

Medium-term outlook for the Hong Kong economy

2.26 Hong Kong's medium-term economic outlook remains bright. While the upside in growth potential among major advanced economies may be constrained by various structural issues, developing Asian economies, notably the Mainland, are expected to thrive going forward as supported by their sound fundamentals, thereby continuing to provide the key growth impetus to the global economy. With strong competitive edge in a wide range of service areas, Hong Kong is well positioned to leverage on these opportunities.

2.27 While the advanced economies should attain further growth in the medium term, their growth pace would likely be moderate. For the US economy, the fiscal boost due to the tax reform may have some stimulus effect on their aggregate demand in 2018, and immediately beyond, but its growth potential in the latter part of the medium term will be constrained by the prevailing slow growth in labour productivity. The euro area should continue to see some moderate growth in the early years into the medium term. Yet its growth prospect going further forward is restricted by structural issues such as the high levels of government debt in some member economies. Separately, the uncertainty surrounding Brexit and the future economic relationship between the UK and the EU may need to be watched over. As for Japan, its long-term growth potential is likewise restrained by structural issues such as public debt overhang and population ageing. Furthermore, there will be a potential drag on demand from the sales tax hike scheduled for late 2019.

2.28 One key aspect of uncertainty that warrants attention is how the financial vulnerabilities will evolve amid the progress of monetary policy normalisation in the advanced economies. The protracted period of very low interest rates since the Global Financial Crisis has encouraged more risk-taking, yield-seeking investment activities over the past few years, as evidenced by surges in global asset prices, narrowing in risk premiums and rapid credit creation. The potential risks of an exposure of hidden financial vulnerabilities as the monetary policy normalisation proceeds in the major economies should not be overlooked.

2.29 Meanwhile, developing Asian economies, notably the Mainland, possess strong underlying growth potential and will continue to be the engine for global economic growth in the medium term. With the Mainland's economic development now entering a new era, the policy focus is to steer the economy towards high-quality development. Supply-side structural reforms will continue, stressing the shift towards consumption, services and innovation. Risk management will also be a top priority of the Central Authorities to ensure

financial stability. All these endeavours should help raise productivity and competitiveness of the Mainland economy, allowing it to maintain medium-to-high speed growth on a sustainable basis and progress towards the target of achieving a moderately prosperous society in all respects by 2020. With all the above, the Mainland economy will generate substantial business opportunities for Hong Kong, given our strong competitiveness in higher-end services.

2.30 Furthermore, one key aspect of the Mainland's policy is the two-way opening up of its economy on trade, finance and investment. This will provide Hong Kong extensive opportunities in stepping up our role as an international centre for fund raising, offshore RMB business and asset management. The closer ties in trade and investment with economies along the Belt and Road will also bring in new growth impetus for the Hong Kong economy.

2.31 At the regional level, the Government will take forward the development of the Guangdong-Hong Kong-Macao Bay Area, which will bring forth vast business opportunities. The synergy of the 11 cities in the Bay Area will be realised through better coordination and further facilitation of free flow of factors of production, thereby raising the overall competitiveness and growth potential of the region. The development of the Hong Kong-Shenzhen Innovation & Technology Park in the Lok Ma Chau Loop serves as a good example. When completed, it will be the largest platform for innovation and technology activities in Hong Kong and help attract top-notch talents around the world that are essential for Hong Kong's economic development.

2.32 Locally, the Government will serve as a facilitator and a promoter when developing the economy, to seize new opportunities and lift Hong Kong's growth potential in a sustainable and inclusive manner. The Government will also strive to address the supply-side constraints arising from land supply and an ageing population, and to make good use of resources to increase competitiveness. More investment will be channelled into infrastructure, education and training to improve connectivity and nurture talents. The Government will strengthen existing pillar industries as well as promote new growth spots, with particular focus on developing innovation and technology to lift productivity.

2.33 Having considered the developments on the external and domestic fronts, the Hong Kong economy is expected to attain a trend growth of 3% per annum in real terms from 2019 to 2022.

2.34 The outlook for inflation in the medium term depends on both external and domestic developments. Global inflation should conceivably return to moderate levels from the very low levels in recent years, as the major advanced economies gradually close their output gaps and emerging market economies continue their solid expansion. Locally, while rental inflation may see some upward pressure in 2018, the tight demand-supply balance of residential flats could eventually ease over the medium term as flat completions will continue to increase in response to the Government’s sustained efforts in stepping up residential land supply. The Government’s various measures to improve productivity should also help lessen some of the local cost pressures at the macro level. However, in the medium term, there remain uncertainties regarding the international food and commodity prices, which are usually volatile. Taking all these developments into account, the trend rate of change in the underlying Composite CPI in Hong Kong from 2019 to 2022 is forecast at a moderate level of 2.5% per annum.

Diagram 2.14 : Medium-term trend growth forecast at 3% per annum

