflation stabilised at around 6.3% in July and August, and notched down slightly to 6.1% in September, thanks to the tapering of food inflation which offset the enlarged increase in private housing costs due to the earlier surges in market rentals. As to the *GDP deflator*, a small increase was recorded in the third quarter, similar to that in the preceding quarter.

Latest GDP and price forecasts for 2008

9. The financial turbulence, which began in August last year stemming from the US sub-prime mortgage problem, erupted into a full-blown global crisis causing significant clogs to financial markets around the world. The credit crunch that

ensued has added woes to the already rapidly faltering global economy. Following a series of unprecedented measures taken by various governments and central banks in the advanced economies, there are signs that stability is gradually returning to the global financial markets. However, the credit markets remain unusually tight and would take time to return to more normal functioning. The risk of a more prolonged and protracted global economic downturn has increased.

10. For many advanced economies, including the US and EU, a recession is already under way. The export-dependent economies in Asia would all be affected by different extents. Amid such an uncertain and difficult external environment, Hong Kong's export performance is likely to remain rather lacklustre in the near term.

11. Domestic demand would likewise slow in the period ahead. The substantial fall-off in stock market triggered by the global-wide stock market crash and the spillover to the property market, coupled with the less promising job prospect, will probably continue to restrain consumers' propensity to spend. Businesses are also likely to turn more cautious in making machinery and equipment acquisitions.

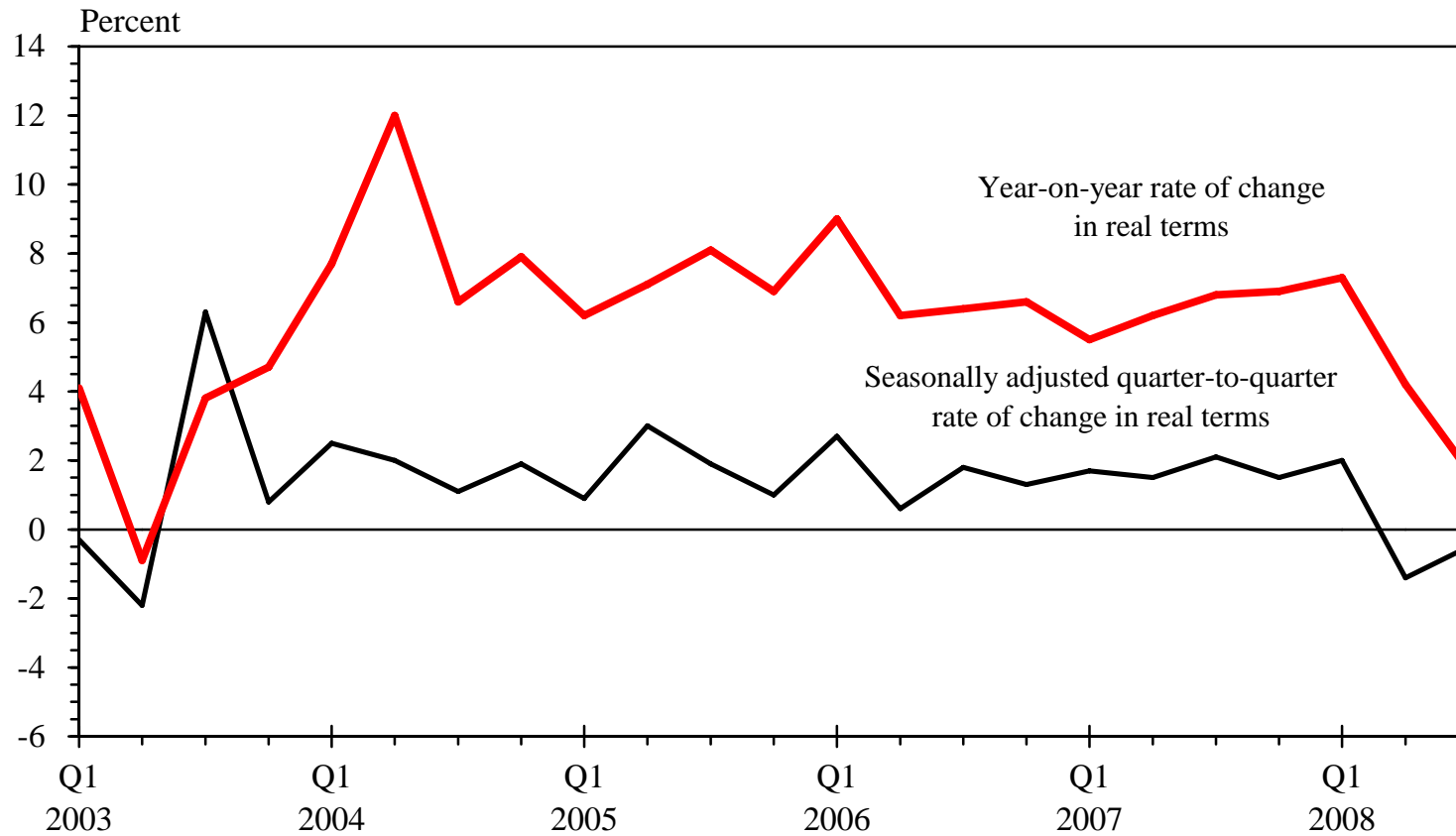
12. Taking into account the GDP growth of 4.3% in the first three quarters of the year, economic growth for the year of 2008 as a whole is forecast at 3-3.5%, revised down from the earlier range forecast of 4-5%. The economy in the rest of this year is likely to be rather subdued.

13. With global commodity prices retreating, especially those of food and oil, and with the rebound in the US dollar since July, inflationary pressures from the external front are receding. The expected slowdown in the Hong Kong economy will also entail lesser pressures from the domestic economy. But the earlier surges in private residential rentals might continue to feed through to consumer price inflation in the coming months. With the favourable effects of the Government's relief measures continuing in the rest of the year, the forecast headline consumer price inflation for 2008 as a whole remains unchanged at 4.2%. Netting out the effects of Government measures, the forecast underlying inflation rate for 2008 is also maintained at 5.5%. As to the GDP deflator, given the recent trends, its forecast rate of increase in 2008 as a whole is also maintained at 2.5%.

(The Third Quarter 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, Third Quarter 2008, which contains the GDP figures up to the third 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 \$66 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 third 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>	<u>Q3⁺</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)	3.2 (-1.5)	0.2 (0.3)
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)	3.0 (2.6)	2.3 (-0.9)
Gross domestic fixed capital formation	7.0	4.2	0.8	8.1	-0.5	8.2	9.9	3.5	3.0
<i>of which :</i>									
Building and construction	-7.3	1.0	-1.9	7.3	-0.2	-1.2	8.2	-3.7	-3.6
Machinery, equipment and computer software	19.1	3.5	0.3	7.8	-2.7	8.5	6.1	6.3	9.9
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)	1.4 (-2.6)
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)	2.2 (-2.1)
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)	8.1 (0.7)	5.3 (1.8)
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)	3.5 (-1.3)	1.8 (-0.7)
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)	1.7 (-0.5)
<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)	2.1 (0.6)	2.1 (1.2)
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)	4.6 (-0.2)
<u>Change in nominal GDP (%)</u>	6.7	9.5	7.0	8.4	10.2	12.1	9.8	6.4	3.8

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.

(#) 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 15.8.2008 (%)	Latest forecasts for 2008 on 14.11.2008 (%)
Gross Domestic Product (GDP)		
<i>Real GDP</i>	4 to 5	3 to 3.5
<i>Nominal GDP</i>	6.5 to 7.5	5.5 to 6.0
Composite Consumer Price Index (CCPI)		
<i>Headline CCPI</i>	4.2	4.2
<i>Underlying CCPI</i>	5.5	5.5
GDP Deflator	2.5	2.5