



2005 Economic Background and 2006 Prospects

Government of the Hong Kong
Special Administrative Region

***2005 ECONOMIC BACKGROUND
AND
2006 PROSPECTS***

ECONOMIC ANALYSIS DIVISION
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HONG KONG SPECIAL ADMINISTRATIVE REGION

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CHAPTER 1 : OVERVIEW OF ECONOMIC PERFORMANCE IN 2005

Summary

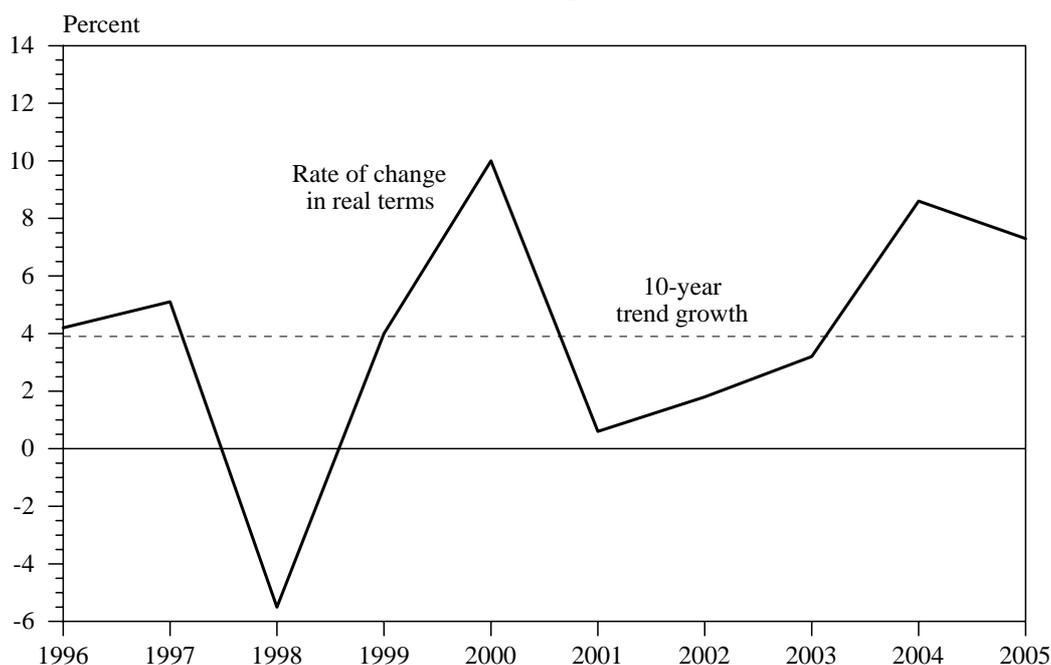
- *The Hong Kong economy was robust throughout 2005. GDP growth was well above-trend in all four quarters, culminating to a strong 7.3% growth for the year as a whole (growth in 2004 is also revised upwards, from the previous 8.2% to 8.6%). 2004 and 2005 together saw the fastest pace of economic growth in any two consecutive years since 1988.*
- *Economic expansion continued to be largely trade-led, marking the third consecutive year that exports of goods and services attained double-digit growth.*
- *Domestic demand also played a role, with consumption well supported by steadily improving employment conditions, and machinery and equipment investment surging in tandem with the business upswing. However, construction activity remained a weak spot in the current recovery.*
- *Thanks to vibrant economic expansion, over 240 000 additional jobs have been created since mid-2003, pushing total employment to successive new highs in the year, and bringing down the overall unemployment rate to a 4-year low of 5.3% by end-2005. The improvement was across-the-board in all sectors, and spanned across all age groups and most occupation categories. As employment conditions improved, labour income continued to increase.*
- *The property market cooled off somewhat in the latter half of 2005, after a rather hectic first half. With higher interest rates, overall property prices had met with some moderation pressure.*
- *The local stock market was active during most of 2005. Notwithstanding the uncertainties arising from higher oil prices and interest rates, local share prices had been rather resilient, underpinned by an improving economy and good corporate earnings.*
- *Consumer price inflation, though creeping up during the year as part of the re-inflation process, had remained benign through to end-2005, as cost pressures were mitigated by the substantial productivity improvement and improved business in the year.*

Overall situation

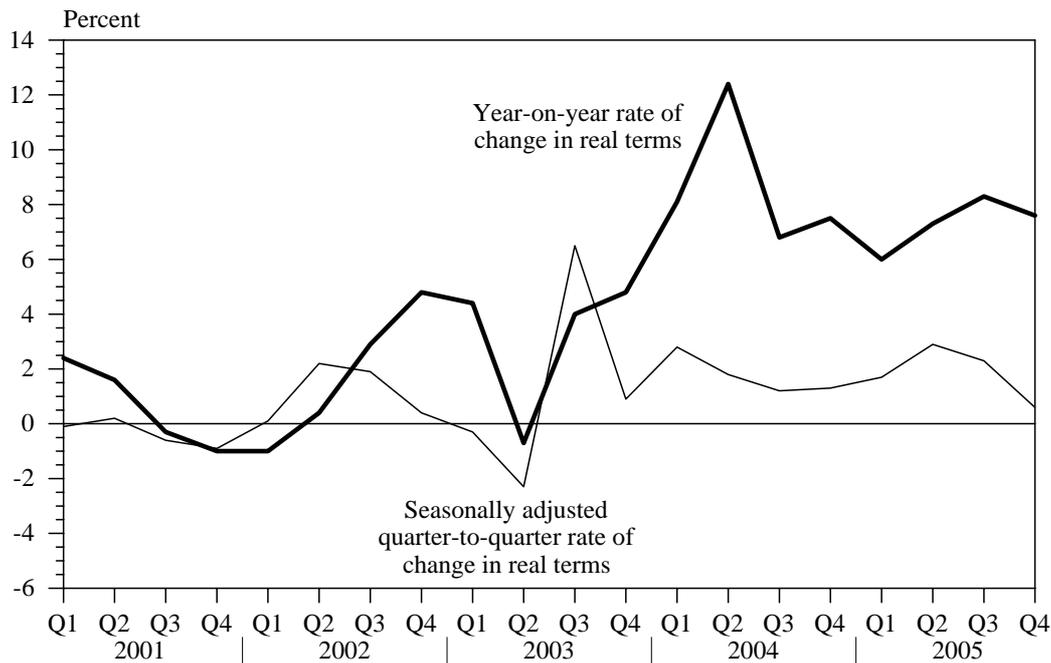
1.1 In 2005 the Hong Kong economy continued to stage a robust performance. 2004 and 2005 together saw the fastest pace of economic growth in any two consecutive years since 1988. Economic expansion continued to be largely trade-led in 2005, marking the third consecutive year that exports of goods and services attained double-digit growth. Domestic demand also played a role, with consumption well supported by steadily improving employment conditions, and machinery and equipment investment surging in tandem with the business upswing. However, construction activity remained a weak spot in the current recovery.

Diagram 1.1 : Gross Domestic Product sustaining well above-trend growth for 9 straight quarters

(a) Annual profile



(b) Quarterly profile



1.2 For 2005 as a whole, the *Gross Domestic Product (GDP)*⁽¹⁾ rose by an impressive 7.3% in real terms, after a strong 8.6% growth in 2004. On a year-on-year comparison, after expanding by 6.0% in the first quarter of 2005, real GDP picked up further to growth at 7.3% and 8.3% respectively in the second and third quarters⁽²⁾. Economic growth remained well above-trend at 7.6% in the fourth quarter, thanks to very strong trade growth, and despite the dampening impact of higher interest rates. On a seasonally adjusted quarter-to-quarter comparison⁽³⁾, GDP expanded briskly in the first three quarters, by 1.7%, 2.9% and 2.3% respectively in real terms before settling to a 0.6% growth in the fourth quarter.

**Table 1.1 : Gross Domestic Product and its main expenditure components
and the main price indicators
(year-on-year rate of change (%))**

	<u>2004[#]</u>	<u>2005⁺</u>	<u>2004</u>				<u>2005</u>			
			<u>Q1[#]</u>	<u>Q2[#]</u>	<u>Q3[#]</u>	<u>Q4[#]</u>	<u>Q1[#]</u>	<u>Q2[#]</u>	<u>Q3[#]</u>	<u>Q4⁺</u>
<i>Change in real terms of GDP and its main expenditure components (%)[@]</i>										
Private consumption expenditure	7.3	3.7	6.5 (1.9)	11.2 (2.2)	5.7 (0.1)	6.0 (1.4)	4.2 (0.5)	2.7 (0.8)	4.1 (1.5)	3.7 (0.8)
Government consumption expenditure	0.7	-3.0	5.6 (0.2)	* (-3.2)	-1.3 (-0.3)	-1.7 (1.5)	-4.6 (-2.6)	-2.3 (-0.7)	-1.6 (0.3)	-3.4 (-0.5)
Gross domestic fixed capital formation	3.0	3.9	(N.A.)	(N.A.)	(N.A.)	(N.A.)	(N.A.)	(N.A.)	(N.A.)	(N.A.)
<i>of which :</i>										
Building and construction	-11.7	-6.8	-12.9	-14.0	-14.9	-4.6	-1.0	-7.5	-5.2	-13.7
Machinery, equipment and computer software	11.0	10.7	15.5	25.2	9.9	-3.2	0.8	10.7	7.1	24.2
Total exports of goods	15.3	11.2	15.0 (2.8)	18.7 (5.1)	15.3 (1.0)	12.6 (3.1)	8.9 (0.1)	11.1 (6.0)	12.8 (3.1)	11.4 (2.2)
Imports of goods	14.1	8.6	16.3 (4.5)	20.3 (3.2)	14.2 (-1.6)	7.0 (1.1)	3.8 (1.9)	7.0 (5.1)	11.0 (2.2)	12.0 (2.6)
Exports of services	17.9	8.4	16.5 (2.0)	35.8 (1.9)	14.4 (4.4)	10.3 (1.5)	8.5 (0.2)	8.8 (2.3)	8.7 (4.3)	7.7 (0.8)
Imports of services	14.6	2.8	7.3 (*)	34.6 (10.0)	10.8 (-2.2)	9.8 (1.0)	5.6 (-2.5)	0.3 (4.4)	3.8 (0.8)	1.4 (-1.4)
Gross Domestic Product	8.6	7.3	8.1 (2.8)	12.4 (1.8)	6.8 (1.2)	7.5 (1.3)	6.0 (1.7)	7.3 (2.9)	8.3 (2.3)	7.6 (0.6)
<i>Change in the main price indicators (%)</i>										
GDP deflator	-3.6	-0.2	-5.2 (-0.9)	-3.7 (-0.7)	-3.2 (-0.8)	-2.6 (-0.1)	-1.3 (0.2)	-0.6 (0.1)	0.2 (*)	0.4 (0.1)
Composite Consumer Price Index	-0.4	1.1	-1.8 (0.3)	-0.9 (*)	0.8 (-0.2)	0.2 (0.3)	0.4 (0.3)	0.8 (0.5)	1.4 (0.4)	1.8 (0.6)
<u>Change in nominal GDP (%)</u>	4.7	7.0	2.5	8.2	3.5	4.7	4.7	6.7	8.5	7.9

Notes : (#) Revised figures.

(+) Preliminary figures.

(@) The entire GDP series have been revised following the completion of an exercise by the Census and Statistics Department to implement the latest international guidelines on dealing with financial intermediation services provided by banks in the estimation of national accounts statistics of Hong Kong in mid-August 2005.

() Seasonally adjusted quarter-to-quarter rate of change.

N.A. Not applicable, as no clear seasonal pattern is found in gross domestic fixed capital formation, due to the presence of considerable short-term fluctuations.

(*) Change of less than 0.05%.

Box 1.1

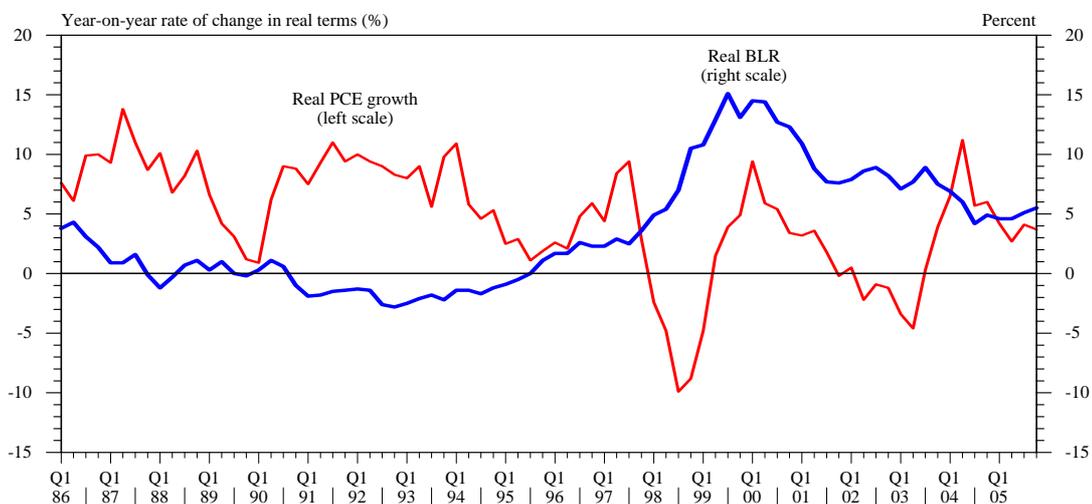
Impact of higher interest rates on the Hong Kong economy

By mid-February 2006, the US Federal Reserve had raised the Fed Funds Target Rate by a cumulative of 3.5 percentage points since June 2004 to 4.5%, with a view to removing the accommodative monetary policy stance so as to contain inflation pressures that come from high oil prices and strong economic growth. Under the linked exchange rate system, Hong Kong's interest rates have largely followed the movements of their US counterparts. As a result, the best lending rates (BLR) charged by major local banks rose from 5% in mid-March 2005 to 7.75 – 8% in mid-February 2006.

Against the background of the successive interest rate hikes, there are concerns about the possible dampening impact on the Hong Kong economy. Specifically, there are concerns that local investment would be curtailed as the interest cost of the business community has been raised and investment confidence dented. Also, there could be some negative impact on consumer demand, if the interest rate hikes induce downward adjustment in the local asset markets and hence trigger negative wealth effects. Yet apart from some cooling off of the property market, which might have put a dent on consumer spending growth, the Hong Kong economy had by and large weathered the effects of higher interest rates rather well up to the fourth quarter of 2005.

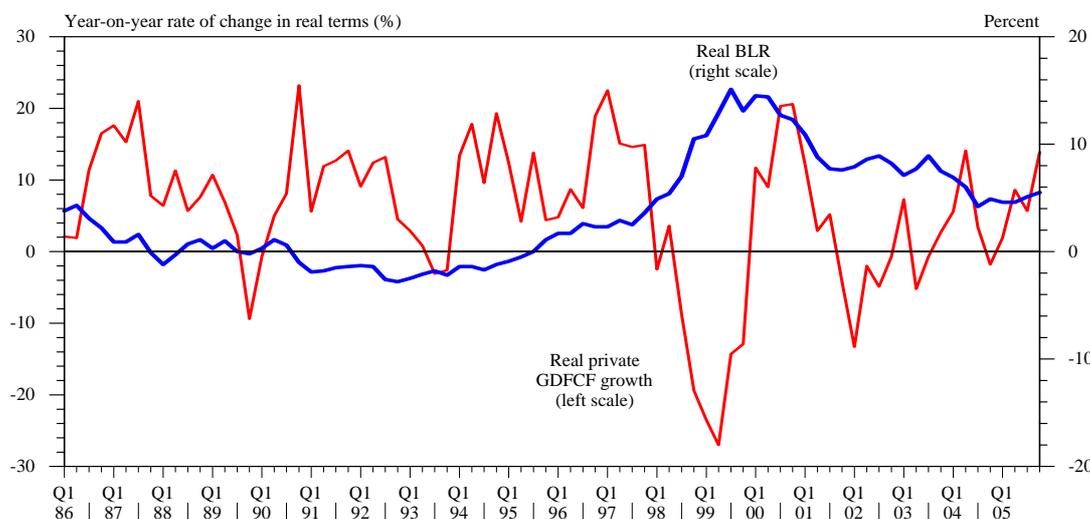
An examination of the historical trend of real interest rates and Hong Kong's GDP and its domestic demand components, however, does not reveal any definite pattern of how real interest rate movements would impact on the economy in a very significant way. This may not be at all surprising given that the levels of indebtedness of the household and corporate sectors are low in Hong Kong, as suggested by the persistently high savings ratio and the strong net external financial asset position of Hong Kong. Also, it is worth noting that the interest rate policy of the US Federal Reserve is to forestall the inflation risk that may arise from a buoyant US economy. Thus a higher interest rate has often been a reflection of the strong state of the US economy, which has been the key driving force of global economic growth. Thus the negative impacts arising from higher interest rates have often been diluted by other positive economic developments.

Real BLR vs real private consumption growth



Box 1.1 (cont'd)

Real BLR vs real private investment growth



In fact, empirical results suggest that domestic demand in Hong Kong is affected more by changes in income than by the level of real interest rates. Correlation analysis indicates a much higher correlation between domestic demand and GDP, and between domestic demand and total exports of goods and services, which are usually the main drivers of economic growth. Granger causality tests also confirm strong evidence of causality running from GDP and exports of goods and services to domestic demand, though with a time lag of around three quarters. This accords well with the a priori reasoning that income and external trade are much more important determinants in influencing the state of domestic demand in Hong Kong.

The current interest rate up-cycle has led to some consolidation in the local housing market during the second half of 2005. This could have some mild dampening effects on consumption demand through the negative wealth effect. The effects may be even felt more fully in 2006. Yet the main concern stemming from the US interest rate up-cycle is that it would work to dampen demand in the US economy, thereby curtailing Hong Kong's export growth and hence Hong Kong's GDP growth. A slow-down in the US economy, given its prominence as the key growth engine in the global economy, would have consequential impacts on demand in the global and regional economies. There would thus be not only a direct impact on Hong Kong's exports to the US, but also an indirect impact on Hong Kong's exports to the rest of the world. The moderation in our export and income growth would also have a spillover effect on the performance of the domestic sector.

Nevertheless, the current levels of interest rates are not regarded as high by historical standards. It is widely expected that the Federal Reserve is aiming at setting the target rate at the 'neutral' level, which will neither stimulate nor constrain the economic growth of the US while keeping inflation in check. The market also expects the current US interest rate up-cycle may be near its end. If so, the slowdown in US economic growth may be rather moderate in the near term, and in such an event the consequential impact on the Hong Kong economy is likely to be of a manageable scale. From a longer-term perspective, maintaining price stability in the US would foster steady economic growth in the US, which is conducive to a sustainable growth in the global economy over the medium to longer term, in turn to the benefit of the Hong Kong economy.

The external sector

1.3 A distinct feature in the current economic recovery is the continued strong growth in the external trade, both in goods and services. Merchandise exports sustained double-digit growth during most part of 2005, supported by the strong performance of the global economy, the Mainland's vibrant trade flows, and the increasing penetration of Mainland products in the world market. *Total exports of goods* surged by 11.2% in 2005, further to the strong 15.3% growth in 2004. Of particular note was the pick-up in domestic exports to double-digit growth in the second half of the year. The strong domestic export performance was attributable not only to the distinct rise-back in clothing items, but also to the remarkable growth in many non-clothing items.

1.4 On invisible trade, inbound tourism continued to expand briskly in 2005 on the top of the robust performance in 2004. The number of incoming visitors reached a record high of more than 23 million. This underscored the further expansion of exports of travel-related services. Meanwhile, the Mainland's vibrant trade flows rendered further support to exports of trade-related services, notably offshore trade, and to a certain extent exports of transportation services. Also, exports of finance, business and other services grew in tandem with the upturn in business activities and an active financial market. *Exports of services* as a whole grew distinctly in 2005, by 8.4% in real terms, after a remarkable 17.9% growth in 2004.

The domestic sector

1.5 Another distinct feature in the current economic recovery is a more balanced growth pattern, with both external demand and the domestic sector contributing to economic growth in 2005. Local consumer spending grew solidly during the year, indicative of the strengthened consumer sentiment on the back of improving employment and rise-back of labour income, as well as the generally positive attitude towards the economic and employment prospects. In the fourth quarter, consumer spending held firm despite the impact of higher interest rates and the consolidation of the residential property market. *Private consumption expenditure (PCE)* grew by 3.7% in real terms for 2005 as a whole, after a 7.3% growth in 2004.

**Table 1.2 : Consumer spending by major component^(a)
(year-on-year rate of change in real terms (%))**

Of which :

		Total consumer spending in the domestic market ^(a)	Food	Durables	Non- durables	Services	Residents' expenditure abroad	Visitor spending	Private consumption ^(b) expenditure
2004	Annual	7.8	4.7	11.7	9.8	7.0	11.5	19.0	7.3
	Q1	7.8	4.7	12.2	5.9	7.9	-2.4	11.1	6.5
	Q2	13.4	1.5	15.1	26.6	12.4	50.1	149.4	11.2
	Q3	5.2	5.9	10.0	4.2	4.4	7.7	3.3	5.7
	Q4	5.3	6.9	10.0	5.3	3.9	2.6	-4.7	6.0
2005	Annual	4.4	3.8	6.7	6.3	3.4	-0.5	7.2	3.7
	Q1	4.5	2.8	9.5	9.1	2.3	6.5	10.1	4.2
	Q2	4.0	4.0	8.2	6.3	2.4	-8.4	6.2	2.7
	Q3	4.7	3.2	7.2	5.0	4.4	0.9	6.9	4.1
	Q4	4.3	4.9	2.5	5.1	4.3	-0.6	5.8	3.7

Notes : (a) Consumer spending in the domestic market comprises both local consumer and visitor spending, which are not separable from the survey data.

(b) Private consumption expenditure is obtained by deducting visitor spending from the total consumer spending in the domestic market, and adding back residents' expenditure abroad.

1.6 Overall investment, after a weak start, improved in the second and third quarters, and picked up distinctly more in the fourth quarter. This was mainly attributable to a surge in machinery and equipment acquisition, particularly so in the fourth quarter, supported by the continued brisk pace of business expansion and strengthened investor confidence. On the other hand, building and construction activity remained slack all through 2005, thereby putting a heavy drag on the growth of overall investment spending, although the rate of decline had narrowed from that in 2004. The lacklustre performance was mainly due to the earlier scale-back of the Public Housing Programme as well as relatively few large-scale infrastructure projects and private sector building projects in progress. Because of the weak spot in building and construction, overall investment spending in terms of *gross domestic fixed capital formation* recorded only a moderate 3.9% growth in real terms in 2005, though further up from that of 3.0% in 2004.

Diagram 1.2 : Consumer spending holding firm in most of the year

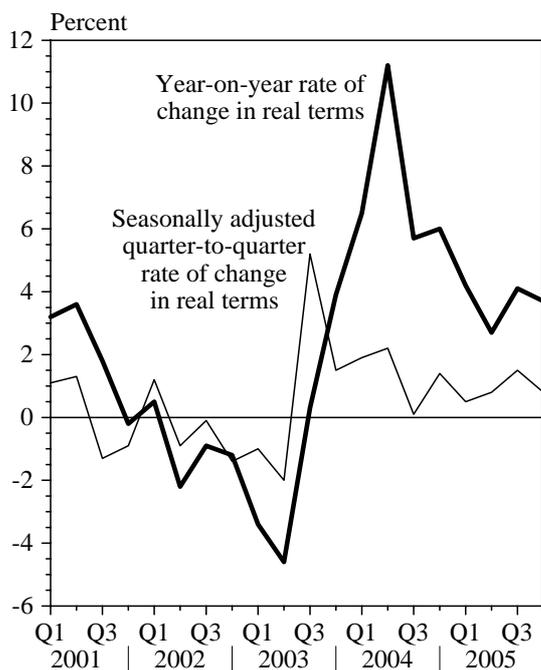
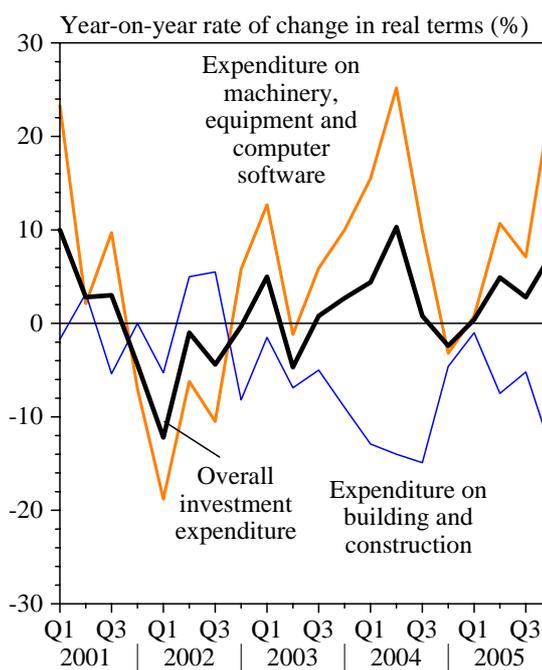


Diagram 1.3 : Pace of upturn in investment spending still held back by weakness in building and construction



The labour sector

1.7 A third salient feature in the current recovery is that it has readily translated into a broad-based improvement in the labour market. *Total employment* expanded notably, by 2.3% in 2005. By the fourth quarter of 2005, the total number reached an all-time high of 3.43 million (which remained stable in the three months ending January 2006). Thus, a total of over 240 000 additional new jobs had been created since the trough in 2003, benefiting both higher and lower skilled workers across different sectors. Job vacancies likewise surged across major sectors. Along with a steadily improving labour demand, the *seasonally adjusted unemployment rate* fell successively, reaching a four-year low of 5.3% in the fourth quarter of 2005 (and further to 5.2% in the three months ending January 2006). The number of long-term unemployment also fell noticeably during the current economic recovery. In 2005, labour income rebounded moderately in money terms, reversing the declining trend in the previous years. While the current economic upswing created a number of higher pay jobs, it also helped raise the average earnings of the lower-income workers. Apart from an almost full-fledged economic upturn, the distinct improvement in labour market conditions over the past few quarters was also helped by a resilient and flexible workforce, thanks to the significant upgrading in educational attainment among the labour force over the past decade.

The asset markets

1.8 The *property* market as a whole turned quieter in the latter half of 2005, representing a consolidation from the hectic situation in earlier part of the year. Overall property prices met with moderation pressure, yet the longer-term market outlook stayed positive on the back of improved economic fundamentals. By December 2005, flat prices were 8% off the peak in April 2005, but were still 6% higher than a year ago. Compared with the peak in 1997, they were 49% lower. On the other hand, the rental markets held up fairly firm. Flat rentals rose steadily throughout the year, by 12% in the fourth quarter of 2005 over a year earlier.

1.9 In the financial market, the *local stock market* was active during most of 2005. Notwithstanding the uncertainties arising from higher oil prices and interest rates, local share prices had been rather resilient, underpinned by an improving economy and good corporate earnings. The Hang Seng Index rose to a high of 15 466 on 15 August, before easing back moderately to close the year at 14 876, 5% higher than at end-2004. The average daily turnover rose to another record high of \$18.3 billion in 2005, up from \$16.0 billion in 2004. Mainland enterprises play an increasingly important role in the local stock market. At end-2005, there were 335 Mainland enterprises listed on the Hong Kong stock market, accounting for 30% of the total number and 39% of the total market capitalisation.

Prices

1.10 Consumer price inflation notched up gradually over the course of 2005, along with the buoyant economic upturn. Also relevant was the progressive feed-through from the earlier rental rebound and higher oil prices. On a year-on-year basis, the *Composite Consumer Price Index* rose modestly by 0.4% and 0.8% respectively in the first and second quarters of 2005, and then accelerated to increases of 1.4% and 1.8% respectively in the third and fourth quarters. That consumer price inflation had remained so benign and that it had not experienced a sharper rise given the very strong economic growth were due to the rather moderate increase in unit rental cost and also stable unit labour cost in the year, the former being mitigated by improving business and the latter by the strong growth in labour productivity. The extent of imported inflation was also mild, especially in the second half of 2005 upon the ease-back in oil prices and the feed-through of a stronger US dollar.

Box 1.2

Oil shocks in the 1970s and how they had impacted on Hong Kong economy

First oil price shock in 1973-1974

Between 1973 and 1974, oil prices more than tripled, triggered by production constraints imposed by OPEC. Given the high oil dependency at that time, this led to severe disruptions to world economic activity. World economic growth slowed from 6.8% in 1973 to 2.8% in 1974 and further to 1.9% in 1975. According to the International Monetary Fund (IMF), the surge in oil prices reduced real GDP of advanced economies by about 2.6 percentage points through the direct impact on net trade balance, as a result of higher oil import bill. World real GDP growth rebounded since late 1975 and showed a 5.1% growth in 1976, partly because oil prices tended to stabilise and partly because advanced economies adopted more accommodative monetary and fiscal policies to revive their economies.

As to Hong Kong, real GDP growth slowed drastically from 12.3% in 1973 to 2.3% in 1974 and further to 0.4% in 1975. This was largely caused by the severe contraction in global and regional demand at that time, resulting in a poor performance of Hong Kong's exports. Real GDP recovered strongly in 1976 to a 16.2% growth, thanks to the revival of exports along with the world economic recovery.

Second oil price shock in 1979-1980

Real oil prices doubled in 1979 and rose by a further 5% in 1980 to an average of about US\$82.4 per barrel (2004 prices), this time triggered by the prolonged war between Iran and Iraq. This occurred at a time when the world economy was already moderating. World real GDP growth slowed from 4.6% in 1978 to 3.8% in 1979 and further to 2.3% and 2.1% in 1980 and 1981 respectively.

By contrast, the Hong Kong economy appeared to have weathered the second oil crisis rather well, partly because of the property market bubble that was building up at that time. Real GDP continued to expand strongly with growth exceeding or near double-digit in all the three years from 1979 to 1981. The impact on Hong Kong was not felt until 1982, when the property bubble burst and GDP growth slowed to 3.0%. Again, the adverse impact came also from the trade front. Economic growth rebounded swiftly to 5.9% in 1983 and then further to 9.9% in 1984, along with a better performance of the world economy and a much weaker Hong Kong dollar.

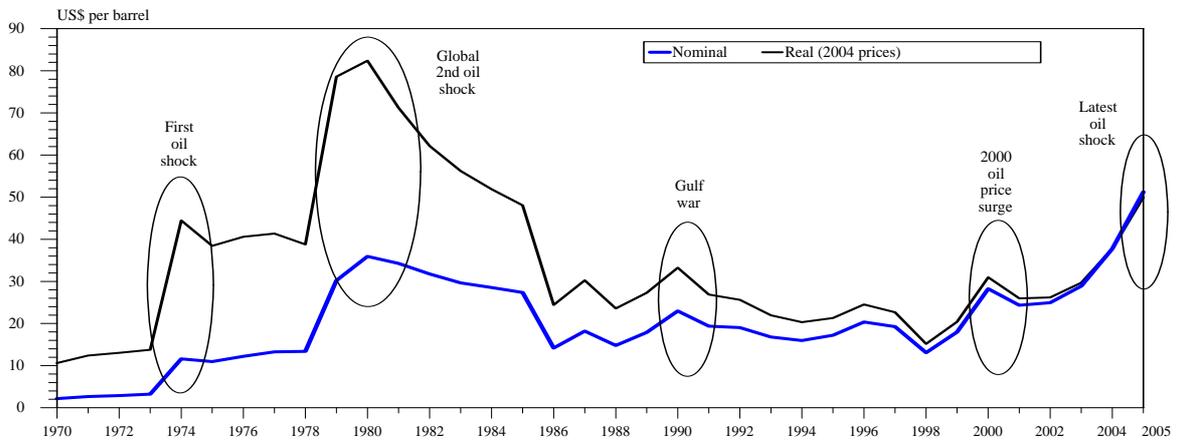
Observations about the oil price shocks in the 1970s

In sum, the first oil price shock in the 1970s resulted in a more significant dampening impact on Hong Kong's economic growth than the second oil price shock did. On both occasions, the adverse impacts on Hong Kong mainly came from the trade front as a result of weakening global demand.

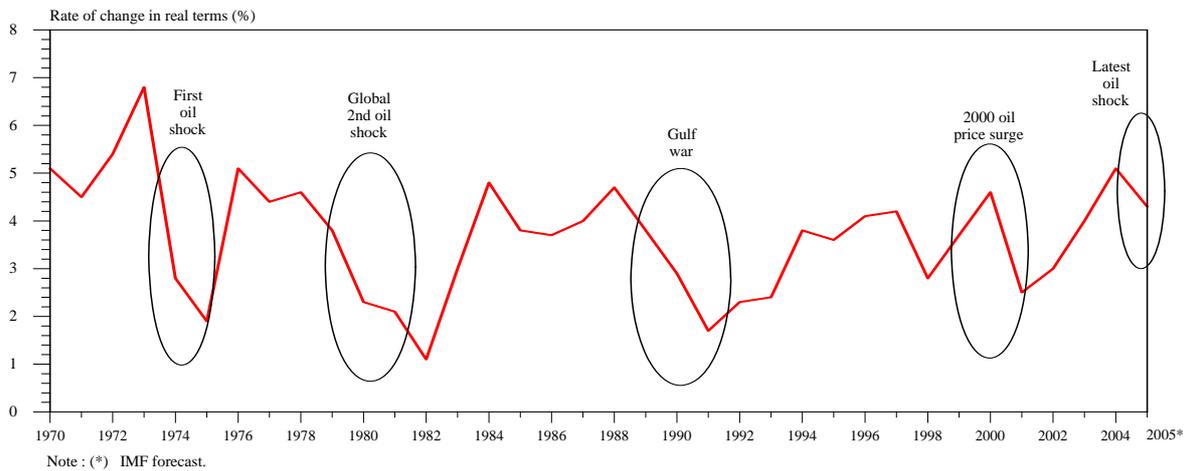
Compared with 30 years ago, the impact of oil price surge on Hong Kong economy should be much milder now. Having gone through the first oil price shock, the Hong Kong economy had adjusted itself to economise on fuel usage, cutting its oil dependency by about one-fourth before the second oil price shock took place. Compared with the early 1970s, by now Hong Kong's oil dependency has come down by some 50%. Also, from the demand side angle, consumers in developed economies, including Hong Kong, now spend more on services than on goods, and the production of consumer services is conceivably less prone to oil price surge than production of goods. Moreover, with globalisation and the substantial improvement in production technology, inflation worldwide has also come down significantly over the past decade, and central banks of the advanced economies are determined to keep inflation in check. All in all, the impact from oil price surge on Hong Kong's economic growth and inflation should be generally less damaging than before.

Box 1.2 (Cont'd)

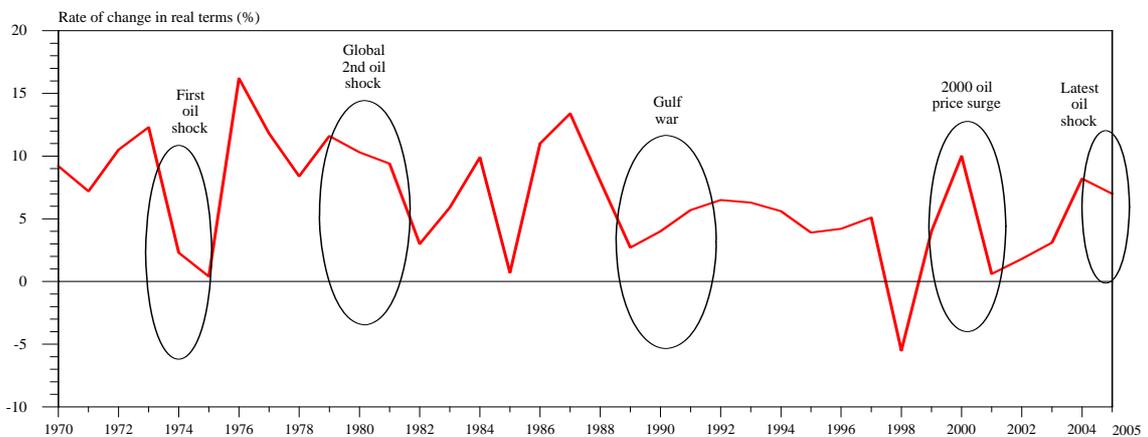
Nominal and real crude oil prices, 1970 - 2005



World GDP, 1970 - 2005

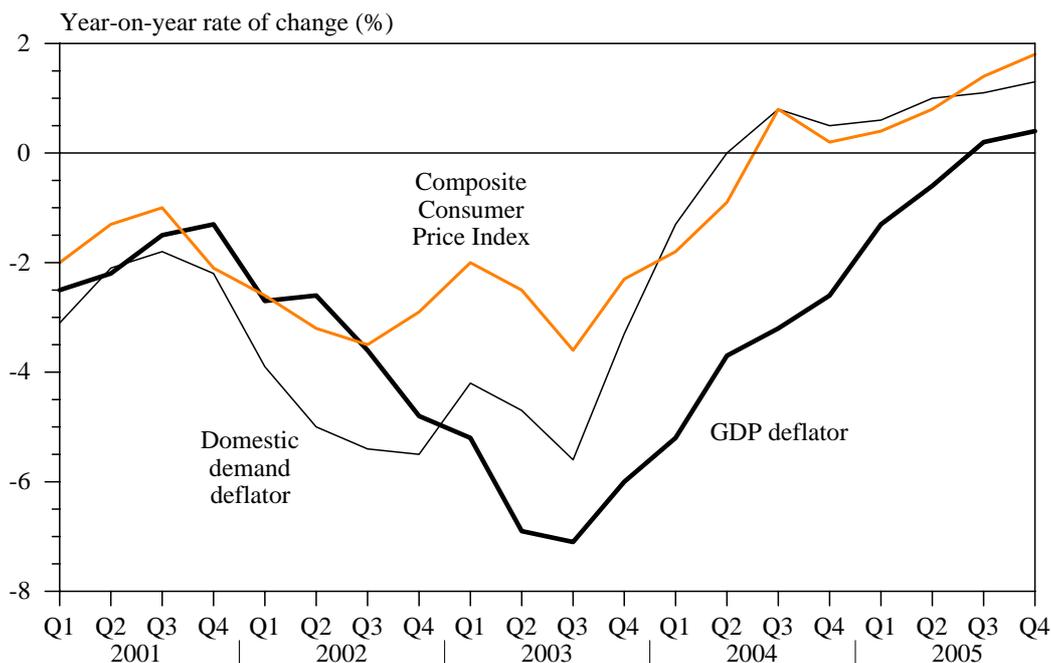


Hong Kong GDP growth , 1970 - 2005



1.11 As to the *GDP deflator*, the year-on-year decline, which began in the third quarter of 1998, was finally arrested in the third quarter of 2005, thanks to higher domestic prices and also the relative improvement in the terms of trade on account of a stronger US dollar. In the fourth quarter, the GDP deflator picked up slightly further to a 0.4% increase over a year earlier, though for 2005 as a whole there was still a marginal decline of 0.2%.

Diagram 1.4 : Inflation well contained through to year-end



Net output or value added by major economic sector

1.12 In 2005, the service sectors as a whole remained the dominant driving force of overall economic growth. In the first three quarters of 2005, its net output or value added rose markedly by 8.1% in real terms over a year earlier. Among the constituent service sectors, transport and storage, import and export trade, financing and insurance, and communications showed the best performance. Meanwhile, the manufacturing sector also showed a small increase in net output for the first three quarters as a whole, supported by the pick-up in domestic exports in the third quarter. Local manufacturers appeared to have established certain niches in the international market. In contrast, the net output of construction sector remained on a decline.

**Table 1.3 : GDP by economic activity^(a)
(year-on-year rate of change in real terms (%))**

			<u>2004[#]</u>				<u>2005[#]</u>		
	<u>2003[#]</u>	<u>2004[#]</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>
Manufacturing	-10.3	1.7	0.5	-0.2	2.3	3.8	-2.3	-0.1	4.1
Construction	-4.9	-9.8	-10.2	-12.1	-13.3	-3.5	0.5	-8.4	-5.5
Services ^(b)	4.5	9.9	9.8	13.7	8.4	8.3	7.0	8.6	8.6
Of which:									
Wholesale, retail and import and export trades, restaurants and hotels	9.1	15.1	13.7	22.9	14.3	11.4	10.5	12.1	11.0
Transport, storage and communications	0.7	13.9	10.7	22.3	12.1	11.9	12.7	12.3	15.3
Financing, insurance, real estate and business services	5.7	13.1	17.6	13.9	9.0	12.4	6.5	11.4	9.9
Community, social and personal services	0.6	2.6	1.6	6.0	1.8	1.3	1.0	0.1	1.1

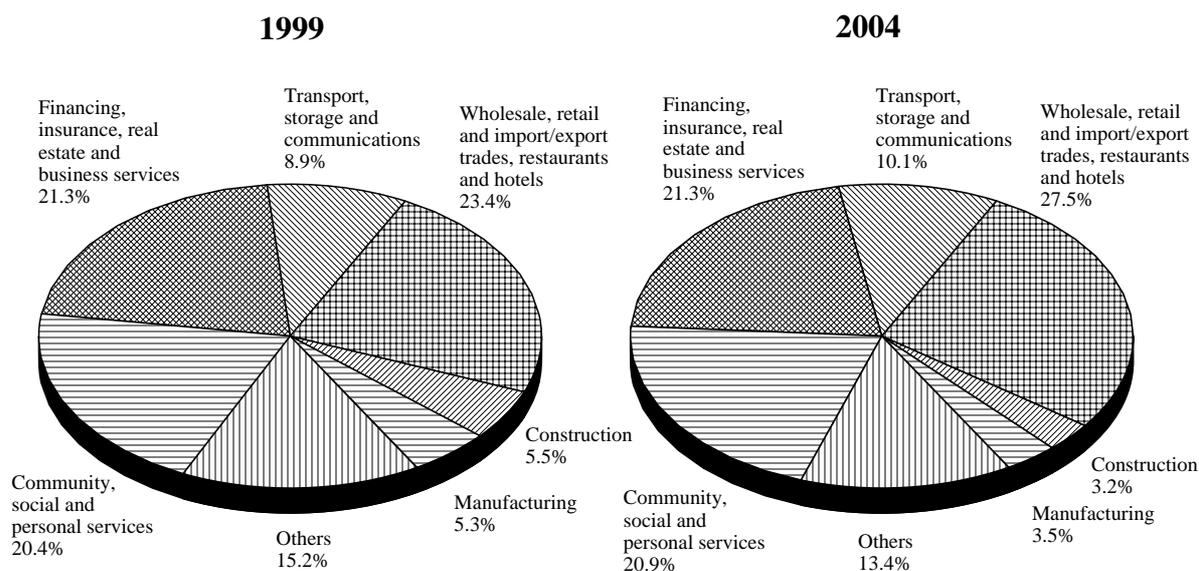
Notes : (a) The GDP figures shown in this table are compiled from the production approach, in parallel with those shown in Table 1.1 which are compiled from the expenditure approach. For details, see Note (1) to this chapter.

(b) In the context of value-added contribution to GDP, the service sectors include ownership of premises as well, which is analytically a service activity.

(#) Revised figures.

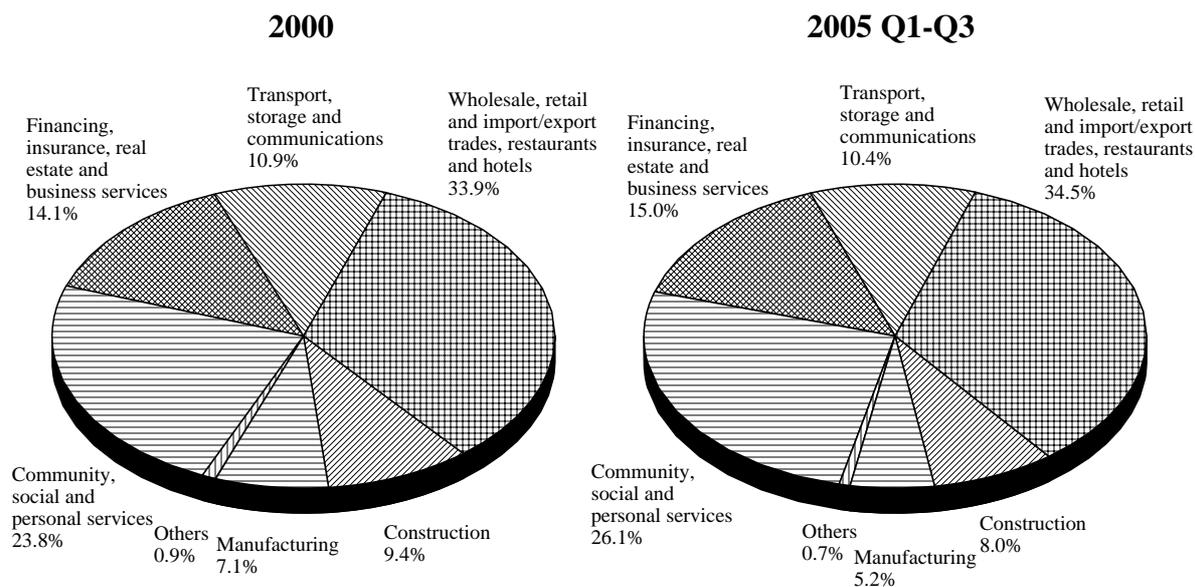
1.13 Over the past several years, the structure of the economy continued to shift towards even more service-oriented, benefitted by the rapid economic development in the Mainland and also adjusting promptly to the challenges brought about by globalisation. Between 1999 and 2004, the contribution of the service sectors as a whole to GDP rose from 86.1% to 90.0%, while those of the manufacturing sector and the construction sector fell from 5.3% and 5.5% respectively to 3.5% and 3.2%.

Diagram 1.5 : Structure of the economy continues to shift towards service activities



1.14 There was a similar development on the employment front, underpinned by a flexible labour market amidst the continuous quality upgrading of the local workforce. For the service sectors as a whole, the share in total employment enlarged from 82.7% in 2000 to 86.1% in the first three quarters of 2005. On the other hand, the shares of the manufacturing sector and the construction sector shrank from 7.1% and 9.4% respectively to 5.2% and 8.0% over the same period. The continuous upgrading of the quality and educational attainment of the local workforce, together with the high flexibility of the labour market, has enabled such restructuring to proceed more smoothly than otherwise.

Diagram 1.6 : Service sectors now taking up 86% of total employment*



Note: (*) These are the composite employment estimates, as derived from the basic data of the General Household Survey and the Quarterly Survey of Employment and Vacancies on business establishments. Figures for 2000 refer to the annual average, while the figures for 2005 refer to the average for the first three quarters of the year.

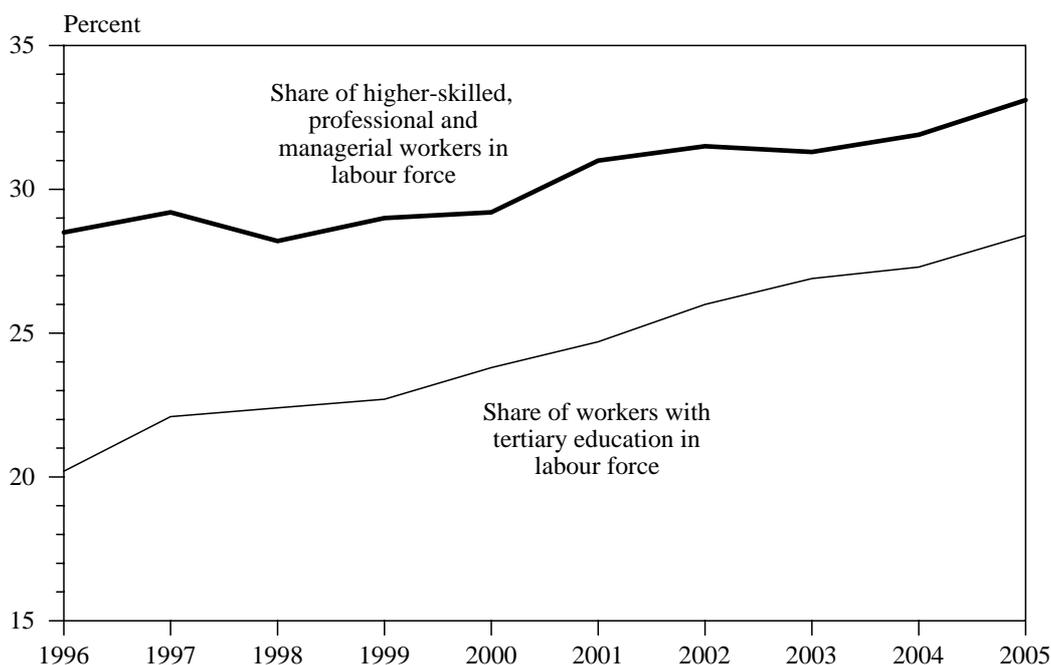
Meeting the challenges from structural changes

1.15 Structural change is nothing new to the Hong Kong economy. The past decades have seen constant changes in the structure of the Hong Kong economy that are brought about by the rapid developments in the regional and global economic environment. From an entrepôt in the 1950s, Hong Kong developed itself into an important manufacturing base serving the world market in the 1960s and 1970s. It then further diversified and evolved into a regional financial centre and a business cum trading hub in the 1980s. Riding on the opening up of the Mainland economy since the late 1970s, Hong Kong has played the key middleman role between the Mainland and the rest of the world, channelling trade and investment flows into and out of the Mainland. In addition, by relocating production facilities across the boundary, as well as investing in this major economic hinterland in a large scale, Hong Kong entrepreneurs have helped transform South China into the world's largest and fastest growing "factory".

1.16 In meeting the challenges from the rapid technological changes and increasingly intense competition brought about by globalisation, the Hong Kong economy has been moving up the value-added chain, shifting towards higher value-added services and more knowledge-based activities. The rising living standards of the Hong Kong people over the decades is a clear testament to the great success of their flexibility and adaptability, with the support from sound and effective market institutions, in meeting the challenges constantly facing them. Structural change is an on-going process, especially with the rapid trend of globalisation. In recent years, the Hong Kong economy has continued to explore its advantage in “leveraging the Mainland and engaging ourselves globally”. For instance, the focus of Hong Kong’s trade has gradually shifted from re-exports to supply-chain management and high value-added logistics services, leading to the flourishing of offshore trade. Hong Kong’s financial markets have not only become the major fund-raising channel for Mainland enterprises, but also play a facilitating role in helping them upgrade corporate governance, enhance operational efficiency, promote brand names and go global. Hong Kong’s professionals are playing an active role in providing professional services to the Mainland economy, thereby contributing to, whilst also gaining substantially, from the Mainland’s new phase of economic development.

1.17 The success of the Hong Kong economy in meeting the challenges and seizing the opportunities arising from the structural changes has always depended, and will continue to depend, on its people. A better educated and higher skilled workforce is the key to the flexibility and resilience of the economy. Over the past decade, Hong Kong’s labour force have been growing at an average annual rate of 1.6%, but the higher-skilled, professional and managerial component of the labour force have been growing at a much faster average annual rate of 4%. Today, one out of three people in Hong Kong’s labour force belongs to this vibrant and vivid group of workers.

Diagram 1.7 : A quality labour force being the key to a sound and flexible economy



Some highlights of economic policy

1.18 In 2005, the robust performance of the Hong Kong economy was a testament to its high degree of flexibility and resilience, particularly when viewed against the looming uncertainties in the external environment. This points to the necessity for the Government to continue to uphold its proactive policy stance to enhance the competitiveness of and reduce the rigidities in the economy, in accordance with the principle of “Market leads, Government facilitates”.

1.19 The rapid economic development in the Mainland has continued to provide ample opportunities for Hong Kong businesses and professionals. Indeed, over the years the dimension of the Mainland economy has featured increasingly prominently in the development of the Hong Kong economy. The agreement reached on Phase III of CEPA in October 2005, on top of the substantial achievements attained in the first two phases, will enlarge further the opportunity set available for Hong Kong enterprises and professionals upon its implementation in January 2006 (*Paragraph 3.10*).

1.20 The Government will continue to cultivate and foster the development of the economic relationships between Hong Kong and the Mainland, with a view to enhancing the role of Hong Kong as the gateway-cum-business

platform for the Mainland and the rest of the world. By engaging in the Pan-PRD co-operation and developing closer ties with the Guangdong Province, the Hong Kong economy will have a deepened and widened relationship with its economic hinterland and enhance its attractiveness to foreign investors. The co-operation with the Guangdong will result in better cross-boundary transport infrastructure to the mutual benefits of the two places (*Paragraph 3.12*).

1.21 It is pivotal for Hong Kong to widen and enrich its range of tourist attractions to meet the increasing travel demand of the Mainland residents as well as visitors from overseas, so as to strengthen the status of Hong Kong as the major tourist destination in the region, bearing in mind that the inbound tourism industry is a major source of generating new jobs for lower skilled workers. The extension of the Individual visit Scheme (IVS) to cover four more cities in November 2005 will be conducive to the further expansion of Hong Kong's inbound tourism. In December 2005, the Central Government indicated its support for the recommendation to extend the IVS to cover all the nine provincial capitals in Pan-PRD (*Paragraphs 4.10 to 4.14*).

1.22 The Government is dedicated to the promotion of free trade in the international arena. In December 2005, Hong Kong successfully hosted the Sixth Session of the WTO Ministerial Conference. The Conference made significant advances and built a platform for completing the Doha round of multinational trade negotiations by end-2006. The successful conclusion of the Conference helped strengthen the image of Hong Kong as a cosmopolitan city and an important hub for international business conventions and events (*Paragraph 3.9*).

1.23 The financial sector is one of the most vibrant components of the Hong Kong economy. The Government will continue to enhance the quality of the financial markets through enhancing the regulatory regime, promoting good corporate governance, and the development of the bond market. Apart from implementing the New Basel Capital Accord to set the highest international standards to strengthen Hong Kong's leading position as an international financial centre, measures have been taken to abolish estate duty and exempt offshore funds from profits tax to foster the growth of the asset management industry (*Paragraph 5.2*).

1.24 At the first meeting of the Committee on Economic Development and Economic Co-operation with the Mainland held in December, a committee under the Commission on Strategic Development, it was agreed that the committee in its future meetings would accord priority to the discussion of four strategic issues, namely employment creation, creative industries, high value-added logistics as well as solidification of talents. These issues are important in the context of bringing about more vitality and strength to the Hong Kong economy.

Notes :

- (1) The Gross Domestic Product (GDP) is an overall measure of net output produced within an economy in a specified period, such as a calendar year or a quarter, before deducting the consumption of fixed capital. In accordance with the expenditure approach to its estimation, GDP is compiled as total final expenditures on goods and services (including private consumption expenditure, government consumption expenditure, gross domestic fixed capital formation, changes in inventories, and exports of goods and services), less imports of goods and services.
- (2) The Census and Statistics Department completed an exercise to implement the latest international guidelines on dealing with financial intermediation services provided by banks in the estimation of national accounts statistics of Hong Kong in mid-August 2005. The latest guidelines enable national accounts statistics to reflect in a better way the economic contribution of banks in facilitating the channeling of funds from units with surplus funds (e.g. depositors) to units with demand for funds (e.g. borrowers). As a result of this statistical development, GDP, GNP and BoP statistics were revised.
- (3) The seasonally adjusted quarter-to-quarter GDP series, by removing the variations that occur at about the same time and in about the same magnitude each year, provides another perspective for discerning the trend, particularly in regard to turning points. A detailed examination reveals the presence of seasonality in the overall GDP and in some of its main components, including private consumption expenditure, government consumption expenditure, exports of goods, imports of goods, exports of services, and imports of services. However, due to the presence of considerable short-term fluctuations, no clear seasonal pattern is found in gross domestic fixed capital formation. Therefore, the seasonally adjusted series of GDP is compiled separately at the overall level, rather than summing up from its main components.

CHAPTER 2 : ECONOMIC OUTLOOK FOR 2006 AND THE MEDIUM TERM

Summary

- *In 2006:*
 - *The Hong Kong economy is expected to gradually settle back to a more sustainable and still solid growth of 4-5% in real terms, after attaining two consecutive years of very rapid growth.*
 - *Conditions in the overseas markets remain generally supportive, but the full effect of the successive interest rate hikes and the earlier surge in oil prices on global and regional demand will be felt more this year than last.*
 - *The labour market looks set to improve further as economic expansion proceeds, likely to be accompanied by further increases in labour wages and earnings. This should help strengthen consumer confidence and lend support to consumer spending.*
 - *The inflation outlook is for a further creeping up during the year, with the economic expansion continuing at a solid pace and the broader return of pricing power. Consumer price inflation is forecast at 2.3%, a still moderate and healthy level.*
- *Over the medium term, Hong Kong will continue to shift towards higher value-added services and knowledge-based economy, riding on increasing economic integration with a rapidly growing Mainland economy. The productivity growth achieved in the process will help the economy attain a 4 % trend GDP growth over the next few years.*

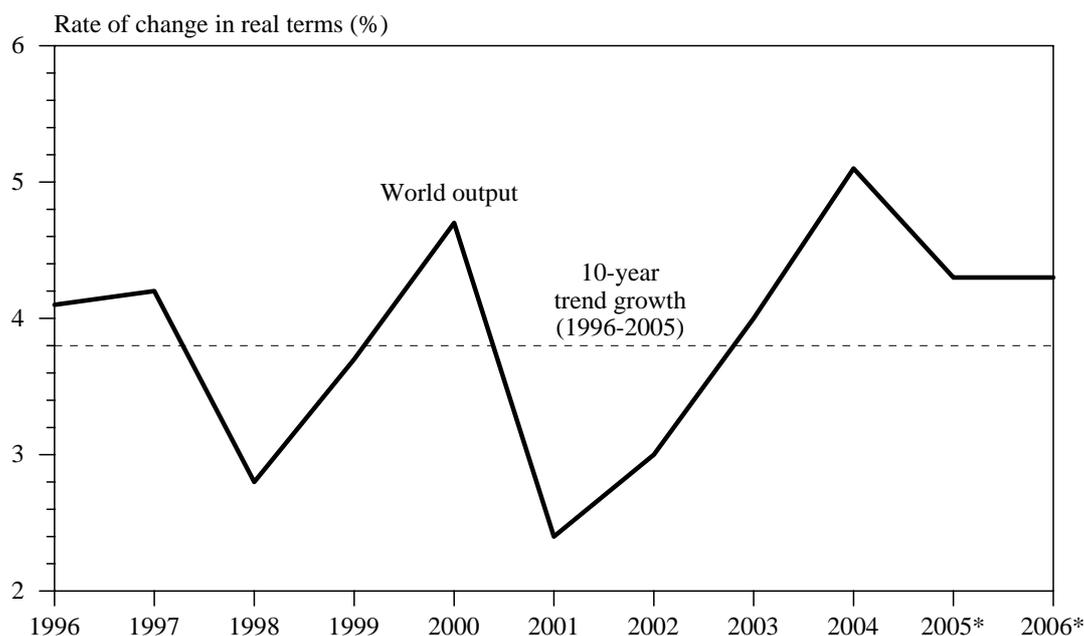
Major external factors

2.1 Hong Kong is a small open economy and its economic performance hinges very much on the developments in the external environment. The economic outlook in 2006 will depend on how the global economic growth momentum will be affected by persistently high oil prices and less accommodative monetary policy in the US. Also, exchange rate movements are crucial, given the substantive role of Hong Kong's external sector and the increasingly intense competition in the international markets. Meanwhile, the increasing economic integration between Hong Kong and the Mainland suggests that the "China factor" is an indispensable item in the discussion about Hong Kong's economic prospects.

Global economic outlook

2.2 In 2005, the global economy displayed a much higher degree of resilience than earlier expected. Notwithstanding the successive hikes in US short-term interest rates as well as the surge in international oil prices, the global economy still continued to expand at a fairly strong pace in 2005. The US economy sustained its fairly robust growth momentum during most of the year and remained one of the key growth engines in the world, even though some moderation was seen in the fourth quarter amidst a relapse in consumer spending on durable goods. The EU economy, on the other hand, showed signs of picking up in the latter part of the year on the back of stronger exports and strengthening business investment. In the Mainland, economic performance continued to exceed expectations, delivering another year of spectacular and broad-based expansion. The recovery in the Japanese economy is taking root, with signs of emergence from its protracted period of deflation, raising hope that it is finally on a self-sustainable growth path. The other East Asian economies, after a relatively weak start, picked up again in the latter half of 2005, alongside an upswing in global demand for electronic products. For 2005 as a whole, IMF expects that the global economy should have attained a solid growth at 4.3%, after an exceptionally strong growth of 5.1% in 2004.

Diagram 2.1 : IMF expects the global economy to attain another year of above-trend growth in 2006



Note : (*) IMF's forecast.

2.3 Riding on the recent strong growth momentum, the global economy is envisaged to sustain above-trend growth in 2006. According to the projection by IMF in September 2005, the world economy would grow further by a solid 4.3% in 2006, compared with the average annual growth of 3.8% over the past ten years. The US economy should be able to attain another year of solid growth, though likely with some moderation from last year, due to the further feed-through of higher oil prices and interest rates and consolidation in the housing market. Recovery in the EU is likely to gather some strength this year, aided by somewhat stabilised employment situation and improved corporate profitability. So would the Japanese economy. The Mainland economy is again the bright spot this year, although the growth momentum may not be as robust as in 2005. The other East Asian economies are also envisaged to fare quite well in 2006, on the back of the largely supportive external environment, although they remain particularly vulnerable to any unfavourable developments in the IT product cycle.

Table 2.1 : Growth forecasts for major economies in 2006⁽¹⁾

	<u>IMF</u>	<u>World Bank</u>	<u>Private sector forecast[^]</u>
	(%)	(%)	(%)
World	4.3	4.3	3.3
US	3.3	3.5	3.4
Euro-area	1.8	1.4	1.9
Asia :			
Mainland China*	8.2	8.7	8.7
Japan	2.0	1.8	2.2
Singapore	4.5	4.7	5.4
Republic of Korea	5.0	4.6	4.9
Malaysia	6.0	5.3	5.4
Thailand	5.0	5.0	5.0
Taiwan	4.3	4.1	4.0
Indonesia	5.8	6.0	5.0

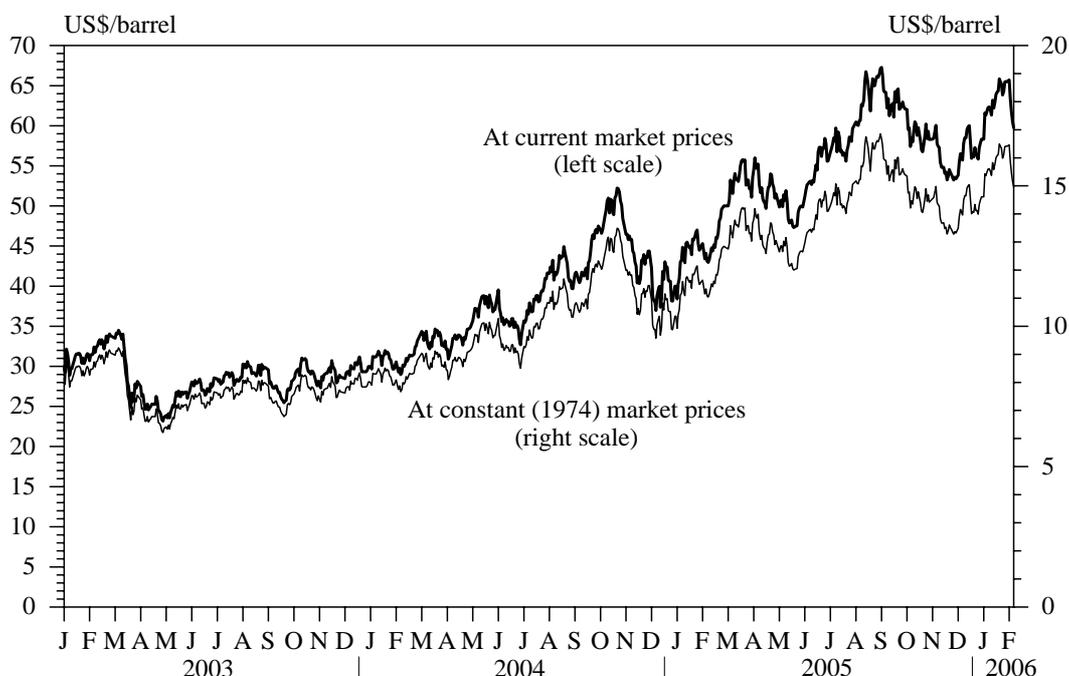
Notes : (*) Private sector forecast on Mainland China is based on the newly revised GDP series, whilst forecasts from IMF and World Bank are based on the old series.

(^) Average.

2.4 While the global economic situation is still largely positive at present and most forecasters and international organisations are upbeat about the outlook in 2006, there are a number of uncertainties and downside risks that could potentially lead to a less favourable outcome. *First*, although so far the global economy seemed to be rather resilient to the oil shock, the extent to which the adverse impact of oil price hike would show up more fully in 2006 is yet unknown. As such, oil price movements and its impact on global economic activity still constitute the key source of uncertainty in the global economic environment this year. *Secondly*, the potential threat of avian flu outbreak in regional economies remains in place. There are great uncertainties as to when and whether a large-scale human flu pandemic will break out, and the severity to which it would hurt tourism, mass transport and consumption sectors. *Third*, the US housing market is already cooling off and could face a bigger-than-expected correction should the long term US interest rates catch up with the rise in the short-term rates. *Fourthly*, global current account imbalances are alarmingly large, and the prospect of self-correcting adjustments does not look promising given the persistent growth divergences across regions. The adjustment process, if occurs abruptly, could potentially be de-stabilising, causing marked slow-down in US consumption and repercussions to the other economies and hence a more fluid external environment. *Fifthly*, the lingering

protectionist sentiment from the US and EU against Mainland's exports continues to be a source of uncertainties hanging over Hong Kong's trading environment.

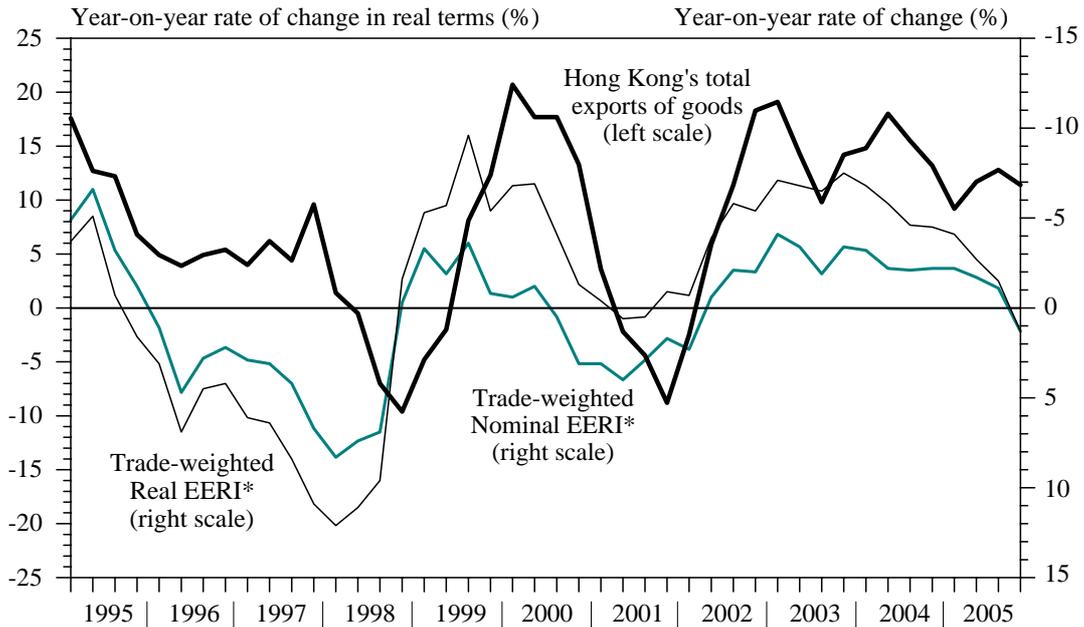
Diagram 2.2 : Oil prices still a key source of risk in the external environment



Exchange rates and price competitiveness

2.5 Exchange rate movements are a crucial factor that will determine Hong Kong's relative price competitiveness. In this regard, the strengthening of the US dollar between March 2005 and December 2005, which resulted in a 3.2% appreciation of Hong Kong's real exchange rate index over the period, would to some extent undermine Hong Kong's external price competitiveness and hence Hong Kong's trade prospect in the months ahead. More recently the trend of the US dollar against the yen and euro have become somewhat unclear, reflecting the increase in uncertainty over whether the US interest rate upcycle would come to an end in the coming months. Nevertheless, against most of the other East Asian currencies, the US dollar has been weakening notably since late 2005. Thus, insofar as Hong Kong's external price competitiveness is concerned, the exchange rate factor should not be particularly adverse on balance, and might even turn more favourable again if the US dollar were to show renewed weakening after the end of the US interest rate upcycle and with the market re-focussing on the alarming US current account deficit.

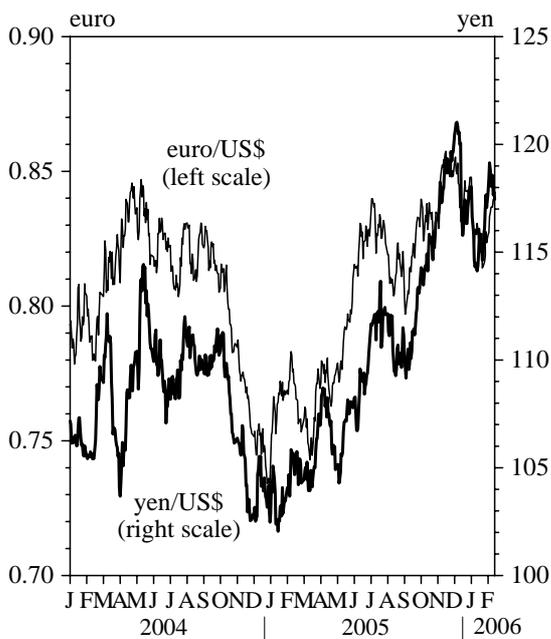
Diagram 2.3 : Exports in the near term likely to be affected by the earlier strengthening in the US dollar



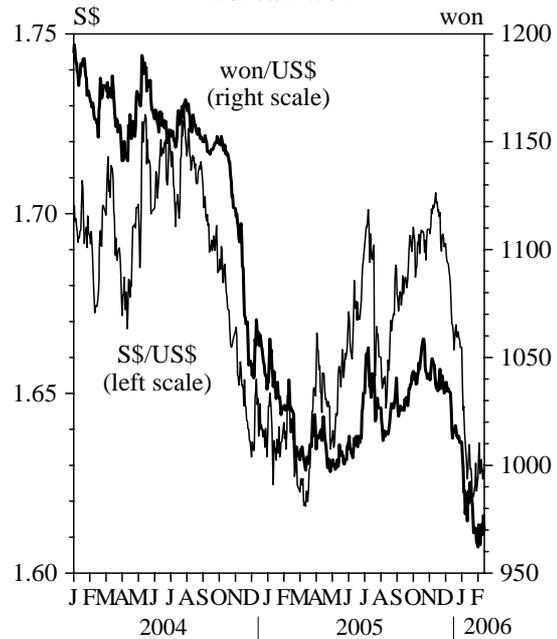
Note : (*) Positive changes in the Real/Nominal EERI denote real/nominal appreciation of the Hong Kong dollar, and negative changes denote real/nominal depreciation.

Diagram 2.4 : Yet the dollar showed divergent movements against different currencies lately

(a) against euro and yen

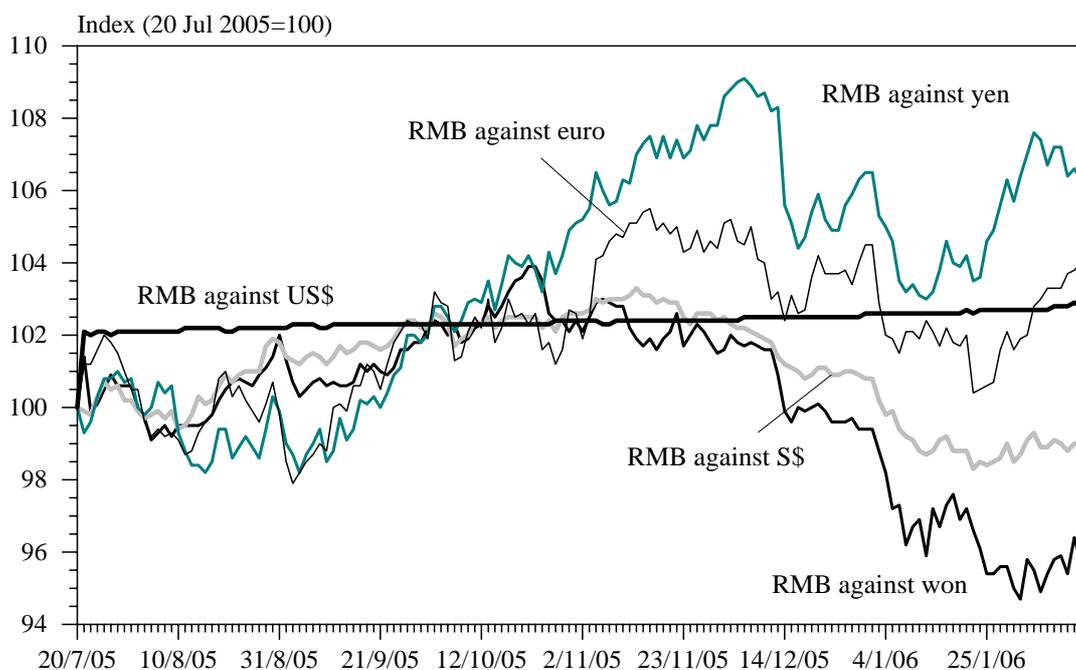


(b) against Singapore dollar and Korean won



2.6 On the exchange rate front, a major event in 2005 was the introduction of the new renminbi exchange rate regime by the People's Bank of China (PBOC) on 21 July 2005. Since then, the renminbi has appreciated by only around 3-4% against the US dollar and the euro, albeit more so against the Japanese yen, over the level immediately before the introduction of the new regime. Yet this has been to some extent offset by the depreciation of the renminbi against some East Asian currencies. Given the still moderate strengthening in the renminbi in overall terms and the availability of vast production capacities in the Mainland, the exchange rate reform should not significantly hurt China's external competitiveness, the major source of Hong Kong's re-export trade. Further changes to the exchange rate regime are likely to be introduced only in a gradual manner, and as such the downside risks to Hong Kong's trade this year should be rather limited. On the other hand, a more flexible exchange rate regime should enhance the Mainland economy's adaptability to changes in the external environment, and is largely conducive to a more sustained economic development in the Mainland to the benefit of the Hong Kong economy in the longer term. The reform may also help address the global current account imbalances, particularly so if it is accompanied by appreciation of other Asian currencies.

Diagram 2.5 : Renminbi appreciation still moderate in overall terms and not yet hurting the Mainland's external competitiveness in a significant way



Note : (*) An increase in the index represents an appreciation of renminbi against the currency concerned.

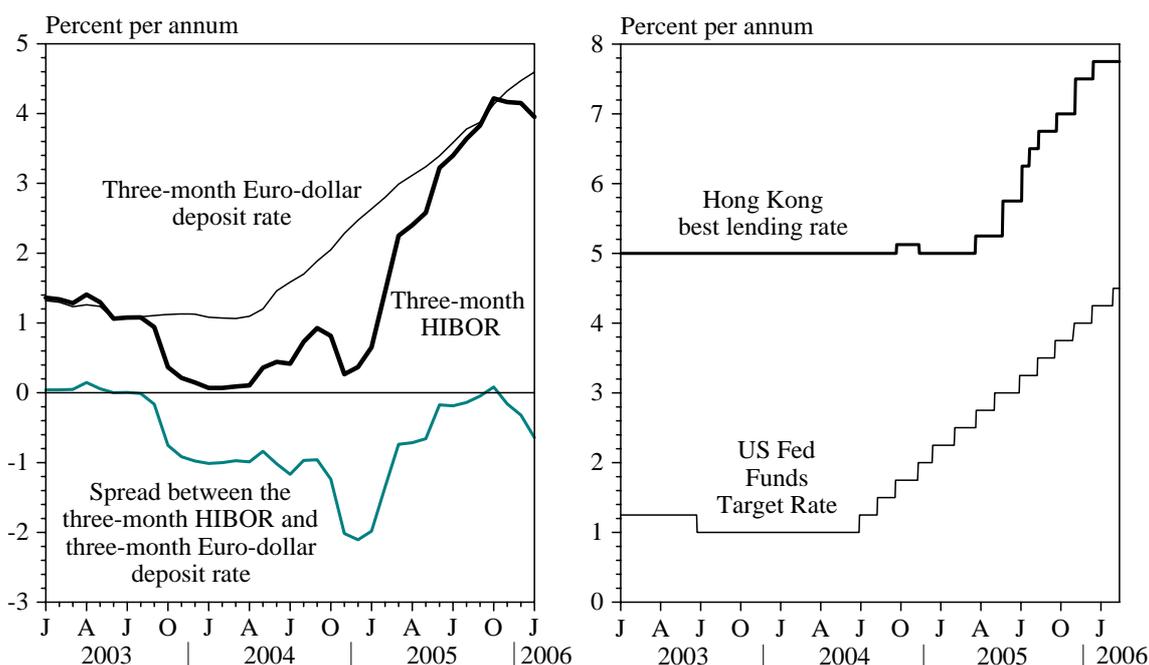
2.7 But the moderate appreciation of renminbi so far should have lifted the production costs incurred by many Hong Kong manufacturers with production facilities in the Mainland. Again, in view of the ease-back in Mainland's producer price inflation and granting that further renminbi appreciation is to occur in a very gradual manner, the increase in production costs is likely to remain limited. Moreover, a significant part of such cost increase can be expected to continue to be absorbed by producers in the form of profit margin squeeze. All these should help keep "Made in China" products still highly competitive in the international markets.

2.8 Locally, upward pressure on business costs are still rather moderate to date, even though some further pick-up is envisaged over the course of 2006. Nevertheless, given the advancement of information technology which facilitates a smoother operation of global supply chain and hence lower sourcing costs, as well as local producers' on-going effort to raise productivity to maintain external competitiveness in face of keen competition in the global markets, the increase in Hong Kong's export prices, if any, is likely to remain relatively contained.

Interest rate movements

2.9 In the current interest rate upcycle that began in June 2004, the US Federal Reserve has lifted the Fed Funds Target Rate 14 times, by a total of 350 basis points, to 4.5%. After a period of divergence, Hong Kong interest rates started to move in sync with US interest rates, more so following the three refinements to the Linked Exchange Rate system in May 2005. Some local banks even moved ahead of the Federal Reserve in raising the best lending rate, or chose to catch up with the earlier hikes that had not been followed. These have resulted in a notable cumulative increase in the best lending rate, by a total of 275-300 basis points in less than a year's time.

Diagram 2.6 : Successive interest rate hikes unlikely to severely derail the cyclical recovery of Hong Kong's domestic demand



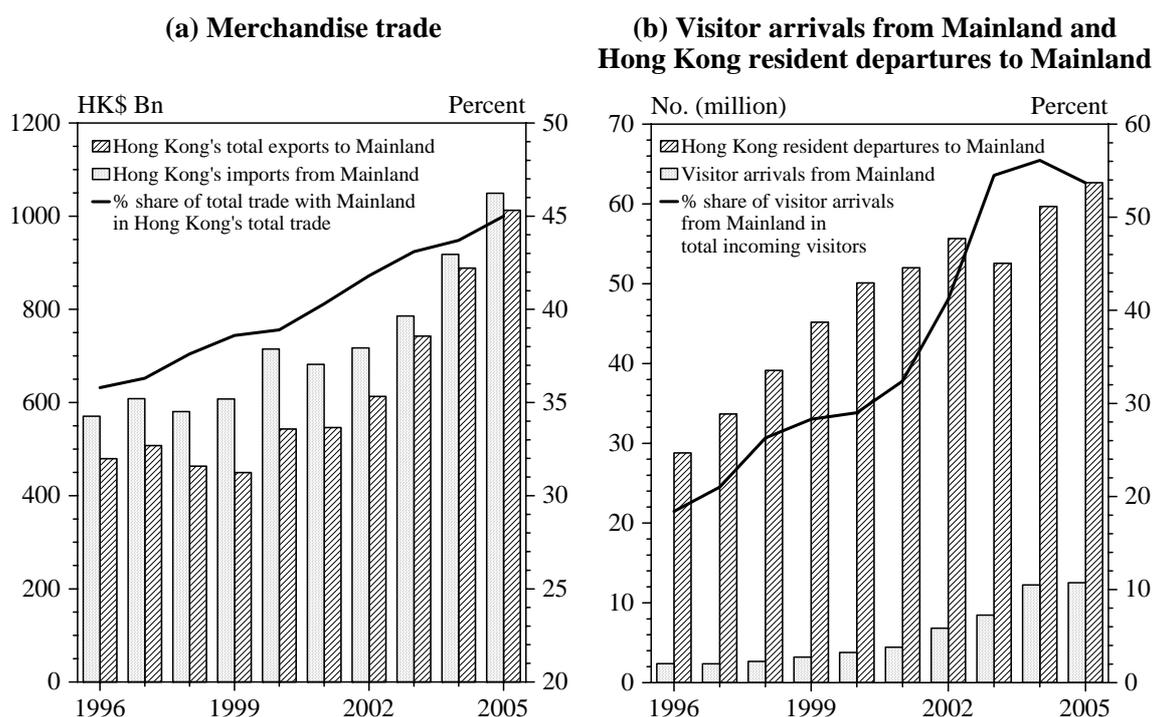
2.10 Higher interest rates should have transmitted into heavier debt-servicing burdens for domestic households and businesses on the whole, with those having substantial amount of variable-rate loans, notably residential mortgages, being the most affected. Together with the negative wealth effect stemming from the consolidation in the local property market in the latter part of 2005, it is not unlikely to see some moderation in local demand. However, with the much stronger balance sheets of local households and corporations, the rise-back in labour income, as well as the still generally sanguine economic sentiment, the successive hikes in local interest rates over the past year is expected to only slow, but not derail, the cyclical recovery of domestic demand.

China factor

2.11 The rapid development and liberalization of the Mainland economy over the past twenty years has presented a lot of opportunities as well as challenges to the Hong Kong economy. Thanks to our superb physical and financial infrastructures, as well as favourable geographical location, Hong Kong is well placed to serve as a natural gateway between the Mainland and the rest of the world, thereby reaping enormous benefits from the rapidly growing Mainland economy. For instance, the increasing interaction between Hong Kong and the Guangdong Province, especially the Pearl River Delta (PRD) region, has contributed significantly to the prosperity of the two places and facilitated the structural transformation for the whole South China. However,

there have been many concerns about whether Hong Kong will eventually “lose out” and with its role as a regional trade and business hub being gradually superseded by other Mainland cities, particularly in light of the rapid expansion of port facilities in Shenzhen and the rest of PRD region. From a broader perspective, greater prosperity in the PRD region would also bring more business opportunities for Hong Kong, as manifested by increased demand for various producer and financial services including notably fund-raising IPO by Mainland enterprises, as well as the increasing number of Mainland tourists coming to Hong Kong. The boost arising from the complementarities between the two economies has been further reinforced by several policy initiatives like CEPA, the Individual Visit Scheme, and the Pan-PRD Regional Co-operation Framework in recent years. On the whole, as long as Hong Kong can strive to maintain its institutional strength and upgrade its workforce to cope with the continuous economic restructuring, further economic integration with the Mainland should continue to render growth impetus to the Hong Kong economy.

Diagram 2.7 : Increasing economic integration with the Mainland continues to render growth impetus to the Hong Kong economy



Outlook for the Hong Kong economy in 2006

2.12 Against the background of the downside risks stemming from the global economic environment, and after two years of exceptionally strong growth, the outlook for 2006 is for the Hong Kong economy to gradually settle back to a growth pace more commensurate with its past trend growth. The implementation of the three phases of CEPA and strengthening Pan-PRD co-operation, together with the still supportive external environment, should continue to lend support to Hong Kong's economic growth. Hence, while the pace of activity growth in 2006 may ease back somewhat, the scope of expansion will remain relatively broad-based.

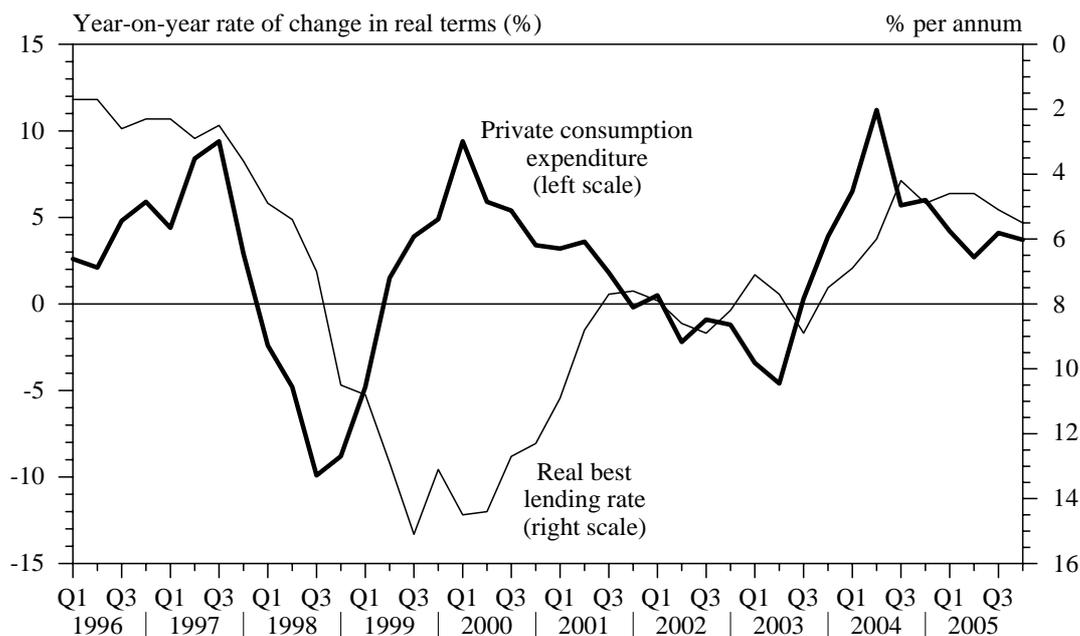
2.13 Externally, the outlook for trade in 2006 remains largely sanguine. But the growth pace is likely to be less hectic than last year's, as US economic growth is expected to take a breather after successive interest rate hikes, and as the relative strength of the US dollar should have some negative effect on Hong Kong's exports in the early part of the year. Also, after the exceptionally strong growth in 2005, Mainland's exports, the key source of Hong Kong's re-exports, have shown signs of some tapering in recent months. Against these, however, the relative improvement in economic performance in Europe and Japan should provide useful support.

2.14 Another positive development is the agreements reached by the Mainland with the US and EU last year over Mainland's exports of textiles and clothing items, which has cleared considerable uncertainty in the trading environment, even though these agreements would also tend to limit the export growth to some extent. Against this backdrop, *total exports of goods* are likely to still see solid growth in 2006, though not as robust as the 11.2% growth last year. Within this total, re-exports will remain the major growth driver. Domestic exports seem likely to continue the rapid growth trend that began in the latter half of 2005, as some local manufacturers have already shifted back their clothing production to Hong Kong.

2.15 *Exports of services* would continue to show notable growth in 2006. The further extension of the Individual Visit Scheme to four more Mainland cities in November 2005, the completion of several new tourist attractions, and the full-year effect of the Disneyland theme park would all help raise the number of incoming visitors to a new high in 2006. Thus the further expansion of inbound tourism will continue to support exports of travel-related services. Exports of trade-related services and, to some extent, exports of transportation services should also fare quite well, boosted by still robust performance of the

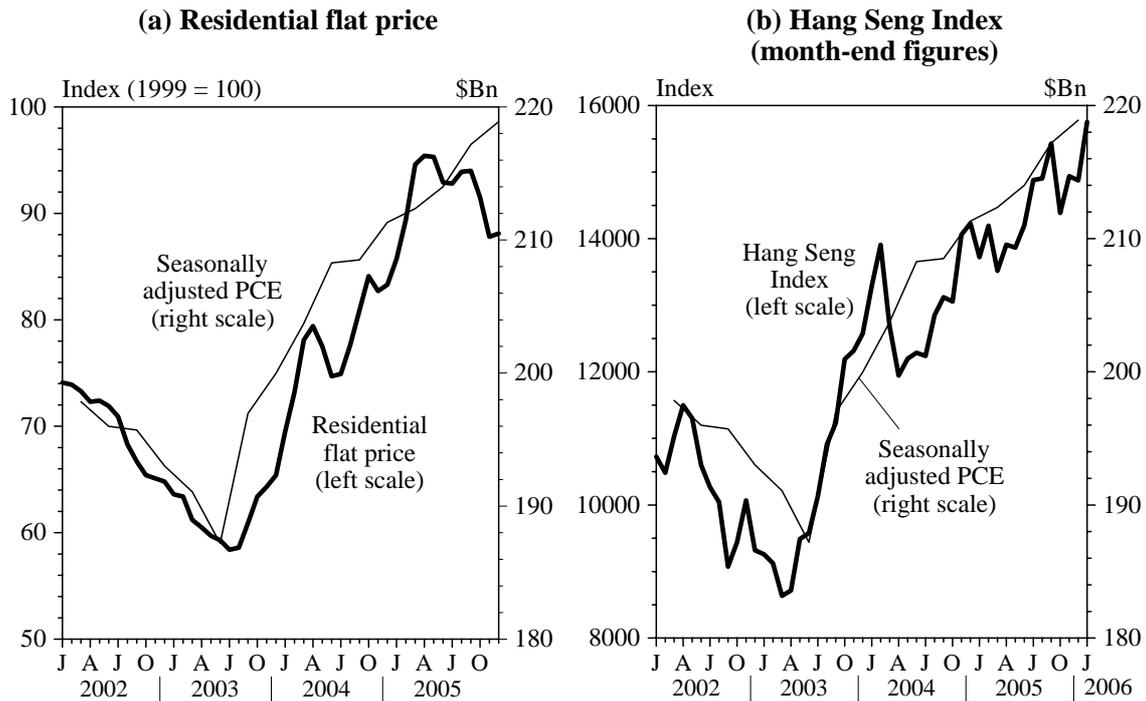
Mainland's external trade and the on-going shift to offshore trade. The implementation of the three phases of CEPA and the strengthening Hong Kong-Mainland economic ties in general will also generate stronger demand for Hong Kong's professional, business and financial services, thereby rendering firm support to exports of finance, business and other services.

Diagram 2.8 : Successive interest rate hikes may slow consumption growth



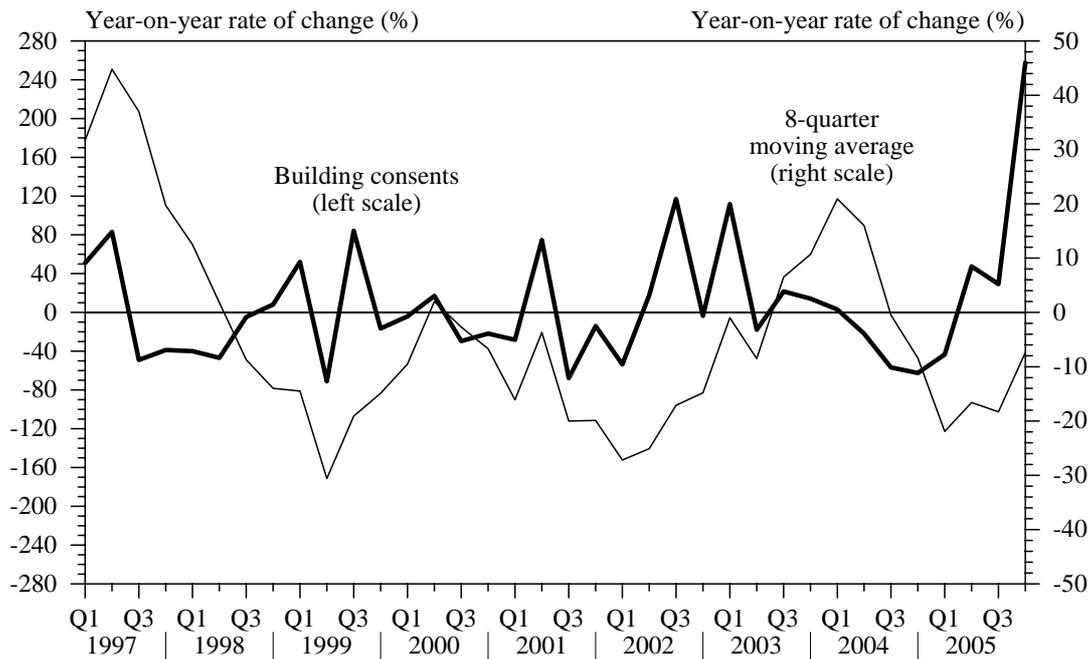
2.16 Locally, with the rise-back in labour income and improving employment conditions, *private consumption expenditure* is likely to attain another year of solid growth in 2006. The past two consecutive years of exceptionally strong economic growth has strengthened consumer confidence considerably, although the feed-through of the interest rate hikes over the past year may rein in somewhat the pace of consumption growth in the near term. Also, developments in the local asset markets should turn more favourable later in the year as the interest rate upcycle hopefully comes to an end, thereby adding further support to consumer spending.

Diagram 2.9 : Asset market developments being another crucial factor affecting local demand



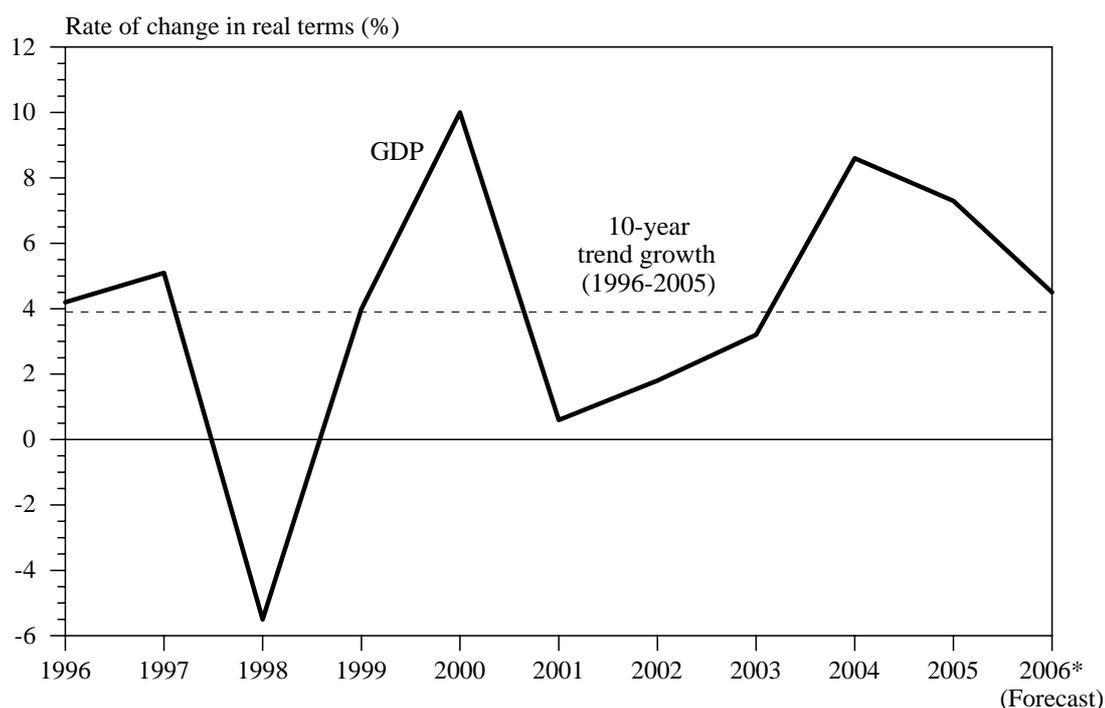
2.17 The main growth impetus to overall *investment spending* in 2006 is expected to come from private sector acquisition of machinery and equipment, continuing the strong trend established in the past two years, on the back of the improved corporate profitability and the drive to raise productivity amidst an increasingly competitive global environment. In contrast, investment in building and construction, having been on a prolonged decline, still shows little signs of turnaround to date. Due to the distinct fall-off in the number of new projects launched in 2004, building consents on an eight-quarter moving average basis was still on a decline in late 2005. As such, the weakness in construction output is expected to extend at least into the early part of 2006. There will also be limited support from the Public Sector Housing Programme following its scaling back in the previous years. Though with the interest rate upcycle probably near its end and with building consents in the more recent quarters showing a significant rebound, the timing and the extent of a turnaround remains subject to great uncertainty.

Diagram 2.10 : Building and construction activity likely to remain slack in near term, thereby continuing to hold back overall investment



2.18 Overall, the *Gross Domestic Product* is expected to attain still solid growth of 4-5% in real terms this year, more commensurate with the trend growth at 3.9% in the past ten years, though coming down from the exceptionally strong growth of 7-8% in the past two years. The forecast is somewhat conservative when compared with the prevailing forecasts by the private sector which are mostly in the range of 4.5 - 5.5%, reflecting the cautiousness stemming from the downside risks and uncertainties in the global economic environment and also the expected feed-through from higher interest rates.

Diagram 2.11 : Economy set for still solid growth in 2006



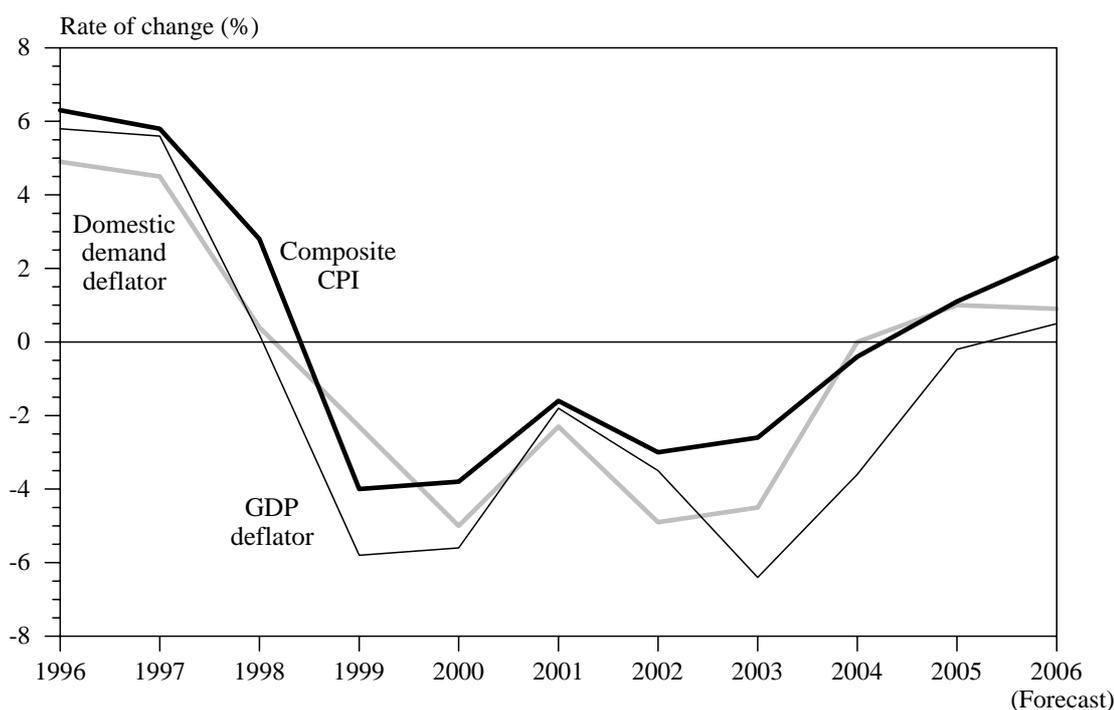
Note : (*) Mid-point of the range forecast.

2.19 The outlook for consumer price inflation is for a further creeping up in 2006. With the economic expansion continuing at a solid growth pace and the broader return of pricing power, any rise in business cost is likely to pass through to the retail price level more readily. In this regard, the rise-back in labour costs over the past year and the continuous increases in office and shopping rentals will add to business cost modestly. Also, the increase in housing rentals, by some 11-12% in 2005, will increasingly show up in the rental components of the consumer price indices. Externally, oil prices and other commodity prices are likely to sustain at high levels in 2006 and may lead to higher import prices, especially if the US dollar were to show some renewed weakening later this year. On the other hand, the envisaged moderation in overall economic growth is likely to keep the CCPI upturn still at a modest pace. Also, continued uplifting in labour productivity along with the on-going shift to higher value-added activities and the hefty investment in machinery and equipment should help expand the productive capacity of the economy, thereby mitigating the overall cost pressures somewhat.

2.20 Overall, consumer price inflation in terms of the year-on-year rate of increase in the *Composite CPI* is likely to climb up over the course of 2006, essentially a continuation of the re-inflation process that began in late 2004.

Yet with economic growth coming down to a level more commensurate with the past trend growth and with continued expansion in production capacity, inflation is expected to average at a still moderate and healthy level of 2.3% for the year as a whole. In tandem with the climb-up in CPI inflation and probably with less of a drag from terms of trade this year, the *GDP deflator* is expected to also revert to an increase at 0.5% in 2006, which if realised would represent the first annual increase since 1999.

Diagram 2.12 : Inflation environment still benign in 2006



Forecast rate of change in 2006 (%)

Gross Domestic Product (GDP)

<i>Real GDP</i>	4-5
<i>Nominal GDP</i>	4.5-5.5
<i>Per capita GDP, in real terms</i>	3.2-4.2
<i>Per capita GDP at current market prices</i>	HK\$206,800-208,700 (US\$26,500-26,800)

Composite Consumer Price Index **2.3**

GDP Deflator **0.5**

Medium-term outlook for the Hong Kong economy

2.21 The medium-term prospect for the Hong Kong economy is bright. With the economy now on a much sounder footing than before, and with the domestic economy shrugging off its earlier sluggishness, Hong Kong would continue to benefit from the increasing integration with a rapidly growing Mainland economy. Unless major external shocks occur, the Hong Kong economy can be expected to forge ahead after the impacts of successive interest rate hikes and earlier oil price surge fade out. Through the CEPA framework and the widening and deepening of co-operation within the Pan-PRD, it is envisaged that the Hong Kong economy will continue to shift towards higher value-added services and more knowledge-based in the coming years.

2.22 There are still lingering uncertainties hanging over the medium term development. The US housing market boom, which has so far provided the key impetus to US consumer demand growth, is already cooling off and may suffer a bigger-than-expected correction should US long-term interest rates shoot up. Also, global trade imbalances are alarmingly large, and it is hard to tell when the process of unwinding will start. If the adjustment process occurs abruptly, it could potentially be destabilising to global economic growth and the stability of international financial markets. Lingering protectionist sentiment from US and EU against Mainland products, as well as mounting pressure on the renminbi, remain an on-going threat to Hong Kong's trade. Domestically, the issue of unemployment, though alleviated to some extent during the current economic upturn, remains a concern, as some lower skilled workers may still have difficulty in finding jobs when Hong Kong continues to move to knowledge-based and high value-added services. Also, attention has to be paid to the increasingly ageing population, given its profound implications on our health and social welfare systems, as well as on the public finance. Moreover, as Hong Kong has moved into a new phase of economic expansion, inflation has already come back and is gradually picking up. So, we will have to stay alert to the possible threat from a resurgence in inflation.

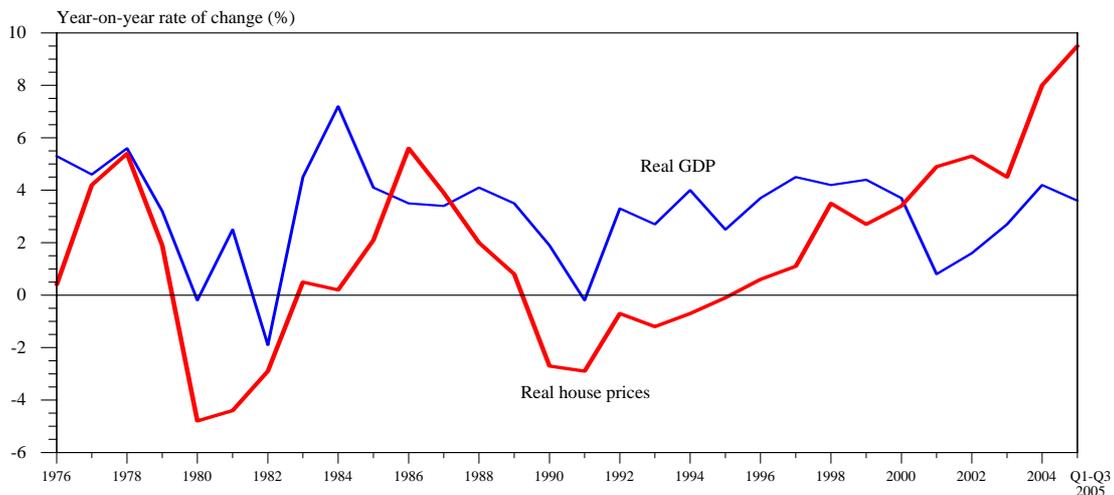
Box 2.1

The US housing boom

The current upswing of the US housing market began in the mid-1990s and continued through most part of 2005, along with the strong income growth in the US. The accommodative monetary policy pursued by the US Federal Reserve following the burst of the IT bubble in late 2000, which led to a very low interest rate environment until recently, has often been blamed as the key factor sustaining the buoyant housing market conditions and causing possible over-valuation of US house prices. In particular, the rapid increases in house prices in 2004 and the first three quarters of 2005 were unprecedented in the recent history of the US economy.

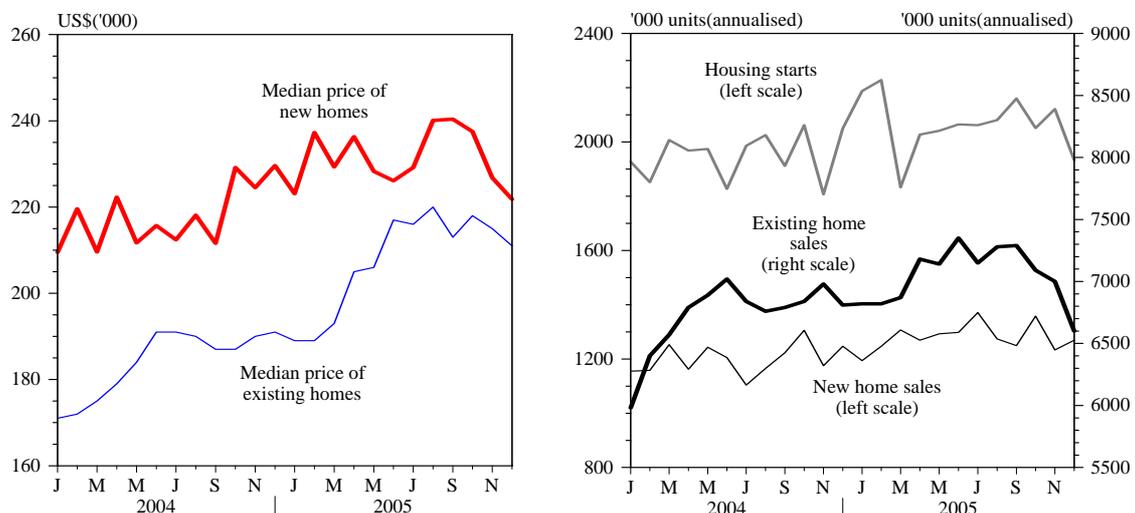
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US real house prices rising distinctly faster than real GDP in recent years



There are mixed views as to whether the current housing boom is a bubble at all, and whether there will be a marked correction down the road. There are also disagreements over whether the bubble, if it exists at all, is only regional or indeed nationwide. Yet cooling of the US housing market seems to be already underway. The latest US housing market indicators showed that median prices of both new and existing homes eased somewhat since the latter part of last year. Meanwhile, the pace of sales activity and housing starts also slowed.

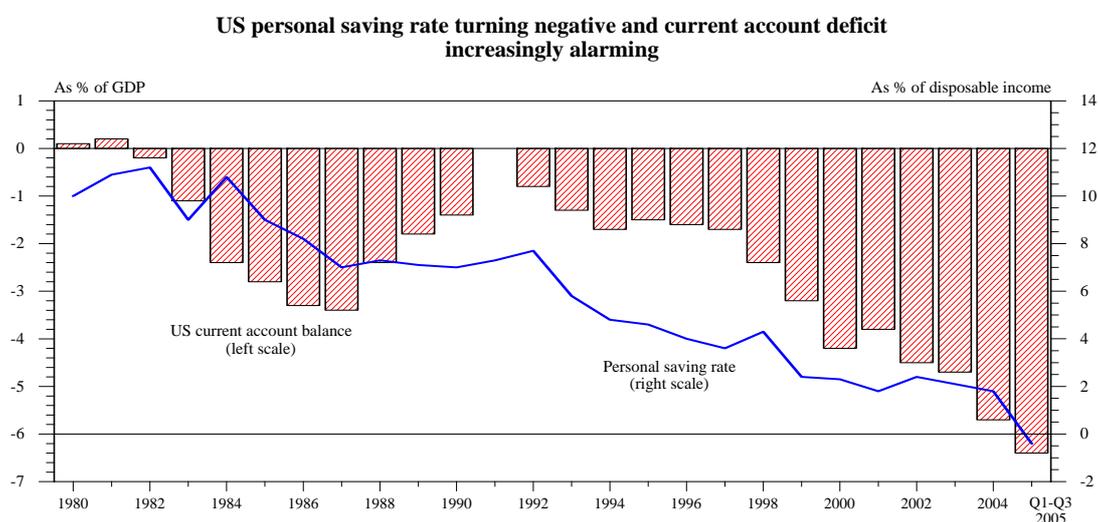
US housing market showing some signs of cooling



Box 2.1 (cont'd)

The prevailing mainstream views are for a continuation of a mild correction in the US housing market. In the near term, the risk of a major correction should not be very significant, especially with the US economy still holding up rather well lately.

Yet there are certain pitfalls. *First*, although US mortgage rates are still low by historical standards, they have crept up gradually since the latter part of last year. Any unexpected upsurge in the mortgage rates may trigger a more abrupt adjustment in the housing market. *Second*, housing affordability of US households has worsened to its lowest level in the 1990s and their debt service ratio has been on the rise, reducing their ability to cope with larger house price corrections. *Third*, US consumption, a key driver of growth in the US economy in recent years, has been led mainly by rising house prices to support consumption, by means of increased trading activity and mortgage re-financing. This could have been the major factor accounting for the decline in personal saving rate over the past decade to negative level in 2005, which has in turn contributed to the rise in the US current account deficit to a historic high. Thus, there is risk that a large correction of the US housing market, if occurred, may also trigger a faster-than-desirable adjustment in US external imbalances, causing significant disruptions to the stability of the international foreign exchange and financial markets.



The impact on the Hong Kong economy will depend much on the extent of the correction in the US housing market and how it will transpire to slow the demand in the US and to dim the US as well as the global growth prospects.

In general, if the US housing market correction is gradual and orderly, the impact on Hong Kong economy should be quite moderate. There would likely be some slow-down in trade growth due to weaker US demand. Domestic demand may also be moderately down as income from trade is reduced, and as there would be some mild negative wealth effect from the asset market spill-overs. However, in the event of a more abrupt and drastic downturn in the US housing market, the repercussions on the Hong Kong economy would be distinctly larger and more damaging, as there would likely be excessive volatility in the international financial and foreign exchange markets, dampening consumption and investment sentiment worldwide. Thus it is important to monitor the downside risks arising from any adverse developments in the US housing market.

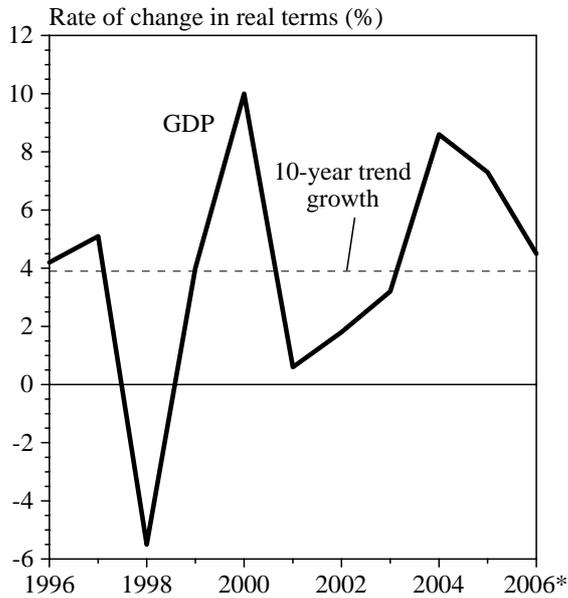
It is also imperative for the Hong Kong economy to continue to build up its capability and flexibility to weather external shocks as they come. Our banking sector needs to remain prudent in lending. The Government should also stay vigilant in fiscal spending, strive to maintain high flexibility in the labour market, continue to invest in education and infrastructure, and uphold the aspects where Hong Kong has competitive edge.

2.23 It is pivotal for Hong Kong to enhance further its attractiveness as a business hub and financial centre in Asia, amidst the keen competition prevailing in the global business environment. To this end, the Government will continue to enhance the quality of the financial markets to strengthen the position of Hong Kong as a leading international financial centre in the region. To maintain the Hong Kong's vitality as Asia's world city, the Government will continue to invest in infrastructure to strengthen its connectivity with the Mainland and the rest of the world. It is also a priority to upgrade the quality of the workforce to effectively cope with competition brought about by globalisation. A proactive stance will also be adopted to attract talent from the Mainland and the overseas to come and settle in Hong Kong. It is also important to nourish the creativity of Hong Kong entrepreneurs and workers alike to add to the flexibility of the Hong Kong economy. In recognition of the sound and efficient market institutions as a key to economic success, the Government will continue to uphold its guiding principle of "Market leads, Government facilitates".

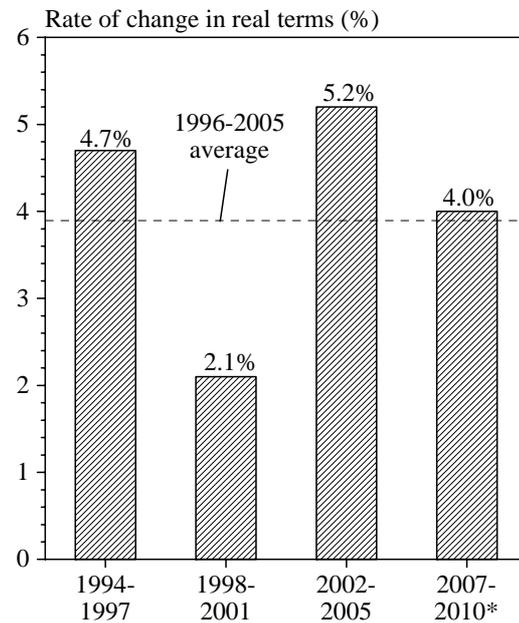
2.24 Co-operation among Hong Kong and other Mainland provinces and cities in the Pan-Pearl River Delta will enhance Hong Kong's role as a gateway and platform for Mainland enterprises to go global and for foreign enterprises to tap the ample resources and opportunities in the Mainland. The Government will also step up efforts to ensure the smooth and effective implementation of the three phases of CEPA to the benefit of Hong Kong enterprises and professionals. The continuous extension of the Individual Visit Scheme will also render further support to Hong Kong's economic growth over the medium term. Overall, Hong Kong will continue to shift towards higher value-added services and knowledge-based economy, riding on increasing economic integration with a rapidly growing Mainland economy. The productivity growth achieved in the process will help the economy attain a 4% trend GDP growth over the next four years 2007-2010.

Diagram 2.13 : Medium-term economic outlook remains bright

(a) Economy to settle back to a more steady growth path



(b) Medium-term outlook underpinned by CEPA and transformation to high value-added services



Note : (*) Forecast.

Note :

- (1) The economic forecasts for Hong Kong's major markets cited in this report are mainly for the purpose of illustration and are not purported to be exhaustive. Economic forecasts from a variety of sources, including the central banks and government departments in the respective economies and certain private sector forecasting agencies, have been taken into account in deriving the forecasts for Hong Kong's exports.

CHAPTER 3 : THE EXTERNAL SECTOR

Summary

- *The external trade turned out another year of spectacular performance in 2005, thanks to the sustained expansion in the global economy and the Mainland's strong trade flows. This was notwithstanding the surge in oil prices, the global interest rate up-cycle, and the strengthening of the US dollar during the year. The robust performance in re-exports also reflected the external competitiveness of Hong Kong as a trade conduit for the Mainland and the region.*
- *Total exports of goods recorded double-digit growth for the third year in a row in 2005, marked by notable increases to such major markets as the Mainland, the EU, Japan and Republic of Korea. Exports to the US recorded a solid growth for 2005 as a whole, though with some ease-back in the fourth quarter.*
- *While re-exports remained the key growth driver, domestic exports showed notable turnaround in the second half of 2005, as some exporters/manufacturers shifted back their clothing production to Hong Kong in the light of the heightened uncertainties over possible safeguarding measures on Mainland's textile and clothing exports by the EU and the US.*
- *Exports of services maintained notable growth throughout 2005. Exports of trade-related services continued to be bolstered by the Mainland's strong trade flows, while exports of travel services maintained appreciable growth along with further expansion of inbound tourism. Exports of finance, business and other services also grew in tandem with the upturn in business activities and a buoyant financial market.*
- *The Sixth WTO Ministerial Conference held in Hong Kong in December 2005 made significant advances and built a platform for completing the current Doha round of multilateral trade negotiations by the end of 2006.*
- *The significance of the Mainland dimension in Hong Kong's external trade has increased markedly over the years, providing ample business opportunities to the Hong Kong economy. To strengthen and capitalise on this development, the Government has been working closely with the Mainland authorities to ensure the smooth and effective implementation of CEPA, as well as to push ahead co-operation under the Pan-PRD framework.*

Visible trade

Total exports of goods

3.1 Notwithstanding the surge in oil prices, return of the global interest rate up-cycle and strengthening of the US dollar during the year, merchandise exports attained another year of robust performance in 2005. *Total exports of goods* (comprising re-exports and domestic exports) recorded double-digit growth for the third year in a row, at 11.4% in real terms⁽¹⁾, following a 15.3% surge in 2004. *Re-exports*⁽²⁾ remained the key growth driver within overall exports, rising by 11.6% in real terms in 2005, after a 16.3% surge in 2004. Strong growth momentum was maintained evenly throughout the four quarters, thanks to the sustained expansion in the global economy and the Mainland's strong trade flows. The robust performance in re-exports also reflected the external competitiveness of Hong Kong as a trade conduit for both the Mainland and the region.

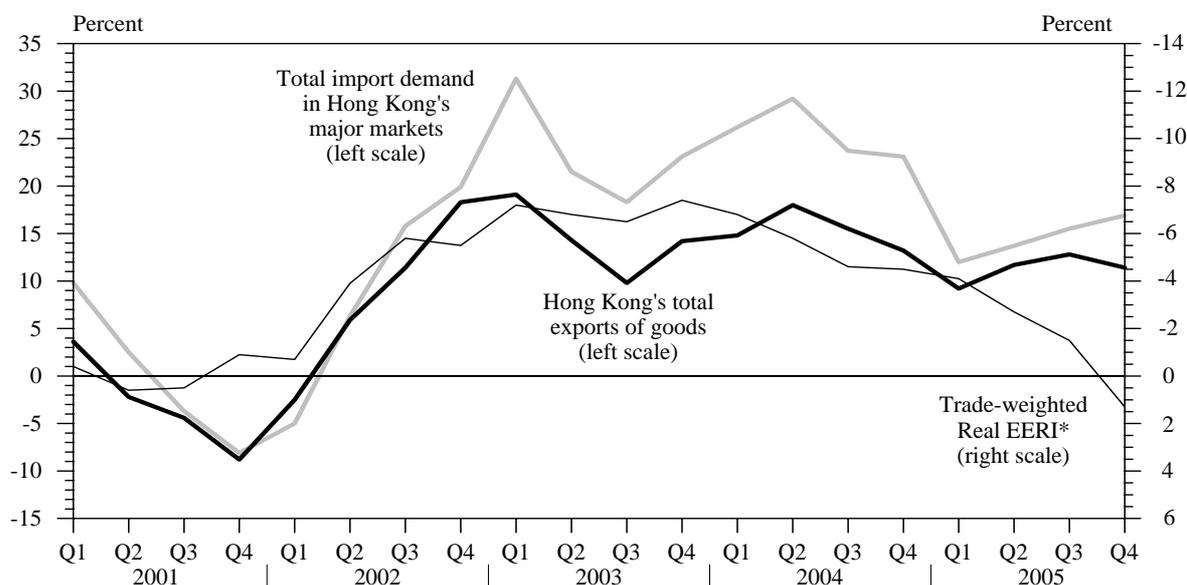
3.2 *Domestic exports* picked up further to a 7.6% growth in real terms in 2005, from a 2.4% growth in 2004. The growth profile over the four quarters was nevertheless very volatile, with marked decreases in the first two quarters followed by a sharp rebound in the ensuing two quarters, as heightened uncertainties over possible safeguard measures on Mainland's textile and clothing (T&C) exports by the US and the EU prompted some shift-back in clothing production to Hong Kong later in the year⁽³⁾. The rise-back in domestic exports was however contributed not only by exports of clothing items, but also by non-clothing items such as office machines, electrical machinery and appliances, and telecommunications equipment. Thus Hong Kong manufacturers seemed to have established certain niches in the international market, despite the relatively high labour cost.

**Table 3.1 : Total exports of goods, re-exports and domestic exports
(year-on-year rate of change (%))**

	<u>Total exports of goods</u>			<u>Re-exports</u>			<u>Domestic exports</u>					
	<u>In value terms</u>	<u>In real terms</u>	<u>Change in prices</u>	<u>In value terms</u>	<u>In real terms</u>	<u>Change in prices</u>	<u>In value terms</u>	<u>In real terms</u>	<u>Change in prices</u>			
2004 Annual	15.9	15.3	1.2	16.8	16.3	1.1	3.5	2.4	1.5			
Q1	13.0	14.8	(3.2)	-0.7	14.0	15.9	(3.4)	-0.8	-0.6	0.7	(0.2)	-0.6
Q2	17.8	18.0	(4.7)	0.5	18.7	19.0	(4.8)	0.5	4.9	5.1	(3.1)	0.2
Q3	17.2	15.5	(1.5)	1.9	18.5	16.8	(1.7)	2.0	0.8	-0.5	(-1.7)	1.8
Q4	15.3	13.2	(3.1)	2.6	15.7	13.8	(3.1)	2.5	8.6	4.8	(2.7)	4.2
2005 Annual	11.4	11.4	1.3	11.7	11.6	1.2	8.0	7.6	2.2			
Q1	10.6	9.2	(0.2)	2.1	11.7	10.4	(0.9)	2.0	-6.9	-9.5	(-11.3)	4.8
Q2	12.5	11.7	(6.0)	1.8	13.8	13.0	(6.1)	1.6	-6.4	-8.3	(4.0)	4.7
Q3	12.5	12.8	(3.0)	1.0	12.4	12.7	(2.0)	1.0	14.0	14.3	(21.7)	1.1
Q4	10.0	11.4	(2.2)	0.4	9.0	10.3	(1.3)	0.5	25.2	28.1	(15.3)	-0.5

Note : Figures in brackets are the seasonally adjusted quarter-to-quarter rates of change.

**Diagram 3.1 : Merchandise exports maintained strong growth throughout 2005, despite fading boost from exchange rate front
(year-on-year rate of change)**

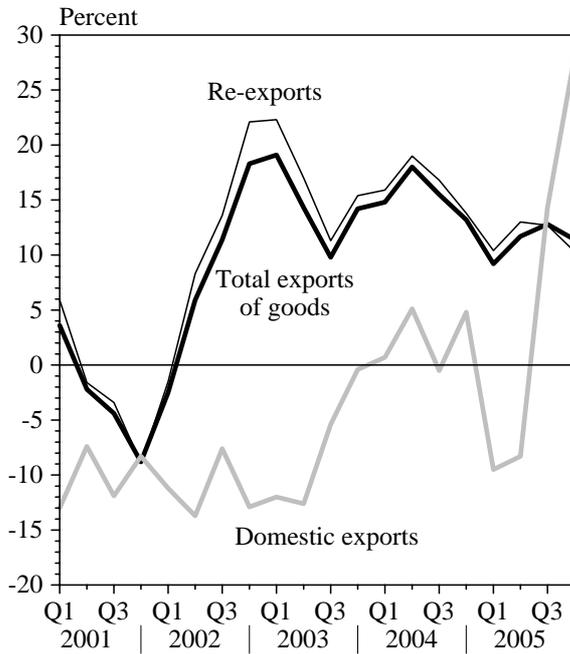


Notes : Total exports of goods as depicted refer to the year-on-year rate of change in real terms, while total import demand in Hong Kong's major markets as depicted refers to the year-on-year rate of change in US dollar terms in the aggregate import demand in East Asia, the United States and the European Union taken together.

(*) For ease of comparison with the rate of change in Hong Kong's total exports of goods, the scale for the Real EERI is presented here upside down, so that positive changes denoting real appreciation of the Hong Kong dollar appear at the lower part and negative changes denoting real depreciation at the upper part of the diagram.

Diagram 3.2 : Re-exports still the growth driver, but domestic exports also rebounded sharply after mid-2005

(a) Year-on-year rate of change in real terms



(b) Seasonally adjusted quarter-to-quarter rate of change in real terms

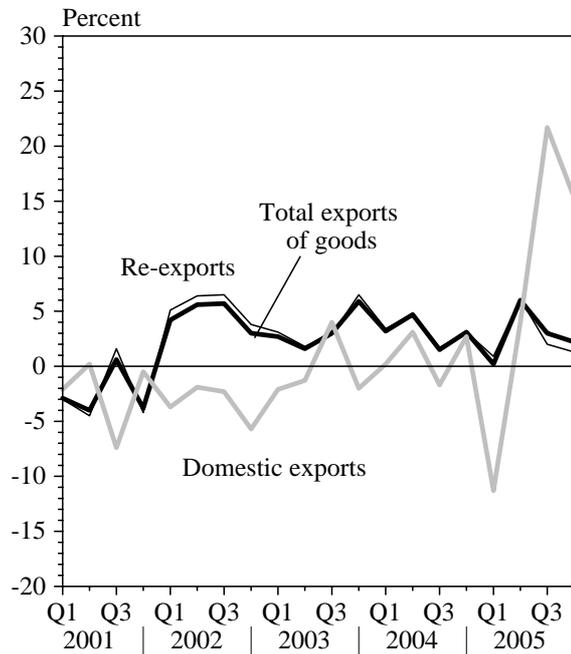
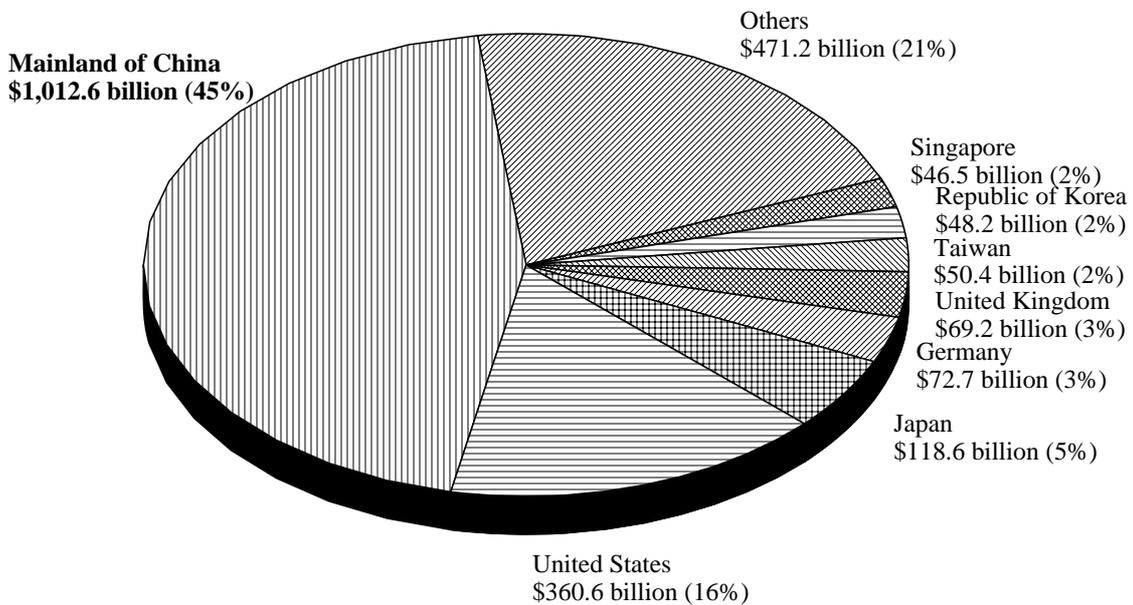


Diagram 3.3 : The Mainland continues to feature prominently in Hong Kong's exports



Total exports of goods in 2005 : \$2,250.2 billion

**Table 3.2 : Total exports of goods by major market
(year-on-year rate of change in real terms (%))**

		<u>Mainland of China</u>	<u>United States</u>	<u>Japan</u>	<u>United Kingdom</u>	<u>Germany</u>	<u>Taiwan</u>	<u>Singapore</u>	<u>Republic of Korea</u>
2004	Annual	17.8	5.3	14.2	14.8	12.0	17.9	24.0	25.1
	Q1	17.0	4.6	10.9	13.8	7.9	26.2	31.1	33.2
	Q2	21.4	7.2	17.4	13.3	16.9	27.0	30.1	27.5
	Q3	19.9	4.1	13.6	14.5	12.0	14.3	20.9	23.1
	Q4	13.4	5.6	14.9	17.1	11.4	7.1	16.8	18.1
2005	Annual	14.2	5.5	9.6	5.4	14.8	4.1	9.0	10.8
	Q1	9.9	5.1	11.5	11.9	18.2	-5.4	15.7	5.4
	Q2	13.3	7.6	10.8	9.4	15.1	4.8	14.5	5.4
	Q3	14.9	8.4	11.1	2.0	12.9	8.4	0.8	12.7
	Q4	17.9	0.9	5.6	1.1	13.6	8.2	6.6	19.0

3.3 Analysed by market, exports to the Mainland sustained double-digit growth for the fourth year in a row, in tandem with the Mainland's booming external trade as well as its robust domestic demand. Exports to Japan also recorded another year of robust growth in 2005, though with some ease-back in the fourth quarter, conceivably affected by the weakening of the yen during the year. Exports to other East Asian markets on the whole grew solidly in 2005. Exports to South Korea regained strong momentum in the second half of 2005, those to Taiwan also fared much better in the second half than in the first, and those to Singapore showed some pick-up in the fourth quarter after a relapse in the third quarter. These developments reflected in part the recovery in global demand for IT products in the latter part of the year. Mainly reflecting the increasing penetration of Mainland's products into the EU market, as well as stronger import demand there, exports to the EU showed double-digit growth throughout 2005. Among the major EU economies, the strong growth in exports to Germany, Netherlands and France helped offset the moderation in exports to the UK. Exports to the US attained solid growth during most of 2005, supported by the fairly strong US economy but also boosted somewhat by rush shipments of T&C exports in the first few months of the year. Yet along with the ease-back in US import demand towards the end of the year, and also as the rush in T&C shipments subsequently subsided, exports to the US slackened considerably in the fourth quarter.

Imports of goods

3.4 *Imports of goods* grew notably further, by 8.5% in real terms in 2005, following a 14.1% strong increase in 2004. While import intake for subsequent re-exporting surged throughout the year, growth in retained imports also picked up progressively along with the increasingly entrenched economic recovery. *Retained imports* edged up by 0.8% in real terms in 2005, as the decline in the first half of 2005 was more than offset by the increase in the second half of the year. In particular, retained imports of capital goods surged during most of the year, particularly so towards the year-end, as many companies replenished or upgraded their machinery and equipment to cater for the expansion of production capacity and efficiency improvement. Retained imports of consumer goods also resumed notable growth in late 2005, conceivably prompted by the need to replenish stock after several quarters of drawdown. On the other hand, retained imports of raw materials and semi-manufactures recorded a moderate decrease, mainly due to the distinct fall in intake of electronic parts and components earlier in the year.

**Table 3.3 : Imports of goods and retained imports
(year-on-year rate of change (%))**

		<u>Imports of goods</u>			<u>Retained imports</u> ^(a)				
		<u>In value terms</u>	<u>In real terms</u>	<u>Change in prices</u>	<u>In value terms</u>	<u>In real terms</u>	<u>Change in prices</u>		
2004	Annual	16.9	14.1	2.9	14.8	8.9	6.0		
	Q1	15.7	15.5	(4.4)	0.7	18.1	14.8	(6.5)	2.7
	Q2	22.1	19.8	(3.3)	2.3	29.5	21.8	(-0.3)	5.4
	Q3	18.4	14.2	(-1.1)	4.0	15.6	7.8	(-7.7)	8.4
	Q4	11.9	7.8	(1.4)	4.3	-0.8	-6.0	(-3.0)	8.1
2005	Annual	10.3	8.5	2.7	6.5	0.8	7.6		
	Q1	8.1	4.4	(1.6)	4.0	-1.4	-8.6	(3.4)	10.3
	Q2	10.1	7.6	(5.2)	3.3	0.4	-4.8	(2.6)	8.8
	Q3	11.5	10.4	(1.6)	2.3	8.8	4.1	(0.6)	6.4
	Q4	11.3	11.0	(2.6)	1.6	18.6	13.0	(6.4)	4.5

Notes : Figures in brackets are the seasonally adjusted quarter-to-quarter rates of change.

- (a) Based on the results of the Annual Survey of Re-export Trade conducted by the Census and Statistics Department, re-export margins by individual end-use category are estimated and adopted for deriving the value of imports retained for use in Hong Kong.

Diagram 3.4 : Total imports picked up during the year as import intake for local use strengthened

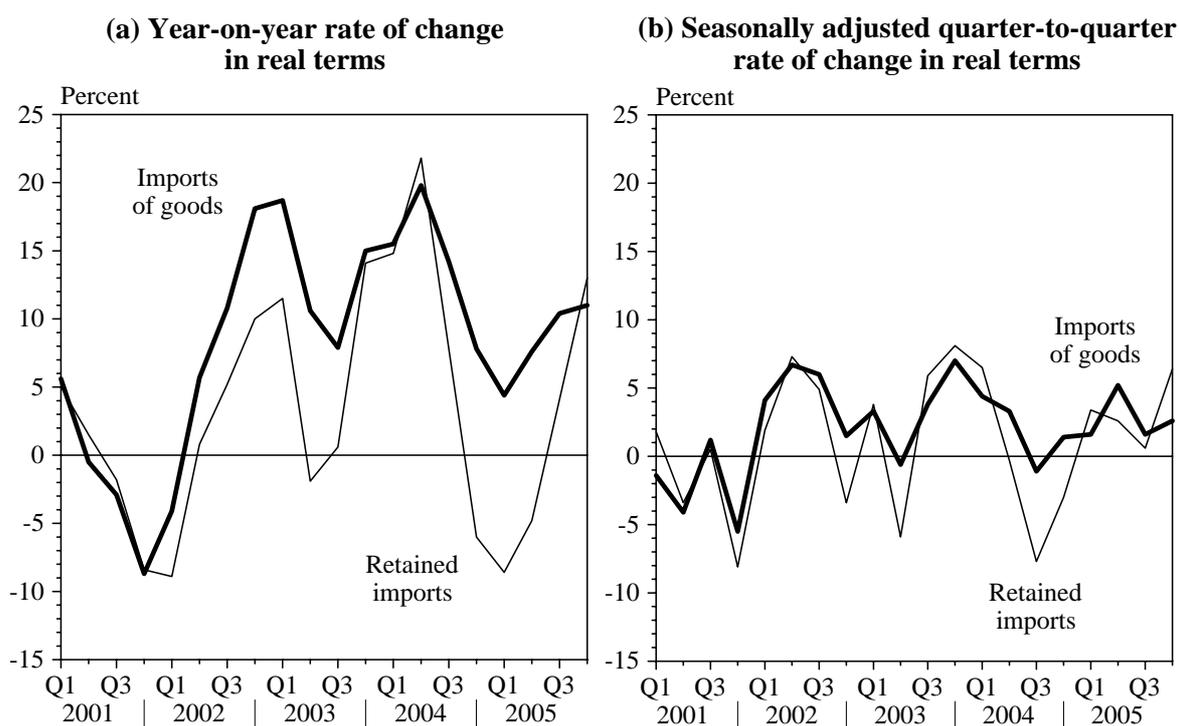


Table 3.4 : Retained imports by end-use category (year-on-year rate of change in real terms (%))

		Consumer goods	Foodstuffs	Capital goods	Raw materials and semi-manufactures	Fuels
2004	Annual	3.0	5.8	13.1	8.0	8.3
	Q1	2.2	7.1	17.8	22.1	9.1
	Q2	21.6	19.6	25.6	15.6	23.7
	Q3	-1.1	5.0	14.8	6.9	4.7
	Q4	-8.5	-4.7	-2.5	-9.5	-1.5
2005	Annual	-4.9	1.8	15.8	-7.5	-6.0
	Q1	-6.7	-1.5	1.5	-19.5	-1.1
	Q2	-22.6	0.7	16.3	-8.8	-10.9
	Q3	-1.2	3.3	10.9	0.9	-1.4
	Q4	13.7	4.5	34.9	-1.4	-10.4

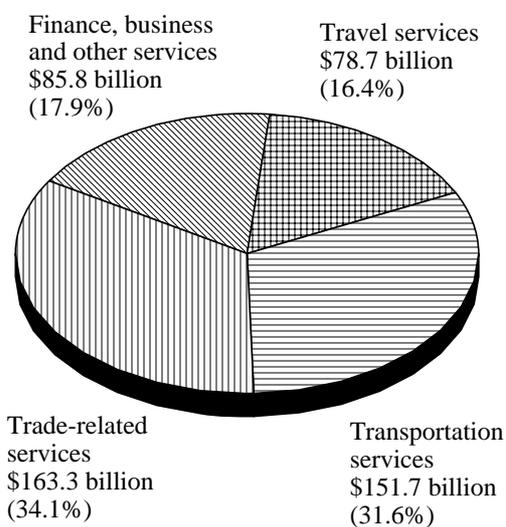
Invisible trade

Exports of services

3.5 *Exports of services* grew distinctly further, by 8.4% in real terms in 2005, following a strong increase of 17.9% in 2004. Exports of trade-related services, including notably the offshore trade, were boosted by the Mainland's strong trade flows. Exports of travel services also attained an appreciable

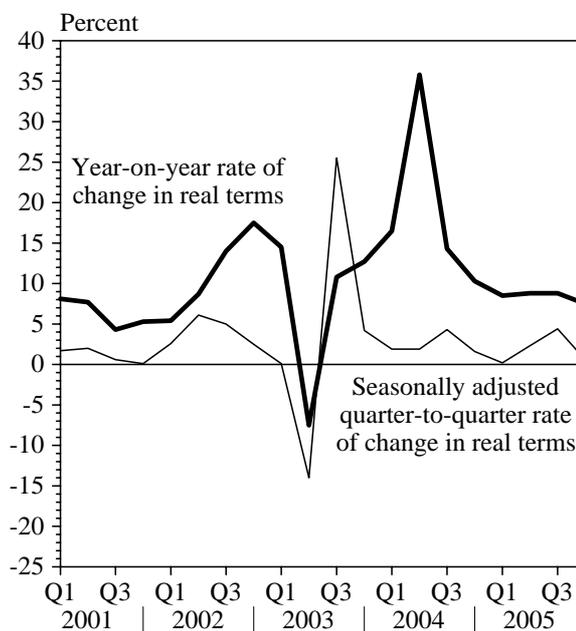
increase, albeit at a less rapid pace than in 2004, along with the further expansion of inbound tourism. The number of incoming visitors hit a new high of 23.4 million in 2005. Particularly noteworthy is that the number of long-haul visitors, who usually have higher per capita spending and longer length of stay, showed a more notable increase in 2005. Robust external trade coupled with the growth in inbound tourism likewise benefited exports of transportation services. Continued upturn in business activities, together with a buoyant financial market, also rendered firm support to exports of finance, business and other services.

Diagram 3.5 : Trade-related and transportation services accounting for around two-thirds of service exports, reflecting the important role of Hong Kong as a trading hub



Exports of services in 2005 : \$479.5 billion

Diagram 3.6 : Exports of services rising in tandem with robust external trade and still vibrant inbound tourism



**Table 3.5 : Exports of services by major service group
(year-on-year rate of change in real terms (%))**

Of which :

		<u>Exports of services</u>		<u>Trade-related services^(a)</u>	<u>Transportation services</u>	<u>Travel services^(b)</u>	<u>Finance, business and other services</u>
2004	Annual	17.9		14.4	19.1	19.2	21.5
	Q1	16.5	(2.0)	16.4	15.0	11.1	22.5
	Q2	35.8	(1.9)	19.8	34.1	152.0	23.4
	Q3	14.4	(4.4)	12.7	18.6	3.3	20.8
	Q4	10.3	(1.5)	11.3	11.4	-4.7	19.7
2005	Annual	8.4		12.6	6.3	7.3	4.9
	Q1	8.5	(0.2)	11.3	5.3	10.2	7.2
	Q2	8.8	(2.3)	14.9	7.0	6.3	4.0
	Q3	8.7	(4.3)	12.2	6.6	6.9	6.0
	Q4	7.7	(0.8)	12.2	6.0	5.8	2.4

Notes : Figures in brackets are the seasonally adjusted quarter-to-quarter rates of change.

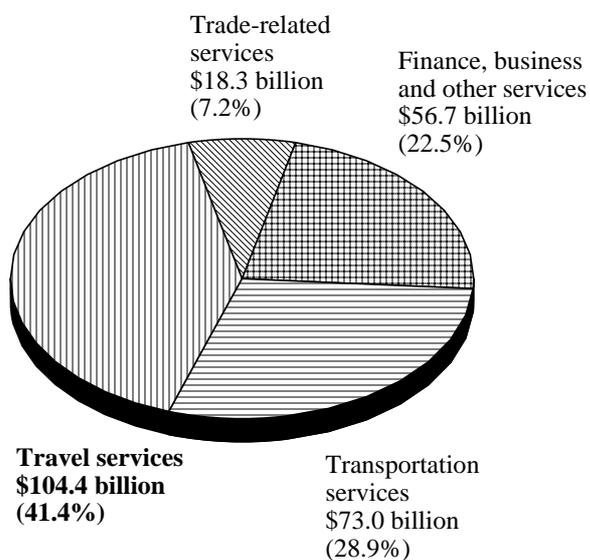
(a) Comprising mainly offshore trade.

(b) Comprising mainly inbound tourism receipts.

Imports of services

3.6 *Imports of services* rose solidly by 2.8% in real terms in 2005, having surged by 14.6% in 2004. Imports of travel services showed a marginal decline in 2005, reflecting the more moderate increase in the number of residents traveling abroad. In contrast, imports of trade-related services and of transportation services rose more noticeably, in tandem with the strong trade flows in the period. Imports of finance, business and other services also grew solidly amidst the continued upturn in business activities and a more active financial market.

Diagram 3.7 : Travel services is the largest component in imports of services



Imports of services in 2005 : \$252.4 billion

Diagram 3.8 : Imports of services rose solidly further in 2005 following the surge in 2004

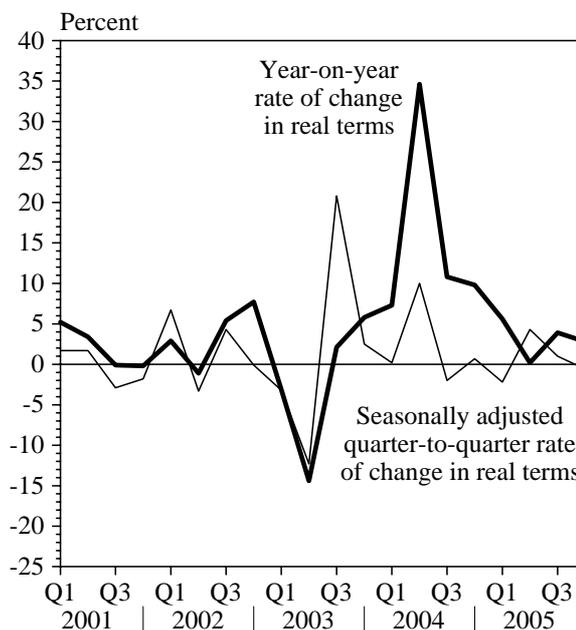


Table 3.6 : Imports of services by major service group (year-on-year rate of change in real terms (%))

		<i>Of which :</i>				
		Imports of services	Travel services ⁽⁺⁾	Transportation services	Trade-related services	Finance, business and other services
2004	Annual	14.6	10.6	24.5	0.1	16.7
	Q1	7.3 (*)	-2.1	19.3	1.8	16.1
	Q2	34.6 (10.0)	45.0	44.6	4.7	17.7
	Q3	10.8 (-2.2)	4.0	22.1	-1.4	17.6
	Q4	9.8 (1.0)	5.8	16.3	-2.7	15.4
2005	Annual	2.8	-0.4	5.4	7.7	3.9
	Q1	5.6 (-2.5)	5.7	6.9	6.5	3.8
	Q2	0.3 (4.4)	-6.9	5.7	10.0	4.8
	Q3	3.8 (0.8)	0.3	6.7	7.4	5.9
	Q4	1.4 (-1.4)	-0.4	2.3	7.4	1.2

Notes : Figures in brackets are the seasonally adjusted quarter-to-quarter rates of change.

(+) Comprising mainly outbound travel spending.

(*) Change of less than 0.05%.

Visible and invisible trade balance

3.7 Thanks to robust trade growth in the year, the surplus in the combined visible and invisible trade balance expanded sharply further to \$167.8 billion in 2005, equivalent to 6.5% of the total value of imports of goods and services, up from the corresponding figures of \$114.5 billion and 4.9% in 2004. This marked the fourth consecutive year of rising trade surplus, a reflection of the strength of Hong Kong's external competitiveness, especially in trade in services, whilst also providing strong impetus to Hong Kong's economic growth and employment over the past few years.

**Table 3.7 : Visible and invisible trade balance
(\$ billion at current market prices)**

		<u>Total exports</u>		<u>Imports</u>		<u>Trade balance</u>		
		<u>Goods</u>	<u>Services</u>	<u>Goods</u>	<u>Services</u>	<u>Goods</u>	<u>Services</u>	<u>Combined</u>
2004	Annual	2,027.0	429.6	2,099.5	242.5	-72.5	187.1	114.5
	Q1	434.4	98.4	467.2	55.3	-32.8	43.1	10.3
	Q2	497.9	97.9	527.3	58.0	-29.4	39.8	10.4
	Q3	546.7	114.6	555.2	65.2	-8.5	49.4	40.9
	Q4	548.0	118.8	549.7	64.0	-1.8	54.7	53.0
2005	Annual	2,251.7	479.5	2,311.1	252.4	-59.3	227.1	167.8
	Q1	479.1	109.5	498.8	59.9	-19.7	49.6	30.0
	Q2	555.4	109.6	575.0	59.6	-19.6	50.0	30.4
	Q3	614.6	128.5	621.6	68.3	-6.9	60.2	53.3
	Q4	602.7	131.9	615.8	64.6	-13.1	67.3	54.2

Note : Figures may not add up exactly to the total due to rounding.

Trade policy and other developments

Promoting free trade in the international arena

3.8 As a small open economy, the external sector has played an important and substantive role in Hong Kong's economic development. Hong Kong's pro-market economic policy, particularly manifested in the free flows of goods and services, has contributed significantly to the vibrancy of the external sector. On this belief, the HKSAR government has strived to facilitate commerce and industry within the framework of a free market and plays a pivotal role in promoting free trade in the international arena.

3.9 Exemplifying this mandate, Hong Kong successfully held the Sixth Session of the WTO Ministerial Conference on 13-18 December 2005. The Conference made significant advances and built a platform for completing the current Doha round of multilateral trade negotiations by the end of 2006⁽⁴⁾. The agreement reached marked a big step forward in promoting global trade liberalisation, in which the increase in efficiency and productivity so obtained would benefit all nations in the long term. The economic benefits so attained will particularly be tremendous for free trading economies like Hong Kong.

Co-operation with the Mainland under CEPA

3.10 The significance of the Mainland dimension in Hong Kong's external sector has increased markedly over the past two decades. In order to capitalise on the enormous business opportunities stemming from the Mainland's rapid economic development, various initiatives are taken by the Government to strengthen economic relations between Hong Kong and the Mainland. On 1 January 2006, liberalisation measures under the third phase of the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA III) began to take effect. The additional measures⁽⁵⁾, on top of the substantial measures provided under CEPA I and II, offer new business opportunities on the Mainland for Hong Kong enterprises and professionals and enhance Hong Kong's attractiveness to overseas investors.

3.11 As at end-January 2006, the Trade and Industry Department (TID) and five Government Approved Certificate Organisations issued 10 750 certificates of Hong Kong origin (CEPA) to goods produced in Hong Kong, involving a total of \$3.74 billion worth of goods. TID also approved 924 applications for certificates of Hong Kong service supplier. The Government will continue to work closely with the Mainland authorities to ensure the smooth and effective implementation of CEPA, and make use of the standing consultation mechanism of CEPA to discuss with the Mainland authorities on further trade liberalisation and additional market access opportunities for Hong Kong goods and services.

Pan-PRD co-operation

3.12 The Government will also continue to push ahead co-operation under the Pan-PRD framework. In late December 2005, the Chief Executive indicated that the Central People's Government had accepted the recommendation to extend the Individual Visit Scheme to cover all the capital cities in the nine provinces of Pan-PRD, and implementation is expected to take place in May 2006⁽⁶⁾. On cross-boundary infrastructure, the Hong Kong-Shenzhen Western

Corridor and the Sheung Shui - Lok Ma Chau Spur Line are expected to be completed by end-2006 and mid-2007 respectively. Construction work on the Guangzhou-Shenzhen section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link has commenced in December 2005, while detailed study on the Shenzhen-Hong Kong section is underway. Meanwhile, preliminary planning work on construction of the Hong Kong-Zhuhai-Macau Bridge also proceeds steadily. The HKSAR government will also strengthen its representation in the Mainland, including broadening geographical coverage of the Guangdong Economic and Trade Office and the setting up of new offices in Shanghai and Chengdu.

Notes :

- (1) Estimates of price changes for the trade aggregates are based on changes in unit values, which do not take into account changes in the composition or quality of the goods traded, except for some selected commodities for which specific price indices are available. Changes in real terms are derived by discounting the effect of price changes from changes in the value of the trade aggregates.
- (2) Re-exports are those goods which have previously been imported into Hong Kong and are subsequently exported without having undergone in Hong Kong any manufacturing processes which change permanently the shape, nature, form or utility of the goods.
- (3) Following the removal of textile and clothing (T&C) quota among WTO members on 1 January 2005, the surge in T&C exports from the Mainland to the EU and the US had triggered the imposition of anti-surge safeguards on the Mainland's exports by both the EU and the US. On 11 June, the Mainland and the EU reached an agreement over Mainland's T&C exports. Under the agreement, the Mainland will restrict growth of 10 categories of its T&C exports to 8-12.5% annually from 2005 to 2007. In return, EU undertakes to exercise restraint in the application of the textiles-specific safeguard actions in other T&C categories till end-2007, and for all T&C products in 2008.

On 8 November, China and the US reached an agreement on China's exports of textile and clothing (T&C) products to the US. The agreement sets the growth rates for 21 categories of T&C products at 10-15% in 2006, 12.5-16% in 2007 and 15-17% in 2008. In return, the US undertook to exercise restraints in application of safeguard measures on other T&C categories not covered in the agreement.

In the light of the surge in China's T&C exports to the EU and the US in the first half of 2005, most of the quotas on the restrained items had reportedly been used up by mid-2005.

- (4) Major agreements made in the Conference include: (i) Agricultural export subsidies will be eliminated by 2013. (ii) All forms of export subsidies for cotton will be eliminated by developed countries in 2006. (iii) Least-developed countries will be guaranteed duty-free and quota-free access for most of their exports from 2008.

- (5) The Mainland gives tariff free treatment to all products of Hong Kong origin starting from 1 January 2006, upon application by local manufacturers and upon the CEPA origin rules being agreed and met. On trade in services, 23 new liberalisation measures spreading across ten sectors are introduced.
- (6) At end-2005, the Individual Visit Scheme has been implemented in 38 Mainland cities, amongst which 25 cities are located within the Pan-PRD region.

CHAPTER 4 : DEVELOPMENTS IN SELECTED SECTORS

Summary

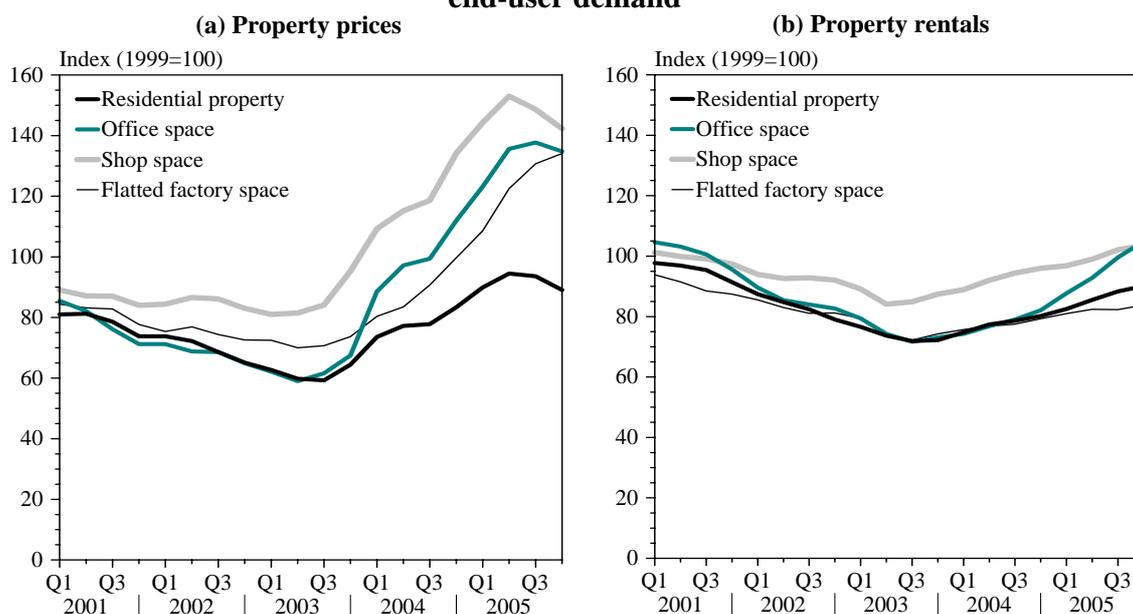
- *The property market experienced a distinct consolidation upon progressive interest rate rises in the second half of 2005, following buoyancy for more than a year. Yet as market fundamentals stayed positive, prices for different types of properties increased by varying degree for 2005 as a whole. Amidst cautious market climate, property developers generally turned more prudent in land acquisition in recent months.*
- *The new franchised bus fare adjustment arrangement effective in January 2006, and the on-going electricity market review, seek to reinforce the regulatory arrangements that enable safe, reliable and efficient provisions of the services concerned at reasonable prices while minimising the impact on environment.*
- *Inbound tourism made another new height in 2005 with more than 23 million incoming visitors, on the back of robust performance of most long-haul and Asian markets. Apart from visitors for vacation and friends/relatives visit, business travellers grew steadily.*
- *Hong Kong's tourism and transport sectors have been benefiting from the Mainland's vibrant inbound tourism in recent years, since lots of travellers to the Mainland use Hong Kong as the gateway with some making a stay in the city. While the advancement of airport facilities in the Mainland has reduced its reliance on our connection services, it helps accommodate a larger number of visitors from which Hong Kong stands to benefit.*
- *The logistics sector in overall terms continued to fare well in 2005, particularly for activities related to air freight. Port cargo movements also expanded further, albeit at a mild pace.*
- *A study commissioned by the Government shows that Hong Kong generally possesses a favourable environment for creativity to flourish and contribute to economic activities. Apart from on-going promotion of technological and innovation activities, a liberal policy towards entry into Hong Kong for employment is amongst the major underpinning factors. To attract more talents around the globe, the Government is considering introducing a more proactive admission scheme for quality immigrants by mid-2006.*

Property

4.1 The property market continued to flourish alongside further economic upturn in the first half of 2005, but experienced a distinct consolidation upon progressive interest rate hikes in the second half. Both sales activities and transacted prices eased off visibly from the earlier peaks, following buoyancy for more than a year. Yet as market fundamentals stayed positive, prices for different types of properties still increased by varying degree for 2005 as a whole. Meanwhile, the leasing market improved steadily across the board amidst solid end-user demand.

4.2 In the sales market for *residential property*, transaction volume and flat prices rose to 7½-year and 5-year highs respectively in the second quarter of 2005. Market sentiment continued to be underpinned by the sanguine economic outlook, improving employment situation, and low interest rate environment prevailing then. Yet acquisition interest cooled off subsequently as the rise in best lending rates by major banks accelerated, bringing a cumulative total of 2.75-3 percentage points for the whole year. Against this backdrop, trading in both the primary and secondary markets retreated. Flat prices came down concurrently, with more visible reduction for small and medium-sized flats. This notwithstanding, overall flat prices in the fourth quarter of 2005 were still 7% higher than a year earlier. During the same period, flat rentals increased steadily by 12%, along with progressive improvement in leasing demand.

Diagram 4.1 : Overall property prices easing back in the second half of 2005 upon successive interest rate rises, yet rentals rising steadily with solid end-user demand



4.3 On *non-residential properties*, market sentiment likewise showed a turnaround since mid-2005 under the influence of higher interest rates, yet the resultant moderation pressure was relatively modest. While prices of *shopping space* eased back somewhat, prices of *office space* held firm. The distinct uptrend in rentals of office space especially the A-graded premises, together with expectation of limited new supply in prime locations in the near future, supported vendors' confidence. Prices of *flatted factory space* even rose further as investment demand continued to be buoyed by high rental yields and desire to convert the premises into other commercial uses. Compared with a year earlier, prices of flatted factory space and office space surged by 35% and 20% respectively in the fourth quarter of 2005, while prices of shopping space rose by 6%. As leasing demand continued to strengthen extensively along with general pick-up in business activities, rentals of office space, shopping space and flatted factory space all moved up, by 28%, 8% and 6% respectively year-on-year in the fourth quarter of 2005.

Diagram 4.2 : Property transactions losing steam after mid-2005 amidst more cautious sentiment

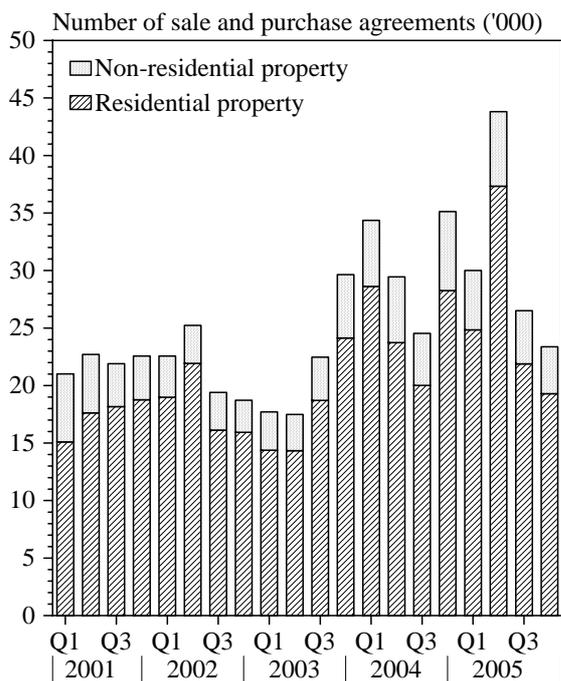
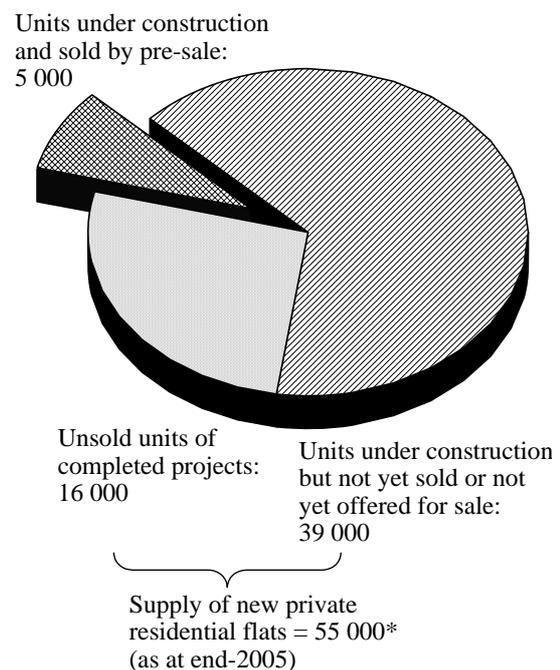


Diagram 4.3 : Supply of new private residential flats in the pipeline still substantial

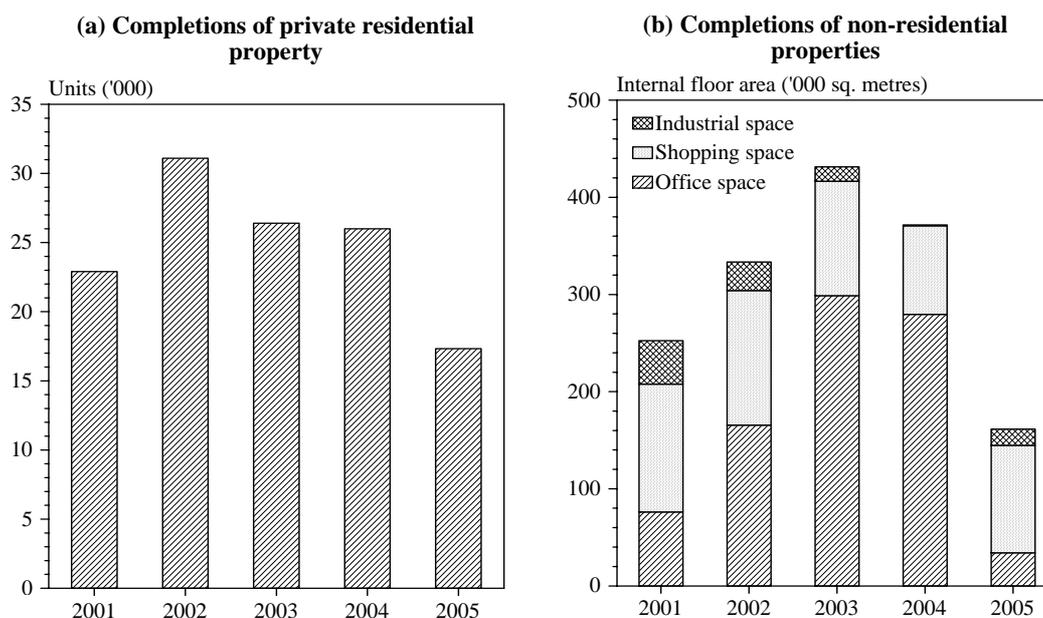


Note : (*) This figure does not include 12 000 units from disposed sites where construction has yet to start.

4.4 On the supply of new property, *completions* of private residential property shrank by 33% to 17 300 units in 2005. The reduction was larger than expected, conceivably due in part to postponement of sales projects for completed flats by developers near the year-end. Taking into account the unsold units of completed projects and units under construction not yet sold or

not yet offered for sale, the supply of new private residential flats totalled 55 000 units at end-2005, 2.5 times the average annual primary sales of private residential flats during 2001-2005. Regarding non-residential properties, completions likewise showed a larger-than-expected drop, by 57% in 2005, with the decrease for office space outweighing increases for shopping and industrial spaces.

Diagram 4.4 : Property completions declining further in 2005 under the lagged impact of slack building activities in the earlier years



4.5 In line with the Government's repositioned housing policy implemented since November 2002, the Housing Authority had looked into the arrangements for disposal of some 16 600 surplus flats under the Home Ownership Scheme (HOS) from 2007 onwards⁽¹⁾. In January 2006, the Subsidized Housing Committee of the Housing Authority approved that the surplus HOS flats would be put up for sale in two phases per year starting from 2007 with around 2000-3000 flats per phase, and that all the surplus flats would be launched for sale within three to four years. Since about 80% of the flats would be offered to Green Form applicants comprising sitting tenants and applicants with established eligibility for allocation of public rental housing units, and the surplus flats are planned for release in phases, the impact on the private residential property market should not be significant. The policy of indefinitely ceasing production and sale of HOS flats remains unchanged.

Land

4.6 In 2005, one commercial site of 0.47 hectare and three residential sites totalling 2.80 hectares were successfully triggered by developers for sale from

the Application List. Responses to the land auction for the commercial site held in February and that for the residential sites in September were favourable, with prices fetched exceeding the trigger prices by 53-70%. However, there was no application for land under the Application List in the fourth quarter of 2005 as developers turned more prudent recently.

4.7 Completions of new railway projects in recent years have made more railway sites available for property development. In 2005, tenders for a site of 1.4 hectares in the MTR Tseung Kwan O Depot Area and another site of 3.4 hectares above KCR Wu Kai Sha Station were awarded for residential property development. In January 2006, another site of 3.2 hectares in the MTR Tseung Kwan O Depot Area was also awarded. For the years ahead, more sites along the KCR West Rail and Ma On Shan Extension and in the MTR Tseung Kwan O Depot Area are expected to come on stream. Regarding modification of lease on existing developed and developable land and exchange of land in the private sector domain, 17 sites totalling 11.5 hectares and three sites totalling 1.2 hectares were approved for private residential and non-residential property developments respectively in 2005.

Public utilities and public transport

4.8 Most of the public utilities and public transport services are regulated by the Government for ensuring safe, reliable, efficient and environment-friendly services at reasonable prices. In preparing for the new regulatory arrangements after expiry of the current Scheme of Control Agreements between the Government and the two power companies in late 2008, the Government further consulted the public through the Stage II Consultation Paper issued on 30 December 2005. The Paper proposes a series of new measures which seek to, *inter alia*, determine the permitted rates of return, strengthen emission controls and prepare the ground for further opening of the electricity market in the longer future⁽²⁾.

4.9 On 10 January 2006, the Government announced its decision to introduce a new franchised bus fare adjustment arrangement with immediate effect⁽³⁾. Its major objectives are to facilitate adjustment of franchised bus fares upwards and downwards for better reflecting the prevailing economic condition and to improve objectivity of fare adjustment process. It is expected that the new arrangement will help ensure affordable high-quality franchised bus services and foster labour mobility across different areas of Hong Kong to the benefit of the city. The Government announced on the same day its decision to grant new franchises of around 10 years to three existing franchised

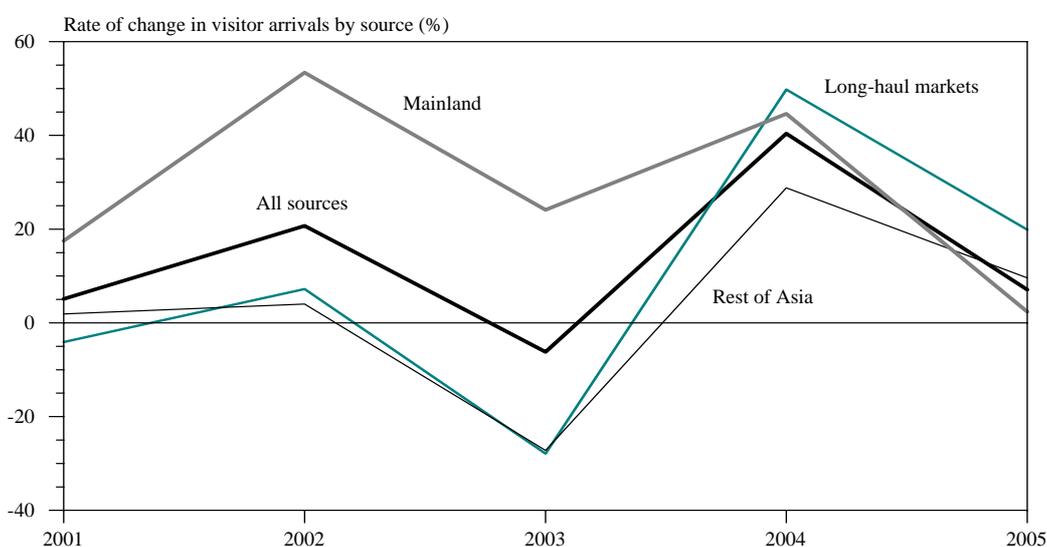
bus companies. Amongst the new and modified provisions in the new franchises to reinforce monitoring arrangements, there are additional provisions to reflect the new franchised bus fare adjustment arrangement.

Tourism

4.10 Inbound tourism registered further growth in 2005, with the number of *incoming visitors* increasing by 7% to a new record high of 23.4 million. This followed a phenomenal rise of 40% in 2004 under the base impact of SARS. The year-on-year growth was relatively faster in the first half of 2005 than the second half, but this was largely due to the base impact stemming from the sharper rise in visitor arrivals under the Individual Visit Scheme (IVS) at its earlier implementation stage.

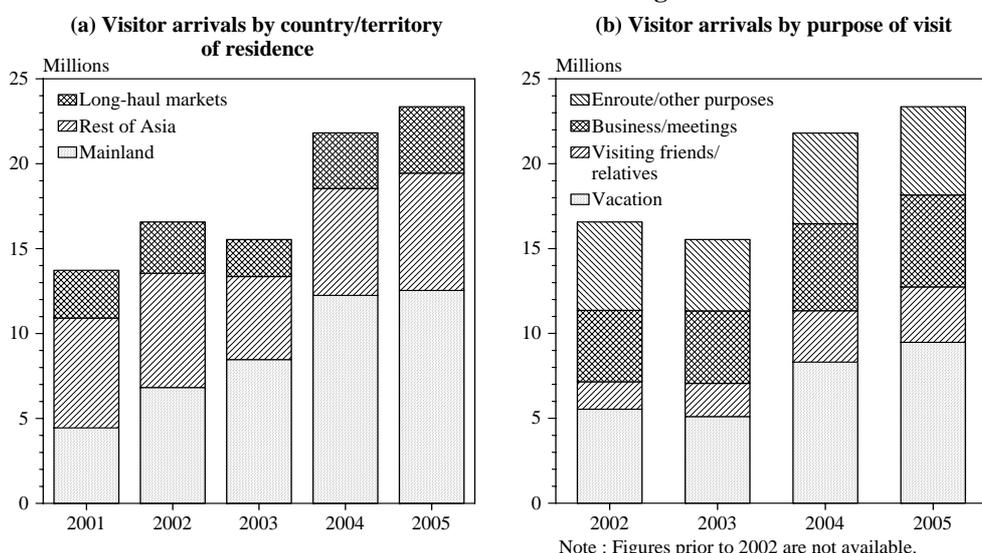
4.11 Analysed by market, double-digit increases were recorded for a majority of long-haul and Asian markets in 2005. Global economic growth, expansion in air connectivity of Hong Kong with the rest of the world, intense airfare competition, and attractions from Hong Kong's new tourism facilities and promotion campaigns contributed. Besides, Hong Kong continued to benefit from the robust performance of inbound tourism in the Mainland as more visitors also travelled to Hong Kong in their trips to the Mainland (see **Box 4.1** for details). Regarding Mainland arrivals that shared 54% of the total, there was a moderated growth of 2% in 2005, following hectic increases for several years. This matched with the deceleration in growth of the Mainland's outbound tourism concurrently.

Diagram 4.5 : Visitor arrivals settling at slower yet solid growth in 2005 as the base impact of SARS almost dissipated



4.12 Consequential to the IVS implementation, the proportion of visitors for vacation and visits to friends/relatives picked up further from 52% in 2004 to 55% in 2005. Meanwhile, the share of business travellers was maintained at around 23%, as the number involved grew steadily. An important source of growth stemmed from non-domestic convention and exhibition participants who surged further by 10% to 336 000 in the first nine months of 2005, equivalent to almost 10% of total business visitor arrivals. Consequential to opening of the AsiaWorld-Expo in December 2005, the convention and exhibition facilities have been markedly expanded. This can be expected to attract more convention and exhibition visitors, benefiting not only the tourism sector but also the economy at large by giving rise to business opportunities and connections, and raising Hong Kong's profile as an international city.

Diagram 4.6 : Long-haul and vacation visitors outperforming behind the scene of broad-based growth



4.13 In recent years, the tourism industry in Asia as a whole thrived in terms of both intra-regional and inter-regional visits. According to the Pacific Asia Travel Association, visitor arrivals in Asia grew by an average of 8% per annum over 2000 to 217 million in 2004. This provided vast market opportunities for the major tourist destinations in Asia including Hong Kong, and concurrently triggered keener competition amongst them. The competition pressure facing Hong Kong is also poised to intensify as the outbound tour regulation by the Mainland authorities has been progressively relaxed⁽⁴⁾.

4.14 Apart from strengthening tourist infrastructures⁽⁵⁾, launching promotion campaigns of various themes and upgrading service quality, Hong Kong's competitiveness as a tourist destination also lies with our world-class external transport network that induces visitors to include the city in their itineraries. On-going efforts have been devoted by the Government to

preserve Hong Kong's leading position as a transport hub that serves as the gateway between the Mainland and rest of the world. At end-2005, there were about 5 200 scheduled flights per week between Hong Kong and about 140 destinations of which 37 were in the Mainland. These were all expanded from the corresponding figures of 4 600, 130 and 35 at end-2004.

Box 4.1

Benefits to Hong Kong stemming from vibrant inbound tourism in the Mainland*

The Mainland is an increasingly pre-eminent destination in Asia for visitors around the globe. Compared with 1999, total number of inbound visitors (excluding Hong Kong and Macao residents) to the Mainland leaped by an average of 13% to 20.6 million in 2004. In the first ten months of 2005, there was a further surge of 21% over a year earlier.

Hong Kong's tourism sector has been benefiting from the growth of the Mainland's inbound tourism, as lots of travellers tie Hong Kong with the Mainland destinations in their itineraries for three major reasons. *First*, Hong Kong is conveniently located in South China and provides easy access to the Mainland, especially the Guangdong Province that hosts about one-third of total inbound visitors (excluding Hong Kong and Macao residents) to the Mainland. *Second*, attractions of Hong Kong are quite unique as compared to many destinations in the Mainland so that they are often packed in one trip. *Third*, Hong Kong with its world-class external transport facilities and connectivity provides an efficient gateway for travellers to the Mainland.

Comparing 2005 with 2002, the proportion of overnight visitors (excluding the Mainland and Macao residents) to Hong Kong who also visited the Mainland rose from 38% to around 45%. The corresponding proportion for long-haul visitors even reached 50-60% in 2005.

Overnight visitors to Hong Kong who also include the Mainland in their itineraries

<u>Country/territory of residence</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005[#]</u>
	(% share in overnight visitors from the sources concerned)			
All (except the Mainland and Macao)	38	36	42	45
Americas	52	48	56	60
Europe, Africa and Middle East	42	40	46	50
Rest of Asia	34	32	36	37

Notes : Figures prior to 2002 and for same-day visitors are not available.
(#) Provisional estimates.

Source : Hong Kong Tourism Board.

Note : (*) Inbound tourism in the Mainland does not cover visits by Hong Kong and Macao residents for the purpose of analysis in this article.

Box 4.1 (cont'd)

Transport is another sector benefiting from the Mainland's inbound tourism through the use of our connection services. Apart from serving those visitors who stay in Hong Kong, Hong Kong International Airport (HKIA) provides air transfer/transit services in connection with the Mainland and other modes of transport in connection with Pearl River Delta (PRD). In recent years, the passenger movements for all these services showed appreciable rises.

HKIA's transfer/transit passenger movements in connection with the Mainland

<u>Mode of transport</u>	<u>Average annual growth (%)</u>
Transfer/transit in connection with the Mainland by air	9.4 (1999-2004) 13.8 (year-on-year in Jan-Nov 2005)
Cross-boundary ferry services ^(a)	56.3 (2005)
Cross-boundary coach services ^(b)	11.2 (2000-2005)

Notes : (a) The ferry services connect HKIA's SkyPier operating since September 2003 with five PRD ports at end-2005. The figure here refers to the growth in 2005 over 2004.

(b) Commencing operation since mid-1999, the coach services now connect HKIA with 40 cities in the PRD region. Non-domestic passengers using this service are classified as incoming visitors as they have to pass through immigration clearance.

Sources : Civil Aviation Department, Government of the Hong Kong Special Administrative Region (HKSARG); Hong Kong Airport Authority.

It is worth of note that the rapid advancement of airport facilities in the Mainland has reduced its reliance on connection services via Hong Kong. Yet from a wider perspective, improved airport facilities enable the Mainland to receive a larger number of visitors, some of whom especially those with footprints in PRD may visit Hong Kong as well. Besides, increased capacity of the Mainland airports facilitates a further expansion in their connections with HKIA. As reckoned by figures below, Hong Kong is positioned to share the fruits from rapid development of the tourism and civil aviation sectors in the Mainland.

	<u>Average annual growth during 1999-2004(%)</u>
Air passenger movements of the Mainland for international routes and regional routes with Hong Kong and Macao	9.0
Air passenger movements of Hong Kong in connection with the Mainland (including terminating, originating, transfer and transit passengers)	8.2
Number of inbound visitors to the Mainland (excluding Hong Kong and Macao residents)	13.1
Number of inbound visitors (excluding Mainland, Hong Kong and Macao residents) to both the Mainland and Hong Kong	7.2 ^(a)

Notes : (a) This is crude estimate based on the record of incoming visitors (excluding the Mainland and Macao residents) kept by the Immigration Department of HKSARG. Within the total for incoming visitors except the Mainland and Macao residents, arrivals with the Mainland being the place of embarkation are added to the departures with the Mainland being the place of immediate destination to provide a proxy of visitors travelling to both the Mainland and Hong Kong in one trip. Due to data limitation, other visitors likewise going to both places yet with elsewhere in-between such as Macao cannot be counted. Besides, the transfer services provided by HKIA's SkyPier since September 2003 has led to a substantial shift in status from en route incoming visitors to transfer passengers, thereby giving restraining impact on the estimated growth rates presented here.

Sources : Ministry of Public Security of Central People's Government (CPG), Civil Aviation Administration of CPG; Immigration Department of HKSARG; Civil Aviation Department of HKSARG.

Box 4.1 (cont'd)

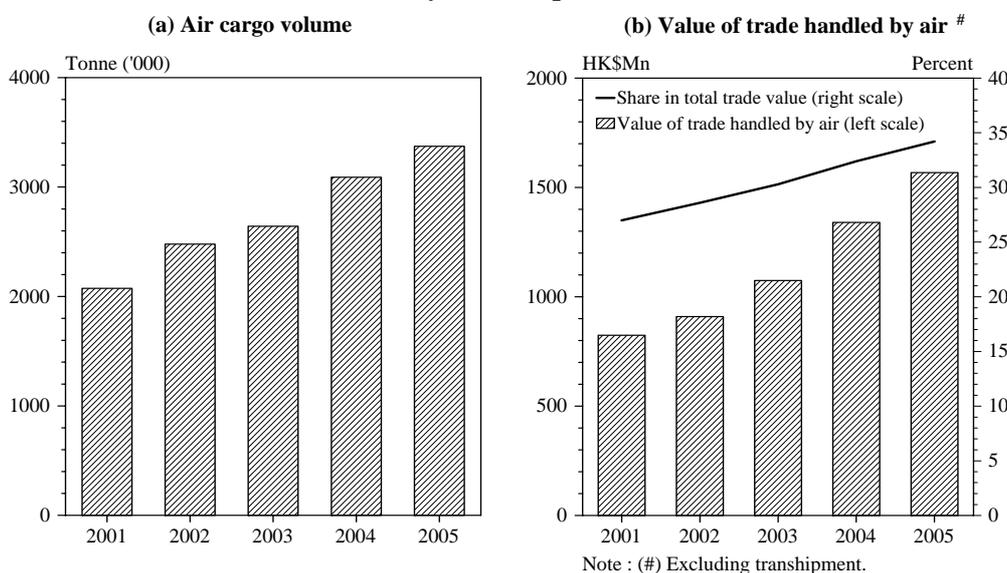
In order to capture the business opportunities arising from increased visitors to the Mainland, it is essential to enhance Hong Kong's overall competitiveness as a premier tourist destination, now ranking seventh globally in terms of incoming visitor number according to the World Tourism Organisation. Continued efforts to develop new infrastructure facilities, upgrade existing tourist attractions, enhance service quality and nurture hospitality culture are necessary. Promotion of multi-destination itineraries also helps to induce travellers to the Mainland, especially those destined for PRD, to include Hong Kong in their trips.

It is also important to maintain Hong Kong's leading transport hub position, which is one of our major strengths to bring in visitors from different markets in the world. In this connection, Hong Kong has to uphold its edge in terms of air connectivity and service frequency, including the inter-modal connection between HKIA and PRD. Regarding handling capacity, the Hong Kong Airport Authority has recently undertaken to invest \$4.5 billion in the next five to six years for capacity enhancement projects at HKIA. These include, for example, construction of a satellite concourse with additional parking stands for small aircrafts, reconfiguration of the Passenger Terminal Building to enhance passenger flow, resurfacing of existing runways and taxiways, and construction of additional taxiways.

Logistics

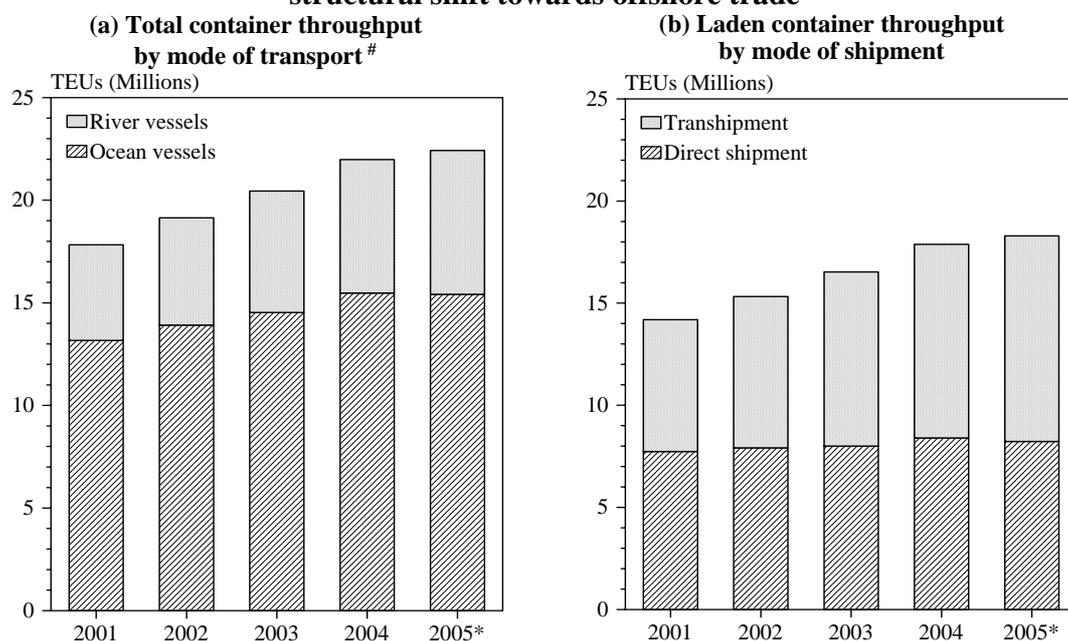
4.15 The logistics sector in overall terms continued to fare well in 2005, particularly for activities related to air freight. Thanks to the rising trend of high-value and time-sensitive items in Hong Kong's external trade particularly with the Mainland, *air cargo* movements rose markedly by 10% to 3.4 million tonnes in 2005, further to an increase of 17% in 2004. Underpinned by its world-class facilities, connectivity and efficiency that enable timely and secure delivery of cargo, Hong Kong has ranked first in terms of international air cargo throughput around the globe since 1996.

Diagram 4.7 : Growing importance of air freight in the logistics sector as the economy moved up the value chain



4.16 On port cargo movement, *container traffic* experienced moderated growth amidst the on-going shift from re-export trade to offshore trade via the Mainland ports. According to the estimate by Port Development Council, total container throughput handled by Hong Kong Port rose modestly by 2% to 22.4 million Twenty-foot Equivalent Units (TEUs) in 2005. Major growth impetus came from transshipment cargo movements which rose visibly by 7% in the first 11 months of 2005, benefiting from increased transshipment activities with Pearl River Delta (PRD) handled by river vessels. This outweighed the concurrent decline of 2% in direct shipment cargo movements, and reinforced the strong foothold of Hong Kong as a regional transshipment hub.

Diagram 4.8 : Port cargo movements holding up well despite the on-going structural shift towards offshore trade



Notes : (*) Estimated from the statistics available up to November 2005.
 (#) Including laden and empty containers.

4.17 As a considerable portion of air and port cargoes handled by Hong Kong is forwarded to or from the PRD through road transport, an efficient cross-boundary highway network is vital to the long-term development of the logistics services to mutual benefit. In this connection, the Hong Kong-Shenzhen Western Corridor linking Yuen Long with Shekou is under construction for target completion by end-2006. Besides, the governments of Guangdong Province, Macao and Hong Kong are actively pursuing advance work on the Hong Kong-Zhuhai-Macao Bridge linking the west side of PRD. On-going efforts have also been devoted to strengthen Hong Kong's connectivity with the Mainland for the sake of enhancing cross-boundary freight flow and Hong Kong's port competitiveness⁽⁶⁾.

4.18 Although the rapid advancement of port and airport facilities in the Mainland has caused diversion pressure for our cargo traffic, many trading and logistics companies maintain their operating bases in Hong Kong to develop higher value-added services such as merchanting, marketing and supply chain management. Apart from the favourable business environment, they are also attracted by the well-established external transport network that provides flexibility in scheduling cargo delivery and convenience in consolidating cargoes from different sources in the supply chain. This restructuring process has fostered the development of our trading and logistics services, with their combined share in GDP reaching about 28% according to latest indications.

Creativity and innovation

4.19 To assess in a holistic way our environment in which creativity can flourish, the Government has commissioned a Study on Creativity Index for Hong Kong that covers not only the economic factors but also other factors underlying the level of creative and innovative activities, including the structural, institutional, social and cultural aspects. The findings published in November 2005 showed that Hong Kong enjoyed a favourable position in overall terms and that most of the major parameters exhibited a growth pattern during 1999 to 2004, especially for the contribution of creativity to economic activities⁽⁷⁾.

4.20 Clustering of talents is amongst the key ingredients in fostering creative activities. The Government is considering introducing a new admission scheme for quality immigrants which will help to achieve, *inter alia*, the goal of attracting more creative talents around the globe. Under the scheme, a certain number of talented people from the Mainland and rest of the world who meet specific eligibility criteria will be allowed to stay in Hong Kong for a certain period of time, without the requirement of securing an offer of local employment beforehand⁽⁸⁾. The Government aims to introduce the scheme in the first half of 2006.

4.21 Regarding technology as another major driver of innovation activities, on-going efforts have been devoted by the Government to promote development and application of new technologies and innovative ideas. In addition to a comprehensive range of technological infrastructures already in place, works are progressing for target full operation of the five new R&D centres in selected technology focus areas and the Inno Centre under the DesignSmart Initiative in 2006. Meanwhile, financial support through various funding schemes to designated areas continued in 2005, with an increase in

designated amount for the Guangdong/Hong Kong Technology Cooperation Funding Scheme. Furthermore, events such as Innovation Festival 2005 and Hong Kong Young Design Talent Awards were organised to foster an innovation and technology culture in the community.

Box 4.2

Major issues in fostering development of creative economy

The concept of creative economy – whereby creativity provides an important means for adding economic value of goods and services – is increasingly popular around the globe in recent years. As creative mind is inherent in virtually all people and generation of new ideas is basically limitless, a good use of human creativity in economic activities can help significantly to foster long-term economic development. In the case of Hong Kong, the pursuit for greater role of creativity in production is also coherent with the ongoing structural shift towards knowledge-based and high value-added activities.

There are two fundamental issues in the development of creative economy viz. generation of creative ideas and their commercialisation. On generation of creative ideas, it depends on whether the creative potentials of people can be enhanced and effectively unleashed. Regarding commercialisation of creative ideas, there has to be an enabling environment that motivates businesses and individuals to turn creative ideas into valuable ends.

Below is a brief account of some major directions identified in addressing these two fundamental issues :

- (i) *Pool of creative talents* : This involves not only nurturing of local talents but also attraction of talents from abroad. The former requires a sophisticated education system that increases the desire and capability of people to engage in creative thinking, and a flexible labour force who are able to alter work norms to adapt to new skills and technologies. On attracting new talents from abroad, a liberal and cosmopolitan society open to differences and receptive to diversity in norms, cultures and values is desirable, apart from a favourable living, business and cultural environment. This environmental factor is also important in containing brain-drains of local talents.
- (ii) *Effective use of technology* : Technology helps to convert abstract ideas into concrete innovation activities for improving product design and features, production methods, and management techniques, etc. The other way round, technology is always advanced by human creativity. Attention should not only be confined to invention of new technologies, but should also be extended to absorption of advanced technologies from abroad followed by appropriate selection and adoption to fit into local condition.
- (iii) *Informative environment* : Freedom of speech and media facilitates flow of information and acquisition of new ideas and knowledge within and outside of the economy. Dissemination of information, ideas and knowledge can be further enhanced by established information and communications technology infrastructures, such as Internet and other telecommunications services.

Box 4.2 (cont'd)

- (iv) *Appreciation of cultures and the arts* : Culture and creativity are closely related in the sense that knowledge and understanding of culture can inspire creativity while creative ideas can give cultural breakthrough. By virtue of the communal nature of culture and its diversities across different societies, good appreciation of cultures and the arts is often a key to success in originating and applying creative ideas into market deliverables that fit the taste and demand in different markets.
- (v) *Protection of intellectual property rights (IPR)* : Creative ideas, innovative products and technologies are all intellectual properties. Sufficient protection of IPR (including ownership rights and the rights to income from use and transfer of the properties) provides the necessary incentives for businesses and individuals to engage in creative and innovation activities, and encourage them to share their ideas and knowledge with the rest of the economy. However, the recent experiences of some developed economies reveal that with increasing cross-over of ideas and techniques, the IPR protection is sometimes subject to abuse by enterprises to block competitors' product development and business expansion by imposing litigation risk on infringement of rights. This has given rise to debates on the optimal level and scope of IPR protection in order to foster rather than retard creativity, and ensure that the IPR protection regime can move with times.
- (vi) *Facilitation of new businesses* : New enterprises are often keen players in experimentation of creative products and techniques in commercial settings away from established norms and practices on which they do not have competitive advantages. To ensure an enabling environment that facilitates their start-ups, it is necessary to maintain a competitive market structure and do away with unnecessary entry barriers. An effective channel to obtain venture capital is also supportive by solving the funding problems faced by new firms. Another view with lesser consensus is to relax the bankruptcy rules so that the business risks for new start-ups can be reduced, but arguably the increased risks to lenders may translate into higher cost of financing.
- (vii) *Promotion of creative industries* : Although the contribution of creativity occurs in every corner of an economy and goes beyond the boundary of industries, there are some economic sectors where creativity serves as a more principal means of production. Promotion of these sectors helps to increase creative intensity of the economy directly and indirectly through sales of their goods and services to other sectors and households.

It is important to note that the seven directions identified above are general prescriptions and are by no means exhaustive. As there is no one-size-fit-all solution, the suitable formula for one place depends on its unique social, cultural and economic situation. Collaboration and communications among various stakeholders is thus necessary to work out the model that fits our economy the best.

Notes :

- (1) The Government announced its repositioned housing policy in November 2002 to address the overlapping between the subsidized housing market and the private residential property market, and to redress the imbalance between demand and supply in the private residential property market. One of the measures was to cease production and sale of HOS flats indefinitely from 2003. Unsold and returned HOS flats would be sold to Green Form applicants while HOS flats completed or under construction would be disposed of through market-friendly means. It was further announced in 2003 that no unsold and returned HOS flats would be offered for sale as subsidized housing units before the end of 2006.
- (2) It is proposed to apply different permitted rates of return on different assets invested by the power companies for the sake of reflecting the different investment risks involved and furthering environmental objectives. It is also proposed to lower the range of permitted return from 13.5 - 15% to 7 - 11%. For other details, see “Consultation on Future Development of the Electricity Market in Hong Kong – Stage II Consultation” issued by Economic Development and Labour Bureau on 30 December 2005.
- (3) The new franchised bus fare adjustment arrangement involves, *inter alia*, inclusion of a fare adjustment formula with new factors of change in price of the cost elements and productivity improvement of the franchised bus companies in the current approach of considering bus fare adjustment. In addition, the Government will also make reference to the median household income and the weighted average cost of capital for the franchised bus industry in gauging public affordability and the reasonable rate of return for franchised bus operators. The triggering point for activating the passenger reward arrangement will be lowered from the original 13% return on average net fixed asset to 9.7%. For other details, see the Legislative Council Brief on Review of the Basis for Considering Bus Fare Adjustments issued by Environment, Transport and Works Bureau on 10 January 2006.
- (4) As at end-2005, there were 76 destinations granted Approved Destination Status for outbound group tours by the Central People’s Government, quadruple the corresponding figure of 19 at end-2002.
- (5) Beyond the Hong Kong Disneyland commencing operation as from 12 September 2005, major tourist infrastructures in the pipeline include, for example, Ngong Ping 360 (Tung Chung Cable Car System on Lantau Island) and Hong Kong Wetland Park targeted for completion in 2006, and redevelopment of the Ocean Park due for completion in phases by 2010. In December 2005, the Government invited expression of interest from the private sector in respect of development of new Cruise Terminal in Hong Kong and received 6 returns.
- (6) See Chapter 3 of “Third Quarter Economic Report 2005” for more details on the recent initiatives by the Government to facilitate cross-boundary road traffic and other measures to promote the logistics development generally.
- (7) For details, see the report entitled “A Study on Creativity Index” published by Home Affairs Bureau in November 2005.

- (8) Hong Kong has a liberal policy towards entry for employment. Overseas professionals who possess special skills, knowledge or experience of value to and not readily available in Hong Kong, or who are in a position to make substantial contributions to the economy may apply to work here under the General Employment Policy (GEP). Professionals from the Mainland may apply to enter Hong Kong for employment under the Admission Scheme for Mainland Talents and Professionals which was introduced in July 2003 to replace earlier more restrictive schemes. The eligibility criteria are basically the same as those applicable under the GEP.

CHAPTER 5 : THE FINANCIAL SECTOR[#]

Summary

- *The financial sector, being one of the most competitive sectors of the Hong Kong economy, stayed vivid and vibrant in 2005 amidst the strong economic upturn. 2005 saw continued healthy developments in various segments of the financial sector, enhancing the role of Hong Kong as an international financial sector. Also, the Mainland dimension has become increasingly important to the developments in Hong Kong's financial markets.*
- *The Hong Kong dollar exchange and money markets were broadly stable in 2005, particularly after the introduction of the refinements to the linked Exchange Rate System. Reflecting continuous fund inflows, the Hong Kong dollar strengthened against the US dollar to near the strong side of the Convertibility Undertaking towards end-2005.*
- *The Hong Kong dollar interest rates rose progressively along with the increases in US dollar interest rates, yet credit demand of individual sectors continued to hold firm. Meanwhile, benefited by the economic upturn, asset quality of the banking sector improved further.*
- *The stock market showed a robust performance during most part of 2005, backed by improved corporate earnings, generally buoyant overseas stock markets, ample liquidity and an optimistic economic outlook. Share prices remained resilient notwithstanding the successive interest rate hikes, and market turnover rose to a record high in 2005.*

(#) **This chapter is jointly prepared by the Hong Kong Monetary Authority (HKMA) and the Economic Analysis Division.**

Overall situation

5.1 The financial market stayed vivid and vibrant in 2005 amidst the robust performance in the real sector of the economy. The Hong Kong dollar exchange and money markets were generally stable in 2005, particularly after the introduction of the refinements to the Linked Exchange Rate system by the HKMA in May 2005⁽¹⁾. Local interest rates edged up progressively since March 2005, in tandem with the rise in US interest rates. Money supply grew steadily. Bank loans also recorded rather solid growth, reflecting the strengthened loan demand along with the strong economic expansion. Amidst the generally sanguine sentiment, there was notable increase in fund raising activities in the stock market. Funds raised in the debt market continued to expand, providing further impetus for developing Hong Kong into a regional bond centre. In addition, Hong Kong's niches as an asset management centre are also manifested in the notable growth in fund management business in Hong Kong.

5.2 In his Policy Address in October 2005, the Chief Executive indicated that the Government will continue to enhance the quality of the financial markets through enhancing the regulatory regime and promoting good corporate governance. The Government will continue to consolidate Hong Kong's leading position as an international financial centre in the Asia-Pacific region, by promoting the development of the bond market, fund management business, as well as the asset management industry in Hong Kong.

Interest rates, aggregate balance and exchange rates

5.3 Hong Kong dollar interest rates drifted progressively higher during 2005, in line with the uptrend in the US dollar interest rates. The Base Rate under the Discount Window operated by the HKMA was adjusted upward eight times during 2005 by a cumulative total of 200 basis points to 5.75% at end-December 2005, in line with the increases in the US Fed Funds Target Rate⁽²⁾. Hong Kong dollar interbank interest rates moved up accordingly. Yet the three-month HIBOR held largely stable in the fourth quarter notwithstanding further US interest rate hikes, as liquidity in the local banking sector remained abundant. The discount of three-month HIBOR over the corresponding Euro-dollar deposit rate narrowed significantly from 227 basis points at end-December 2004 to 37 basis points at end-December 2005. Meanwhile, the Hong Kong dollar yield curve flattened distinctly during 2005, largely reflecting the successive increases in short-term interest rates.

5.4 While the deposit rates and the best lending rates also rose, the magnitude of increases varied among different banks, reflecting the different cost structure and funding costs of the banks. At end-December 2005, there were two best lending rates, at 7.75% and 8.0%. In December 2005, the HKMA published a new data series on composite interest rate, reflecting movements in various deposit rates, interbank and other interest rates to closely track the average cost of funds of banks⁽³⁾. The published data enable the banks to keep track of changes in funding cost and thus help improve interest rate risk management in the banking sector. Meanwhile, notwithstanding that the Aggregate Balance declined from \$3.8 billion in mid-May to around \$1.3 billion towards end-2005 following the introduction of the refinements to the Linked Exchange Rate system by the HKMA in May, there was no lack of liquidity in the banking sector.

Diagram 5.1 : Aggregate balance in the banking system held steady notwithstanding rising interest rates as liquidity remained adequate (end for the week)

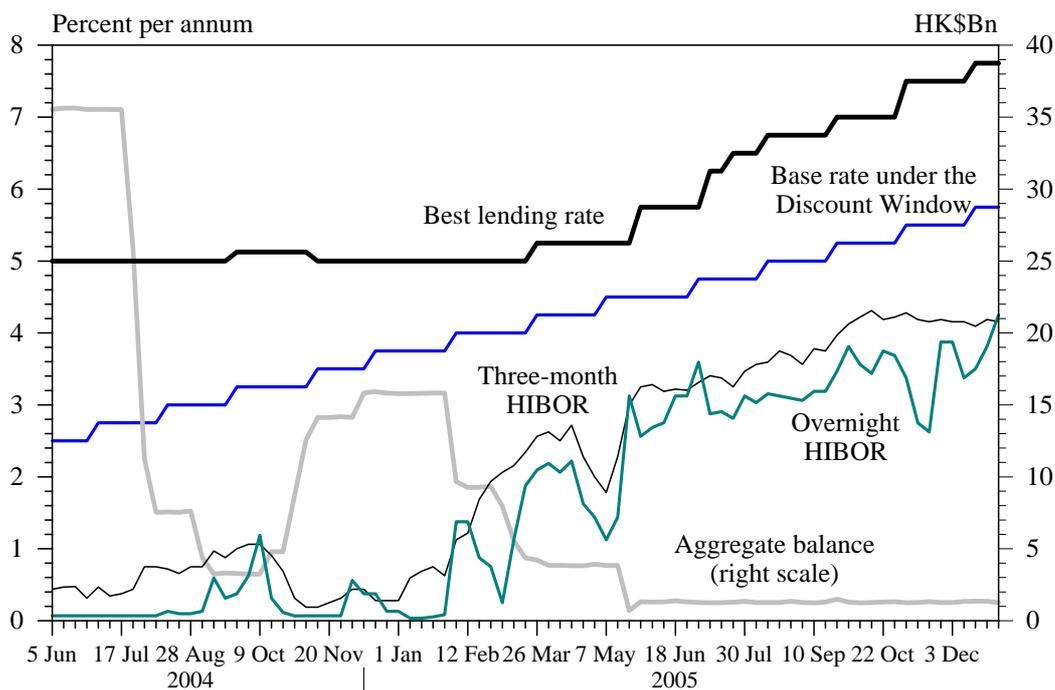
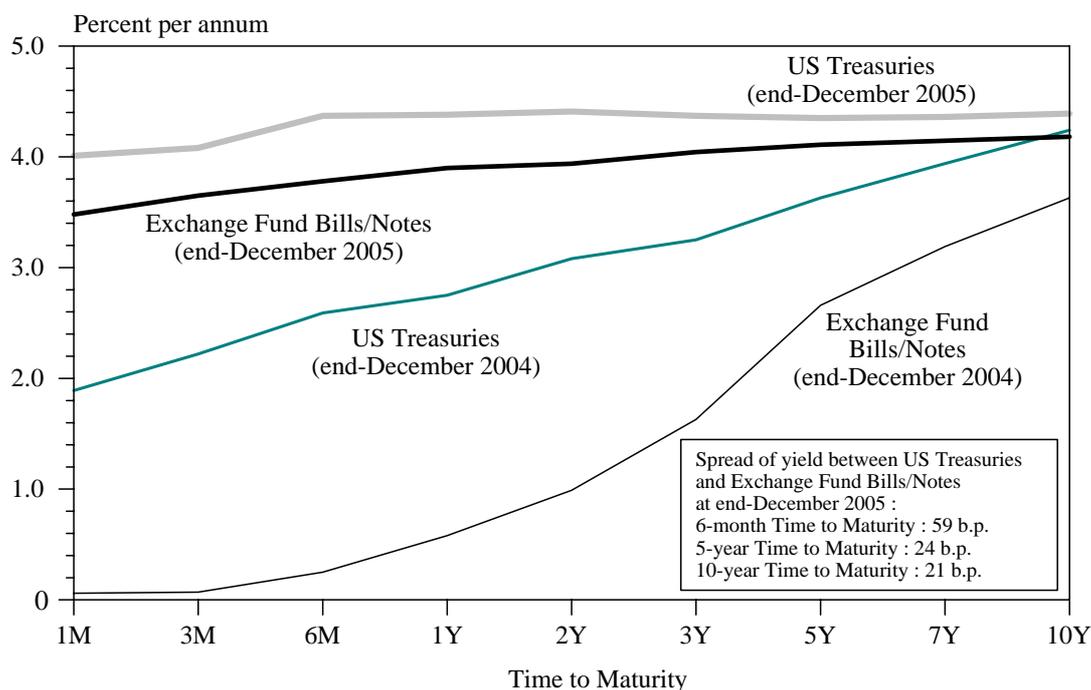


Diagram 5.2 : Hong Kong dollar yield curve flattened towards end-2005, and below its US counterpart



5.5 The Hong Kong dollar strengthened slightly against the US dollar in the second half of 2005 following the People’s Bank of China (PBOC)’s announcement of a major reform in the renminbi trading regime on 21 July⁽⁴⁾. The spot exchange rate of Hong Kong dollar against the US dollar hovered at only a touch below the strong side of the link during most of the fourth quarter, and closed at 7.7525 at end-2005, compared with 7.7735 at end-2004. During the past year, the discount of the twelve-month Hong Kong dollar forward rate over the spot rate narrowed markedly from 1 625 pips to 255 pips.

5.6 Under the Linked Exchange Rate System, movements in the exchange rate of the Hong Kong dollar against other currencies follow closely those in the US dollar. Having declined for about three years, the US dollar showed a moderate rebound during 2005, strengthening against major currencies including the Pound Sterling, the Euro and Yen. As a result, the trade-weighted Nominal and Real Effective Exchange Rate Indices⁽⁵⁾ of the Hong Kong dollar rose moderately by 2.2% and 2.3% respectively over the year.

Diagram 5.3 : The Hong Kong dollar strengthened slightly against the US dollar and moved towards the strong side of the link in late 2005 (end for the week)

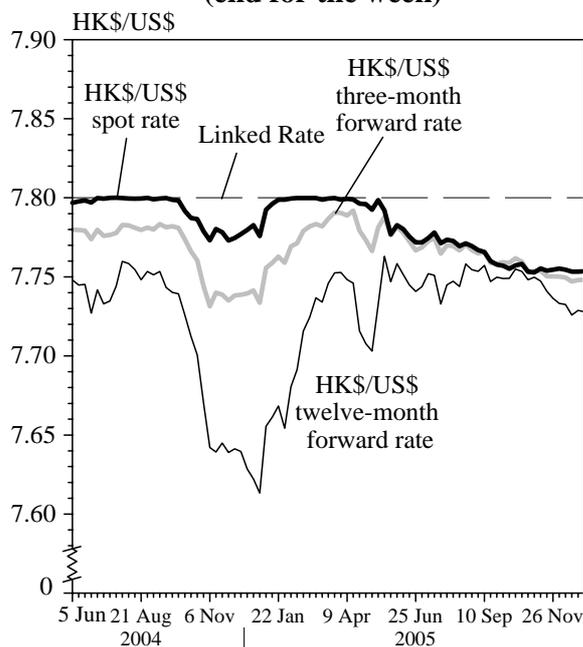
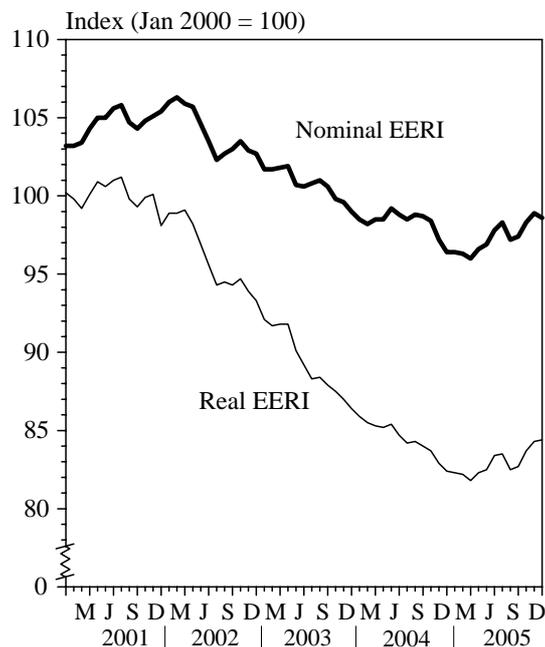


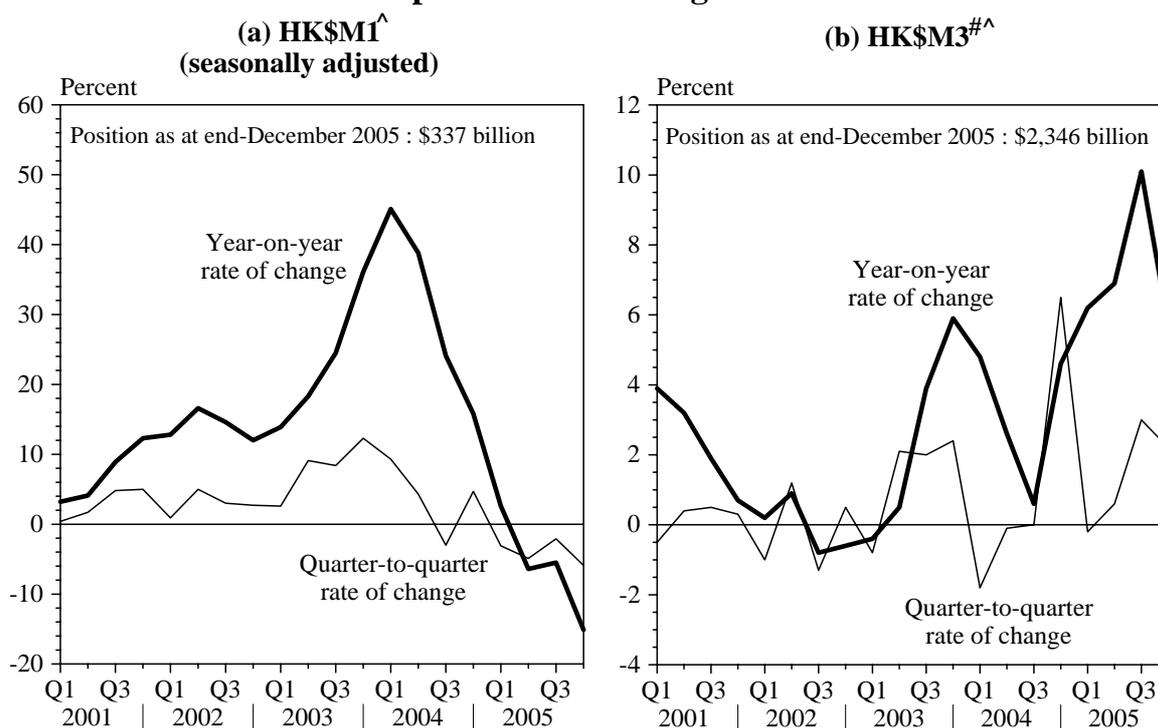
Diagram 5.4 : Trade-weighted Effective Exchange Rate Index of the Hong Kong dollar rose moderately during 2005 (average for the month)



Money supply and deposits

5.7 The monetary conditions held generally stable in 2005. Yet the movements of narrow and broad money supply showed widening divergence since the second quarter of 2005, reflecting in part portfolio re-allocation from more liquid monetary assets to term deposits stemming from the higher interest rates over the course of 2005. The seasonally adjusted Hong Kong dollar narrow money supply (HK\$M1)⁽⁶⁾ dropped by 15.1% at end-December 2005 over a year earlier, largely reflecting a higher opportunity cost of holding liquid deposits. On the other hand, Hong Kong dollar broad money supply (HK\$M3) continued to rise, by 5.7% during the same period, in line with the growth in fixed deposits but somewhat slower than that of the nominal GDP.

Diagram 5.5 : There was a shift from demand deposits to time deposits amidst rising interest rates



Notes: (^) Figures refer to the positions at end of quarter.

(#) Adjusted to include foreign currency swap deposits.

5.8 Total deposits with authorized institutions⁽⁷⁾ rose further by 5.2% to \$4,068 billion (comprising Hong Kong dollar deposits of \$2,132 billion and foreign currency deposits of \$1,936 billion) at end-December 2005 over a year earlier, as household and corporate incomes improved amidst the economic upturn. Increases were seen in both Hong Kong dollar deposits (adjusted to include foreign currency swap deposits)⁽⁸⁾ and foreign currency deposits.

Loans and advances

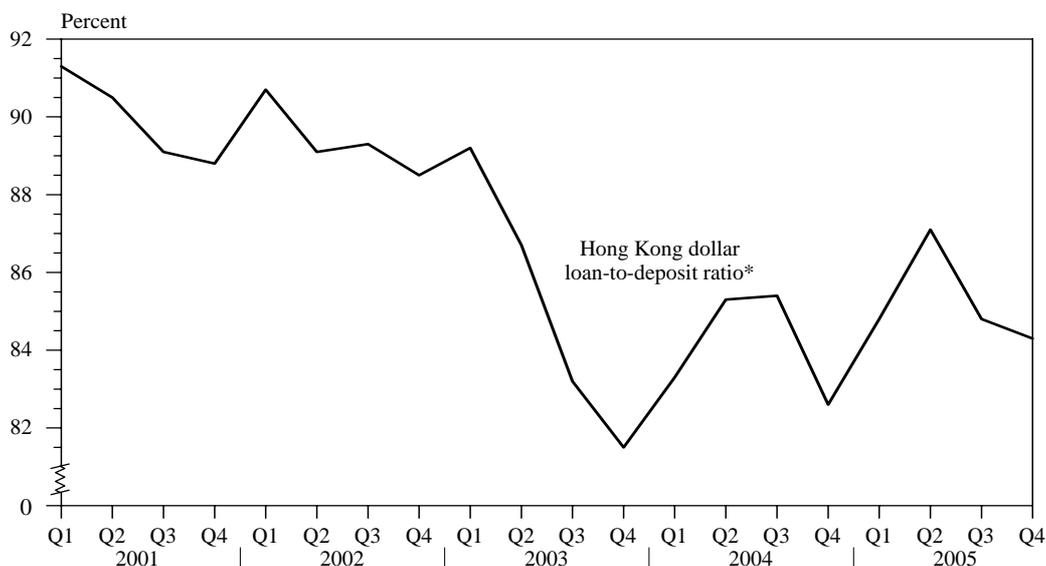
5.9 Total loans and advances increased by 7.3% to \$2,313 billion (comprising Hong Kong dollar loans of \$1,797 billion and foreign currency loans of \$515 billion) at end-December 2005 over a year earlier, driven mainly by the increase in loans for use in Hong Kong on the back of the brisk pace of economic expansion. Double-digit increases were recorded in loans to building, construction, property development and investment, and to manufacturing. On the other hand, the outstanding amount of loans for purchase of residential properties eased back towards end-2005, as trading activity in the property market turned quiet in the second half of 2005. As total loans and advances rose faster than total deposits during 2005, the loan-to-deposit ratio picked up from 82.6% at end-2004 to 84.3% at end-2005.

Table 5.1 : Loans and advances for use in Hong Kong by major usage

Loans to :								All loans and advances for use in Hong Kong ^(b)	
% change during the quarter		Finance visible Trade	Manu- facturing sector	Whole- sale and retail trade	Building, construction, property development and investment	Purchase of residential property ^(a)	Financial concerns	Stock- brokers	
2004	Q1	6.4	5.4	2.5	-1.5	0.1	4.3	6.0	0.3
	Q2	14.7	8.7	0.2	1.5	-0.7	2.1	-5.9	1.9
	Q3	5.5	4.9	5.8	-0.3	-0.5	0.8	-8.8	0.8
	Q4	1.0	6.4	0.4	7.6	0.2	6.5	5.7	3.2
2005	Q1	2.4	8.1	-0.6	4.3	0.6	-0.8	5.8	1.6
	Q2	12.2	10.1	6.7	2.7	1.1	3.4	10.9	4.2
	Q3	-1.4	-2.1	-2.3	2.1	-1.1	2.2	-7.8	*
	Q4	-3.8	3.5	-0.5	7.1	-1.3	1.9	-36.6	1.8
Total amount at the end of December 2005 (HK\$Bn)		142	119	101	450	607	179	7	2,072
% change over a year		9.1	20.6	3.1	17.1	-0.7	6.9	-31.4	7.8

- Notes : (a) Figures also include loans for the purchase of flats under the Home Ownership Scheme, Private Sector Participation Scheme and Tenants Purchase Scheme, in addition to those for the purchase of private residential flats.
- (b) Loans to individual sectors may not add up to all loans and advances for use in Hong Kong, as some sectors are not included in this table.
- (*) Change of less than 0.05%.

Diagram 5.6 : Hong Kong dollar loan-to-deposit ratio being on average higher in 2005 than in 2004 amidst strengthening credit demand



Note : (*) Hong Kong dollar deposits have been adjusted to include foreign currency swap deposits.

Banking

5.10 Along with the economic upturn, asset quality of the local banking sector improved noticeably over the course of 2005. The ratio of classified loans to total loans of retail banks dropped further from 2.25% at end-December 2004 to 1.49% at end-September 2005. Over the same period, the arrears for over three months in *credit card repayment* decreased to 0.39% from 0.44%. The revival of the property market also saw delinquency ratio for *residential mortgage loans* falling to 0.19% at end-December 2005 from 0.38% a year ago. The consolidated capital adequacy ratio for local banks averaged at 15.3% at end-September 2005, well above the minimum international standard of 8% set by the Bank for International Settlements.

5.11 In late December 2005, a fifth consultation package on implementation of the New Basel Capital Adequacy Standards ("Basel II") in Hong Kong was published by the Hong Kong Monetary Authority (HKMA)⁽⁹⁾. Basel II contains a revised international capital adequacy framework promulgated by the Basel Committee on Banking Supervision in June 2004, which is more risk-sensitive and covers a wider range of banking risks compared with the existing framework. Similar to the existing requirement under Basel I, the requirement of banks to maintain minimum capital adequacy ratio of 8% underscores the importance of abundant capital held by a bank to absorb losses and thus protects the depositors in the event of the bank being wound up. Implementation of Basel II in Hong Kong is scheduled to commence in phases starting on 1 January 2007. In this connection, the Banking (Amendment) Ordinance 2005 was enacted on 6 July 2005 to provide for the implementation of Basel II in Hong Kong through capital and disclosure rules to be issued by HKMA under the Ordinance. Adopting the highest international banking standards will help strengthen the position of Hong Kong as a leading international financial centre.

Table 5.2 : Asset quality of retail banks^(a)
(as % of total loans)

<u>As at the end of</u>	<u>Pass loans</u>	<u>Special mention loans</u>	<u>Classified loans</u> (gross)
2004 Q1	90.07	6.26	3.66
Q2	91.41	5.59	3.00
Q3	92.35	4.98	2.67
Q4	93.76	3.99	2.25
2005 Q1	94.30	3.75	1.95
Q2	95.05	3.21	1.74
Q3	95.26	3.25	1.49

Notes : (a) Period-end figures relate to Hong Kong offices and overseas branches. Loans and advances are classified into the following categories: Pass, Special Mention, Substandard, Doubtful and Loss. Loans in the substandard, doubtful and loss categories are collectively known as “classified loans”.

Due to rounding, figures may not add up to 100.

5.12 Since February 2004, banks in Hong Kong have been offering renminbi deposit-taking, exchange and remittance services to customers. At end-December 2005, a total of 38 licensed banks were engaged in renminbi banking business in Hong Kong. Renminbi deposits with authorized institutions increased from RMB 12.1 billion at end-December 2004 to RMB 22.6 billion at end-December 2005. Notwithstanding the widening interest rate spreads between renminbi and other major foreign currencies in favour of the latter, the share of renminbi deposits in total foreign currency deposits with all authorized institutions still rose from 0.62% to 1.12% during the period.

5.13 In October 2005, the Chief Executive announced in the Policy Address that the Central People’s Government had in principle agreed to expand the scope of renminbi business conducted by banks in Hong Kong⁽¹⁰⁾. In late December 2005, the Chief Executive also put forth further measures to deepen renminbi business in Hong Kong which were pending approval by the central government. To cater for the expanded business, a new Renminbi Settlement System will be launched in March 2006, following which Hong Kong residents will be able to open renminbi current accounts and use renminbi cheques for consumer spending in the Guangdong Province. The increase in participation in renminbi business by banks in Hong Kong would help strengthen Hong Kong’s position as an international financial centre.

Table 5.3 : Renminbi deposits in licensed banks

<u>As at end of</u>		<u>Savings deposits</u> (RMB Mn)	<u>Time deposits</u> (RMB Mn)	<u>Total deposits</u> (RMB Mn)	<u>Interest rates on</u> ^(a)		<u>Number of licensed banks engaged in RMB business</u> ^(c)
					<u>Saving deposits</u> ^(b) (%)	<u>Three-month time deposits</u> ^(b) (%)	
2004	Q1	2,095	2,298	4,394	N.A.	N.A.	36
	Q2	2,853	3,950	6,803	0.50	0.58	39
	Q3	3,136	4,533	7,669	0.48	0.60	38
	Q4	5,417	6,710	12,127	0.46	0.60	38
2005	Q1	6,440	8,536	14,976	0.46	0.65	38
	Q2	9,358	11,540	20,898	0.46	0.65	39
	Q3	10,219	12,425	22,643	0.46	0.65	38
	Q4	10,619	11,966	22,585	0.46	0.65	38

Notes : (a) The interest rates are sourced from a survey conducted by the HKMA.
(b) Period average figures.
(c) Licensed banks started to offer RMB deposit taking, currency exchange and remittance services on 25 February 2004.

N.A Not available.

The debt market

5.14 To enhance Hong Kong's strength as an international financial centre, the Government has steadily pushed ahead the growth in Hong Kong's debt market both in size and in depth, by facilitating the introduction of new instruments and enhancing market liquidity. Over the past decade, the outstanding amount of the Hong Kong dollar debt market has increased significantly. In 2005, gross issuance of Hong Kong dollar debt has increased by \$25 billion over 2004 to \$402 billion. At end-December 2005, the total outstanding value of all Hong Kong dollar debt securities rose by 9% over a year earlier to \$664 billion⁽¹¹⁾. This was equivalent to 28% of HK\$M3, or 22% of the Hong Kong dollar-denominated assets of the entire banking sector⁽¹²⁾. Around two-thirds of the outstanding debt were owed to the private sector and Multilateral Development Banks, while the remaining one-third, comprising mainly Exchange Fund papers, were owed by the Government and statutory organisations.

5.15 Over the medium to longer term, the Government targets to develop and strengthen Hong Kong's bond market into Asia's bond centre, with particular aim to attract Mainland enterprises to raise capital from Hong Kong and international investors through the Hong Kong bond market. As at

end-December 2005, over 20 Mainland enterprises have issued and listed their bonds in Hong Kong, raising about US\$8.5 billion.

Table 5.4 : New issuance and outstanding value of HK dollar debt securities (HK\$Bn)

		Exchange Fund paper	Statutory bodies/govern ment-owned corporations	Govern- ment	Public sector total	AIs ^(a)	Local corporates	Non-MDBs overseas borrowers ^(b)	Private sector total	MDBs ^(b)	Total
New Issuance											
2004	Annual	206.0	17.8	10.3	234.0	50.7	9.1	79.4	139.3	3.5	376.8
	Q1	51.6	4.4	-	56.0	8.9	3.1	24.9	36.9	1.4	94.3
	Q2	52.1	10.1	-	62.3	13.1	0.1	17.9	31.2	2.0	95.4
	Q3	51.2	0.8	10.3	62.2	13.6	0.6	15.6	29.8	0.1	92.1
	Q4	51.1	2.5	-	53.6	15.1	5.3	21.0	41.4	-	95.0
2005	Annual	213.6	8.5	-	222.1	62.6	9.9	105.4	177.9	1.8	401.8
	Q1	52.0	1.3	-	53.4	18.0	1.1	31.1	50.3	-	103.7
	Q2	53.1	2.3	-	55.4	20.1	2.4	36.3	58.7	1.1	115.3
	Q3	54.1	1.9	-	56.0	11.7	4.7	24.5	40.0	0.7	96.7
	Q4	54.4	3.0	-	57.4	12.8	1.7	13.5	28.0	-	85.4
Outstanding (period-end figures)											
2004	Q1	120.6	53.8	-	174.4	137.9	35.7	196.0	369.6	24.9	568.9
	Q2	121.2	60.3	-	181.5	139.2	32.7	203.4	375.3	25.1	582.0
	Q3	121.9	58.5	10.3	190.7	141.4	31.0	207.8	380.2	24.7	595.6
	Q4	122.6	60.1	10.3	193.0	144.3	34.6	211.2	390.2	24.7	607.9
2005	Q1	123.2	57.3	10.3	190.8	145.9	32.0	228.7	406.6	23.5	620.9
	Q2	124.3	56.1	10.3	190.7	148.4	33.3	248.1	429.7	23.6	644.1
	Q3	125.4	57.1	10.3	192.8	154.1	36.4	257.1	447.6	24.1	664.5
	Q4	126.7	57.7	10.3	194.7	153.4	38.1	256.0	447.5	21.5	663.7

Notes: Figures may not add up to the corresponding totals due to rounding.

(a) AIs : Authorized Institutions.

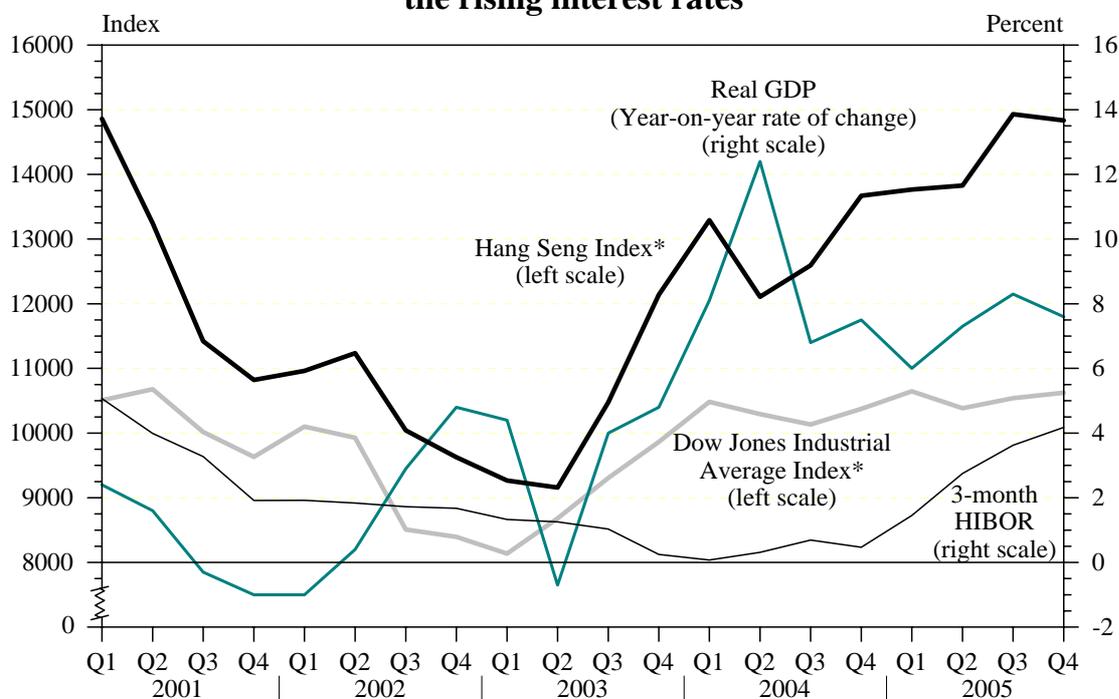
(b) MDBs : Multilateral Development Banks.

The stock and futures markets

5.16 *The local stock market* showed a robust performance during most of 2005, backed by improved corporate earnings, generally buoyant stock markets in the US and other economies, ample liquidity brought about by capital inflows, as well as an optimistic outlook for the economy. This was notwithstanding the successive interest rate hikes during the year. The launch of a few large IPOs also helped boosted market sentiment. The Hang Seng Index surged to a

near 4 1/2-year high of 15 466 on 15 August, and closed the year at 14 876, up by 4.5% over end-December 2004. Average daily turnover expanded markedly to a record high of \$18.3 billion, up by 14.7% from 2004.

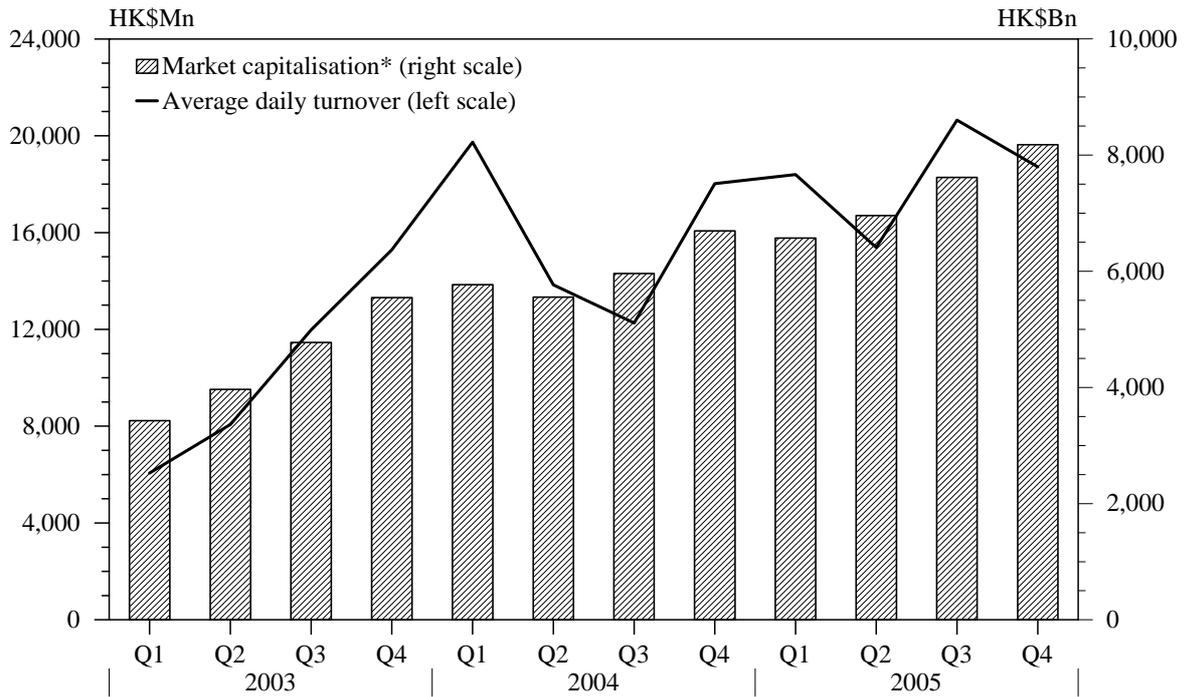
Diagram 5.7 : The stock market rose further during 2005 in tandem with the strong economic performance notwithstanding the rising interest rates



Note: (*) Period average figures.

5.17 Market capitalisation for the Main Board at end-December 2005, at \$8,113 billion, soared remarkably by 22.4% from the end-December 2004 position. In contrast, market capitalisation for the Growth Enterprise Market (GEM) contracted to \$66.6 billion at end-December 2005, representing a 0.2% fall from a year ago. According to the World Federation of Exchanges⁽¹³⁾, at end-December 2005, the Hong Kong stock market was the eighth largest in the world and second largest in Asia in terms of market capitalisation. In 2005, the total amount of equity capital raised through new share flotations and post-listing in the Main Board and the GEM rose to \$295.4 billion⁽¹⁴⁾. This value ranked fourth internationally among major international stock exchanges.

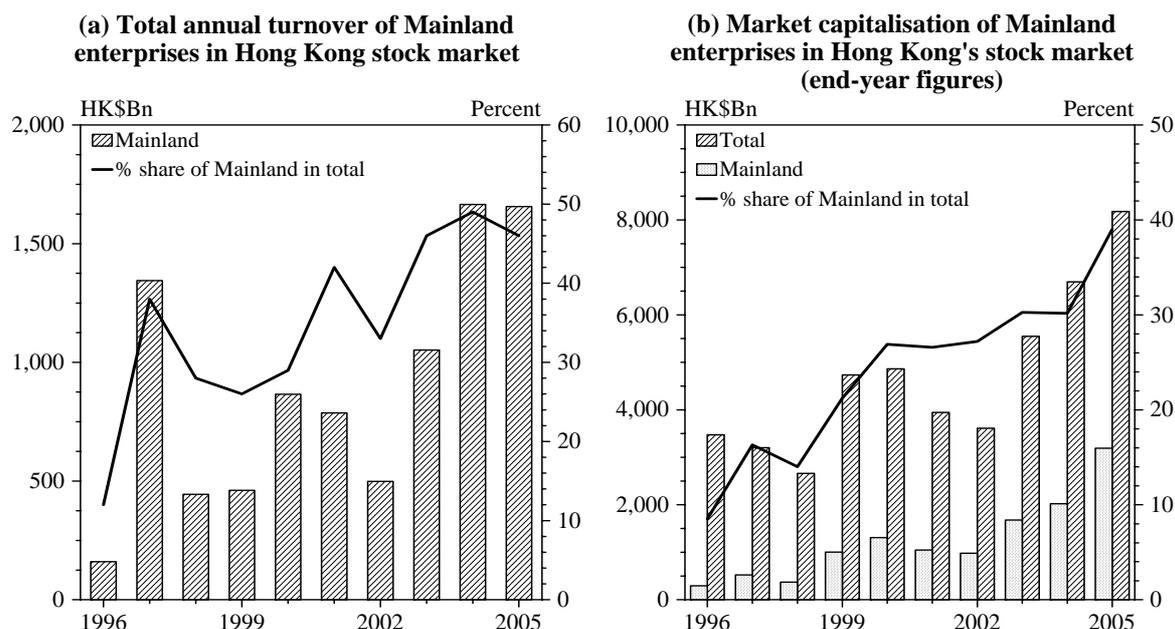
Diagram 5.8 : Both average daily turnover and total market capitalisation in the Hong Kong stock market hit record high in 2005



Note: (*) Position at end of quarter.

5.18 The growing importance of Hong Kong as a fund raising centre for the Mainland enterprises can be seen in the dominant presence of Mainland enterprises in the Hong Kong stock market. At end-December 2005, there are 335 Mainland enterprises (including 120 H-share companies, 89 “Red Chips” companies and 126 private enterprises) listed on the Hong Kong stock market, accounting for 30% of the total number of listed companies. The capital raised by these Mainland enterprises since January 1993 amounted to \$1,097 billion, accounting for 51% of the total funds raised in the stock market. As at end-December 2005, the market capitalisation of these Mainland enterprises stood at \$3.2 trillion, accounting for 39% of the total market capitalisation of the Hong Kong stock market. In 2005, 46% of the market turnover in the stock market was contributed by trading of the above Mainland-related stocks.

Diagram 5.9 : The Hong Kong stock market is an increasingly important fund raising centre for Mainland enterprises



5.19 Mirroring the buoyant trading in the spot market, *derivatives trading* was also brisk in 2005. The average daily turnover of the Hang Seng Index Futures contracts, the Hang Seng Index options contracts, H-shares Index Futures contracts and stock options all surged, by 20% - 76% over a year earlier⁽¹⁵⁾.

Table 5.5 : Average daily turnover of derivatives contracts of the Hong Kong stock market

		Hang Seng Index Futures	Hang Seng Index Options	H-shares Index Futures	Stock Options	Stock Futures
2004	Annual	34 824	8 215	7 060	22 720	70
	Q1	33 468	8 030	5 517	25 723	81
	Q2	36 649	10 053	8 565	21 002	65
	Q3	34 386	7 143	7 331	20 995	52
	Q4	34 852	7 717	6 856	23 170	82
2005	Annual	40 205	12 462	8 027	35 385	53
	Q1	38 872	10 243	7 510	26 583	45
	Q2	36 396	11 266	7 492	23 907	34
	Q3	42 122	14 543	8 809	49 784	71
	Q4	43 294	13 603	8 242	40 304	61
% change from 2004 Q4 to 2005 Q4		24.2	76.3	20.2	73.9	-25.6
% change in 2005 average over 2004 average		15.5	51.7	13.7	55.7	-24.3

The gold market

5.20 The gold market in Hong Kong rejuvenated in 2005 amidst the distinct surge in gold price. Conceivably, the fear of renewed weakening of the US dollar and inflation concerns triggered by high oil prices stimulated strong demand for gold as a hedging instrument by investors. Price of gold surged above US\$500 per ounce for the first time in 18 years, and closed the year at US\$517.2 per ounce, compared with US\$438.1 per ounce at end-2004. Gold price at the Chinese Gold and Silver Exchange Society likewise went up distinctly, by 17.8% during 2005 to \$4,775 per tael at end-2005. Turnover on the Exchange expanded markedly to 3.9 million taels in 2005, from 3.0 million taels in 2004.

Fund management and investment funds

5.21 Reflecting the prominent role of Hong Kong as an international financial centre, both the depth and breadth of investment funds managed in Hong Kong increased notably in the more recent years. This paves the way for Hong Kong to evolve as Asia's leading asset management centre in the years to come. In the first eleven months of 2005, gross sales and net sales (after deducting redemptions) of *unit trusts and mutual funds*⁽¹⁶⁾ amounted to US\$12,976 million and US\$1,580 million respectively. Analysed by asset size, equity funds continued to take up a predominant portion, accounting for 61.2% of the total value of funds at end-November 2005. Funds managed under the *MPF schemes* continued to grow in 2005. The aggregate net asset value of the approved constituent funds rose to \$151.4 billion at end-December 2005, from \$120.2 billion at end-2004⁽¹⁷⁾. Apart from the above, there were three new Real Estate Investment Trusts (REIT) launched onto the market during 2005, with a total market capitalisation of US\$4,538 million at end-2005.

5.22 More recently, the number of hedge funds launched for sale to the public in Hong Kong also increased in line with the growing popularity of this type of funds among the investors. There were 13 retail hedge funds authorised by the Securities and Futures Commission (SFC) with net asset size of US\$1.04 billion as at end-2005, slightly down from US\$1.17 billion a year ago. Nevertheless, the 2005 net asset size was more than six times larger than that as at end-2002, the year when the hedge funds guidelines were first issued. Apart from authorised hedge funds, based on the information available as at January 2006, about 133 hedge funds were operating in Hong Kong with total assets under management (AUM) amounted to US\$14.8 billion. As the presence of hedge funds can contribute to or may adversely impact financial

stability, the SFC is building partnership with both other regulators, whether local or overseas, and the industry itself to build a fair and transparent regulatory framework with the primary objective to safeguard investor interests. Besides, the co-operation can also facilitate market and product development, maintain market confidence and promote high standards.

Insurance

5.23 The insurance sector continued to flourish amidst the pick-up in economic activities. The total value of business receipts surged further by 17.7% in the third quarter of 2005 over a year earlier⁽¹⁸⁾. For the first three quarters of 2005 as a whole, there was an increase of 14.0%. Growth in individual life and annuity business continued to outpace notably that in non-life business, reflecting partly the increase in employment income and greater public awareness of the needs for retirement planning.

Table 5.6 : Insurance business in Hong Kong (HK\$Mn)

	<u>General business :</u>			<u>Premium for long-term business* :</u>				
	<u>Gross premium</u>	<u>Net premium</u>	<u>Underwriting profit</u>	<u>Individual life and annuity (non-linked)</u>	<u>Individual life and annuity (linked)</u>	<u>Other individual business</u>	<u>Non-retirement scheme group business</u>	<u>All long-term business</u>
2004 Q1	6,878	4,855	386	5,663	3,802	49	58	9,572
Q2	5,430	3,907	893	5,137	4,946	47	38	10,168
Q3	5,691	3,998	580	3,939	3,788	47	41	7,815
Q4	4,993	3,513	295	4,983	5,979	52	26	11,040
2005 Q1	6,944	4,909	63	4,814	4,209	45	41	9,109
Q2	6,171	4,422	141	6,099	5,376	41	48	11,564
Q3	5,704	4,177	433	5,749	5,281	43	39	11,112
% change from 2004 Q3 to 2005 Q3	0.2	4.5	-25.3	46.0	39.4	-8.5	-4.9	42.2

Note : (*) Figures refer to new businesses only. Retirement scheme businesses are excluded.

Notes :

- (1) To remove uncertainty about exchange rate expectations on the strong side under the Linked Exchange Rate System and promote smooth functioning of the money and foreign exchange markets in accordance with Currency Board arrangements, the HKMA announced three refinements to the operation of the Linked Exchange Rate system on 18 May 2005. These refinements include: introducing a strong-side Convertibility Undertaking (CU) at 7.75, shifting the weak-side CU to 7.85, and creating a Convertibility Zone defined by the levels of the Convertibility Undertakings, within which the HKMA may choose to conduct market operations consistent with Currency Board principles.
- (2) At present, the Base Rate is set at either 150 basis points above the prevailing US Fed Funds Target Rate or the average of the five-day moving averages of the overnight and one-month HIBORs, whichever is higher.
- (3) The composite interest rate rose from 0.3% at end-2004 to 2.33% at end-September 2005, mainly reflecting the successive increases in interest rates during the period.
- (4) The People's Bank of China reform in the renminbi (RMB) exchange rate regime includes, inter alia, an initial adjustment of the exchange of the US dollar against the RMB to 8.11 yuan per US dollar (equivalent to 2% revaluation) and a move of the exchange rate regime into a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. In addition, the daily trading price of the US dollar against the RMB in the inter-bank foreign exchange market will continue to be allowed to float within a band of ± 0.3 percent around the central parity published by the People's Bank of China.
- (5) The trade-weighted Nominal Effective Exchange Rate Index (EERI) is an indicator of the overall exchange value of the Hong Kong dollar against a fixed basket of other currencies. Specifically, it is a weighted average of the exchange rates of the Hong Kong dollar against some 14 currencies of its major trading partners, with the weights adopted being the respective shares of these trading partners in the total value of merchandise trade for Hong Kong during 1999 and 2000.

The Real EERI of the Hong Kong dollar is obtained by adjusting the Nominal EERI for relative movements in the seasonally adjusted consumer price indices of the respective trading partners.

- (6) The various definitions of the money supply are as follows:

M1 : notes and coins with the public, plus customers' demand deposits with licensed banks.

M2 : M1 plus customers' savings and time deposits with licensed banks, plus negotiable certificates of deposit (NCDs) issued by licensed banks, held outside the monetary sector as well as short-term Exchange Fund placements of less than one month.

M3 : M2 plus customers' deposits with restricted licence banks and deposit-taking companies, plus NCDs issued by such institutions and held outside the monetary sector.

Among the various monetary aggregates, more apparent seasonal patterns are found in HK\$M1, currency held by the public, and demand deposits.

- (7) Authorized institutions include licensed banks, restricted licence banks and deposit-taking companies. At end-December 2005, there are 133 licensed banks, 33 restricted licence banks and 33 deposit-taking companies in Hong Kong. Altogether, 199 authorized institutions (excluding representative offices) from 31 countries and territories (including Hong Kong) had a presence in Hong Kong.
- (8) Foreign currency swap deposits are deposits involving customers buying foreign currencies in the spot market and placing them as deposits with authorized institutions, whilst at the same time entering into a contract to sell such foreign currencies (principal plus interest) forward in line with the maturity of such deposits. For most analytical purposes, they should be regarded as Hong Kong dollar deposits.
- (9) The consultation paper was related to the determination of capital base for calculation of the capital adequacy ratio (CAR).
- (10) The new measures are: First, designated merchants are to be allowed to open RMB deposit accounts and conduct one-way exchange of their RMB deposits into Hong Kong dollars, and the categories of merchants defined as designated merchants are to be expanded. Second, Hong Kong residents are to be allowed to open RMB current accounts and make payments for consumer spending in Guangdong Province by cheques within a daily limit, and the limits applicable to the exchange of RMB cash and RMB remittances are to be relaxed. Third, the cap on credit limits for RMB cards issued by participating banks is to be removed. These measures will be implemented in phases after the respective arrangements and technical preparatory work are completed.
- (11) The figures for private sector debt may not represent a full coverage of all the Hong Kong dollar debt paper issued.
- (12) Assets of the banking sector include notes and coins, amount due from authorized institutions in Hong Kong as well as from banks abroad, loans and advances to customers, negotiable certificates of deposits (NCDs) held, negotiable debt instruments other than NCDs held, and other assets. Certificates of indebtedness issued by Exchange Fund and the counterpart bank notes issued are nevertheless excluded.
- (13) The ranking is sourced from the World Federation of Exchanges, a global trade association for the stock exchange industry. Its membership comprises 54 stock exchanges, covering almost all globally recognised stock exchanges.

- (14) At end-December 2005, there were 934 and 201 companies listed on the Main Board and GEM respectively.
- (15) At end-December 2005, there were 43 classes of stock options contracts and 42 classes of stock futures contracts.
- (16) These figures are sourced from the Sales and Redemptions Survey conducted by the Hong Kong Investment Funds Association on their members, and cover only the active authorized funds that have responded to the survey. To provide a more accurate picture of the retail fund market in Hong Kong, the survey has been revamped, with effect from 2005, such that it would cover only retail transactions (including switching) and exclude institutional transactions. At end-November 2005, there were a total of 1 004 authorized-funds covered by the Survey.
- (17) There were 19 approved trustees at end-December 2005. On MPF products, 42 master trust schemes, two industry schemes and two employer sponsored schemes, comprising altogether 332 constituent funds, were approved by the Mandatory Provident Fund Schemes Authority. Around 226 500 employers, 1.97 million employees and 288 000 self-employed persons have participated in MPF schemes.
- (18) As at end-December 2005, there were 175 authorized insurers in Hong Kong. Within this total, 46 were engaged in long-term insurance business, 110 in general insurance business, and 19 in composite insurance business. These authorized insurers come from 22 countries and territories (including Hong Kong).

CHAPTER 6 : THE LABOUR SECTOR

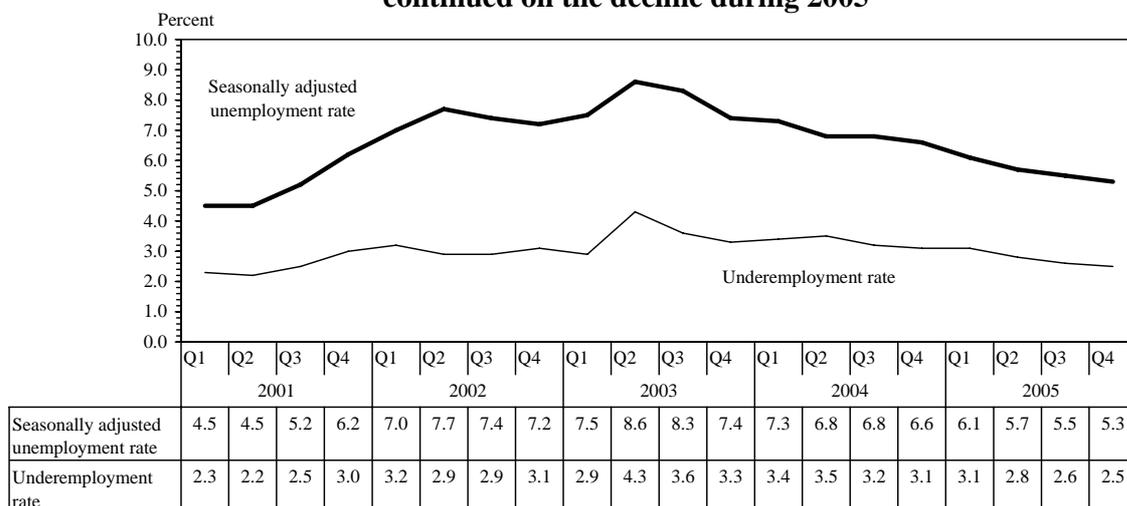
Summary

- *The labour market improved visibly for the second consecutive year in 2005, thanks to the continued upsurge in labour demand amid sustained economic growth and restructuring.*
- *Throughout the year total employment went up progressively, reaching a record high of 3.43 million in the fourth quarter, while the seasonally adjusted unemployment rate declined steadily to a four-year low of 5.3%.*
- *Overall labour wages and earnings staged a modest rebound during 2005, reversing the downtrend seen in the preceding three years.*

Overall labour market situation

6.1 After a year of visible revival in 2004, the labour market continued to fare strongly in 2005, on the back of sustained recovery in overall economic activity. Total employment trended upward over the course of the year to a new high of 3 431 500 in the fourth quarter, whereas the *seasonally adjusted unemployment rate*⁽¹⁾ subsided to 5.3%, the lowest level since July-September 2001. For 2005 as a whole, the unemployment rate went down markedly by 1.2 percentage points to 5.6%. Unemployment fell not only on a broad front, but also in terms of intensity, as manifested by a reduction in its median duration from 97 days to 83 days as well as in the number of unemployed persons for six months or more from 83 100 to 61 100. Meanwhile, the underemployment⁽²⁾ situation also improved, albeit to a lesser extent. (The seasonally adjusted unemployment rate and the underemployment rate fell further to 5.2% and 2.4% respectively in November 2005 - January 2006.)

Diagram 6.1 : Both unemployment and underemployment rates continued on the decline during 2005



Total employment and labour supply

6.2 *Employment growth*⁽³⁾ continued to distinctly outstrip the *labour supply growth*⁽⁴⁾ for the second year in a row, with respective increases of 2.3% and 1.0% in 2005. For the year as a whole, the number of employed person averaged at 3.39 million, up by 77 000 from a year earlier. This employment gain was not much different from the average annual growth of 85 200 recorded during the strong economic up-cycle over 1992-97. Moreover, total employment stayed on an uptrend during the course of 2005, hitting a new high of 3.43 million by the year-end. When compared to the trough in mid-2003, there was a significant jump of 242 400, much outpacing the increase of 116 400 in the labour force over the same period. While employment gains were observed extensively in almost all the major economic sectors, occupations and educational categories, a relatively greater proportion of the new jobs were still found at the upper end of the market. This underlines the importance of skills upgrading of the local workforce in order to meet the growing demand for higher-skilled workers in the economy.

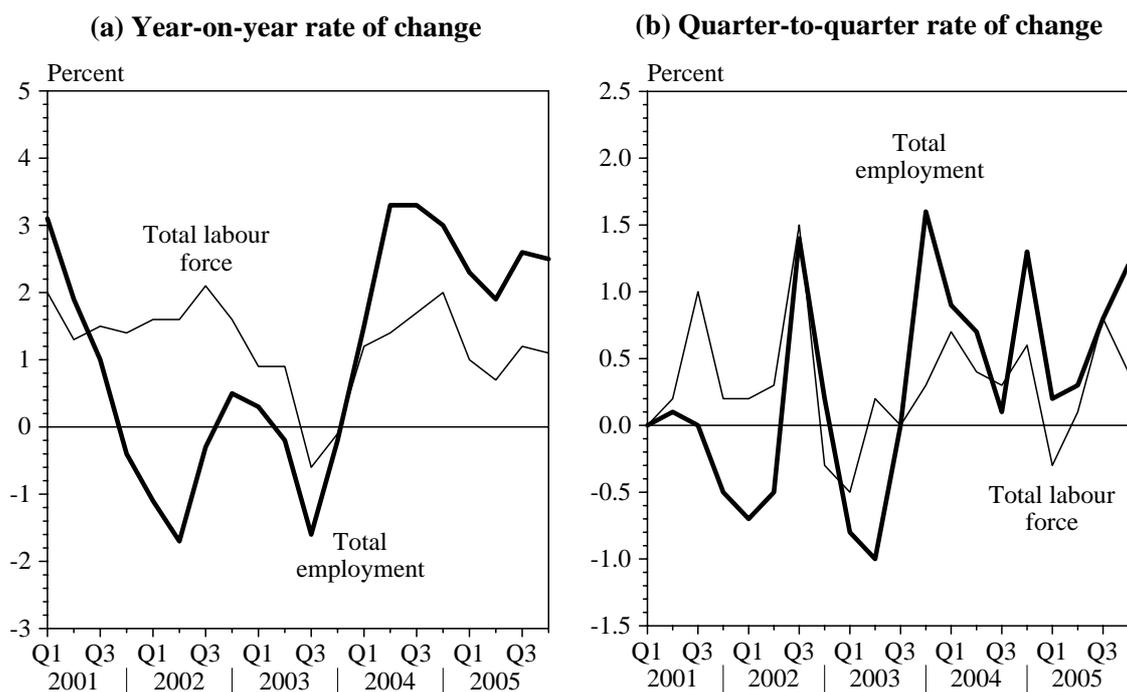
Table 6.1 : The labour force, and persons employed, unemployed and underemployed

		<u>Labour force</u>		<u>Persons employed</u>		<u>Persons unemployed</u> ^(a)	<u>Persons underemployed</u>
2004	Annual	3 551 000	(1.6)	3 308 600	(2.8)	242 500	116 700
	Q1	3 530 300	(1.2)	3 279 700	(1.5)	250 700	119 100
	Q2	3 543 800	(1.4)	3 302 900	(3.3)	240 900	122 800
	Q3	3 555 200	(1.7)	3 304 700	(3.3)	250 500	113 500
	Q4	3 574 900	(2.0)	3 347 000	(3.0)	227 900	111 300
2005	Annual	3 586 300	(1.0)	3 385 500	(2.3)	200 700	98 700
	Q1	3 565 100	(1.0)	3 354 500	(2.3)	210 600	109 800
	Q2	3 569 200	(0.7)	3 364 700	(1.9)	204 500	100 400
	Q3	3 597 300	(1.2)	3 391 600	(2.6)	205 700	95 000
	Q4	3 613 400	(1.1)	3 431 500	(2.5)	182 000	89 500
			<0.4>		<1.2>		

Notes : (a) These include first-time job-seekers and re-entrants into the labour force.
 () % change over a year earlier.
 < > % change over the preceding quarter.

Source : General Household Survey, Census and Statistics Department.

Diagram 6.2 : Total employment maintained a faster growth than total labour force in 2005



Profile of employment

6.3 Within the corporate sector, employment likewise surged by 2.3% in September 2005 and by 2.7% in the first nine months of 2005 over a year earlier. The main impetus to growth continued to come from the service sectors, with respective increases of 3.1% and 3.6% in the two periods. These outweighed the decreases seen in the local manufacturing sector by 1.0% and 3.0%, as well as those at building and construction sites by 12.4% and 10.4%⁽⁵⁾. More specifically for the service sectors, whereas employment gains were seen virtually across-the-board, more notable increases were observed in recreational and other personal services, sanitary services, financing and insurance, real estate, and hotels and boarding houses.

6.4 As regards the *civil service*, employment was reduced further by 2.4% year-on-year in September 2005 and by 3.0% for the first nine months as a whole. Consequential to natural wastage and the series of measures implemented over the past several years including the general recruitment freeze and the two Voluntary Retirement Schemes, the size of civil service establishment will be reduced to around 161 900 by end-March 2007.

Table 6.2 : Employment by major economic sector

	<u>2004</u>					<u>2005</u>		
	<u>Annual average</u>	<u>Mar</u>	<u>Jun</u>	<u>Sep</u>	<u>Dec</u>	<u>Mar</u>	<u>Jun</u>	<u>Sep</u>
Wholesale and import/export trades	567 700 (1.7)	556 600 (-1.3)	563 100 (0.9)	577 000 (3.8)	574 100 (3.4)	583 100 (4.8)	579 100 (2.8)	585 300 (1.4)
Retail trade	217 300 (3.1)	214 600 (2.3)	216 500 (3.6)	219 400 (6.0)	218 400 (0.6)	216 000 (0.7)	224 600 (3.7)	221 700 (1.0)
Restaurants and hotels	207 900 (6.0)	204 600 (3.2)	209 500 (9.7)	206 600 (6.6)	210 900 (4.7)	210 700 (2.9)	214 500 (2.3)	214 300 (3.7)
Water transport, air transport and services allied to transport	104 500 (6.6)	101 600 (1.4)	104 500 (8.7)	104 800 (8.5)	107 000 (8.1)	107 900 (6.2)	110 900 (6.1)	110 100 (5.1)
Storage and communications	35 900 (2.2)	35 900 (8.0)	36 100 (2.2)	35 300 (0.1)	36 100 (-1.0)	35 300 (-1.7)	36 400 (0.8)	35 300 (0.1)
Financing, insurance, real estate and business services	437 000 (3.6)	428 600 (1.4)	434 200 (3.6)	437 800 (3.7)	447 400 (5.6)	447 600 (4.4)	457 200 (5.3)	455 400 (4.0)
Community, social and personal services	420 200 (3.2)	412 000 (3.5)	418 100 (4.4)	415 700 (0.4)	435 200 (4.5)	434 400 (5.4)	437 000 (4.5)	437 700 (5.3)
Manufacturing	168 000 (-3.0)	168 900 (-5.6)	169 600 (-1.7)	168 000 (-2.8)	165 300 (-1.8)	163 100 (-3.5)	161 900 (-4.5)	166 300 (-1.0)
Building and construction sites	66 300 (-5.7)	69 100 (-4.5)	69 900 (-0.1)	64 900 (-8.1)	61 200 (-10.3)	65 800 (-4.8)	60 000 (-14.2)	56 800 (-12.4)
<i>All establishments surveyed in the private sector^(a)</i>	<i>2 271 400 (2.4)</i>	<i>2 239 000 (0.6) <0.6></i>	<i>2 268 400 (3.1) <1.0></i>	<i>2 276 000 (2.7) <0.2></i>	<i>2 302 100 (3.1) <1.1></i>	<i>2 310 000 (3.2) <0.8></i>	<i>2 327 300 (2.6) <0.5></i>	<i>2 328 900 (2.3) <-0.1></i>
<i>Civil service^(b)</i>	<i>160 800 (-3.8)</i>	<i>163 000 (-3.6)</i>	<i>161 700 (-3.9)</i>	<i>160 100 (-3.8)</i>	<i>158 400 (-3.8)</i>	<i>157 300 (-3.5)</i>	<i>156 800 (-3.0)</i>	<i>156 200 (-2.4)</i>

Notes : Employment figures enumerated from business establishments, as obtained from the Quarterly Survey of Employment and Vacancies, are somewhat different from those enumerated from households, as obtained from the General Household Survey. This is mainly due to difference in sectoral coverage: while the former survey covers selected major sectors, the latter survey covers all sectors in the economy.

(a) The total figures on private sector employment cover also employment in mining and quarrying and in electricity and gas supply, besides employment in the major sectors indicated above.

(b) These figures cover only those employed on civil service terms of appointment. Judicial officers, ICAC officers, locally engaged staff working in overseas Hong Kong Economic and Trade Offices, and other Government employees such as non-civil service contract staff are not included.

() % change over a year earlier.

< > Seasonally adjusted quarter-to-quarter % change.

Source : Quarterly Survey of Employment and Vacancies, Census and Statistics Department.

Profile of unemployment

6.5 The unemployment rate, whilst declining almost across-the-board, fell by different magnitudes in various economic sectors, occupations and educational categories, owing to variations in their labour demand/supply conditions. In 2005, the construction sector had the largest drop in unemployment rate, but this was attributable mainly to a contraction in labour force within the industry. Even so, its unemployment rate, at 12.9%, was still distinctly above the overall average (at 5.6%). Similarly, reduced labour supply was also the primary factor behind the fall in unemployment rate for the manufacturing sector to 6.3%. On the other hand, whilst the unemployment rate for the service sectors likewise decreased to 4.2%, it was rather due to a continued pick-up in labour demand in a wide range of service activities like the retail trade, real estate and sanitary services. More recently, increased labour demand has however become the most important factor affecting the unemployment situation in both the service and non-service sectors. Reflecting this, the unemployment rates for the manufacturing, and decoration and maintenance sectors, as well as for many of the service sectors such as transport and personal services, all went down considerably in the fourth quarter of 2005, consequential to notable employment gains.

6.6 Analysed by occupation category, the higher-skilled workers continued to face lower unemployment than the less-skilled workers, with their respective unemployment rates averaging at 2.4% and 6.4% for 2005 as a whole. This notwithstanding, in the fourth quarter of the year, it was the plant and machine operators and assemblers, and workers in elementary occupations, who faced a more visible decline in unemployment.

6.7 Analysed by educational attainment, workers with higher educational levels generally had a lower unemployment rate than the less educated ones. In 2005, the unemployment rate for persons with tertiary education was just 3.2% and for those with upper secondary or matriculated education was 5.0%, distinctly below the 8.5% for workers with lower secondary education or below. In the fourth quarter of 2005, persons with tertiary education witnessed a further drop in unemployment, as more of the fresh graduates were absorbed into employment. Meanwhile, the unemployment rate for the less educated workers also fell, albeit to a smaller extent.

Diagram 6.3 : Unemployment rate* fell across almost all the major sectors in 2005

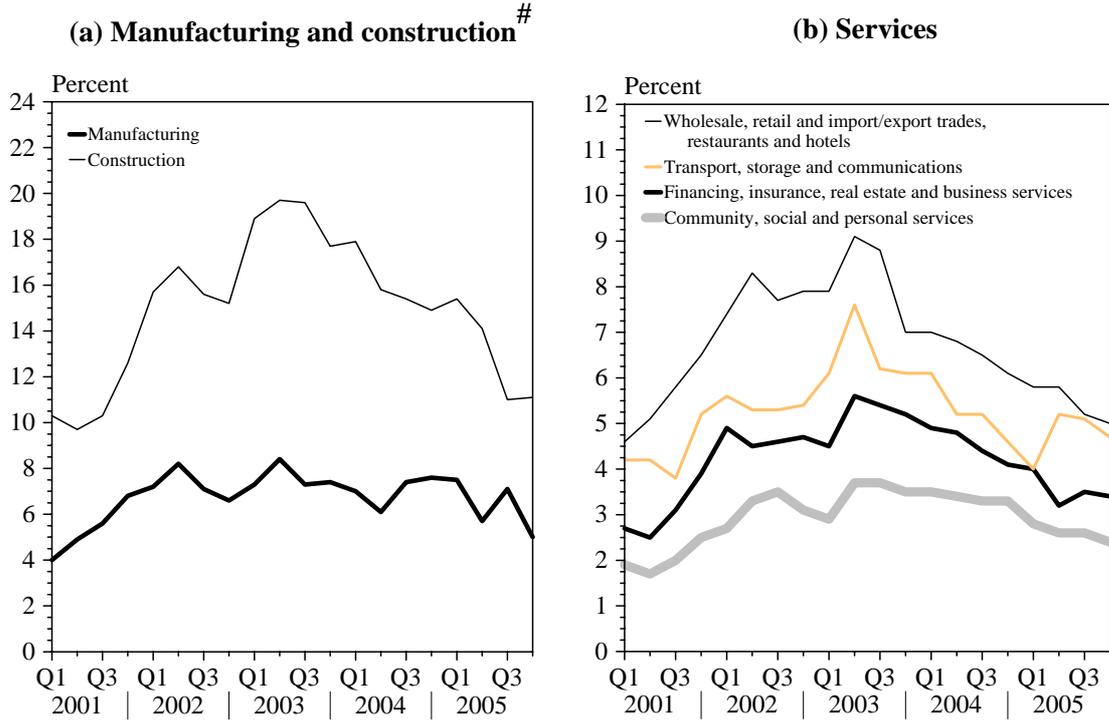


Diagram 6.4 : Unemployment rate* still generally higher among the less skilled workers

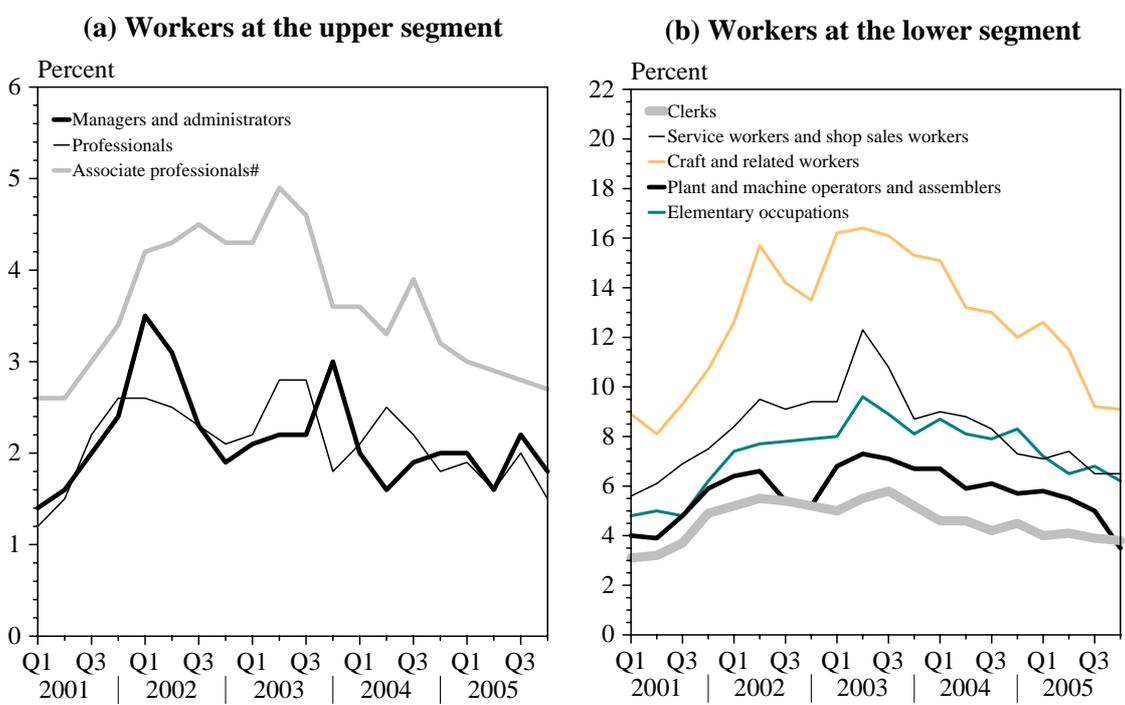
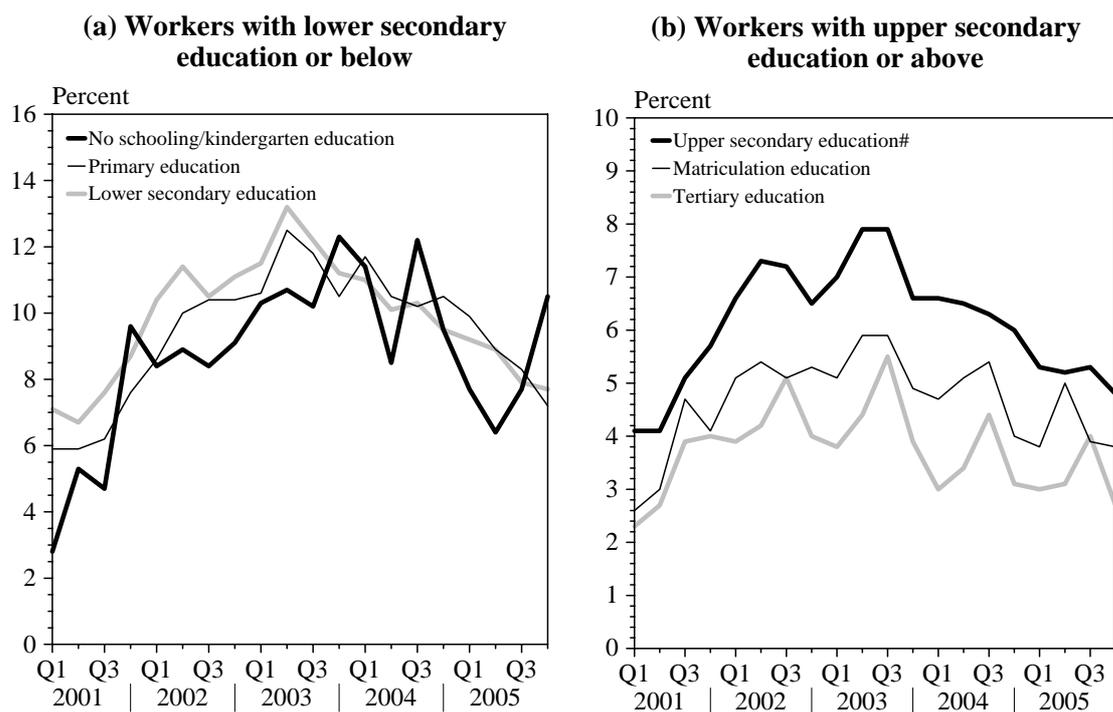


Diagram 6.5 : Workers with higher educational levels had lower unemployment rate*



Notes : (*) Not seasonally adjusted, but including first-time job seekers and re-entrants into the labour force.

(#) Including craft courses.

Profile of underemployment

6.8 In 2005, the underemployment rate averaged at 2.8%, down from 3.3% in 2004. Analysed by economic sector, decreases were concentrated in decoration and maintenance, the retail trade, welfare services, and amusement and recreational services. Within the local workforce, the less educated and lower-skilled workers, especially craft and related workers, plant and machine operators and assemblers, and workers in elementary occupations, were the ones most affected by underemployment, although the situation also showed some improvement over the course of the year.

6.9 More recently, while the underemployment rate kept edging lower to 2.5% in the fourth quarter of 2005, more visible decreases were seen mainly among service workers and shop sales workers, and workers in elementary occupations, among persons with lower secondary education or below, or among those engaged in foundation and superstructure construction, restaurants, sanitary services and miscellaneous personal services.

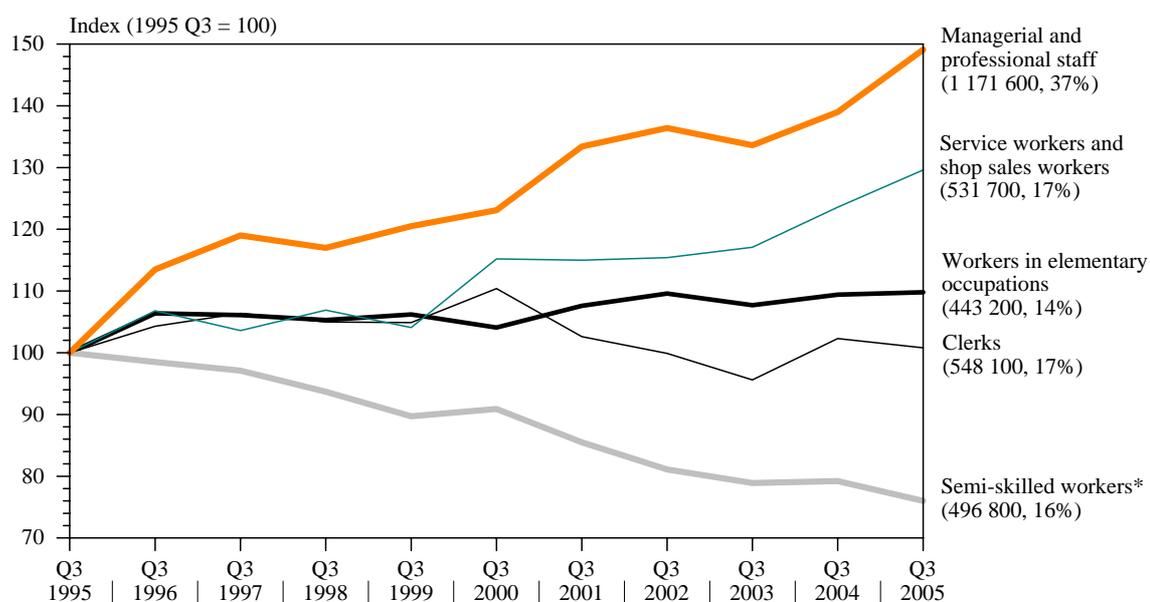
Box 6.1

An analysis of employment and income growth

Over the past decade, the total number of employed persons⁽¹⁾ grew by an average of 1.3% per annum, reaching 3.19 million in Q3 2005. The increase was most apparent among higher-skilled workers, including managers and administrators, professionals and associate professionals, with an average growth at 4.1% per annum, followed by service workers and shop sales workers, at 2.6% per annum. Meanwhile, workers in the other occupations registered relatively minor changes.

At 37% in Q3 2005, the share of higher-skilled workers in total employment was distinctly higher than that of 28% in Q3 1995. During the decade, the ratio of lower-skilled workers to higher-skilled workers decreased considerably from 2.6 : 1 to 1.7 : 1, amid the increasing transformation of the economy towards higher value-added and knowledge-based activities, as well as the on-going trend of office automation and relocation of back-office jobs to the Mainland. Concurrent with this shift in employment composition, there was a continuous improvement in the educational attainment of the local workforce, as manifested by the increase in the proportion of workers with tertiary education from 18.9% in Q3 1995 to 29.2% in Q3 2005.

Employment by major occupation category



Notes : Figures in brackets represent the number of employed persons (excluding foreign domestic helpers) in Q3 2005, and the percentage figures refer to the proportion of employed persons in the respective occupations.

(*) Semi-skilled workers include craft and related workers, and plant and machine operators and assemblers.

With proportionately more people moving up the occupational hierarchy, employment earnings for employees⁽²⁾ as a whole improved over the past decade. Reflecting this, the average monthly employment earnings of employees rose from \$11,800 in Q3 1995 to \$14,800 in Q3 2005⁽³⁾, representing a cumulative gain of 25% over the period. Improvement

(1) Foreign domestic helpers are excluded throughout the analysis.

(2) Employees accounted for an overwhelming proportion of 87% of total employment in Q3 2005. Self-employed persons and employers are excluded in the analysis and they had smaller shares of 7% and 5% respectively.

(3) The price levels for 1995 Q3 and 2005 Q3 were broadly similar, as the deflation prevailing during late 1998 to mid-2004 was virtually offset by the inflation in the remaining periods.

Box 6.1 (cont'd)

in workers' earnings was also reflected by the decline in the number and proportion of full-time employees with monthly employment earnings less than \$5,000 between Q3 1995 and Q3 2005. During this period, whereas the number of low-income employees went up in overall terms, it was attributable primarily to an increase in the number of part-time employees working voluntarily for less than 35 hours a week, from 44 000 to 77 400. At the same time, the number of underemployed low-income employees also increased, but to a lesser extent.

Employees with monthly employment earnings below \$5,000

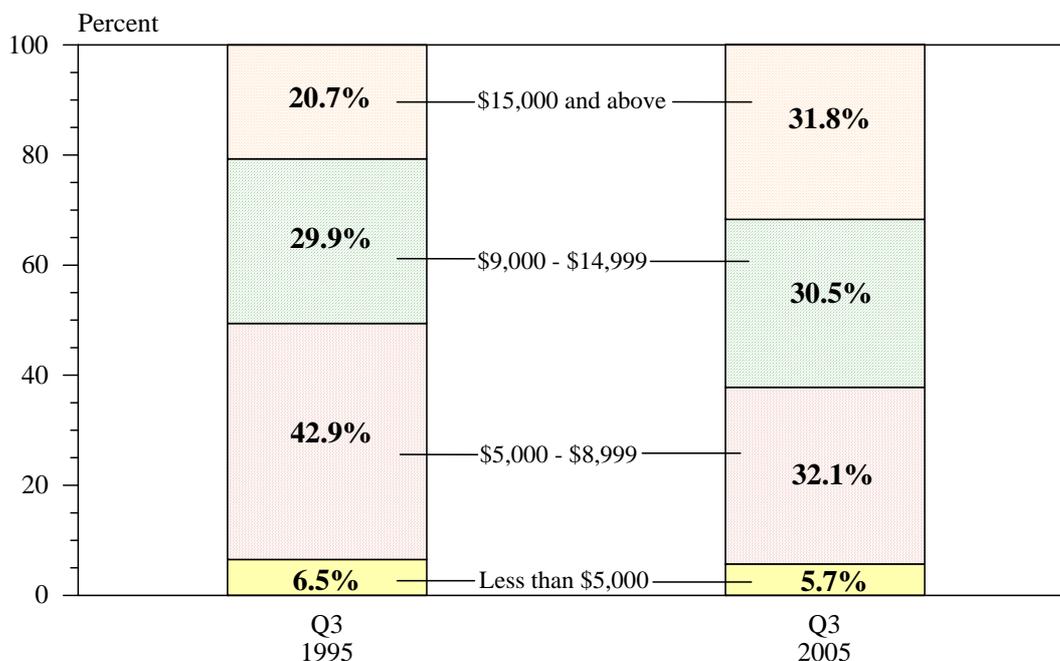
Part-time, of whom :

	<u>Full-time</u>	<u>Involuntary or underemployed</u>	<u>Voluntary</u>	<u>Overall</u>
1995 Q3	149 000 (6.0)	32 700 (1.3)	44 000 (1.8)	225 700 (9.1)
2005 Q3	140 100 (5.0)	49 800 (1.8)	77 400 (2.8)	267 300 (9.6)

Note : () Figures in brackets represent percentage shares in all employees.

More specifically on employment earnings of full-time employees, there was a distinct surge in those employees in the upper strata earning \$15,000 or more per month, from one-fifth of the total in Q3 1995 to around one-third in Q3 2005. This offset the concurrent decline in the proportion of full-time employees earning \$5,000 - 8,999 per month. Meanwhile, the proportion of middle-income employees earning \$9,000 - 14,999 per month held broadly stable.

Share of full-time employees* by monthly employment earnings



Note : (*) Excluding foreign domestic helpers.

Vacancies

6.10 Job vacancies in the *private sector establishments* maintained double-digit growth of 32.7% over a year earlier to 43 600 in September 2005. This was almost back to the end-1997 level, just before the Asian financial crisis. Also worth noting was that over the past year, there was a much larger increase in vacancies for the lower-skilled workers than for the higher-skilled ones, by 47.1% as against 15.1%. Consequently, more than three-fifths of the vacancies were created at the lower segment of the labour market, mainly in such sectors as the retail, import/export trades, restaurants and business services. For the first nine months of 2005 as a whole, vacancies in the private sector surged by 26.9% over a year earlier. As to openings in the *civil service*, the number remained small at only 700 in September 2005, with most of them involving posts from the disciplinary services exempt from the general recruitment freeze.

6.11 More recent data on job vacancies in selected industries can be available from the Employment Services of the Labour Department. The figures indicated that the number of vacancies in the private sector registered a further robust growth of 32.2% year-on-year in the fourth quarter of 2005. On average, 1 600 vacancies were received on each working day. Meanwhile, the number of placements attained by the Department also increased markedly by 28.9%.

6.12 In addition to its regular employment services provided through the network of job centres, a telephone employment service centre, a job vacancy processing centre and an interactive employment service website, the Labour Department has also organised a number of general or theme-specific job fairs. These provide an efficient channel for job seekers to look for suitable jobs, and for employers to do recruitment. In 2005, 12 large-scale and 46 district-based job fairs had been held, reaching out to such remote districts as Sheung Shui, Tin Shui Wai, Yuen Long and Tuen Mun.

Table 6.3 : Vacancies by major economic sector

	<u>No. of vacancies</u>								Vacancy rate in Sep 2005 (%)
	Annual average	<u>2004</u>				<u>2005</u>			
		<u>Mar</u>	<u>Jun</u>	<u>Sep</u>	<u>Dec</u>	<u>Mar</u>	<u>Jun</u>	<u>Sep</u>	
Wholesale and import/export trades	7 600 (56.5)	7 200 (64.7)	8 700 (77.5)	8 000 (51.7)	6 400 (33.0)	10 300 (42.4)	9 300 (7.2)	9 100 (13.4)	1.5
Retail trade	2 600 (58.7)	2 300 (108.2)	2 400 (55.2)	3 300 (97.3)	2 600 (11.0)	3 000 (33.7)	3 300 (35.7)	4 800 (46.8)	2.1
Restaurants and hotels	2 100 (63.2)	1 800 (113.1)	2 200 (100.6)	2 500 (50.1)	2 100 (27.1)	2 400 (39.3)	2 700 (24.3)	4 300 (70.8)	2.0
Water transport, air transport and services allied to transport	1 100 (129.0)	900 (102.3)	1 300 (161.0)	1 300 (192.8)	800 (60.6)	1 400 (57.9)	1 500 (19.0)	1 800 (37.4)	1.6
Storage and communications	600 (55.7)	600 (83.8)	400 (-3.3)	800 (83.7)	400 (73.7)	400 (-27.4)	600 (38.8)	1 200 (46.3)	3.3
Financing, insurance, real estate and business services	9 000 (59.6)	8 600 (106.0)	9 000 (45.4)	9 300 (62.2)	8 900 (40.4)	10 500 (21.5)	11 200 (23.8)	12 000 (28.8)	2.6
Community, social and personal services	5 900 (40.7)	5 200 (56.5)	6 200 (34.2)	5 800 (20.7)	6 200 (59.2)	6 800 (30.1)	7 200 (15.2)	8 000 (39.3)	1.8
Manufacturing	1 500 (46.9)	1 500 (37.5)	1 600 (30.2)	1 500 (67.0)	1 400 (61.7)	2 000 (33.1)	1 900 (16.2)	2 000 (28.8)	1.2
Building and construction sites	# (53.9)	# (57.7)	100 (118.5)	# (69.2)	# (-8.3)	# (-92.7)	# (-84.7)	# (-77.3)	*
<i>All establishments surveyed in the private sector^(a)</i>	<i>30 700 (55.8)</i>	<i>28 400 (78.7)</i>	<i>32 200 (55.0)</i>	<i>32 800 (55.3)</i>	<i>29 200 (39.8)</i>	<i>37 100 (30.4)</i>	<i>38 000 (17.9)</i>	<i>43 600 (32.7)</i>	<i>1.8</i>
		<i><12.9></i>	<i><9.9></i>	<i><7.9></i>	<i><4.8></i>	<i><4.7></i>	<i><0.2></i>	<i><19.7></i>	
<i>Civil service^(b)</i>	<i>600 (-59.8)</i>	<i>400 (-72.3)</i>	<i>300 (-82.6)</i>	<i>100 (-94.2)</i>	<i>1 600 (36.8)</i>	<i>1 500 (231.5)</i>	<i>1 100 (270.4)</i>	<i>700 (672.5)</i>	<i>0.4</i>

Notes : Vacancy rate refers to the ratio of vacancies to total employment opportunities (actual employment plus vacancies).

(a) The total figures on private sector vacancies cover also vacancies in mining and quarrying and in electricity and gas supply, besides vacancies in the major sectors indicated above.

(b) These figures cover only vacancies for those staff to be employed on civil service terms of appointment. They have been adjusted by deducting the vacant posts emerging from the Voluntary Retirement Schemes. A general recruitment freeze to the civil service has been imposed with effect from 1 April 2003. The civil service vacancies during the general recruitment freeze period refer only to the number of vacant posts for which exemptions from recruitment freeze have been granted.

() % change over a year earlier.

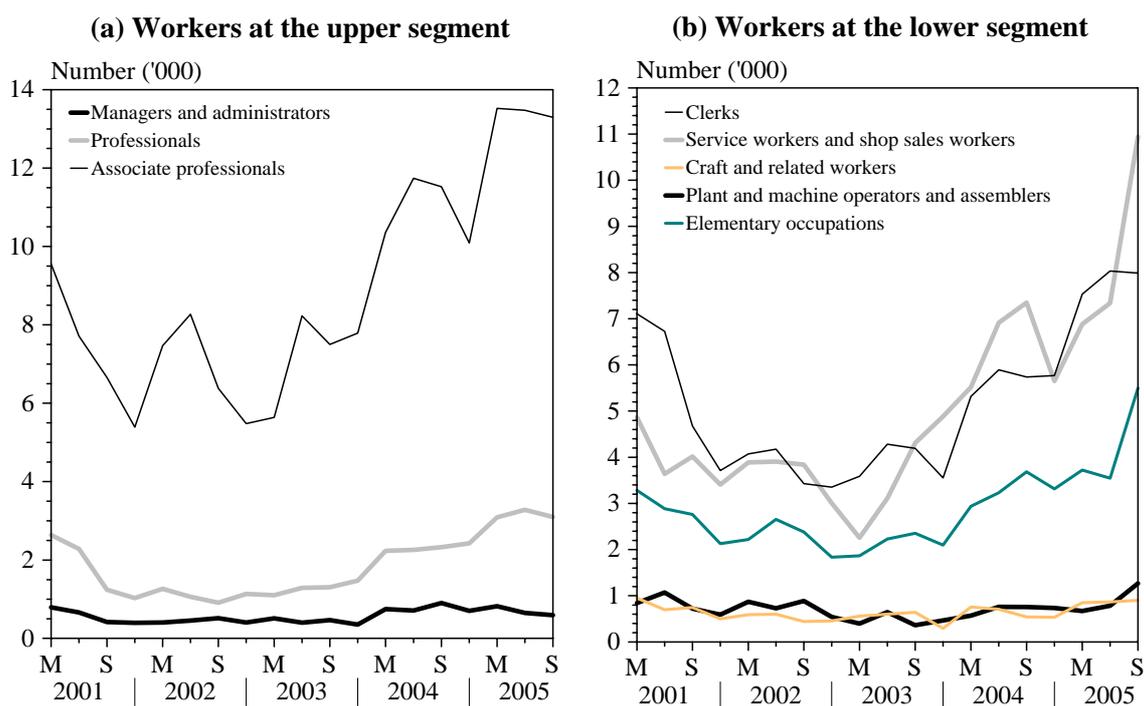
< > Seasonally adjusted quarter-to-quarter % change.

(#) Less than 50.

(*) Less than 0.05%.

Source : Quarterly Survey of Employment and Vacancies, Census and Statistics Department.

**Diagram 6.6 : Vacancies in the private sector
rose back to the end-1997 level**

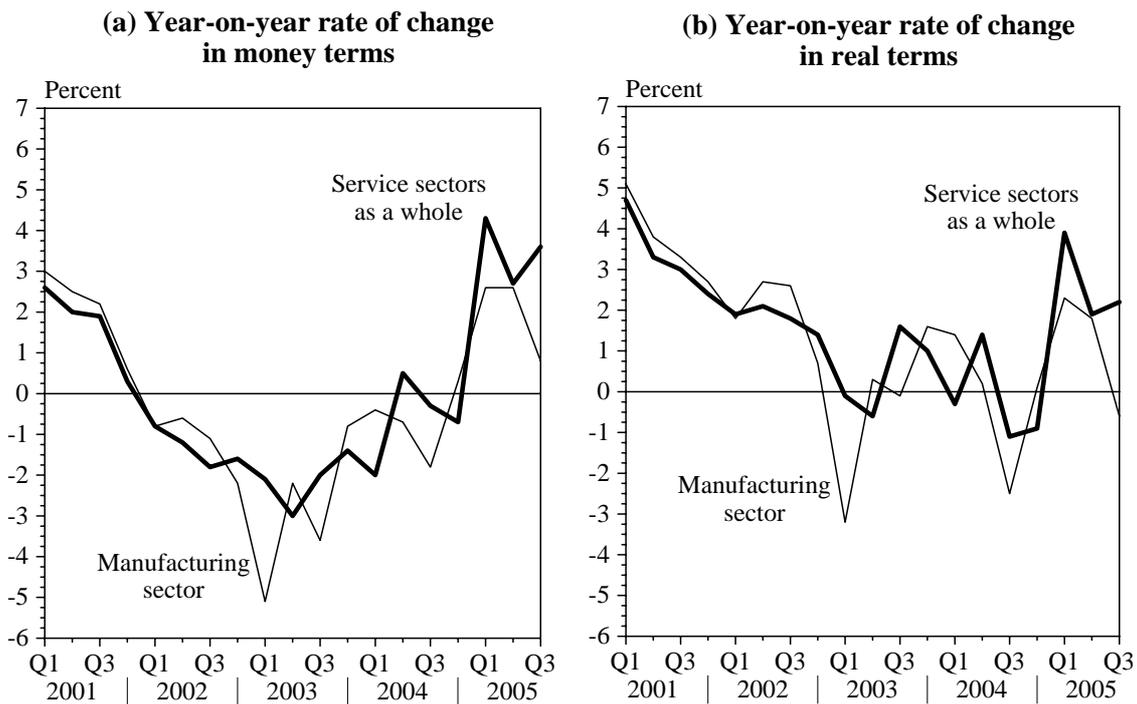


Earnings and wages

6.13 Labour earnings reverted to increase since the beginning of 2005, along with progressive tightening of the labour market conditions, thereby reversing the downtrend in the preceding three years. *Labour earnings*⁽⁶⁾, as measured by payroll per person engaged in private sector, moved up by 3.5% in money terms or 2.6% in real terms⁽⁷⁾ in the first three quarters of 2005 over a year earlier.

6.14 In the third quarter of 2005, labour earnings rose by 3.2% in money terms or 1.8% in real terms. There was a widespread increase in earnings among workers in the service sectors, save for those engaged in community, social and personal services which were still subject to the spill-over effect arising from the pay cut of civil servants since January 2005. Meanwhile, earnings for manufacturing workers, whilst also up modestly in money terms, registered a slight decrease in real terms. Based on the latest indications from the General Household Survey, the median monthly employment earnings of the entire workforce showed a further increase of 3.2% in money terms or 1.4% in real terms in the fourth quarter over a year earlier.

Diagram 6.7 : Labour earnings bounced up since the beginning of 2005



6.15 As for *labour wages*, there had been a similar upturn since early 2005. Comparing the first nine months of 2005 with a year earlier, labour wages edged up by 0.6% in money terms. This smaller gain as compared to labour earnings reflects the difference in coverage of the two sets of earning data, with wages covering only the regular earnings of workers up to the supervisory level. Yet in times of economic upturn, business establishments tend to rely more on the variable or discretionary pay (and thus less on basic wages) in rewarding employees in order to maintain greater flexibility in labour cost. Discounting the increase in consumer prices, labour wages were slightly down by 0.7% in real terms over the same period.

6.16 In September 2005 alone, labour wages had a 0.8% rise in money terms or a 0.7% decrease in real terms on a year-on-year comparison. Wages went up mildly in money terms in the manufacturing, transport, and financing, insurance, real estate and business services sectors. Concurrently, a larger increase was seen in the distributive and catering trades, due to stronger labour demand amid the buoyant external trade and solid growth in consumer spending and inbound tourism. On the other hand, some reduction in wages was observed in personal services.

Box 6.2

An analysis of the low-income employees

In the current phase of economic recovery between Q3 2003 and Q3 2005, the total number of employees⁽¹⁾ has gone up by about 200 000 or 8%. This increase occurred entirely among employees with monthly income of \$5,000 or above⁽²⁾. Meanwhile, the number of employees earning less than \$5,000 per month⁽³⁾ fell amid the economic upturn. Conceivably, some of the low-income employees (i.e. with monthly employment earnings below \$5,000) might have moved up the income ladder and a certain proportion of the previously unemployed persons might have taken up jobs with income of \$5,000 or more, whereas some others found jobs with lower earnings.

Employees by monthly employment earnings

	<u>Q3 2003</u>	<u>Q3 2005</u>	<u>Difference</u>
Below \$5,000	274 700	267 300	-7 400
\$5,000 - \$7,999	558 100	622 800	64 700
\$8,000 - \$9,999	380 400	422 100	41 600
\$10,000 - \$12,999	390 400	454 300	63 800
\$13,000 or above	974 100	1 010 000	35 900
Total	2 577 800	2 776 400	198 600

Among the 267 300 low-income employees in Q3 2005, 29% were part-time workers (working voluntarily less than 35 hours per week) and 19% underemployed employees (working involuntarily less than 35 hours per week). The remaining 52% or 140 100 comprised full-time workers. Over the period Q3 2003 to Q3 2005, the size of low-income employees working on a full-time or underemployed basis decreased in both absolute and proportionate terms. Concurrently, those employees working voluntarily on a part-time basis, including homemakers, students, etc, showed a considerable increase, along with the pick-up in economic activity and new job opportunities.

Employees with monthly employment earnings below \$5,000

	<u>Full-time</u>	<u>Part-time, of whom :</u>		<u>Overall</u>
		<u>Involuntary or underemployed</u>	<u>Voluntary</u>	
2003 Q3	150 400 (5.8)	62 300 (2.4)	62 100 (2.4)	274 700 (10.7)
2005 Q3	140 100 (5.0)	49 800 (1.8)	77 400 (2.8)	267 300 (9.6)

Note : () Figures in brackets represent percentage shares in all employees.

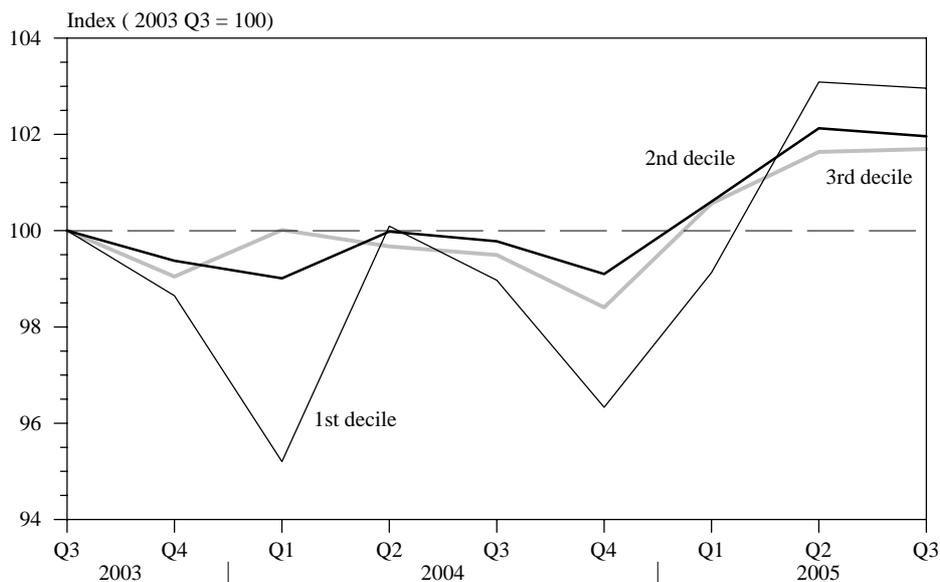
- (1) Defined here to exclude foreign domestic helpers. In Q3 2005, employees accounted for 87% of total employment, while self-employed persons and employers accounted for 7% and 5% respectively.
- (2) The price levels in Q3 2003 and in Q3 2005 were broadly similar, as the rebound in prices after mid-2004 had been mild.
- (3) The overall median monthly employment earnings (excluding FDHs) stood at \$10,000 in Q3 2005. Hence employees earning less than \$5,000 per month had income less than half of the overall median.

Box 6.2 (cont'd)

A more detailed analysis indicated that among the 140 100 full-time low-income employees in Q3 2005, about two-thirds were female workers, whereas about half were aged 40-59. Analysed by educational attainment, persons with primary education or below accounted for over one-third of the total, while those with lower or upper secondary education accounted for around one-quarter each. Furthermore, around half of the people in this particular group were workers in elementary occupations, and another one-quarter service workers and shop sales workers, as the wholesale, retail and import/export trades, restaurants and hotels, and community, social and personal services were the economic sectors where an overwhelming majority (71%) of the full-time low-income employees were found. As to the 49 800 underemployed low-income workers, their socio-economic characteristics were broadly similar, except that there were comparatively larger proportions of male workers as well as craft and related workers, many of whom were engaged in the construction sector.

A further analysis of employment earnings by decile group showed that for low-income employees in the bottom three decile groups, their average monthly employment earnings, having mostly followed a downtrend during 2003 and 2004, began to bounce up in the early part of 2005. Comparing Q3 2005 with a year earlier, such employment earnings rose by 2-4%. This was the combined result of a rise in the number of full-time employees within those decile groups, as well as a broad-based improvement in the average employment earnings among all the full-time, underemployed and part-time employees concerned.

Average monthly employment earnings of employees at the lowest three decile groups



6.17 Pursuant to the Public Officers Pay Adjustments (2004/2005) Ordinance, civil service pay was reduced by 3% on 1 January 2004 and a further 3% on 1 January 2005. All civil service pay points, expressed in dollar terms, have henceforth been brought back to their levels at 30 June 1997. In 2005, the government embarked on a pay level survey for the civil service to ascertain whether civil service pay is broadly comparable with the private sector counterpart. The survey field work is currently underway. The government will consider the next civil service pay adjustment in 2006 when the findings of the pay level survey are available.

Notes :

- (1) For a person aged 15 or above to be classified as unemployed, he or she should: (a) not have a job and not be performing any work for pay or profit during the reference period (i.e. seven days before enumeration); and (b) be available for work during the reference period; and (c) be seeking work during the 30 days before enumeration.

Notwithstanding the above, the following types of persons are also considered unemployed: (a) persons without a job, having sought work but not available for work because of temporary sickness; (b) persons without a job, available for work but not having sought work because they will take up new jobs or start business at a subsequent date, or expect to return to their original jobs; and (c) discouraged workers not having sought work because they believe work is not available to them.

Even at full employment, some frictional unemployment is bound to exist as workers move between jobs in order to obtain better terms of employment. The precise level of unemployment which can be described as purely frictional varies amongst economies, depending on the structure and characteristics of their labour markets.

In April 2001, the Census and Statistics Department put out a revised series of seasonally adjusted unemployment rate compiled by reference to the X-11 ARIMA method, which adjusts for all seasonal variations in employment and unemployment (i.e. the changes due to holiday effects, seasonally ups and downs in economic activity, seasonal variations in first-time job-seekers, etc). This replaces the former series which adjusts only for seasonal variations in the proportion of first-time job-seekers in the labour force. For more details, see Note (3) at the end of Chapter 5 of the Half-yearly Economic Report 2001.

- (2) The main criteria for an employed person aged 15 or above to be classified as underemployed are: involuntarily working less than 35 hours during the reference period (i.e. seven days before enumeration), and either available for additional work during the reference period or seeking additional work during the 30 days before enumeration.

Following these criteria, employed persons taking no-pay leave due to slack work during the reference period are also classified as underemployed if they had worked less than 35 hours or were on leave for the entire reference period.

- (3) The employed population refers to those persons aged 15 or above who performed work for pay or profit or had a formal job attachment during the reference period (i.e. seven days before enumeration).
- (4) The labour force, or the economically active population, is defined to include all persons aged 15 or above who either were engaged in productive work during the reference period (i.e. seven days before enumeration) or would otherwise have been engaged in productive work but were unemployed.
- (5) Taking into account off-site workers and related professional and support staff, employment in the entire building and construction sector increased, by 0.7% in 2005 over a year earlier.

Employment for the construction sector as a whole is enumerated from the General Household Survey carried out by the Census and Statistics Department. Apart from site workers, it also includes non-site workers engaged in minor alteration and addition, repair, maintenance and interior decoration work on existing buildings. In addition, it includes professional, administrative and other support personnel engaged in that sector, such as engineers, architects, surveyors and contract managers, as well as general clerical staff.

- (6) In addition to wages, which include all regular payments like basic pay and stipulated bonuses and allowances, earnings also cover overtime pay and other non-guaranteed or irregular bonuses and allowances, except severance pay and long service payment. Because of this difference, as well as the difference in sectoral and occupational coverage, the movements in average earnings, as measured by payroll per person engaged, do not necessarily match closely with those in wage rates.
- (7) Different consumer price indices are used for compiling the real indices of labour earnings and wages, taking into account their relevance to the respective occupation coverage. Specifically, the Composite CPI, being an indicator of overall consumer prices, is taken as the price deflator for earnings received by employees at all levels of the occupational hierarchy. The CPI(A), being an indicator of consumer prices for the middle to lower income groups, is taken as the price deflator for wages in respect of workers on occupations up to the supervisory level, and also in respect of manual workers engaged in the construction sector.

CHAPTER 7 : PRICES

Summary

- *The CCPI inflation climbed up progressively over the course of 2005, reaching 1.8% in December yet averaging at a modest 1.1% for the year as a whole. This essentially is a continuation of the re-inflation process that began in late 2004, as local costs resumed increases after a prolonged period of decline, now that the economy has finally embarked on a full-fledged upswing.*
- *While the economy grew briskly throughout 2005, the pressure on aggregate supply, though with some build-up over the year, was not particularly heavy as to drive up inflation to a significant extent. Domestic cost pressures actually stayed modest through to the year-end, being mitigated by substantial expansion in production capacity afforded by rapid productivity growth. Unit labour costs were flat through the year, while unit rental costs in overall terms showed only a moderate increase.*
- *The decline in the GDP deflator tapered in the first half of 2005, turned positive by the third quarter and edged up further in the fourth quarter, mainly due to the faster increase in domestic prices and the continued fading out of the terms of trade drag amidst a stronger US dollar.*
- *2006 is likely to see some further creeping up in consumer price inflation, when the impact of higher rentals shows up more and as an improving labour market gives rise to higher wages and earnings. But with aggregate demand expected to grow at a pace broadly in line with aggregate supply, inflation is likely to remain at a rather healthy level for the year as a whole.*

Consumer prices

7.1 After the return to positive inflation in late 2004, consumer price inflation continued to climb up over the course of 2005, in tandem with the rise-back in wages and rentals along the concurrent economic upswing. Domestic cost pressures, though naturally with some building up over the course of 2005, were actually quite well contained through to the year-end, especially when seen in conjunction with the very strong economic growth over the past two years. The imminent pressure on resources have been mitigated by solid expansion in production capacity – thanks to continued surge in labour productivity and also heavy investment in machinery and equipment, but a

rather slow pass-through of the earlier rental cost increase had also helped maintain the pace of CPI upturn at a modest pace. Although there was some feed-through from soaring oil prices, the upward price pressure from the external front in overall terms was not strong and actually easing in the year, owing to the modest appreciation of the Hong Kong dollar after the first quarter, and also some easing back in oil prices in late 2005.

7.2 Reflecting these underlying developments, consumer price inflation in terms of the *Composite Consumer Price Index (CPI)*⁽¹⁾ climbed modestly from 0.4% in the first quarter to 0.8% in the second quarter, then rose further to 1.4% in the third quarter and 1.8% in the fourth quarter. For the year as a whole, Composite CPI inflation was only a modest 1.1%, the first year of inflation since 1999. Looking ahead, consumer price inflation is expected to creep up further in 2006, when the more recent increase in rentals⁽²⁾ and higher wages from a tighter labour market are transmitted to the retail price level (*Paragraphs 2.19-2.20*).

Diagram 7.1 : Consumer price inflation, though edging up, remained benign through to end-2005

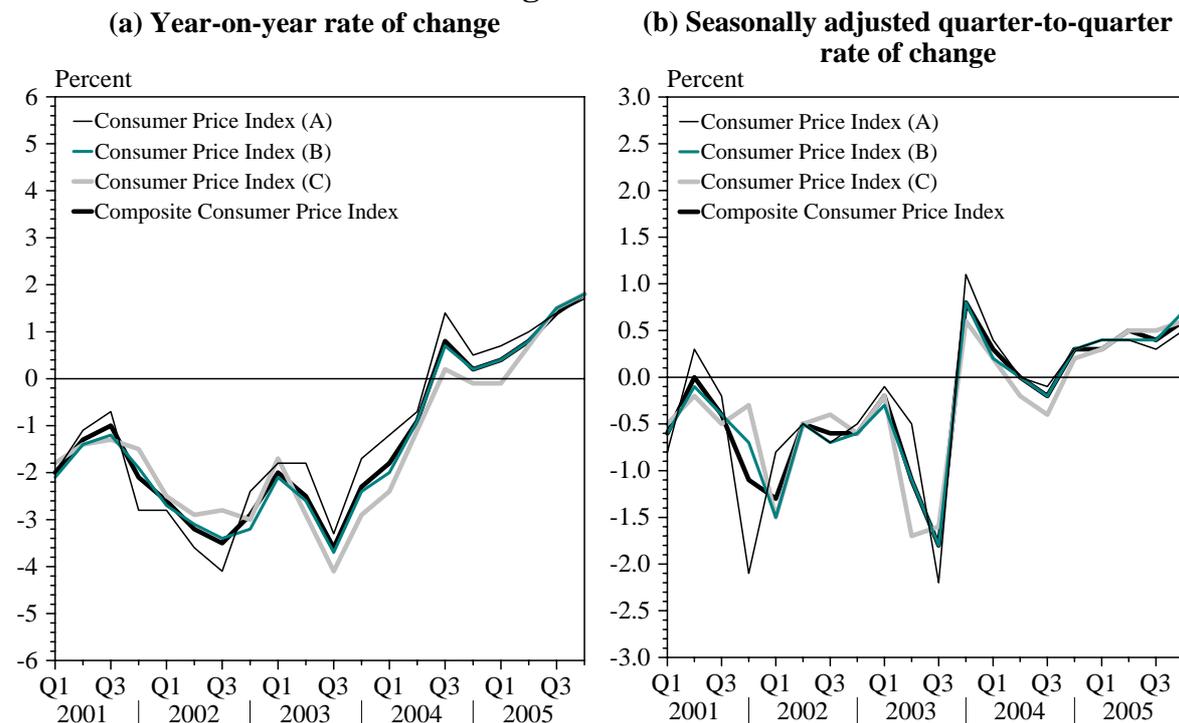


Diagram 7.2 : Broad-based price increases amidst the return of pricing power of retailers

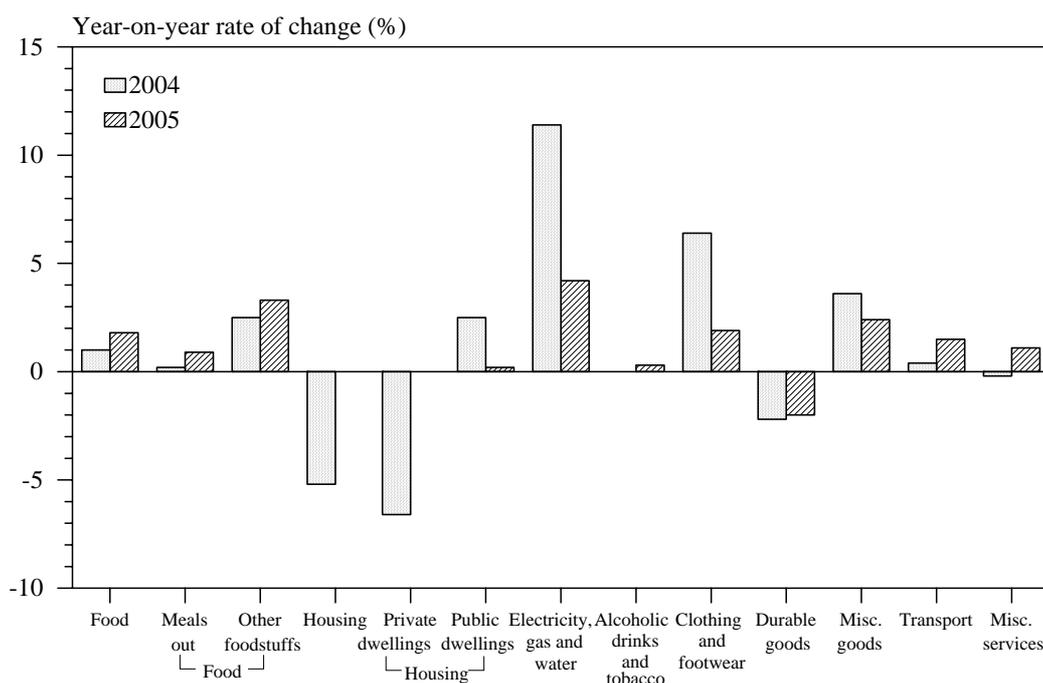


Table 7.1 : Consumer Price Indices (year-on-year rate of change (%))

		<u>Composite CPI</u>		<u>CPI(A)</u>		<u>CPI(B)</u>		<u>CPI(C)</u>	
2004	Annual	-0.4		*		-0.5		-0.9	
	H1	-1.3		-1.0		-1.4		-1.8	
	H2	0.5		0.9		0.4		0.1	
	Q1	-1.8	(0.3)	-1.2	(0.4)	-2.0	(0.2)	-2.4	(0.2)
	Q2	-0.9	(*)	-0.7	(*)	-0.9	(*)	-1.1	(-0.2)
	Q3	0.8	(-0.2)	1.4	(-0.1)	0.7	(-0.2)	0.2	(-0.4)
	Q4	0.2	(0.3)	0.5	(0.3)	0.2	(0.3)	-0.1	(0.2)
	2005	Annual	1.1		1.2		1.1		1.0
H1		0.6		0.8		0.6		0.3	
H2		1.6		1.5		1.7		1.7	
Q1		0.4	(0.3)	0.7	(0.4)	0.4	(0.4)	-0.1	(0.3)
Q2		0.8	(0.5)	1.0	(0.4)	0.8	(0.4)	0.7	(0.5)
Q3		1.4	(0.4)	1.4	(0.3)	1.5	(0.4)	1.5	(0.5)
Q4		1.8	(0.6)	1.7	(0.5)	1.8	(0.7)	1.8	(0.6)

Notes : () Figures in parentheses denote seasonally adjusted quarter-to-quarter rates of change.

(*) Change of less than 0.05%.

**Table 7.2 : Composite Consumer Price Index by component
(year-on-year rate of change (%))**

<u>Expenditure component</u>	<u>Weighting</u>	<u>2004</u>	<u>2005</u>	<u>2005</u>			
				<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>
Food	26.67	1.0	1.8	1.9	1.9	1.9	1.5
<i>Meals bought away from home</i>	16.39	0.2	0.9	0.6	0.8	1.1	1.1
<i>Other foodstuffs</i>	10.28	2.5	3.3	3.9	3.6	3.3	2.3
Housing ^(a)	29.91	-5.2	*	-2.6	-0.9	1.0	2.7
<i>Private dwellings</i>	24.59	-6.6	*	-3.4	-1.3	1.3	3.3
<i>Public dwellings</i>	2.07	2.5	0.2	0.1	0.2	0.2	0.1
Electricity, gas and water	2.98	11.4	4.2	4.1	5.1	3.2	4.3
Alcoholic drinks and tobacco	0.94	*	0.3	0.1	0.4	0.6	0.2
Clothing and footwear	4.13	6.4	1.9	3.4	2.2	2.2	0.1
Durable goods	6.24	-2.2	-2.0	-2.2	-1.9	-1.7	-2.1
Miscellaneous goods	5.70	3.6	2.4	1.5	2.1	2.7	3.2
Transport	9.01	0.4	1.5	0.7	1.2	2.1	2.0
Miscellaneous services	14.42	-0.2	1.1	1.4	0.7	0.8	1.4
All items	100.00	-0.4	1.1	0.4	0.8	1.4	1.8

Notes : (a) The housing component covers rents, rates, Government rent, maintenance costs and other housing charges. Its sub-components on private and public dwellings as presented here, however, cover rents, rates and Government rent only. Hence, the combined weighting of private and public dwellings is slightly less than the weighting of the entire housing component.

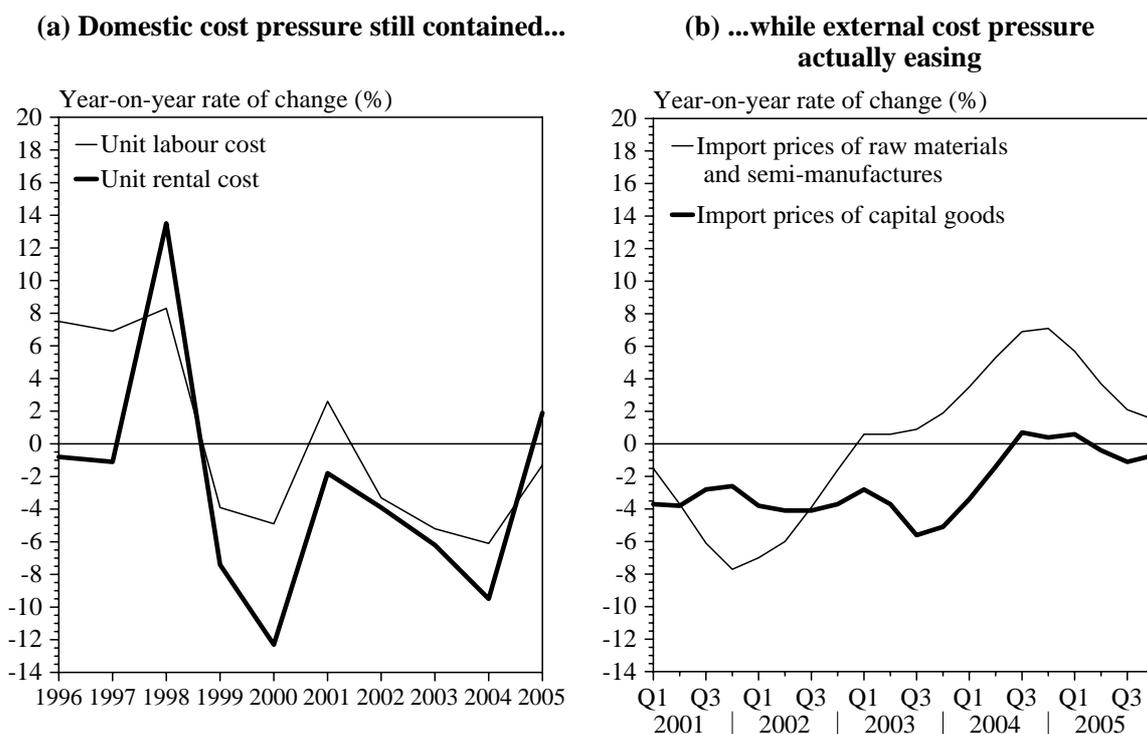
(*) Change of less than 0.05%.

Costs of factor inputs

7.3 The fact that inflation had not experienced a sharper rise over the year despite the very strong economic growth owed much to the still modest cost pressure stemming from factor inputs, as much of the pressure was mitigated by matching expansion in production capacity and productivity upgrading. On a per unit cost basis, labour cost was still broadly stable. Although business-related rentals on new leases had risen quite distinctly over the past year, particularly those for office space and retail premises, they seemed to have been mostly supported by vibrant business – thanks to the robust economic expansion. Thus again, on a unit cost basis, the increase in unit rental cost was also modest in overall terms (*Box 7.1*).

7.4 The cost pressures from the external front were likewise modest and actually moderating through the year. This can be seen from slower increase in the prices of imports of both *capital goods and raw materials*, due mainly to a stronger Hong Kong dollar after March. Nevertheless, for some sectors which are oil-intensive users, such as transport, restaurants and construction, there were more cost pressures due to the surge in fuel costs. Yet for the economy as a whole, the price pressures from soaring oil price had so far been rather contained.

Diagram 7.3 : Costs of factor inputs



Box 7.1

Unit cost analysis and consumer price inflation

Over the past year or so, there have been increasing concerns about the resurgence of cost-push inflation stemming from the surge in rentals for newly leased retail premises and office space. Now that the Hong Kong economy has completely shrugged off its earlier sluggishness and is now on a full-fledged upswing, it is generally believed that local producers and retailers will be more inclined to pass any cost increases onto the retail price level alongside the broader return of pricing power, thereby pushing up overall consumer prices.

Nevertheless, despite two consecutive years of very robust economic growth, consumer price inflation, though creeping up, has remained modest and well contained, which appears to be quite contradictory to the above argument. This suggests that some important elements in business operations might have been overlooked. Indeed, what matters more to business operators should be unit operating cost, i.e. operating costs per unit of real output or real sales revenue, instead of merely total operating costs, the former being the key determinant of profitability. In other words, productivity of factor inputs such as labour and land (retail premises/office space) also features prominently in the business cost formula. Since the distinct rise in business costs over the past two years has been well underpinned by the concurrent pick-up in overall economic activity and business turnover, the increase in business costs, if reckoned on a per unit cost basis, is actually not that considerable as to push up inflation significantly.

With reference to international statistical practices, the two most prominent components of business cost for the economy as a whole, viz. unit rental cost and unit labour cost (URC and ULC) can be proxied as follow:

$$URC = (\text{Area of occupied retail premises}^{\#} \times \text{8-quarter moving average rental index for retail premises}) \div \text{Real consumption expenditure in the domestic market}$$

$$ULC = (\text{Nominal index of payroll per person engaged} \times \text{Total employment}) \div \text{Real GDP}$$

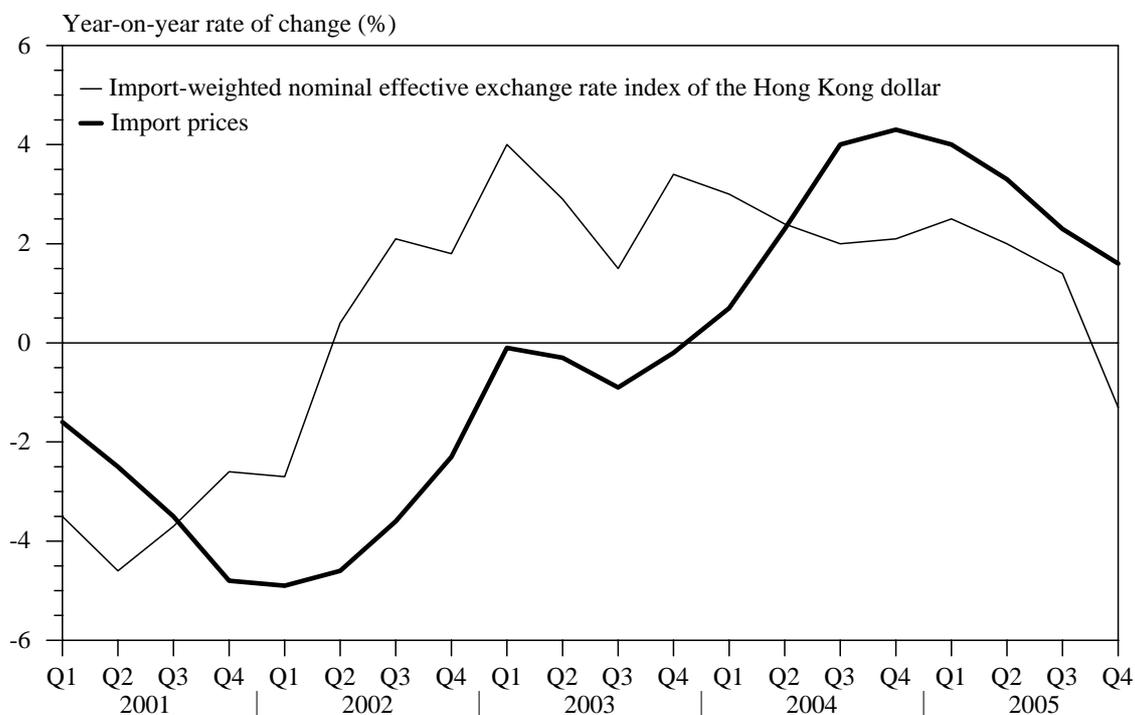
As shown in part (a) of Diagram 7.3, both URC and ULC actually rose markedly in 1998, largely attributable to the sharp contraction in economic activity and business turnover during the Asian financial turmoil. Such surge in unit business costs could rather be interpreted as a signal of the need for downward cost adjustment to restore competitiveness, through a combination of reduction in operating scale (e.g. retrenchment of employees and scale-down of unprofitable retail premises), wage cut, and a decline in rentals. That both URC and ULC eased back in the ensuing years actually reflected the speedy adjustment process undergone by the Hong Kong economy in the aftermath of the Asian financial turmoil, being a manifestation of our flexibility and resilience to adverse shocks.

Note: (#) Derived from end-year stock and vacancy data for retail premises published by the Rating & Valuation Department (RVD).

**Table 7.3 : Prices of imports by end-use category
(year-on-year rate of change (%))**

		<u>Foodstuffs</u>	<u>Consumer goods</u>	<u>Raw materials</u>	<u>Fuels</u>	<u>Capital goods</u>	<u>All</u>
2004	Annual	3.7	1.2	5.7	27.0	-0.8	2.9
	H1	3.8	0.5	4.5	14.4	-2.4	1.5
	H2	3.7	1.8	7.0	39.7	0.6	4.1
	Q1	3.9	0.5	3.5	5.0	-3.4	0.7
	Q2	3.6	0.6	5.3	24.8	-1.4	2.3
	Q3	4.1	1.6	6.9	37.1	0.7	4.0
	Q4	3.5	1.9	7.1	42.4	0.4	4.3
2005	Annual	0.9	2.8	3.1	32.9	-0.5	2.7
	H1	2.1	3.4	4.6	33.3	0.1	3.6
	H2	-0.4	2.3	1.8	32.4	-0.9	1.9
	Q1	2.8	3.2	5.7	27.1	0.6	4.0
	Q2	1.5	3.6	3.7	39.9	-0.4	3.3
	Q3	-0.3	2.9	2.1	38.3	-1.1	2.3
	Q4	-0.4	1.8	1.5	26.7	-0.7	1.6

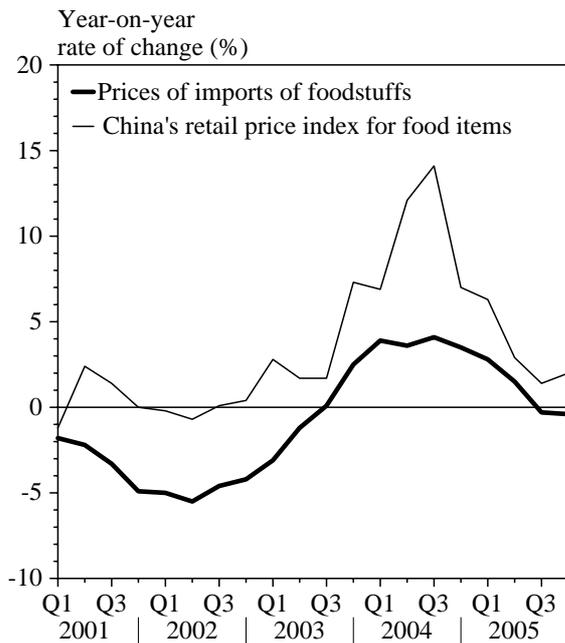
Diagram 7.4 : Imported inflation eased as US dollar strengthened



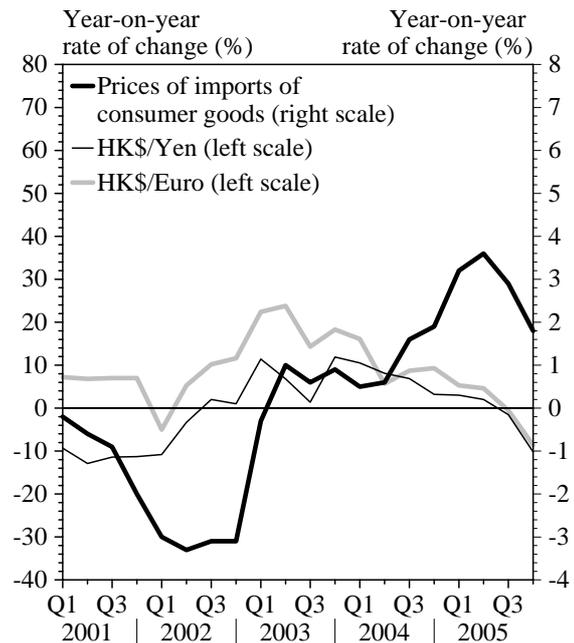
Note : An increase in nominal EERI indicates weakening of the Hong Kong dollar.

Diagram 7.5 : The increase in import prices of most commodities, with the exception of fuel, slowed during the year

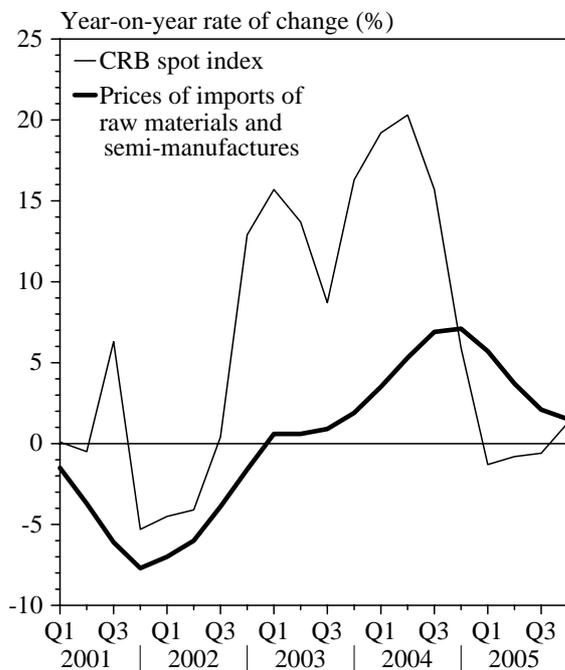
(a) Prices of imports of foodstuffs and China's food prices



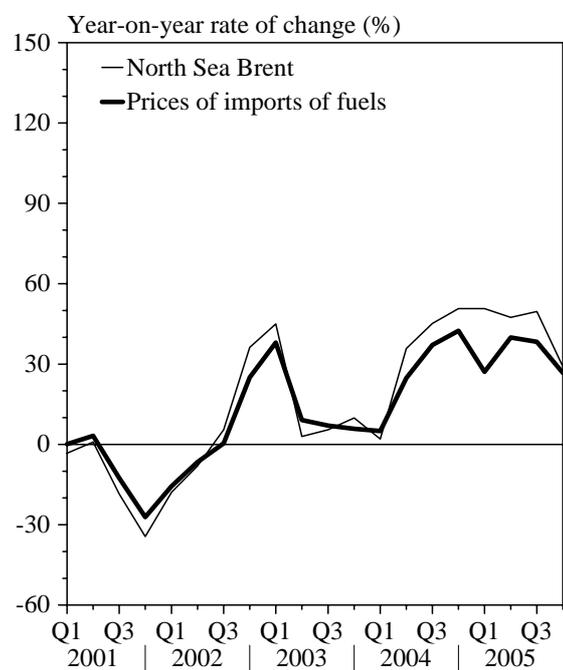
(b) Prices of imports of consumer goods and selected exchange rates



(c) Prices of imports of raw materials and semi-manufactures and international commodity prices



(d) Prices of imports of fuel and international crude oil prices



Output prices

7.5 Owing to muted cost pressures stemming from both the domestic and external fronts as well as the presence of competitive pressure in the markets, the rise in domestic output prices remained small. The increase in the *prices of local manufacturing output*, as measured by the Producer Price Index ⁽³⁾, though registered an increasing trend as the year unfolded, was actually slower than that in the previous year. As for the *prices of output in selected service sectors*, there were continued modest increases in many of them, with the exception of a relatively sharp increase in the output prices of the hotel sector, thanks to the still vibrant inbound tourism. Another exception was a consistent decline in the output prices of the telecommunications sector, due to keen competition and continued technological advancement within the sector.

Table 7.4 : Producer Price Indices for the local manufacturing sector and selected service sectors (year-on-year rate of change (%))

<u>Industry group</u>	<u>Annual</u>	<u>2004</u>				<u>2005</u>		
		<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>
Manufacturing	2.2	2.8	2.7	2.0	1.4	0.5	0.7	0.8
Selected services sector ^(#)								
Hotels and boarding houses	10.6	2.9	17.7	12.4	10.4	14.0	11.8	11.4
Land transport	-0.1	-1.9	0.4	1.2	*	0.9	0.4	1.3
Maritime transport	1.3	2.7	0.8	1.2	0.6	1.6	0.2	0.8
Air transport	2.3	1.2	4.9	3.5	-0.2	1.6	2.9	2.9
Telecommunications	-10.1	-13.6	-7.9	-10.2	-8.3	-8.2	-7.6	-7.9
Miscellaneous communications services	2.4	2.9	2.8	2.0	1.8	-0.3	0.1	0.1

Notes : (#) Producer Price Indices for the other service sectors are not available, due to the difficulties involved in defining and delineating the various types of services and hence in measuring their respective price changes. This is particularly so for such sectors as banking and insurance, where the producers often do not charge their customers explicitly.

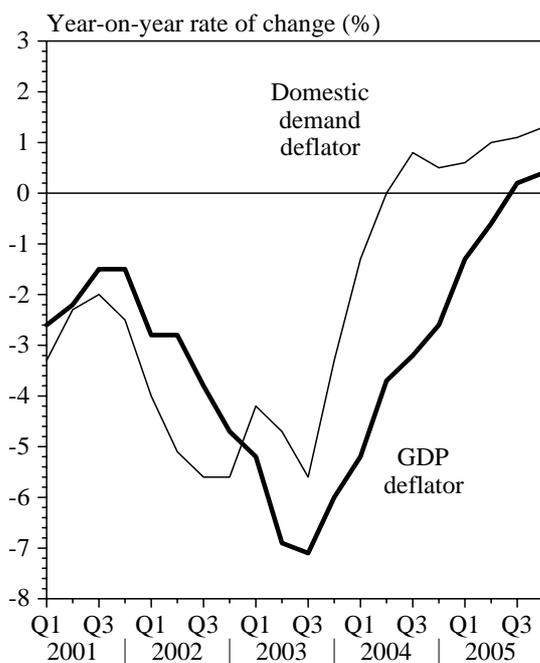
(*) Change of less than 0.05%.

GDP deflator

7.6 The decline in the *GDP deflator*⁽⁴⁾, a broad measure of overall changes in prices of the economy, tapered in the first half of 2005, turned positive by the third quarter and then picked up slightly further in the fourth quarter. The reversion to an increase in the second half of 2005 symbolised the end of a persistent decline that began in the third quarter of 1998. Apart from the firming up in domestic prices, the turnaround was also helped by fading drag from a declining terms of trade⁽⁵⁾, again due to the US dollar strengthening in the year. Excluding the effect from terms of trade, the *domestic demand deflator* picked up in the year, indicating slight build-up though still modest pressure on production capacity.

Diagram 7.6 :

(a) GDP deflator finally arrested its downtrend after the second quarter...



(b) ...aided by lesser drag from terms of trade

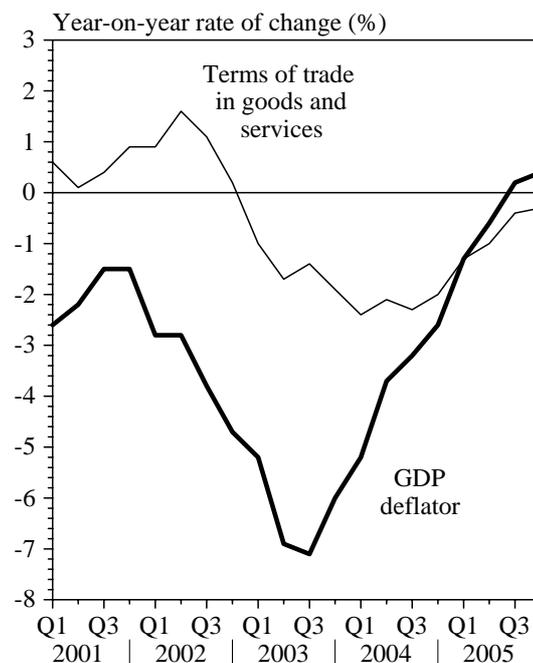


Table 7.5 : GDP deflator and the main expenditure component deflators[@]
(year-on-year rate of change (%))

	<u>2004</u>					<u>2005</u>				
	<u>Annual[#]</u>	<u>Q1[#]</u>	<u>Q2[#]</u>	<u>Q3[#]</u>	<u>Q4[#]</u>	<u>Annual⁺</u>	<u>Q1[#]</u>	<u>Q2[#]</u>	<u>Q3[#]</u>	<u>Q4⁺</u>
Private consumption expenditure	-0.5	-2.6	-0.5	1.0	0.1	1.6	0.7	1.6	1.5	2.8
Government consumption expenditure	-2.9	-3.3	-3.1	-2.6	-2.6	-1.7	-1.8	-1.6	-1.7	-1.6
Gross domestic fixed capital formation	2.1	1.6	2.6	1.7	2.2	0.8	2.3	1.8	1.3	-2.2
Total exports of goods	0.5	-1.5	0.1	1.3	1.6	-0.1	1.3	0.4	-0.2	-1.3
Imports of goods	2.5	0.5	2.2	3.7	3.5	1.3	2.9	1.8	0.8	*
Exports of services	0.4	-1.6	1.8	1.2	0.9	3.1	2.6	3.0	3.3	3.2
Imports of services	4.0	3.9	3.6	4.8	3.8	1.3	2.6	2.4	0.9	-0.6
Gross Domestic Product	-3.6	-5.2	-3.7	-3.2	-2.6	-0.2	-1.3	-0.6	0.2	0.4
		<-0.9>	<-0.7>	<-0.8>	<-0.1>		<0.2>	<0.1>	<*>	<0.1>
Total final demand	0.4	-1.4	0.2	1.3	1.3	0.8	1.3	1.0	0.7	0.1
Domestic demand	*	-1.3	*	0.8	0.5	1.0	0.6	1.0	1.1	1.3

Notes : (#) Revised figures.

(+) Preliminary figures.

< > Seasonally adjusted quarter-to-quarter % change.

(*) Change of less than 0.05%.

(@) The entire series of GDP deflator has been revised following the completion of an exercise by the Census and Statistics Department to implement the latest international guidelines on the compilation of financial intermediation services produced by banks in the estimation of national accounts statistics of Hong Kong in mid-August 2005.

Notes :

- (1) The Consumer Price Indices (A), (B) and (C) are compiled by reference to the average expenditure patterns for different groups of households as enumerated from the Household Expenditure Survey. Then, by aggregating the expenditure patterns of all the households covered by these three indices, a Composite CPI is compiled.

The expenditure ranges of the households covered in the 1999/2000-based CPIs are shown below:

	<u>Approximate proportion of households covered</u> (%)	<u>Monthly expenditure range (at 1999/2000 prices)</u> (\$)
CPI(A)	50	4,500 to 18,499
CPI(B)	30	18,500 to 32,499
CPI(C)	10	32,500 to 65,999

The weightings of the various components in the 1999/2000-based CPIs are as follows:

<u>Expenditure Component</u>	<u>Composite CPI</u> (%)	<u>CPI(A)</u> (%)	<u>CPI(B)</u> (%)	<u>CPI(C)</u> (%)
Food	26.67	31.88	25.94	21.38
<i>Meals bought away from home</i>	16.39	17.94	17.20	13.28
<i>Other foodstuffs</i>	10.28	13.94	8.74	8.10
Housing	29.91	29.13	29.68	31.22
<i>Private dwellings</i>	24.59	21.76	25.48	26.67
<i>Public dwellings</i>	2.07	5.08	1.03	--
<i>Maintenance costs and other housing charges</i>	3.25	2.29	3.17	4.55
Electricity, gas and water	2.98	3.99	2.81	2.02
Alcoholic drinks and tobacco	0.94	1.50	0.86	0.39
Clothing and footwear	4.13	3.36	4.47	4.55
Durable goods	6.24	4.96	6.93	6.73
Miscellaneous goods	5.70	5.25	5.58	6.43
Transport	9.01	8.23	9.05	9.94
Miscellaneous services	14.42	11.70	14.68	17.34
All items	100.00	100.00	100.00	100.00

- (2) It should be noted that, in any particular period, only a small proportion of the tenancies of private dwellings are new lettings for which rentals are freshly determined, and lease renewals upon which rentals are revised. The majority of the tenancies are existing leases with rentals fixed until their expiry. Upon aggregation, the movements in private housing cost thus tend to be less responsive than the corresponding movements in market rentals, as reflected in the rental index for private residential flats compiled by the Rating and Valuation Department (RVD). According to RVD, rentals for new lettings rose further by an average of 11.4% in the year 2005, a significant jump, after a 5.8% increase in the year 2004.

- (3) The Producer Price Index is designed to reflect changes in the prices of goods and services received by local producers. Producer prices refer to the transacted prices, net of any discounts or rebates allowed to the buyers. Transportation and other incidental charges are not included.

- (4) The implicit price deflators of GDP and its main expenditure components are derived by dividing GDP at current prices by the corresponding constant price figures. The rate of change in the GDP deflator may differ substantially from that in the Composite CPI over the same time span. The Composite CPI covers consumer price inflation in particular. Yet the GDP deflator is a much broader measure of inflation for the entire economy, and takes into account all the price changes related to consumption, investment, exports and imports. Also, the rate of change in the GDP deflator may differ appreciably from that in the total final demand deflator, depending on the movement in the prices of final demand and imports. Likewise, the rate of change in the GDP deflator may differ appreciably from that in the domestic demand deflator, depending on the movement in the prices of imports and exports.

- (5) The terms of trade is defined as the ratio of the prices of total exports to the prices of total imports.

Calendar of Events of Significance for the Hong Kong Economy in 2005

- 1Jan The second phase of Closer Economic Partnership Arrangement (CEPA) between the Mainland and Hong Kong came into effect. CEPA II allowed Hong Kong products in 1 108 Mainland 2005 tariff codes meeting the CEPA origin rules to enter the Mainland tariff free, and provided Hong Kong service suppliers with preferential access to the Mainland market in 27 service areas.
- The Mainland continued to reduce its import tariffs in line with her commitments to the World Trade Organisation (WTO). The import tariff rates were lowered from an average of 10.4% in 2004 to 9.9% in 2005.
- In accordance with WTO Agreement on Textiles and Clothing, all quota restrictions on textiles exports were eliminated with effect from 1 January 2005. Since then, Hong Kong's textiles and clothing (T&C) exports have been enjoying quota-free access to the world market. With the elimination of textiles quotas, Hong Kong's textiles import and export arrangements have been suitably streamlined to bring greater facilitation to the trade, whilst maintaining the integrity and credibility of Hong Kong's origin control system.
- The "four-up-four-down" rule for cross boundary freight vehicles was relaxed such that the tractor, trailer and container would no longer need to be "tied together" for crossing the boundary. This would allow for better deployment of tractors, trailers and containers to increase trip frequency, enhance efficiency and reduce cost.
- The second phase of adjustments to civil service pay as specified in the Public Officers Pay Adjustments (2004/2005) Ordinance came into effect. The pay pertaining to each pay point on the civil service pay scales was restored to the level it was at, in dollar terms, on 30 June 1997.
- The Code on Corporate Governance Practices and related Listing Rules amendments promulgated by the Stock Exchange of Hong Kong came into effect. The Code set out provisions and practices which were on a par with the prevailing international standards in respect of board practices.
- Listing Rules amendments to impose more stringent due diligence requirements on sponsors and independent financial advisers came into effect. The new requirements helped enhance the overall standard of sponsors and independent financial advisers in Hong Kong and uphold standards of disclosure and integrity of the listing regime.
- 4 Jan The Heritage Foundation and the Wall Street Journal released the 2005 Index of Economic Freedom. Hong Kong was rated the freest economy in the world for the eleventh consecutive year, followed by Singapore and Luxembourg.
- 7 Jan The Financial Services and the Treasury Bureau (FSTB) issued a Consultation Paper on Proposed Amendments to the Securities and Futures Ordinance (SFO) to Give Statutory Backing to Major Listing Requirements, which were to give effect to the recommendations announced in March 2004 to enhance the

regulation of listing. The proposed legislative amendments were to, amongst others, extend the market misconduct regime to cover breaches of statutory listing rules to be made by the Securities and Futures Commission (SFC).

- 12 Jan Mr Tung Chee Hwa, the Chief Executive (CE) of the Hong Kong Special Administrative Region (HKSAR), delivered his eighth Policy Address.
- 13 Jan The Office of the Telecommunications Authority (OFTA) issued a statement on lifting the prior approval requirement on prices of PCCW-HKT Telephone Limited through issuing it with a new fixed carrier licence. The adoption of the *ex post* regulation was to take care of updated development in the market where competition had become more firmly established.
- 14 Jan The Housing Authority (HA) decided not to pursue rent allowance in lieu of public rental housing as a means to help families in need of housing assistance. Having regard to the number of live applicants, the projected production of Public Rental Housing (PRH) units in the coming years and the overall average waiting time for PRH currently standing at 1.8 years, it was envisaged that the HA could continue to meet the Government's pledge of keeping the overall average waiting time at around three years.
- 17 Jan The Hong Kong Mortgage Corporation Limited (HKMC) expanded the eligibility criteria under its Mortgage Insurance Programme (MIP) in relation to self-employed borrowers and debt-to-income ratio. Such modifications were introduced in response to the suggestions from banks to cover a wider group of homebuyers.
- 18 Jan The Hong Kong Monetary Authority (HKMA) modified the Supervisory Policy Manual module on the sharing and use of consumer credit data through a credit reference agency. The Manual specified the minimum standards that authorised institutions should observe in relation to the sharing and use of consumer credit data through a credit reference agency.
- 19 Jan The new boundary bridges between Lok Ma Chau and Huanggang and between Sha Tau Kok and Shatoujiao, both joint projects of Hong Kong and Shenzhen, were open to traffic.
- 20 Jan HKMA announced the investment performance of the Exchange Fund for 2004. The Exchange Fund recorded an investment income of HK\$56.7 billion in 2004. Of this investment income, the Fiscal Reserves' share amounted to HK\$14.5 billion, which exceeded the amount budgeted (HK\$12.3 billion) in the fiscal year 2004-05. At the end of 2004 the Accumulated Surplus stood at HK\$423.4 billion.
- 27 Jan The Financial Secretary (FS) appointed 18 non-official members to the Commission on Poverty, for a term of two years. The Commission, chaired by FS, would focus on inter-departmental and inter-disciplinary issues with a view of enhancing policy coordination and integration.
- 29 Jan – 20 Feb Non-stop charter flights were made between the Mainland and Taiwan around the Chinese New Year period, the first time ever since 1949. There was a total of 48 charter flights, all of which were required to fly through Hong Kong or Macao air space.

- 31 Jan The existing Scheme of Control Agreements between the Government and the two power companies would expire in 2008. The Economic Development and Labour Bureau launched Stage I of a two-stage consultation exercise to seek the views of the public on possible options and various issues relating to the future development of the electricity market after 2008. This public consultation ended on 30 April 2005 with over 900 submissions.
- Both medical and health care industry and clock, watch and jewellery industry were admitted to the Skills Upgrading Scheme to provide training for their in-service workers.
- 1 Feb The "Measures for the Administration of Commercial Franchises" promulgated by the Ministry of Commerce of the People's Republic of China (PRC) entered into force. The Measures governed the administration of all franchising operations in the Mainland, including franchising businesses operated by Hong Kong and foreign investors.
- 1 – 2 Feb "Europe-Asia Heads of Intellectual Property Offices Conference" was held in Hong Kong. The event brought together heads of intellectual property offices from the European Patent Office, the World Intellectual Property Organization, the United States (US), the Mainland, Hong Kong and other Asian regions to enhance cooperation and experience sharing in intellectual property protection.
- 3 Feb The Base Rate under the Discount Window operated by HKMA was raised by 25 basis points to 4%, following an increase of the US Fed Funds target rate by the same magnitude to 2.5% after the US Federal Open Market Committee (FOMC) meeting on 2 February.
- 5 Feb The China Ferry Terminal extended its operating hours from 10 p.m. to 2 a.m. on weekends and public holidays to enable cross-boundary ferry operators to provide additional services.
- 6 Feb The Inland Revenue Department introduced via the Electronic Service Delivery Scheme the online delivery of electronic extract of information on the Business Register.
- 12 Feb The Land Registry launched the Integrated Registration Information System which allowed the public to search land registers conveniently and less costly through the Internet.
- 17 Feb A detailed feasibility study to establish the planning and technical feasibility of the Lantau Logistics Park commenced. The Park would be a designated facility for the provision of one-stop integrated logistics services to enhance Hong Kong's status as Asia's premier logistics hub.
- 22 Feb The International Monetary Fund projected that sustained economic growth and concerted efforts at government expenditure restraint in the HKSAR would result in the achievement of budget balance ahead of schedule.

A site for non-residential use with a total area of 4 715 square metres was sold for \$1.82 billion at a government land auction.

- 24 Feb The Government launched a package of anti-spam measures under the “STEPS” campaign to tackle the problem of unsolicited electronic messages. “STEPS”, standing for strengthening existing regulatory measures, technical solutions, education, partnerships and statutory measures, included a new anti-spam legislation.
- 28 Feb The Companies Registry launched the Phase I of the Integrated Companies Registry Information System. The new electronic search services enabled the public to obtain information on companies registered with the Registrar of Companies less costly through the Internet.
- The Commerce, Industry and Technology Bureau of the Hong Kong SAR Government and the Ministry of Transport and Communications of the Republic of Finland signed the second Memorandum of Understanding (MOU) on co-operation in information and communications technology (ICT) in Hong Kong.
- 1 Mar The Mainland implemented the Automatic Export Licence requirement for T&C products of 216 tariff codes for export to all places, including Hong Kong, to further self-regulate its T&C exports amid threats of safeguard restrictions from the US and European Union (EU).
- The Individual Visit Scheme (IVS) was extended to cover two more Mainland cities, including Tianjin and Chongqing, bringing the total number of IVS cities to 34.
- 4 Mar The Government announced the new annual Application List for the sale of Government land. A total of 35 sites (29 residential and 6 commercial/business) of different sizes and various locations were included in the List. At the same time, measures to enhance the operation of the Application List System were also introduced.
- The Film Guarantee Fund was extended with a commitment of \$30 million to assist local film production companies in obtaining loans for film production and to help create an environment conducive to the development of a film financing infrastructure in Hong Kong. The Film Development Fund was revived with a commitment of \$20 million to finance projects conducive to the long-term development of the film industry.
- The Finance Committee of the Legislative Council (LegCo) approved to extend some 11 600 temporary jobs in the public sector, to meet operational needs of concerned government departments/agencies. Many of these job were suitable for job seekers with lesser education, lower skills and limited job experience.
- 8 Mar The first-ever Hong Kong-Shanghai joint investment promotion seminar was successfully held in Tokyo. The seminar was designed to promote the business opportunities and market potential for Japanese companies in the Mainland – particularly in the leading commercial regions, the Greater Pearl River Delta (PRD) and Yangtze River Delta.
- 10 Mar Mr Tung Chee Hwa tendered his resignation as the CE of the HKSAR to the Central People's Government. His resignation was approved by the Central People's Government on 12 March.

- 11 – 12 Mar The Hong Kong Accreditation Service organised a workshop on accreditation of reference material producer on behalf of the Asia-Pacific Laboratory Accreditation Cooperation. This workshop was the first of its kind in the world.
- 14 Mar The income limits for Waiting List applicants were adjusted upward by an average of 1.8% for 2005/06, the first increase in six years. The asset limits for elderly households were also set at two times the asset limits for non-elderly applicants.
- 16 Mar FS presented the Budget for the financial year 2005/06 to the LegCo.
- FS proposed, among others, to increase the child allowance under salaries tax from \$30,000 per child to \$40,000; to introduce new allowances for salaries taxpayers taking care of dependent parents or grandparents aged between 55 and 59 in addition to the existing allowances in respect of those aged 60 or above; and the abolition of estate duty.
- FS announced that an internal committee set up by the Government had carried out a GST study and the next step would be to conduct a public consultation on this subject.
- The 2004 Economic Background and 2005 Economic Prospects were published along with the 2005-06 Budget. On Hong Kong's economic outlook for 2005, the Gross Domestic Product (GDP) growth was forecast at 4.5% to 5.5% in real terms, while the Composite Consumer Price Index (CPI) was forecast to increase by 1.5%.
- 17 Mar The Task Force on Facilitating the Adoption of Wireless and Mobile Services and Technology, comprising members from the Government, industry and academia, was established to facilitate the wider adoption of wireless and mobile services and technology in Hong Kong.
- 18 Mar HKMC expanded the eligibility criteria under the MIP for a maximum loan size of up to HK\$20 million on a case-by-case basis, and a combined age of property and loan tenor of up to 75 years.
- 22 Mar – 6 Apr The Entertainment Expo Hong Kong 2005 was held. The event combined Hong Kong's leading entertainment events under one roof, and attracted the attendance of the very best of international film talents and industry professionals.
- 22 Mar The Government decided that a pay level survey should be conducted for the civil service to compare the levels of civil service pay with those of private sector pay.
- 23 Mar The second Digital Entertainment Leadership Forum was held, where overseas experts in digital entertainment shared their vision and experience with the local practitioners.
- The Government and the State Ministry of Railway convened the fourth meeting of the Guangzhou-Shenzhen-Hong Kong Express Rail Link (ERL) Joint Expert

Group in Guangzhou. It was agreed that the Mainland section of the ERL would start from Shibi in Guangzhou, pass through Humen in Dongguan and Longhua in Shenzhen, and then cross the boundary at Huanggang into Hong Kong.

The Base Rate under the Discount Window operated by HKMA was raised by 25 basis points to 4.25%, following an increase of the US Fed Funds target rate by the same magnitude to 2.75% after the FOMC meeting on 22 March.

- 24 Mar The third Hong Kong Digital Entertainment Excellence Awards Presentation Ceremony was held. The awards aimed to recognize and honour the best works produced in Hong Kong in digital entertainment and to promote excellence in the field.
- 30 Mar The Office of the US Trade Representative released the 2005 National Trade Estimate Report on Foreign Trade Barriers. The report gave recognition to Hong Kong's continued efforts in protecting intellectual property rights and highlighted Hong Kong's efforts in removing service barriers and opening up markets.
- 1 Apr The US State Department published its eighth report on Hong Kong after Hong Kong's reunification with the Mainland. The report gave an overall positive assessment of the developments in Hong Kong in the 12-month period ending March 2005. It recognized that Hong Kong remained an international city and one of the world's freest and most open economies. It affirmed Hong Kong's autonomy, rule of law, respect for freedom and civil liberties, as well as praised Hong Kong's contribution to issues of interests to the US. It also gave recognition to Hong Kong's strong support for global anti-terrorism efforts.
- 1 – 2 Apr The three governments of Hong Kong, Guangdong and Macao reached agreement on the alignment and landing points of the Hong Kong-Zhuhai-Macao Bridge. The alignment adopted, known as the northern bridge-cum-tunnel alignment, would land in Northwest Lantau near San Shek Wan headland on the east, and in Gongbei of Zhuhai and A Pérola of Macao on the west.
- 12 Apr The US State Department published the US-Hong Kong Policy Act Report 2005. The report pointed out that Hong Kong's autonomy as an international economic actor remained intact and continued to play an important role as an international financial centre. Hong Kong also remained one of the world's most open economies and was found to be attractive as a headquarters location for China and the wider Asia region.
- HKMC announced its financial results for 2004. The profit after tax amounted to HK\$664.0 million, 75.2% higher than that of 2003. The total assets of HKMC increased by 10% to HK\$44.9 billion in 2004.
- 13 Apr Hong Kong International Airport (HKIA) was voted, for the fifth consecutive year, the "World's Best Airport 2005" in a large scale annual survey undertaken by Skytrax Research in the United Kingdom involving over 5.5 million nominations of over 90 nationalities.
- 14 – 17 Apr The International Wireless Forum was held. The forum aimed to accelerate the

development of wireless technology and application in Hong Kong.

The International ICT Expo 2005, co-organised by the Office of the Government Chief Information Officer (OGCIO) and the Trade Development Council (TDC), was held to provide a platform for the industry to promote their ICT products and services, as well as to explore business collaboration opportunities, especially with the China market.

- 15 Apr The Airport Authority (AA) entered into an agreement to acquire 35% share in Hangzhou Xiaoshan International Airport at a cost of about \$1.89 billion.
- 21 Apr The Immigration Department introduced two automated vehicle clearance channels (e-channels) at the Lok Ma Chau Control Point. Cross-boundary drivers holding Hong Kong permanent resident smart identity cards could use the e-channels.
- 26 Apr – 3 May Taiwan’s Kuomintang Chairman Lien Chan embarked on a landmark visit to the Mainland, the first time since 1949.
- 28 Apr – 1 May The Hong Kong Gifts and Premium Fair, being the largest event of its kind in Asia and the second largest gifts fair in the world, was held. The event served as an important trading platform for over 3 500 exhibitors and 54 000 buyers from around the globe.
- 29 Apr China Securities Regulatory Commission launched a pilot scheme to gradually float non-tradable shares of state-owned enterprises held by the Mainland government in the stock market, subject to a number of conditions including qualified consent from shareholders of existing tradable shares.
- 3 May HKMA announced the issue of up to HK\$300 million of two-year Exchange Fund Notes for retail investors, the first under a refined Retail Exchange Fund Notes Programme.
- 5 – 13 May A delegation of Taiwan’s People First Party, led by its Chairman James Soong Chu-yu, visited the Mainland.
- 4 May The Base Rate under the Discount Window operated by HKMA was raised by 25 basis points to 4.5%, following an increase of the US Fed Funds target rate by the same magnitude to 3% after the FOMC meeting on 3 May.
- 6 May The LegCo Finance Committee agreed to provide additional funding to extend the operation of the Small and Medium Enterprise (SME) Loan Guarantee Scheme, the SME Export Marketing Fund and the SME Development Fund. The Government’s total commitment to these SME funding schemes (including the SME Training Fund which ceased to accept new applications starting from 1 July 2005) was increased from \$7.5 billion to \$12 billion.
- 11 May A Digital Entertainment Industry Support Centre was opened in Cyberport to provide one-stop support services to help local SMEs source and make use of resources available from the Government, industry organizations and academic institutions.
- 12 May Hong Kong was ranked the second most competitive economy in the world in

2005 (and the most competitive amongst the small economies), according to the ranking results of the International Institute for Management Development.

18 May HKMA introduced three refinements to the operation of the Linked Exchange Rate system. The refinements were aimed at removing uncertainty about the extent to which the exchange rate may strengthen under the Linked Exchange Rate system and promoting the smooth functioning of the money and foreign exchange markets in accordance with Currency Board arrangements.

20 May The Wisdom Path, an outdoor wood inscription art work featuring the calligraphy of the "Prajna Paramita Hrdaya Sutra" (Heart Sutra) by Professor Jao Tsung-I was opened in Ngong Ping, Lantau. This added to the wide range of tourist attractions in Hong Kong.

24 May The Hong Kong Institute of Planners and the Hong Kong Institute of Surveyors signed agreements with their Mainland counterparts on the mutual recognition of professional qualifications for planners and quantity surveyors respectively.

26 May HA decided to allow Home Ownership Scheme and Tenants Purchase Scheme (TPS) flat owners to pay premium after the lapse of the first two-year alienation restriction period. The new arrangement would provide greater flexibility for the property market.

27 May The Government published the First Quarter Economic Report 2005. The report pointed out that notable growth momentum of the Hong Kong economy continued in the first quarter of 2005, with GDP growing solidly further by 6.0% in real terms over a year earlier. The robust growth momentum was underpinned by the growth in exports of both goods and services amidst Mainland's strong trade flows and vibrant inbound tourism. Locally, consumer spending held firm along with the more entrenched economic recovery, improving labour market conditions and a strong property market. Investment expenditure recovered after a temporary relapse in the fourth quarter of 2004, underscored by a promising business outlook.

In the May update of the economic forecast for 2005, the forecast growth rate in real terms of GDP was kept at 4.5% to 5.5%, same as the forecast first released in the Budget. Likewise, the forecast rate of increase in the Composite CPI was maintained at 1.5%.

30 May HKMA, the Hong Kong Association of Banks and the Hong Kong Police Force jointly announced the launch of two-factor authentication for Internet banking by the banking industry.

31 May SFC released Consultation Conclusions on the Review of the Disclosure of Interests Regime under Part XV of the SFO. Most proposals which aimed at making the disclosure regime more user-friendly received general support.

The public consultation on partial privatization of the AA ended with a total of 69 written submissions received. Public views on privatization were divided. The Government undertook to continue to discuss with the stakeholders with a view to addressing their concerns.

1 Jun The Central People's Government levied a 5% business tax on the full earnings

of home sales, when owners sold them within two years of purchase. This was a move to curb housing speculation and stabilise property prices in the Mainland.

The Mainland removed the export duty on T&C products covered by 81 tariff codes and exempted the export duty of Hong Kong-origin T&C products that underwent outward processing on the Mainland.

The Competition Policy Review Committee, comprising mostly non-official members, was appointed by the Government to conduct a comprehensive review of the existing competition policy as well as the role and functions of the existing Competition Policy Advisory Group to ensure that Hong Kong continues to maintain its competitive edge.

2 Jun Cathay Pacific Airways Limited (CPA) was voted “Airline of the Year 2005” and Dragonair “Best Airline – China” in a large scale annual survey undertaken by Skytrax Research in the United Kingdom involving over 12.3 million eligible nominations of over 90 nationalities from June 2004 to May 2005.

10 Jun The Town Planning (Amendment) Ordinance 2004 came into operation, with a view to enhancing the transparency of the planning system, streamlining the town planning process and strengthening planning enforcement control against unauthorised developments in the rural areas.

The Mainland and the EU reached an agreement, in the form of an MOU, on limiting the quantity of 10 categories of Mainland’s T&C imports into the EU till the end of 2007.

11 – 14 Jun Hong Kong hosted the 38th International General Meeting of Pacific Basin Economic Council. Prestigious guests including China’s Vice Premier, Wu Yi, Prime Minister of Malaysia, Dato’ Seri Adbullah Haji Ahmad Badawi, and former US Secretary of State, Colin Powell, spoke at the meeting.

13 Jun The “2005 Guangdong-Hong Kong Technology Cooperation Funding Scheme” invited applications. Jointly launched by the Innovation and Technology Commission of the HKSARG (ITC) and the Guangdong Provincial Department of Science and Technology since 2004, the scheme aimed to enhance collaborations among research institutions and technology enterprises in Hong Kong and Guangdong. In 2005, the two sides each earmarked \$260 million to support applied research and development projects that would facilitate industry upgrading.

16 Jun Mr Donald Tsang was elected uncontested as the CE of the HKSAR.

17 Jun The Government announced a package of preliminary proposals on various copyright-related issues formulated after a public consultation exercise earlier in the year on the review of certain provisions of the Copyright Ordinance (Cap. 528). Major proposals related to the scope of business end-user liability for copyright infringements, copyright exemption, parallel importation, protection of technological measures for copyright protection and rental rights for films and comic books.

17 – 18 Jun The Fourth Pan-PRD Regional Cooperation Information Technology (IT)

Department Directors Joint Conference was held in Jiangxi. The “MOU on Cooperation in Information Sharing between Software Enterprises of Jiangxi, Guangzhou and Hong Kong” was signed between industry representatives of Hong Kong, Guangzhou and Jiangxi.

- 20 Jun OFTA announced his decision to introduce a two-class licensing framework to regulate the provision of Internet Protocol (IP) telephony services, which would facilitate the deployment of innovative, IP telephony services and ensure adequate protection to consumers at the same time.
- 21 Jun The Asian Bond Fund (ABF) Hong Kong Bond Index Fund, the first bond fund under ABF2, was listed on the Stock Exchange of Hong Kong. The Fund was the first bond exchange-traded fund listed in Hong Kong. The ABF2 aimed at broadening and deepening the domestic and regional bond markets in Asia, and represented a historic milestone in central banking cooperation in Asia.
- An additional measure was introduced to smooth the operation of the Application List System for Government land sales. This measure was an enhancement of the triggering mechanism whereby a bid equivalent to at least 80% of the assessed open market value would be accepted as a trigger to initiate an auction or tender.
- 23 Jun Bank of Communications was listed in Hong Kong raising equity fund of HK\$16.8 billion. This marked the first overseas sale of shares by a Mainland-based bank.
- 24 Jun The Finance Committee of the LegCo approved a funding of \$358.7 million to support the establishment of Research and Development Centres in four technology areas, namely automotive parts and accessory systems, logistics and supply chain management enabling technologies, nanotechnology and advanced materials, and textile and clothing. Also, funding was allocated to the setting up of an incubation-cum-training centre for digital entertainment in the Cyberport and the development of mechanical watch movements technology.
- 27 Jun – 1 Jul The 88th Lions Clubs International Convention was staged in Hong Kong for the second time, following its previous Convention in 1992. The event attracted some 20,000 Lions Clubs Members from around the world.
- 30 Jun Public consultation for the development of the West Kowloon Cultural District was completed.
- The Government invited the MTR Corporation Limited to proceed with the preliminary planning and design of the West Island Line.
- 1 Jul As part of its effort in facilitating business operations in Hong Kong, the Government had, since July 2005, started to implement measures to streamline the licensing of food business including simplifying the procedures to reduce the processing time for various food business licences and liquor licence and relaxing certain licensing requirements.
- 2 Jul The Base Rate under the Discount Window operated by HKMA was raised by 25 basis points to 4.75%, following an increase of the US Fed Funds target rate by the same magnitude to 3.25% after the FOMC meeting on 30 June.

- 6 Jul The LegCo passed the Banking (Amendment) Ordinance 2005, which was to put in place a legislative framework for the implementation in Hong Kong of the Basel Committee on Banking Supervision's revised capital adequacy standards for banks, commonly known as "Basel II".
- 7 Jul The ABF Pan Asia Bond Index Fund (PAIF) under ABF2 was listed on the Stock Exchange of Hong Kong. The PAIF was the first listed bond fund investing in sovereign and quasi-sovereign local currency-denominated bonds issued in the eight markets of Executives Meeting of East Asia and Pacific Central Banks, and also the first foreign institutional investor granted access to Mainland China's interbank bond market.
- The terrorist bomb attacks in London led to some mild fluctuations in the international financial and exchange rate markets.
- 8 Jul The European Commission published its seventh report on the HKSAR. The report commented, among others, that Hong Kong's economy achieved a remarkable recovery in 2004. The report also highlighted the good trade relations between the EU and Hong Kong.
- The LegCo Finance Committee approved an allocation of \$1 billion to launch a Second Matching Grant Scheme. The Scheme was opened for application by the eight University Grants Committee-funded institutions from 1 August 2005 to 28 February 2006 to match their private donations. The response was most encouraging. Private donations of over \$1.6 billion was secured within four months, indicating that the initiative was successful in attracting community investment in education.
- 9 Jul The "Innovation Festival 05" was officially kicked-off. Organized by ITC, the Festival was the first event of its kind in Hong Kong and was supported by over 50 organizations, including universities, technology support organizations, industry and trade organizations, youth groups and government departments. With the theme "Take Wings, City of Innovation", the Festival aimed to foster an innovation and technology culture in the community.
- 19 Jul The Health and Medical Development Advisory Committee issued the Discussion Paper entitled "Building a Healthy Tomorrow", which put forth a host of recommendations for the future service delivery model for Hong Kong's healthcare system for public consultation.
- 20 Jul The Court of Final Appeal unanimously ruled that the sale of the retail and car park facilities by HA to The Link Real Estate Investment Trust (The Link REIT) was within the capacity of HA.
- 21 Jul The People's Bank of China (PBOC) introduced a major reform to the renminbi exchange rate regime. A managed floating exchange rate regime with reference to a basket of currencies was adopted, and at the same time a 2.1% revaluation of renminbi was effected.
- 25 Jul The website of "Pan-PRD Cooperation" (www.pprd.org.cn) was formally launched. It was a dedicated official portal to disseminate comprehensive information of cooperation and development in the Pan PRD region.

A series of measures to enhance the competitiveness of Hong Kong port and the maritime industry received support from the LegCo Panel on Economic Services. These included introduction of a multiple entry permit to streamline port formality procedures, reduced port fees and charges, provision of more anchorages to increase mid-stream cargo handling capacity, and a 6-month annual tonnage fee reduction for Hong Kong registered vessels. They would be implemented in early 2006 on completion of the necessary legislative procedures.

Hongkong Post established alliance with Australia Post, China Post, Japan Post, Korea Post and the US Postal Service to provide enhanced date-certain Speedpost delivery service in Asia Pacific Rim markets.

25 – 28 Jul A HKSAR delegation led by the CE attended the Second Pan-PRD Regional Cooperation and Development Forum and the Second Pan-PRD Trade Fair in Chengdu, Sichuan. The delegation met ‘9+2’ officials and experts and held fruitful discussions with them on ways forward of Pan-PRD cooperation.

26 Jul The Hong Kong SAR Government signed the “Pan-PRD Intellectual Property Cooperation Agreement” with nine Pan-PRD provinces. The Agreement aimed to promote collaboration on intellectual property protection, and enhance the overall strength and competitiveness of the Pan-PRD region.

1 Aug The first set of emission caps in Hong Kong was imposed on the Castle Peak Power Station of China Light & Power as conditions of the Specified Process Licence (SPL) renewal under the Air Pollution Control Ordinance. The Environmental Protection Department would continue to impose emission caps to other power plants upon expiry of their SPLs and would progressively tighten up the emission caps to ensure that the emission reduction targets agreed between Hong Kong and Guangdong would be achieved by 2010, for improving the air quality of the region.

The Mainland further removed the export duty on T&C products covered by 17 tariff codes.

MTR Corporation Limited’s Disneyland Resort Line commenced operation, a 3.5km new line comprising two stations, i.e. Sunny Bay and Disney Resort, providing a rail shuttle to and from the Hong Kong Disneyland.

Construction works of the Kowloon-Canton Railway Corporation’s Kowloon Southern Link commenced. The 3.8km long strategic passenger railway would link the West Rail to the East Rail.

3 Aug Hong Kong Aircraft Engineering Company Limited announced the investment of \$320 million to construct a second hangar at HKIA.

10 Aug PBOC allowed qualified participants of the Mainland’s inter-bank market to conduct forward foreign exchange transactions.

The Base Rate under the Discount Window operated by HKMA was raised by 25 basis points to 5%, following an increase of the US Fed Funds target rate by the same magnitude to 3.5% after the FOMC meeting on 9 August.

- 22 Aug OFTA issued a consultation paper on the licensing conditions and licence fee structure for the creation of a new Services-Based Operator Licence for the provision of IP Telephony services. The proposal would enable services-based operators to enter the IP Telephony services market, thereby further enhancing market competition.
- 26 Aug The Government published the Half-yearly Economic Report 2005. The report pointed out that the Hong Kong economy continued to expand at a brisk pace in the second quarter of 2005, with GDP leaping by 6.8% in real terms over a year earlier. Externally, both exports of goods and services grew noticeably further amidst the sustained expansion of the global economy as well as continued soaring of inbound tourism. Locally, domestic demand also grew further on the back of improving labour market conditions and positive wealth effect stemming from the cumulative increase in asset prices.
- In the August update of the economic forecast for 2005, the forecast growth rate in real terms of GDP was kept at 4.5% to 5.5%, same as the forecast in May round. Likewise, the forecast rate of increase in the Composite CPI was maintained at 1.5%.
- 30 Aug The prices of crude oil futures surged to a historic high of US\$70.85 per barrel in New York, as US oil production was severely curtailed following the destructions to US oil refineries by Hurricane Katrina.
- The Sector-specific Programme for the Travel Industry was completed. This programme aimed to promote the use of IT and e-commerce in the industry for better efficiency and effectiveness in the Travel Industry.
- Sale of the last phase of the TPS, Phase 6B, was launched, including a total of 23 290 flats in five public rental housing estates.
- 31 Aug OFTA issued a second consultation paper on the licensing framework for provision of broadband wireless access services, which might be deployed as a substitute for Type-II interconnection links in the fixed telecommunications services network.
- 1 Sep The Aviation Development Advisory Committee (ADAC), a non-statutory advisory body, was set up to advise the Government on strategic issues that would help foster the long term development of Hong Kong's local aviation industry and its position as an aviation hub. The ADAC replaced the Aviation Advisory Board.
- 5 Sep The Chief Secretary for Administration and the Mayor of Shenzhen co-chaired a Hong Kong/Shenzhen cooperation meeting. The meeting reviewed the progress of work since the signing of an overarching memorandum on enhancing co-operation between the two places and eight co-operation agreements on individual subjects in June 2004. It also exchanged views on further strengthening co-operation in a number of areas, including control points, infrastructure, town planning, implementation of the CEPA, science and technology, environmental protection, food safety and education.
- 6 Sep HA decided to relaunch the global offering of units in The Link REIT in

November 2005 for the divestment of 180 of its retail and car park facilities.

- 7 Sep A comprehensive agreement for avoidance of double taxation was signed between the governments of the HKSAR and Thailand.
- 8 Sep Hong Kong remained the freest economy in the world, according to the 2005 Annual Report on the Economic Freedom of the World jointly released by the Fraser Institute of Canada, CATO Institute of the US and 67 other research institutes around the world.
- Hong Kong Express Airways Limited, the fourth Hong Kong-based passenger carrier, launched its first scheduled passenger service on the route between Hong Kong and Guangzhou.
- The Hong Kong Maritime Museum was opened to give Hong Kong people and tourists an insight into the heritage of Hong Kong port and to enhance public awareness and understanding of the maritime history.
- 12 Sep Grand Opening of Hong Kong Disneyland was held. Vice President Zeng Qinghong, the CE Donald Tsang, Mr Michael Eisner and Mr Bob Iger of The Walt Disney Company officiated at the opening ceremony.
- 13 Sep Hong Kong's regulations were ranked the seventh most business-friendly in the world (and the second most business-friendly in Asia), according to the World Bank's report on Doing Business in 2006.
- 20 – 27 Sep FS participated in the International Monetary Fund/World Bank Annual Meeting held on 24 September in Washington DC, and also took this opportunity to meet with major credit rating agencies to update them on Hong Kong's latest economic outlook and fiscal position.
- 21 Sep OFTA issued a consultation paper to solicit public views on the creation of a unified carrier licence for fixed and mobile services, to pave the way for fixed-mobile convergence.
- The automobile industry was admitted to the Skills Upgrading Scheme, which aimed at providing skills upgrading courses for more than 3 600 in-service workers in 2006.
- The Base Rate under the Discount Window operated by HKMA was raised by 25 basis points to 5.25%, following an increase of the US Fed Funds target rate by the same magnitude to 3.75% after the FOMC meeting on 20 September.
- 23 Sep PBOC widened the renminbi's trading band against non-US dollar currencies, from $\pm 1.5\%$ to $\pm 3\%$, while keeping the band against the US dollar unchanged at $\pm 0.3\%$.
- 26 Sep Results of the Annual Survey of Regional Offices Representing Overseas Companies in Hong Kong conducted by Census and Statistics Department showed that Hong Kong remained a magnet for international companies to oversee their regional operations. Both the number of regional headquarters and regional offices in Hong Kong again reached all-time highs.

- 27 Sep Three residential sites with a total area of 28 035 square metres were sold for \$10.15 billion at a government land auction.
- 28 Sep Hong Kong was ranked the 28th most competitive economy in the world, according to the World Economic Forum's Global Competitiveness Report 2005-2006.
- The Eighth Plenary meeting of the Hong Kong Guangdong Cooperation Joint Conference was held under the co-chairmanship of the CE of the HKSAR and the Governor of Guangdong. The two governments reached agreement on a number of issues, including stepping up cooperation in food safety, relaxing the "one-truck one-driver" requirement for cross-boundary freight vehicle to enhance the efficiency of land-based cross-boundary cargo flow, releasing daily the PRD Regional Air Quality Index, and strengthening cooperation in areas including Pan-PRD cooperation, infrastructure, supporting development of enterprises, tourism, innovation and technology, education and culture. The meeting also agreed to set up a new expert group on informatisation, thus increasing the number of expert groups to 18 in total.
- 29 Sep – 2 Oct Innovation Expo 05, the finale event of the Innovation Festival, was held at the HKCEC. The Expo showcased Hong Kong's latest technological achievements, inventions and research and development results.
- 30 Sep Hong Kong retained its position as Asia's second largest destination for foreign direct investment (FDI), according to the "World Investment Report 2005", released by the United Nations Conference on Trade and Development. FDI flows to Hong Kong in 2004 reached US\$34.0 billion. On a global scale, Hong Kong ranked seventh in FDI inflows in 2004.
- The Fourth Meeting of the PRD Joint Conference on Regional Cooperation in Science and Technology was held in Hong Kong. The meeting endorsed the report on the Planning Study on Pan PRD Cooperation in Science and Technology for 2006 – 2010 and agreed to take forward proposals in the report to enhance technology collaborations in the region and promote better use of resources.
- The Cyberport Digital Entertainment Incubation-cum-Training Centre was opened. The Centre aimed at incubating 30-45 digital entertainment start-up companies and providing professional training for the industry.
- 3 Oct Maritime Industry Council launched Phase I of the Hong Kong Maritime Net to link the websites of various stakeholders of the maritime industry into an integrated and user-friendly website.
- 6 Oct DHL signed an agreement with AA to invest \$858 million to expand its express cargo facility at HKIA.
- 7 Oct Taking into account public views, the Government announced its proposal for introducing additional development parameters and conditions for the West Kowloon Cultural District.
- 8 – 11 Oct The 5th Plenary Session of the 16th Central Committee of the Communist Party

of China (CPC) was held in Beijing. It examined and passed the “Proposal by the CPC Central Committee Concerning the 11th Five-Year Plan for National Economy and Social Development”, which stressed the need to switch to a more balanced, resource saving, and sustainable mode of socio-economic development. The Proposal mentioned Hong Kong for the first time, stating that it supported HKSAR to develop service industries like finance, shipping, tourism and information technology, and to maintain its role as an international financial, trading and shipping centre.

- 12 Oct Mr Donald Tsang, CE of the HKSAR, delivered his Policy Address.
- CE announced in the Policy Address the reactivation of the Tamar Development Project.
- 14 Oct A large-scale joint investment promotion event, “Hong Kong – Guangdong Business Conference USA 2005” was held in San Francisco by Hong Kong and Guangdong governments to promote business opportunities in the Greater PRD, Hong Kong and Guangdong for companies in US. FS and the Governor of the People's Government of Guangdong Province, Huang Huahua, led high-level delegations to join this event.
- 18 Oct The Government of the HKSAR and the Central People's Government reached agreement on further trade liberalization measures under the third phase of CEPA, which would be implemented on 1 January 2006. The agreement provided for tariff free treatment to exports of all products of Hong Kong origin to the Mainland, upon application by local manufacturers and upon the CEPA origin rules being agreed and met. There were also 23 liberalization measures in 10 service areas, providing Hong Kong service suppliers with preferential access to the Mainland market. In addition, rules of origins for watches of Hong Kong brand names would be relaxed.
- In respect of Trade and Investment Facilitation under the CEPA III agreement, T&C products under Hong Kong’s Outward Processing Arrangement would be exempted from the Mainland’s export duty when being re-imported to Hong Kong.
- 19 Oct The seventh IT Excellence Awards Presentation Ceremony was held. The award aimed to encourage the use of IT, stimulate innovation and competitiveness in the IT industry and raise public awareness of IT application development.
- 21 Oct The Mainland Ministry of Health signed a "Cooperation Agreement on Response Mechanism for Public Health Emergencies" with Hong Kong and Macao to establish a mutual co-ordination and support mechanism in terms of manpower, technical expertise and resources in case of serious public health emergencies.
- 24 Oct US President George Bush nominated Ben Bernanke to succeed Alan Greenspan upon the latter’s retirement from his 18 years of Chairmanship of the Federal Reserve Board on 31 January 2006.
- A major joint investment promotion event, “Hong Kong – Guangdong Business Forum in Canada 2005”, was held in Vancouver by Hong Kong and Guangdong governments to promote business opportunities in Greater PRD, Hong Kong and

Guangdong for companies in Canada. CE and the Governor of Guangdong Province, Huang Huahua, led the delegations.

25 Oct The Executive Council endorsed the Redevelopment Plans for Ocean Park, which would turn the 28 year-old Ocean Park into a world-class marine themed attraction.

25 - 28 Oct The Cable and Satellite Broadcasting Association of Asia Conference 2005 took place in Hong Kong. Over 800 senior executives from the broadcasting and telecommunications industries gathered in Hong Kong for Asia's premier broadcasting event.

27 Oct China Construction Bank, one of the four largest state-owned commercial banks in the Mainland, was listed in Hong Kong, raising equity fund of HK\$71.6 billion through initial public offering (IPO). This was the largest IPO worldwide in four years, and also the largest IPO ever launched in Hong Kong.

Subsequent to its passage of the national law providing for immunity of property of foreign central banks from judicial enforcement measures (“the National Law”) on 25 October, the Standing Committee of the National People’s Congress decided to add the National Law to Annex III to the Basic Law. The Government would implement the National Law in Hong Kong by way of local legislation. This would be beneficial to maintaining Hong Kong’s status as an international financial centre.

28 Oct The Securities and Futures (Investor Compensation – Levy) (Amendment) Rules 2005 (“Amendment Rules”) took effect on 28 October 2005. Under the Amendment Rules, the investor compensation levies would be suspended when the net asset value of the Investor Compensation Fund (ICF) exceeding HK\$1.4 billion, and reinstated when the net asset value of the ICF falling below HK\$1 billion.

1 Nov The Customs and Excise Department implemented a Red and Green System at all entry points. The System, providing a new mode of clearance service to arrival passengers, aimed to facilitate passenger clearance, enhance revenue protection and align Hong Kong’s clearance system with international practices.

The Film Development Committee was established on 1 November 2005. The Committee would advise the Government on all matters relating to the development of the film industry in Hong Kong and to promote Hong Kong films on the Mainland and overseas.

The IVS was further extended to cover four more Mainland cities, including Chengdu, Jinan, Dalian and Shenyang, bringing the total number of IVS cities to 38.

HKMA announced the details of the expansion of renminbi business in Hong Kong. The expansion covered four broad areas: opening of renminbi accounts by designated merchants; use of renminbi cheques in Guangdong Province by Hong Kong residents; exchange and remittance of renminbi by Hong Kong personal depositors; credit limits for renminbi cards issued by participating banks.

2 Nov The Revenue (Abolition of Estate Duty) Bill 2005, which sought to implement

the proposal to abolish estate duty announced in the 2005-06 Budget, was passed by LegCo.

The Base Rate under the Discount Window operated by HKMA was raised by 25 basis points to 5.5%, following an increase of the US Fed Funds target rate by the same magnitude to 4% after the FOMC meeting on 1 November.

3 Nov HKMC launched a special scheme under the Fixed Adjustable Rate Mortgage Programme for fixed rate mortgage of 1, 2, 3, 5, 7 and 10 years with up to 95% loan-to-value ratio. This was the first time that a fixed rate product of over 5 years was launched in the local market, generating much publicity and interest.

The Government invited interested parties to submit Expressions of Interest by 31 December 2005 for the development of a new cruise terminal, in order to ascertain whether feasible locations other than Kai Tak would be available for development of new cruise terminal facilities before 2011.

7 – 10 Nov TDC organised the largest-ever expo of Hong Kong's stylish products in the Middle East, "Hong Kong in Style", with 230 Hong Kong companies to expand their reach further into this emerging market.

7 – 11 Nov The three-day Competitiveness Institute's 8th Annual Global Conference was held in Hong Kong. Over 170 business executives, academics and government officers from 43 countries participated and discussed the competitiveness of the Mainland, especially the PRD region, and Hong Kong.

8 Nov The US and the Mainland signed a MOU concerning trade in T&C products which set out the arrangements and limits for the imports into the US of 21 product groups involving 34 categories of Mainland-origin T&C products from 2006 to 2008.

The International Monetary Fund Staff Mission to Hong Kong completed its Article IV Consultation, stating that it was supportive of the Government's fiscal policy and its commitment to the Linked Exchange Rate system.

9 Nov The Stage 2 Public Participation Programme for the Kai Tak Planning Review was launched with three different Outline Concept Plans prepared for public consultation.

The LegCo passed the Carriage by Air (Amendment) Bill 2005, which sought to apply to Hong Kong the Convention for the Unification of Certain Rules for International Carriage by Air signed at Montreal on 28 May 1999 to further enhance the legal protection to passengers and shippers.

10 Nov After considering the feedbacks received from concerned stakeholder groups, the Government announced some refinements to the preliminary proposals on various copyright-related issues put forward in June 2005.

13 Nov HA and The Link Management Limited announced details of the global offering of units in The Link REIT. The Link REIT was Hong Kong's first REIT. Its IPO was the world's largest IPO of a real estate investment trust, and Hong Kong's biggest privatisation of its kind. The Link REIT was listed on the Stock Exchange of Hong Kong on 25 November.

- 14 – 18 Nov The Institute for International Research organised the 3G World Congress & Exhibition in Hong Kong. The event, which attracted over 1 000 delegates from around the world, promoted the adoption and growth of 3G worldwide.
- 15 Nov HKMC launched a new series of Mortgage-Backed Securities issued under its Bauhinia US\$3 Billion Mortgage-Backed Securitisation Programme.
- The Treasury Markets Association was incorporated to further promote the development of the treasury markets in Hong Kong.
- The Organizing Committee of the first Hong Kong ICT Awards was established as a collaborative effort among the industry support organizations, ICT professional bodies, academia and the Government to build a large scale and internationally recognized branding of ICT awards of Hong Kong. The Awards scheme would start in 2006.
- 16 Nov AA joined hands with Shenzhen’s Shekou port to launch the world’s first cross boundary check-in service, whereby travellers would obtain their boarding passes and check in luggage at Shekou port and enjoy a hassle-free ferry journey from Shekou to HKIA for onward international flights.
- 18 Nov China and Chile signed a bilateral Free Trade Agreement (FTA). The FTA covered typical areas of trade in goods, as well as cooperation in such fields as research, science and technology, social security and environment, intellectual property rights and promotion of investment.
- 18 – 19 Nov The 13th Asia-Pacific Economic Cooperation (APEC) Economic Leaders’ Meeting was held in Busan. The 21 leaders agreed in their joint statement to push for wider market access and full-fledged global trade talks. The APEC leaders also agreed on a series of joint measures to shield their economies from threats of avian influenza and terrorism.
- 19 Nov The Government of the HKSAR and the Government of the Kingdom of Thailand signed an Agreement for the Promotion and Protection of Investments in the margin of the Economic Leaders’ Meeting of the APEC in Busan, Korea. Under the Agreement, the two governments would provide for equal treatment of investors, compensation if investments were expropriated, free transfer abroad of investments and returns, and settlement of investment disputes under internationally accepted rules.
- 20 Nov An Air Services Agreement was signed between Hong Kong and Saudi Arabia.
- 21 Nov The inauguration of the Hong Kong/ France Business Partnership was held. It was a bilateral committee to foster closer understanding and cooperation between Hong Kong and French businesses.
- “A Symphony of Lights” was awarded the world’s “Largest Permanent Light and Sound Show” by Guinness World Records.
- 21 – 23 Nov TDC organised the World SME Expo and Innovation & Design Expo to foster a strong business network among thousands of local, Mainland and overseas SMEs.

- 22 Nov The Lantau Development Task Force released the Public Consultation Report on the Concept Plan for Lantau. There was general public support for the planning vision of Lantau to promote sustainable development by balancing development and conservation needs. The Task Force would review and revise the Concept Plan in the light of the public comments received.
- 23 Nov A coordination group under the Guangzhou-Hong Kong CEPA Market Entry Facilitation Mechanism was set up. The group was tasked to facilitate Hong Kong business to better capitalise on the CEPA advantages to explore the Guangzhou market, through solving their problems in applications for business approvals and for setting up individually owned businesses.
- The Logistics Awards Hong Kong 2005, co-organised by LOGSCOUNCIL, were presented in recognition of the achievements of outstanding enterprises and practitioners in Hong Kong's logistics industry.
- 25 Nov SFC released a Report on the Derivative Warrants Market in Hong Kong, which addressed the concerns of the market, investors and the Government about the current market practices and regulatory regime of the derivative warrants market. SFC proposed in the report a Six-Point Plan with measures aimed at facilitating the healthy growth of the derivative warrants market. Public comments on the plan were invited.
- The Government published the Third Quarter Economic Report 2005. The report pointed out that the Hong Kong economy turned out a spectacular performance in the third quarter of 2005, with GDP leaping by 8.2% in real terms over a year earlier. Externally, both exports of goods and services continued to surge amidst the fairly strong performance of the overseas markets as well as further growth in inbound tourism. Locally, domestic demand re-accelerated to a solid growth supported by improving employment incomes and a generally upbeat sentiment.
- In the November update of the economic forecast for 2005, the forecast growth rate in real terms of GDP was revised upwards to 7%, from 4.5% to 5.5% in August round. Meanwhile, the forecast rate of increase in the Composite CPI was lowered to 1.2%, from 1.5% in August round.
- 28 Nov The Intellectual Property Department launched Phase I of their interactive electronic services for real-time renewal of registered trademarks and patents, and up-dating of the data of patent applications.
- 29 Nov – 1 Dec The Central Economic Work Conference of the Central Committee of the Communist Party of China and the State Council was held. The meeting set guidelines and major tasks for the Mainland economy in 2006, stating that the country would continue to aim at achieving fast and stable growth and at the same time intensifying efforts to raise farmers' income, save resources and protect the environment.
- 30 Nov The Pearl River Delta Regional Air Quality Monitoring Network jointly established by Hong Kong and Guangdong came into full operation, and the daily reporting of a Regional Air Quality Index started.
- The Merchant Shipping (Local Vessels and Miscellaneous Amendments)

Ordinance was passed by the LegCo. The Bill amended the Merchant Shipping (Local Vessels) Ordinance (“LVO”) and its subsidiary legislation to provide for the effective operation of LVO and better control of vessels.

- 1 Dec The Construction Waste Disposal Charging Scheme came into operation, with the levy of disposal charges to be commenced on 20 January 2006. The scheme provided financial incentives to construction waste producers to reduce waste through sorting, reuse and recycling so that they could minimise their disposal cost as well as help preserve the valuable landfill space at the same time.
- The total net asset value of all Mandatory Provident Fund (MPF) schemes reached HK\$146.3 billion, five years after the launch of the MPF System on 1 December 2000.
- 3 Dec The Hong Kong Shipping Register celebrated its 15th Anniversary with a new record of 29.6 million gross tonnes, an increase of over 380% since its establishment in 1990.
- 5 Dec The Mainland authorities permitted foreign-funded financial institutions to conduct renminbi businesses in seven more cities ahead of its WTO schedule, bringing the total number of opened cities to 25. The operating capital requirements for engaging in renminbi businesses in the Mainland were also lowered.
- 6 Dec The European Central Bank raised its refinancing rate by 25 basis points to 2.25%, the first increase since October 2000.
- Dragonair was named “the Cargo Airlines of the Year” in the Centre for Asia Pacific Aviation’s Awards for Excellence 2005.
- 8 Dec HKMA and Bank Negara Malaysia announced the signing of a MOU for the establishment of a large-value payment-system link between Malaysia and Hong Kong. The two central banks would establish a link between the Ringgit real time gross settlement system in Malaysia (the RENTAS system) and the US dollar real time gross settlement system in Hong Kong (USD RTGS system). This link, scheduled to be completed in 2006, would be the first cross-border payment-versus-payment link between two real time gross settlement systems for two different currencies in this region.
- HKMA released a new data series on the composite interest rate, which was to help improve interest rate risk management in the banking sector.
- 8 – 9 Dec OGCIO co-organised the 2005 Pan-PRD Software World, which aimed to promote cooperation between the software industries in the Pan-PRD region and was held in Zhuhai. Hundreds of government officials and software industry representatives from the Mainland, Hong Kong and Macao participated in the event.
- 13 – 18 Dec The Sixth Ministerial Conference of the WTO was successfully held in Hong Kong. The Conference, chaired by the Secretary for Commerce, Industry and Technology, adopted the Hong Kong Ministerial Declaration. The Declaration set out a series of agreements in the major negotiating areas and a timetable for

the next and final phase of the negotiations under the Doha Development Agenda.

- 14 Dec The Base Rate under the Discount Window operated by HKMA was raised by 25 basis points to 5.75%, following an increase of the US Fed Funds target rate by the same magnitude to 4.25% after the FOMC meeting on 13 December.
- 15 Dec The Environmental Protection Department published “A Policy Framework for the Management of Municipal Solid Waste (MSW) (2005-2014)”, which set out a comprehensive strategy for MSW management in Hong Kong for the ten years from 2005 to 2014. It proposed simple and effective economic tools, based on the "polluter-pays" principle, to create incentives for the community to recycle more and discard less.
- 17 Dec The Broadcasting Authority approved the investment plans of Asia Television Limited and Television Broadcasts Limited for digital terrestrial television services. Their digital services would include free-to-air high-definition TV programmes and multi-channel broadcasts.
- 20 Dec Following the Mainland’s first nationwide economic census, the Mainland’s GDP for 2004 was revised up by RMB2,300 billion, equivalent to 16.8% of that year’s pre-revision GDP level. The new figures showed a larger share of the services sector in the Mainland economy.
- The sixth meeting of the Hong Kong-Guangdong Joint Working Group on Sustainable Development and Environmental Protection was held in Guangzhou to examine the implementation of various co-operation initiatives and discuss the progress of implementing the Pearl River Delta Regional Air Quality Management Plan and the work plan for 2006.
- The Office of the Commissioner of Insurance and SFC concluded a MOU to promote mutual assistance and the exchange of information between the two regulators, including the fostering of a closer cooperation of regulatory effort in the regulation of insurance-related investment products.
- 21 Dec AsiaWorld-Expo, Hong Kong’s largest exhibition and events complex located at the HKIA, was opened. The HK\$2.35 billion state-of-the-art facility, one of the largest in the region, would further enhance Hong Kong’s position as a leading exhibition and events hub, and give Hong Kong the opportunity to host world-class entertainment and special events with a regional reach. AsiaWorld-Expo, a public-private partnership, received its funding from the Government and a private sector consortium, with AA contributing the land. In parallel, MTR Corporation Limited’s Airport Express service was extended to the new terminus AsiaWorld-Expo Station on 20 December.
- 23 Dec “A Symphony of Lights” achieved a new world record when its Phase II was launched and extended to Kowloon covering 33 buildings on both sides of the Victoria Harbour.
- 28 Dec The Digital Trade and Transportation Network System was launched to provide a neutral and open e-platform for logistics players to exchange information and data in an efficient, reliable and low-cost manner.

- 29 Dec OFTA published the second report arising from an independent consultancy study on the effectiveness of competition in Hong Kong's telecommunications market, as benchmarked against seven major overseas markets. The report showed that Hong Kong was able to maintain its position as a leading market with effective competition in telecommunications, and that Hong Kong had the highest outgoing International Direct Dialing traffic among the benchmarked economies.
- 30 Dec The Economic Development and Labour Bureau launched Stage II of the two-stage consultation exercise, scheduled to end on 31 March 2006, to seek the views of the public on the proposals pertaining to the future regulatory arrangements and other matters related to the development of the electricity market after 2008.
- 31 Dec Hong Kong's container throughput rose by 2.0% over 2004 to about 22.4 million twenty-foot equivalent units (TEU) in 2005, making Hong Kong the second busiest port in the world in terms of containers handled.
- The construction of the Hong Kong Section of the Hong Kong-Shenzhen Western Corridor (HK-SWC) was substantially completed for commissioning by end-2006 to tie in with the completion of the new boundary control facilities at Shekou. The HK-SWC would be the fourth vehicular boundary crossing between Hong Kong and the Mainland, and would serve to relieve the traffic at the three existing boundary crossings (Lok Ma Chau, Man Kam To and Sha Tau Kok) and meet the increasing cross-boundary traffic needs.
- The Hong Kong stock market staged a robust performance in 2005, with market turnover, IPO equity funds raised and total market capitalisation all hitting record highs. The total market capitalisation amounted to HK\$8,180 billion in end-2005, up some 20% from end-2004.

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Table 1 : Gross Domestic Product by expenditure component[@]
(at current market prices)

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>
	(\$Mn)				
Private consumption expenditure	755,508	833,825	795,948	765,282	774,280
Government consumption expenditure	103,541	112,751	116,550	119,993	120,172
Gross domestic fixed capital formation	378,486	451,891	388,731	325,328	347,375
<i>of which:</i>					
Building and construction	185,648	223,264	208,235	171,930	155,441
Machinery, equipment and computer software	170,652	190,760	165,177	141,349	180,204
Changes in inventories	9,762	12,313	-15,651	-10,612	14,399
Total exports of goods	1,397,917	1,455,949	1,347,649	1,349,000	1,572,689
Domestic exports	212,160	211,410	188,454	170,600	180,967
Re-exports	1,185,758	1,244,539	1,159,195	1,178,400	1,391,722
Imports of goods	1,511,365	1,589,876	1,408,317	1,373,500	1,636,711
Exports of services	285,385	286,595	262,099	276,385	315,012
Imports of services	189,753	198,424	194,245	185,174	192,427
GDP	1,229,481	1,365,024	1,292,764	1,266,702	1,314,789
<i>Per capita GDP (\$)</i>	<i>191,047</i>	<i>210,350</i>	<i>197,559</i>	<i>191,736</i>	<i>197,268</i>
GNP	1,218,405	1,363,409	1,317,362	1,291,470	1,323,543
<i>Per capita GNP (\$)</i>	<i>189,326</i>	<i>210,101</i>	<i>201,318</i>	<i>195,485</i>	<i>198,581</i>
Total final demand	2,930,599	3,153,324	2,895,326	2,825,376	3,143,927
Total final demand excluding re-exports ^(a)	1,949,977	2,130,313	1,952,900	1,886,191	2,045,858
Domestic demand	1,247,297	1,410,780	1,285,578	1,199,991	1,256,226
Private	1,078,661	1,233,803	1,107,816	1,014,347	1,075,654
Public	168,636	176,977	177,762	185,644	180,572
External demand	1,683,302	1,742,544	1,609,748	1,625,385	1,887,701

Definitions of Terms :

Total final demand	= private consumption expenditure + government consumption expenditure + gross domestic fixed capital formation + changes in inventories + total exports of goods + exports of services
Private sector domestic demand	= private consumption expenditure + gross domestic fixed capital formation by the private sector + changes in inventories
Public sector domestic demand	= government consumption expenditure + gross domestic fixed capital formation by the public sector
Domestic demand	= private sector domestic demand + public sector domestic demand
External demand	= total exports of goods + exports of services

**Table 1 : Gross Domestic Product by expenditure component[@]
(at current market prices) (cont'd)**

	(\$Mn)				
	<u>2001</u>	<u>2002</u>	<u>2003[#]</u>	<u>2004[#]</u>	<u>2005⁺</u>
Private consumption expenditure	782,587	747,850	719,304	767,769	809,244
Government consumption expenditure	128,866	131,291	130,151	127,309	121,419
Gross domestic fixed capital formation	333,036	286,020	261,367	274,872	287,862
<i>of which:</i>					
Building and construction	142,651	131,752	116,419	107,532	104,757
Machinery, equipment and computer software	180,011	144,832	136,537	150,543	163,215
Changes in inventories	-4,060	5,660	9,111	7,076	-4,106
Total exports of goods	1,480,987	1,562,121	1,749,089	2,027,031	2,251,744
Domestic exports	153,520	131,079	122,126	126,386	136,324
Re-exports	1,327,467	1,431,041	1,626,964	1,900,645	2,115,419
Imports of goods	1,549,222	1,601,527	1,794,059	2,099,545	2,311,091
Exports of services	320,799	347,836	362,420	429,563	479,510
Imports of services	194,180	202,494	203,400	242,507	252,379
GDP	1,298,813	1,276,757	1,233,983	1,291,568	1,382,203
<i>Per capita GDP (\$)</i>	<i>193,135</i>	<i>188,118</i>	<i>181,385</i>	<i>187,657</i>	<i>199,282</i>
GNP	1,327,356	1,282,409	1,262,474	1,314,978	N.A.
<i>Per capita GNP (\$)</i>	<i>197,379</i>	<i>188,951</i>	<i>185,573</i>	<i>191,058</i>	<i>N.A.</i>
Total final demand	3,042,215	3,080,778	3,231,442	3,633,620	3,945,673
Total final demand excluding re-exports ^(a)	1,982,896	1,923,066	1,895,705	2,061,787	2,196,221
Domestic demand	1,240,429	1,170,821	1,199,933	1,177,026	1,214,419
Private	1,053,568	985,985	938,326	1,001,274	1,051,687
Public	186,861	184,836	181,607	175,752	162,732
External demand	1,801,786	1,909,957	2,111,509	2,456,594	2,731,254

Notes : (@) The Census and Statistics Department completed an exercise to implement the latest international guidelines on dealing with financial intermediation services provided by banks in the estimation of national accounts statistics of Hong Kong in mid-August 2005. As a result of this statistical development, GDP, GNP and BoP statistics presented in this Appendix were revised.

(a) Re-export margin is nevertheless retained in the total final demand.

(#) Revised figures.

(+) Preliminary figures.

N.A. Not available.

**Table 2 : Rates of change in Gross Domestic Product
by expenditure component (in real terms)**

(%)

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>
Private consumption expenditure	3.9	6.2	-6.6	1.4	6.0	2.1
Government consumption expenditure	3.8	2.4	0.7	3.1	2.1	6.0
Gross domestic fixed capital formation	10.9	12.6	-7.3	-16.6	11.0	2.6
<i>of which:</i>						
Building and construction	7.0	10.5	-2.4	-15.5	-7.6	-1.1
Machinery, equipment and computer software	12.0	13.1	-7.9	-18.2	27.0	6.2
Total exports of goods	4.8	6.1	-4.3	3.7	17.1	-3.3
Domestic exports	-8.4	2.1	-7.9	-7.2	7.5	-10.2
Re-exports	7.5	6.8	-3.7	5.4	18.5	-2.4
Imports of goods	4.3	7.3	-7.3	*	18.2	-1.9
Exports of services	10.2	-0.4	-3.5	8.8	12.1	6.4
Imports of services	5.1	3.9	1.6	-4.4	4.2	2.0
GDP	4.2	5.1	-5.5	4.0	10.0	0.6
Per capita GDP (\$)	-0.3	4.2	-6.2	3.0	9.0	-0.3
GNP	2.4	6.0	-3.5	4.0	8.6	2.2
Per capita GNP (\$)	-2.1	5.1	-4.3	3.0	7.6	1.3
Total final demand	4.3	6.2	-6.0	1.3	14.4	-0.6
Total final demand excluding re-exports ^(a)	2.2	5.8	-7.6	-1.7	11.3	0.4
Domestic demand	2.1	8.2	-9.2	-4.4	10.3	1.0
Private	1.2	9.5	-9.9	-5.4	12.3	0.7
Public	9.2	-1.0	-3.8	2.1	-2.8	3.3
External demand	5.4	5.3	-4.3	4.4	16.4	-1.7

Notes : (a) Re-export margin is nevertheless retained in the total final demand.

(#) Revised figures.

(+) Preliminary figures.

**Table 2 : Rates of change in Gross Domestic Product
by expenditure component (in real terms) (cont'd)**

(%)

	<u>2002</u>	<u>2003[#]</u>	<u>2004[#]</u>	<u>2005⁺</u>	Average annual rate of change:	
					10 years 1995 to 2005 ⁺	5 years 2000 to 2005 ⁺
Private consumption expenditure	-1.0	-0.9	7.3	3.7	2.1	2.2
Government consumption expenditure	2.5	1.9	0.7	-3.0	2.0	1.6
Gross domestic fixed capital formation	-4.5	0.9	3.0	3.9	1.3	1.1
<i>of which:</i>						
Building and construction	-1.1	-5.6	-11.7	-6.8	-3.7	-5.3
Machinery, equipment and computer software	-7.6	6.7	11.0	10.7	4.5	5.2
Total exports of goods	8.7	14.2	15.3	11.2	7.1	9.0
Domestic exports	-11.2	-7.3	2.4	7.6	-3.5	-4.0
Re-exports	11.0	16.3	16.3	11.4	8.5	10.3
Imports of goods	7.9	13.1	14.1	8.6	6.2	8.2
Exports of services	10.9	7.9	17.9	8.4	7.7	10.2
Imports of services	3.9	-2.1	14.6	2.8	3.1	4.1
GDP	1.8	3.2	8.6	7.3	3.9	4.3
<i>Per capita GDP (\$)</i>	0.9	3.0	7.3	6.5	2.6	3.4
GNP	0.1	5.1	8.0	N.A.	3.7 ^	4.7 ~
<i>Per capita GNP (\$)</i>	-0.8	4.8	6.8	N.A.	2.3 ^	3.9 ~
Total final demand	5.1	8.1	12.0	7.8	5.1	6.4
Total final demand excluding re-exports ^(a)	2.0	3.5	9.2	5.4	2.9	4.1
Domestic demand	-0.7	0.1	5.1	2.1	1.3	1.5
Private	-1.0	-0.2	6.4	3.6	1.5	1.9
Public	1.2	1.7	-1.6	-6.8	0.1	-0.5
External demand	9.1	13.1	15.8	10.7	7.2	9.2

Notes (cont'd) : (^) Average annual rate of change for the 10-year period 1994 to 2004.

(~) Average annual rate of change for the 5-year period 1999 to 2004.

(*) Change of less than 0.05%.

N.A. Not available.

**Table 3 : Gross Domestic Product by economic activity
(at current prices)**

	2000		2001		2002		2003 [#]		2004 [#]	
	\$Mn	% share	\$Mn	% share	\$Mn	% share	\$Mn	% share	\$Mn	% share
Agriculture and fishing	920	0.1	1,003	0.1	1,002	0.1	824	0.1	886	0.1
Mining and quarrying	241	*	174	*	136	*	116	*	72	*
Manufacturing	67,646	5.4	59,760	4.8	51,396	4.2	44,403	3.7	44,455	3.5
Electricity, gas and water	36,917	2.9	37,957	3.1	39,609	3.2	38,839	3.2	39,726	3.2
Construction	62,054	4.9	57,167	4.6	51,534	4.2	44,910	3.7	40,376	3.2
Services	1,087,570	86.6	1,088,211	87.5	1,091,272	88.4	1,073,941	89.3	1,128,939	90.0
<i>Wholesale, retail and import/export trades, restaurants and hotels</i>	308,600	24.6	309,926	24.9	310,500	25.1	308,872	25.7	345,092	27.5
<i>Transport, storage and communications</i>	118,974	9.5	117,526	9.4	121,766	9.9	117,420	9.8	126,820	10.1
<i>Financing, insurance, real estate and business services</i>	268,399	21.4	251,495	20.2	247,045	20.0	251,085	20.9	266,834	21.3
<i>Community, social and personal services</i>	249,997	19.9	262,960	21.1	265,746	21.5	261,917	21.8	262,403	20.9
<i>Ownership of premises</i>	141,600	11.3	146,304	11.8	146,214	11.8	134,648	11.2	127,790	10.2
GDP at factor cost	1,255,348	100.0	1,244,271	100.0	1,234,949	100.0	1,203,034	100.0	1,254,453	100.0
Taxes on production and imports	57,908		53,917		43,325		48,057		58,729	
Statistical discrepancy (%)	0.1		*		-0.1		-1.4		-1.7	
GDP at current market prices	1,314,789		1,298,813		1,276,757		1,233,983		1,291,568	

Notes : Figures may not add up exactly to the total due to rounding.

(#) Revised figures.

(*) Less than 0.05%.

**Table 4 : Rates of change of Gross Domestic Product by economic activity
(in real terms)**

	(%)						
	<u>2001</u>	<u>2002</u>	<u>2003[#]</u>	<u>2004[#]</u>	<u>2005[#]</u>		
					Q1	Q2	Q3
Agriculture and fishing	4.1	-0.7	-5.6	2.8	-3.0	7.4	5.4
Mining and quarrying	-14.1	-11.1	2.2	-17.0	*	12.8	18.9
Manufacturing	-9.1	-10.0	-10.3	1.7	-2.3	-0.1	4.1
Electricity, gas and water	1.7	3.8	1.8	2.0	5.0	4.8	0.5
Construction	-2.2	-1.5	-4.9	-9.8	0.5	-8.4	-5.5
Services	1.8	2.8	4.5	9.9	7.0	8.6	8.6
<i>Wholesale, retail and import/export trades, restaurants and hotels</i>	<i>0.3</i>	<i>4.5</i>	<i>9.1</i>	<i>15.1</i>	<i>10.5</i>	<i>12.1</i>	<i>11.0</i>
<i>Transport, storage and communications</i>	<i>1.9</i>	<i>6.5</i>	<i>0.7</i>	<i>13.9</i>	<i>12.7</i>	<i>12.3</i>	<i>15.3</i>
<i>Financing, insurance, real estate and business services</i>	<i>0.5</i>	<i>2.7</i>	<i>5.7</i>	<i>13.1</i>	<i>6.5</i>	<i>11.4</i>	<i>9.9</i>
<i>Community, social and personal services</i>	<i>4.0</i>	<i>-0.6</i>	<i>0.6</i>	<i>2.6</i>	<i>1.0</i>	<i>0.1</i>	<i>1.1</i>
<i>Ownership of premises</i>	<i>3.4</i>	<i>2.0</i>	<i>2.7</i>	<i>0.8</i>	<i>4.6</i>	<i>5.3</i>	<i>5.7</i>
Taxes on production and imports	-1.1	-0.1	3.4	13.0	-1.3	2.1	10.0
GDP at constant (2000) market prices	0.6	1.8	3.2	8.6	6.0	7.3	8.3

Notes : (#) Revised figures.

(*) Change of less than 0.05%.

**Table 5 : Balance of payments account by major component
(at current prices)**

(\$Mn)

	2001	2002	2003	2004 [#]	2005 [#]	2005 [#]		
						Q1-Q3	Q1	Q2
Current account	76,315	96,800	128,240	122,491	106,589	32,487	31,198	42,905
Goods	-64,970	-39,406	-44,970	-72,514	-46,264	-19,677	-19,646	-6,941
Services	126,620	145,341	159,020	187,056	159,846	49,645	50,002	60,199
Income	28,543	5,652	28,491	23,410	5,677	6,999	4,763	-6,085
Current transfers	-13,878	-14,787	-14,301	-15,461	-12,669	-4,481	-3,921	-4,268
Capital and financial account	-97,359	-151,179	-179,086	-184,640	-110,482	-54,444	-7,427	-48,610
Capital and financial non-reserve assets (net change)	-60,829	-169,720	-171,497	-159,155	-110,456	-51,890	-12,926	-45,639
Capital transfers	-9,155	-15,686	-8,292	-2,561	-4,847	-2,653	-1,511	-683
Financial non-reserve assets (net change)	-51,674	-154,033	-163,205	-156,594	-105,609	-49,238	-11,415	-44,956
<i>Direct investment</i>	96,948	-60,685	63,372	-91,038	-25,709	970	3,928	-30,607
<i>Portfolio investment</i>	-322,045	-302,484	-264,619	-306,368	-181,164	-70,770	-91,131	-19,263
<i>Financial derivatives</i>	39,640	51,563	78,288	44,319	10,907	4,206	5,749	952
<i>Other investment</i>	133,783	157,573	-40,247	196,492	90,357	16,357	70,038	3,961
Reserve assets (net change) ^(a)	-36,530	18,541	-7,589	-25,486	-25	-2,554	5,500	-2,971
Net errors and omissions	21,044	54,379	50,846	62,149	3,892	21,958	-23,771	5,706
Overall balance of payments	36,530	-18,541	7,589	25,486	25	2,554	-5,500	2,971

Notes: Figures may not add up exactly to the total due to rounding.

(a) A negative value for net change in reserve assets represents a net increase, and a positive value represents a net decrease.

(#) Revised figures.

**Table 6 : Visible and invisible trade
(at current market prices)**

	(\$Mn)								
	<u>2001</u>	<u>2002</u>	<u>2003[#]</u>	<u>2004[#]</u>	<u>2005⁺</u>	<u>2005</u>			
						Q1 [#]	Q2 [#]	Q3 [#]	Q4 ⁺
Total exports of goods	1,480,987	1,562,121	1,749,089	2,027,031	2,251,744	479,096	555,352	614,625	602,671
Imports of goods	1,549,222	1,601,527	1,794,059	2,099,545	2,311,091	498,773	574,998	621,566	615,754
Visible trade balance	-68,235	-39,406	-44,970	-72,514	-59,347	-19,677	-19,646	-6,941	-13,083
	<-4.4>	<-2.5>	<-2.5>	<-3.5>	<-2.6>	<-3.9>	<-3.4>	<-1.1>	<-2.1>
Exports of services	320,799	347,836	362,420	429,563	479,510	109,508	109,601	128,501	131,900
Imports of services	194,180	202,494	203,400	242,507	252,379	59,863	59,599	68,302	64,615
Invisible trade balance	126,619	145,342	159,020	187,056	227,131	49,645	50,002	60,199	67,285
	<65.2>	<71.8>	<78.2>	<77.1>	<90.0>	<82.9>	<83.9>	<88.1>	<104.1>
Exports of goods and services	1,801,786	1,909,957	2,111,509	2,456,594	2,731,254	588,604	664,953	743,126	734,571
Imports of goods and services	1,743,402	1,804,021	1,997,459	2,342,052	2,563,470	558,636	634,597	689,868	680,369
Visible and invisible trade balance	58,384	105,936	114,050	114,542	167,784	29,968	30,356	53,258	54,202
	<3.3>	<5.9>	<5.7>	<4.9>	<6.5>	<5.4>	<4.8>	<7.7>	<8.0>

Notes : Figures in this table are reckoned on a GDP basis.

(#) Revised figures.

(+) Preliminary figures.

() As a percentage of the total value of imports of goods/services.

< > As a percentage of the total value of imports of goods and services.

**Table 7 : Total exports of goods by market
(in value terms)**

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>		<u>2005</u>			
	(% change)					\$Mn	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>
							(% change over a year earlier)			
All markets	-5.8	5.4	11.7	15.9	11.4	2,250,174	10.6	12.5	12.5	10.0
Mainland of China	0.6	12.3	21.1	19.7	14.0	1,012,565	12.0	14.7	14.2	14.5
United States	-9.8	1.0	-2.6	5.4	5.6	360,639	5.6	7.3	7.9	1.7
Japan	0.5	-4.5	12.3	14.4	10.3	118,578	11.9	11.6	12.5	5.7
Germany	-13.9	-5.3	15.1	11.9	15.6	72,720	18.1	15.7	14.5	14.7
United Kingdom	-12.2	-2.0	5.8	14.8	5.2	69,247	10.5	9.8	2.8	0.1
Taiwan	-11.1	-2.2	22.2	16.2	2.7	50,427	-3.2	4.3	6.5	3.0
Republic of Korea	-9.4	17.2	16.9	24.0	9.5	48,241	5.0	4.9	11.0	16.4
Singapore	-19.5	6.8	13.0	22.0	6.8	46,541	14.7	12.9	-2.0	3.4
Rest of the world	-8.4	3.5	7.1	17.3	13.3	471,215	12.1	13.9	16.7	10.4

Note : Figures may not add up exactly to the total due to rounding.

**Table 8 : Imports of goods by source
(in value terms)**

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>		<u>2005</u>			
	(% change)						\$Mn	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>
							(% change over a year earlier)			
All sources	-5.4	3.3	11.5	16.9	10.3	2,329,469	8.1	10.1	11.5	11.3
Mainland of China	-4.6	5.1	9.6	16.9	14.3	1,049,335	13.9	14.2	15.3	13.5
Japan	-11.2	3.4	17.2	19.7	0.1	256,501	-0.8	0.2	-0.4	1.5
Taiwan	-13.1	7.4	8.0	22.8	9.4	168,227	3.1	3.8	8.5	21.2
Singapore	-2.8	3.9	19.6	22.5	21.8	135,190	12.4	14.2	26.9	32.6
United States	-7.0	-12.8	7.9	13.4	6.5	119,252	5.7	13.8	9.6	-2.4
Republic of Korea	-12.2	7.3	15.0	15.0	2.6	103,035	-9.0	-1.0	4.5	15.4
Rest of the world	0.5	2.2	12.1	13.6	8.4	497,928	7.5	10.4	9.4	6.2

Note : Figures may not add up exactly to the total due to rounding.

**Table 9 : Retained imports of goods by end-use category
(in value terms)**

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>		<u>2005</u>			
	(% change)						\$Mn	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>
							(% change over a year earlier)			
Overall	-9.1	-9.0	2.6	14.8	6.5	581,072	-1.4	0.4	8.8	18.6
Foodstuffs	-2.6	0.2	1.5	8.6	3.3	50,834	3.6	1.1	2.9	5.2
Consumer goods	3.9	-5.2	-1.8	7.4	3.7	125,616	4.9	-11.9	6.3	17.5
Fuels	-10.2	3.9	12.9	37.5	23.7	57,034	25.0	21.4	33.4	15.0
Raw materials and semi-manufactures	-22.3	-1.6	10.7	17.6	4.9	217,297	-7.3	2.2	10.5	14.7
Capital goods	-2.8	-24.9	-6.6	13.3	6.6	129,521	-6.9	4.0	-0.1	31.2

Note : Figures may not add up exactly to the total due to rounding.

**Table 10 : Exports and imports of services by component
(at current market prices)**

	<u>2001</u>	<u>2002</u>	<u>2003[#]</u>	<u>2004[#]</u>	<u>2005⁺</u>		<u>2005</u>			
	(% change)						\$Mn	<u>Q1[#]</u>	<u>Q2[#]</u>	<u>Q3[#]</u>
							(% change over a year earlier)			
Exports of services	1.8	8.4	4.2	18.5	11.6	479,510	11.3	12.0	12.2	11.0
Transportation	-5.9	10.8	3.8	25.5	12.2	151,721	13.1	13.3	12.0	10.7
Travel	0.7	25.4	-4.4	26.1	12.3	78,698	15.8	10.9	11.0	11.6
Trade-related	9.0	9.0	12.2	12.6	11.4	163,278	12.1	12.8	10.8	10.6
Other services	3.4	-5.9	-1.4	12.7	10.4	85,813	3.5	9.3	16.4	12.1
Imports of services	0.9	4.3	0.4	19.2	4.1	252,379	8.3	2.7	4.8	0.9
Transportation	4.7	-4.7	7.8	29.4	7.8	72,954	10.2	9.2	9.3	3.0
Travel	-1.4	0.8	-8.0	15.9	1.0	104,425	8.9	-3.9	1.2	-1.3
Trade-related	5.7	24.2	9.2	3.2	10.5	18,252	10.7	13.6	9.7	9.0
Other services	0.5	20.0	8.2	19.7	3.2	56,748	4.6	4.7	4.7	-0.6
Net exports of services	3.3	14.8	9.4	17.6	21.4	227,131	15.1	25.6	21.9	22.9

Notes : Figures may not add up exactly to the total due to rounding.

(#) Revised figures.

(+) Preliminary figures.

Table 11 : Incoming visitors by source

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>		<u>2005</u>		
						Q1	Q2	Q3	Q4
<u>('000)</u>									
All sources	13 725.3	16 566.4	15 536.8	21 810.6	23 359.4	5 469.9	5 508.1	5 975.6	6 405.8
Mainland of China	4 448.6	6 825.2	8 467.2	12 245.9	12 541.4	3 038.8	2 845.0	3 293.7	3 364.0
South and Southeast Asia	1 746.6	1 905.2	1 359.6	2 077.7	2 413.0	499.2	617.4	544.5	751.9
Taiwan	2 418.8	2 428.8	1 852.4	2 074.8	2 130.6	502.0	513.8	573.5	541.3
Europe	1 019.9	1 083.9	780.8	1 142.7	1 398.0	308.5	345.4	329.1	414.9
Japan	1 336.5	1 395.0	867.2	1 126.3	1 210.8	316.8	264.5	303.5	326.0
United States	935.7	1 000.8	683.8	1 051.7	1 143.1	260.8	293.6	274.9	313.8
Others	1 819.2	1 927.4	1 525.8	2 091.7	2 522.6	543.8	628.5	656.4	693.9
<u>(% change over a year earlier)</u>									
All sources	5.1	20.7	-6.2	40.4	7.1	10.8	8.5	4.0	5.8
Mainland of China	17.5	53.4	24.1	44.6	2.4	4.1	3.5	-0.5	3.0
South and Southeast Asia	*	9.1	-28.6	52.8	16.1	32.6	15.8	8.8	12.7
Taiwan	1.4	0.4	-23.7	12.0	2.7	4.2	2.6	2.0	2.2
Europe	-4.6	6.3	-28.0	46.3	22.3	17.8	29.2	26.2	17.6
Japan	-3.3	4.4	-37.8	29.9	7.5	44.0	3.0	-4.5	-1.7
United States	-3.1	7.0	-31.7	53.8	8.7	18.9	11.6	4.3	2.7
Others	5.6	5.9	-20.8	37.1	20.6	19.1	24.0	24.1	15.8

Notes : Figures may not add up exactly to the total due to rounding.

(*) Change of less than 0.05%.

Table 12 : Property market

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
Completion of new property by the private sector							
<i>('000 m² of internal floor area)</i>							
Residential property ^(a) (in units)	19 875	18 202	22 278	35 322	25 790	26 262	31 052
Commercial property	390	705	945	634	160	208	304
<i>of which :</i>							
Office space	269	456	737	428	96	76	166
Other commercial premises ^(b)	121	249	208	206	64	132	138
Industrial property ^(c)	440	343	300	191	62	45	29
<i>of which :</i>							
Industrial-cum-office premises	115	72	145	40	37	14	0
Conventional flatted factory space	242	181	31	4	19	30	3
Storage premises ^(d)	83	90	124	147	6	0	27
Production of public housing							
<i>(in units)</i>							
Rental housing flats ^(e)	18 358	16 046	14 267	26 733	40 944	47 590	20 154
Subsidized sales flats ^(e)	10 725	21 535	21 993	26 532	22 768	26 174	2 224
Building plans with consent to commence work in the private sector							
<i>('000 m² of usable floor area)</i>							
Residential property ^(f)	1 058.2	1 631.4	1 472.0	1 692.8	1 142.7	1 002.5	790.0
Commercial property	1 005.7	599.0	395.7	287.5	337.5	265.0	365.3
Industrial property ^(g)	530.5	461.6	69.5	84.9	129.2	45.7	107.1
Other properties	375.8	259.2	201.5	125.8	240.2	75.0	109.3
Total	2 970.2	2 951.2	2 138.7	2 190.9	1 849.5	1 388.1	1 371.8
Agreements for sale and purchase of property							
<i>(Number)</i>							
Residential property ^(h)	129 484	172 711	85 616	77 087	65 340	69 667	72 974
Non-residential property	17 939	32 750	25 873	21 379	20 404	18 523	12 947
Total	147 423	205 461	111 489	98 466	85 744	88 190	85 921
Total value (\$Bn)							
Residential property ^(h)	381.7	690.3	278.5	212.0	168.4	150.9	154.3
Non-residential property	92.9	177.7	62.4	44.6	54.1	41.9	31.1
Total	474.7	868.0	340.9	256.6	222.5	192.8	185.4

Notes : (a) Figures before 2002 cover all completed residential premises to which either temporary or full Occupation Permits have been granted, as well as village type houses issued with Letters of Compliance. Property developments subject to a Consent Scheme need a Certificate of Compliance, Consent to Assign or Consent to Lease in addition to an Occupation Permit before the premises can be individually assigned. Village-type housing units are excluded as from 2002 and units issued with temporary Occupation Permits are also excluded as from 2004 onwards.

Residential premises here pertain to private residential units, excluding units built under the Private Sector Participation Scheme (PSPS), Home Ownership Scheme (HOS), Buy or Rent Option, Mortgage Subsidy Scheme, Sandwich Class Housing Scheme, Urban Improvement Scheme (UIS) and Flat-for-Sale Scheme. Figures from 2004 onwards also cover those private flats converted from subsidised flats.

(b) These include retail premises and other premises designed or adapted for commercial use, with the exception of purpose-built offices. Car-parking space and commercial premises built by the Hong Kong Housing Authority and the Hong Kong Housing Society are excluded.

(c) These include industrial-cum-office premises, but exclude specialised factory buildings which are developed mainly for own use.

(d) These include storage premises at the container terminals and the airport.

Table 12 : Property market (cont'd)

	<u>2003</u>	<u>2004</u>	<u>2005</u>		<u>2005</u>		
				Q1	Q2	Q3	Q4
Completion of new property by the private sector							
<i>('000 m² of internal floor area)</i>							
Residential property ^(a) (in units)	26 397	26 036	17 321	3 921	7 251	4 627	1 522
Commercial property	417	371	145	18	40	4	83
<i>of which :</i>							
Office space	299	279	34	0	32	0	2
Other commercial premises ^(b)	118	91	111	18	8	4	81
Industrial property ^(c)	15	1	17	0	4	0	13
<i>of which :</i>							
Industrial-cum-office premises	15	0	4	0	4	0	0
Conventional flatted factory space	0	1	0	0	0	0	0
Storage premises ^(d)	0	0	13	0	0	0	13
Production of public housing							
<i>(in units)</i>							
Rental housing flats ^(e)	13 948	20 947	24 691	9 571	5 864	5 534	3 722
Subsidized sales flats ^(e)	320	0	0	0	0	0	0
Building plans with consent to commence work in the private sector							
<i>('000 m² of usable floor area)</i>							
Residential property ^(f)	1 038.4	530.0	550.7	104.6	40.8	151.6	253.8
Commercial property	200.0	161.3	481.9	46.2	164.4	43.4	228.0
Industrial property ^(g)	0.8	16.4	35.1	0.0	11.6	20.6	2.9
Other properties	444.2	407.1	408.0	132.2	178.9	35.1	61.8
Total	1 683.3	1 114.8	1 475.8	283.0	395.7	250.6	546.5
Agreements for sale and purchase of property							
<i>(Number)</i>							
Residential property ^(h)	71 576	100 630	103 362	24 842	37 337	21 895	19 288
Non-residential property	15 733	22 850	20 335	5 165	6 468	4 615	4 087
Total	87 309	123 480	123 697	30 007	43 805	26 510	23 375
Total value (\$Bn)							
Residential property ^(h)	153.6	276.7	312.8	73.5	115.1	64.3	60.0
Non-residential property	35.8	75.1	82.7	20.0	24.9	19.1	18.8
Total	189.4	351.8	395.5	93.4	140.0	83.4	78.7

Notes (cont'd): (e) The Housing Authority's housing production figures have been revised as from 1998. The revision is to exhaustively cover all housing production and to count projects (including surplus HOS projects) which undergo transfer of usage at the time of disposal and according to their actual usage. Moreover, surplus HOS courts and blocks pending disposal are excluded from production statistics until they are disposed. Rental and sales flats projects of the Housing Society are included.

(f) As from 1995, the classification of residential property has been revised to include developments under the UIS of the Housing Society, but to exclude developments under the HOS and the PSPS of the Housing Authority.

(g) These include multi-purpose industrial premises designed also for office use.

(h) It should be noted that primary sales of units under the HOS and the Tenants Purchase Scheme are not covered in this table, as sale and purchase agreements are commonly not required for these transactions. Also, sale and purchase agreements for primary sales of units under the PSPS are not included in the row on residential property, yet they are included in the row on non-residential property, and thus also in the row for the total.

Table 13 : Property prices and rentals

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
<u>(Index (1999=100))</u>							
Property price indices :							
Residential flats ^(a)	116.9	163.1	117.1	100.0	89.6	78.7	69.9
Office space ^(b)	188.4	213.1	134.5	100.0	89.9	78.7	68.4
Shopping space	134.0	177.3	128.3	100.0	93.6	86.8	85.0
Flatted factory space	171.4	168.9	131.8	100.0	91.2	82.0	74.8
Property rental indices ^(c) :							
Residential flats	119.0	134.5	112.6	100.0	98.1	95.4	83.4
Office space ^(b)	152.3	156.8	135.9	100.0	98.5	101.0	85.4
Shopping space	117.8	123.5	111.2	100.0	101.3	99.4	92.9
Flatted factory space	132.4	132.5	118.1	100.0	95.4	90.3	82.7
<u>(% change)</u>							
Property price indices :							
Residential flats ^(a)	8.9	39.5	-28.2	-14.6	-10.4	-12.2	-11.2
Office space ^(b)	-3.2	13.1	-36.9	-25.7	-10.1	-12.5	-13.1
Shopping space	3.3	32.3	-27.6	-22.1	-6.4	-7.3	-2.1
Flatted factory space	-13.7	-1.5	-22.0	-24.1	-8.8	-10.1	-8.8
Property rental indices ^(c) :							
Residential flats	-1.4	13.0	-16.3	-11.2	-1.9	-2.8	-12.6
Office space ^(b)	-14.7	3.0	-13.3	-26.4	-1.5	2.5	-15.4
Shopping space	*	4.8	-10.0	-10.1	1.3	-1.9	-6.5
Flatted factory space	-9.9	0.1	-10.9	-15.3	-4.6	-5.3	-8.4

Notes : (a) Figures pertain to prices of existing flats traded in the secondary market, but not new flats sold in the primary market.

(b) Since 2000, price and rental indices for office space in the private sector have been recompiled according to the revised grading criteria for office space. Hence, the figures from 2000 onwards are not strictly comparable to those in the earlier years.

(c) All rental indices shown in this table have been adjusted for concessionary leasing terms such as provision of refurbishment, granting of rent-free periods, and waiver of miscellaneous charges, if known.

For residential property, changes in rentals cover only new tenancies for which rentals are freshly determined. For non-residential property, changes in rentals cover also lease renewals upon which rentals may be revised.

Table 13 : Property prices and rentals (cont'd)

	<u>2003</u>	<u>2004</u>	<u>2005⁺</u>		<u>2005</u>		
				Q1	Q2	Q3 [#]	Q4 ⁺
<u>(Index (1999=100))</u>							
Property price indices :							
Residential flats ^(a)	61.6	78.0	91.8	89.9	94.5	93.6	89.1
Office space ^(b)	62.5	99.3	132.8	123.2	135.6	137.7	134.8
Shopping space	85.5	119.3	147.1	144.3	153.0	148.6	142.3
Flatted factory space	71.7	88.6	124.0	108.6	122.5	130.7	134.1
Property rental indices ^(c) :							
Residential flats	73.6	77.7	86.6	82.5	85.5	88.3	90.1
Office space ^(b)	74.6	78.1	96.2	87.7	92.8	99.6	104.9
Shopping space	86.4	92.8	100.4	96.8	99.0	102.1	103.6
Flatted factory space	74.9	77.3	82.4	81.0	82.4	82.3	83.8
<u>(% change over a year earlier)</u>							
Property price indices :							
Residential flats ^(a)	-11.9	26.6	17.7	22.1	22.4	20.3	6.8 <50.3> {-47.4}
Office space ^(b)	-8.6	58.9	33.7	39.1	39.5	38.5	20.4 <128.5> {-40.1}
Shopping space	0.6	39.5	23.3	32.0	32.8	25.3	6.0 <75.7> {-26.4}
Flatted factory space	-4.1	23.6	40.0	35.1	46.7	44.1	34.5 <91.6> {-22.7}
Property rental indices ^(c) :							
Residential flats	-11.8	5.6	11.5	10.3	10.5	12.3	12.3 <25.3> {-35.1}
Office space ^(b)	-12.6	4.7	23.2	18.0	20.8	26.1	27.8 <46.3> {-34.0}
Shopping space	-7.0	7.4	8.2	8.9	7.6	8.2	7.9 <23.2> {-16.9}
Flatted factory space	-9.4	3.2	6.6	7.0	7.3	6.2	5.7 <16.1> {-37.3}

Notes (cont'd) : (#) Figures for non-residential property are provisional.

(+) Provisional figures.

(*) Change of less than 0.05%.

< > % change from the trough in 2003.

{ } % change from the peak in 1997.

Table 14 : Monetary aggregates

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
<u>(as at end of period)</u>							
Hong Kong dollar money supply (\$Mn) :							
M1	198,311	188,135	178,260	205,339	203,966	229,841	259,411
M2 ^(a)	1,503,603	1,666,419	1,828,691	1,923,481	1,987,963	1,998,774	1,984,049
M3 ^(a)	1,520,461	1,684,325	1,840,824	1,935,471	2,002,358	2,016,635	2,004,225
Total money supply (\$Mn)							
M1	217,460	208,093	197,666	225,156	243,847	258,056	295,650
M2	2,532,236	2,788,808	3,111,942	3,386,196	3,649,492	3,550,060	3,518,326
M3	2,611,636	2,871,425	3,168,199	3,434,467	3,692,753	3,594,130	3,561,852
Deposit ^(b) (\$Mn)							
HK\$	1,400,077	1,551,555	1,699,726	1,773,169	1,851,177	1,854,651	1,824,911
Foreign currency	1,058,180	1,158,728	1,300,302	1,477,448	1,676,670	1,551,852	1,492,631
Total	2,458,256	2,710,282	3,000,027	3,250,617	3,527,847	3,406,502	3,317,542
Loans and advances (\$Mn)							
HK\$	1,447,844	1,742,481	1,695,027	1,607,126	1,652,191	1,647,684	1,615,667
Foreign currency	2,467,045	2,379,189	1,609,400	1,205,784	809,259	537,301	460,659
Total	3,914,890	4,121,670	3,304,427	2,812,910	2,461,450	2,184,986	2,076,325
Nominal Effective Exchange Rate Indices (Jan 2000 = 100) ^{(c)(d)}							
Trade-weighted	94.0	98.0	103.4	100.9	101.7	104.7	104.0
Import-weighted	93.0	97.9	105.5	101.4	101.5	105.1	104.7
Export-weighted	95.1	98.1	101.3	100.4	101.9	104.3	103.3
<u>(% change)</u>							
Hong Kong dollar money supply :							
M1	15.5	-5.1	-5.2	15.2	-0.7	12.7	12.9
M2 ^(a)	19.3	--	9.7	5.2	3.4	0.5	-0.7
M3 ^(a)	18.9	--	9.3	5.1	3.5	0.7	-0.6
Total money supply :							
M1	14.2	-4.3	-5.0	13.9	8.3	5.8	14.6
M2	10.9	--	11.6	8.8	7.8	-2.7	-0.9
M3	10.5	--	10.3	8.4	7.5	-2.7	-0.9
Deposit ^(b)							
HK\$	19.5	--	9.5	4.3	4.4	0.2	-1.6
Foreign currency	0.3	--	12.2	13.6	13.5	-7.4	-3.8
Total	10.4	--	10.7	8.4	8.5	-3.4	-2.6
Loans and advances							
HK\$	17.0	20.4	-2.7	-5.2	2.8	-0.3	-1.9
Foreign currency	-1.4	-3.6	-32.4	-25.1	-32.9	-33.6	-14.3
Total	4.7	5.3	-19.8	-14.9	-12.5	-11.2	-5.0
Nominal Effective Exchange Rate Indices ^{(c)(d)}							
Trade-weighted	2.6	4.3	5.5	-2.4	0.8	2.9	-0.7
Import-weighted	3.8	5.3	7.8	-3.9	0.1	3.5	-0.4
Export-weighted	1.5	3.2	3.3	-0.9	1.5	2.4	-1.0

Definition of Terms :

The Hong Kong Dollar Money Supply is the Hong Kong dollar component of the respective monetary aggregate. Starting from April 1997, money supply definition has been revised to include short-term Exchange Fund placements of less than one month in the monetary aggregates. As such, figures after 1997 cannot be compared with those in the previous period.

Total Money Supply:

- M1: Legal tender notes and coins with the public, plus customers' demand deposits with licensed banks.
- M2: M1 plus customers' savings and time deposits with licensed banks, plus negotiable certificates of deposit issued by licensed banks and held outside the monetary sector.
- M3: M2 plus customers' deposits with restricted licence banks and deposit-taking companies, plus negotiable certificates of deposit issued by such institutions and held outside the monetary sector.

Table 14 : Monetary aggregates (cont'd)

	<u>2003</u>	<u>2004</u>	<u>2005</u>		<u>2005</u>		
				Q1	Q2	Q3	Q4
<u>(as at end of period)</u>							
Hong Kong dollar money supply (\$Mn) :							
M1	354,752	412,629	348,247	387,168	360,889	350,711	348,247
M2 ^(a)	2,107,269	2,208,591	2,329,697	2,201,393	2,214,261	2,278,988	2,329,697
M3 ^(a)	2,122,861	2,219,557	2,345,866	2,214,594	2,227,479	2,294,680	2,345,866
Total money supply (\$Mn)							
M1	413,423	484,494	434,684	464,340	438,286	431,190	434,684
M2	3,813,442	4,166,706	4,379,088	4,164,250	4,166,961	4,243,288	4,379,088
M3	3,858,044	4,189,544	4,407,231	4,189,596	4,192,238	4,270,883	4,407,231
Deposit ^(b) (\$Mn)							
HK\$	1,930,790	2,017,911	2,131,607	2,004,436	2,017,544	2,080,347	2,131,607
Foreign currency	1,636,227	1,848,145	1,936,337	1,848,632	1,837,973	1,845,628	1,936,337
Total	3,567,018	3,866,056	4,067,944	3,853,068	3,855,517	3,925,974	4,067,944
Loans and advances (\$Mn)							
HK\$	1,573,079	1,666,740	1,797,270	1,699,027	1,757,390	1,763,803	1,797,270
Foreign currency	462,000	488,964	515,326	482,728	499,281	505,312	515,326
Total	2,035,079	2,155,704	2,312,596	2,181,755	2,256,671	2,269,115	2,312,596
Nominal Effective Exchange Rate Indices (Jan 2000 =100) ^{(c)(d)}							
Trade-weighted	100.7	98.3	97.4	96.2	97.1	97.6	98.6
Import-weighted	101.6	99.2	98.1	96.9	97.7	98.3	99.5
Export-weighted	99.8	97.3	96.7	95.5	96.4	96.9	97.7
<u>(% change over a year earlier)</u>							
Hong Kong dollar money supply :							
M1	36.8	16.3	-15.6	2.9	-6.3	-5.5	-15.6
M2 ^(a)	6.2	4.8	5.5	6.4	7.1	10.1	5.5
M3 ^(a)	5.9	4.6	5.7	6.2	6.9	10.1	5.7
Total money supply :							
M1	39.8	17.2	-10.3	6.4	-2.1	-3.1	-10.3
M2	8.4	9.3	5.1	9.2	8.9	8.6	5.1
M3	8.3	8.6	5.2	8.6	8.2	8.2	5.2
Deposit ^(b)							
HK\$	5.8	4.5	5.6	6.2	7.1	10.6	5.6
Foreign currency	9.6	13.0	4.8	10.8	9.0	5.4	4.8
Total	7.5	8.4	5.2	8.4	8.0	8.1	5.2
Loans and advances							
HK\$	-2.6	6.0	7.8	8.1	9.4	9.8	7.8
Foreign currency	0.3	5.8	5.4	2.7	6.5	6.9	5.4
Total	-2.0	5.9	7.3	6.9	8.7	9.2	7.3
Nominal Effective Exchange Rate Indices ^{(c)(d)}							
Trade-weighted	-3.2	-2.4	-0.9	-2.2	-1.7	-1.1	1.3
Import-weighted	-3.0	-2.4	-1.1	-2.5	-2.0	-1.4	1.3
Export-weighted	-3.4	-2.5	-0.6	-2.0	-1.5	-0.8	1.3

- Notes : (a) Adjusted to include foreign currency swap deposits.
(b) Starting from April 1997, deposits include short-term Exchange Fund placements of less than one month. As such, figures after 1997 cannot be compared with those in the previous period.
(c) Period average.
(d) The Effective Exchange Rate Indices (EERIs) from January 2000 onwards are compiled on the basis of the average merchandise trade pattern from 1999 to 2000. The EERIs for the earlier periods are compiled on the basis of the average merchandise trade pattern in a much earlier period from 1991 to 1993, and have been re-scaled to the new base period for linking up with the new index series.
(--) Not applicable.

Table 15 : Rates of change in business receipts indices for service industries/domains

(%)

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2005</u>		
					Q1-Q3	Q1	Q2	Q3
Wholesale trade	-12.0	-10.7	-5.0	4.7	5.5	3.9	7.9	4.8
Retail trade	-1.2	-4.1	-2.3	10.8	7.3	8.5	7.3	6.1
Import/export trade	-14.1	-2.8	6.5	12.4	10.5	13.5	10.0	8.7
Restaurants	-2.5	-5.4	-9.7	10.1	5.7	6.1	4.5	6.3
Hotels	-7.6	-2.3	-19.7	39.4	21.5	22.8	22.3	19.2
Transport ^(a)	-2.4	2.3	0.5	22.8	18.7	19.1	15.5	21.2
Storage	-14.9	-19.6	-4.5	17.0	9.6	5.2	10.5	12.9
Communications	-13.2	-2.6	-2.4	1.0	5.6	3.8	4.9	7.9
Banking	2.7	-0.8	*	4.4	11.6	5.9	11.6	17.5
Financing (other than banking)	-12.6	-14.3	17.3	33.2	12.6	-1.9	11.8	30.0
Insurance	14.2	10.3	19.1	22.3	14.0	9.4	14.7	17.9
Real estate	-16.9	-2.5	6.2	13.5	23.0	17.8	42.2	12.1
Business services	-9.6	-5.8	0.5	8.3	4.7	1.7	6.2	6.2
Film entertainment	15.2	-9.1	2.3	3.7	4.2	9.1	5.2	-1.3
Tourism, convention and exhibition services ⁺	-3.8	10.7	-7.3	26.5	11.8	13.9	13.0	8.7
Computer and information services	-11.6	5.7	5.7	20.5	22.5	14.5	27.0	25.2

Notes : (a) Including business receipts from the Airport Authority Hong Kong.

(+) Figures for 2004 and 2005 are provisional figures.

(*) Change of less than 0.05%.

Table 16 : Labour force characteristics

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>		<u>2005</u>		
						Q1	Q2	Q3	Q4
<u>(%)</u>									
Labour force participation rate	61.4	61.8	61.4	61.3	60.9	61.1	60.8	61.0	60.9
Seasonally adjusted unemployment rate	5.1	7.3	7.9	6.8	5.6	6.1	5.7	5.5	5.3
Underemployment rate	2.5	3.0	3.5	3.3	2.8	3.1	2.8	2.6	2.5
<u>('000)</u>									
Population of working age	5 579.2	5 642.8	5 694.0	5 796.0	5 884.4	5 837.7	5 866.5	5 899.5	5 933.7
Labour force	3 427.1	3 487.1	3 496.2	3 551.0	3 586.3	3 565.1	3 569.2	3 597.3	3 613.4
Persons employed	3 252.3	3 231.6	3 219.1	3 308.6	3 385.5	3 354.5	3 364.7	3 391.6	3 431.5
Persons unemployed	174.8	255.5	277.2	242.5	200.7	210.6	204.5	205.7	182.0
Persons underemployed	85.5	105.2	123.3	116.7	98.7	109.8	100.4	95.0	89.5
<u>(% change over a year earlier)</u>									
Population of working age	1.5	1.1	0.9	1.8	1.5	1.4	1.4	1.6	1.7
Labour force	1.6	1.8	0.3	1.6	1.0	1.0	0.7	1.2	1.1
Persons employed	1.4	-0.6	-0.4	2.8	2.3	2.3	1.9	2.6	2.5
Persons unemployed	4.7	46.2	8.5	-12.5	-17.2	-16.0	-15.1	-17.9	-20.1
Persons underemployed	-8.6	23.0	17.3	-5.4	-15.4	-7.9	-18.3	-16.3	-19.6

Table 17 : Employment in selected major economic sectors

Major economic sector	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>			No.
	(% change)				<u>Mar</u>	<u>Jun</u>	<u>Sep</u>	
Manufacturing	-8.6	-9.0	-10.3	-3.0	-3.5	-4.5	-1.0	166 300
<i>of which :</i>								
Wearing apparel, except footwear	-14.9	-19.3	-11.6	-0.8	-4.3	-9.9	-1.7	22 700
Textiles	-8.7	-1.1	-16.8	-11.1	-3.8	1.5	3.8	20 400
Electronics	-17.4	-13.1	-18.9	-2.3	1.1	-7.3	-4.3	14 200
Plastic products	-16.4	-17.0	-19.1	-16.8	-11.0	-4.8	-1.0	3 100
Fabricated metal products, except machinery and equipment	-16.9	-14.6	-20.7	-4.9	-14.6	-7.0	-12.8	5 500
Wholesale, retail, import/export trades, restaurants and hotels	-1.2	-2.3	-3.0	2.9	3.5	2.9	1.8	1 021 400
<i>of which :</i>								
Wholesale, retail and import/export trades	-1.9	-1.6	-1.9	2.1	3.6	3.1	1.3	807 100
Restaurants and hotels	1.2	-4.8	-7.3	6.0	2.9	2.3	3.7	214 300
Transport, storage and communications	2.4	-1.8	-4.4	3.7	2.9	3.4	2.8	183 100
<i>of which :</i>								
Land transport	2.6	-0.3	0.5	-2.2	-1.5	-1.7	-1.1	37 700
Water transport	3.3	1.0	-3.6	0.1	1.3	1.4	1.2	27 000
Services allied to transport	-0.8	1.1	-3.7	10.3	9.2	8.6	6.3	61 300
Financing, insurance, real estate and business services	1.6	-1.3	-1.9	3.6	4.4	5.3	4.0	455 400
<i>of which :</i>								
Financial institutions	-0.5	-5.6	-6.5	1.1	3.7	5.2	5.1	125 900
Insurance	7.1	0.3	1.2	2.4	2.3	13.1	7.6	29 300
Real estate	-3.0	5.2	0.7	2.2	5.8	6.0	5.7	93 800
Business services except machinery and equipment rental and leasing	4.5	-1.2	-0.2	6.0	4.6	3.9	2.2	205 600
Community, social and personal services	7.2	5.9	2.9	3.2	5.4	4.5	5.3	437 700
<i>of which :</i>								
Sanitary and similar services	5.1	13.8	6.0	1.5	1.6	0.9	5.6	59 100
Education services	6.9	2.5	2.9	1.8	1.4	1.6	1.2	128 800
Medical, dental and other health services	5.5	3.2	-0.3	2.5	1.3	0.4	2.9	77 200
Welfare institutions	25.4	11.9	13.9	2.1	4.9	-2.4	-3.3	52 500
Civil Service^(a)	-3.5	-3.7	-2.4	-3.8	-3.5	-3.0	-2.4	156 200

Note : (a) These figures cover only those employed on Civil Service terms of appointment. Judicial officers, consultants, contract staff and temporary staff not appointed on Civil Service terms are not included.

Table 18 : Number of workers engaged at building and construction sites

	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u> Mar-Sep	Mar	<u>2005</u> Jun	Sep
<u>(number)</u>								
Building sites								
Private sector	40 556	40 017	33 892	33 619	31 971	33 967	31 266	30 679
Public sector ^(a)	17 183	11 727	16 183	13 325	10 693	11 482	10 027	10 571
Sub-total	57 738	51 744	50 074	46 944	42 664	45 449	41 293	41 250
Civil engineering sites								
Private sector	2 633	2 869	2 755	2 564	2 411	3 090	2 281	1 861
Public sector ^(a)	19 931	18 611	17 466	16 772	15 795	17 222	16 427	13 735
Sub-total	22 564	21 480	20 221	19 336	18 205	20 312	18 708	15 596
Total	80 302	73 223	70 295	66 280	60 869	65 761	60 001	56 846
<u>(% change over a year earlier)</u>								
Building sites								
Private sector	19.2	-1.3	-15.3	-0.8	-7.7	-2.1	-13.3	-7.4
Public sector ^(a)	-37.0	-31.8	38.0	-17.7	-24.5	-28.4	-30.0	-12.7
Sub-total	-5.8	-10.4	-3.2	-6.3	-12.6	-10.4	-18.1	-8.8
Civil engineering sites								
Private sector	58.9	9.0	-4.0	-6.9	-2.3	49.6	-14.4	-30.4
Public sector ^(a)	19.6	-6.6	-6.2	-4.0	-5.4	5.7	-2.3	-19.1
Sub-total	23.1	-4.8	-5.9	-4.4	-5.0	10.7	-4.0	-20.6
Total	0.9	-8.8	-4.0	-5.7	-10.4	-4.8	-14.2	-12.4

Note : (a) Including the Mass Transit Railway Corporation Limited, the Kowloon-Canton Railway Corporation and the Airport Authority Hong Kong.

Table 19 : Average labour earnings by major economic sector

	(\$)							
	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2005</u>		
Major economic sector					Q1-Q3	Q1	Q2	Q3
Wholesale, retail and import/export trades	12,700 (2.0) <3.7>	12,500 (-1.6) <1.4>	12,300 (-1.5) <1.1>	12,400 (0.4) <0.9>	13,200 (6.7) <5.8>	15,100 (5.6) <5.2>	12,100 (5.2) <4.4>	12,400 (9.6) <8.1>
Restaurants and hotels	9,000 (0.1) <1.7>	8,700 (-4.2) <-1.1>	8,100 (-6.2) <-3.7>	8,100 (-0.1) <0.4>	8,300 (3.0) <2.1>	9,100 (6.4) <6.0>	7,900 (2.7) <1.9>	8,000 (-0.4) <-1.8>
Transport, storage and communications	18,900 (1.3) <3.0>	18,900 (-0.2) <2.9>	18,500 (-1.7) <0.9>	18,300 (-1.3) <-0.9>	18,900 (5.7) <4.9>	20,500 (5.5) <5.2>	18,000 (4.3) <3.5>	18,100 (7.4) <5.9>
Financing, insurance, real estate and business services	19,200 (0.4) <2.0>	18,800 (-2.2) <0.8>	18,600 (-1.4) <1.2>	18,500 (-0.1) <0.4>	18,800 (2.0) <1.2>	21,000 (3.1) <2.8>	18,100 (1.2) <0.4>	17,200 (1.5) <0.1>
Community, social and personal services	20,000 (0.7) <2.3>	19,800 (-1.3) <1.9>	18,900 (-4.7) <-2.2>	18,400 (-2.6) <-2.2>	17,900 (-2.6) <-3.4>	17,800 (-2.7) <-3.1>	17,800 (-0.3) <-1.1>	18,100 (-4.5) <-5.8>
Manufacturing	11,900 (2.1) <3.8>	11,800 (-1.2) <1.9>	11,400 (-3.0) <-0.4>	11,300 (-0.6) <-0.2>	11,500 (2.0) <1.2>	12,700 (2.6) <2.3>	11,200 (2.6) <1.8>	10,600 (0.8) <-0.6>
All sectors surveyed	15,400 (1.8) <3.5>	15,300 (-1.1) <2.0>	15,000 (-1.8) <0.8>	14,900 (-0.7) <-0.2>	15,300 (3.5) <2.6>	16,800 (4.4) <4.0>	14,600 (2.7) <1.8>	14,600 (3.2) <1.8>

Notes : () % change over a year earlier in money terms.

< > % change over a year earlier in real terms.

Table 20 : Rates of change in wage indices by selected major economic sector

(%)

Selected major economic sector	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2005</u>		
					Mar-Sep	Mar	Jun	Sep
<u>(in money terms)</u>								
Wholesale, retail and import/export trades	1.4	-0.6	-1.7	-1.6	1.5	1.9	0.9	1.9
Restaurants and hotels	0.7	-2.6	-4.1	-2.2	-0.3	-0.1	-1.0	0.2
Transport services	0.7	0.6	-1.9	-1.0	0.9	0.7	1.5	0.5
Financing, insurance, real estate and business services	-0.9	-0.8	-0.1	-0.5	-0.6	-1.9	-0.3	0.5
Personal services	0.7	-1.5	-3.1	1.3	-1.1	2.1	-0.9	-4.5
Manufacturing	2.2	-1.4	-2.7	-1.3	0.7	1.2	0.5	0.5
All sectors surveyed	0.8	-1.0	-1.9	-1.1	0.6	0.7	0.4	0.8
<u>(in real terms)</u>								
Wholesale, retail and import/export trades	4.1	1.7	0.4	-1.7	0.2	0.7	-0.4	0.4
Restaurants and hotels	3.3	-0.3	-2.1	-2.2	-1.6	-1.2	-2.3	-1.3
Transport services	3.4	2.9	0.1	-1.0	-0.4	-0.4	0.2	-1.0
Financing, insurance, real estate and business services	1.7	1.5	2.0	-0.5	-1.8	-3.0	-1.5	-1.0
Personal services	3.3	0.8	-1.1	1.3	-2.4	0.9	-2.2	-5.9
Manufacturing	4.8	0.8	-0.7	-1.3	-0.6	0.1	-0.8	-1.0
All sectors surveyed	3.4	1.3	0.2	-1.2	-0.7	-0.5	-0.9	-0.7

Table 21 : Rates of change in prices

	(%)						
	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
GDP deflator	5.8	5.6	0.2	-5.8	-5.6	-1.8	-3.5
Domestic demand deflator	4.9	4.5	0.4	-2.3	-5.0	-2.3	-4.9
Consumer Price Indices ^(a) :							
Composite CPI	6.3	5.8	2.8	-4.0	-3.8	-1.6	-3.0
CPI(A)	6.0	5.7	2.6	-3.3	-3.0	-1.7	-3.2
CPI(B)	6.4	5.8	2.8	-4.7	-3.9	-1.6	-3.1
CPI(C)	6.6	6.1	3.2	-3.7	-4.5	-1.5	-2.8
Unit Value Indices :							
Domestic exports	0.3	-2.4	-2.8	-2.4	-1.0	-4.7	-3.3
Re-exports	-0.5	-1.5	-3.9	-2.8	-0.1	-2.0	-2.7
Total exports of goods	-0.3	-1.6	-3.8	-2.7	-0.2	-2.3	-2.7
Imports of goods	-1.3	-2.3	-4.9	-2.0	0.8	-3.1	-3.9
Terms of Trade Index	1.0	0.7	1.2	-0.7	-1.0	0.9	1.2
Producer Price Index for all manufacturing industries	-0.1	-0.3	-1.8	-1.6	0.2	-1.6	-2.7
Construction Labour and Material Cost Index	6.8	9.3	7.5	1.4	1.8	0.3	-0.3
Tender Price Indices :							
Public sector building projects	14.4	17.6	9.1	-4.4	-13.1	-8.5	-11.7
Public housing projects	11.4	18.9	9.0	-3.3	-11.9	-15.1	-9.6

Notes : (a) As from October 2000 onwards, the year-on-year rates of change in the Consumer Price Indices are computed from the new 1999/2000-based CPI series. For the earlier periods, they are computed from the CPIs with old base period.

(#) Revised figures.

(+) Preliminary figures.

(* Change of less than 0.05%.

N.A. Not available.

Table 21 : Rates of change in prices (cont'd)

	(%)						
	<u>2003</u>	<u>2004</u>	<u>2005</u>		<u>2005</u>		
				Q1	Q2	Q3	Q4
GDP deflator	-6.4 #	-3.6 #	-0.2 +	-1.3 #	-0.6 #	0.2 #	0.4 +
Domestic demand deflator	-4.5 #	* #	1.0 +	0.6 #	1.0 #	1.1 #	1.3 +
Consumer Price Indices ^(a) :							
Composite CPI	-2.6	-0.4	1.1	0.4	0.8	1.4	1.8
CPI(A)	-2.1	*	1.2	0.7	1.0	1.4	1.7
CPI(B)	-2.7	-0.5	1.1	0.4	0.8	1.5	1.8
CPI(C)	-2.9	-0.9	1.0	-0.1	0.7	1.5	1.8
Unit Value Indices :							
Domestic exports	0.2	1.5	2.2	4.8	4.7	1.1	-0.5
Re-exports	-1.5	1.1	1.2	2.0	1.6	1.0	0.5
Total exports of goods	-1.4	1.2	1.3	2.1	1.8	1.0	0.4
Imports of goods	-0.4	2.9	2.7	4.0	3.3	2.3	1.6
Terms of Trade Index	-1.0	-1.7	-1.4	-1.8	-1.4	-1.3	-1.2
Producer Price Index for all manufacturing industries	-0.3	2.2	N.A.	0.5	0.7	0.8	N.A.
Construction Labour and Material Cost Index	-1.0	-1.2	N.A.	-1.7	-1.3	-2.7	N.A.
Tender Price Indices :							
Public sector building projects	-0.3	-1.5	N.A.	3.8	0.6	2.0	N.A.
Public housing projects	-10.0	3.5	7.7	8.5	8.8	7.5	6.2

Table 22 : Rates of change in Composite Consumer Price Index

(%)

	Weight	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
All items	100.0	6.3	5.8	2.8	-4.0	-3.8	-1.6	-3.0
Food	26.67	3.9	3.6	1.9	-1.8	-2.2	-0.8	-2.1
<i>Meals bought away from home</i>	<i>(16.39)</i>	<i>3.9</i>	<i>4.0</i>	<i>2.2</i>	<i>-1.2</i>	<i>-0.9</i>	<i>-0.3</i>	<i>-1.5</i>
<i>Food, excluding meals bought away from home</i>	<i>(10.28)</i>	<i>3.9</i>	<i>3.0</i>	<i>1.5</i>	<i>-2.8</i>	<i>-4.2</i>	<i>-1.7</i>	<i>-3.1</i>
Housing ^(a)	29.91	10.2	9.2	4.7	-5.1	-8.2	-3.1	-5.7
<i>Private housing rent</i>	<i>(24.59)</i>	<i>10.7</i>	<i>9.1</i>	<i>5.5</i>	<i>-6.1</i>	<i>-9.8</i>	<i>-2.9</i>	<i>-6.5</i>
<i>Public housing rent</i>	<i>(2.07)</i>	<i>8.3</i>	<i>13.5</i>	<i>-3.4</i>	<i>1.4</i>	<i>1.1</i>	<i>-8.3</i>	<i>-2.7</i>
Electricity, gas and water	2.98	5.0	5.0	1.4	-0.4	3.6	-1.9	-7.0
Alcoholic drinks and tobacco	0.94	5.7	5.6	6.6	1.2	-0.9	3.3	2.4
Clothing and footwear	4.13	8.3	8.4	-0.8	-20.6	-10.1	-4.6	0.7
Durable goods	6.24	1.9	2.2	0.2	-6.3	-4.6	-7.1	-6.3
Miscellaneous goods	5.70	2.7	5.4	2.6	-0.7	0.9	1.3	1.7
Transport	9.01	6.2	4.0	3.9	0.5	1.0	0.4	-0.6
Miscellaneous services	14.42	6.1	4.5	2.7	-1.3	-0.2	0.5	-2.3

Notes : As from October 2000 onwards, the year-on-year rates of change are computed from the 1999/2000-based Consumer Price Indices series. For the earlier periods, the year-on-year rates of change are computed from the 1994/95-based CPI series.

(a) Apart from "Private housing rent" and "Public housing rent", the "Housing" section also includes "Management fee and other housing charges" and "Tools and materials for housing maintenance".

(*) Change of less than 0.05%.

Table 22 : Rates of change in Composite Consumer Price Index (cont'd)

(%)

	Weight	<u>2003</u>	<u>2004</u>	<u>2005</u>	Q1	<u>2005</u> Q2	Q3	Q4
All items	100.0	-2.6	-0.4	1.1	0.4	0.8	1.4	1.8
Food	26.67	-1.5	1.0	1.8	1.9	1.9	1.9	1.5
<i>Meals bought away from home</i>	<i>(16.39)</i>	<i>-1.5</i>	<i>0.2</i>	<i>0.9</i>	<i>0.6</i>	<i>0.8</i>	<i>1.1</i>	<i>1.1</i>
<i>Food, excluding meals bought away from home</i>	<i>(10.28)</i>	<i>-1.7</i>	<i>2.5</i>	<i>3.3</i>	<i>3.9</i>	<i>3.6</i>	<i>3.3</i>	<i>2.3</i>
Housing ^(a)	29.91	-4.8	-5.2	*	-2.6	-0.9	1.0	2.7
<i>Private housing rent</i>	<i>(24.59)</i>	<i>-6.3</i>	<i>-6.6</i>	<i>*</i>	<i>-3.4</i>	<i>-1.3</i>	<i>1.3</i>	<i>3.3</i>
<i>Public housing rent</i>	<i>(2.07)</i>	<i>9.1</i>	<i>2.5</i>	<i>0.2</i>	<i>0.1</i>	<i>0.2</i>	<i>0.2</i>	<i>0.1</i>
Electricity, gas and water	2.98	1.4	11.4	4.2	4.1	5.1	3.2	4.3
Alcoholic drinks and tobacco	0.94	0.1	*	0.3	0.1	0.4	0.6	0.2
Clothing and footwear	4.13	-2.7	6.4	1.9	3.4	2.2	2.2	0.1
Durable goods	6.24	-6.4	-2.2	-2.0	-2.2	-1.9	-1.7	-2.1
Miscellaneous goods	5.70	2.3	3.6	2.4	1.5	2.1	2.7	3.2
Transport	9.01	-0.4	0.4	1.5	0.7	1.2	2.1	2.0
Miscellaneous services	14.42	-3.2	-0.2	1.1	1.4	0.7	0.8	1.4

**Table 23 : Rates of change in implicit price deflators of GDP
and its main expenditure components**

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
							(%)
Private consumption expenditure	5.2	3.9	2.1	-5.2	-4.5	-1.0	-3.4
Government consumption expenditure	6.5	6.4	2.6	-0.1	-1.9	1.1	-0.6
Gross domestic fixed capital formation	2.0	6.0	-7.2	0.4	-3.8	-6.6	-10.1
Total exports of goods	-0.7	-1.9	-3.3	-3.4	-0.5	-2.6	-2.9
Imports of goods	-1.2	-1.9	-4.4	-2.6	0.8	-3.5	-4.2
Exports of services	2.1	0.8	-5.1	-3.1	1.6	-4.3	-2.2
Imports of services	-0.1	0.7	-3.6	-0.3	-0.3	-1.1	0.4
Gross Domestic Product	5.8	5.6	0.2	-5.8	-5.6	-1.8	-3.5
Total final demand	1.7	1.3	-2.3	-3.7	-2.7	-2.6	-3.7
Domestic demand	4.9	4.5	0.4	-2.3	-5.0	-2.3	-4.9

Notes : (#) Revised figures.
 (+) Preliminary figures.
 (*) Change of less than 0.05%.

**Table 23 : Rates of change in implicit price deflators of GDP
and its main expenditure components (cont'd)**

(%)

	<u>2003[#]</u>	<u>2004[#]</u>	<u>2005⁺</u>	Q1 [#]	<u>2005</u> Q2 [#]	Q3 [#]	Q4 ⁺
Private consumption expenditure	-2.9	-0.5	1.6	0.7	1.6	1.5	2.8
Government consumption expenditure	-2.7	-2.9	-1.7	-1.8	-1.6	-1.7	-1.6
Gross domestic fixed capital formation	-9.4	2.1	0.8	2.3	1.8	1.3	-2.2
Total exports of goods	-2.0	0.5	-0.1	1.3	0.4	-0.2	-1.3
Imports of goods	-0.9	2.5	1.3	2.9	1.8	0.8	*
Exports of services	-3.4	0.4	3.1	2.6	3.0	3.3	3.2
Imports of services	2.6	4.0	1.3	2.6	2.4	0.9	-0.6
Gross Domestic Product	-6.4	-3.6	-0.2	-1.3	-0.6	0.2	0.4
Total final demand	-3.0	0.4	0.8	1.3	1.0	0.7	0.1
Domestic demand	-4.5	*	1.0	0.6	1.0	1.1	1.3

