

Press Release

(embargoed until 4:30 p.m. on 12 August 2011)

Economic Situation in the Second Quarter of 2011 and Latest GDP and Price Forecasts for 2011

The Government released today (Friday) the Half-yearly Economic Report 2011, together with the preliminary figures on Gross Domestic Product for the second quarter of 2011.

The Acting Government Economist, Mr Andrew Au, described the economic situation in the second quarter of 2011 and provided the latest GDP and price forecasts for the year.

MAIN POINTS

- * The Hong Kong economy expanded at a solid pace in the second quarter of 2011, by 5.1% in real terms over a year earlier, despite a more challenging external environment. This exceeded the average annual growth of 4.0% over the past ten years, albeit moderated from the exceptionally strong growth of 7.5% in the first quarter. On a seasonally adjusted quarter-to-quarter comparison, GDP however declined slightly by 0.5% in real terms in the second quarter, mainly reflecting the drag from merchandise trade and a very high base of comparison in the first quarter.
- * Exports of goods decelerated noticeably in the second quarter to show virtually little change in real terms over a year earlier. While this was partly attributable to the temporary disruptions to regional supply chains caused by the Japan incident, the slower growth in demand in many export markets was also relevant. Nevertheless, the Asian markets continued to outperform the developed markets.
- * Exports of services held up well in the second quarter, growing notably by 7.8% in real terms over a year earlier. Exports of travel services as well as financial and other business services provided the main impetus, on the back of vibrant inbound tourism and active cross-border financing, fund-raising and other commercial activities. Yet exports of trade-related services and transportation services showed more moderate growth, along with the slowdown in regional trade flows.
- * Domestic demand strengthened in the second quarter, becoming the key driver of overall economic growth. Private consumption expenditure grew by 9.2% in real terms over a year earlier, thanks to sanguine consumer sentiment and improving income conditions. Overall investment spending increased markedly by 8.1%, bolstered by the continued expansion in public building and construction works as well as a notable rebound in private machinery and equipment acquisition.
- * The pace of job creation accelerated in tandem with the sustained economic upturn, pushing total employment to an all-time high and absorbing most of the

increase in labour force. The seasonally adjusted unemployment rate stood at a low level of 3.5% in the second quarter. Thanks to a relatively tight labour market, wages and earnings rose further. The median household income rose appreciably by 9.6% in the second quarter in nominal terms over a year earlier, or by 4.2% in real terms after discounting inflation. Over the same period, average employment earnings for the lowest decile of full-time employees also posted a notable increase of 10.0% in nominal terms or 4.3% in real terms.

- * The local stock market drifted lower during the second quarter, due to heightened uncertainties in the external environment. Residential flat prices rose further during the quarter, but property trading turned quieter amid more stringent mortgage loan terms and further Government measures to stabilise the housing market.
- * The level of uncertainty in the external environment has been increasing since the beginning of the year. The fragile economic recovery and fiscal positions of the US and the lingering sovereign debt problem in the eurozone remain the key sources of downside risks to the global economy. The austerity measures being implemented in the advanced economies to redress their fiscal weakness may also weigh on their growth momentum in the period ahead. Nevertheless, the dampening effects of the Japan incident on regional trade flows are expected to gradually fade out. The Asian and emerging market economies as a whole should continue to outperform the advanced economies, notwithstanding their need to tighten policy to rein in inflation. These latter two factors should continue to provide support to Hong Kong's trade performance in the rest of the year.
- * The domestic sector is expected to stay resilient. Local consumer spending will be underpinned by the improving income and employment conditions. The results of the latest Quarterly Business Tendency Survey also showed that large enterprises have remained positive on the near-term business outlook. Meanwhile, the sustained high level of public sector construction works should render additional support to domestic demand.
- * Given the strong outturn of a 6.3% year-on-year real GDP growth in the first half of 2011, barring any abrupt external shocks and even allowing for some moderation in growth in the second half of the year, the economy should be on track to achieve the growth forecast as announced in the May round. The forecast GDP growth for 2011 as a whole is maintained at 5-6% in the current round.
- * As part of a global-wide phenomenon, inflationary pressures increased during the second quarter. Underlying consumer price inflation, which nets out the effects of the Government's relief measures to reflect the inflation trend more accurately, rose to 5.0% in the second quarter from 3.7% in the first quarter. Higher food prices and private housing rentals remained the key contributory factors.

- * Although global food and commodity prices have shown signs of stabilisation in recent months, they are still markedly higher than year-ago levels. Moreover, given rising inflation in import sources, Hong Kong will continue to experience elevated price pressure from the external front in the near term. Locally, the feed-through of higher private residential rentals to the consumer price indices will also continue in the coming months. The sustained economic upturn and the one-off effect from the implementation of statutory minimum wage will also exert upward pressures on domestic costs. Against this background, inflation is likely to climb up further in the coming months before peaking out. The inflation forecasts for 2011 as a whole announced in the May round had already factored in the above developments and the consumer price trend has so far been largely in line with expectations. As such, the forecast rates of headline and underlying consumer price inflation for 2011 as a whole are kept unchanged at 5.4% and 5.5% respectively.

DETAILS

GDP

According to preliminary data on the *Gross Domestic Product (GDP)* released today by the Census and Statistics Department, real GDP expanded solidly by 5.1% in the second quarter of 2011 over a year earlier, moderating from the exceptionally strong 7.5% growth in the first quarter (revised upwards from the preliminary estimate of 7.2%). The year-on-year growth in the second quarter still exceeded the average annual growth of 4.0% over the past ten years. On a seasonally adjusted quarter-to-quarter comparison, real GDP however contracted slightly by 0.5% in the second quarter, after eight consecutive quarters of expansion (*Chart*). This reflected mainly the higher base of comparison due to the strong quarterly growth of 3.1% in the first quarter and the moderation in merchandise trade during the quarter.

2. The latest figures on GDP and its major expenditure components up to the second quarter of 2011 are presented in *Table 1*. Developments in different segments of the economy in the second quarter of 2011 are described below.

External trade

3. *Total exports of goods* decelerated noticeably to show virtually little change in real terms from a year earlier in the second quarter, in stark contrast to the 16.8% surge in the first quarter, dragged by the temporary disruptions to the global and regional supply chains arising from the Japan incident and also by slowing growth momentum in many export markets. Exports to both the US and the EU relapsed to declines. As to the Asian markets, exports to Japan plunged in the aftermath of the March earthquake. While exports to the Mainland saw a moderate decline, those to many other Asian and emerging markets continued to post appreciable growth. On a seasonally adjusted quarter-to-quarter comparison, total exports of goods fell sharply by 11.1% in real terms in the second quarter.

4. *Exports of services* fared relatively better in the second quarter, still showing appreciable growth of 7.8% in real terms over a year earlier, albeit moderated from the 9.3% growth in the first quarter. Exports of travel services provided the main impetus, driven by the strong increase in incoming visitor arrivals. Exports of financial and other business services also expanded robustly further, bolstered by buoyant fund-raising, cross-border financing and other commercial activities. However, exports of trade-related services (comprising mainly offshore trade activities) and transportation services showed more moderate growth, mirroring the relatively sluggish performance of merchandise trade and cargo flows. On a seasonally adjusted quarter-to-quarter basis, exports of services grew by 1.0% in real terms in the second quarter.

Domestic sector

5. The domestic sector displayed strong growth momentum, becoming the major driving force of overall economic growth in the second quarter. Local consumer spending stayed robust, thanks to sanguine consumer sentiment and continued improvement in income conditions. *Private consumption expenditure* grew markedly by 9.2% in real terms in the second quarter over a year earlier, further to the 8.0% growth in the first quarter. On a seasonally adjusted quarter-to-quarter basis, private consumption expenditure grew strongly further by 2.3% in real terms in the second quarter. *Government consumption expenditure* also increased modestly by 1.4% in real terms over a year earlier.

6. *Overall investment spending* rebounded significantly in the second quarter, by 8.1% in real terms over a year earlier, after dipping temporarily by 0.3% in the first quarter. The reversal was mainly driven by the sharp rise-back in private machinery and equipment acquisition, by 18.0% year-on-year in the second quarter, after a brief relapse in the first quarter. Meanwhile, overall building and construction expenditure relapsed to a modest decline of 2.4% in real terms in the second quarter. While public sector expenditure on building and construction still expanded at a double-digit pace, even against a higher base of comparison, private sector construction activity declined further in the quarter.

The labour sector

7. The demand for labour stayed fairly strong in the second quarter. Notwithstanding the implementation of statutory minimum wage from 1 May, the brisk job creation amid a vibrant local economy pushed the total employment to an all-time high and helped to absorb most of the additional workforce. As a result, the *seasonally adjusted unemployment rate* only inched up to 3.5% in the second quarter from 3.4% in the first quarter, and was still near the post-1997 low of 3.3% in mid-2008. The *underemployment rate* likewise stayed low at 1.8%. Meanwhile, labour wages and earnings rose further. The median household income rose appreciably by 9.6% in the second quarter in nominal terms over a year earlier, or by 4.2% in real terms after discounting inflation. Over the same period,

average employment earnings for the lowest decile of full-time employees also posted a notable increase of 10.0% in nominal terms or 4.3% in real terms.

The asset markets

8. The *local stock market* exhibited wider fluctuations along with other major overseas markets during the second quarter. Having fared strongly in April, the stock market drifted lower as market sentiments were dented by the re-intensification of sovereign debt problem in the eurozone, the worse-than-expected performance of the US economy, and further policy tightening in the Mainland. The Hang Seng Index (HSI) closed the month of June at 22 398, down 4.8% from end-March this year and 2.8% from end-2010.

9. *Residential property market* saw mixed developments in the second quarter. While overall flat prices rose by a further 4% between March 2011 and June 2011, cumulating to a 14% increase during the first half of 2011, transactions in the second quarter fell by 9% over the preceding quarter, as potential flat buyers turned more cautious in view of more stringent mortgage loan terms offered by banks, further Government measures to stabilise the housing market, and heightened uncertainties in the external environment. Meanwhile, flat rentals went up further, by 4% during the second quarter, while office and shop rentals rose even faster, by 5% and 6% respectively.

Prices

10. Inflation picked up further and remained a major challenge to the economy. In the second quarter, the appreciable increase in import prices continued to fuel local inflation, as global food and commodity prices stayed elevated on the back of abundant liquidity. The rise in oil prices amid heightened geopolitical tensions in the Middle East and North Africa early in the quarter was also relevant. The further feed-through of higher private housing rentals after the surge last year was another major factor. Meanwhile, upward price pressures stemming from rising local business costs also turned more evident, in tandem with the sustained brisk economic expansion. The low unemployment rate, coupled with the one-off effect from the implementation of statutory minimum wage, also led to stronger local wage pressures. *Headline consumer price inflation* rose from 3.8% in the first quarter to 5.2% in the second quarter. Netting out the effect of the Government's relief measures, *underlying consumer price inflation* went up from 3.7% to 5.0%.

11. Food and housing remained the key drivers behind the rise in inflation in the second quarter, given their relatively large weightings in the consumption basket. Food prices (including charges at restaurants) and private housing rentals accounted for over 70% of the year-on-year rate of increase in the underlying Composite CPI in the second quarter, at 5.0%.

Latest GDP and price forecasts for 2011

12. The level of uncertainty in the external environment has been increasing since the beginning of the year. The fragile economic recovery and fiscal positions of the US and the lingering sovereign debt problem in the eurozone remain the key sources of downside risks to the global economy. The austerity measures being implemented in the advanced economies to redress their fiscal weakness may also weigh on their growth momentum in the period ahead. Nevertheless, the dampening effects of the Japan incident on regional trade flows are expected to gradually fade out. The Asian and emerging market economies as a whole should continue to outperform the advanced economies, notwithstanding their need to tighten policy to rein in inflation. These latter two factors should continue to provide support to Hong Kong's trade performance in the rest of the year.

13. The domestic sector is expected to stay resilient. Local consumer spending will be underpinned by the improving income and employment conditions. The results of the latest Quarterly Business Tendency Survey also showed that large enterprises have remained positive on the near-term business outlook. Meanwhile, the sustained high level of public sector construction works should render additional support to domestic demand.

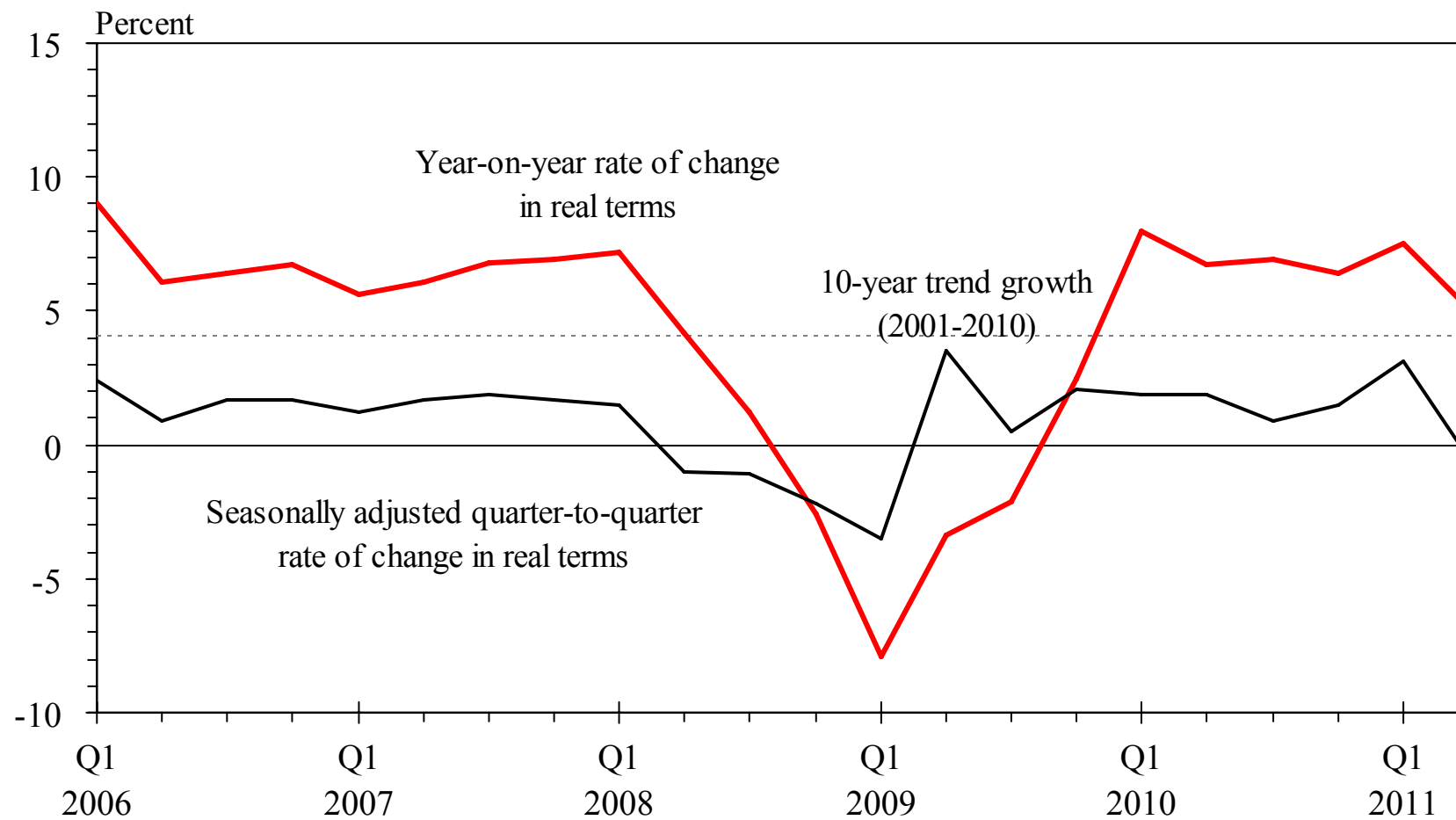
14. Given the strong outturn of a 6.3% year-on-year real GDP growth in the first half of 2011, barring any abrupt external shocks and even allowing for some moderation in growth in the second half of the year, the economy should be on track to achieve the growth forecast as announced in the May round. The forecast GDP growth for 2011 as a whole is maintained at 5-6% in the current round (*Table 2*). For reference, the latest forecasts by private sector analysts mostly range from 5-6%, averaging at around 5.6%.

15. As part of a global-wide phenomenon, inflationary pressures increased during the second quarter. Although global food and commodity prices have shown signs of stabilisation in recent months, they are still markedly higher than year-ago levels. Moreover, given rising inflation in import sources, Hong Kong will continue to experience elevated price pressure from the external front in the near term. Locally, the feed-through of higher private residential rentals to the consumer price indices will also continue in the coming months. The sustained economic upturn and the one-off effect from the implementation of statutory minimum wage will also exert upward pressures on domestic costs. Against this background, inflation is likely to climb up further in the coming months before peaking out. The inflation forecasts for 2011 as a whole announced in the May round had already factored in the above developments and the consumer price trend has so far been largely in line with expectations. As such, the forecast rates of headline and underlying consumer price inflation for 2011 as a whole are kept unchanged at 5.4% and 5.5% respectively.

(The Half-yearly Economic Report 2011 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 \$116 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 2011, which contains the GDP figures up to the second quarter of 2011, 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 2011 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>2009[#]</u>	<u>2010[#]</u>	<u>2010</u>				<u>2011</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	0.7	6.2	7.4 (0.7)	4.1 (1.3)	5.3 (1.8)	8.1 (3.7)	8.0 (1.0)	9.2 (2.3)
Government consumption expenditure	2.3	2.7	3.3 (0.9)	2.7 (0.8)	3.2 (0.9)	1.6 (-0.8)	2.6 (1.8)	1.4 (-0.6)
Gross domestic fixed capital formation	-3.9	7.8	8.2	15.8	-0.3	8.6	-0.3	8.1
<i>of which :</i>								
Building and construction	-5.5	6.6	-7.1	13.2	9.6	11.3	16.0	-2.4
Machinery, equipment and computer software	-3.0	5.9	11.5	15.9	-7.3	6.4	-12.1	17.4
Total exports of goods	-12.7	17.3	21.6 (6.2)	20.2 (3.9)	20.8 (1.8)	8.2 (-3.5)	16.8 (14.4)	0.3 (-11.1)
Imports of goods	-9.5	18.1	28.3 (7.5)	23.4 (3.3)	16.7 (-0.6)	7.5 (-2.3)	12.6 (12.0)	2.6 (-5.9)
Exports of services	0.3	15.0	18.4 (4.1)	17.5 (2.2)	15.8 (2.2)	9.3 (0.3)	9.3 (4.1)	7.8 (1.0)
Imports of services	-4.9	10.4	11.2 (2.2)	11.9 (2.4)	10.8 (1.0)	7.7 (1.7)	5.8 (0.6)	2.9 (-0.4)
Gross Domestic Product	-2.7	7.0	8.0 (1.9)	6.7 (1.9)	6.9 (0.9)	6.4 (1.5)	7.5 (3.1)	5.1 (-0.5)
<i>Change in the main price indicators (%)</i>								
GDP deflator	-0.6	0.5	0.9 (1.1)	-1.9 (-2.4)	1.7 (2.3)	1.1 (0.2)	1.2 (1.0)	4.6 (1.1)
Composite CPI								
Headline	0.5	2.4[@]	1.9 (0.8)[@]	2.6 (0.5)[@]	2.3 (-2.2)[@]	2.7[@] (3.7)[@]	3.8[@] (1.8)[@]	5.2[@] (1.8)[@]
Underlying[^]	1.0	1.7[@]	0.8 (0.5)[@]	1.5 (0.5)[@]	2.0 (0.4)[@]	2.4[@] (1.0)[@]	3.7[@] (1.8)[@]	5.0[@] (1.8)[@]
<u>Change in nominal GDP (%)</u>	-3.3	7.5	8.9	4.7	8.7	7.6	8.7	9.9

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.

(@) By reference to the new 2009/10-based CPI series.

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

Table 2**Economic forecasts for 2011
(rate of change (%))**

	Forecasts for 2011 as released on <u>13.5.2011</u> (%)	Latest forecasts for 2011 on <u>12.8.2011</u> (%)
Gross Domestic Product (GDP)		
<i>Real GDP</i>	5 to 6	<i>5 to 6</i>
<i>Nominal GDP</i>	7.5 to 8.5	<i>7.5 to 8.5</i>
Composite Consumer Price Index (CCPI)		
<i>Headline CCPI</i>	5.4	<i>5.4</i>
<i>Underlying CCPI</i>	5.5	<i>5.5</i>
GDP Deflator	2.5	2.5