Medium-term outlook for the Hong Kong economy

2.24 The Hong Kong economy will continue to face a challenging external environment over the medium term, as the monetary policy normalisation in the advanced economies will be a long drawn-out process and as most advanced economies are expected to stay at low gear under the "new normal". Considerable scope remains for structural reforms in the eurozone and Japan to improve labour market conditions, enhance growth and boost competitiveness. Furthermore, the prevailing sovereign debt and fiscal sustainability issues as well as problems of population ageing will continue to trouble many advanced economies beyond the near term.

2.25 As to emerging market economies, their performance will be constrained by the developments in the advanced economies. Those relying on export-led growth will be affected more. Moreover, those economies with high degrees of external vulnerabilities and less resilient financial systems may find themselves more prone to sharp fluctuations of asset prices and capital flows amid the varying monetary policy stances among major central banks. Nevertheless, emerging market economies in Asia should continue to outperform their counterparts in the rest of the world, given their stronger fundamentals.

2.26 The possibility of a prolonged period of slow growth in the advanced economies underscores the importance of deepening our economic integration with the Mainland as part of our growth strategy. With the Mainland economy shifting towards a more sustainable growth path, it will still outpace other major economies, presenting Hong Kong with extensive growth opportunities. Specifically, Hong Kong is well-positioned to leverage on the opportunities brought about by the Mainland's national strategy of rebalancing growth towards domestic demand and the services sector. In the coming years, further opening-up of the Mainland economy and the enactment of institutional reforms will likely increase demand for high-end services, particularly in the area of financial and professional services which Hong Kong possesses competitive In this regard, the Government will constantly strive to strengthen edge. economic ties with the Mainland through the CEPA and other regional cooperation platforms. Besides, further progress will be made to enhance Hong Kong's status as the leading offshore RMB business centre and premier asset management hub amid the internationalisation of the RMB. Separately, in face of the highly uncertain external environment, the Government will continue to proactively forge economic ties with new and emerging markets.

2.27 Locally, the Government is committed to maintaining Hong Kong's competitiveness and sustaining longer-term economic development. As Hong Kong is moving towards a high value-added, knowledge-based economy, the Government will strive to consolidate our competitive edge in pillar industries and provide support to new growth areas. The Government will continue to upgrade human capital and infrastructure to increase Hong Kong's productivity and competitiveness. Large-scale ongoing infrastructure works will also lend support to domestic demand. In sum, taking into account the challenges in the external and domestic fronts, the economy is expected to attain a trend growth of 3.5% per annum from 2016 to 2019.

2.28 It is worth noting that population ageing remains an imminent challenge to our medium to longer-term economic growth, as labour force growth may stagnate after 2018. Such demographic changes will also have significant implications on our public expenses, especially on healthcare and social welfare. While the 2015 Policy Address has announced a more proactive population policy with a view to boosting labour force at source, it is still important for the Government to exercise fiscal prudence, so as to preserve our ability to meet the upcoming various challenges to our economy. In particular, sufficient public resources must be ensured for infrastructure and human capital investment to drive the economy and also to tackle social issues through various programmes.

2.29 Inflationary pressures are likely to remain moderate over the medium term. Slower global growth under the "new normal" will lower the risks of global inflation. Locally, the productivity gain should help to alleviate some of the local cost pressures. Also important is the Government's incessant efforts to increase land and housing supply, which should bring about a better balance between demand and supply in the property market, helping to ease the upward pressures on rental costs in the coming years. Taking all these developments into account, the trend rate of change in the underlying CCPI in Hong Kong from 2016 to 2019 is forecast at 3% per annum. However, there are still upside risks, including the possibility of sharp fluctuations in food and energy prices arising from adverse supply shocks. Uncertainties about global economic and monetary conditions may also increase the volatility of international commodity prices. Furthermore, if global growth is stronger than expected and major central banks delay their response to the rise in inflation pressures, global inflation may accelerate faster than expected, with repercussions on Hong Kong's inflation.

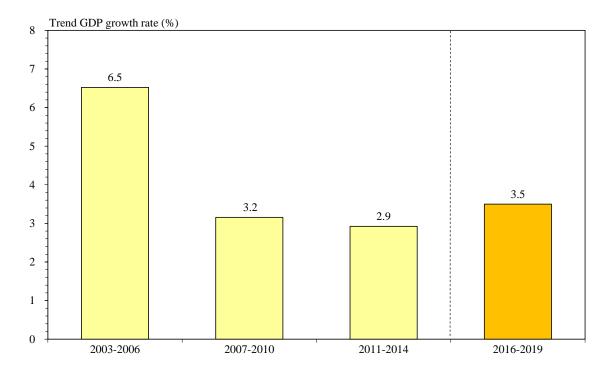


Diagram 2.14 : Medium term trend growth likely to be moderate