## Medium-term outlook for the Hong Kong economy

2.24 Over the medium term, challenges arising from the hangovers of the global financial crisis could stay and continue to evolve. Given notable weak fundamentals and continued efforts of fiscal retrenchment, the European and Japanese economies are likely to remain on a slow-growing path with non-negligible risks of setbacks in the coming years. The US economy may perform comparatively better, now that the private sector demand there has been recovering. However, the policy risks arising from the normalisation of the monetary policy and attaining long-term fiscal sustainability will remain, with possible negative spill-over to the rest of the world, especially the emerging markets. Years of underinvestment in infrastructure and persistent high long-term unemployment after the global financial crisis may also have undermined the growth potential of the advanced economies beyond the near term.

2.25 Emerging markets, with their stronger underlying growth potential, should remain the key growth drivers of the world in the coming years. Nonetheless, their growth pace will also likely be more moderate than in the past given the external and domestic constraints. Moreover, those economies with weaker financial systems and larger external imbalances could be more susceptible to the possible shocks brought about by the unwinding of monetary stimulus in the advanced economies.

2.26 Against the lower growth potential of major advanced economies, the Mainland will remain our primary sources of growth opportunities, and the opportunities could be grasped by strengthening economic ties between Hong Kong and the Mainland and by positioning Hong Kong in line with the nation's economic reform agenda. The Government has constantly sought ways to forge deeper economic integration with the Mainland through the CEPA and other Government-to-Government platforms, via which Hong Kong service providers could tap the ever-growing markets amid the nation's rebalancing the economy towards consumption and services. The endeavour of developing Hong Kong into a leading offshore RMB business centre and asset management centre has made visible progress and the efforts will continue, realising the role laid out in the dedicated chapter of National 12th Five Year Plan. Sweeping economic reforms and opening-up in the coming years, as set out by various decisions passed by the Third Plenary Session of the 18th Central Committee of the Communist Party of China, will create new demand for high-end services, which our highly efficient service sectors are well-positioned to take advantage of. In sum, the combination of Mainland factor and the qualities of a worldclass international financial and business hub offered by the "One Country, Two Systems" will remain our biggest competitive edge to develop our economy in the face of possible extended sluggishness of the advanced economies and other external uncertainties.

2.27 Domestically, the Government will continue its efforts in upgrading human capital and physical infrastructure to maintain Hong Kong's competitiveness. Large-scale infrastructure construction will continue to proceed intensively in the coming few years, adding impetus to domestic demand growth. However, the working age population has already been growing at a slower pace amid an ageing population, and the effects of the demographic shift will turn more apparent over time and restrain Hong Kong's medium to longer-term growth. Taking into account the lingering external challenges, the still-bright Mainland's prospect as well as Hong Kong's advantages and demographic challenges, the economy is expected to attain a trend growth of 3.5% per annum from 2015 to 2018.

2.28 Productivity growth in Hong Kong will continue to come from the shift of Hong Kong towards higher value added and knowledge-based economy. Although this structural shift is important in sustaining Hong Kong's competitiveness and hence longer-term development, there are also concerns about the possible implications for income and wealth disparities. While an ageing population will cause the issue of labour shortages to become even more prominent and constrain economic growth, it also has profound implications for our public expenses on healthcare and other social services. In view of all these, it is important to continue to exercise fiscal prudence, so as to preserve our ability and ensure sufficient public resources to invest in infrastructure and human capital to drive the economy and also to tackle the social issues through various programmes.

2.29 Over the medium term, the upside risks to inflation still should not be taken lightly in view of the global liquidity glut and substantial uncertainties monetary policies surrounding global and economic performance. Government's efforts in increasing land and housing supply must continue, so as to expand Hong Kong's economic growth capacity and also help contain domestic inflation risks in the years to come. In particular, in the unlikely event that the global economic expansion proceeds faster than expected, any delay by central banks in the advanced economies in draining the excess liquidity could lift international commodity prices and worldwide inflation quickly and pose renewed upside risks to Hong Kong's inflation outlook. Taking these factors together, the trend rate of change in the underlying CCPI in Hong Kong for the four years from 2015 to 2018 is forecast at 3.5% per annum.

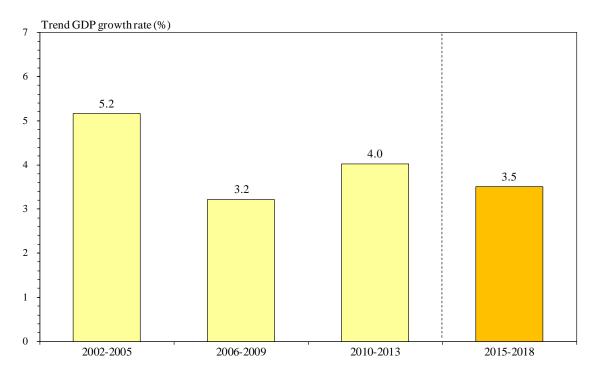


Diagram 2.14 : Medium term economic prospects slightly below past trend