

Press Release

(embargoed until 4:30 p.m. on 13 August 2010)

Economic Situation in the Second Quarter of 2010 and Latest GDP and Price Forecasts for 2010

The Government released today (Friday) the Half-yearly Economic Report 2010, together with the preliminary figures on Gross Domestic Product for the second quarter of 2010.

The economic situation in the second quarter of 2010 and the latest GDP and price forecasts for the year are set out below.

MAIN POINTS

- * The Hong Kong economy continued to show a broadly-based recovery in the second quarter of 2010, benefited mainly from the robust growth momentum in the Mainland and other Asian economies. Real GDP leaped distinctly further by 6.5% in the second quarter over a year earlier, after a growth of 8.0% in the first quarter, the second quarter of above-trend growth. On a seasonally adjusted quarter-to-quarter comparison, real GDP expanded by 1.4%.
- * Merchandise exports remained vibrant in the second quarter, expanding by 20.1% in real terms over a year earlier, propelled by the strong growth in many Asian markets and the further recovery in import demand in the United States. The European markets continued to lag behind the others, although the sovereign debt problem in Europe had not yet posed a significant drag on global trade flows.
- * Exports of services likewise maintained strong momentum, up 16.9% year-on-year in real terms in the second quarter. Inbound tourism continued to benefit from the surge in Mainland visitors and the recovery in regional markets. Exports of trade-related services were buoyant, thanks mainly to the thriving intra-regional trade flows, which in turn rendered firm support to exports of transportation services. Exports of business services picked up strongly on vibrant commercial activities, but exports of financial services grew only moderately as the European sovereign debt problem dampened market sentiment during the quarter.
- * Domestic sector stayed resilient in the second quarter. Private consumption expenditure rose by 4.6% year-on-year in real terms, thanks to a general improvement in overall economic situation and incomes. Overall investment spending accelerated to a distinct 15.2% growth. Construction activity was boosted by further marked growth in public sector works, while machinery and equipment acquisition also maintained strong momentum.
- * The performance of the labour market was somewhat mixed. While the underemployment situation improved further, the seasonally adjusted

unemployment rate rose back slightly to 4.6% in the second quarter. The latter, when matched against the concurrent rise in job vacancies, indicates that the rise in unemployment was in large part due to frictional factors, as more workers were in search of employment opportunities with better terms and conditions.

- * Local stock market saw some retreat in April and May, along with other major overseas stock markets in face of the sovereign debt problem in Europe, before stabilising somewhat in June. The local property market also turned slightly quieter in May, yet picked up again in June.
- * The global economy remained on track to recovery in the second quarter. Asia continued to take the lead, with the Mainland and many other Asian economies growing robustly. However, the outlook for the external environment has turned more uncertain as the sovereign debt problem in Europe, leading many European economies to implement austerity measures, posed downside risks to the global recovery. Recent indications also suggest that the growth momentum in the United States has weakened. Given these developments, it is likely that Hong Kong's year-on-year export growth may experience some deceleration in the second half of the year.
- * Nevertheless, local consumer sentiment remained firm so far. The results of the latest Quarterly Business Tendency Survey conducted in June and early July also indicated that large enterprises were still positive on the outlook, and their intention to hire new hands strengthened further. In addition, the sustained high level of public sector construction work will render a further support to domestic demand.
- * Given the actual outturn of a 7.2% robust GDP growth in the first half of 2010, and even allowing for some possible deceleration in year-on-year growth in the second half of the year, there is still an upside to the annual GDP growth forecast of 4-5% put out earlier. The GDP growth forecast for 2010 as a whole is revised upwards to 5-6%, from the forecast of 4-5% growth in the May round.
- * Inflationary pressure climbed up moderately in the second quarter amid the sustained economic revival and higher import prices. Underlying consumer price inflation went up to 1.5% in the second quarter from 0.8% in the first quarter, and may edge up further in the coming months, as the reflationary process proceeds and as import prices rise further. Nevertheless, the sustained productivity growth in the economy should provide a useful offset to the domestic cost pressures. With the developments on the price front so far in line with expectations, the forecast rate of the underlying consumer price inflation in 2010 as a whole is maintained at 1.5%. The corresponding forecast rate of the headline consumer price inflation is also kept unchanged at 2.3%.

DETAILS

GDP

According to preliminary data on the *Gross Domestic Product (GDP)* released today by the Census and Statistics Department, real GDP leaped by 6.5% in the second quarter of 2010 over a year earlier. This was further to the expansion of 8.0% in the first quarter of 2010 (revised from the earlier estimate of 8.2%). In the first half of 2010, real GDP grew by 7.2% over a year earlier. On a seasonally adjusted quarter-to-quarter comparison, GDP grew by 1.4% in real terms in the second quarter (*Chart*). As a result, the seasonally adjusted GDP level in the second quarter surpassed the pre-crisis peak in the first quarter of 2008 by some 1.6%.

2. The latest figures on GDP and its major expenditure components up to the second quarter of 2010 are presented in *Table 1*. Developments in different segments of the economy in the second quarter of 2010 are described below.

External trade

3. *Total exports of goods* continued to fare strongly in the second quarter, amid the sustained global economic recovery. Total exports of goods surged by 20.1% in real terms in the second quarter over a year earlier, further to the 21.6% growth in the first quarter. The Asian markets still outperformed the other markets by a wide margin. Specifically, total exports to the Mainland continued to show a double-digit year-on-year growth, even against a higher base of comparison in the second quarter, and those to Taiwan, Japan, Korea and Singapore all recorded double-digit growth in the region of 15-30%. The US market also improved visibly further, as economic recovery there continued at a moderate pace. Although the full impact on global trade flows from the sovereign debt problem in Europe has yet to be seen, the European markets continued to lag markedly behind other markets in the quarter. On a seasonally adjusted quarter-to-quarter basis, total exports of goods leaped by 4.2% in real terms in the second quarter.

4. *Exports of services* maintained strong growth momentum in the second quarter, up 16.9% in real terms over a year earlier, after a 17.9% increase in the first quarter. With the strong influx of incoming visitors, exports of travel services rebounded sharply from the relatively low base due to human swine flu in the same quarter last year. Exports of transportation and trade-related services were buoyant, helped by the strong intra-regional trade in Asia and normalisation in global trade flows. Exports of business services picked up strongly on vibrant commercial activities, but exports of financial services grew only moderately as the European sovereign debt problem dampened market sentiment during the quarter. On a seasonally adjusted quarter-to-quarter basis, exports of services grew marginally, by 0.8% in real terms in the second quarter.

Domestic sector

5. The domestic sector held firm in the second quarter, on the back of rising incomes and generally upbeat economic sentiment. *Private consumption expenditure* increased by 4.6% in real terms over a year earlier, further to the 7.1% growth in the first quarter. On a seasonally adjusted quarter-to-quarter comparison, private consumption expenditure grew by 1.5% in real terms in the second quarter. Despite the correction in the stock market and concerns about the European debt problem, local consumer confidence remained rather sanguine, as evidenced by sustained increase in spending on big-ticket items, including motor vehicles and other consumer durables.

6. *Overall investment spending* picked up to a distinct increase of 15.2% in real terms in the second quarter over a year earlier, further to the 8.2% growth in the first quarter. Investment in machinery and equipment grew strongly further by 16.2% in the second quarter. The growth impetus came from a sharp increase in spending by the private sector, reflecting the prevailing positive business sentiment. Expenditure on building and construction resumed a marked increase of 11.4% in the second quarter, mainly contributed by a further pick-up in public sector works, following an already hectic growth in the first quarter. Private sector construction activity saw some relative improvement, but still registered a small year-on-year decline.

The labour sector

7. The performance of the labour market was somewhat mixed. While the *seasonally adjusted unemployment rate* rose back slightly to 4.6% in the second quarter, the concurrent increase in job vacancies suggests that the relapse was in large part frictional, caused by workers temporarily breaking from employment whilst seeking jobs with better terms and conditions. The intensity of work actually improved slightly, as evidenced by the continued decline in the *underemployment rate*, to 2.0% in the second quarter. Labour wages and earnings picked up further in the first quarter of 2010.

The asset markets

8. The *local stock market* experienced sharp volatilities and sell-off alongside other major overseas markets in April and May on deepening concerns over the European sovereign debt crisis. The market recovered somewhat towards the end of the second quarter as the situation in Europe stabilised. The Hang Seng Index closed the month of June at 20 129, down by 5.2% over end-March this year and by 8.0% over end-2009.

9. The *residential property market* also consolidated somewhat in May, subsequent to the Government's further measures to ensure a healthy and stable development of the property market. But the upward momentum resumed in June. Overall flat prices went up by a further 1.5% between March 2010 and June 2010,

after rising successively by a cumulative 28.5% during 2009 and a further 6.5% during the first quarter of 2010. Nevertheless, transactions in the second quarter fell slightly by 2.6% over the preceding quarter, mainly reflecting the cooling off in May. Thanks to the exceptionally low mortgage interest rates, the home purchase affordability (i.e. the ratio of mortgage payment for a 45-square metre flat to median income of households, excluding those living in public housing) was about 41.5% in the second quarter, as compared to the long-term average of 52.6% over 1989 to 2008.

Prices

10. Inflationary pressure notched up moderately in the second quarter alongside the sustained economic recovery. *Underlying consumer price inflation* on a year-on-year basis rose to 1.5% in the second quarter from 0.8% in the first quarter. Taking into account the effect of the Government's one-off measures, *headline consumer price inflation* went up to 2.6% in the second quarter from 1.9% in the first quarter. The fading of the effect of electricity charge subsidy largely explains the difference in the two inflation rates.

Latest GDP and price forecasts for 2010

11. The global economy remained on track to recovery in the second quarter. Asia continued to take the lead, with the Mainland and many other Asian economies growing robustly. However, the outlook for the external environment has turned more uncertain as the sovereign debt problem in Europe, leading many European economies to implement austerity measures, posed downside risks to the global recovery. Recent indications also suggest that the growth momentum in the United States has weakened. Given these developments, it is likely that Hong Kong's year-on-year export growth may experience some moderation in the second half of the year.

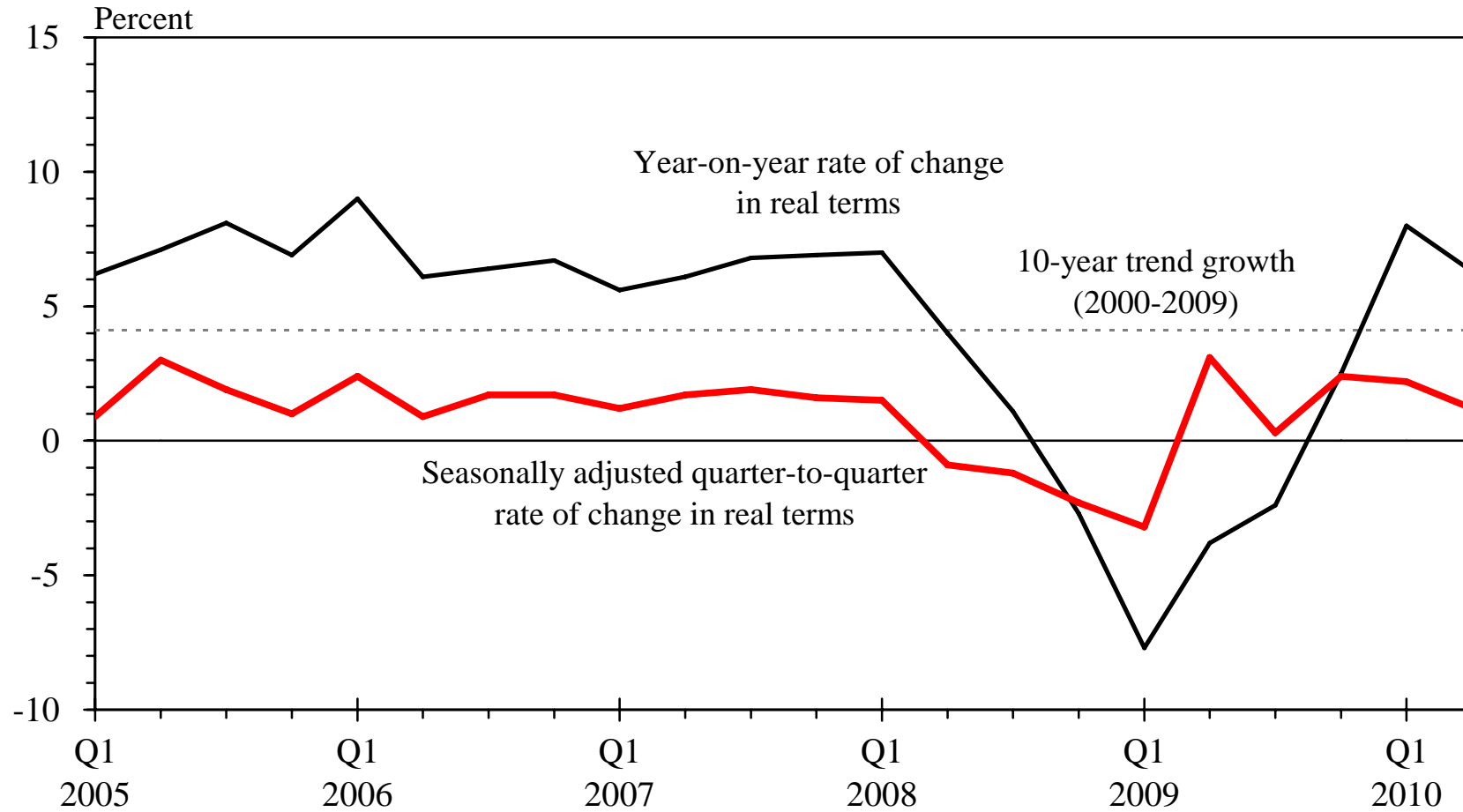
12. Nevertheless, local consumer sentiment remained firm so far. The results of the latest Quarterly Business Tendency Survey conducted in June and early July also indicated that large enterprises were still positive on the outlook, and their intention to hire new hands strengthened further. In addition, the sustained high level of public sector construction work will render a further support to domestic demand.

13. Given the actual outturn of a robust GDP growth in the first half of 2010, and even allowing for some possible deceleration in year-on-year growth in the second half of the year, there is still an upside to the annual GDP growth forecast of 4-5% put out earlier. The GDP growth forecast for 2010 as a whole is thus revised upwards to 5-6%, from the forecast of 4-5% growth in the May round (*Table 2*). For information, most private sector analysts are currently projecting the economy to expand by 4.5-7%, averaging at around 5.5%.

14. Underlying consumer price inflation may edge up further in the coming months, as the reflationary process proceeds and as import prices rise further. Nevertheless, the sustained productivity growth in the economy should provide a useful offset to the domestic cost pressures. With the developments on the price front so far in line with expectations, the forecast rate of the underlying consumer price inflation in 2010 as a whole is maintained at 1.5%. The corresponding forecast rate of the headline consumer price inflation is also kept unchanged at 2.3%.

(The Half-yearly Economic Report 2010 is now available for online download, free of charge at <http://www.hkeconomy.gov.hk/en/reports/index.htm>. The print version is available for sale at \$98 per issue, plus postage charge. Users can purchase the print version 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 Report of the Gross Domestic Product, Second Quarter 2010, which contains the GDP figures up to the second quarter of 2010, is also available for online download, free of charge at the homepage of the Census and Statistics Department, <http://www.censtatd.gov.hk>.)

Hong Kong's Gross Domestic Product



Note : Figures for the second quarter of 2010 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>2008[#]</u>	<u>2009[#]</u>	<u>2009</u>				<u>2010</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	2.4	-0.4	-6.2 (-1.7)	-0.6 (4.1)	0.6 (0.4)	4.8 (2.0)	7.1 (0.6)	4.6 (1.5)
Government consumption expenditure	1.8	2.4	1.5 (-0.3)	2.6 (1.8)	3.4 (0.6)	2.0 (-0.2)	3.4 (1.2)	2.7 (1.0)
Gross domestic fixed capital formation	0.8	-1.8	-10.3	-11.8	3.2	14.1	8.2	15.2
<i>of which :</i>								
Building and construction	6.1	-0.5	-5.6	-2.4	5.4	1.3	-7.2	11.4
Machinery, equipment and computer software	-0.8	-2.6	-4.1	-16.6	-2.1	16.2	11.9	16.2
Total exports of goods	1.9	-12.7	-22.7 (-12.7)	-12.8 (6.0)	-13.2 (-1.3)	-2.9 (7.3)	21.6 (8.4)	20.1 (4.2)
Imports of goods	1.8	-9.5	-20.8 (-10.4)	-12.6 (5.3)	-8.3 (2.5)	3.3 (7.1)	28.0 (10.3)	23.6 (1.6)
Exports of services	5.0	0.3	-5.5 (-1.8)	-3.8 (1.9)	0.8 (3.7)	8.9 (4.8)	17.9 (6.7)	16.9 (0.8)
Imports of services	6.3	-3.7	-9.7 (-3.5)	-5.0 (1.9)	-2.7 (1.6)	2.5 (2.6)	10.9 (4.3)	12.3 (3.3)
Gross Domestic Product	2.2	-2.8	-7.7 (-3.2)	-3.8 (3.1)	-2.4 (0.3)	2.5 (2.4)	8.0 (2.1)	6.5 (1.4)
<i>Change in the main price indicators (%)</i>								
GDP deflator	1.5	0.2	0.7 (0.2)	0.9 (0.2)	-1.0 (-0.6)	0.2 (0.4)	2.0 (2.0)	-0.6 (-2.4)
Composite CPI								
Headline	4.3	0.5	1.7 (0.4)	-0.1 (-0.2)	-0.9 (-1.1)	1.3 (2.2)	1.9 (1.0)	2.6 (0.5)
Underlying[^]	5.6	1.0	3.1 (-0.1)	1.2 (-0.3)	-0.3 (-0.2)	-0.1 (0.5)	0.8 (0.7)	1.5 (0.5)
<u>Change in nominal GDP (%)</u>	3.7	-2.6	-7.0	-2.9	-3.4	2.7	10.1	5.9

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.

(^) After netting out effects of Government's one-off relief measures.

Table 2**Economic forecasts for 2010
(rate of change (%))**

	Forecasts for 2010 as released on 14.5.2010 (%)	Latest forecasts for 2010 on 13.8.2010 (%)
Gross Domestic Product (GDP)		
<i>Real GDP</i>	4 to 5	5 to 6
<i>Nominal GDP</i>	4 to 5	5 to 6
Composite Consumer Price Index (CCPI)		
<i>Headline CCPI</i>	2.3	2.3
<i>Underlying CCPI</i>	1.5	1.5
GDP Deflator	0	0