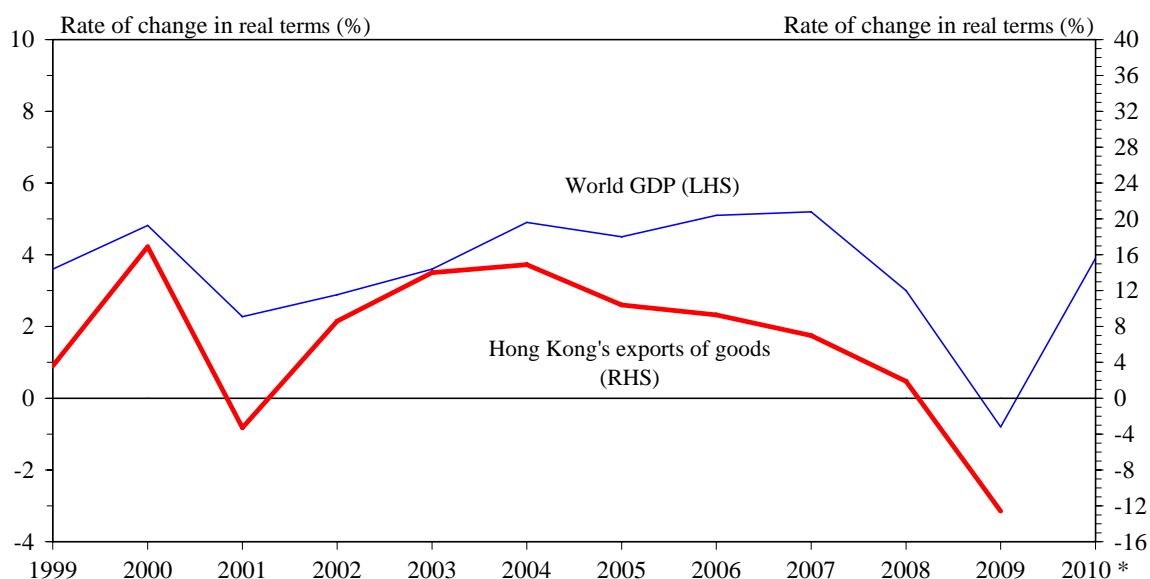


Outlook for the Hong Kong economy in 2010

2.15 Against the global scene of a gradually improving environment and having already experienced the sharply slower growth in 2008 followed by the recession last year, the outlook for Hong Kong this year is a return to positive growth more in line with the past trend growth. Continuing the momentum in the latter part of 2009, the economy should start off with a strong, broad-based growth in both domestic and external sectors. Growth in the first quarter is likely to be particularly strong on a year-on-year basis, though partly boosted by the distinct low base in early 2009. And, granting no significant adverse developments from the global economic and financial fronts to the extent of the derailing the current improving trend, the revival in the Hong Kong economy should hopefully stay on track in the rest of the year. But the strength of the growth momentum may not be very steady through the four quarters, for the various uncertainties and pitfalls as discussed earlier (paragraphs 2.10 and 2.14). Apart from possible gyrations in the asset markets during the year, there is risk that external trade may lose steam again after the effects of the earlier strong policy stimulus in the advanced economies fade in the latter part of the year. How the situation will evolve is still somewhat uncertain at this juncture, and will depend very much on the timing and tactics to be adopted by governments and central banks of the major economies.

Diagram 2.6 : Hong Kong's exports of goods poised for a notable rebound this year



Source: (*) Forecast from the IMF World Economic Outlook Update January 2010.

2.16 With the austere external environment in 2009 turning progressively better, and even with a weaker-than-usual global recovery in 2010, Hong Kong's *exports of goods* are still poised for a notable rebound this year, having experienced the marked contraction at the juncture of late 2008 and early 2009.

Even so, the expected sluggishness in the advanced economies is likely to hold back the export recovery in Hong Kong, and as such, for 2010 as a whole, the rebound is unlikely to be significant enough for overall exports to return to their pre-crisis level in 2008. In particular, exports to the advanced economies, though poised to regain some of the lost grounds, are likely to lag behind and would probably expand only at a slow pace. Yet exports to Asia, the Mainland in particular, should grow quite strongly in 2010 in tandem with the expected further recovery in Asia and vibrant growth in the Mainland, thereby rendering the key driver of export growth in 2010. This will mirror the divergence in the paces of economic recovery across regions, as discussed in Paragraphs 2.3 to 2.8.

Diagram 2.7 : Exchange rate factor also favourable to further export recovery in the first half of 2010

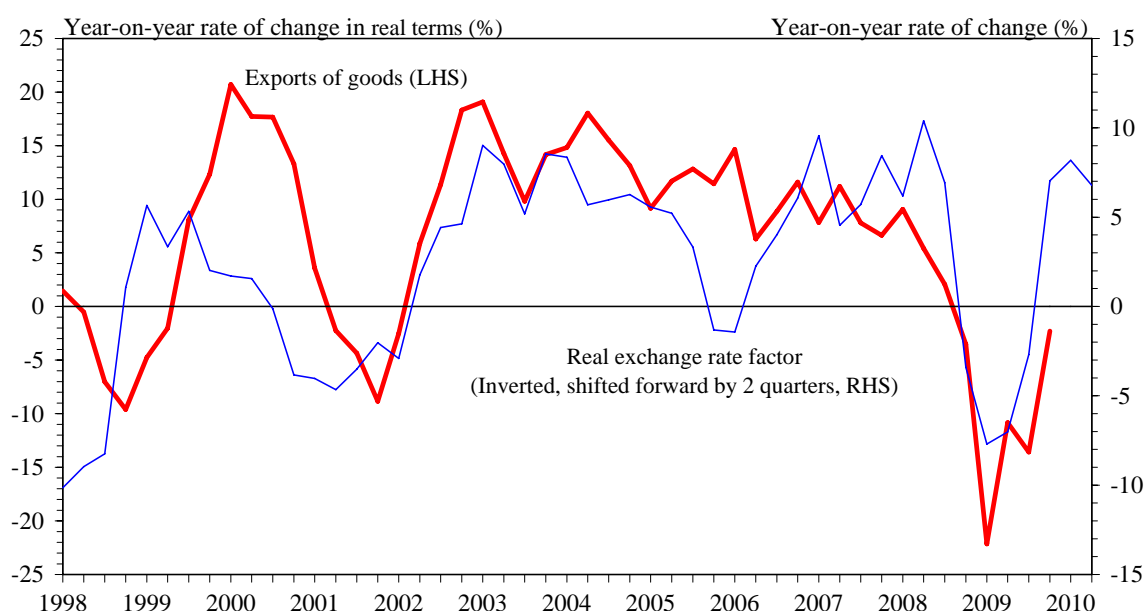
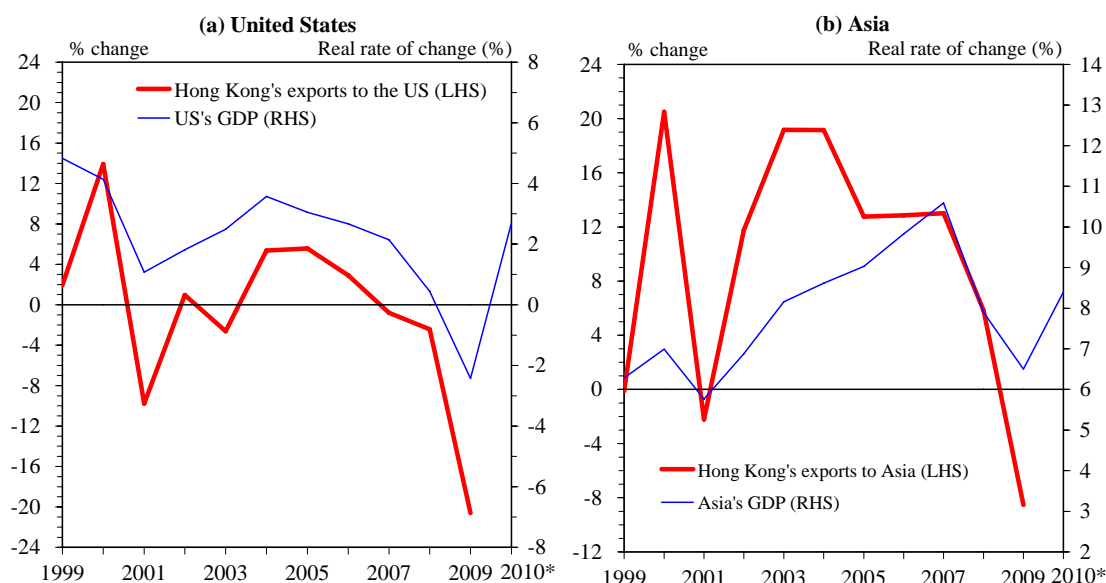


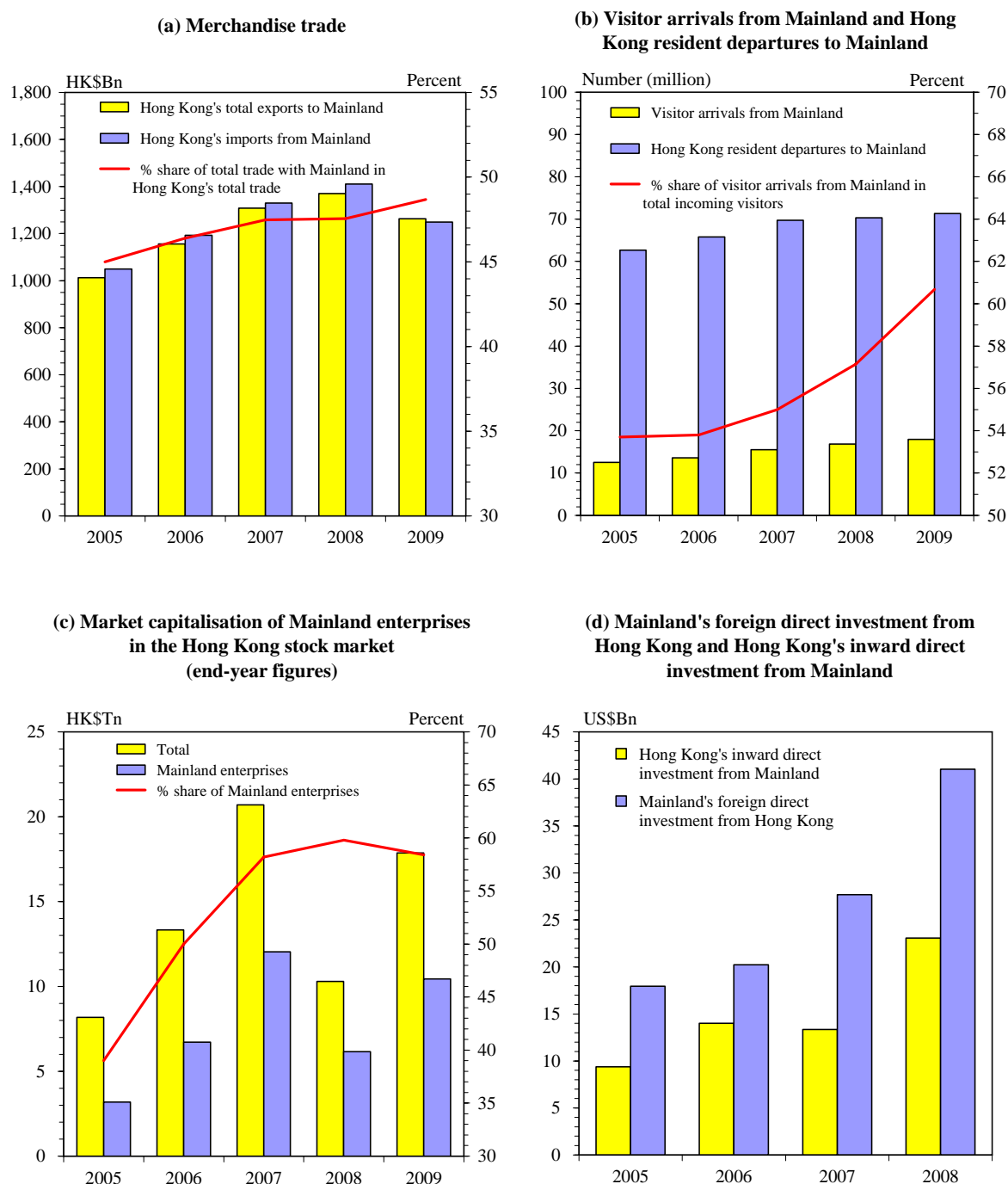
Diagram 2.8 : Exports to Asia should grow quite strongly in 2010, but those to advanced economies might lag behind



Source: (*) Forecast from the IMF World Economic Outlook Update January 2010.

2.17 In comparison, the outlook for *exports of services* is even more encouraging. Exports of finance, business and other services have already shown a marked revival since the latter part of 2009, benefiting from the increase of Mainland-related IPO activities and the return of business in tandem with the regional recovery. This trend will hopefully gather further momentum in 2010. Inbound tourism, which was relatively resilient all through 2009, is likely to stay vibrant and provide a stable growth source for exports of services. Offshore trade and other services related to merchandise trade will likewise benefit from the rebound in global and regional trade flows.

Diagram 2.9 : Robust growth in the Mainland economy will continue to benefit Hong Kong



2.18 On the *domestic* front, local consumption has regained much strength in the second half of 2009, and judging from the current sentiment, consumption looks set for a further solid growth in 2010. The key driver of consumption growth this year will come from the expected improvements in labour market conditions in tandem with the economic recovery. The latest package of measures in the latest 2010/11 Budget, coupled with the relief measures announced in 2009, will give a further boost to consumption spending this year. Yet the uncertainty in the timing of exit strategies, the on-going concern over the fiscal situation in some of the European economies, and their repercussions on the global and local asset markets in 2010 are areas to watch out.

Diagram 2.10 : Local consumer sentiment has been strengthening along with improvement in labour market

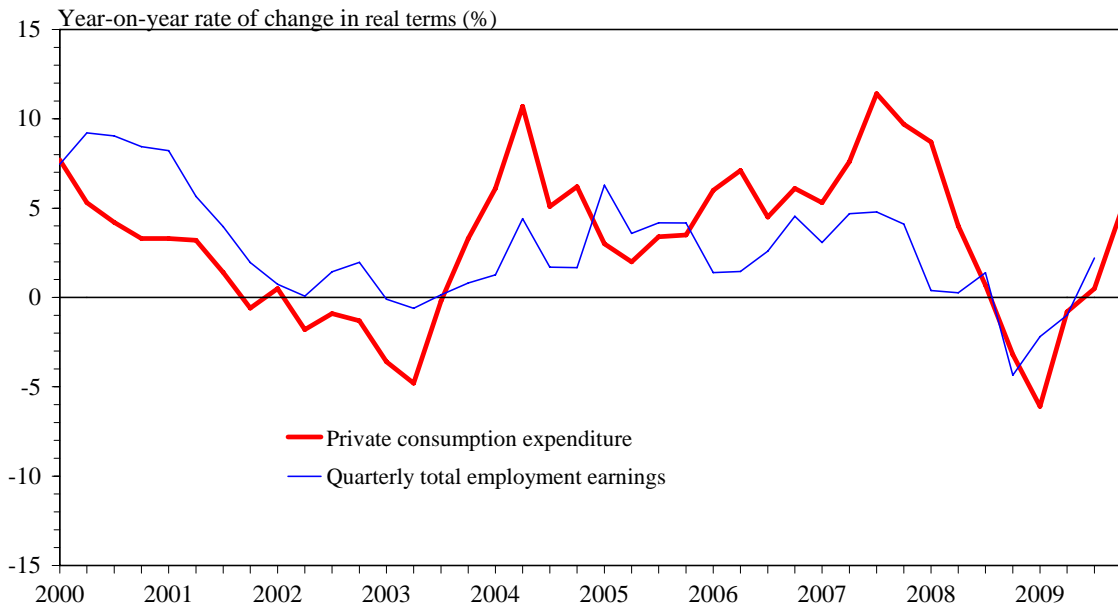
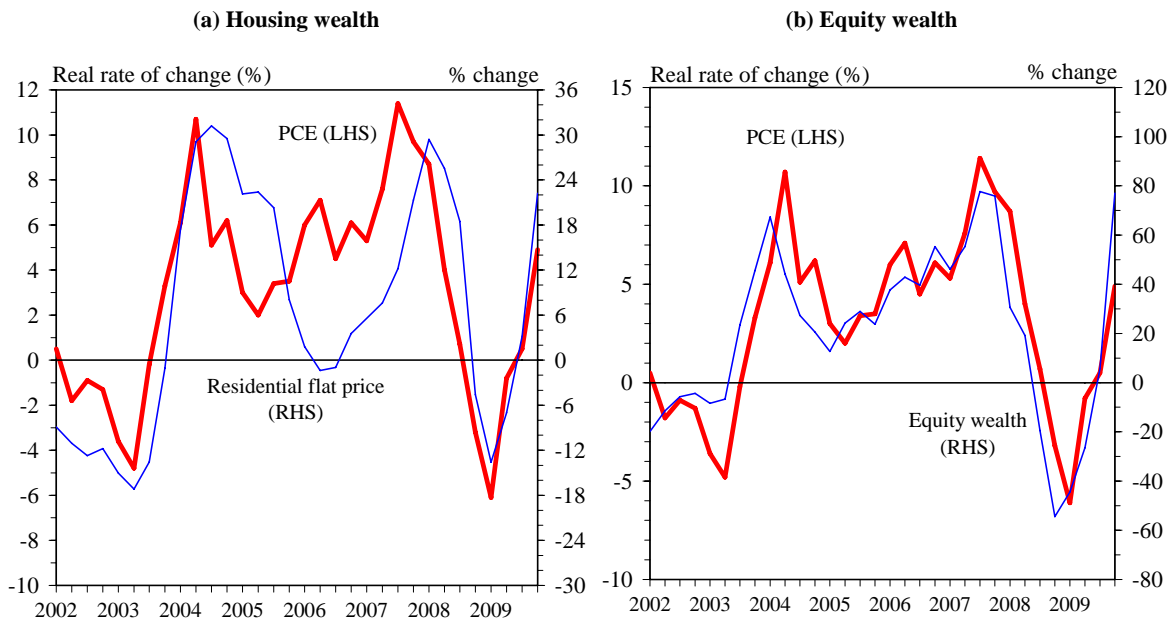
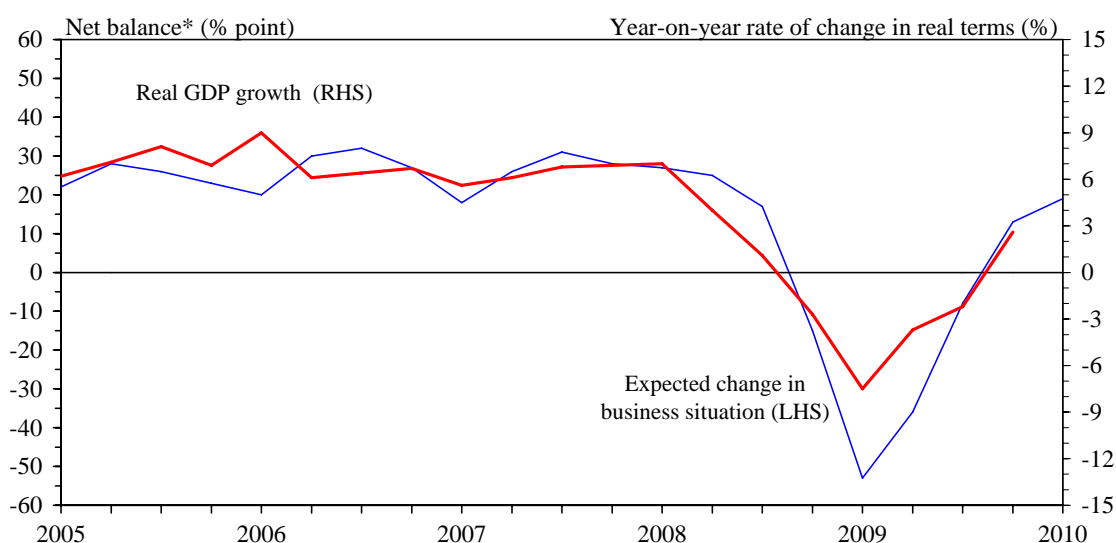


Diagram 2.11 : Asset market volatility could dent consumer sentiment



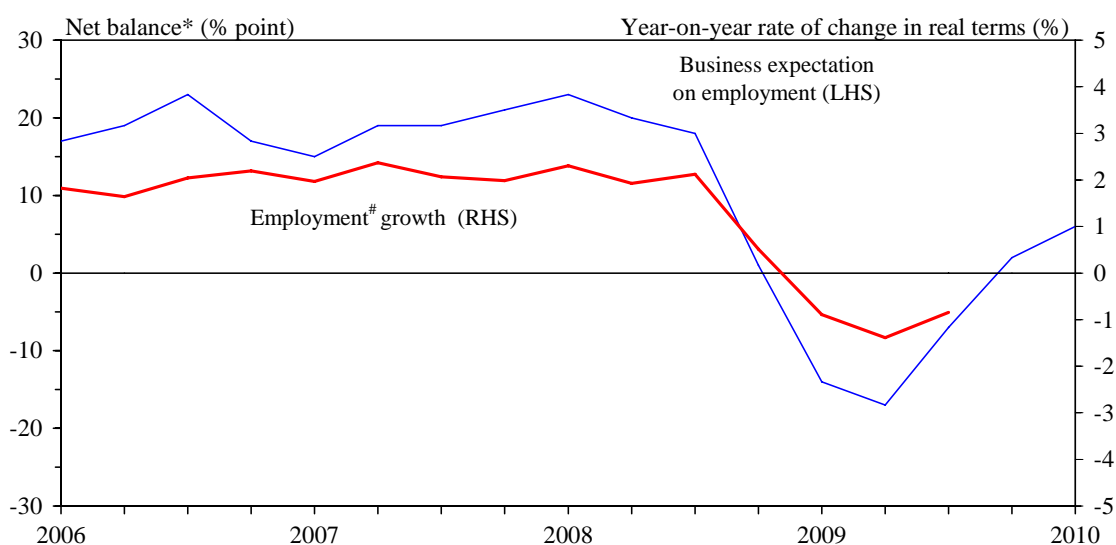
2.19 Overall investment will similarly recover, with business confidence now much improved upon the better economic prospects. Indeed, the results of the latest Business Tendency Survey conducted by the Census and Statistics Department indicate an across-the-board uptick in business sentiments towards the year-end. Adding to the strength of overall investment is the expected pick-up in infrastructure construction, which should provide further impetus to Hong Kong's recovery process and render a cushion against the possible renewed weakening in the external sector in the latter part of the year.

Diagram 2.12 : Business sentiment turned up distinctly since the latter part of 2009



Note : (*) Net balance indicates the direction of expected change in business situation versus preceding quarter. It refers to the difference in percentage points between the proportion of establishments choosing "better" over that choosing "worse". A positive sign indicates a likely upward trend while a negative sign, a likely downward trend.

Diagram 2.13 : Business expectation on employment also turned more positive

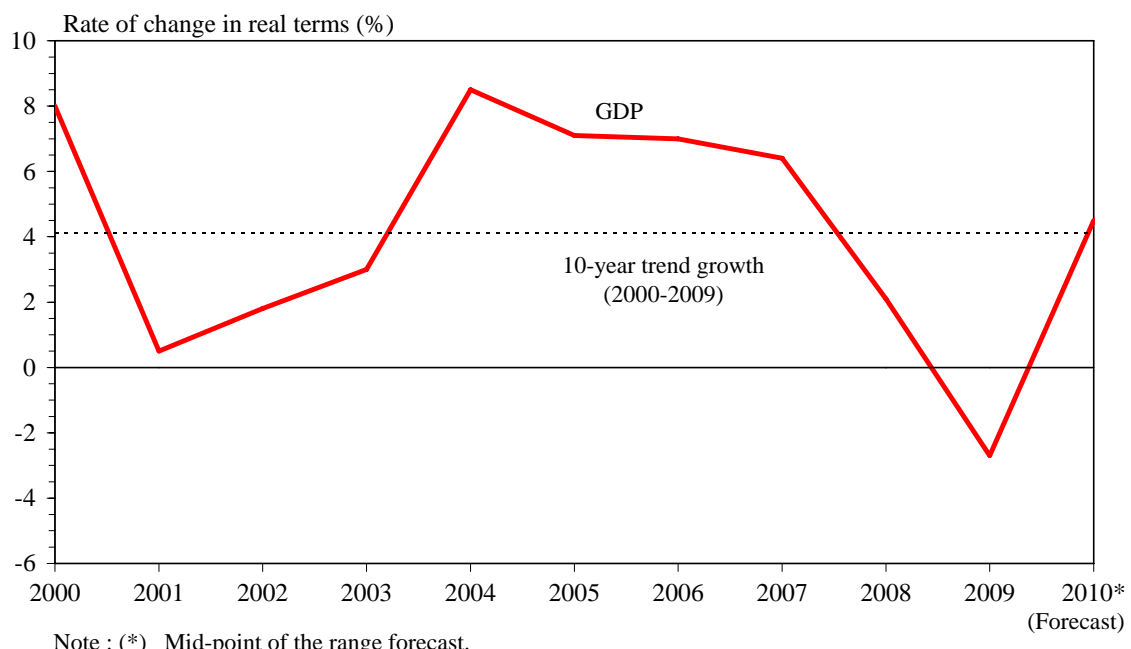


Notes : (*) Net balance indicates the direction of expected change in number of persons engaged versus preceding quarter. It refers to the difference in percentage points between the proportion of establishments choosing "up" over that choosing "down". A positive sign indicates a likely upward trend while a negative sign, a likely downward trend.

(#) Employment in private sector.

2.20 Taking all these factors into account, and granting no major relapse in the global economy to the extent of disrupting the recovery process now in Asia, the Hong Kong economy is poised to return to positive annual growth in 2010, by 4% to 5%. This will be largely on par with the 10-year average annual growth rate of 4.7% just before the global crisis hit Hong Kong, and is also broadly in line with the prevailing forecasts by private sector analysts, which mostly fall within the range of 3% to 6%. As discussed in Paragraphs 2.1 and 2.14, the economic outlook this year is still subject to a host of uncertainties stemming mainly from the concern about the fragile nature of the global recovery, and the uncertainties regarding the timing and pace of unwinding of the extraordinary fiscal and monetary stimulus and their potential shocks to the global and local asset markets. The Government will stay alert to these risks and challenges, and will stick to the strategy of “stabilising the financial system, supporting enterprises and preserving employment” until employment resumes growth and unemployment comes down visibly. Indeed, the Government’s decision to extend the loan guarantee schemes for another six months until June 2010 and the package of measures in the 2010-11 Budget are precisely aimed at providing the supportive conditions for the economy’s further recovery against the background of a still uncertain external environment.

Diagram 2.14 : Economy poised for further recovery in 2010

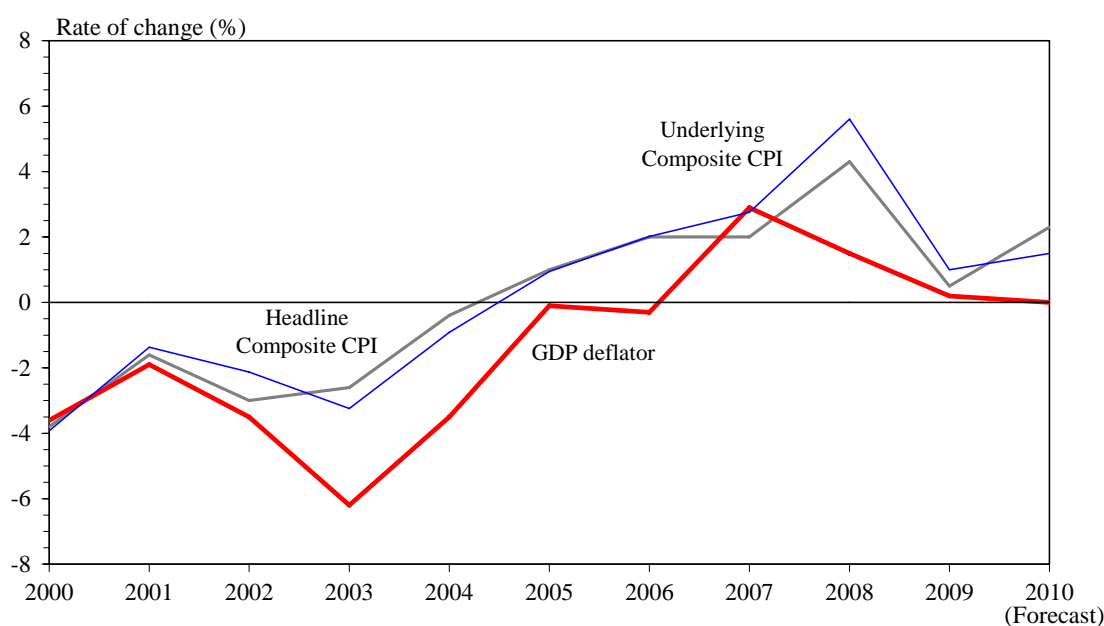


2.21 Both local and external price pressures were virtually absent during most of 2009 in the midst of the economic downturn and global-wide recession. After experiencing a brief period of mild deflation, downward pressures on consumer prices abated notably near the end of 2009. As the recovery gathers

2009 Economic Background and 2010 Prospects (extracts)

pace going forward, some modest price pressures are likely to return, and as such, consumer price inflation is expected to climb back gradually over the course of 2010. Nevertheless, inflationary pressures should still be rather modest in most of 2010, as it takes time for the economy to reduce the spare capacity caused by two years of economic slack, and as imported inflation may remain modest in the near term given the weak global recovery. Against this backdrop, the *underlying Composite CPI* is forecast to increase by 1.5% in 2010 as a whole. The *headline Composite CPI* is forecast to be slightly higher in 2010, at 2.3%. The *GDP deflator* is forecast to be flat, taking into account the modest inflationary pressures at the aggregate economy level as well as the relative price change in the external sector. There may be some upside risks to the above forecasts, if rentals continue to rise back, food prices edge further higher, and if international oil prices stay at a high level. A weaker US dollar may also add to imported inflation and hence overall inflation.

Diagram 2.15 : Some price pressures will return as economic recovery takes hold



Forecast rate of change in 2010 (%)

Gross Domestic Product (GDP)

<i>Real GDP</i>	4 to 5
<i>Nominal GDP</i>	4 to 5
<i>Per capita GDP, in real terms</i>	3.1 to 4.1
<i>Per capita GDP at current market prices</i>	HK\$240,500-242,800 (US\$30,800-31,100)

Composite Consumer Price Index

<i>Headline</i>	2.3
<i>Underlying</i>	1.5

GDP Deflator **0**

**Forecast on Hong Kong's GDP growth in 2010
recently made by other selected parties**

	(%)
International Monetary Fund	5
The University of Hong Kong	4 to 5
The Hong Kong University of Science and Technology	6.8
Average forecast by private sector analysts [#]	4.8

Note: (#) Forecast GDP growth by private sector analysts mostly falls between 3% and 6%.

ECONOMIC PERFORMANCE IN 2009

1. Estimated rates of change in the Gross Domestic Product and its expenditure components and in the main price indicators in 2009 :

	(%)
(a) Growth rates in real terms of :	
Private consumption expenditure	-0.3
Government consumption expenditure	2.0
Gross domestic fixed capital formation	-2.2
<i>of which :</i>	
Building and construction	0.0
Machinery, equipment and computer software	-3.6
Total exports of goods	-12.6
Imports of goods	-9.7
Exports of services	-0.7
Imports of services	-4.0
Gross Domestic Product (GDP)	-2.7
<i>Per capita GDP, in real terms</i>	-3.0
<i>Per capita GDP at current market prices</i>	HK\$233,200 (US\$30,100)
(b) Rates of change in :	
Composite Consumer Price Index	0.5
GDP Deflator	0.2
Government Consumption Expenditure Deflator	0.1
(c) Growth rate of nominal GDP	-2.5

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> (%)
2007	10	-20
2008	4	-22
2009	-11	-35
<i>Share in the value of total exports of goods in 2009</i>	98	2

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> (%)
2007	12	6	7	11	18	9
2008	-1	12	13	7	-30	-4
2009	-4	-9	7	-4	-10	23

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> (%)
2007	11	-5	-5	6	26
2008	7	0	6	57	14
2009	-4	-9	-31	63	5

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

Exports of services

	<i>Total</i> (%)	<i>Trade-related</i> <i>services</i> (%)	<i>Transportation</i> <i>services</i> (%)	<i>Travel</i> <i>services</i> (%)	<i>Finance,</i> <i>insurance,</i> <i>business and</i> <i>other services</i> (%)
2007	14	9	13	14	24
2008	5	4	3	6	7
2009	-1	-7	-2	8	3

6. Hong Kong's visible and invisible trade balance in 2009 reckoned on GDP basis ^(Note 1):

	(HK\$ billion)
Total exports of goods	2,494.7
Imports of goods	2,703.0
<i>Visible trade balance</i>	-208.2
Exports of services	670.0
Imports of services	344.1
<i>Invisible trade balance</i>	325.9
<i>Combined visible and invisible trade balance</i>	117.7

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>
2007	4.0	2.2	1.6	2.4
2008	3.6	1.9	0.5	1.0
2009	5.2	2.3	1.3	-0.5

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>
2007	2.0	1.3	2.2	2.7
2008	4.3	3.6	4.6	4.7
2009	0.5	0.4	0.5	0.6

ECONOMIC PROSPECTS FOR 2010

Forecast rates of change in the Gross Domestic Product and prices in 2010 :

	(%)
Gross Domestic Product (GDP)	
<i>Real GDP</i>	4 to 5
<i>Nominal GDP</i>	4 to 5
<i>Per capita GDP, in real terms</i>	3.1 to 4.1
<i>Per capita GDP at current market prices</i>	HK\$240,500-242,800 (US\$30,800-31,100)
Composite Consumer Price Index	
<i>Headline Composite Consumer Price Index</i>	2.3
<i>Underlying Composite Consumer Price Index</i>	1.5
GDP Deflator	0
Government Consumption Expenditure Deflator	1