

Press Release

(embargoed until 4:30 p.m. on 12 November 2010)

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

The Government released today (Friday) the Third Quarter Economic Report 2010, together with the preliminary figures on Gross Domestic Product for the third quarter of 2010.

The Government Economist, Mrs Helen Chan, described the economic situation in the third quarter of 2010 and provided the latest GDP and price forecasts for the year.

MAIN POINTS

- * The Hong Kong economy remained robust in the third quarter of 2010. Real GDP expanded briskly further by 6.8% year-on-year, following a strong growth of 7.2% in the first half of 2010. On a seasonally adjusted quarter-to-quarter comparison, GDP grew by 0.7% in real terms in the third quarter, the sixth consecutive quarter of expansion.
- * Merchandise exports maintained strong momentum in the third quarter, surging by 20.8% in real terms over a year earlier. The strong domestic demand and further expansion in intra-regional production activity in the Asian markets provided the main impetus. The further recovery in the US and European markets from their troughs was also contributory, though demand in these markets had yet to return to their pre-crisis levels in 2008.
- * Exports of services were likewise vibrant, up 14.0% year-on-year in real terms in the third quarter. Inbound tourism thrived on the surge in visitor arrivals from the Mainland and other Asian markets. Exports of trade-related and transportation services continued to benefit from the resurgence in trade flows. Exports of financial and business services grew solidly further.
- * Domestic sector held up rather well in the third quarter. Riding on improving employment situation and rising incomes, private consumption expenditure picked up further and grew by 5.7% year-on-year in real terms. Investment saw a slower growth of 0.3% in real terms over a year earlier, mainly due to the relapse in machinery and equipment acquisition after three quarters of very rapid growth. Construction activity grew notably further, as the surge in public sector works went on.
- * Labour market continued to improve on a broad front. Total employment rose to a new high since early 2009, pushing the seasonally adjusted unemployment rate down to 4.2%. Labour income continued to increase.
- * Local stock market was range-bound in July and August, and rallied in September alongside other markets worldwide on increasing market

expectations of a new round of monetary easing in the US. Local property market made further gains in July and August, turned quieter in September, yet picked up again lately.

- * The global economy continued to recover at an uneven pace across regions. While the strength of recovery in most advanced economies remained weak, many emerging and developing economies, in particular the Mainland China, saw further strong growth. Given that the advanced economies are still the main driving force behind the final demand in global trade, their dimmer growth prospect may eventually pose a drag on external trade performance in Hong Kong and Asia as a whole. The more volatile exchange rates as well as the rise of protectionism will also increase the headwinds in the trading environment. While export orders have held relatively stable so far, the downside risks to Hong Kong's trade outlook have increased somewhat going forward.
- * Nevertheless, local consumer sentiment should remain firm in the near term, supported by the improving income and job prospects. As to business sentiment, the latest Quarterly Business Tendency Survey results indicate that the large enterprises remain positive about the near-term business outlook. Public sector construction works will sustain at high levels, also rendering support to domestic demand. Yet the Government will closely monitor the increasing asset market bubble risks facing the region, especially with the new round of quantitative easing in the US.
- * In the first three quarters of 2010, GDP expanded strongly by 7.1% in real terms over a year earlier. Even allowing for some possible deceleration in the fourth quarter, economic growth in 2010 should exceed the forecast of 5-6% announced in August. Thus, the GDP growth forecast for 2010 as a whole is revised upwards to 6.5%.
- * Underlying consumer price inflation, which excludes the effects of the Government's relief measures to give a more accurate indication of the inflation trend, rose to 2.0% in the third quarter. Indeed, rising inflation along with strong economic expansion is a common phenomenon among many Asian economies, and Hong Kong is no exception. Looking ahead, inflation in Hong Kong is likely to go up further, as the rise-back in domestic costs, as well as higher import prices amid a weaker US dollar and elevated global food and commodity prices, continue to feed through. The new round of quantitative easing in the US, which could trigger further funds influx into the region, will also pose upside risks to inflation. Nevertheless, the sustained productivity growth in the economy should provide a partial offset. Underlying consumer price inflation, which averaged at 1.4% in the first three quarters of 2010, is now forecast at 1.7% for the year as a whole, revised upwards from 1.5% in the August round. The forecast rate of headline consumer price inflation for 2010 as a whole is also revised upwards accordingly, from 2.3% to 2.5%.

DETAILS

GDP

According to preliminary data on the *Gross Domestic Product (GDP)* released today by the Census and Statistics Department, real GDP leaped by 6.8% in the third quarter over a year earlier, following a 6.5% growth in the second quarter. On a seasonally adjusted quarter-to-quarter comparison, real GDP grew by 0.7% in the third quarter, the sixth consecutive quarter of expansion (*Chart*). As a result, the seasonally adjusted level of real GDP in the third quarter surpassed the pre-crisis peak in the first quarter of 2008 by some 2.3%.

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

External trade

3. *Total exports of goods* maintained strong momentum in the third quarter. Total exports of goods surged by 20.8% in real terms over a year earlier, further to the 20.1% growth in the second quarter. Exports to major Asian markets continued to be the key growth driver, thanks to the strong domestic demand in these economies and also the increase in intra-regional production activity. Exports to the US and Europe also improved further, as their import demand continued to rise back from their troughs in 2009. Yet demand in the US and European markets had yet to return to their pre-crisis levels in 2008. On a seasonally adjusted quarter-to-quarter basis, total exports of goods stayed steady in real terms in the third quarter.

4. *Exports of services* continued to perform well in the third quarter, up 14.0% in real terms over a year earlier, after the 17.1% increase in the second quarter. Exports of travel services were buoyed by robust growth in incoming visitors across most major markets, in particular the Mainland and other Asian markets. Exports of transportation and trade-related services continued to benefit from the vibrant trade flows in the region and the resurgence in trade with the rest of the world. Exports of financial and business services expanded further despite a higher base of comparison a year earlier. On a seasonally adjusted quarter-to-quarter basis, exports of services grew further by 0.8% in real terms in the third quarter.

Domestic sector

5. The domestic sector held up well in the third quarter. Supported by improving job and income prospects, *private consumption expenditure* picked up further in the third quarter, by 5.7% year-on-year in real terms, following a 4.4% growth in the second quarter. On a seasonally adjusted quarter-to-quarter comparison, private consumption expenditure leaped by 1.7% in real terms in the

third quarter. *Government consumption expenditure* also grew steadily further, by 3.4% in real terms in the third quarter as compared to a year earlier.

6. *Overall investment spending* increased marginally by 0.3% in real terms in the third quarter over a year earlier, after the strong growth of 15.6% in the second quarter. The slower growth of overall investment in the third quarter, despite the largely sanguine business confidence, was due to the 6.4% decline in machinery and equipment acquisitions after three quarters of double-digit year-on-year growth, the latter being a highly volatile component which can show big fluctuations from quarter to quarter. Expenditure on building and construction grew notably further by 9.2% in the third quarter, again driven by the continued surge in public sector works. Private sector construction activity was still flat.

The labour sector

7. The labour market improved further on a broad front, thanks to an increasingly entrenched economic recovery. Total employment continued to climb back, pushing the *seasonally adjusted unemployment rate* down further to 4.2% in the third quarter, the lowest since end-2008. The *underemployment rate* also continued its downtrend, reaching 1.9% in the third quarter. Meanwhile, labour wages and earnings rose further in the second quarter.

The asset markets

8. *Local stock market* showed some rebound in July but fell again in August, generally range-bound as market sentiment remained under the influence of the ongoing sovereign debt problem in Europe and the bumpy recovery in the advanced economies. Nevertheless, local stock market resumed an uptrend alongside other major markets worldwide entering September, on expectations of an extension of the super-loose monetary stance in the advanced economies and in particular, a new round of quantitative easing by the US. The Hang Seng Index rallied during September, closing the month at 22 358, up 11% and 2% respectively over end-June this year and end-2009.

9. *Residential property market* remained vibrant in July and August, gaining in both prices and transaction volume. It then turned quieter in September, after the Government's further round of measures in mid-August to contain the housing market bubble risk. Yet the market resumed momentum again lately, along with the stock market rally and market expectations that interest rates would remain exceptionally low for an expanded period of time. Overall flat prices rose by 5% between June 2010 and September 2010, giving a cumulative increase of 22% over the pre-crisis peak in June 2008. Transactions in the third quarter leaped by 18% over the preceding quarter, reflecting the active trading amid positive market sentiment. With the exceptionally low mortgage interest rates, 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 still below the long-term average of 53% over 1989 to 2008, but has risen further to 42%

in the third quarter. Meanwhile, rentals for flats, offices and shops notched up further, along with the pick-up in leasing demand and commercial activities.

Prices

10. *Underlying consumer price inflation* rose further from 1.5% in the second quarter to 2.0% in the third quarter. Taking into account the effect of the Government's one-off measures, *headline consumer price inflation* stood at 2.3% in the third quarter, down from 2.6% in the second quarter. The narrowing gap between the headline and underlying inflation rates in the third quarter was largely due to the dissipation of the lower base effect created by the electricity subsidy with the final payment ended in August last year, as well as an extra month of public housing rental waiver in the third quarter this year as compared to the previous year.

Latest GDP and price forecasts for 2010

11. The global economy continued to recover at an uneven pace across regions. While the strength of recovery in most advanced economies remained weak, many emerging and developing economies, in particular the Mainland China, saw further strong growth. Given that the advanced economies are still the main driving force behind the final demand in global trade, their dimmer growth prospect may eventually pose a drag on external trade performance in Hong Kong and Asia as a whole. The more volatile exchange rates as well as the rise of protectionism will also increase the headwinds in the trading environment. While export orders have held relatively stable so far, the downside risks to Hong Kong's trade outlook have increased somewhat going forward.

12. Nevertheless, local consumer sentiment should remain firm in the near term, supported by the improving income and job prospects. As to business sentiment, the latest Quarterly Business Tendency Survey results indicate that the large enterprises remain positive about the near-term business outlook. Public sector construction works will sustain at high levels, also rendering support to domestic demand. Yet the Government will closely monitor the increasing asset market bubble risks facing the region, especially with the new round of quantitative easing in the US.

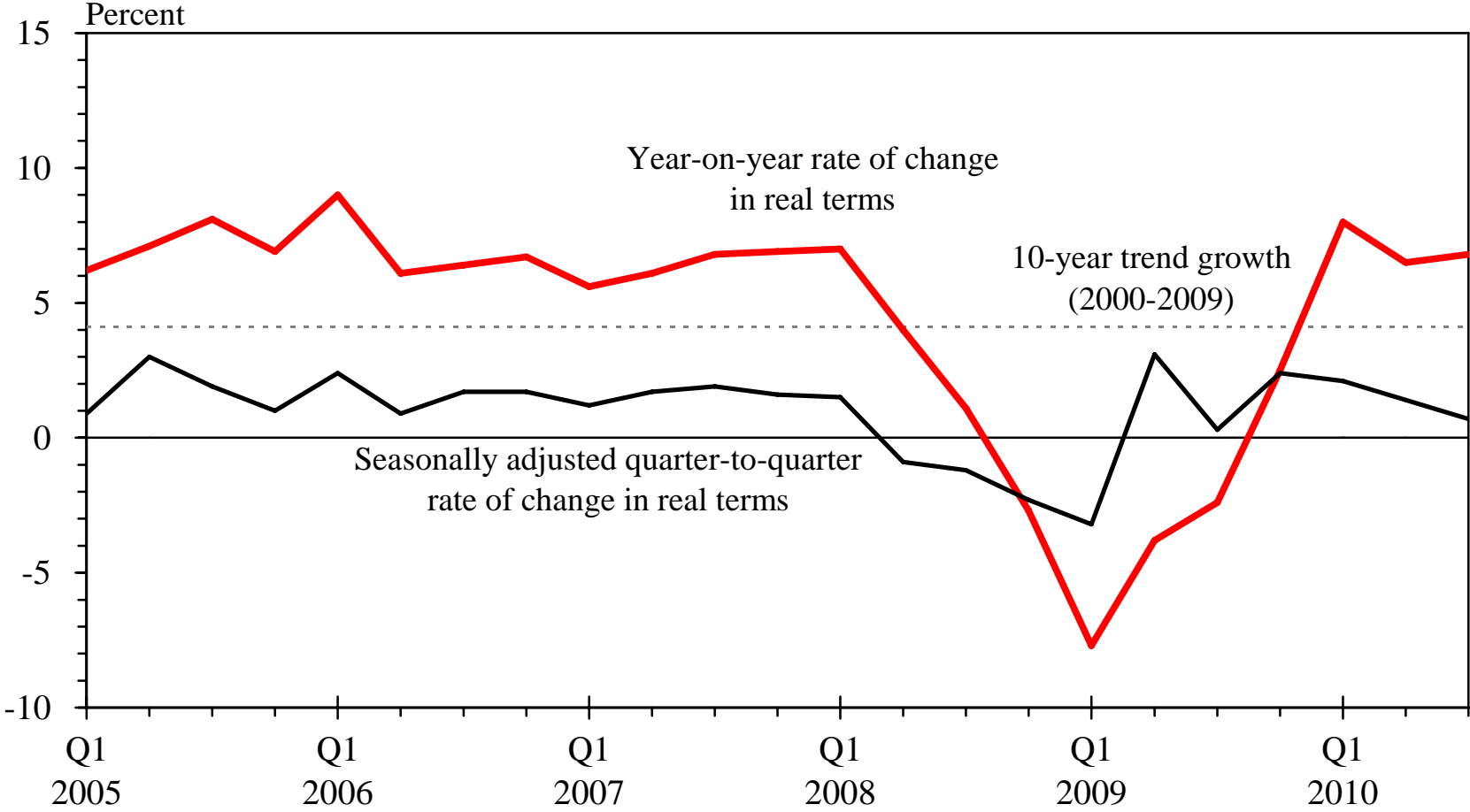
13. In the first three quarters of 2010, GDP expanded strongly by 7.1% in real terms over a year earlier. Even allowing for some possible deceleration in the fourth quarter, economic growth in 2010 should exceed the forecast of 5-6% announced in August. Thus, the GDP growth forecast for 2010 as a whole is revised upwards to 6.5% (*Table 2*). For information, most private sector analysts are currently projecting the economy to expand by 5-7%, averaging at around 6%.

14. Inflation in Hong Kong is likely to go up further, as the rise-back in domestic costs, as well as higher import prices amid a weaker US dollar and elevated global food and commodity prices, continue to feed through. The new round of quantitative easing in the US, which could trigger further funds influx into

the region, will also pose upside risks to inflation. Nevertheless, the sustained productivity growth in the economy should provide a partial offset. Underlying consumer price inflation, which averaged at 1.4% in the first three quarters of 2010, is now forecast at 1.7% for the year as a whole, revised upwards from 1.5% in the August round. The forecast rate of headline consumer price inflation for 2010 as a whole is also revised upwards accordingly, from 2.3% to 2.5%.

(The Third Quarter 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 \$100 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, Third Quarter 2010, which contains the GDP figures up to the third 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 third 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>	<u>Q3⁺</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)	4.4 (1.4)	5.7 (1.7)
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)	3.4 (1.4)
Gross domestic fixed capital formation	0.8	-1.8	-10.3	-11.8	3.2	14.1	8.2	15.6	0.3
<i>of which :</i>									
Building and construction	6.1	-0.5	-5.6	-2.4	5.4	1.3	-7.2	12.3	9.2
Machinery, equipment and computer software	-0.8	-2.6	-4.1	-16.6	-2.1	16.2	11.9	16.4	-6.4
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)	20.8 (*)
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)	16.5 (-3.1)
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)	17.1 (0.9)	14.0 (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)	12.4 (3.4)	9.9 (-0.8)
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)	6.8 (0.7)
<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)	* (-1.7)	2.5 (1.8)
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)	2.3 (-1.4)
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)	2.0 (0.3)
<u>Change in nominal GDP (%)</u>	3.7	-2.6	-7.0	-2.9	-3.4	2.7	10.1	6.5	9.5

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%.

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

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

	<u>Forecasts for 2010 as released on 13.8.2010</u> (%)	<u>Latest forecasts for 2010 on 12.11.2010</u> (%)
Gross Domestic Product (GDP)		
<i>Real GDP</i>	5 to 6	6.5
<i>Nominal GDP</i>	5 to 6	8
Composite Consumer Price Index (CCPI)		
<i>Headline CCPI</i>	2.3	2.5
<i>Underlying CCPI</i>	1.5	1.7
GDP Deflator	0	1.5