Medium-term outlook for the Hong Kong economy

Over the medium term, the Hong Kong economy will still likely be 2.26 confronted with a challenging and unsteady external environment. After the Global Financial Crisis of 2008, the world economy has entered an era of underinvestment and high unemployment, which coupled with the challenges of population ageing, have lowered the growth potential of many advanced economies. In the absence of a strong recovery from the demand side, global growth is likely to remain sub-par for an extended period under the "new normal". For instance, growth in the eurozone and Japan would stay slow, with potential risks of setbacks, amid unresolved structural problems such as high debt levels, fiscal sustainability and certain market rigidities. While the economic performance of the US fares relatively better, there remains notable policy risks associated with its interest rate normalisation and the possible adverse repercussions to global economic and financial conditions. Also, the problem of population ageing in advanced economies would intensify over time, pulling a rein on their growth in the longer term.

2.27 While emerging market economies are likely to remain the key drivers of the global economy, they may see growth at a more moderate pace in the coming years. Aside from adjustments to past years of exceptionally brisk expansion, the protracted slow growth in the advanced economies may continue to affect those economies that are export-oriented. In addition, economies with a build-up of domestic and external vulnerabilities over the years and less resilient financial systems may be more susceptible to potential negative shocks from sharp asset price fluctuations and capital flow reversals triggered by the monetary policy normalisation in the US. Nonetheless, Asian economies, generally with stronger economic fundamentals and resilient domestic demand, should continue to be the bright spots in the global economic arena.

2.28 With the shift in the gravity of global economic activities towards the East, deepening economic linkages with the Mainland will continue to be an integral part of our growth strategy. The Mainland is moving towards a lower but more sustainable growth path under the National 13th Five-Year Plan for 2016-2020. In the coming years, the Mainland's increasing emphasis on its services sector and domestic consumption should offer ample opportunities for Hong Kong, as our companies have a competitive edge in providing higher-end services. In addition, the further opening up of the Mainland market, closer integration with the Mainland's financial markets, the internationalisation of the RMB and the "going out" of Mainland enterprises will likely increase the demand for high value-added services, particularly financial and professional services. Against this, the Government will continue to forge closer economic

ties with the Mainland through CEPA and other regional co-operation platforms. Further efforts will be made to reinforce Hong Kong's status as the leading offshore RMB business centre and premier asset management hub. Separately, the Government will strive to strengthen economic co-operation with new and emerging markets. In particular, the Mainland's "Belt and Road" Initiative, which encompasses over 60 economies (including many emerging market economies in Southeast and Central Asia, Central and Eastern Europe, as well as Africa), will bring forth extensive business opportunities stemming from infrastructural investments, deepening of financial linkages, trade expansion and people-to-people connectivity. Hong Kong is well-positioned to serve as a fund-raising and financial management platform, a trade and logistics hub, as well as an investment springboard when tapping into these markets with huge growth potential.

2.29 On the domestic front, the Government is committed to uplifting Hong Kong's competitiveness and promoting sustainable and diversified economic development. In order to lay a solid foundation for our longer-term development, the Government constantly strives to enhance our strengths in pillar industries, while exploring and promoting new growth areas. Efforts in upgrading human capital and infrastructure will continue to uphold Hong Kong's productivity and competitiveness. Ongoing large-scale infrastructure works should render support to domestic demand beyond the near term.

2.30 Meanwhile, the Government is mindful of the key challenges that could limit our economic growth potential going forward. Population ageing, a common phenomenon across advanced economies, will pose a key constraint to Hong Kong's medium to longer-term economic growth. The Government is proactively adopting a multi-pronged population policy including unleashing the potential of the local workforce, enhancing the quality of home-grown talent, attracting foreign investors and talent, fostering a family-friendly environment and embracing opportunities in an ageing society. Notwithstanding the Government's efforts in boosting labour force at source, the demographic shift makes it all the more important for the Government to exercise fiscal prudence, in view of the profound impacts on our public expenses from an ageing population, especially on healthcare and social welfare. Also, we need to preserve our ability in meeting the upcoming various challenges to our economy. Sufficient public resources must be ensured for infrastructure and human capital investment to increase growth potential of our economy and also to tackle social issues through various programmes. Taking into account the challenges in the external environment and on the domestic front, the economy is expected to attain a trend growth of 3% per annum from 2017 to 2020.

2.31 Over the medium term, inflationary pressures are expected to remain moderate. Externally, slow global growth under the "new normal" will likely keep global inflation low. Locally, the Government's continuous efforts to increase land and housing supply will be conducive to keeping rental cost pressures contained in the years ahead amid a better demand-supply balance in the property market. Also, productivity gains should help lessen some of the local cost pressures. Taking all these developments into account, the trend rate of change in the underlying Composite CPI in Hong Kong from 2017 to 2020 is forecast at 2.5% per annum. However, there are upside risks to Hong Kong's inflation outlook, if global growth is stronger than expected, and if major central banks delay their monetary policy responses to faster-than-expected increases in inflationary pressures, or if commodity prices rise sharply due to adverse supply shocks.

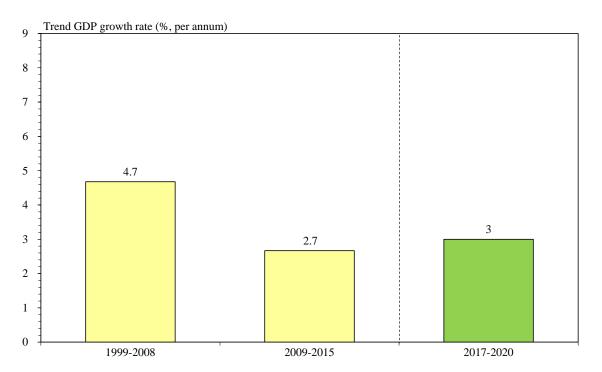


Diagram 2.14 : Medium-term trend growth likely to be moderate