

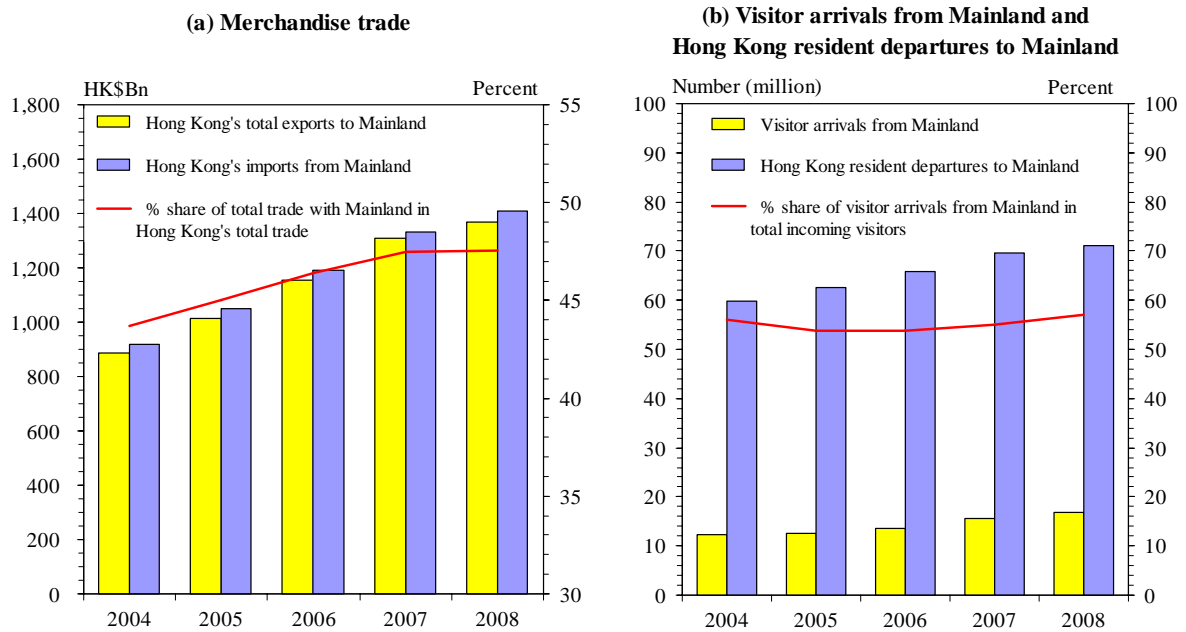
Outlook for the Hong Kong economy in 2009

Hong Kong is a small open economy. The vicissitudes of the economy are closely tied to the demand conditions of its major economic partners. Given the sheer scale of the global financial crisis, advanced economies are now in their worst recession in decades, and Asian economies have also deteriorated rapidly since the latter part of last year. Hong Kong's economic performance in 2009 is bound to be severely affected. Nevertheless, the Government has already implemented a series of measures to stabilise the financial markets, ease credit conditions, support enterprises, accelerate public works, and create employment. Also, the sustained economic growth in the Mainland and particularly the 14 supportive measures to Hong Kong announced by the Central Government in December 2008 will render support to Hong Kong economy.

External environment will be extremely challenging going forward, with Hong Kong's major overseas markets deep in recession into 2009. Many export-dependent Asian economies should lose most of their growth momentum, putting a further drag on intra-regional trade. The strength of the US dollar in the past few months, with its lagged effects on Hong Kong's external price competitiveness, will also add to the strains on Hong Kong's exports in the near term. Overall, *total exports of goods* are likely to show a rather notable decline in most of 2009.

The outlook for *exports of services* is likewise not encouraging. Inbound tourism will be subject to the pressure from shrinkage in travel demand as the incomes of overseas tourists drop alongside the global economic downturn. In this regard, visitors from the Mainland, being relatively less affected by the crisis, will continue to play an important role in supporting the performance of inbound tourism. Hong Kong's offshore trade will also fall victim to the fallout from global trade flows. Exports of finance, business and other services, having expanded rapidly prior to the financial tsunami, should now turn very sluggish, as financial market and other commercial activities will continue to be dampened by the headwinds from the financial tsunami.

Diagram 2.6 : Sustained growth in the Mainland economy will be a positive factor



As to *domestic demand*, local consumer spending will be depressed by heightened uncertainties, falling household wealth and rising unemployment. Private sector investment will similarly stall until clearer signs of an economic recovery are in sight. The results of the latest Business Tendency Survey conducted by the Census and Statistics Department confirm that large companies surveyed were pessimistic about the near-term business outlook. Nevertheless, the fast-tracking of public sector works by the Government should provide some timely support. Measures to ease the credit tightness facing the small and medium-sized enterprises will also help to reduce their difficulties to some extent.

Diagram 2.7 : Local consumer spending will remain depressed amid rising unemployment

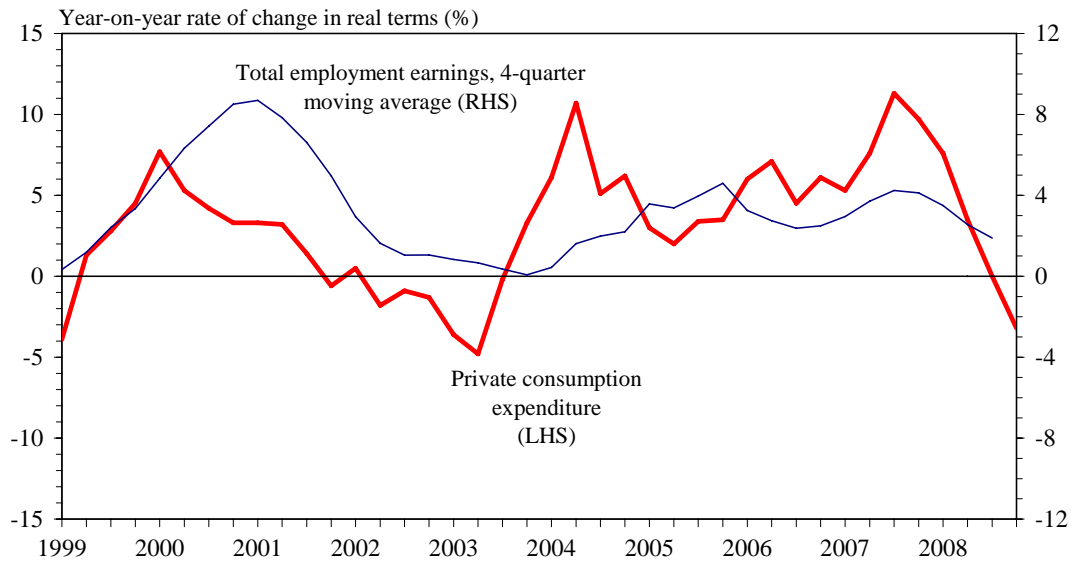
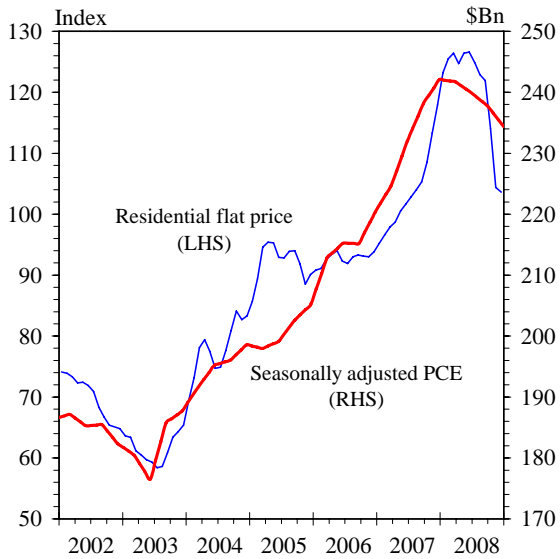


Diagram 2.8 : Asset market correction has hurt consumer sentiment

(a) Residential flat price



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

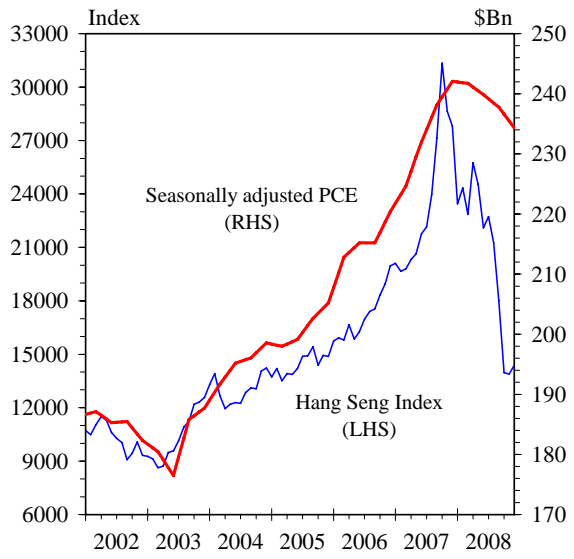
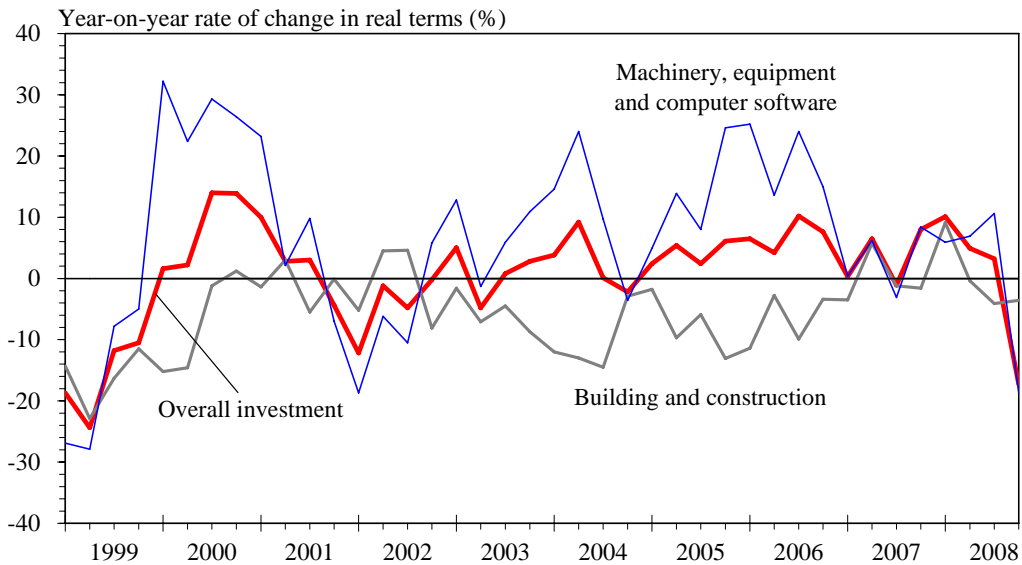


Diagram 2.9 : Investment sentiment will turn more cautious



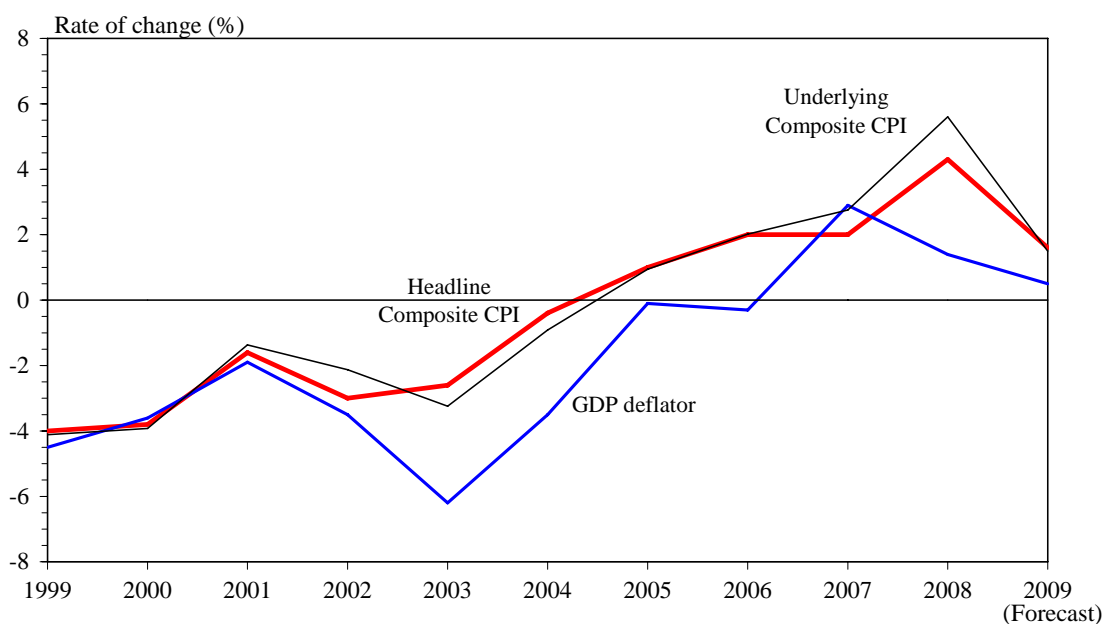
Taking all these developments together, the Hong Kong economy is likely to contract in 2009, by 2% to 3%, the first annual decline since 1998. The prospects for a turnaround will depend much on how the financial tsunami will play out and when the global economic environment will begin to improve. The forecast is broadly in line with the prevailing views by the private sector analysts, with their forecast rates of contraction averaging at around 2%. This projection is subject to considerable uncertainty, especially if the negative feedback loop between global economic weakness and financial stress continues to intensify to prolong and deepen the crisis.

Diagram 2.10 : Economy set to face a contraction in 2009 amid the global recession



Inflationary pressures have been receding notably since the latter part of 2008, as the deepening global downturn has precipitated subdued demand conditions worldwide. The earlier sharp declines in food and energy prices in the international markets have also contributed. The adjustment of the property market is also keeping the housing and commercial rents in check. Taking a broader perspective, global inflationary pressures are expected to come down further in 2009. Along with this global trend, underlying inflation in Hong Kong would also fall visibly during the course of 2009. Against this background, the *underlying Composite CPI* is forecast to increase by 1.5% in 2009 as a whole, down from the 5.6% increase in 2008. The one-off relief measures announced in the 2009-10 Budget will help to lower the Composite CPI, but the impact will be largely offset by the lower base effect created by those one-off relief measures introduced during 2008. Thus, for 2009 as a whole, the *headline Composite CPI* is forecast to increase by 1.6%. The *GDP deflator* is forecast to rise by 0.5%, largely reflecting the deceleration in the increase of domestic prices and also the more stagnant movement in export prices.

Diagram 2.11 : Inflation will recede visibly over the coming 2009



Forecast rate of change in 2009 (%)

Gross Domestic Product (GDP)

<i>Real GDP</i>	-2 to -3
<i>Nominal GDP</i>	-1.5 to -2.5
<i>Per capita GDP, in real terms</i>	-2.8 to -3.8
<i>Per capita GDP at current market prices</i>	HK\$232,500-234,900 (US\$29,800-30,100)

Composite Consumer Price Index

<i>Headline</i>	1.6
<i>Underlying</i>	1.5

GDP Deflator **0.5**

Forecast on Hong Kong's GDP growth in 2009 recently made by other selected parties

	(%)
International Monetary Fund	-2.0
The University of Hong Kong	-3.0
The Hong Kong University of Science and Technology	-2.2
Average forecast by private sector analysts [#]	-2.1

Note: (#) Forecast GDP growth by private sector analysts mostly falls between -1% and -3%.

ECONOMIC PERFORMANCE IN 2008

1. Estimated rates of change in the Gross Domestic Product and its expenditure components and in the main price indicators in 2008:

	(%)
(a) Growth rates in real terms of:	
Private consumption expenditure	1.8
Government consumption expenditure	2.0
Gross domestic fixed capital formation	-0.3
<i>of which:</i>	
Building and construction	0.3
Machinery, equipment and computer software	0.6
Total exports of goods	2.0
Imports of goods	1.9
Exports of services	5.6
Imports of services	3.2
Gross Domestic Product (GDP)	2.5
<i>Per capita GDP, in real terms</i>	1.7
<i>Per capita GDP at current market prices</i>	HK\$240,600 (US\$30,900)
(b) Rates of change in:	
Composite Consumer Price Index	4.3
GDP Deflator	1.4
Government Consumption Expenditure Deflator	5.2
(c) Growth rate of nominal GDP	3.9

2. Annual growth rates in real terms of re-exports and domestic exports based on external trade quantum index numbers:

	<i>Re-exports</i> (%)	<i>Domestic exports</i> (%)
2006	11	1
2007	10	-20
2008	4	-22
<i>Share in the value of total exports of goods in 2008</i>	97	3

3. Annual growth rates in real terms of retained imports by type:

<i>Retained imports</i>						
	<i>Total</i> (%)	<i>Consumer goods</i> (%)	<i>Foodstuffs</i> (%)	<i>Capital goods</i> (%)	<i>Raw materials and semi-manufactures</i> (%)	<i>Fuels</i> (%)
2006	8	14	2	28	-17	5
2007	12	6	7	11	18	9
2008	-1	12	13	7	-30	-4

4. Annual growth rates in real terms of retained imports of capital goods by type:

<i>Retained imports of capital goods</i>					
	<i>Total</i> (%)	<i>Office equipment</i> (%)	<i>Industrial machinery</i> (%)	<i>Construction machinery</i> (%)	<i>Telecommunications equipment</i> (%)
2006	28	32	3	34	39
2007	11	-5	-5	6	26
2008	7	0	6	57	14

5. Annual growth rates in real terms of exports of services by type:

Exports of services

	<i>Total</i>	<i>Trade-related</i>	<i>Transportation</i>	<i>Travel</i>	<i>Finance, insurance, business and other services</i>
	(%)	(%)	(%)	(%)	(%)
2006	10	9	8	6	19
2007	14	9	13	14	24
2008	6	6	2	6	9

6. Hong Kong's visible and invisible trade balance in 2008 reckoned on GDP basis ^(Note 1):

	(HK\$ billion)
Total exports of goods	2,844.0
Imports of goods	3,024.1
<i>Visible trade balance</i>	-180.1
Exports of services	719.9
Imports of services	357.3
<i>Invisible trade balance</i>	362.6
<i>Combined visible and invisible trade balance</i>	182.5

Note 1 Preliminary figures.

7. Annual averages of the unemployment and underemployment rates and growth in labour force and total employment:

	<i>Unemployment rate (%)</i>	<i>Underemployment rate (%)</i>	<i>Growth in labour force (%)</i>	<i>Growth in total employment (%)</i>
2006	4.8	2.4	1.1	1.9
2007	4.0	2.2	1.6	2.4
2008	3.5	1.9	1.0	1.6

8. Annual rates of change in the Consumer Price Indices:

	<i>Composite CPI (%)</i>	<i>CPI(A) (%)</i>	<i>CPI(B) (%)</i>	<i>CPI(C) (%)</i>
2006	2.0	1.7	2.1	2.2
2007	2.0	1.3	2.2	2.7
2008	4.3	3.6	4.6	4.7

ECONOMIC PROSPECTS FOR 2009

Forecast rates of change in the Gross Domestic Product and prices in 2009:

	(%)
Gross Domestic Product (GDP)	
<i>Real GDP</i>	-2 to -3
<i>Nominal GDP</i>	-1.5 to -2.5
<i>Per capita GDP, in real terms</i>	-2.8 to -3.8
<i>Per capita GDP at current market prices</i>	HK\$232,500-234,900 (US\$29,800-30,100)
Composite Consumer Price Index	
<i>Headline Composite Consumer Price Index</i>	1.6
<i>Underlying Composite Consumer Price Index</i>	1.5
GDP Deflator	0.5
Government Consumption Expenditure Deflator	1.5