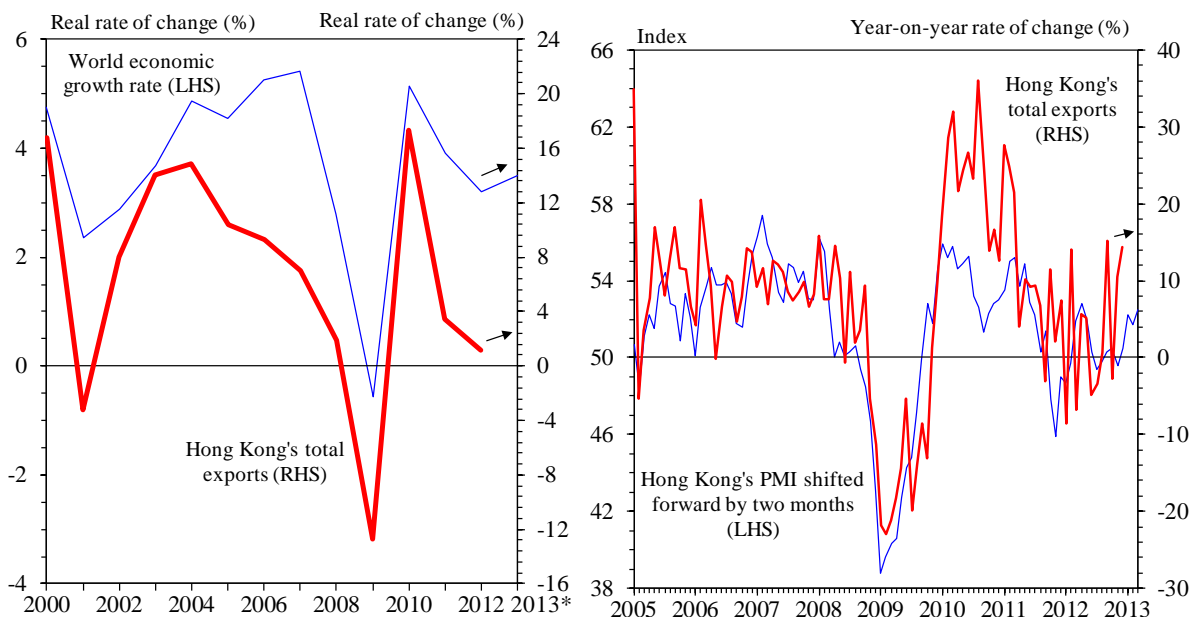


Outlook for the Hong Kong economy in 2013

2.22 With the strong headwinds on the external front in mid-2012 by and large subsided towards the latter part of the year, the downside risks should abate somewhat in 2013 when compared with the unusually austere situation in 2012. Indeed, global economic conditions were more sanguine than earlier expected on entering 2013, with improved financial conditions in Europe, sustained revival in the housing market and partial aversion of the fiscal cliff in the US, firmer momentum in the Mainland, and signs of some pick-up in production and export activities in many Asian economies. Hong Kong as a highly externally-oriented economy should benefit from these developments, and barring any abrupt deterioration in the demand conditions of the advanced economies, our *total exports of goods* are poised to see some improvement in 2013.

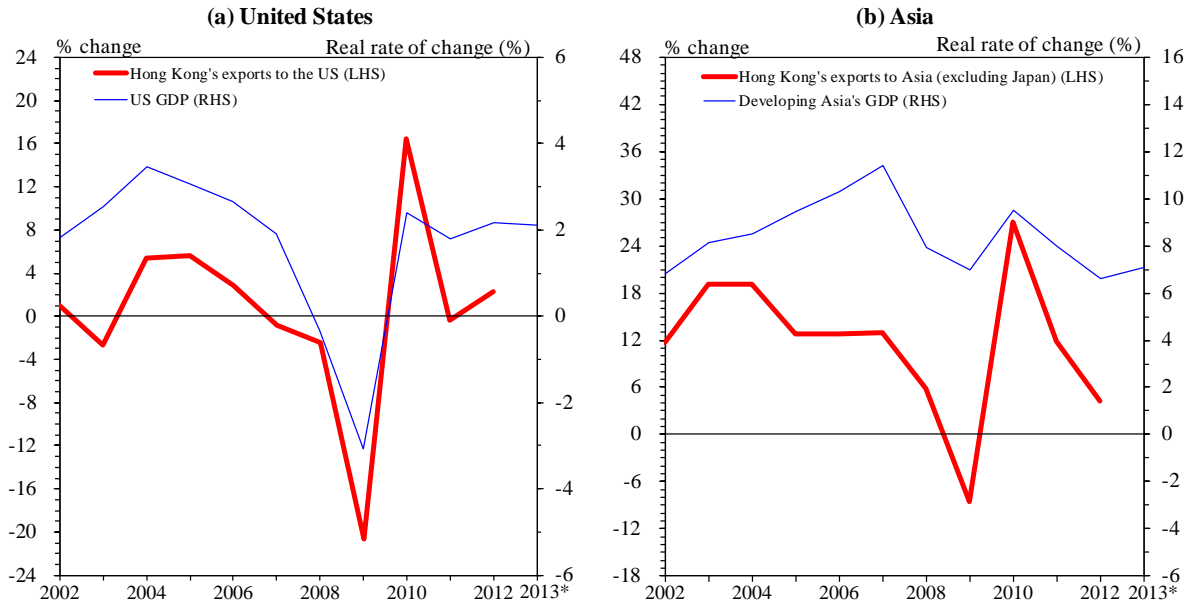
2.23 Nevertheless, the fundamentals of the advanced economies remain weak, with growth still heavily constrained by high unemployment, fiscal uncertainty, and structural problems. On the other hand, the Mainland economy has resumed faster growth and would render a stabilising force to intra-regional trade flows going forward. In sum, the global economy, and hence global trade flows, will likely see another year of modest growth. In view of the still rather fluid external environment, Hong Kong's export performance is not envisaged at this juncture to see a sharp rebound in 2013, and indeed could still see rather uneven performance over the course of the year.

Diagram 2.5 : Hong Kong's exports of goods should see some improvement in 2013



Source : IMF World Economic Outlook Update January 2013.
 Note : (*) Forecast from the IMF.

Diagram 2.6 : The Mainland's faster growth momentum should benefit regional trade

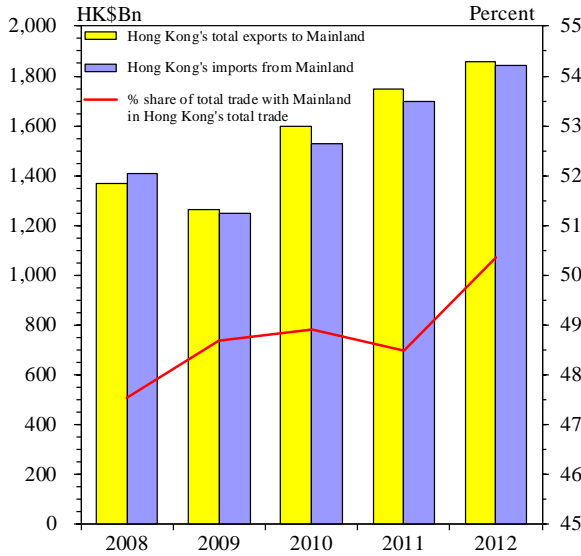


Note : (*) Forecasts from the IMF World Economic Outlook Update, January 2013.

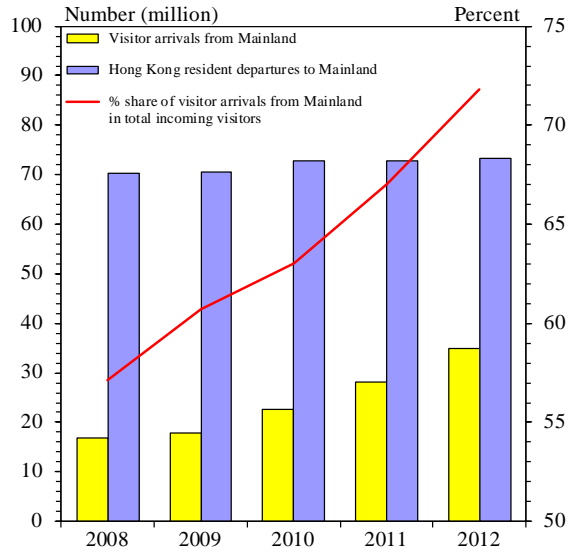
2.24 *Exports of services* experienced a visible slowdown during 2012. Looking ahead, service exports should likewise see some pick-up in growth in 2013. In particular, exports of trade-related services and transportation services should fare better in tandem with the somewhat improved trade and cargo flows. Exports of financial and business services should also regain some momentum thanks to the further development of RMB business, the expected revival of fund-raising activities, as well as the better growth prospects of the Mainland economy, thereby spurring investment flows and cross-border financing activities. In addition, exports of travel services should continue to see solid growth, along with the sustained vibrancy of inbound tourism.

Diagram 2.7 : The Mainland factor will remain supportive to the Hong Kong economy

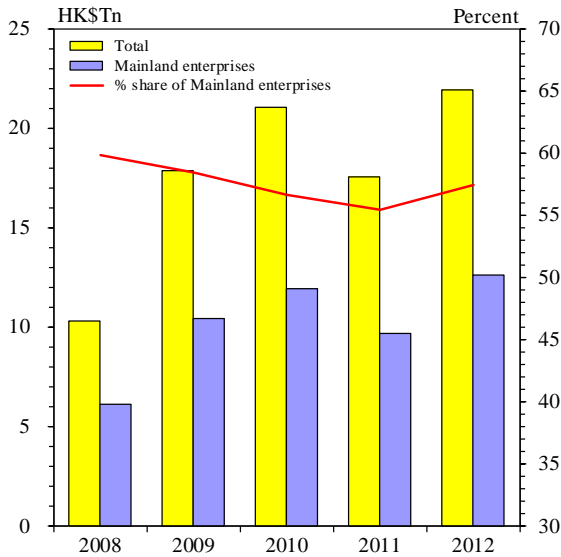
(a) Merchandise trade



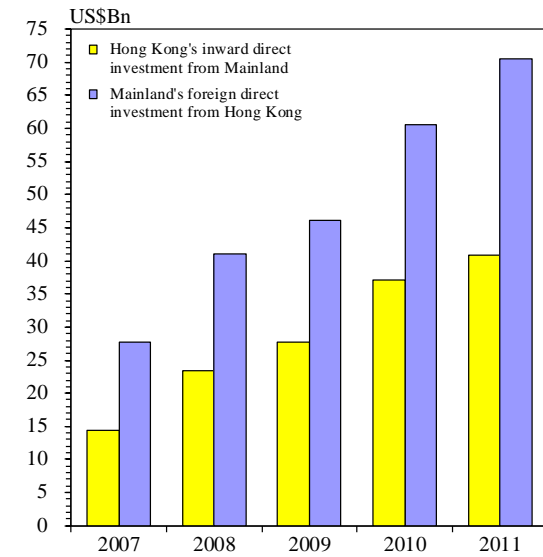
(b) Visitor arrivals from Mainland and Hong Kong resident departures to Mainland



(c) Market capitalisation of Mainland enterprises in the Hong Kong stock market (end-year figures)



(d) Mainland's foreign direct investment from Hong Kong and Hong Kong's inward direct investment from Mainland



2.25 *Domestic demand* stayed resilient in 2012 and remained the key driver of overall economic growth. In 2013, local consumer sentiment should still be underpinned by the solid employment growth and broad-based income improvement, as well as the positive wealth effect from the asset markets fuelled in part by the loose monetary stance in the advanced economies. Indeed, the latest Quarterly Business Tendency Survey and consultation on small and medium-sized enterprises (SMEs) indicated generally positive and stable hiring sentiments among large enterprises and SMEs respectively. This should be favourable to private consumption spending, granting no abrupt deterioration in the external environment to the extent of severely denting local sentiment and willingness to spend. As for investment, while machinery and equipment acquisition tends to be volatile, the building and construction component should be well sustained by the high level of public infrastructure works under way, as well as the expected notable pick-up in private building activity. All in all, the domestic sector is expected to hold up generally well in 2013.

Diagram 2.8 : Private consumption should be well underpinned by job and income growth

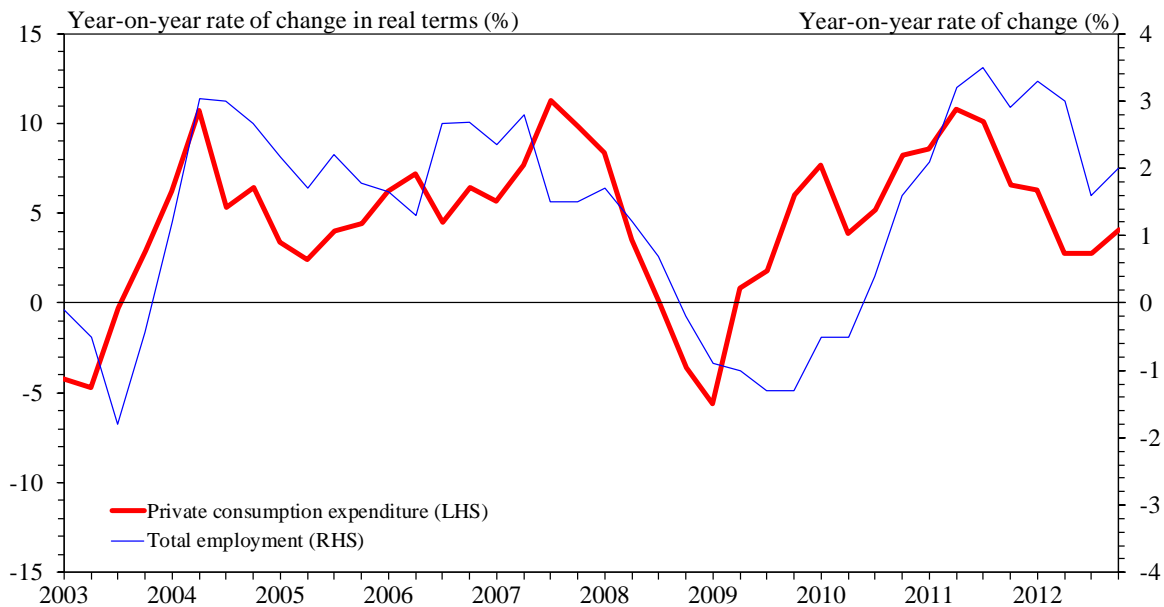


Diagram 2.9 : Consumer sentiment may also be affected by asset market performance

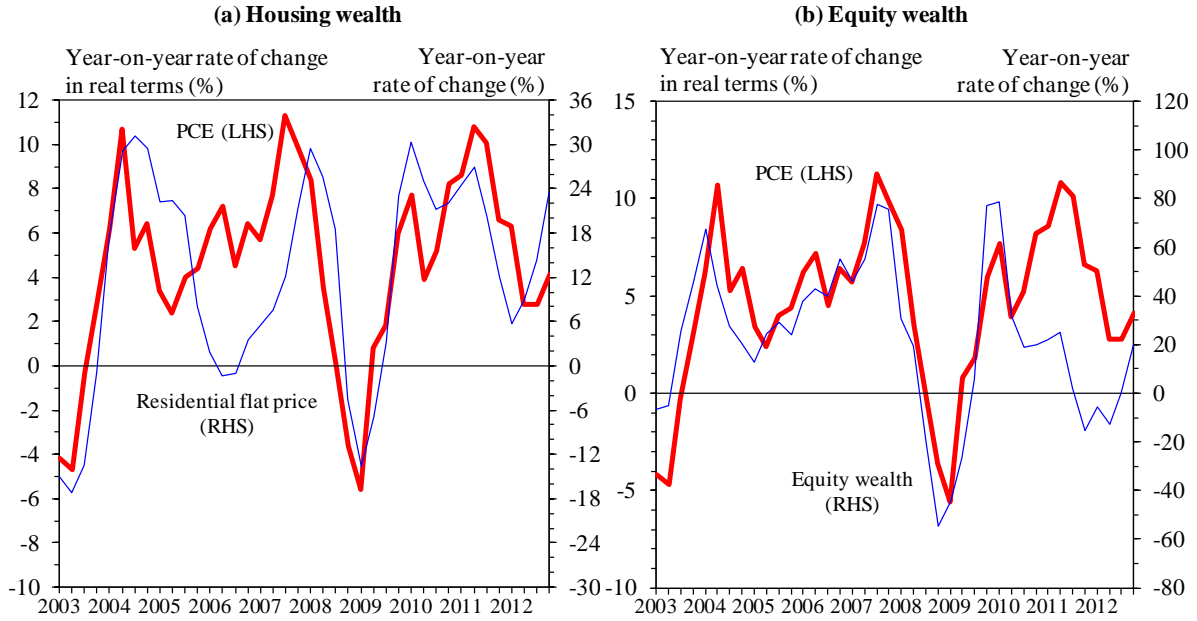
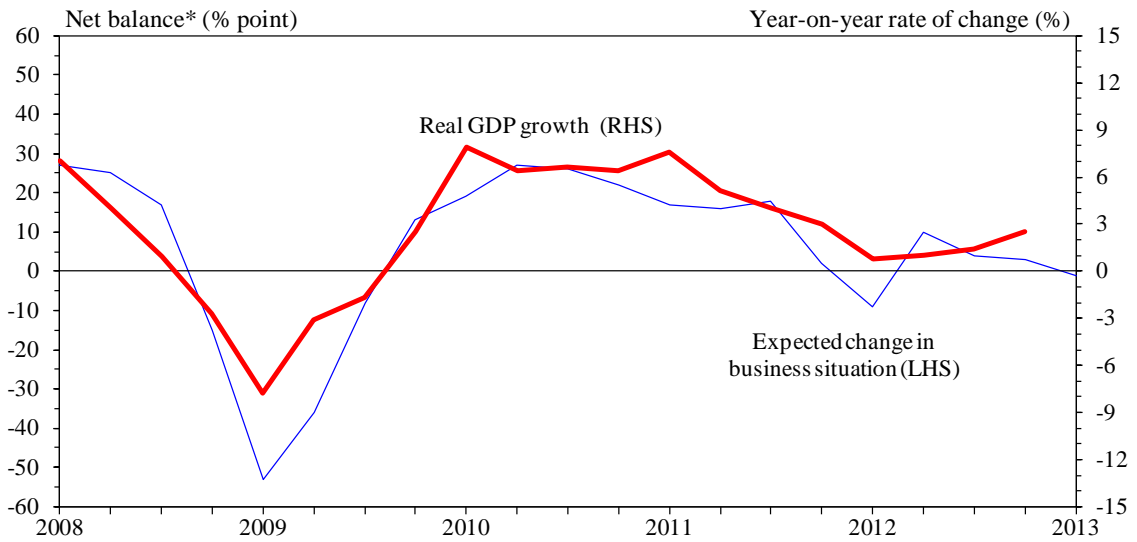
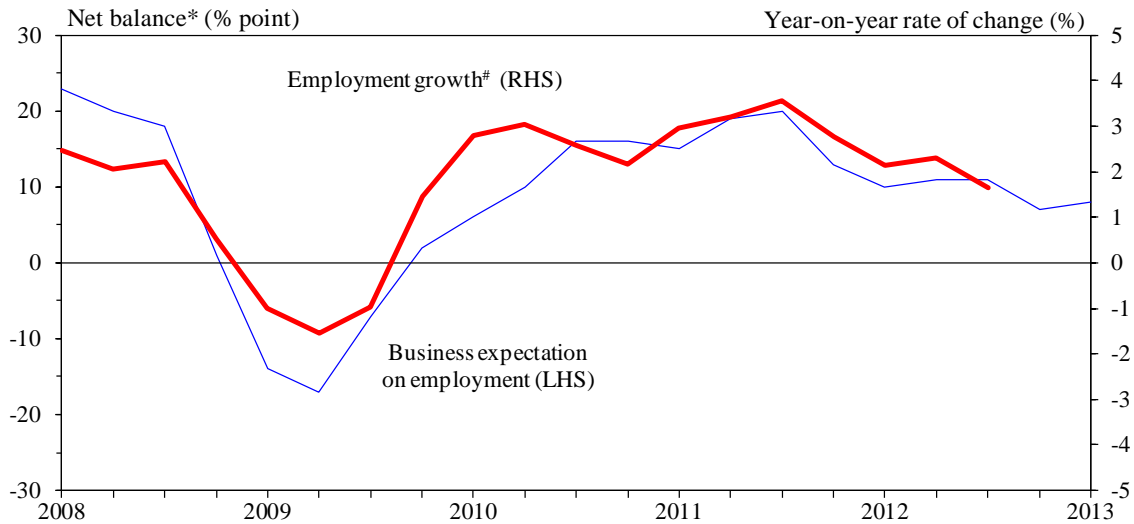


Diagram 2.10 : Business sentiment remains generally cautious



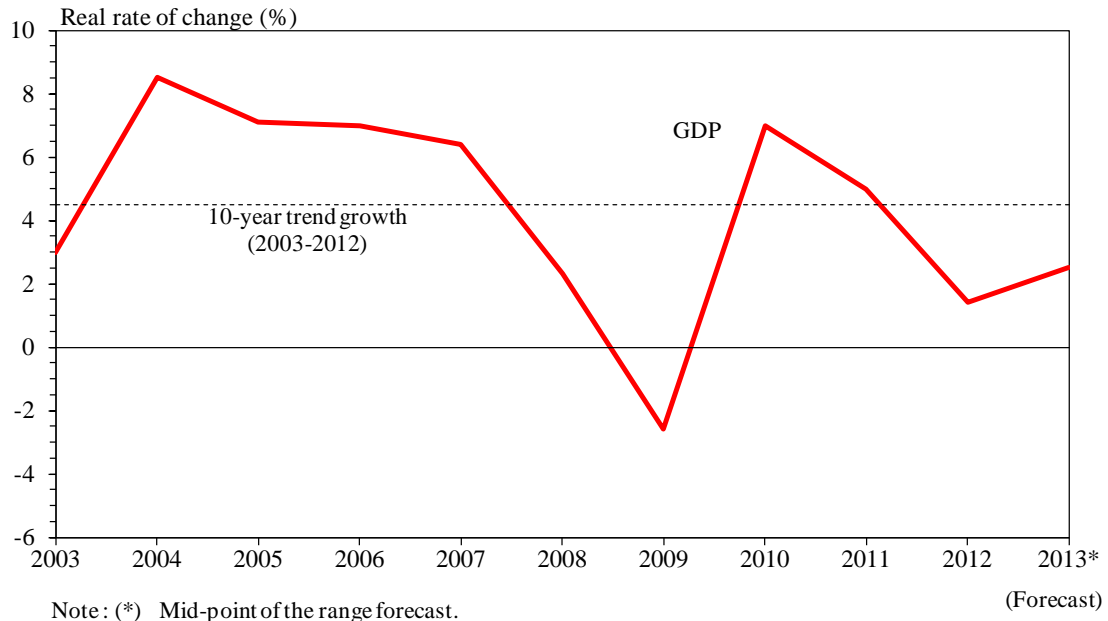
Note : (*) Net balance indicates the direction of expected change in business situation versus preceding quarter. It refers to the difference in percentage points between the proportion of establishments choosing "better" over that choosing "worse". A positive sign indicates a likely upward trend while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

Diagram 2.11 : Yet hiring sentiment is still largely positive



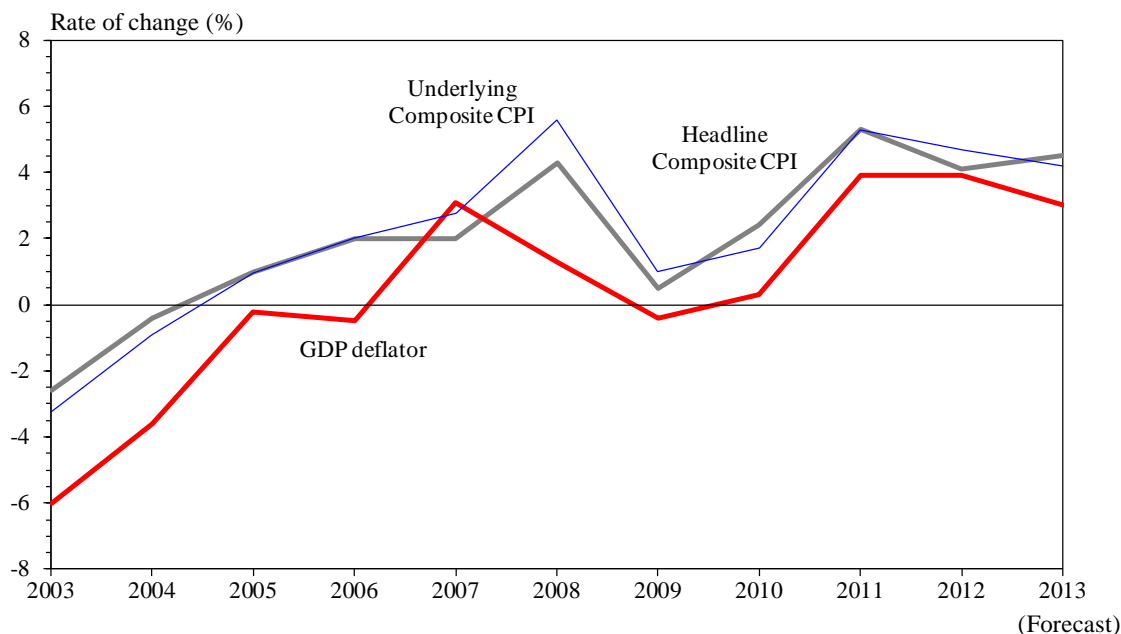
Notes : (*) Net balance indicates the direction of expected change in number of persons engaged versus preceding quarter. It refers to the difference in percentage points between the proportion of establishments choosing "up" over that choosing "down". A positive sign indicates a likely upward trend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

2.26 Taking into account the further steady growth in domestic demand and likely improvement in external trade, the Hong Kong economy is projected to expand modestly by 1.5-3.5% in 2013, somewhat faster than the 1.4% growth in 2012. Yet, this would still be slower than the trend growth of 4.5% in the past ten years, largely due to the continued headwinds from a sub-par, below-trend pace of expansion in the advanced economies. As in the previous year, the range forecast is wider than usual, as the global economic outlook is still subject to a high degree of uncertainty in 2013. The prevailing forecasts by private sector analysts mostly fall within the range of 2.5-4.7%. The official forecast is predicated on the assumption that the euro debt crisis would remain contained with ongoing progress towards reforms at the national and eurozone levels, that the US debt ceiling and fiscal issues would be largely resolved without derailing the ongoing economic recovery, and that the Mainland economy would sustain a faster momentum. Downside risks for 2013, while diminishing, are still prominent, as renewed strains arising from fragilities in the advanced economies cannot be ruled out. On the other hand, there could also be some upside potential to the forecast, should Asian domestic demand prove to be more impervious to the sluggishness in the advanced economies, or should the economic recovery in the US, Japan and EU regain firmer-than-expected footing.

Diagram 2.12 : Economy expected to grow slightly faster, albeit still at a sub-trend rate

2.27 Inflation in Hong Kong was largely on an easing trend in 2012, though the pace of tapering slowed towards the year-end. While inflationary pressures will likely remain contained in the near term amid the sub-par local economic growth and moderated imported inflation, the room for further easing will be increasingly limited. Recent developments also suggest that there may be renewed upside risks to inflation further down the road. Externally, global food prices, after peaking in early 2011, have shown signs of bottoming out of late, and the global liquidity glut may induce another round of global commodity price surge, thereby posing upward pressure to imported inflation. Locally, the renewed pick-up in fresh letting flat rentals since early 2012 will feed through to consumer price inflation over the course of 2013. Wage pressure, while moderated of late, may emerge again after the implementation of the new statutory minimum wage rate in May 2013. This, coupled with the rise in commercial rentals over the past year, may entail higher local business costs. That said, given the subdued economic growth, the risk of a sharp resurgence in inflation is not high. Overall, *underlying Composite CPI* is forecast to increase by 4.2% for 2013 as a whole, still lower than the average of 4.7% in 2012. Taking into account the effects of the Government's one-off measures, *headline Composite CPI* is forecast to increase by 4.5% in 2013. The *GDP deflator* is forecast to rise by 3.0%, in line with the expected increase in domestic prices as well as the likely change in the terms of trade.

Diagram 2.13 : Inflation may face some upside risks in 2013



Forecast rate of change in 2013 (%)

Gross Domestic Product (GDP)

<i>Real GDP</i>	1.5 to 3.5
<i>Nominal GDP</i>	4.5 to 6.5
<i>Per capita GDP, in real terms</i>	0.7 to 2.7
<i>Per capita GDP at current market prices</i>	HK\$295,600-301,300 (US\$37,900-38,600)

Composite Consumer Price Index

<i>Headline</i>	4.5
<i>Underlying</i>	4.2

GDP Deflator **3.0**

**Forecast on Hong Kong's GDP growth in 2013
recently made by other selected parties**

	(%)
The University of Hong Kong	3.5 to 4.3
Average forecast by private sector analysts [#]	3.4

Note : (#) Forecast GDP growth by private sector analysts mostly falls between 2.5% and 4.7%.

ECONOMIC PERFORMANCE IN 2012

1. Estimated rates of change in the Gross Domestic Product and its expenditure components and in the main price indicators in 2012 :

	(%)
(a) Growth rates in real terms of :	
Private consumption expenditure	4.0
Government consumption expenditure	3.7
Gross domestic fixed capital formation	9.1
<i>of which :</i>	
Building and construction	12.3
Machinery, equipment and Intellectual property products	10.6
Total exports of goods	1.3
Imports of goods	2.7
Exports of services	1.2
Imports of services	0.7
Gross Domestic Product (GDP)	1.4
<i>Per capita GDP, in real terms</i>	0.3
<i>Per capita GDP at current market prices</i>	HK\$285,100 (US\$36,800)
(b) Rates of change in :	
Composite Consumer Price Index	4.1
GDP Deflator	3.9
Government Consumption Expenditure Deflator	6.1
(c) Growth rate of nominal GDP	5.4

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> (%)
2010	18	16
2011	3	-12
2012	0	-13
<i>Share in the value of total exports of goods in 2012</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> (%)
2010	20	22	12	16	31	14
2011	8	33	6	15	-4	-10
2012	4	6	2	22	-6	-7

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> (%)
2010	16	-6	12	18	27
2011	15	-20	-10	-14	126
2012	22	22	-26	-26	100

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

Exports of services

	<i>Total</i> (%)	<i>Trade-related services</i> (%)	<i>Transportation services</i> (%)	<i>Travel services</i> (%)	<i>Finance, insurance, business and other services</i> (%)
2010	15	12	8	26	17
2011	5	3	1	13	5
2012	1	1	-3	9	-1

6. Hong Kong's visible and invisible trade balance in 2012 reckoned on GDP basis ^(Note 1) :

	(HK\$ billion)
Total exports of goods	3,580.8
Imports of goods	4,116.4
<i>Visible trade balance</i>	-535.6
Exports of services	985.8
Imports of services	449.4
<i>Invisible trade balance</i>	536.4
<i>Combined visible and invisible trade balance</i>	0.8

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> (%)
2010	4.3	2.0	-0.8	0.2
2011	3.4	1.7	2.0	2.9
2012	3.3	1.5	2.4	2.5

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>
	<i>Headline</i> (%)	<i>Underlying</i> (%)	(%)	(%)	(%)
2010	2.4	1.7	2.7	2.3	2.1
2011	5.3	5.3	5.6	5.2	5.1
2012	4.1	4.7	3.6	4.3	4.1

ECONOMIC PROSPECTS FOR 2013

Forecast rates of change in the Gross Domestic Product and prices in 2013 :

	(%)
Gross Domestic Product (GDP)	
<i>Real GDP</i>	1.5 to 3.5
<i>Nominal GDP</i>	4.5 to 6.5
<i>Per capita GDP, in real terms</i>	0.7 to 2.7
<i>Per capita GDP at current market prices</i>	HK\$295,600-301,300 (US\$37,900-38,600)
Composite Consumer Price Index	
<i>Headline Composite Consumer Price Index</i>	4.5
<i>Underlying Composite Consumer Price Index</i>	4.2
GDP Deflator	3.0
Government Consumption Expenditure Deflator	4.5