

Press Release

(embargoed until 4:30 p.m. on 14 November 2014)

Economic Situation in the Third Quarter of 2014 and Latest GDP and Price Forecasts for 2014

The Government released today (Friday) the Third Quarter Economic Report 2014, together with the preliminary figures on Gross Domestic Product for the third quarter of 2014.

The Government Economist, Mrs Helen Chan, described the economic situation in the third quarter of 2014 and provided the latest GDP and price forecasts for the year.

MAIN POINTS

- * The Hong Kong economy regained some momentum in the third quarter of 2014, growing by 2.7% in real terms over a year earlier, up from the 1.8% growth in the second quarter. This was underpinned by a relative improvement in both services exports and private consumption. On a seasonally adjusted quarter-to-quarter comparison, real GDP rebounded visibly, by 1.7% in the third quarter, after a 0.1% dip in the preceding quarter.
- * The global economic recovery remained moderate and uneven in the third quarter, with US economic growth increasingly gaining traction whilst eurozone and Japan staying subdued. Yet, Mainland sustained solid growth, and Asia in general improved in tandem. Against this backdrop, Hong Kong's total exports of goods made further growth in the third quarter. Exports of services also reverted to growth, as the drag from travel services lessened visibly, while exports of trade-related services and financial services both improved alongside revival in trade flows and cross-border financial activity.
- * On the domestic front, private consumption expenditure, after operating in low gear in the preceding two quarters, strengthened in the third quarter. However, investment expenditure remained soft, with a plunge in machinery and equipment acquisition, even though building and construction activity showed further slight growth.
- * The labour market was largely stable during the quarter. The seasonally adjusted unemployment rate edged up to 3.3% in the third quarter, from 3.2% in the second quarter. Wages and earnings recorded further increases in real terms.
- * The local stock market showed sharp swings in the past few months, with a rally in July and August followed by a visible correction in September under increasing concerns about the global economic outlook. The residential property market remained rather active in the third quarter, marked by higher flat prices and turnover.
- * Looking ahead, the rather encouraging developments in the third quarter may not be able to extend into the fourth quarter, in light of disruptions to economic activities due to the "Occupy Movement" since late September. At this

juncture, forecasting economic growth is subject to unusually large uncertainty, with the outlook hinging not only on the play-out of various downside risks in the external environment, but more crucially, also on how the “Occupy Movement” will impact on economic sentiment and domestic demand. Also, the lack of hard data for October renders an assessment of the negative impact inflicted by the “Occupy Movement” not possible at this stage.

- * So far, the financial system has been functioning properly and remains in good order. The Hong Kong dollar exchange rate remains steady, with no abnormality spotted in the financial markets. But retail, catering and transportation in the affected districts have been affected more by the “Occupy Movement”. Apart from the disruptions to normal economic activities, there is also a heightened concern that if the “Occupy Movement” situation gets protracted, the adverse impacts might extend to the wider economy, hitting local economic sentiment, with possible knock-on to the labour market. Indeed, the latest survey result indicated a negative turn in business sentiment among the small and medium-sized enterprises. The domestic segment is the key growth driver cushioning the economy against the lull in external demand over the past few years, and as such, downside risks now stemming from the “Occupy Movement” warrant particular concern.
- * At the same time, the external environment is still subject to various uncertainties. With uneven recovery in the advanced economies, the pace of global economic expansion is at best moderate in the period ahead. The divergence in monetary policy stance among major central banks could also pose threats to global financial stability, shifting interest rate expectations and instilling more volatile fund flows from time to time. Moreover, geopolitical risks in various parts of the world remain elevated. Nonetheless, here in Asia, the Mainland economy should sustain steady growth and many other Asian economies are also likely to stay relatively resilient, hopefully rendering some cushion to Hong Kong’s exports in the rest of 2014.
- * With the outlook for the fourth quarter clouded by the considerable uncertainties arising from the “Occupy Movement”, and with exports poised for only modest growth in the coming months, the real GDP growth for 2014 is now forecast at 2.2%, near the lower end of the range forecast of 2-3% announced in the August round of review.
- * Underlying consumer price inflation eased further, from 3.5% in the second quarter to 3.3% in the third quarter. As local cost pressures look set to ease while global inflation stays benign, inflation risks should recede further in the period ahead. Taking into account the actual outturn of an average 3.5% underlying inflation in the first nine months of 2014, as well as the current easing inflation trend, the forecast rate of underlying consumer price inflation for 2014 as a whole is marked down slightly to 3.4%, from 3.5% in the previous round.

DETAILS

GDP

According to the preliminary data on the *Gross Domestic Product (GDP)* released today by the Census and Statistics Department, GDP grew by 2.7% in real terms in the third quarter of 2014 over a year earlier, up from the 1.8% growth in the preceding quarter (same as the earlier estimate). On a seasonally adjusted quarter-to-quarter comparison, real GDP also rebounded visibly, by 1.7% in the third quarter, after a 0.1% dip in the preceding quarter (same as the earlier estimate) (*Chart*).

2. The latest figures on GDP and its major expenditure components up to the third quarter of 2014 are presented in *Table 1*. Developments in different segments of the economy in the third quarter of 2014 are described below.

External trade

3. *Total exports of goods* rose by 1.3% year-on-year in real terms in the third quarter, further to a 2.4% growth in the preceding quarter. Excluding the notable decline in non-monetary gold exports, export performance was actually somewhat better than in the previous quarter. Exports to major advanced markets as a whole remained weak in the third quarter, reflecting the slow recovery of their import demand. Exports to the US recorded only a marginal growth, while those to the EU and Japan both slackened to a decline. Yet, exports to Asia picked up visibly upon increased intake of raw materials and capital goods, with those to India, Taiwan, Korea and many ASEAN economies registering particularly notable growth. On a seasonally adjusted quarter-to-quarter basis, total exports of goods increased visibly by 2.0% in real terms in the third quarter.

4. *Exports of services* recovered to growth at 2.0% year-on-year in real terms in the third quarter, reversing the 2.0% decline in the second quarter. The drag from exports of travel services lessened visibly to a mere decline of 0.8%, in stark contrast to the double-digit decline in the previous quarter, reflecting in part the waning of base effects and in part also benefitting from the pick-up in visitor arrivals back to double-digit growth. Also, other services exports generally improved. Trade-related services grew slightly faster, underpinned by more active regional trade and production. Exports of financial and other business services also picked up visibly, driven by buoyant cross-border financial and fund-raising activities. On the other hand, exports of transportation services remained soft, with only a marginal year-on-year growth, partly associated with weak cargo flows. On a seasonally adjusted basis, exports of services rebounded notably, by 1.3% in real terms in the third quarter over the preceding quarter.

Domestic sector

5. Domestic demand made further modest growth, though with mixed performance amongst different components. *Private consumption expenditure* strengthened to a 3.2% year-on-year growth in real terms in the third quarter of 2014, after two quarters of slowdown. On a seasonally adjusted basis, private consumption expenditure bounced back by 1.9% over the preceding quarter. The stronger performance during the quarter reflected that local consumption sentiment turned more positive, under the support of the favourable job and income conditions, as well as positive wealth effects. *Government consumption expenditure* maintained steady growth at 3.5% in real terms in the third quarter.

6. On the other hand, overall investment spending in terms of *gross domestic fixed capital formation* contracted for the second consecutive quarter, down by 4.7% year-on-year in real terms in the third quarter, further to a 5.7% decline in the preceding quarter. The decline largely reflected subdued machinery and equipment acquisition, which plunged by 11.9% year-on-year in the third quarter. Overall building and construction expenditure grew modestly further, with activity in the private sector regaining some momentum, while large-scale infrastructure works fell marginally from the high level attained in the same period last year.

The labour sector

7. The labour market remained generally stable during the quarter. The *seasonally adjusted unemployment rate* edged up by 0.1 percentage point to 3.3% in the third quarter, while the *underemployment rate* stayed at 1.5%. Job vacancies bounced back slightly in June, while employment posted moderate growth in the third quarter, both signifying firm labour demand up till the third quarter. Both wages and earnings sustained broad-based and solid growth. Specifically, growth in nominal wages picked up to 4.5% in June, and average employment earnings of full-time employees at the unskilled level increased by 6.8% in nominal terms in the third quarter over a year earlier.

The asset markets

8. The *local stock market* fluctuated sharply in the past few months. Market sentiment was initially boosted by such factors as the Shanghai-Hong Kong Stock Connect and hopes for strengthening global growth momentum, pushing the Hang Seng Index higher in July and August before hitting a six-year peak of 25 318 in early September. Mounting evidence on weaker-than-expected economic recovery of some major economies, particularly in Europe and Japan, and elevated geopolitical tensions in various parts of the world, instigated a visible correction in the major overseas stock markets, hitting the local stock market in the rest of September. Nevertheless, the Hang Seng Index subsequently recovered some ground in tandem with rebounds in overseas stock markets and further monetary easing in Japan, reaching 23 998 at end-October, 3.5% higher than at end-June yet

still 5.2% lower than the early-September peak.

9. The *residential property market* remained active. Trading volume increased by a further 25% in the third quarter from the preceding quarter, though the level remained low by historical standards. Residential property prices rose by 6% between June and September, with overall flat prices in September exceeding the 1997 peak by 54% and the housing affordability ratio remaining elevated at around 57% in the third quarter. Separately, flat rentals rose by 3% during the third quarter, while office and shop rentals went up by 2% and 1% respectively.

Prices

10. Underlying inflation trended lower in the third quarter. On the domestic front, rental cost pressures stayed tame, while the growth in labour costs was also rather steady, helping to keep local cost pressures contained. On the external front, imported inflationary pressures were also not visible, thanks to the softer energy and raw material prices in the international markets and the benign inflationary trend in major import sources. *Underlying consumer price inflation*, which netted out the Government's one-off relief measures to more accurately reflect the underlying inflation trend, eased to 3.3% in the third quarter, down from 3.5% in the preceding quarter. By contrast, *headline consumer price inflation* went up to 4.8% in the third quarter of 2014, from 3.6% in the preceding quarter, but the increase was merely due to the Government's one-off relief measures, and in particular, the temporary lower base effect created by the Government's payment of public housing rentals in September last year, and the gradual depletion of the Government's one-off electricity charge subsidy by some households.

Latest GDP and price forecasts for 2014

11. Looking ahead, the rather encouraging developments in the third quarter may not be able to extend into the fourth quarter, in light of disruptions to economic activities due to the "Occupy Movement" since late September. At this juncture, forecasting economic growth is subject to unusually large uncertainty, with the outlook hinging not only on the play-out of various downside risks in the external environment, but more crucially, also on how the "Occupy Movement" will impact on economic sentiment and domestic demand. Also, the lack of hard data for October renders an assessment of the negative impact inflicted by the "Occupy Movement" not possible at this stage.

12. So far, the financial system has been functioning properly and remains in good order. The Hong Kong dollar exchange rate remains steady, with no abnormality spotted in the financial markets. But retail, catering and transportation in the affected districts have been affected more by the "Occupy Movement". Apart from the disruptions to normal economic activities, there is also the heightened concern that if the "Occupy Movement" situation gets protracted, the adverse impacts might extend to the wider economy, hitting local economic sentiment, with possible knock-on to the labour market. Indeed, the latest survey

result indicated a negative turn in business sentiment among the small and medium-sized enterprises. The domestic segment is the key growth driver cushioning the economy against the lull in external demand over the past few years, and as such, downside risks now stemming from the “Occupy Movement” warrant particular concern.

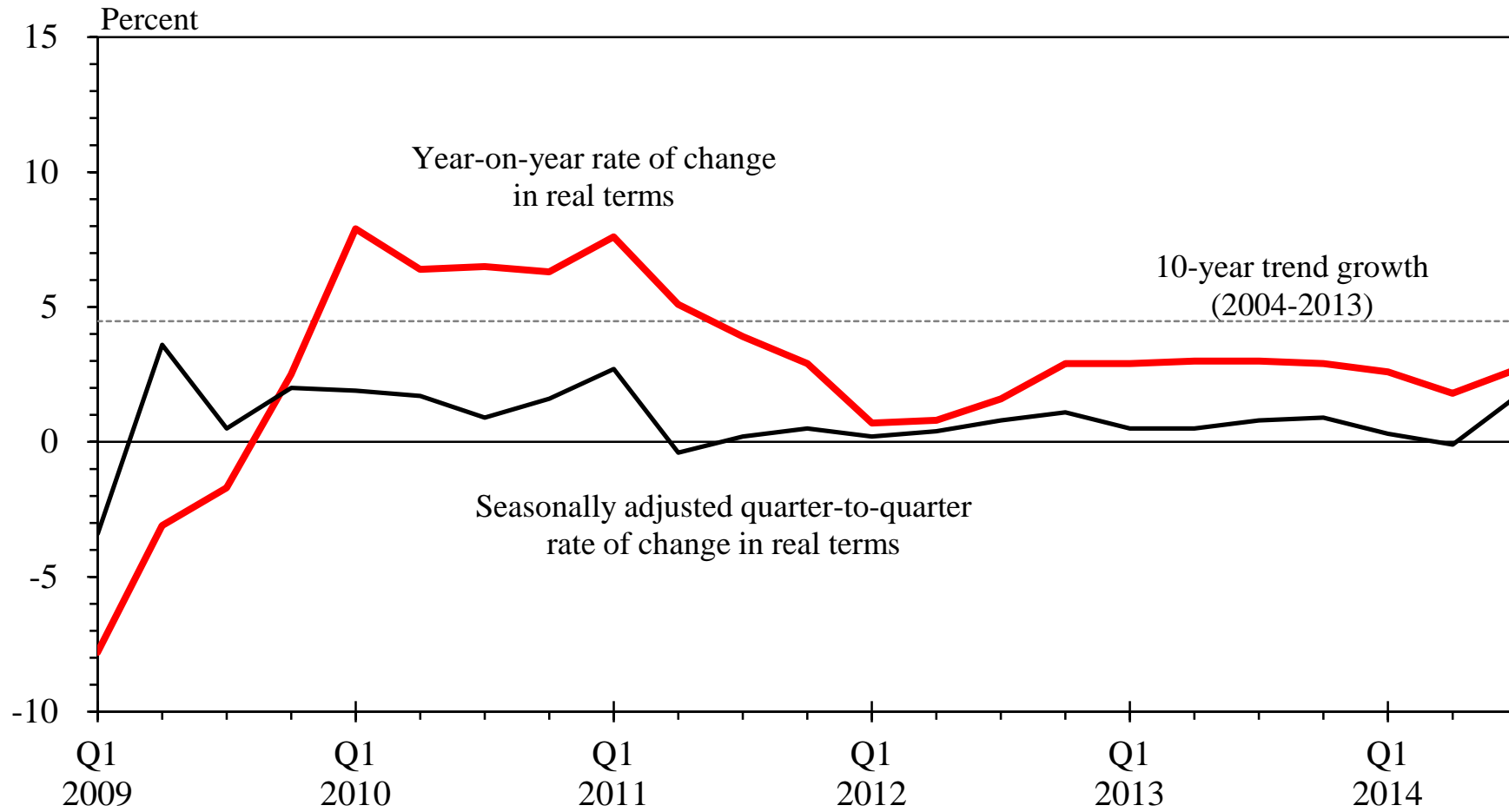
13. At the same time, the external environment is still subject to various uncertainties. With uneven recovery in the advanced economies, the pace of global economic expansion is at best moderate in the period ahead. The divergence of monetary policy stance among major central banks could also pose threats to global financial stability, shifting interest rate expectations and instilling more volatile fund flows from time to time. Moreover, geopolitical risks in various parts of the world remain elevated. Nonetheless, here in Asia, the Mainland economy should sustain steady growth and many other Asian economies are also likely to stay relatively resilient, hopefully rendering some cushion to Hong Kong’s exports in the rest of 2014.

14. With the outlook for the fourth quarter clouded by the considerable uncertainties arising from the “Occupy Movement”, and with exports poised for only modest growth in the coming months, the real GDP growth for 2014 is now forecast at 2.2%, near the lower end of the range forecast of 2-3% announced in the August round of review (*Table 2*). For reference, the latest forecasts by private sector analysts mostly range from 1.9-2.8%, averaging around 2.4%.

15. On inflation outlook, as local cost pressures look set to ease while global inflation stays benign, the upside risks to inflation should recede further in the period ahead. Taking into account the actual outturn so far this year, as well as the current easing inflation trend, the forecast rates of headline and underlying consumer price inflation for 2014 as a whole are slightly adjusted downwards to 4.3% and 3.4% respectively in the current round of review, from 4.4% and 3.5% respectively in the previous round (*Table 2*).

(The Third Quarter Economic Report 2014 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 \$196 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 2014, which contains the GDP figures up to the third quarter of 2014, 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 2014 are preliminary estimates.

Table 1

**Gross Domestic Product, its main expenditure components
and the main price indicators
(year-on-year rate of change (%))**

	<u>2012</u>	<u>2013</u>	<u>2013</u>				<u>2014</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	4.1	4.3	6.3 (2.9)	4.7 (-0.9)	2.7 (-0.2)	3.6 (1.8)	1.6 (0.7)	1.2 (-1.0)	3.2 (1.9)
Government consumption expenditure	3.6	2.3	1.9 (*)	3.1 (1.8)	2.3 (*)	2.0 (0.3)	2.6 (0.5)	2.7 (1.9)	3.5 (0.8)
Gross domestic fixed capital formation	6.8	3.3	-3.0	7.6	2.7	5.3	3.5	-5.7	-4.7
<i>of which :</i>									
Building and construction	7.2	-0.9	-1.5	-0.7	3.1	-3.8	10.6	0.5	1.1
Machinery, equipment and intellectual property products	10.1	10.8	-4.4	19.8	7.6	17.5	1.9	-9.8	-11.9
Total exports of goods	1.8	6.6	8.8 (1.5)	6.1 (-1.4)	6.1 (3.2)	5.7 (2.1)	0.5 (-3.4)	2.4 (0.7)	1.3 (2.0)
Imports of goods	3.0	7.4	9.5 (3.4)	7.6 (-1.7)	6.6 (1.7)	6.1 (2.3)	1.2 (-0.6)	1.1 (-2.2)	0.7 (1.3)
Exports of services	2.2	5.5	4.7 (1.8)	7.7 (3.3)	5.0 (-2.9)	4.7 (2.6)	3.2 (0.3)	-2.0 (-1.9)	2.0 (1.3)
Imports of services	1.9	2.0	0.3 (1.1)	-0.7 (-1.1)	2.6 (1.7)	5.5 (3.7)	-0.8 (-5.0)	5.0 (4.9)	1.8 (-1.5)
Gross Domestic Product	1.5	2.9	2.9 (0.5)	3.0 (0.5)	3.0 (0.8)	2.9 (0.9)	2.6 (0.3)	1.8 (-0.1)	2.7 (1.7)
<i>Change in the main price indicators (%)</i>									
GDP deflator	3.7	1.4	1.8 (-0.7)	0.6 (*)	1.6 (1.7)	1.5 (0.5)	2.2 (0.1)	3.6 (1.5)	2.5 (0.3)
Composite CPI									
Headline	4.1	4.3	3.7 (1.1)	4.0 (1.3)	5.3 (-0.8)	4.3 (2.7)	4.2 (1.0)	3.6 (0.7)	4.8 (0.4)
Underlying[^]	4.7	4.0	3.8 (1.1)	3.9 (1.1)	4.3 (0.8)	4.0 (1.0)	3.8 (0.9)	3.5 (0.7)	3.3 (0.7)
<i>Change in nominal GDP (%)</i>	5.3	4.3	4.8	3.6	4.6	4.4	4.8	5.5	5.3

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 the effects of Government's one-off relief measures.

(*) Change within $\pm 0.05\%$.

Table 2**Economic forecasts for 2014
(rate of change (%))**

	Forecasts for 2014 as released <u>on 15.8.2014</u> (%)	Latest forecasts for 2014 <u>on 14.11.2014</u> (%)
Gross Domestic Product (GDP)		
<i>Real GDP</i>	2 to 3	2.2
<i>Nominal GDP</i>	4 to 5	4.5
Composite Consumer Price Index (CCPI)		
<i>Headline CCPI</i>	4.4	4.3
<i>Underlying CCPI</i>	3.5	3.4