



2006 Economic Background and 2007 Prospects

Government of the Hong Kong
Special Administrative Region

***2006 ECONOMIC BACKGROUND
AND
2007 PROSPECTS***

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HONG KONG SPECIAL ADMINISTRATIVE REGION

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CALENDAR OF EVENTS OF SIGNIFICANCE TO THE HONG KONG ECONOMY IN 2006

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CHAPTER 1 : OVERVIEW OF ECONOMIC PERFORMANCE IN 2006

Summary

- *After two years of very rapid growth, the Hong Kong economy continued to expand at a brisk pace in 2006. With a strong start in the first quarter, GDP growth moderated somewhat in the second quarter, but soon regained robust momentum that was well sustained through to the end of the year. The robust 6.8% GDP growth for 2006 as a whole marked the third consecutive year of distinctly above-trend growth (GDP growth figure in 2005 also revised upwards, from the previous 7.3% to 7.5%). The past three years saw a sustained period of high growth and low inflation, giving a highly supportive macroeconomic environment.*
- *While external trade continued to display strength on the back of the Mainland's vibrant trade flows and a generally strong global economy, domestic demand played an increasingly vital role as both consumer and investor confidence held up well on the back of improving fundamentals.*
- *The financial services did very well in 2006, so were the trading and logistics sectors. The Hong Kong economy has become more dynamic and continued to move up the value chain in the year.*
- *The property market consolidated earlier in the year upon successive interest rate rises, but re-activated in the latter part of the year as uncertainty over interest rate outlook waned. On the other hand, the local stock market was on a general uptrend during the year, supported by the strong economic upturn, improved corporate earnings, and also fund inflow induced by Mainland's thriving growth and expectation of renminbi appreciation. The Hang Seng Index broke the 20 000 mark for the first time near the year-end, and the stock market capitalisation rose distinctly to become the world's sixth largest.*
- *The labour market experienced further extensive improvements in 2006. The strong economic recovery since mid-2003 has created 299 000 additional jobs, benefiting workers in all age groups and all occupation categories. The unemployment rate fell to a 6-year low of 4.4% by end-2006. Job vacancies and employment income remained on the rise.*

- *Consumer price inflation remained benign throughout 2006, thanks to the continued significant increase in labour productivity and to the global competitive pressures containing the rise in import prices of foodstuffs and consumer goods, which helped to offset the impacts from the renminbi appreciation and a weaker Hong Kong dollar in general.*

Overall situation

1.1 The Hong Kong economy continued to stage a robust and broad-based expansion in 2006. The past three years marked the fastest pace of sustained above-trend growth in any three consecutive years since 1987. On the trade front, Hong Kong's merchandise exports attained another year of double-digit growth in 2006, thanks to the thriving Mainland economy and improved price competitiveness stemming from a weaker US dollar. Apart from the impetus from robust trade growth, domestic demand also held up well to render a steady and prominent growth driver all through the year.

Diagram 1.1 : The past three years saw the fastest economic expansion in recent history

(a) Annual profile

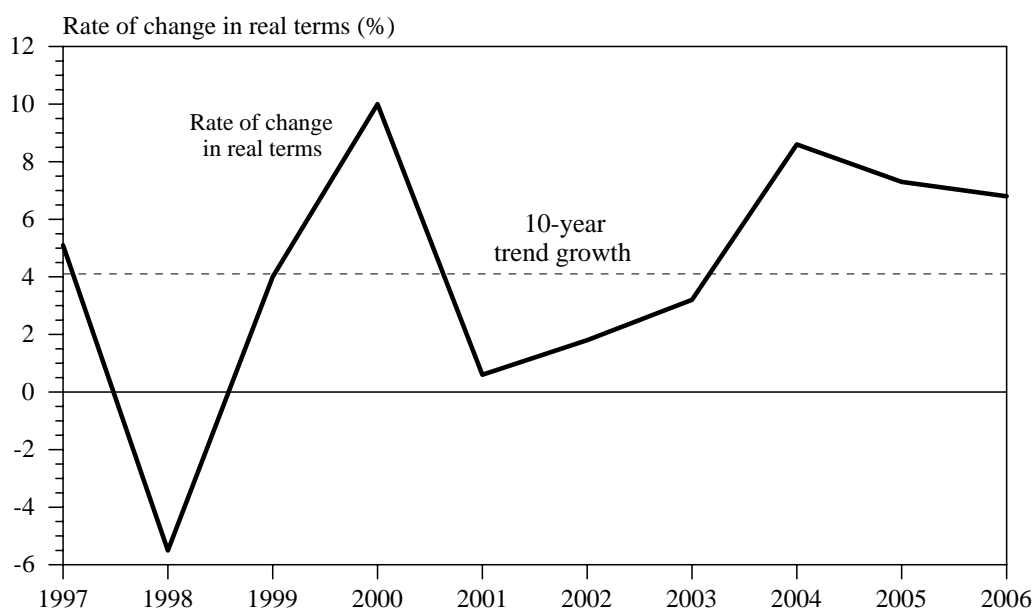
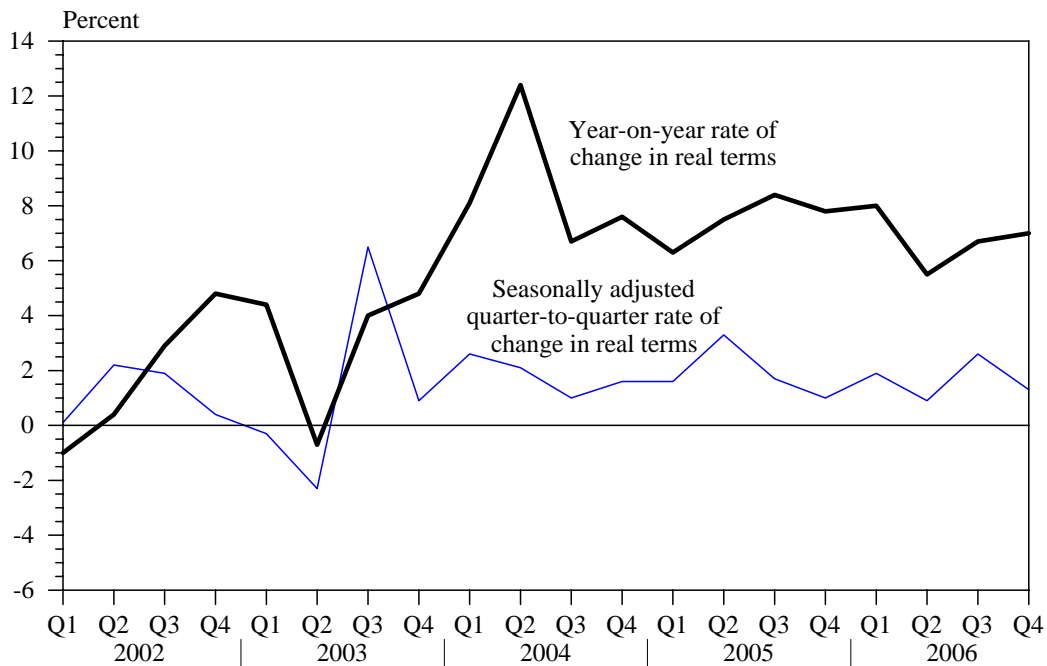


Diagram 1.1 (cont'd) :
(b) Quarterly profile



1.2 For 2006 as a whole, the *Gross Domestic Product (GDP)*⁽¹⁾ leaped by 6.8% in real terms, following a strong 7.5% growth in 2005 (figure revised up from 7.3%). On a year-on-year comparison, after a strong 8.0% expansion in the first quarter, the economy moderated to a 5.5% growth in the second quarter, but soon regained momentum to a 6.7% growth in the third quarter as trade showed renewed vigour. The strength of external trade extended well into the fourth quarter, boosted by vibrant regional trade flows and a further weakening of the US dollar. With domestic demand also maintaining solid growth momentum, economic growth in the fourth quarter remained well above-trend at 7.0%. On a seasonally adjusted quarter-to-quarter comparison⁽²⁾, GDP expanded strongly during the year, by 1.9%, 0.9%, 2.6% and 1.3% respectively in the four quarters.

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

	<u>2005</u> [#]	<u>2006</u> ⁺	<u>2005</u>				<u>2006</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	3.3	5.1	3.7 (*)	2.5 (0.6)	4.0 (1.8)	3.1 (0.5)	4.8 (1.6)	5.4 (1.3)	4.4 (1.0)	5.8 (1.7)
Government consumption expenditure	-3.1	0.3	-4.5 (-2.5)	-2.3 (*)	-1.6 (*)	-3.9 (-1.7)	1.1 (2.9)	-1.5 (-2.3)	-1.1 (0.3)	2.4 (1.6)
Gross domestic fixed capital formation	4.6	7.9	1.3 (N.A.)	5.0 (N.A.)	3.2 (N.A.)	8.9 (N.A.)	7.3 (N.A.)	4.5 (N.A.)	10.3 (N.A.)	9.5 (N.A.)
<i>of which :</i>										
Building and construction	-8.4	-7.2	-3.2	-9.9	-7.6	-13.1	-11.4	-4.1	-10.1	-2.6
Machinery, equipment and computer software	12.9	17.2	3.9	12.2	9.1	26.5	22.4	11.9	20.4	14.9
Total exports of goods	11.2	10.2	8.9 (0.8)	11.1 (6.2)	12.8 (2.3)	11.4 (1.5)	14.4 (3.2)	6.4 (0.1)	8.9 (4.1)	11.7 (3.3)
Imports of goods	8.6	10.0	3.8 (1.3)	7.0 (6.6)	11.0 (2.0)	12.0 (1.9)	14.0 (2.7)	6.7 (-0.2)	8.5 (4.2)	11.4 (3.8)
Exports of services	11.3	8.7	11.7 (2.7)	11.7 (2.6)	11.3 (3.1)	10.7 (2.2)	9.0 (1.0)	9.3 (2.5)	9.3 (3.1)	7.5 (0.7)
Imports of services	7.4	6.3	10.5 (0.6)	4.4 (2.1)	8.0 (2.8)	6.8 (0.9)	5.2 (-0.2)	8.6 (4.8)	5.4 (-0.2)	6.3 (1.6)
Gross Domestic Product	7.5	6.8	6.3 (1.6)	7.5 (3.3)	8.4 (1.7)	7.8 (1.0)	8.0 (1.9)	5.5 (0.9)	6.7 (2.6)	7.0 (1.3)
<i>Change in the main price indicators (%)</i>										
GDP deflator	-0.4	-0.4	-1.5 (0.1)	-0.9 (*)	0.2 (0.1)	0.2 (*)	-0.1 (-0.2)	-0.2 (-0.1)	-0.4 (*)	-0.5 (-0.1)
Composite Consumer Price Index	1.0	2.0	0.4 (0.2)	0.8 (0.3)	1.4 (0.3)	1.3 (0.5)	1.6 (0.4)	2.0 (0.7)	2.3 (0.6)	2.1 (0.4)
Change in nominal GDP (%)	7.1	6.5	4.7	6.6	8.6	8.1	7.9	5.3	6.3	6.5

Notes : Figures are subject to revision later on as more data become available.

(#) Revised figures.

(+) Preliminary figures.

() 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

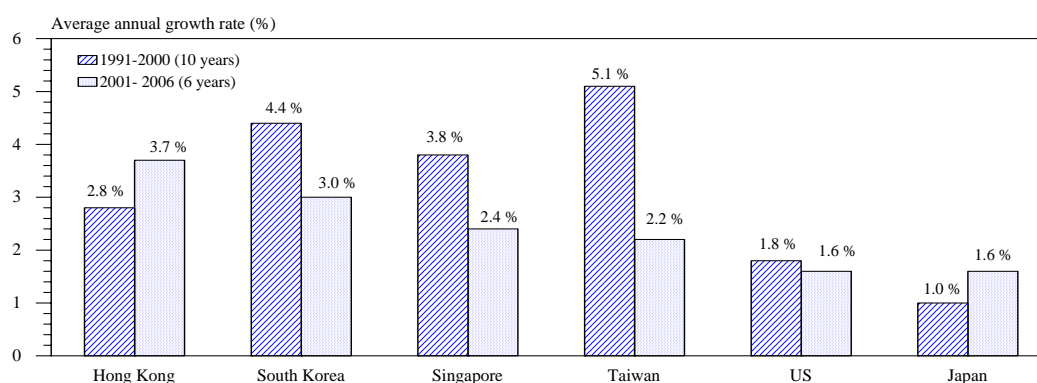
Productivity growth in Hong Kong

Economic growth over the medium to longer run is determined more by supply factors, including labour force growth and labour productivity growth. The former is largely dependent on demographic and immigration trends. The latter is affected by a host of factors, such as technological progress, capital deepening and widening, as well as the quality of labour. Indeed, the trend of productivity growth is a key determinant of the sustainable rate of expansion of the economy over the longer run.

From a macroeconomic perspective, higher labour productivity growth enables the economy to expand at a more rapid pace than otherwise possible, whilst containing the pressure on local costs and hence prices. The benign inflation associated with the continued strong economic expansion of the Hong Kong economy over the past three years was to a large extent a result of the distinct productivity improvement in Hong Kong.

The underlying trend of labour productivity, as measured by GDP per person engaged, is better revealed by examining its movement over a longer period, as the year-to-year movement may be susceptible to the influence of business cycles. Between 2000 and 2006, labour productivity in Hong Kong as crudely measured by GDP per person engaged rose by about 3.7% per year. This was notably higher than the 2.8% average increase in the 1990s, reflecting the on-going shift of the economy towards high value-added and knowledge-based activities, which has been matched by the continuous quality upgrading of Hong Kong's labour force. Conceivably, the Hong Kong economy has also benefited markedly from the boom in information and communication technology since mid-1990s and the eventual adoption of the associated new technologies and innovations into business applications. With highly flexible markets and sound institutions, Hong Kong should be more responsive and better prepared than many other economies in adopting new technologies and innovations. Indeed, compared with the more advanced economies and even our neighbouring economies at a similar stage of development, Hong Kong has fared well in terms of labour productivity growth in the recent past.

Hong Kong's labour productivity growth has outperformed many other economies in recent years



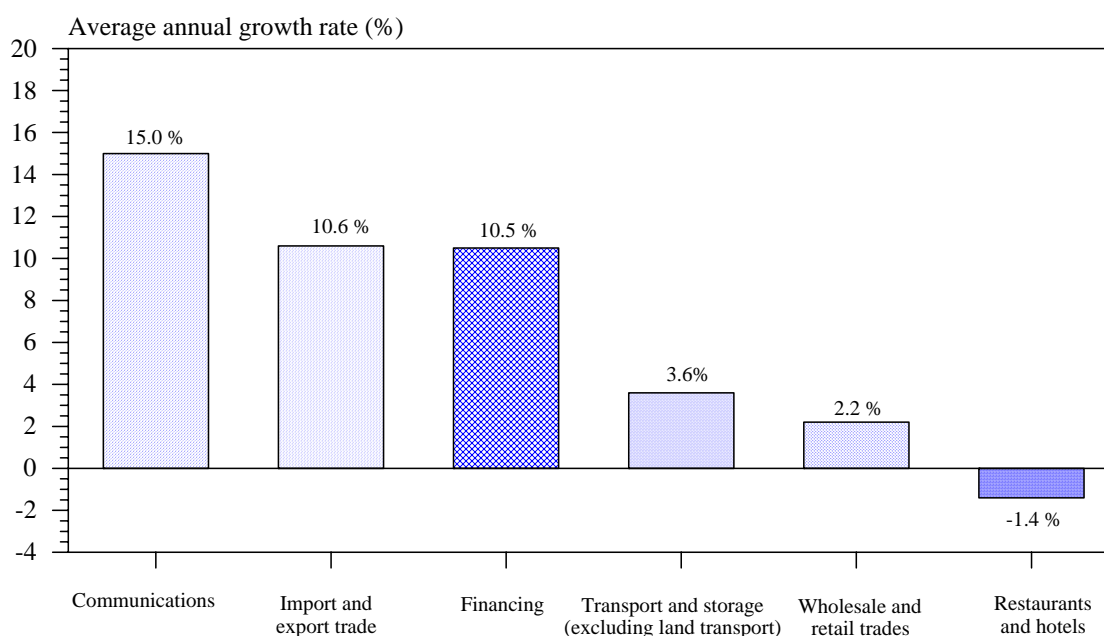
Note : For comparability reason, labour productivity here is defined as GDP per person engaged, due to the difficulty in obtaining data on average hours worked for the selected economies.

Box 1.1 (cont'd)

Labour productivity for individual economic sectors can be measured in terms of net output (i.e. constant price value added as compiled in the GDP accounting framework) per person-hours worked. Figures are available starting from 2000. Among the various economic sectors, “communications” showed the fastest increase in labour productivity between 2000 and 2005, bolstered by rapid technological advancement in this sector. By contrast, “wholesale and retail trade”, a more labour intensive sector, showed only modest increase in labour productivity over this five-year period. Labour productivity in “restaurants and hotels” recorded a small decline, but this reflected more the significant cyclical downturn in 2001-2003 as well as the impact of SARS, rather than its underlying trend.

Yet of particular note was the significant growth in productivity in “import and export trade” and “financing”. Given the larger sizes of these sectors in the economy, they have provided significant impetus to overall productivity growth. These developments also bode well for the competitiveness of Hong Kong as an international financial centre and a regional trade and logistics hub.

Hong Kong's average productivity growth in selected service sectors in 2000 - 2005



Note : Labour productivity here has adjusted for changes in working hours.

The external sector

1.3 As an open economy with the ratio of total trade in goods and services to GDP amounting to 400%, external trade is always very important in driving Hong Kong's overall economic growth. For 2006, external trade again put up a robust performance, both in goods and services. Over the four quarters of the year, merchandise exports were exceptionally strong in the first quarter, followed by a temporary moderation in the second quarter, yet they regained much vigor in the second half of the year, marked by notable improvements in almost all of the major markets. This was mainly due to the generally resilient global economy, the Mainland's robust trade flows, and the competitiveness gain from the weakening of the Hong Kong dollar along with the US dollar. For 2006 as whole, *total exports of goods* grew markedly by 10.2%, further to the strong 11.2% growth in 2005. That exports were able to attain double-digit growth for the fourth year in a row is also a testament to the well-established role of Hong Kong as a trading and logistics hub in the region.

1.4 Invisible trade was likewise robust. Buoyed by surging financial market activity and rapid commercial expansion, exports of financial and other business services attained double-digit growth. Exports of transportation services also grew solidly. But exports of travel services showed more moderate growth due to the slower pace of expansion in inbound tourism in the second half of the year. Yet this was well cushioned by the continued surge in exports of merchanting and other trade-related services throughout 2006, thanks to the strong performance of both conventional and offshore trade involving the Mainland. Overall, *exports of services* still leaped by 8.7% in real terms in 2006, though less rapid than the 11.3% growth in 2005.

The domestic sector

1.5 Compared to trade, the domestic sector was a more steady, though equally important, contributor to the economic growth in 2006. Local consumption demand grew solidly throughout the year, as the labour market continued to show a broad-based improvement and as the asset markets performed well to render a positive wealth effect. Apart from the sanguine economic prospects, the generally upbeat consumer sentiment also benefited from reduced uncertainty over interest rate outlook in the latter part of the year. *Private consumption expenditure (PCE)* grew by 5.1% in real terms for 2006 as a whole, up considerably from the 3.3% growth in 2005.

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

		<i>Of which :</i>							
		Total consumer spending in the domestic market ^(a)	Food	Durables	Non- durables	Services	Residents' expenditure abroad	Visitor spending	Private consumption expenditure^(b)
2005	Annual	4.3	2.8	7.1	6.5	3.2	-0.6	10.3	3.3
	Q1	4.1	0.7	9.8	9.3	1.8	7.7	12.3	3.7
	Q2	4.0	3.7	8.5	6.4	2.4	-9.1	8.7	2.5
	Q3	5.0	2.7	7.5	5.1	4.8	-1.5	9.0	4.0
	Q4	4.0	3.7	3.0	5.3	3.9	0.9	11.3	3.1
2006	Annual	5.4	4.3	5.3	3.5	6.2	2.9	5.9	5.1
	Q1	5.7	5.5	4.1	3.4	6.8	1.0	10.9	4.8
	Q2	5.4	4.8	4.4	3.3	6.4	7.3	7.4	5.4
	Q3	4.8	2.7	6.1	3.8	5.3	1.3	5.9	4.4
	Q4	5.5	4.4	6.3	3.4	6.3	2.7	0.1	5.8

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 picked up for the fourth year in a row, attaining a 7.9% growth in 2006, the fastest since 2000. The strength in investment was mainly propelled by a sustained surge in machinery and equipment acquisition, a clear reflection of investor confidence against the backdrop of a briskly expanding economy. However, overall construction activity continued to be slack in 2006. Having attained a temporary rebound in the second quarter, private sector building and construction activity relapsed again to record moderate declines in the latter half of the year. Also, public sector building and construction activity remained lacklustre, due to the fall-off in public housing works as well as the lack of large-scale infrastructure projects in progress.

Diagram 1.2 : Solid growth of consumer spending throughout 2006

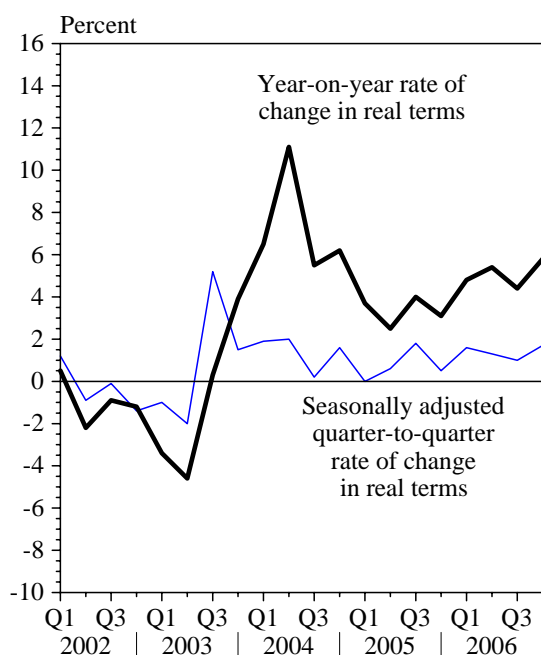
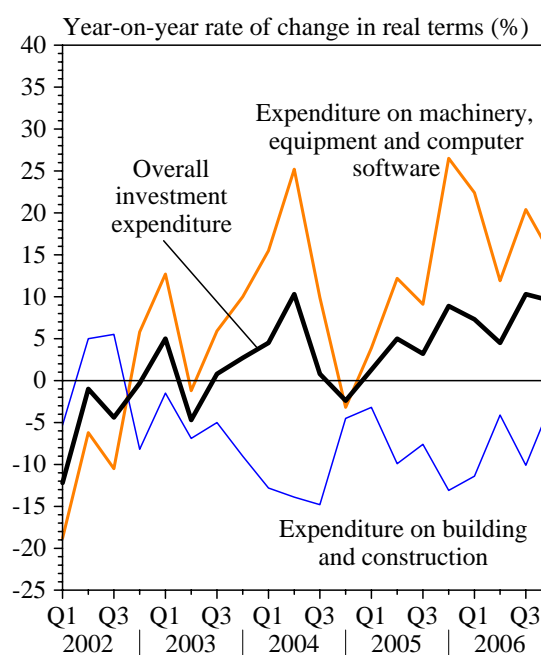


Diagram 1.3 : Fastest growth in overall investment since 2000



The labour sector

1.7 The labour market continued to improve on a broad front, riding on the sustained strong economic growth over the past three years. *Total employment* attained a 2.1% growth in 2006, slightly faster than that of 2.0% in 2005. By the fourth quarter of 2006, the total number reached an all-time high of 3.47 million (and rose further to a new high of 3.48 million in the three months ending January 2007). Thus, a total of 299 000 additional new jobs had been created since the trough in 2003, benefiting both higher and lower skilled workers across different sectors. In tandem, the *seasonally adjusted unemployment rate* fell to a six-year low of 4.4% in the fourth quarter of 2006 (and held steady at this level in the three months ending January 2007).

1.8 Amidst a persistently stronger demand for professional and higher-skilled workers, the unemployment rate at the upper segment of the labour market had fallen to below 2% towards the year-end. Yet the employment conditions at the lower segment of the labour market also improved distinctly, with their unemployment rate down to 5.0% in the fourth quarter of 2006 from the peak of 10.1% in 2003. The number of long-term unemployment came down by more than half during the current economic recovery. These suggest that the lesser skilled workers and the hard core of the unemployed who are generally of older age and less educated are also able

to benefit from the current economic upturn. In 2006, labour income increased modestly in money terms, continuing the trend established in early 2005.

The asset markets

1.9 The *residential property* market went through a healthy consolidation in 2006, though with less hectic trading activity than in the past two years. Flat prices edged up only modestly over the course of the year. With reduced uncertainty over future interest rate movement and overall economic prospect being generally supportive, the general sentiment about the longer-term market development remained positive. By December 2006, flat prices were around 3.0% higher than a year ago. In tandem with rising employment income, the rental market was rather active, with flat rentals increasing steadily throughout the year, by around 5% in the fourth quarter of 2006 over a year earlier.

1.10 In the financial market, the *local stock market* was on an uptrend during most of 2006, benefiting much from being a platform for overseas investors investing into the future of the fast-growing Mainland economy as well as for Mainland enterprises to raise capital internationally. The IPO activities, including the listing of several prominent Mainland enterprises, had attracted much interest. In terms of the amount of funds raised through IPO, Hong Kong ranked second in the world in 2006, just after London. The Hang Seng Index broke the 20 000 mark for the first time in late December before closing the year at 19 965, 34% higher than at end-2005. The average daily turnover rose to another year of record high of \$33.9 billion. With the stock market capitalisation surpassing \$13 trillion at end-December, Hong Kong's stock market overtook Toronto's to become the sixth largest in the world. Reflecting the increasing prominence of Hong Kong as the premier IPO centre for Mainland enterprises, at end-2006, there were 367 Mainland enterprises listed on the Hong Kong stock market, accounting for 31% of the total number, 50% of the total market capitalization, and 60% of turnover in 2006.

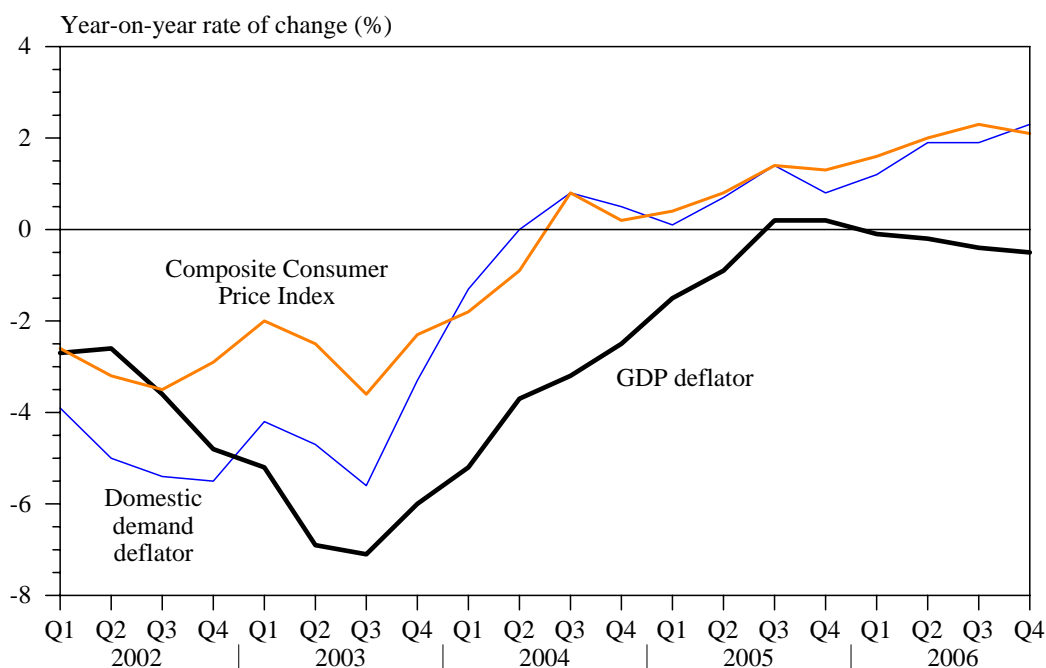
Inflation

1.11 Consumer price inflation, though inching up in the first three quarters of 2006, remained moderate through to the end of 2006. The strong economic upturn, coupled with the low inflation rate, has provided a highly supportive macroeconomic environment for Hong Kong. The rapid increase in business investment over the past year or so had contributed to notable productive

improvement and capacity expansion, which in turn helped to contain inflationary pressures. The more steady increase in housing rentals over the course of the year also helped. Externally, the substantial easing in oil prices in the latter part of 2006 had offset to some extent the mild impacts of the weakening of the Hong Kong dollar along with the US dollar and the modest appreciation of renminbi on import prices. In overall terms, import prices increased only modestly faster towards the end of the year. On a year-on-year basis, the increase in the *Composite Consumer Price Index* inched up from 1.6% in the first quarter to 2.0% and 2.3% respectively in the second and third quarters, before edging down to 2.1% in the fourth quarter upon the easing back in oil prices and a more steady increase in housing cost.

1.12 As to the *GDP deflator*, it recorded a further slight decline of 0.4% in 2006. Notwithstanding higher domestic prices, there was a heavier drag from the terms of trade effect after the first quarter. While export prices could rise only moderately due to the need to maintain competitiveness, import prices have picked up more upon the surge in oil prices, and although oil prices subsequently eased, there was more cost push from a weaker US dollar and renminbi appreciation later in the year. Excluding the effect of terms of trade, the *domestic demand deflator* actually rose by 1.9% in 2006, largely in sync with consumer price inflation.

Diagram 1.4 : Inflation remained moderate through to year-end



GDP by economic activity

1.13 Being a highly service-oriented economy, the services sector has long been the dominant driving force of overall economic growth. In the first three quarters of 2006, its value added rose markedly by 8.3% in real terms over a year earlier. Among the constituent service sectors, financing and insurance, communications, import and export trade, and restaurants and hotels were the best performers. Meanwhile, the manufacturing sector increased moderately in value added. That of construction sector remained on a decline.

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

	2006		2005				2006		
	2005	Q1-Q3	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Manufacturing	2.1	3.5	-2.3	-0.1	4.1	5.9	7.0	5.3	-0.6
Construction	-9.2	-9.5	-2.6	-10.9	-7.8	-14.9	-12.6	-4.6	-10.9
Services ^(b)	8.0	8.3	6.9	8.4	8.7	8.1	9.2	7.6	8.1
Wholesale, retail and import and export trades, restaurants and hotels	14.4	10.0	13.2	15.2	14.7	14.4	12.5	7.1	10.4
Import and export trade	16.1	10.6	14.7	17.1	16.4	16.1	13.8	7.3	10.9
Wholesale and retail trades	7.4	4.8	8.4	8.6	6.7	6.2	3.8	3.5	7.0
Restaurants and hotels	6.0	9.4	6.5	5.6	5.5	6.2	10.9	9.1	8.2
Transport, storage and communications	8.0	8.9	8.2	6.8	8.9	8.1	11.2	6.8	8.6
Transport and storage	6.8	8.0	7.5	5.2	7.8	6.7	10.6	5.6	7.9
Communications	11.5	11.1	10.2	11.2	12.1	12.3	12.7	9.9	10.7
Financing, insurance, real estate and business services	8.7	13.4	6.5	11.0	9.5	7.7	13.3	15.2	11.7
Financing and insurance services	11.9	19.9	9.0	15.1	13.1	10.6	20.6	22.7	16.4
Real estate and business services	3.2	1.6	2.5	3.9	3.9	2.6	0.9	0.5	3.5
Community, social and personal services	0.4	1.8	0.5	-0.4	0.7	0.7	1.4	1.5	2.5

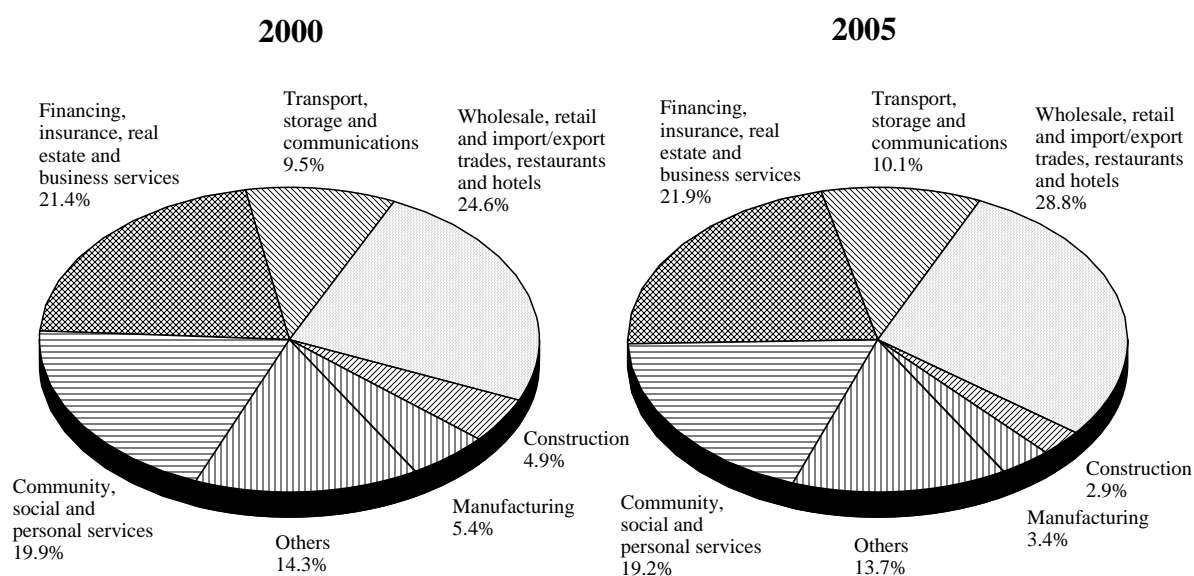
Notes : (a) The GDP figures shown in this table are compiled from the production approach, in parallel with those shown in Table 1.1 which are compiled from the expenditure approach. For details, see Note (1) to this chapter.

(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.

Figures are subject to revision later on as more data become available.

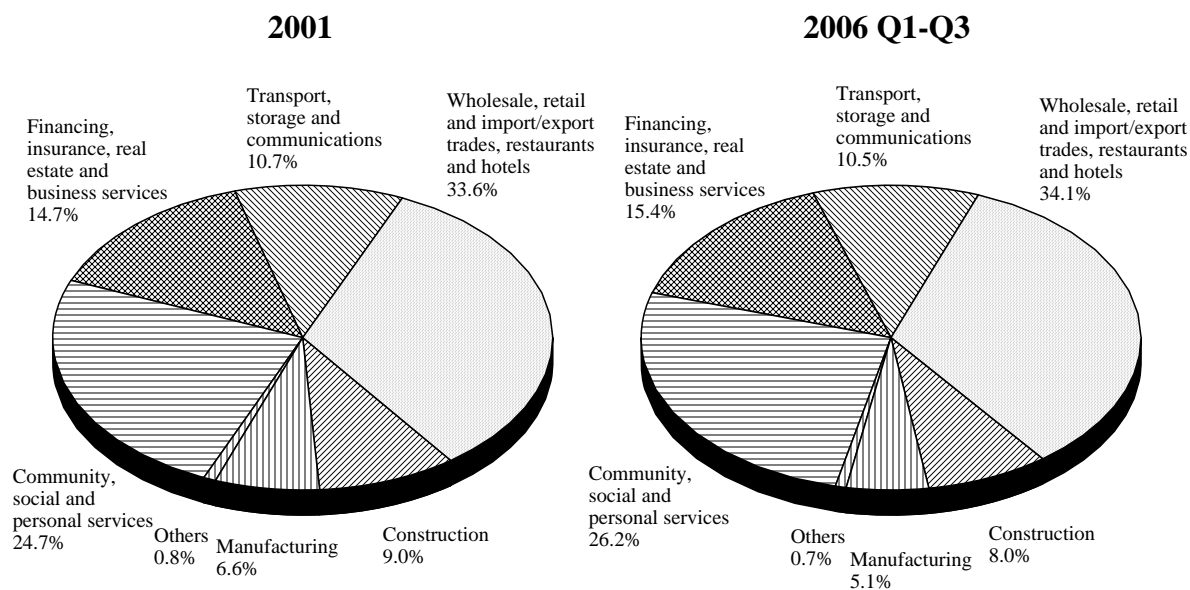
1.14 Over the past five years, Hong Kong continued to re-orient itself towards service activities, prompted by the changing regional and global economic environment and also by closer integration with the Mainland. In particular, while the thriving Mainland economy has provided ample business opportunities for Hong Kong's service sectors, the availability of cheaper land and labour across the border and Mainland's rising productivity have also propelled Hong Kong to move up the value chain. Between 2000 and 2005, the contribution of the service sectors as a whole to GDP rose from 86.6% to 90.7%, while those of the manufacturing sector and the construction sector fell from 5.4% and 4.9% respectively to 3.4% and 2.9%.

Diagram 1.5 : Economy becoming even more service-oriented



1.15 As the economy becomes more service-oriented and strives to enhance its status as a leading trading, logistics, business cum financial centre, there are strong needs for the labour market to stay flexible enough to respond to the changes and for the continuous quality upgrading of the local workforce. For the service sectors as a whole, the share in total employment enlarged from 83.7% in 2001 to 86.2% in the first three quarters of 2006, indicative of the significant shifts in labour resources across sectors. By comparison, the shares of the manufacturing sector and the construction sector shrank from 6.6% and 9.0% respectively to 5.1% and 8.0% over the same period. The shift towards knowledge-based, high-value-added activities was well supported by a progressive upgrading of the workforce over the years as can be seen from the significant rise in proportion of the workforce attaining tertiary education over the past five years, from 24.7% to 29.3%.

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 2001 refer to the annual average, while the figures for 2006 refer to the average for the first three quarters of the year.

Strengthening Hong Kong’s role in the Mainland’s economic development

1.16 In September 2006, the Economic Summit on “China’s 11th Five-Year Plan and the Development of Hong Kong” was held to discuss how Hong Kong should respond to the challenges and opportunities arising from the National 11th Five-Year Plan, which unequivocally supports Hong Kong in the development of its services industries such as financial services, logistics, tourism and information services; and the maintenance of its status as an international centre of financial services, trade, and shipping. After four months of intensive work, the four Focus Groups of the Economic Summit submitted their reports together with their proposed Action Agenda to the Chief Executive in January 2007. A total of 50 strategic proposals and 207 action items were proposed by the four Focus Groups.

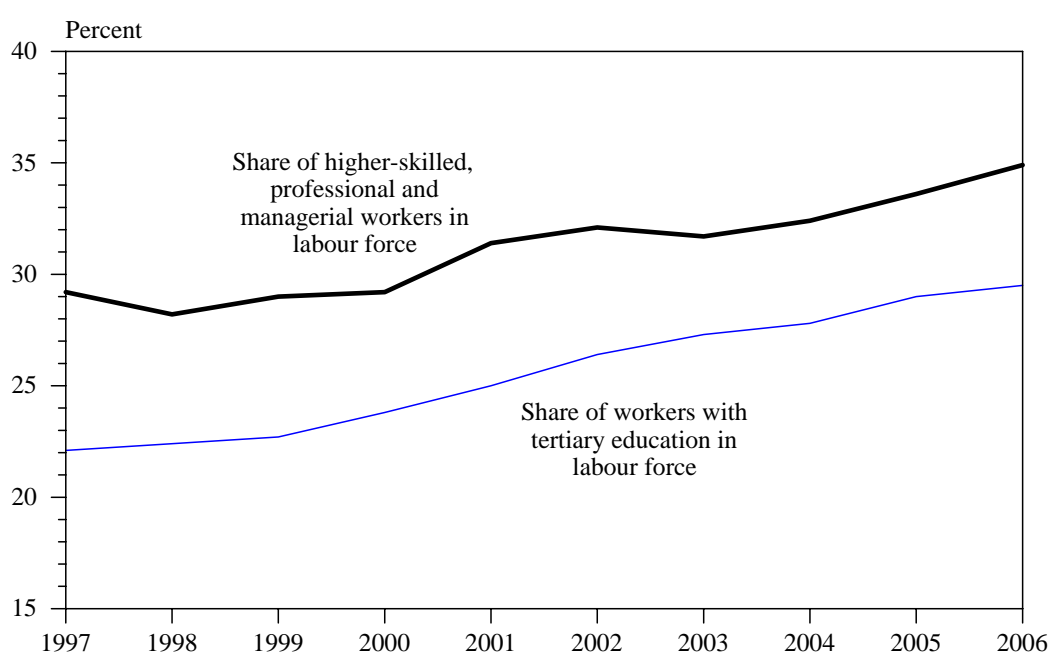
1.17 The Focus Group on Trade and Business proposed a policy direction of enhancing Hong Kong’s status as an international trade and business centre and strengthening its international competitiveness. The strategic proposals aim at building up a “Brand Hong Kong” culture, optimising the potentials and

benefits under CEPA, assisting Hong Kong-invested factories in Guangdong to comply with the Mainland rules and regulations and to tap the Mainland market, raising the quality of human capital, and setting up a high-level mechanism to address the clean air issue.

1.18 On financial services, the Focus Group concerned proposed a policy direction of building upon Hong Kong's strength in financial services to develop it as China's international financial centre of global significance. The key strategic proposals aim at deepening and broadening the markets for securities, foreign exchange, commodities futures, and insurance and asset management.

1.19 On maritime, logistics and infrastructure, the Focus Group concerned highlighted the policy direction of leveraging on Hong Kong's air transport, shipping and high-value logistics experience in strengthening the status as an international maritime centre, and air transport and logistics hub. On professional services, information and technology and tourism, the Focus Group concerned emphasised the development of these service sectors to complement Hong Kong's status as international financial services, trade and shipping centres, recognising that these services play a unique role as an international gateway to the Mainland and contribute to the national economic and social development.

Diagram 1.7 : Enhancing the quality of the labour force is a key to future success



Some highlights of economic policy

1.20 The strong economic growth attained over the past three years, at an annual average of 7.6%, together with a moderate inflation rate, is a clear indication of the success of Hong Kong's pro-market economic policy in accordance with the principle of "Market leads, Government facilitates". In December 2006, the Executive Board of the International Monetary Fund (IMF) concluded its annual Article IV Consultation discussions with Hong Kong. The Board attributed Hong Kong's sustained economic expansion to its skillful macroeconomic management, flexible markets and highly developed financial infrastructure.

1.21 Competition serves Hong Kong well. It drives the economy by providing opportunities for entrepreneurs to enter and trade freely in markets. It encourages businesses to provide good quality products and services at prices that are attractive to consumers, and promotes innovation and creativity, thereby helping to make Hong Kong competitive vis-à-vis other economies. The Government considers that high priority should be given to ensuring that our competition policy keeps pace with the times and continues both to serve the public interest and to facilitate a business-friendly environment. In November 2006, the Government launched a 3-month public consultation with a view to charting a course for Hong Kong's future competition policy, to consult the public on the appropriateness of the introduction of a cross-sector competition law, and also on how to assure the business community, particularly small and medium enterprises, that this will not impose on them onerous compliance cost.

1.22 The dynamism and versatility generated from the economic integration between Hong Kong and the Mainland will continue to underpin Hong Kong's economic growth in the years to come. Over the past year, there were significant developments in a wide range of areas. More notably in June 2006, further liberalisation measures, including 15 new measures in ten existing service sectors, under the Closer Economic Partnership Arrangement (CEPA) framework were introduced. In early January 2007, the Central Government announced its agreement to a further expansion of renminbi business in Hong Kong. Financial institutions on the Mainland, upon obtaining approval, can issue renminbi-denominated financial bonds in Hong Kong. This is indicative of the on-going financial integration between Hong Kong and the Mainland. It will not only provide channels for returning renminbi circulating in Hong Kong back to the Mainland, but also help to further develop Hong Kong as a bond centre in the region.

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 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 2007 AND THE MEDIUM TERM

Summary

- *In 2007:*
 - *The Hong Kong economy is expected to remain on a broad-based upturn, with growth forecast at 4.5-5.5% in real terms. This will signify another year of above-trend growth, having already experienced three consecutive years of robust expansion.*
 - *The external trading environment still looks largely supportive. Despite the uncertainties stemming from the US economy, there are positive developments in other parts of the world, including the thriving Mainland economy, continued expansion in Europe and Japan, and solid growth in most parts of Asia. The fallback in oil prices and a weaker US dollar will also help.*
 - *Locally, the current strong economic upturn has put the economy on a much sounder footing, resulting in rising consumer and investor confidence. Domestic demand is thus likely to be an important driving force of overall economic growth.*
 - *The inflation outlook remains generally benign, as sustained productivity improvement in the economy and receding impact from oil prices should help to offset the expected pick-up in imported inflation due to a weak US dollar and renminbi appreciation. Taking into account the various one-off factors which will push down the Composite CPI level in the year, consumer price inflation is forecast at 1.5%.*
- *The medium-term prospects for the economy are promising, as the strategy of leveraging on our fast-growing economic hinterland continues to pay off. The action agenda from the Economic Summit on China's 11th Five Year Plan will help Hong Kong to strengthen its vital role in the economic development of our country. These will also further enhance our continuous integration with the Mainland under the CEPA framework and Pan-PRD cooperation, thereby bringing significant benefits to both sides. Coupled with the productivity uplift achieved in the process of restructuring*

towards knowledge-based economy, the Hong Kong economy is expected to attain a 4.5% trend GDP growth over the next few years.

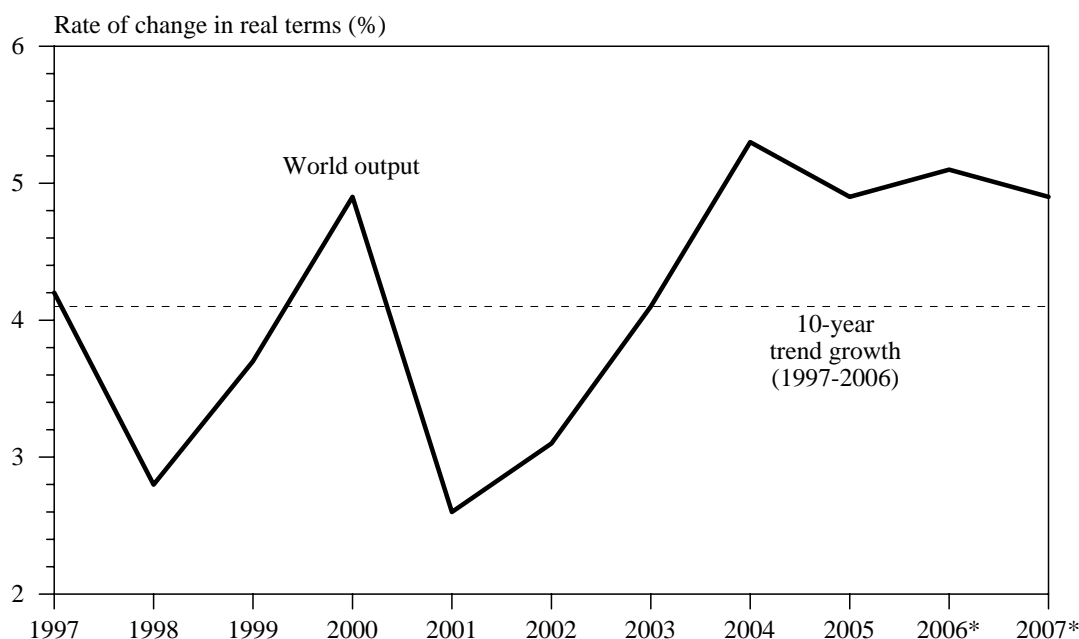
Major external factors

2.1 Global economic performance is vital to the Hong Kong economy due to its open nature. The developments on the external front will continue to have decisive influence on Hong Kong's economic growth in 2007. Unlike last year, the uncertainty surrounding interest rate movements has reduced and the threat from oil prices has also become less imminent. However, weaker growth in the US remains as the major downside risk to Hong Kong's trade performance in 2007. With the integration with the Mainland economy getting ever closer, the China factor will continue to feature prominently in driving Hong Kong's economic growth. Finally, the liquidity-driven surges in stock markets worldwide over the recent period should also deserve our attention when discussing Hong Kong's near-term economic prospects.

Global economic outlook

2.2 2006 saw another year of vibrant performance of the global economy. The robust growth in the past four consecutive years represented one of the longest sustained periods of global economic expansion over the past half of a century. In the US, notwithstanding the oil price upsurge and interest rate hikes earlier in the year, and even with the subsequent cooling of the housing market, US consumption still displayed a degree of resilience during most of 2006. In Europe, the economic upturn has finally gathered strength and also broadened in scope. Buoyant export performance and upbeat economic sentiment had helped to underpin business investment, and in turn consumption as labour market progressively improved. 2006 was also a good year for the Mainland economy and for the other Asian economies in general. For the Mainland in particular, while exports thrived throughout the year, private consumption was also strong. Fixed asset investment surged further, with some taming in its growth pace towards the end of the year as the macro-tightening policy yielded more results. Also on the growth track was Japan's economy, supported by the strength of both exports and business investment, although private consumption was still lagging behind. With the vibrant Mainland economy and with Japan's economic upturn firmly in place, the other Asian economies also attained solid growth amidst the booming trade. For 2006 as a whole, IMF estimates that the global economy should have attained robust growth at 5.1%, up even from an already strong growth of 4.9% in 2005.

Diagram 2.1 : IMF expects the strength of the global economy to extend into 2007 despite the below-trend growth in US



Note : (*) IMF's forecast.

2.3 Looking ahead to 2007, the global picture still looks largely sanguine, although the pace of economic expansion this year may be slightly slower than in 2006 owing to the envisaged sub-par growth in the US. The prevailing market views are for a generally benign scenario of soft-landing in the US with no significant ramifications to the rest of the world. Indeed, so far the correction of the US housing market has not been particularly disruptive and has not transpired into a broad-based downturn in the US economy. Also, lower oil prices and a tight labour market have helped to sustain US consumer sentiment at a high level. Elsewhere, the economic situation is also rather positive. Economic expansion in the EU and Japan can be expected to continue at a solid pace. More importantly, the Mainland economy is likely to remain as the bright spot in Asia this year. The other Asian economies should also fare quite well. In short, the global picture this year is likely to show a rebalancing of growth pattern, with the euro area, Japan and Asia taking up a bigger role in driving the global economy when the US economy may face a moderate growth slow-down after many years of above-trend growth. According to the projection by IMF in September 2006, the world economy would post another year of notable growth at 4.9% in 2007, broadly on par with the growth in 2006 and considerably higher than the average annual growth of 4.1% over the past ten years.

Table 2.1 : Growth forecasts for major economies in 2007⁽¹⁾

	<u>IMF</u>	<u>World Bank</u>	<u>Private sector forecast[^]</u>
	(%)	(%)	(%)
World	4.9	4.5	3.3
US	2.9	2.1	2.7
Euro-area	2.0	1.9	2.1
Asia :			
Mainland China	10.0	9.6	9.7
Japan	2.1	2.4	1.9
Singapore	4.5	5.0	5.2
Republic of Korea	4.3	4.5	4.4
Malaysia	5.8	5.5	5.5
Thailand	5.0	4.6	4.6
Taiwan	4.2	4.0	4.1
Indonesia	6.0	6.2	5.9

Note : (^) Average.

2.4 There are however several downside risks. *First*, if the slow-down in US economic growth turns out to be more abrupt, with more severe spill-over effects on other sectors, then the global picture would not be as benign as currently presumed. *Secondly*, the international oil market, whilst moving in the favourable direction in recent months, is also subject to a wide range of uncertainties ranging from potential supply disruptions to adverse geo-political developments. The continued limited spare capacity along the oil supply chain is likely to keep oil prices fairly sensitive to such developments. *Thirdly*, the global imbalances, still alarmingly large, have yet to be resolved. Although the prevailing market views do not see the risk of a sudden adjustment as being that high in the near term, the disruptions to the global economy could indeed be very severe if a disorderly unwinding of the imbalances were to take place. *Fourthly*, the core inflation rate in the US has yet to come down to the Fed's comfort zone, thus dimming the hope of an imminent interest rate cut. And if inflation were to show an unexpected uptick leading to a fresh round of monetary tightening, this could potentially trigger big reactions in the already richly priced asset markets. *Fifthly*, the low risk premiums in financial markets worldwide would also pose risks, especially if risk perceptions suddenly change to reverse the direction of funds flows and global sentiment.

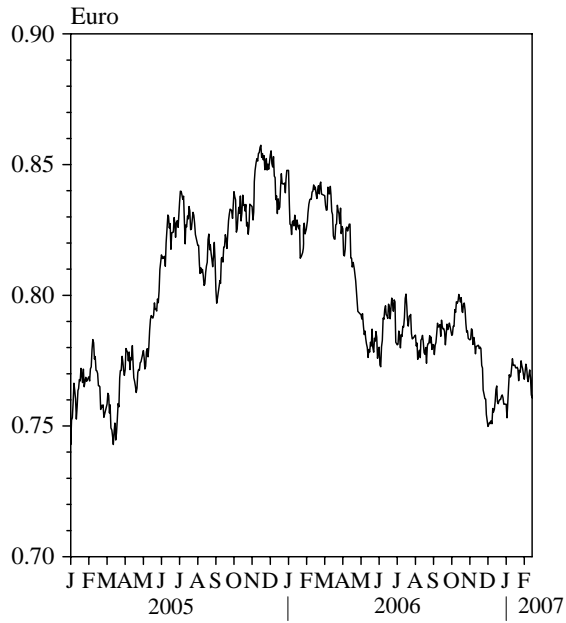
Exchange rates and price competitiveness

2.5 Apart from demand side factors, Hong Kong's external trade also depends a lot on the exchange rate movements. The continued weakening of the US dollar after the first quarter of 2006 was indeed a major factor leading to the renewed strength in Hong Kong's exports in recent periods. By December 2006, the depreciation of the US dollar had led to a cumulative fall in the Real Effective Exchange Rate Index of the Hong Kong dollar by 4% over a year earlier. Looking ahead, Hong Kong's price competitiveness in the early part of 2007 should continue to benefit from the lag effects of previous depreciation. Beyond that, while the movements of US dollar are far from certain, the widely held view is for the weakness of the dollar to persist, particularly in face of the pause in US interest rate hikes against the expected further rise in interest rates elsewhere, and the expected sub-trend growth of the US economy against the continued expansion in Europe and Asia. As such, the exchange rate movements, though unpredictable as always, are quite likely to remain favourable to Hong Kong's export competitiveness.

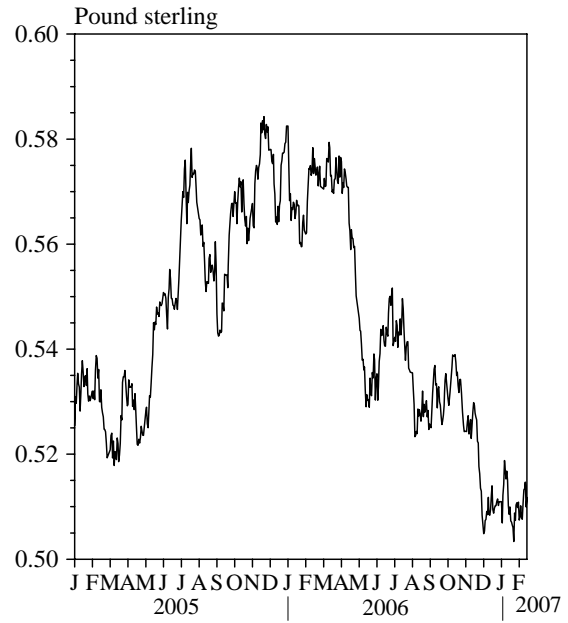
2.6 Another important factor on the exchange rate front relates to the movements of the renminbi. Since the introduction of the managed float regime on 21 July 2005, the renminbi had appreciated against the US dollar in an orderly and gradual manner. By mid-February 2007, the renminbi had strengthened by around 7% against the US dollar since the regime change. But it is worth noting that most of the Asian currencies, including the Singapore dollar, Korean won, Malaysian ringgit and Thai baht, had likewise appreciated against the US dollar, and by an even greater extent than that of the renminbi. Major currencies like the euro and pound sterling had similarly risen distinctly against the US dollar over the past year or so. Thus, while the renminbi rose against the US dollar, it actually depreciated against the various major currencies, so much so that the exchange rate movements of the renminbi as a whole had not impacted on the external competitiveness of Mainland's exports in any adverse manner. As a result and with also the sustained productivity improvements in the Mainland, Mainland's exports were able to maintain robust growth of close to or even exceeding 30% during 2006, hence also underpinning the strength of Hong Kong's exports. Going forward, if further appreciation of renminbi this year again coincides with a global weakening of the US dollar during 2007, then the impact on Hong Kong's external trade should again be rather mild as that observed over the past year.

Diagram 2.2 : Persistent weakness of US dollar seen lately

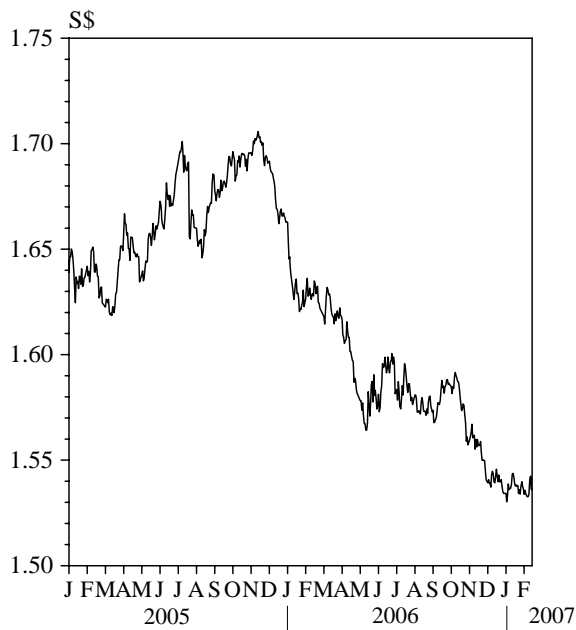
(a) against euro



(b) against pound sterling



(c) against Singapore dollar



(d) against Korean won

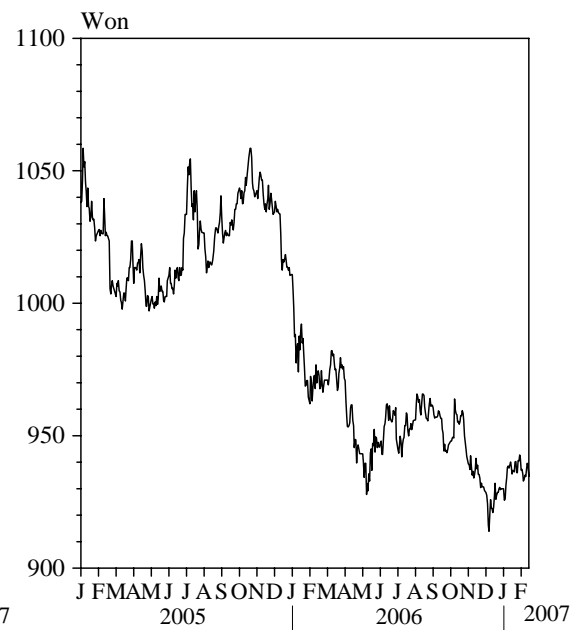


Diagram 2.2 (cont'd) : Persistent weakness of US dollar seen lately

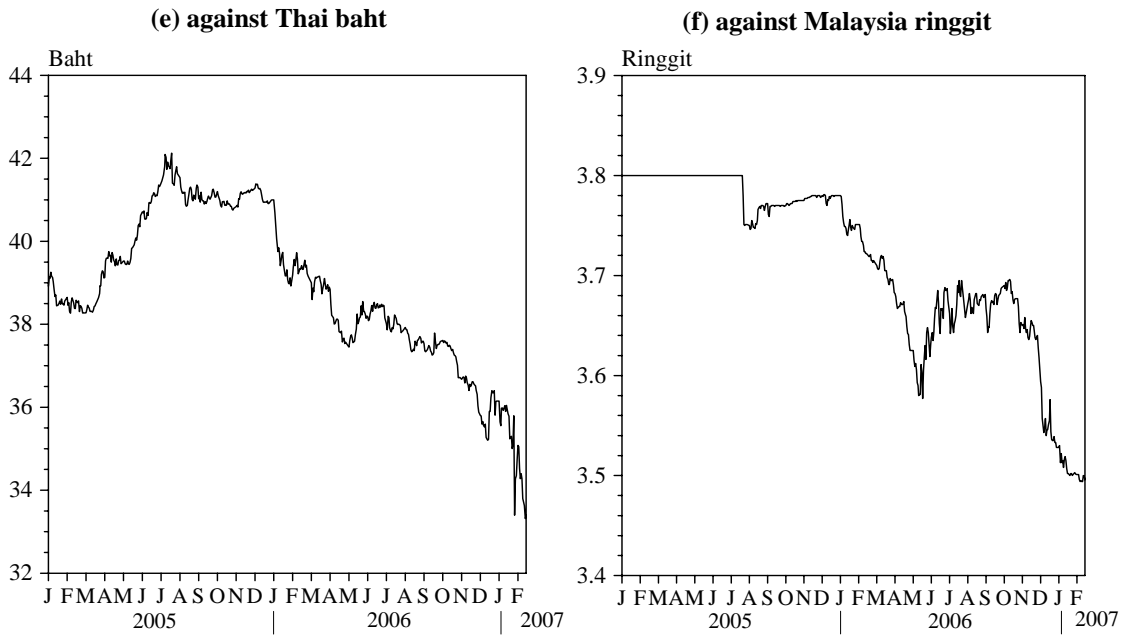
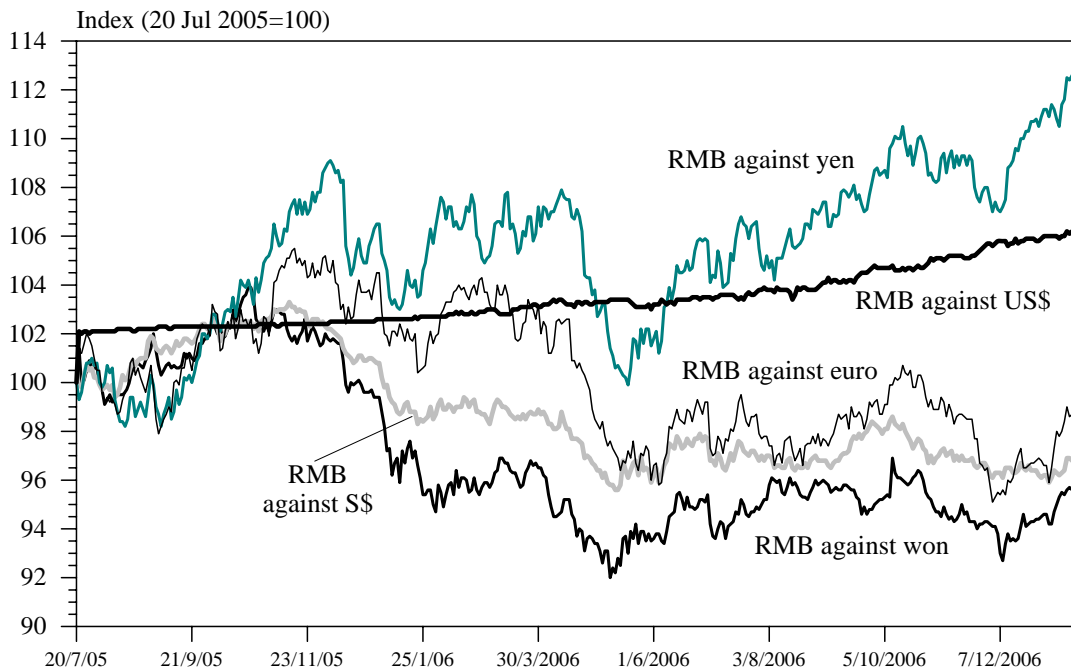


Diagram 2.3 : While renminbi rose against the US dollar, it actually depreciated against euro and many Asian currencies in 2006



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

Box 2.1

Exchange rate movement as a prominent factor affecting Hong Kong's export performance

Among the bundle of factors affecting two economies' bilateral trade, exchange rate is one prominent factor underlying the price competitiveness of an economy's exports. In gauging the broad movement of the Hong Kong dollar, the Census & Statistics Department compiles the Nominal Effective Exchange Rate Index (NEERI) to measure movements in the weighted average of the nominal exchange rate of the Hong Kong dollar against the currencies of Hong Kong's principal trading partners. Apart from the nominal exchange rate between two economies, the relative change in price level of goods and services in the two economies also affects the price competitiveness of the exporting economy. In this regard, the Hong Kong Monetary Authority also compiles a series on the Real Effective Exchange Rate Index (REERI) by adjusting the NEERI for relative movements in consumer price indices against selected trading partners of Hong Kong.

Intuitive reasoning suggests that both the NEERI and REERI should bear a relationship with Hong Kong's exports. Moreover, due to the lead time from changing consumer demand in response to a change in exchange rate to placing purchase orders by the importers and final shipment of goods by the exporters, the exchange rate movement can be expected to carry lagged effect on exports for a few quarters. The following empirical outcomes help to discern the above theoretical relationship in the case of Hong Kong.

Using data for the past ten-year period Q1 1997 – Q4 2006, the correlation coefficients of the year-on-year rate of change of the quantum index of total exports with the year-on-year rates of change of the NEERI and REERI for various lag periods are shown below:

	<u>NEERI</u>	<u>REERI</u>
Lag 1	-0.6196	-0.6404
Lag 2	-0.7702	-0.7481
Lag 3	-0.7794	-0.7180
Lag 4	-0.7030	-0.6046

The results show that the year-on-year rate of change in total exports has negative correlations with both the rates of change in NEERI and REERI, affirming the proposition that a weak Hong Kong dollar would bolster exports. The higher correlation coefficients for lag periods of two quarters suggest that the exchange rate impacts would more fully filter through after around two quarters.

While the above lead-lag correlations should also throw light on the causal relationship between exchange rate movement and export performance, further attempts are made to conduct Granger Causality Test on the variables for various lag structure. The results again confirm that movements in exchange rates are a prominent factor affecting export growth.

Significance of Granger Causality of REERI and NEERI on total exports

	<u>REERI</u>	<u>NEERI</u>
Lag 1	***	***
Lag 2	***	***
Lag 3	***	***
Lag 4	**	***

Notes : (***) Significant at 1% level.
(**) Significant at 5% level.

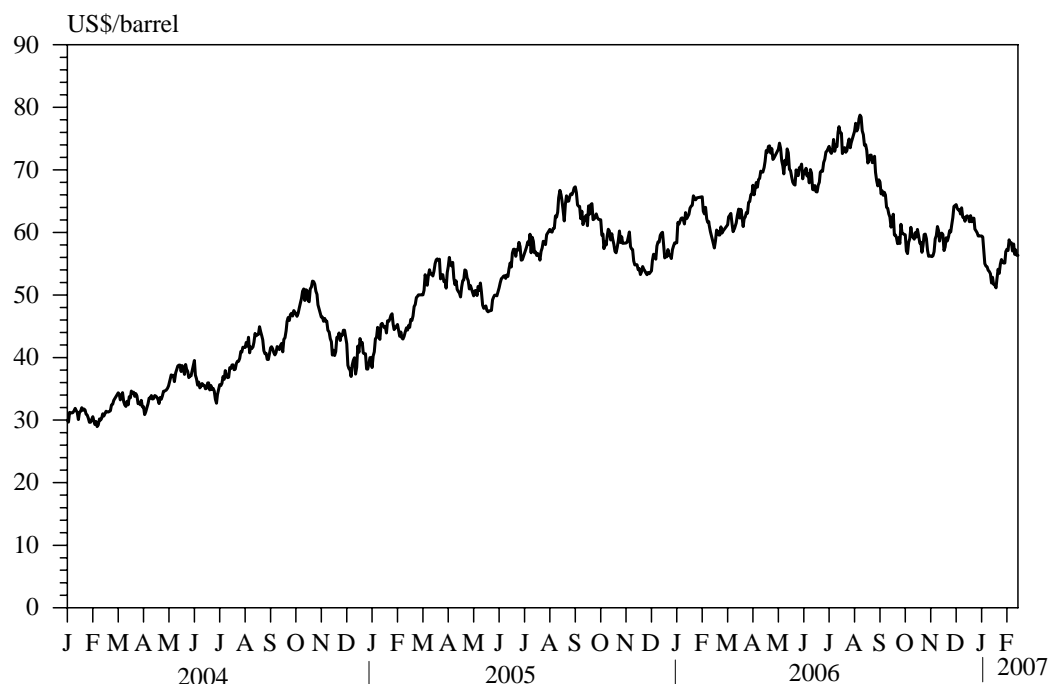
2.7 The expected appreciation of the renminbi would help to strengthen the domestic demand in the Mainland economy, which incidentally also strives to attain a more balanced growth. This would bode well for Hong Kong's exports of goods to this market. Indeed, with the rising purchasing power that comes with the appreciation, there would also be stronger demand for Hong Kong's exports of services to this market as well. Of particular note would be the favourable impact on Hong Kong's inbound tourism. The appreciation could induce more Mainland residents to visit Hong Kong and spend more here.

2.8 The expected appreciation of the renminbi, coupled with a weaker US dollar, however, would have an impact on local inflation by exerting stronger price pressures from the external front. Towards the end of 2006, there were signs of a pick-up in the import prices of food, and to a certain extent, also for consumer goods. The food price inflation in the Mainland had further reinforced the exchange rate effect on Hong Kong's import prices of food. If the appreciation of renminbi turns out to be faster than expected, then the resultant impacts on trade and inflation would be somewhat larger than currently assumed.

Oil Prices

2.9 Partly offsetting the impact of higher import prices of food and consumer goods on imported inflation was the fall in oil prices since the third quarter of 2006. Although the risk of oil prices showing a significant renewed upsurge as that seen in the earlier part of last year seems to have reduced, it is likely that oil prices in the international market would still be rather volatile over the course of 2007. The spare capacity along the global oil supply chain remains limited, thereby making oil prices fairly sensitive to unexpected events relating to supply disruptions or geo-political developments in the oil-producing regions.

Diagram 2.4 : Oil prices moving in a more favourable direction recently, but the risk of a renewed upsurge remains



Major domestic factors

Interest rate movements

2.10 The cycle of interest rate hikes started by the US Federal Reserve (Fed) in June 2004 extended into the first half of 2006. Over this two-year period, the Fed had raised its target rate 17 times by 25 basis points each to the current level of 5.25%, with four of them in the first half of 2006, at a pace that largely matched market expectations. Since then the interest rate hikes in the US were put on a pause, as the cumulative impacts of the earlier interest rate rise showed up in the US housing market consolidation thus denting the US economic growth momentum to below-trend. On the other hand, the Hong Kong dollar interest rates were quite stable during 2006. The best lending rate (BLR) only rose once by 25 basis points in late March 2006 following the Fed's target rate hike by the same magnitude just before that. The BLR did not follow the rises of the Fed's target rate afterwards, and actually fell back to 7.75% in early November due to strong capital inflows into Hong Kong. As a result of capital inflows and the abundant liquidity in the local banking sector, the interest rate gap between the Hong Kong dollar and its US counterpart widened successively over the course of 2006.

2.11 Looking forward, the market generally expects the Fed to put the interest rate hike on the “pause” mode until there is clear sign of core inflation receding. This is a welcome development for the Hong Kong economy in 2007, more so if interest rates in the US were to be lowered later in the year as inflation indeed edges down as expected upon the moderate US economic growth. Against this, however, is the continuing uncertainty over the direction and magnitude of funds flows into and out of Hong Kong, in particular whether and when the earlier funds inflows would retreat to narrow the interest rate gap between Hong Kong dollar and US dollar. If this does occur, Hong Kong dollar interest rates have to move higher to catch up with the earlier hikes in US interest rates, potentially triggering asset market corrections and undermining the growth momentum now seen in the domestic economy. While this is clearly a risk to watch out on the local front, an improving labour market and the much stronger household and corporate balance sheets after three years of robust economic growth are the positive factors which should help to cushion off some of the negative impact in the event of unexpected volatilities in the asset markets.

Integration with the Mainland

2.12 The rapid development and opening up of the Mainland economy over the past thirty years or so has generated enormous business opportunities for the Hong Kong economy. With Hong Kong’s world-class physical and financial infrastructures, Hong Kong has been serving as a natural gateway between the Mainland and the rest of the world, reaping enormous benefits from the vibrant Mainland economy.

2.13. Over the years, the economic relations between Hong Kong and the Mainland have grown in terms of both breadth and depth. The prominence of the Mainland in Hong Kong economy is seen not only in trade and direct investment, but increasingly also in people and capital movements. In particular, on the financial front, Hong Kong is now the Mainland’s major international financial and premier IPO centre. In 2006 alone, 73% of the equity capital was raised by Mainland enterprises, and 60% of the stock market turnover was related to Mainland-related stocks trading in Hong Kong’s stock market. Moreover, the launch of RMB banking businesses since February 2004 and their subsequent expansion in activities have enabled Hong Kong to develop RMB clearing and settlement links with the banking system in China, thereby facilitating further economic integration between the two places.

2.14 The policy directions proposed by the Focus Groups of the Economic Summit on “China’s 11th Five-Year Plan and the Development of Hong Kong”, coupled with the policy initiatives under the CEPA and Pan-PRD cooperation framework, would certainly help to enhance further the vital role of Hong Kong in the development of the Mainland economy, much to the benefit of Hong Kong. Yet at the same time, there are also developments in the Mainland which could affect the Hong Kong economy in a less positive manner. Apart from the on-going macro tightening measures to arrest the excessive surge in investment⁽²⁾, the Mainland had rolled out new rules affecting processing trade in the latter part of 2006, involving a cut in tax rebate rates for certain export items and also an expansion in the list of the prohibited category under processing trade⁽³⁾. Many Hong Kong manufacturers with production across the border are worried that this may signify the beginning of a gradual tightening up in the Mainland’s policy towards processing trade. This has emerged as a new area of uncertainties for Hong Kong’s trade.

Diagram 2.5 : Closer economic integration with the Mainland on all fronts remains a key driving force of Hong Kong's economic growth

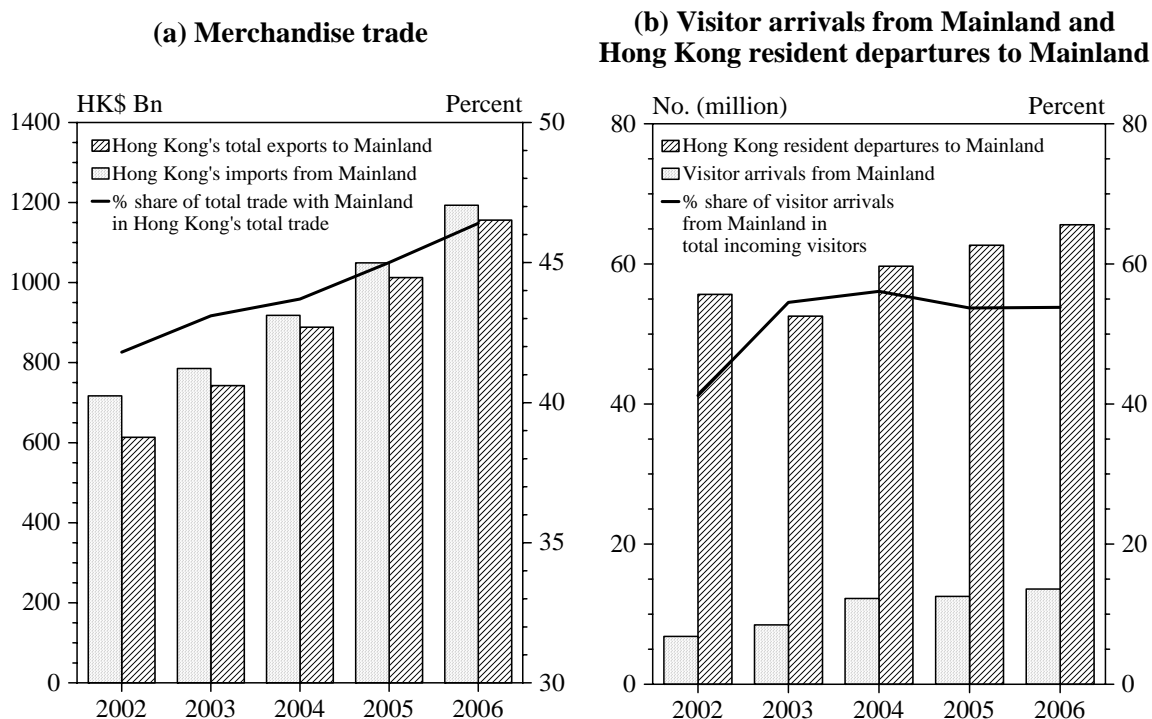
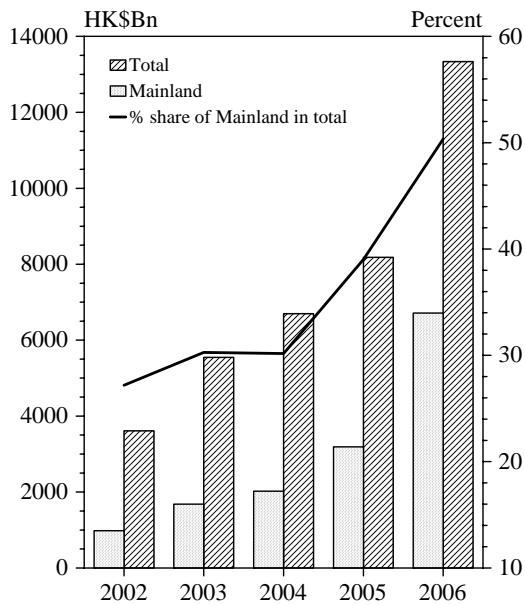
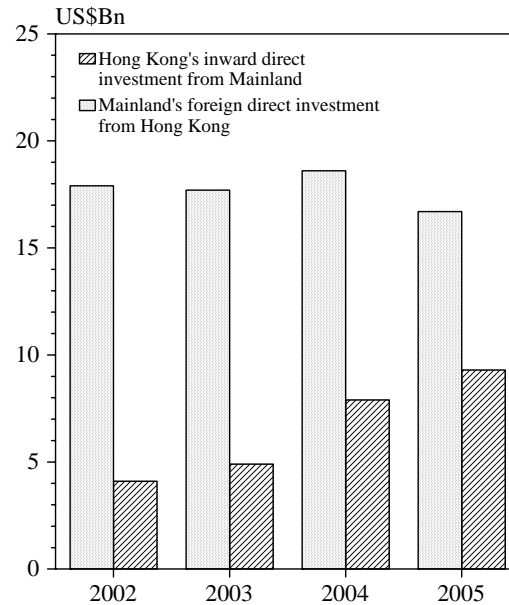


Diagram 2.5 (cont'd) :

(c) Market capitalisation of Mainland enterprises in Hong Kong's stock market (end-year figures)



(d) Mainland's foreign direct investment from Hong Kong and Hong Kong's inward direct investment from Mainland



Outlook for the Hong Kong economy in 2007

2.15 Having already experienced three years of robust economic expansion, the outlook for 2007 is for another year of balanced and solid growth. The closer integration with the Mainland economy, through the progressive implementation of the liberalisation measures under the CEPA framework and the strengthening of Pan-PRD cooperation, has contributed to a highly supportive business environment with more opportunities and greater dynamism.

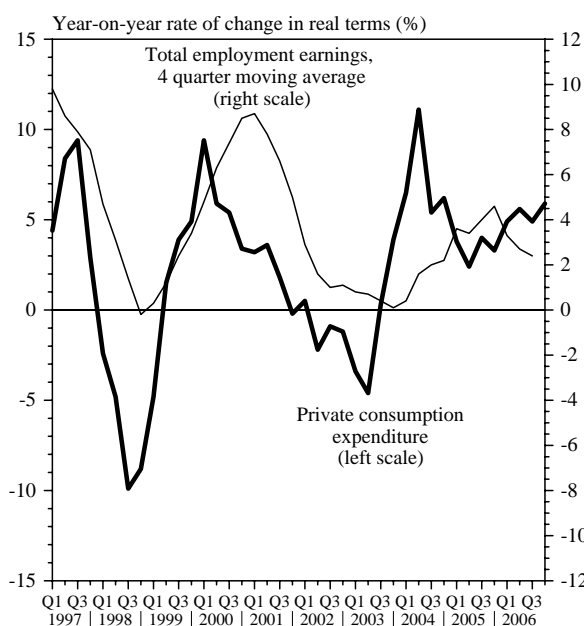
2.16 Externally, the trade outlook still looks rather good this year, under the support of a thriving Mainland economy and its vibrant trade flows, sustained economic expansion in Europe and Japan, and also with the general weakness of the US dollar rendering a boost to Hong Kong's external competitiveness. The substantial ease-back in oil prices has removed a key element of uncertainty which has persistently overshadowed the global economy over the past few years. Lower oil prices would also help to alleviate global inflationary pressures, reduce production costs, and raise households' purchasing power thereby supporting overseas' consumer spending. Overall, granting a soft-landing scenario in the US, *total exports of goods* are likely to see further notable growth in 2007, though probably not as strong as the 10.2% growth in 2006.

2.17 The outlook for *exports of services* is even more promising. Exports of finance, business and other services have been increasing at double-digit rates over the past year, and with the pace of economic and financial integration with the Mainland advancing further, the prospect for this year is likewise good. Exports of trade-related services are expected to remain on a strong surge, thanks again to vibrant trade flows of the Mainland and the regional trade boom. Exports of transportation services would then benefit in tandem. As to inbound tourism, the further extension of the Individual Visit Scheme in January 2007 and the expected further growth in visitors from overseas markets should lend support, although, judging from the recent trend, the momentum in visitor growth might not be as strong as in previous years.

2.18 Locally, the strong economic growth over the past three years has placed the economy on a much sounder footing. Economic fundamentals are much improved, while both consumer and investor confidence are on the rise. Domestic demand can thus be expected to render an important driving force of overall economic growth in 2007, at a time when external trade is subject to uncertainties from a slowing US economy. *Private consumption expenditure* is set to grow firmly further, under the support of improving employment conditions and steadily rising labour income. Movements of interest rates, which are likely to hold steady if not edging down later in the year, may help to sustain the prevailing upbeat consumer sentiment. There would be an added boost if asset market developments continue to be favourable.

Diagram 2.6 : Private consumption set to grow firmly further

(a) Sustained improvement in employment conditions is a key factor underpinning consumer spending



(b) Pause in interest rate also helps

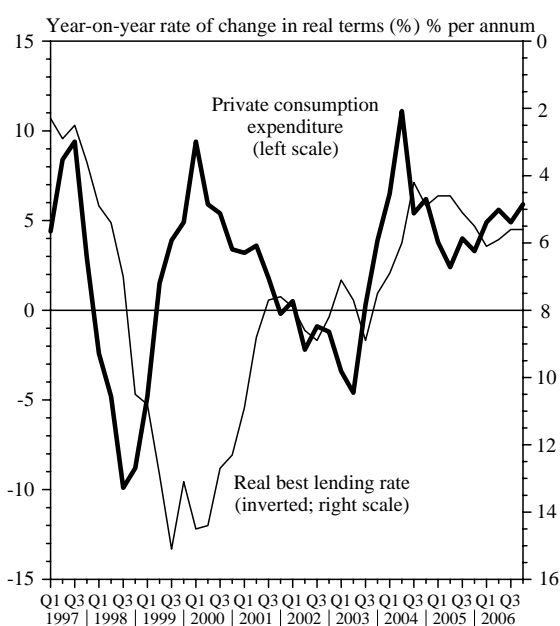
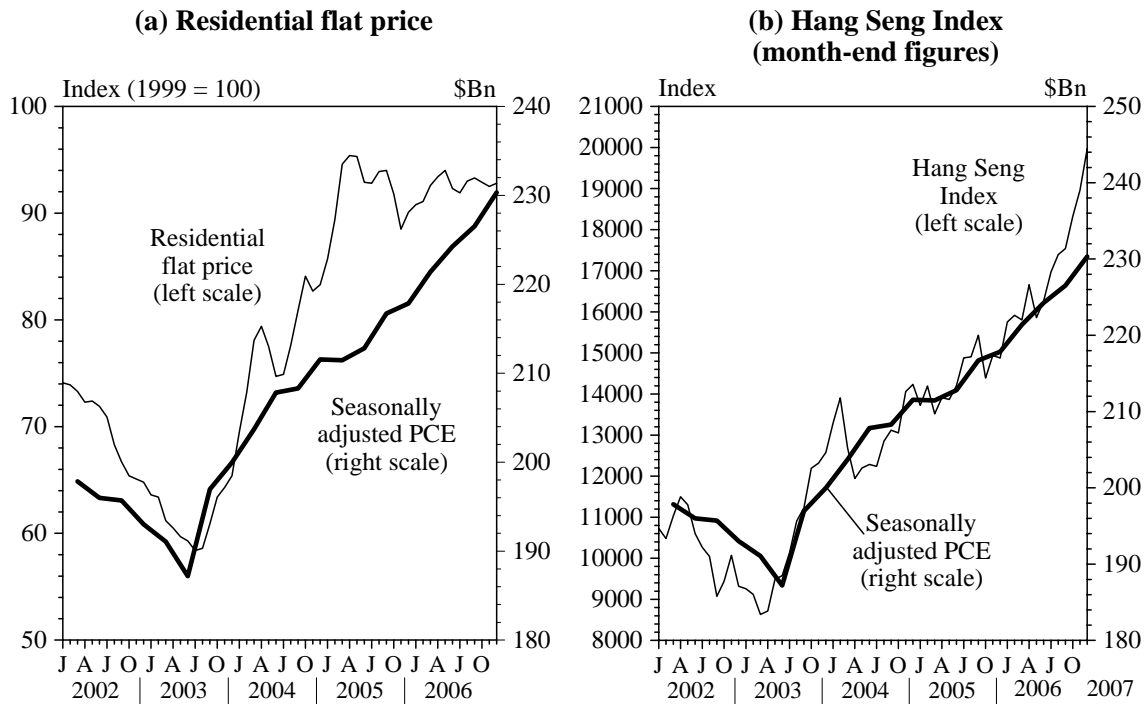
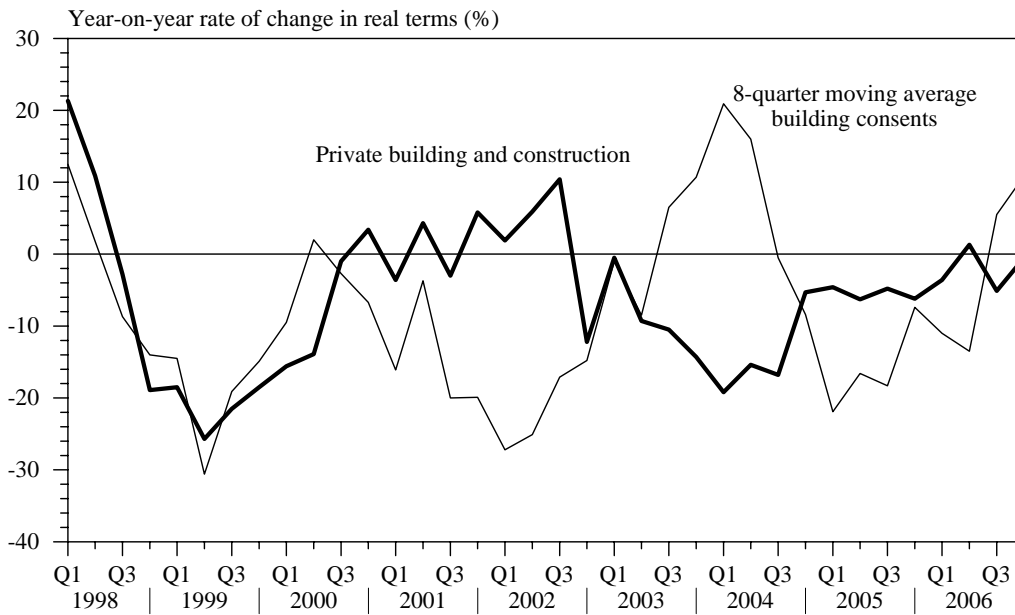


Diagram 2.7 : Asset market developments also crucial in affecting local demand



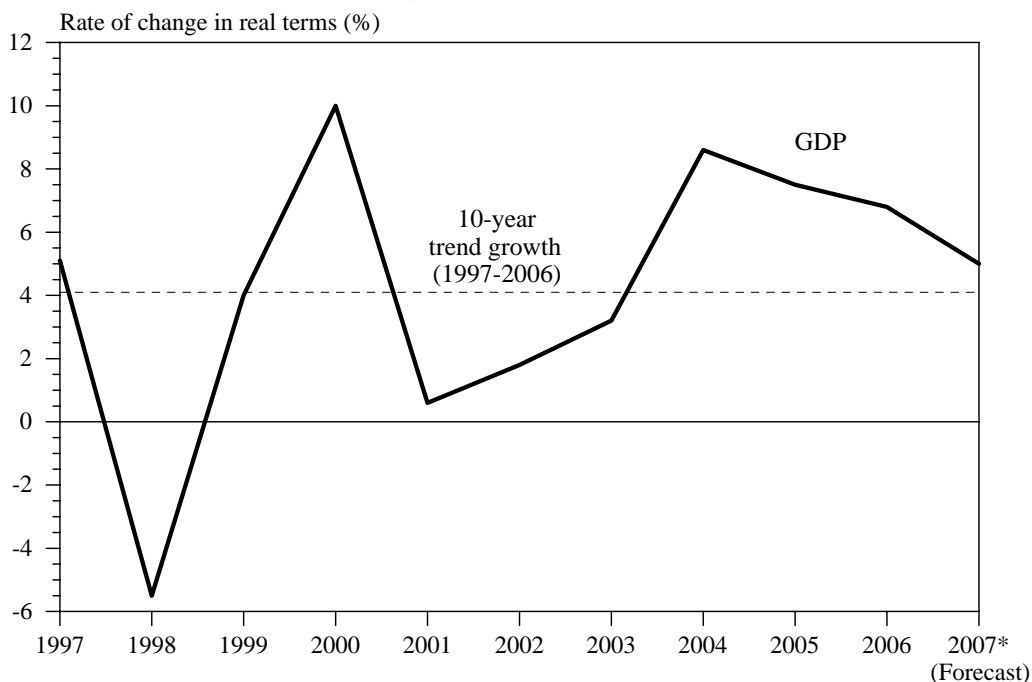
2.19 *Investment spending* in overall terms picked up distinctly over the past year, despite the continued slack in construction activity. Riding on the prevailing strength in business confidence and also on the business activity upturn, this trend is likely to extend into 2007. The major impetus to growth would again come from machinery and equipment acquisition, as many companies see increasing need to expand operation to meet the envisaged growth in activity. Indeed, the results of the latest Business Tendency Survey conducted by the Census and Statistics Department confirm that large companies surveyed remained optimistic about the near-term business outlook. On the other hand, overall construction activity might continue to be dragged by a lack of large-scale public sector infrastructure projects. Also, although the pick-up in building consents should point to some relative improvement in private sector building activity in 2007, the timing and extent of a turnaround remains subject to considerable uncertainty at this juncture.

Diagram 2.8 : Although building consents have improved, the timing and extent of turnaround in private building activity remains uncertain



2.20 Overall, the Hong Kong economy is expected to attain solid and broad-based growth of 4.5 – 5.5% in real terms in 2007. This, if realised, would signify another year of above-trend growth when compared with the trend growth at 4.1% in the past ten years. The prevailing forecasts by the private sector are likewise upbeat about further expansion of Hong Kong economy at a solid pace, which are mostly in the range of 5 – 5.5 %.

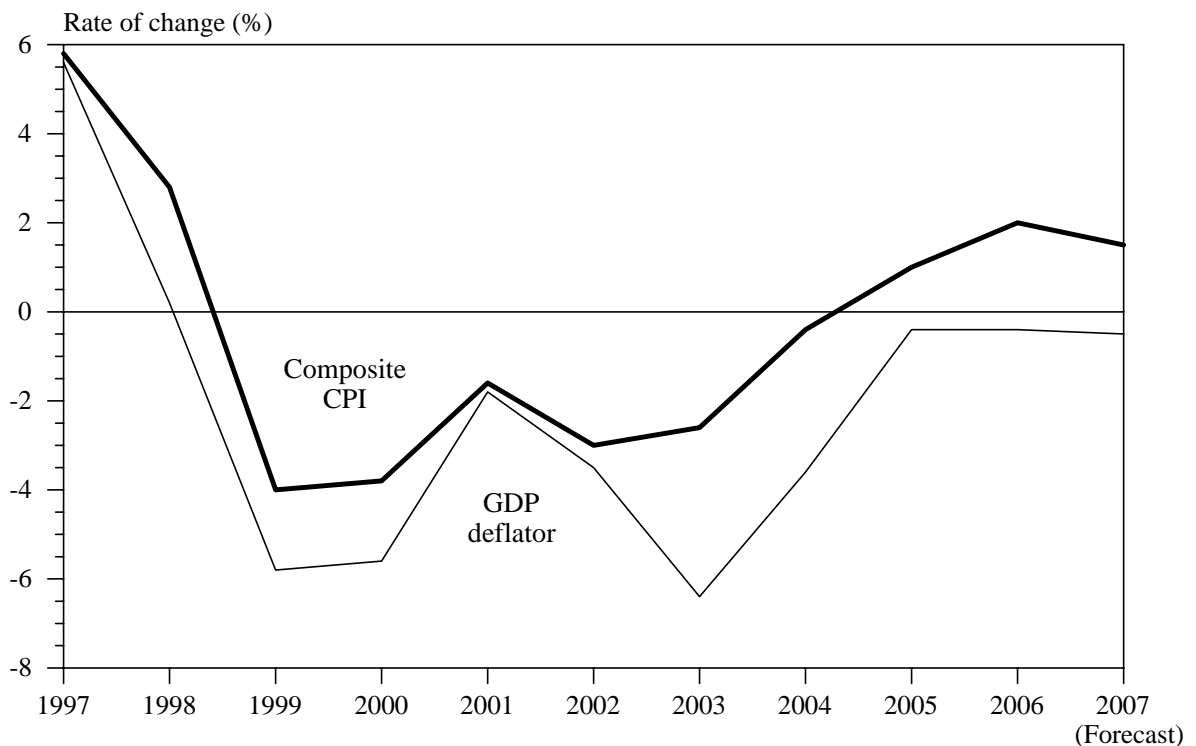
Diagram 2.9 : Economy set for another year of solid and balanced growth in 2007



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

2.21 Consumer price inflation has been creeping up over the past two years amidst the sustained brisk expansion of the economy. Looking ahead, the underlying cost pressures are likely to build up slightly further in 2007, as continued economic expansion at above-trend pace is bound to add more pressure on local costs, and as a weak US dollar and renminbi appreciation would give rise to higher imported inflation. Yet with wages still showing a modest increase and well matched by notable productivity improvement, and with the pressures from rental increase also receding lately, the risk of a significant pick-up in consumer price inflation does not seem that high in 2007. The substantial ease-back in oil prices and the introduction of natural gas in towngas production will also bring down energy-related prices. Coupled with the various one-off factors, including the Budget measures announced for 2007/08, the one-month public housing rental waiver in February, the cut in public housing rentals and the granting of government subsidy in pre-primary education later this year, which would lower the Composite CPI level, for 2007 as a whole, the *Composite CPI* is forecast to increase by 1.5%. The *GDP deflator* is forecast to decline marginally by 0.5%, largely due to the expected further fall in terms of trade stemming from a weak US dollar.

Diagram 2.10 : Inflation environment still benign in 2007



Forecast rate of change in 2007 (%)

Gross Domestic Product (GDP)

<i>Real GDP</i>	4.5-5.5
<i>Nominal GDP</i>	4-5
<i>Per capita GDP, in real terms</i>	3.7-4.7
<i>Per capita GDP at current market prices</i>	HK\$221,500-223,700 (US\$28,400-28,700)

Composite Consumer Price Index **1.5**

GDP Deflator **-0.5**

Medium-term outlook for the Hong Kong economy

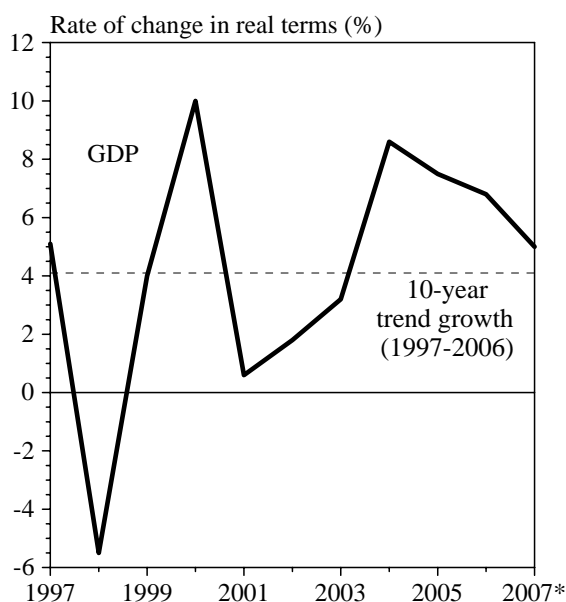
2.22 The medium-term prospects for the economy remain bright, as the strategy of leveraging on our fast-growing economic hinterland continues to pay off. The action agenda from the Economic Summit on the National 11th Five-Year Plan will help Hong Kong to strengthen its vital role in the economic development of our country. These will also further enhance our continuous integration with the Mainland under the CEPA framework and Pan-PRD cooperation, thereby bringing significant benefits to both sides. On the supply side, the Hong Kong economy will continue to shift towards higher value-added services and knowledge-based activities in the coming years. Hong Kong will further enhance its status as an international financial centre and a regional hub for trade, logistics, tourism and business. The productivity growth achieved in the process will help the economy attain a 4.5% trend GDP growth over the next four years 2008-2011.

2.23 The external environment would still be clouded by some lingering uncertainties over the medium term. Of particular note are the evolving situation in the US economy and the persistent global trade imbalances. Although it is generally expected that the US economy would attain soft landing over the course of 2007, the possibility that it may show a sharper-than-expected downturn cannot be ruled out at this stage. Should this latter unfavourable scenario happen, there are bound to have more significant ramifications on the global economy over the coming years. The global trade imbalances, not only alarmingly large but also still growing, are yet to be resolved. Concerted efforts among the economies concerned are badly needed to ensure an orderly adjustment. The lingering protectionist sentiment from the US and EU against Mainland products and continuing pressure on the renminbi to appreciate would also pose risk to Hong Kong's trade. Domestically, the

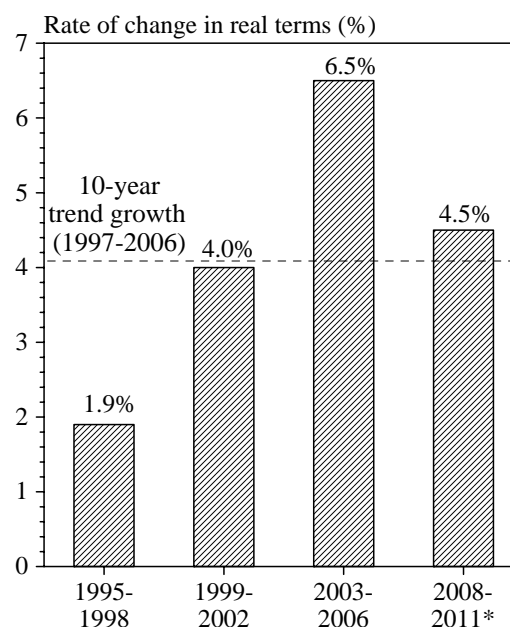
structural shift of the economy to knowledge-based activities, whilst a much needed development in response to the forces of globalisation and regional competition, may also present a challenging situation for some lower skilled workers. Furthermore, the increasingly ageing population will have profound implications on the health and social welfare systems, as well as on the public finance. Although inflation has remained well contained so far, there is risk of re-emergence of a higher inflation over the medium term, especially if the economy continues to grow at above-trend rate thereby exerting increasing pressures on the overall resource balance.

Diagram 2.11 : Medium-term economic outlook remains bright

(a) Another year of above-trend growth expected for 2007



(b) Medium-term outlook underpinned by integration with the Mainland and continuous shift forwards



Note : (*) Forecast.

Notes :

(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.

- (2) The new round of tightening measures in the Mainland in 2006 included monetary tightening measures and sector-specific administrative measures, with respective objectives of reining in the rapid credit expansion and cooling the overheated sectors in the economy. Specifically, the PBoC increased the benchmark 1-year lending rate twice by 27 basis points each in April and August, to 6.12% currently. It also raised the reserve requirement ratio by half percentage point to 8% in July, and further to 8.5% in August and 9% in November (further to 9.5% in January 2007 and 10% in February 2007). Moreover, a window guidance meeting was held in June, with a view to exercising proper control over the excessive credit expansion and improving loan structure.

Apart from the accelerated structural adjustment and consolidation in the overheated industries, including the cement, aluminium, ferroalloy and coke industries, new cooling measures were implemented against the property sector. On 17 May 2006, the State Council announced six guidelines aiming at cooling the property market. On 24 May, 15 detailed measures were issued based on the six guidelines. Further measures were announced in July and September to restrain overseas investment in the property market, to raise the cost of land use and to contain speculative activities.

The measures introduced so far are rather moderate in nature, and should not result in a significant slow-down in the Mainland economy. Their impact on the Hong Kong economy so far has also been rather insignificant. In the longer term, the tightening measures should help the Mainland achieve more sustainable growth, which is beneficial to Hong Kong.

- (3) On 14 September 2006, the Mainland authorities released a new list of export tax rebate rates, which involves cancelling the tax rebate for such natural resources as natural gas and coal, and for such raw materials as specific kinds of wool and wood; reducing tax rebate for commodities including textiles, plastics, furniture, leather goods, steel and ceramic; and raising tax rebate for those high value-added products such as IT products, large equipment, biomedical products and high-tech products. The list of products prohibited from processing trade was also expanded. A supplementary notice was then released on 29 September. In the subsequent announcement of the Mainland authorities as released on 1 November, the list of prohibited products has been revised and has taken out some of the items that raised most concern amongst Hong Kong manufacturers. This should have alleviated some of the more imminent pressures on Hong Kong's manufacturers affected by the new policies.

CHAPTER 3 : THE EXTERNAL SECTOR

Summary

- *The Mainland's vibrant trade flows and the generally resilient global economy saw merchandise exports attaining another year of double-digit growth in 2006. The ease-back in oil prices in the second half of the year, strengthening intra-regional trade, as well as the weakness of the US dollar since the second quarter of 2006 all rendered support.*
- *The Mainland market continued to show a stellar performance, with exports to this market picking up further in 2006 after an already robust growth in 2005. Boosted by the strengthening of many Asian currencies during the year and their solid economic growth, exports to many East Asian economies continued to fare well. Exports to Japan and the European Union, however, showed less rapid increases, partly dragged by their weaker currencies in late 2005 and early 2006. Exports to the US also registered mild growth, mainly against a high base from the surge in textile and clothing exports to this market in 2005.*
- *Exports of services were likewise robust. The vibrant trade flows in the Mainland continued to bolster exports of trade-related services, offshore trade in particular. Exports of financial services also grew remarkably in 2006 amidst the buoyant financial market. But exports of travel services slowed upon a more moderate growth in incoming visitors during the second half of the year.*
- *During 2006, various policy measures were implemented and put forward on the trade front to strengthen Hong Kong's external competitiveness. A series of co-operation agreements on logistics, tourism and transport under the Pan-PRD co-operation framework were reached. The Chief Executive's Policy Address also put forth measures to reduce cost and improve efficiency of cargo flows between Hong Kong and the Mainland. Moreover, following the Economic Summit held in September 2006, strategic recommendations in response to the National 11th Five-Year Plan were proposed by the Focus Groups, covering such areas as trade and business, as well as logistics, maritime, and air transport services.*

Visible trade

Total exports of goods

3.1 Merchandise exports attained another year of strong growth in 2006. *Total exports of goods* (comprising re-exports and domestic exports) grew further by 10.2% in real terms⁽¹⁾ in 2006, after an 11.4% increase in 2005. After kicking off with a rapid growth in the first quarter of 2006, growth relapsed somewhat in the second quarter, before regaining strong momentum in the third and fourth quarters. Notwithstanding the uncertainties envisaged at the beginning of 2006 from an expected slowing external demand, a number of favourable factors set in during the second half of the year, including notably fall-back in oil prices, improved competitiveness upon the successive weakening of the US dollar, and the strengthening intra-regional trade, which together cushioned the dampening impact from the slow-down of the US economy. Apart from these, there was also on-going support from the strong Mainland economy and its vibrant trade flows.

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

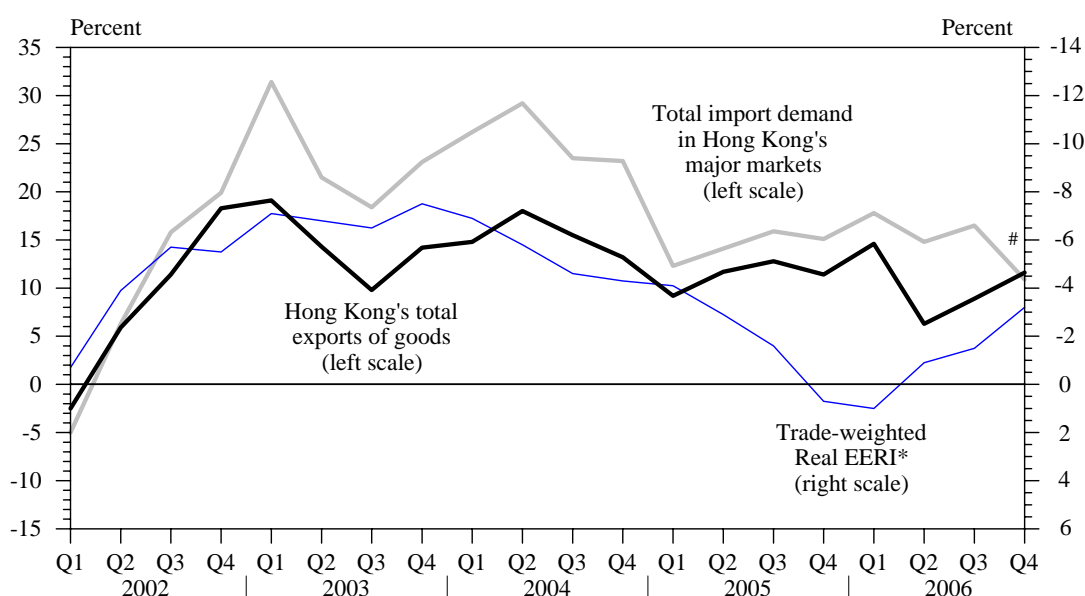
	<u>Total exports of goods</u>				<u>Re-exports</u>			<u>Domestic exports</u>			
	In value terms	In real terms	Change in prices	In value terms	In real terms	Change in prices	In value terms	In real terms	Change in prices		
2005 Annual	11.4	11.4	1.3	11.7	11.6	1.2	8.0	7.6	2.2		
Q1	10.6	9.2 (0.9)	2.1	11.7	10.4 (1.7)	2.0	-6.9	-9.5 (-11.2)	4.8		
Q2	12.5	11.7 (6.2)	1.8	13.8	13.0 (6.1)	1.6	-6.4	-8.3 (7.9)	4.7		
Q3	12.5	12.8 (2.3)	1.0	12.4	12.7 (1.3)	1.0	14.0	14.3 (20.1)	1.1		
Q4	10.0	11.4 (1.5)	0.4	9.0	10.3 (0.8)	0.5	25.2	28.1 (11.6)	-0.5		
2006 Annual	9.4	10.2	1.0	10.0	10.8	1.1	-1.1	1.1	-2.1		
Q1	12.1	14.6 (3.4)	-0.3	10.7	13.2 (3.9)	-0.2	38.7	42.3 (-3.1)	-2.9		
Q2	5.4	6.3 (-0.2)	0.6	4.6	5.3 (0.2)	0.9	19.9	23.9 (-6.7)	-3.9		
Q3	8.4	8.9 (4.1)	1.4	9.4	9.8 (4.9)	1.5	-6.1	-4.2 (-8.0)	-1.3		
Q4	11.9	11.6 (3.3)	1.9	15.3	14.9 (4.6)	2.0	-31.8	-30.9 (-19.9)	-0.8		

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

3.2 Within total exports, *re-exports*⁽²⁾ continued to be the growth driver, rising by 10.8% in real terms in 2006, following an 11.6% growth in 2005, marking the fifth consecutive year of double-digit growth. With a similar growth profile to total exports, re-exports growth slowed in the second quarter

after a strong start in the first quarter, but picked up again in the second half of the year on the back of the strengthening intra-regional trade and the further weakening of the US dollar. *Domestic exports* exhibited more volatilities during 2006, with the strong surge in the first half of the year from the lift in textile and clothing (T&C) exports reverting to decline in the second half of the year as the high base set in. For 2006 as a whole, domestic exports settled back to a 1.1% growth in real terms, after a 7.6% growth in 2005. The year 2006 was the third consecutive year which domestic exports registered positive growth.

Diagram 3.1 : Merchandise exports attained another year of strong growth in 2006 (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.

(#) Import demand figure for Q4 2006 refers to Oct-Nov 2006 only.

Diagram 3.2 : Re-exports picked up in the second half of 2006, while domestic exports showed great volatilities during the year

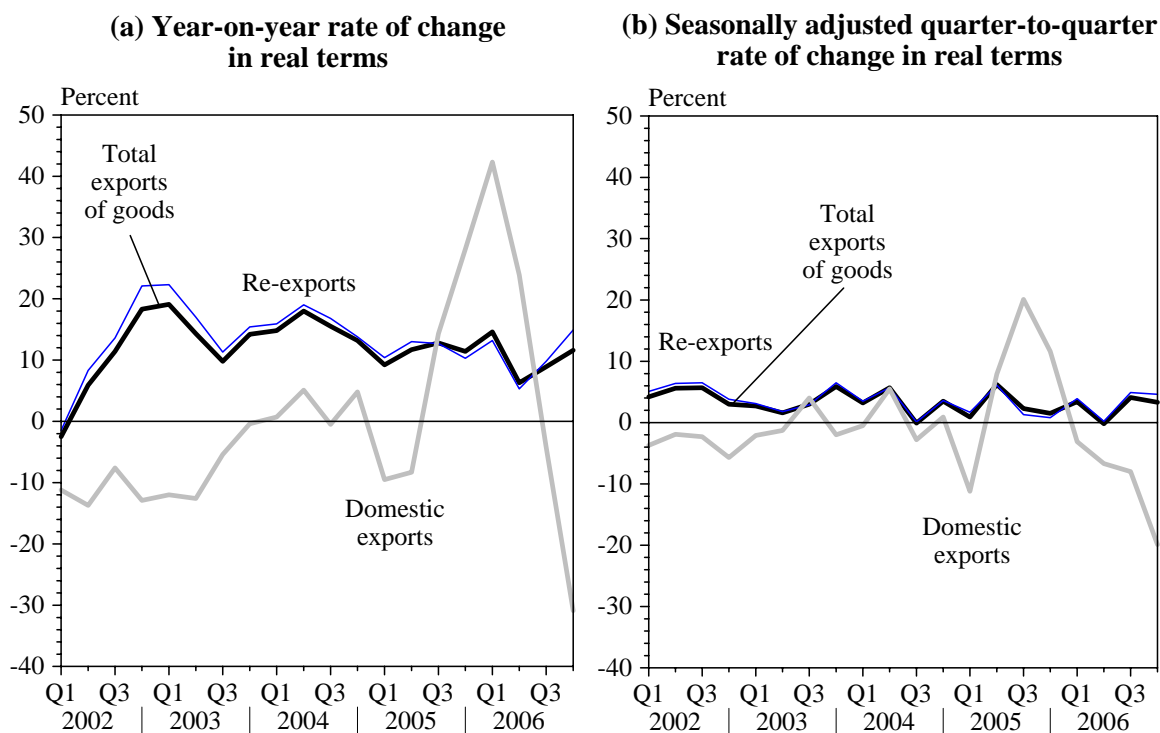
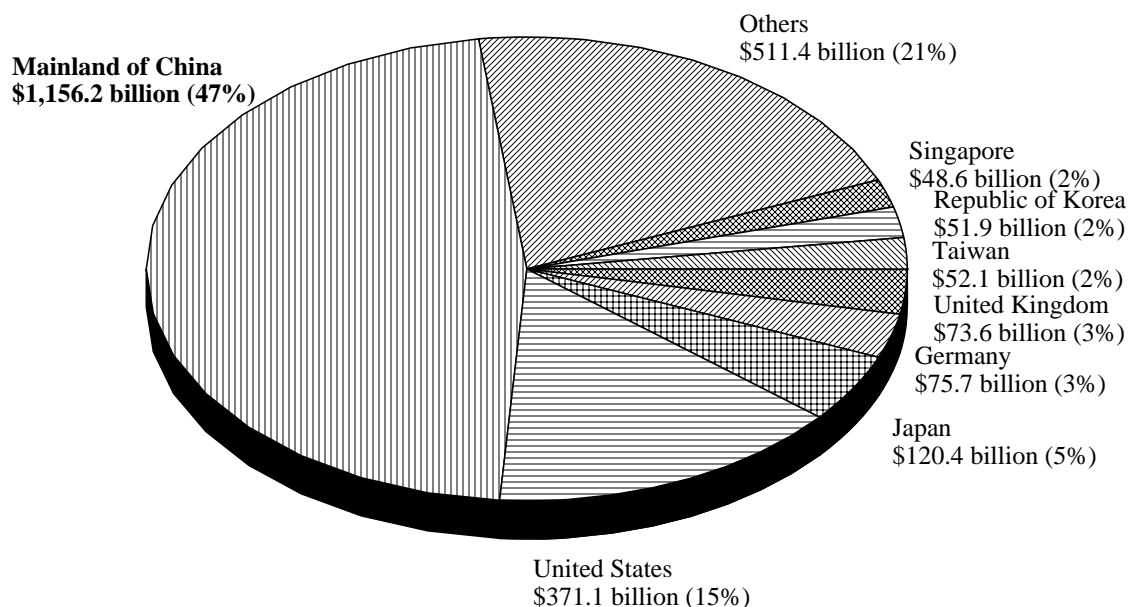


Diagram 3.3 : The Mainland featured prominently in Hong Kong's exports



Total exports of goods in 2006 : \$2,461.0 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>European Union</u>	<u>Japan</u>	<u>Republic of Korea</u>	<u>Taiwan</u>	<u>Singapore</u>
2005	Annual	14.2	5.5	16.6	9.6	10.8	4.1	9.0
	Q1	9.9	5.1	21.4	11.5	5.4	-5.4	15.7
	Q2	13.3	7.6	19.3	10.8	5.4	4.8	14.5
	Q3	14.9	8.4	14.9	11.1	12.7	8.4	0.8
	Q4	17.9	0.9	12.5	5.6	19.0	8.2	6.6
2006	Annual	16.7	1.7	4.7	2.4	8.8	4.3	4.5
	Q1	23.1	3.5	9.5	8.2	20.9	10.4	2.3
	Q2	11.4	-2.4	4.1	3.0	12.0	-5.3	-5.4
	Q3	15.8	-1.1	1.9	0.6	10.7	8.3	12.8
	Q4	17.5	7.0	4.1	-1.4	-5.4	4.2	8.3

3.3 Analysed by market, the Mainland remained the bright spot, with exports to this market picking up further in 2006 after the already very robust growth in 2005. This owed much to the Mainland's vibrant trade flows, including strong imports spurred by its buoyant domestic demand. While the gradual renminbi appreciation in the year had helped to lift the Mainland's imports even more, the impact of renminbi appreciation on Mainland's exports was by far rather negligible. Thus both streams of Hong Kong's exports to the Mainland for outward processing and for meeting Mainland's own demand continued to show robust growth. As the East Asia economies generally performed well during the course of 2006, and backed by the flourishing intra-regional trade as well as the strengthening of many Asian currencies during the year, exports to many Asian economies continued to register decent growth in 2006. In contrast, the slow-down in exports to Japan since the fourth quarter of 2005 continued into 2006, mainly dragged by the weakness of the yen.

Diagram 3.4 : Hong Kong's total exports of goods to Mainland of China

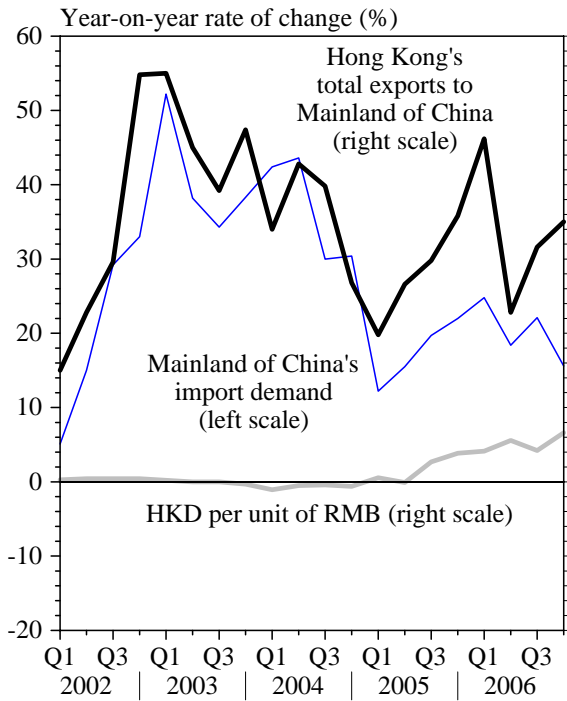


Diagram 3.5 : Hong Kong's total exports of goods to Singapore

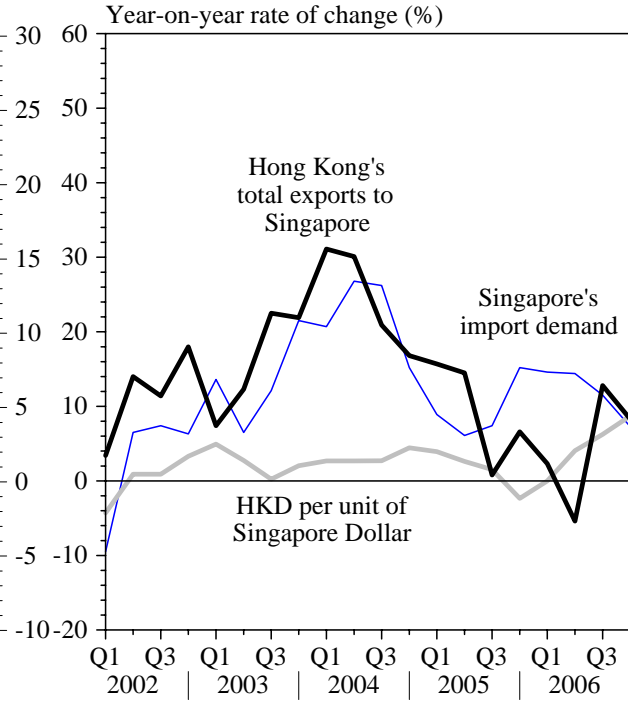


Diagram 3.6 : Hong Kong's total exports of goods to Republic of Korea

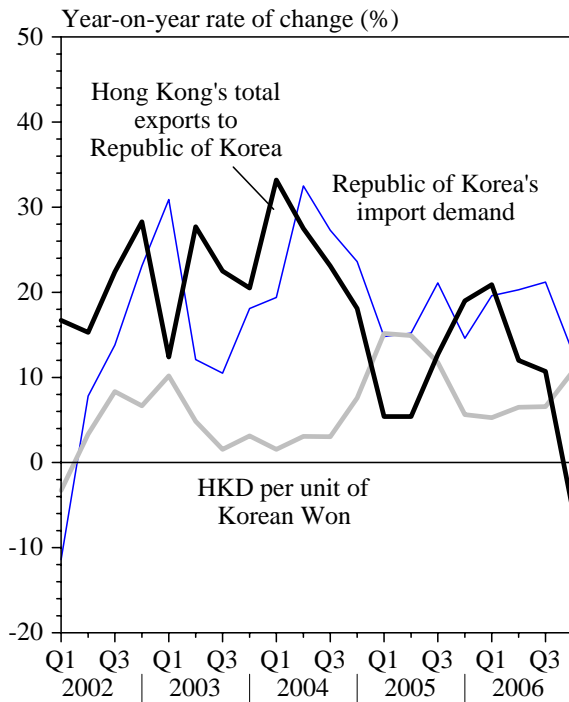
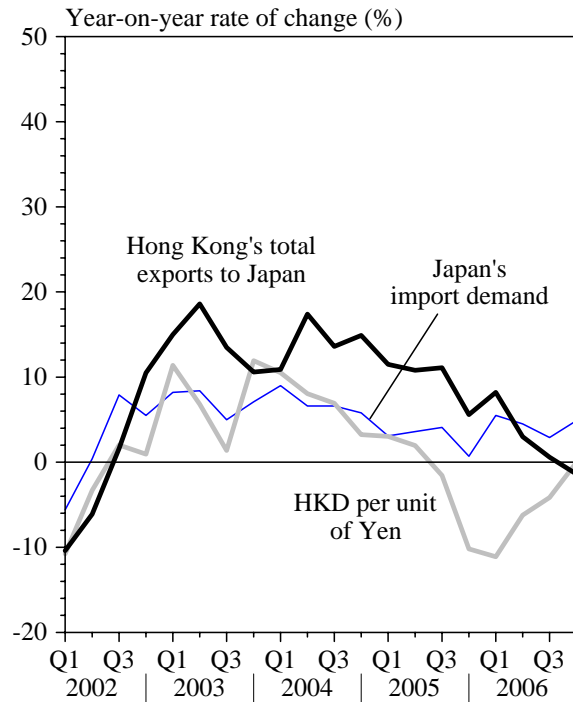


Diagram 3.7 : Hong Kong's total exports of goods to Japan



3.4 Compared with the growth in the Asian export markets, the conventional markets in Europe and the US fared less well. Notwithstanding the economic upturn in EU in 2006, exports to this market slowed rather significantly in the year, mainly dragged by its moderating import demand and the lagged effect of a weaker euro in late 2005 and early 2006, and also owing to the high base effect resulting from the surge in textile and clothing exports to these markets in the first three quarters of 2005. Exports to the US market registered only a small increase in 2006, likewise affected by the relatively high base in most of 2005 due to the T&C distortion. The increasing trend for Mainland products to be shipped out direct from ports in the Mainland was probably another relevant factor.

Diagram 3.8 : Hong Kong's total exports of goods to EU

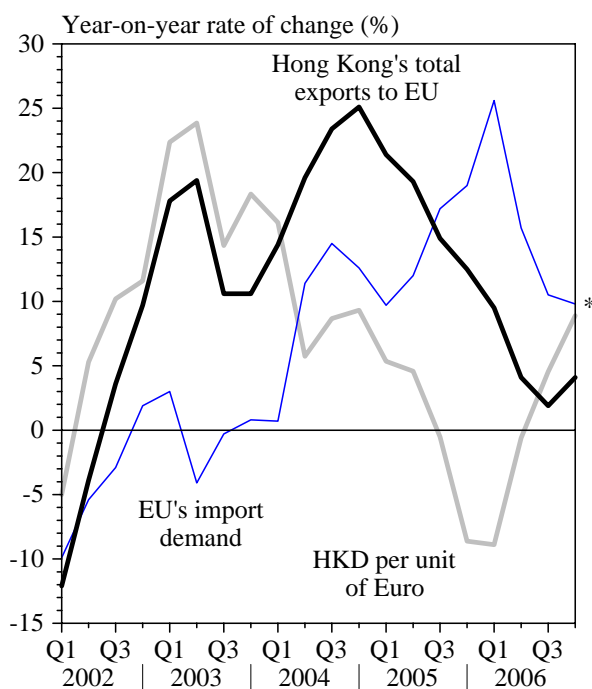
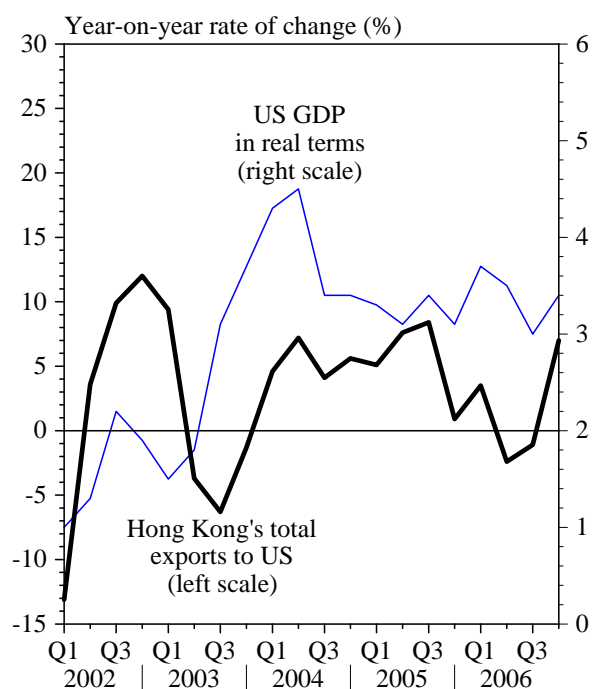


Diagram 3.9 : Hong Kong's total exports of goods to US



Note : (*) Figure for Oct-Nov 2006 only.

Box 3.1

How would US economic slow-down impact on Hong Kong's exports?

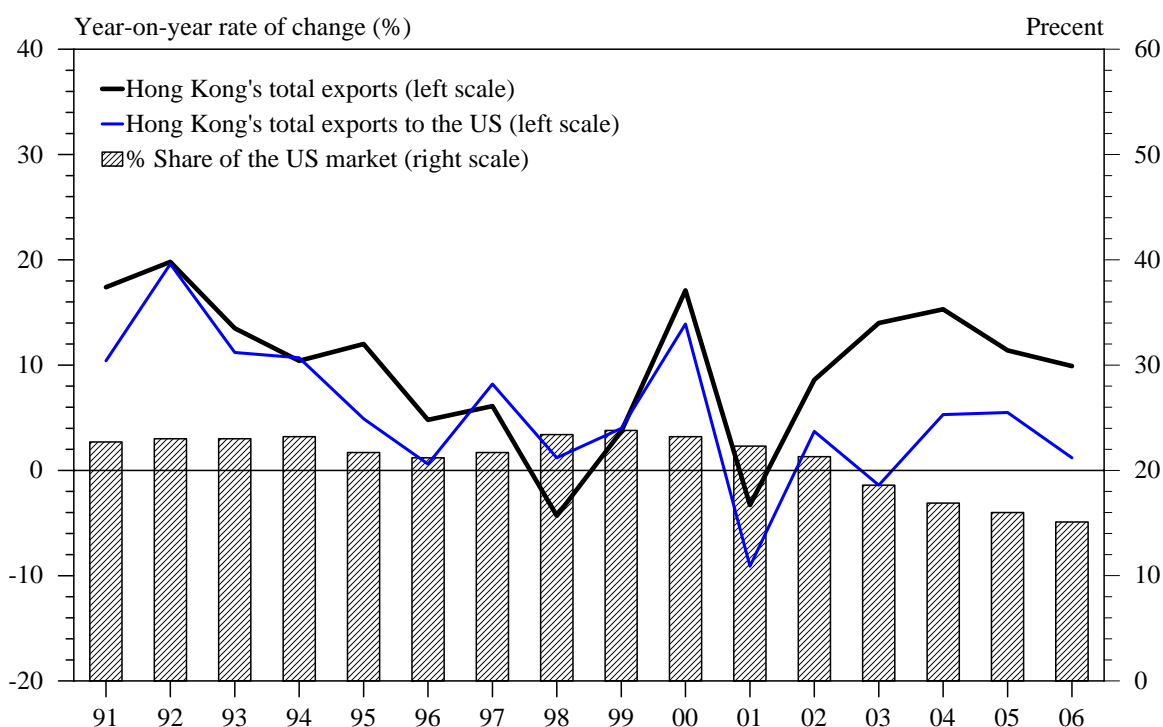
The US economic slow-down is one of the uncertainties underlying global economic outlook for 2007. Being Hong Kong's second largest export market, a slowing US economy will inevitably dampen Hong Kong's export growth to this market. Nevertheless, the evolving developments in this market over time indicate that the impacts of a slowing US economy on Hong Kong on the trade front may be milder than commonly believed.

Direct impact has fallen over time

First, over the past decade or so, the US market has taken a diminishing share in Hong Kong's exports, from one-quarter in late 1980s to 15% in 2006. After the rapid growth in the early 1990s, the on-going structural shift in Hong Kong's re-exports to offshore trade amidst the expansion and improvement in port infrastructure in South China saw Hong Kong's exports to the US settle to a more modest growth since mid-1990s. The declining share of US in Hong Kong's total exports means that the direct impact of a US economic slow-down on Hong Kong's exports in itself would likely be milder now than before.

	<u>Total exports to the US in volume terms</u> (% per annum)	<u>US import demand growth</u> (% per annum)
1991-95 (5 years)	11.2	8.5
1996-2000 (5 years)	5.4	10.4
2001-06 (6 years)	0.8	5.8

Diminishing prominence of US in Hong Kong's exports

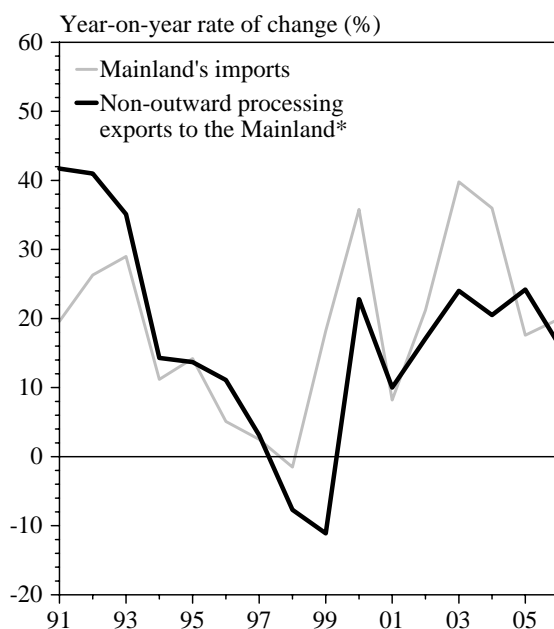


Box 3.1 (cont'd)

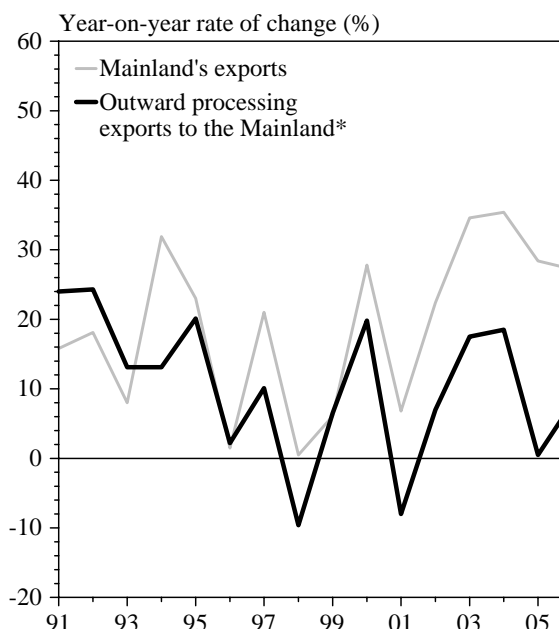
The Mainland market now a more important market

Secondly, compared to US, the Mainland market is a more prominent driver of Hong Kong's export growth. They now account for nearly half of Hong Kong's exports, up from less than 30% in the early 1990s. Excluding outward processing trade, the share is still very prominent, at 30% in 2006, bigger than the combined share of US and EU taken together. The growing integration with the Mainland economy and with the latter's expansion in export capacity and speed-up in trade liberalisation following its WTO accession, coupled with the robust growth in domestic demand, saw a significant increase in Hong Kong's exports to the Mainland, by an average of 17.4% per annum between 2001 and 2006.

Total exports to the Mainland for meeting Mainland's own demand on a distinct surge, particularly after China's accession to WTO in 2001



Total exports to the Mainland for outward processing more related to the Mainland's export performance



Note: (*) Figures for Q1-Q3 2006 only.

Indirect impact through the Mainland likely to be mild

Thirdly, over the past decade, the Mainland's exports to the US demonstrated very robust performance amidst the fluctuation of the US economic cycle. The Mainland's exports to the US surged markedly by an average of 23% per annum between 1996 and 2006, with double-digit growth recorded in all years except 2001. On this, it is noteworthy that the US has become the Mainland's largest export market since 1999. So, conceivably, the distinct slow-down in US demand will also impact on Hong Kong's exports in an indirect way, through reduced exports to the Mainland for export processing. Yet by way of the competitiveness and improved quality of Mainland products, such indirect impact is unlikely to be very large. Also, the diversification of the Mainland's exports to other markets, particularly to the EU in recent years, should help to cushion the impact of a US economic slow-down if other economies can continue to hold up well. As such, the plausibility of Hong Kong's exports being pummeled by a sharp slow-down in the Mainland's exports caused by a US downturn should be rather small, granting a soft landing scenario in US.

Box 3.1 (cont'd)

Sharper-than-expected US economic downturn still a downside risk

As the Mainland economy is now a predominant factor shaping Hong Kong's export growth, and that with the strong competitiveness of the Mainland's exports which is further cushioned by the relative strengthening of other Asian currencies, it can be expected that the impact of a mild growth slow-down in the US alone on Hong Kong's exports should not be too significant. The weakness of the US dollar is also another favourable factor supporting Hong Kong's exports (for details, see **Box 2.1**). However, should the US economy show a sharper-than-expected slow-down, thereby triggering global recession, or should the growth momentum of the Mainland economy lose steam, Hong Kong's exports would likely be more significantly affected.

Imports of goods

3.5 *Imports of goods* picked up to double-digit growth of 10.2% in real terms in 2006, from an 8.5% growth in 2005. Import intake for subsequent re-exporting maintained strong growth during 2006 in tandem with the robust re-export growth. The further pick-up in domestic demand also saw *retained imports* accelerate to a notable 8.4% growth in real terms in 2006, following a mere 0.8% rise in 2005. Retained imports of capital goods surged throughout 2006, boosted by strong acquisition of telecommunications equipment and office equipment required for continuous business expansion. Retained imports of consumer goods, after a modest decline in 2005, also revived sharply in 2006, as the sanguine economic sentiment gave a lift to consumer spending. But retained imports of raw materials and semi-manufactures fell further.

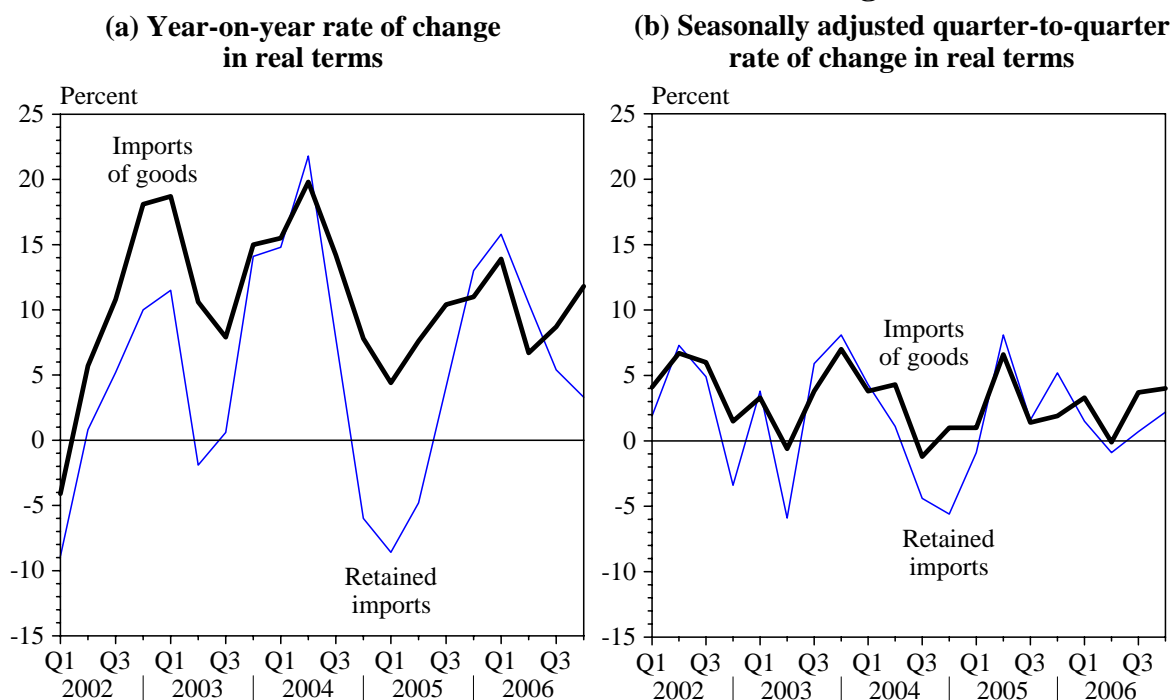
**Table 3.3 : Imports of goods and retained imports
(year-on-year rate of change (%))**

		<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>		
2005	Annual	10.3	8.5	2.7	7.3	0.8		8.4	
	Q1	8.1	4.4	(1.0)	4.0	-0.7	-8.6	(-0.9)	11.1
	Q2	10.1	7.6	(6.6)	3.3	1.1	-4.8	(8.1)	9.6
	Q3	11.5	10.4	(1.4)	2.3	9.6	4.1	(1.6)	7.2
	Q4	11.3	11.0	(1.9)	1.6	19.5	13.0	(5.2)	5.3
2006	Annual	11.6	10.2	2.1	16.3	8.4		5.0	
	Q1	13.8	13.9	(3.3)	1.0	22.7	15.8	(1.5)	4.4
	Q2	8.1	6.7	(-0.1)	1.9	18.5	10.5	(-0.9)	4.7
	Q3	10.7	8.7	(3.7)	2.7	14.8	5.4	(0.7)	5.8
	Q4	14.0	11.8	(4.0)	2.7	10.3	3.3	(2.2)	5.1

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 3.10 : Total imports picked up in 2006,
as both import intake for re-exporting
and intake for local use were strong**



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

		<u>Consumer goods</u>	<u>Foodstuffs</u>	<u>Capital goods</u>	<u>Raw materials and semi-manufactures</u>	<u>Fuels</u>
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
2006	Annual	14.4	2.0	27.6	-16.8	5.4
	Q1	16.9	4.3	38.4	-6.4	4.0
	Q2	37.3	4.8	19.8	-13.4	-4.9
	Q3	7.8	2.3	32.5	-27.5	3.5
	Q4	0.5	-2.9	22.2	-18.9	19.5

Invisible trade

Exports of services

3.6 *Exports of services*, which were on a sustained robust uptrend over the past several years, grew briskly further by 8.7% in real terms in 2006. Exports of trade-related services, comprising mainly offshore trade, surged at double-digit rate, underpinned by the vibrant trade flows of the Mainland. The buoyant financial markets, particularly with the notable expansion in IPO and other fund raising activities during the year, also saw a double-digit surge in exports of financial services in 2006. Thus, even though exports of travel services slowed quite distinctly in the latter part of the year as the number of incoming visitors settled back to a more moderate growth, exports of services as a whole were still able to sustain notable growth through to the year-end.

Diagram 3.11 : Trade-related and transportation services accounting for three-fifths of service exports, reflecting the important role of Hong Kong as a trading hub

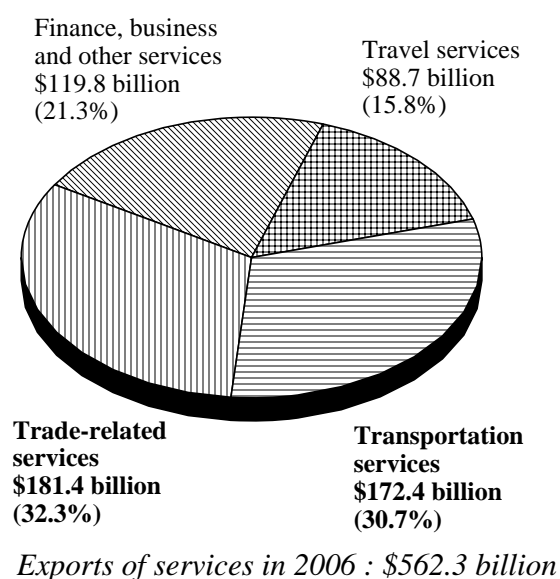


Diagram 3.12 : Exports of services were robust throughout 2006, amidst continued surge in offshore trade and a pick-up in financial market activity

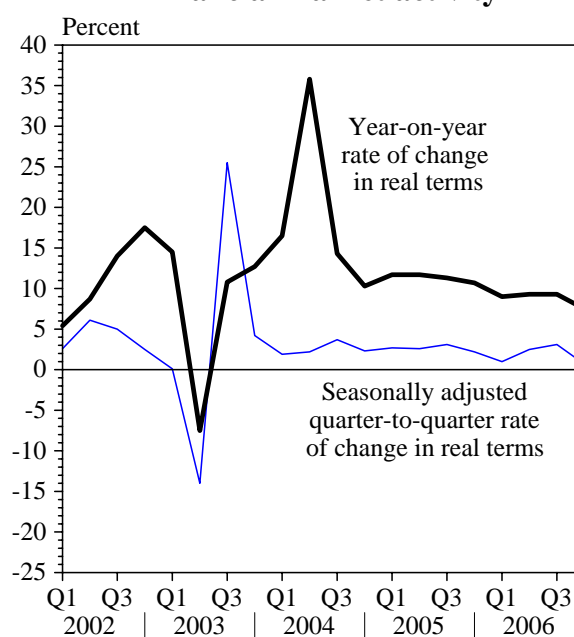


Table 3.5 : Exports of services by major service group (year-on-year rate of change in real terms (%))

Of which :

		<i>Of which :</i>				
		Exports of services	Trade-related services ^(a)	Transportation services	Travel services ^(b)	Finance, business and other services
2005	Annual	11.3	11.4	10.6	10.4	12.9
	Q1	11.7 (2.7)	10.4	9.6	12.4	15.6
	Q2	11.7 (2.6)	14.0	11.1	8.7	11.5
	Q3	11.3 (3.1)	11.3	10.4	9.1	14.2
	Q4	10.7 (2.2)	10.5	11.2	11.3	10.3
2006	Annual	8.7	10.8	6.2	6.0	10.5
	Q1	9.0 (1.0)	13.3	7.0	11.0	4.2
	Q2	9.3 (2.5)	10.8	7.1	7.5	11.5
	Q3	9.3 (3.1)	11.5	5.2	5.9	13.0
	Q4	7.5 (0.7)	8.3	5.6	0.1	13.4

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

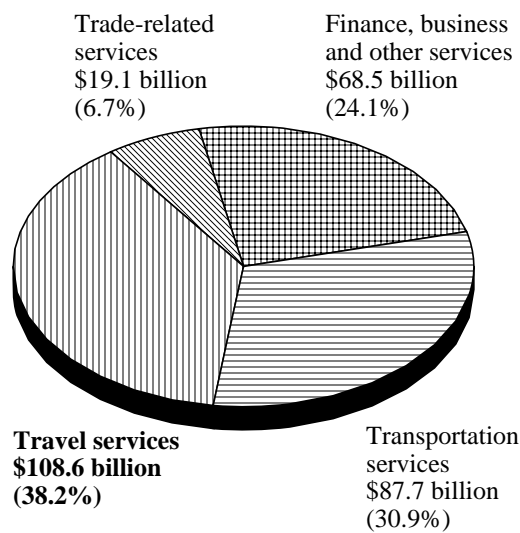
(a) Comprising mainly offshore trade.

(b) Comprising mainly inbound tourism receipts.

Imports of services

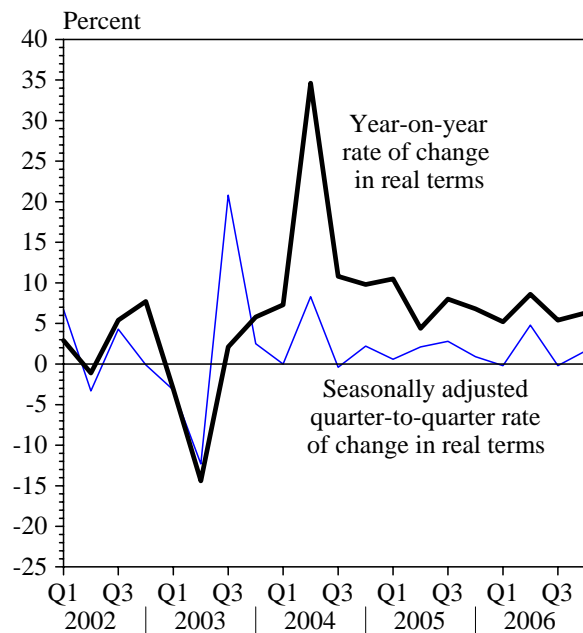
3.7 *Imports of services* grew by 6.3% in real terms in 2006, after a 7.4% growth in 2005. Imports of financial, business and other services showed double-digit growth in 2006, while imports of transportation services recorded solid growth in the year. Imports of travel services reverted to a mild increase in 2006, while growth in imports of trade-related services was moderate through the year.

Diagram 3.13 : Travel services being the largest component in imports of services



Imports of services in 2006 : \$283.9 billion

Diagram 3.14 : Imports of services showed fairly rapid growth in 2006



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

		<i>Of which :</i>				
		<u>Imports of services</u>	<u>Travel services⁽⁺⁾</u>	<u>Transportation services</u>	<u>Trade-related services</u>	<u>Finance, business and other services</u>
2005	Annual	7.4	-0.7	17.1	10.0	9.9
	Q1	10.5	(0.6)	6.3	18.5	8.9
	Q2	4.4	(2.1)	-7.6	16.9	12.5
	Q3	8.0	(2.8)	-0.8	18.5	9.9
	Q4	6.8	(0.9)	-0.2	14.6	9.0
2006	Annual	6.3	3.4	6.3	1.4	12.8
	Q1	5.2	(-0.2)	1.3	6.6	3.8
	Q2	8.6	(4.8)	6.8	8.8	1.5
	Q3	5.4	(-0.2)	1.4	5.2	2.1
	Q4	6.3	(1.6)	4.7	4.7	-0.8

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

(+) Comprising mainly outbound travel spending.

Visible and invisible trade balance

3.8 Boosted by the surge in exports of services, the combined visible and invisible trade balance continued to record sizable surplus of \$169.4 billion in 2006, equivalent to 5.9% of the total value of imports of goods and services. These compared with the corresponding figures of \$172.2 billion and 6.7% in 2005. The considerable surplus underscored the strength of Hong Kong's external competitiveness on the one hand, and increased resilience to volatilities and external shocks on the other.

**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>
2005	Annual	2,251.7	495.8	2,311.1	264.2	-59.3	231.6	172.2
	Q1	479.1	113.4	498.8	62.5	-19.7	50.9	31.2
	Q2	555.4	112.7	575.0	62.0	-19.6	50.7	31.0
	Q3	614.6	131.5	621.6	71.3	-6.9	60.2	53.3
	Q4	602.7	138.2	615.8	68.4	-13.1	69.8	56.7
2006	Annual	2,467.4	562.3	2,576.3	283.9	-109.0	278.4	169.4
	Q1	538.5	128.8	568.3	65.8	-29.8	63.1	33.3
	Q2	586.7	129.8	622.1	67.9	-35.4	61.9	26.5
	Q3	667.2	150.8	685.8	76.2	-18.6	74.6	56.0
	Q4	674.9	152.9	700.2	74.0	-25.2	78.9	53.6

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

Trade policy and other developments

3.9 Being a small and highly open economy, the external sector continues to play a paramount role in Hong Kong's economic development. Yet its high degree of openness also renders it more susceptible to the volatilities and shocks in the external environment. In this regard, the Hong Kong SAR Government has strived to strengthen Hong Kong's external competitiveness, in order to preserve our edges as a leading international trade and logistics centre, and to leverage on the growing integration with the Mainland economy.

Strengthening institutional framework

3.10 The Government will continue to uphold a free trade policy, while at the same time strengthen the institutional framework established over the past years with a view to expanding the trade and business opportunities for Hong Kong, particularly with the Mainland. Since CEPA was signed in mid-2003, significant progress has been achieved and with the third phase of CEPA taking effect in 2006, the liberalisation measures are extended to altogether 27 service areas, and more goods with Hong Kong origin can be exported to the Mainland tariff-free. Since 1 January 2007, all products of Hong Kong origin can be exported to the Mainland tariff-free.

3.11 As at end-December 2006, the Trade and Industry Department (TID) and five Government Approved Certificate Organisations issued 19 033 certificates of Hong Kong origin (CEPA) to goods produced in Hong Kong,

involving a total of \$6.77 billion worth of goods. TID also approved 1 021 applications for certificates of Hong Kong Service Supplier. CEPA adopts a building block approach that provides a mechanism for more liberalisation measures to be included as and when they are agreed by both parties. The Government will continue to work closely with the Mainland authorities on further liberalisation measures under CEPA for the benefits of the Hong Kong economy. On the other hand, the Individual Visit Scheme, which was introduced in July 2003, is expanded further in January 2007 to cover a total of 49 Mainland cities⁽³⁾.

3.12 Co-operation under the Pan-PRD Regional Co-operation Framework Agreement also made good progress in 2006. Following the third forum held under this framework in June 2006, a series of co-operation agreements among Hong Kong, Macau and provinces in the Pan-PRD region were reached on areas such as logistics, tourism, transport, energy, information, technology and environmental protection.

Other policy measures

3.13 Following the Economic Summit on “China’s 11th Five-Year Plan and Development of Hong Kong” held in September 2006, a number of strategic recommendations were proposed by the Focus Groups. Amongst the recommendations, the Focus Group on Trade and Business put forth proposals to optimise the potentials and benefits under CEPA, and to assist Hong Kong-invested factories in Guangdong to comply with Mainland rules and regulations. The Focus Group on Maritime, Logistics and Infrastructure considered that the policy direction was to leverage on our air transport, shipping and high-value logistics experience in strengthening the status as an international maritime centre, and as an air transport and logistics hub. An action agenda on specific measures to enhance cost-effectiveness of cross-boundary freight transport, to strengthen the maritime industry, and to enhance operative efficiency and capacity of the aviation industry were also proposed.

3.14 Meanwhile, the Chief Executive in his Policy Address also put forward a host of policy measures to reduce cost and improve efficiency of cargo flows between Hong Kong and the Mainland. These included streamlining administrative measures to improve operating efficiency of the river trade, and plans to expand the air cargo handling capacity.

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) The Scheme is extended to cover an addition of 5 provincial capitals, viz. Shijiazhuang, Zhengzhou, Changchun, Hefei and Wuhan, starting from 1 January 2007.

CHAPTER 4 : DEVELOPMENTS IN SELECTED SECTORS

Summary

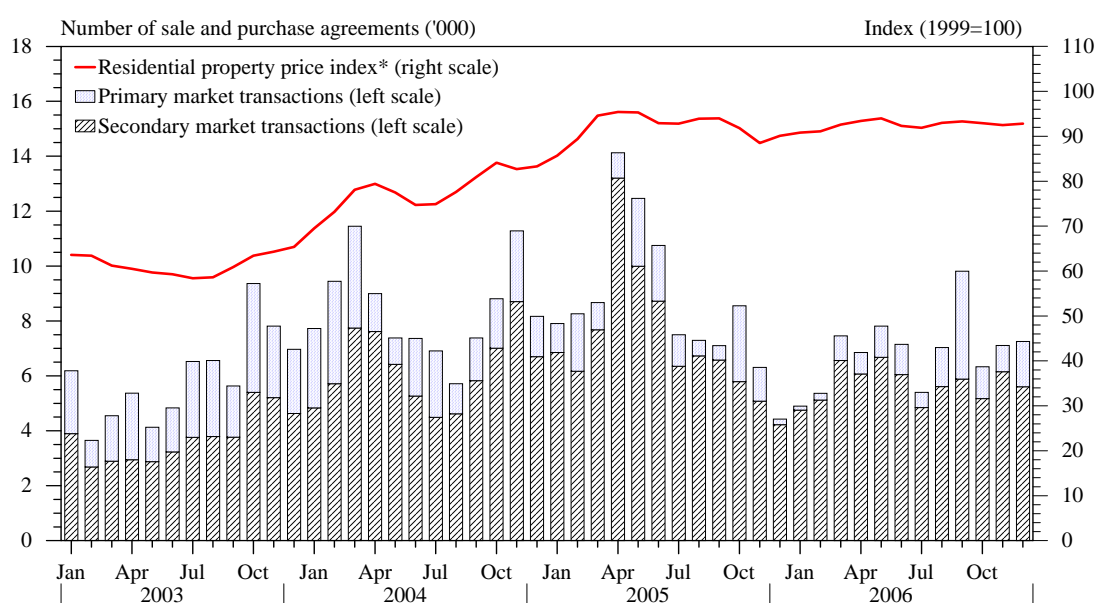
- *The residential property market went through a healthy consolidation in 2006, adjusting further to the earlier hectic situation till mid-2005. Sales activities were less hectic than in the preceding two years. Flat prices edged up only modestly. Yet market sentiment was largely positive as the longer-term outlook was well underpinned by improving economic fundamentals. The non-residential segment kept faring well amidst the general trend of business expansion.*
- *On-going efforts are made by the Government towards more efficient external transport network that fosters smoother flows of people and goods with the rest of the world. This is particularly so for the cross-boundary link with the Mainland where transport facilities are being developed fast, with a view to extending the hinterlands of Hong Kong's port and airport.*
- *Inbound tourism advanced further, with visitor arrivals rising to a new record high in 2006. Arrivals from the Mainland continued to increase, albeit at a moderated pace in the latter part of the year. Meanwhile, the growth in arrivals from other major markets stayed solid in general.*
- *The logistics sector showed a steady performance, with further expansion in both air and water cargo traffic. In face of keener competition in the region, the industry players have increasingly shifted their focus towards high value-added logistics instead of carriage of goods alone.*
- *Many professional and business services sectors have capitalised on the opportunities presented by market expansion and liberalisation in the Mainland over the past few years. This reinforces the competitiveness of Hong Kong as the platform for Mainland enterprises to "go out" and also for foreign enterprises to expand into the Mainland market.*
- *The tendency of the business sector to engage in innovation and technology activities is echoed by continuous policy support and public-private sector collaboration. A major challenge ahead for the community as a whole is how to leverage on the market potentials of the Mainland to raise our innovation capacity, upgrade our technology level and explore new business opportunities.*

Property

4.1 The sales market for *residential property* went through a healthy consolidation in 2006, adjusting further to its earlier hectic situation till mid-2005. Trading activities were less hectic than in the preceding two years as home buyers turned prudent after the earlier price surge. Also contributed was the more uncertain interest rate outlook in the earlier part of 2006 that curbed acquisition interest. Yet trading activities revived modestly in the second half of the year upon the pause in US interest rate hike and intensified mortgage competition amongst the banks. For 2006 as a whole, the number of transactions for private residential property was 82 472. This was lower by some 20% as compared to 2004 and 2005, whilst exceeding the annual figures hovering around 70 000 during 2001-03.

4.2 Flat prices held broadly stable over the course of 2006. Market sentiment was largely positive as the longer-term outlook was well underpinned by improving economic fundamentals. Comparing December 2006 with a year earlier, overall flat prices edged up modestly by 3.0%, comprising increases of 2.7% for small to medium flats and 3.2% for large flats. Flat prices in December 2006 were 59% higher than the trough in 2003, but still 46% off the peak in 1997.

Diagram 4.1 : Flat prices continued to move narrowly over the course of 2006, sustaining the healthy market consolidation since mid-2005

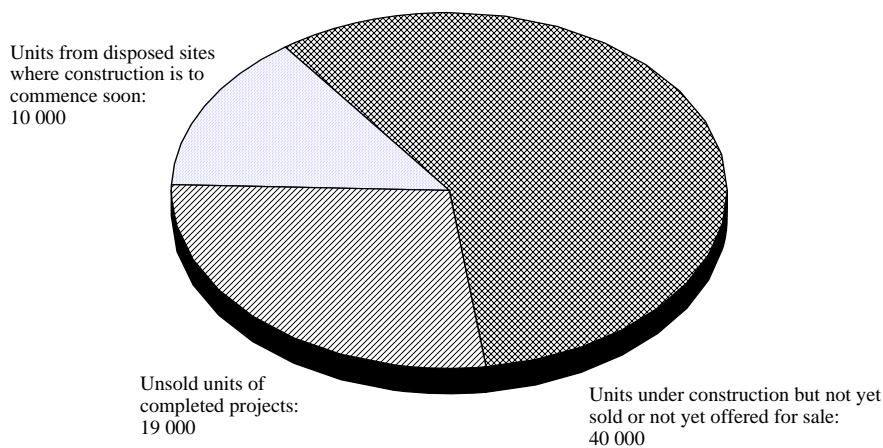


Note : (*) Residential property price index pertains to secondary market transactions only.

4.3 Leasing of residential flats performed steadily throughout 2006, along with a progressive build-up in user demand. Compared with a year earlier, flat rentals rose further by 6.1% in December 2006.

4.4 Affected by the slow-down in primary sales, completions of new private residential flats registered a larger-than-expected decline of 4.3% to 16 600 units in 2006. Yet according to the latest official estimate, the potential supply of new private residential flats would be some 69 000 units in the next 3-4 years. This is more than triple the average annual primary sales in the past five years.

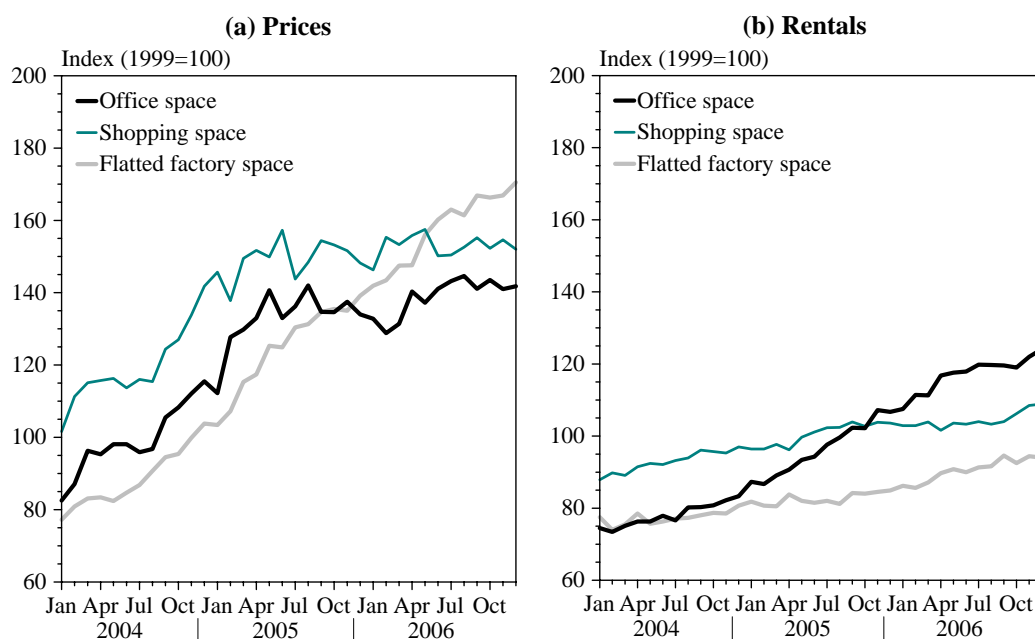
Diagram 4.2 : Supply of new private residential flats* remains quite abundant



Note : (*) Represented by unsold flats of completed and to-be-completed projects according to the administrative record of Housing, Planning and Lands Bureau as at December 2006.

4.5 The *non-residential* segment continued to fare well in 2006. Leasing demand kept strengthening extensively amidst the general trend of business expansion. Comparing December 2006 with a year earlier, the rentals of office and industrial spaces soared further by 16.3% and 10.7% respectively. The rentals of shopping space also rose as retail sales stayed strong, though the increase narrowed to 5.1% after the earlier surge. For office and shopping spaces, leasing of quality premises in prime locations was particularly buoyant. The sanguine leasing outlook, together with attractive market yield, underpinned the price performance against the restraint of interest rate uncertainty. The prices of office and shopping spaces rose moderately further by 5.8% and 2.6% respectively during 2006, while the prices of industrial space leaped by 22.5%.

Diagram 4.3 : Current business upturn providing a solid support to the prices and rentals of non-residential properties



Land

4.6 Following a quiet state in the first half of 2006, property developers turned more active in land acquisition through the *Application List* in the second half as sentiment improved and more prime sites on the List were released for disposal. The number of applications rose from 7 to 19 between the two periods. For 2006 as a whole, five residential sites totalling 3.4 hectares were successfully triggered from the List for sale through auction. The market response was generally favourable, with prices fetched all exceeding the trigger prices by a considerable margin.

4.7 Sale of *new railway sites* keeps drawing considerable market attention due to location advantages, and should constitute an important land supply for property development in the next several years. In 2006, one MTR site and two KCR sites were tendered and awarded after receiving good response. Totalling 12.9 hectares, these three sites are expected to provide about 10 500 residential units upon completion. Regarding *modification of lease* on existing developed and developable land and *exchange of land* in the private sector domain, 53 sites totalling 18.9 hectares and 49 sites totalling 0.9 hectare were approved for private residential and non-residential property developments respectively in 2006.

External transport

4.8 To cater for the fast expansion in passenger and cargo traffic with the rest of the world, the Government has been striving to enhance Hong Kong's external transport network and connectivity. This includes in particular the cross-boundary connection with the Mainland where both internal and external transport infrastructures are being developed rapidly.

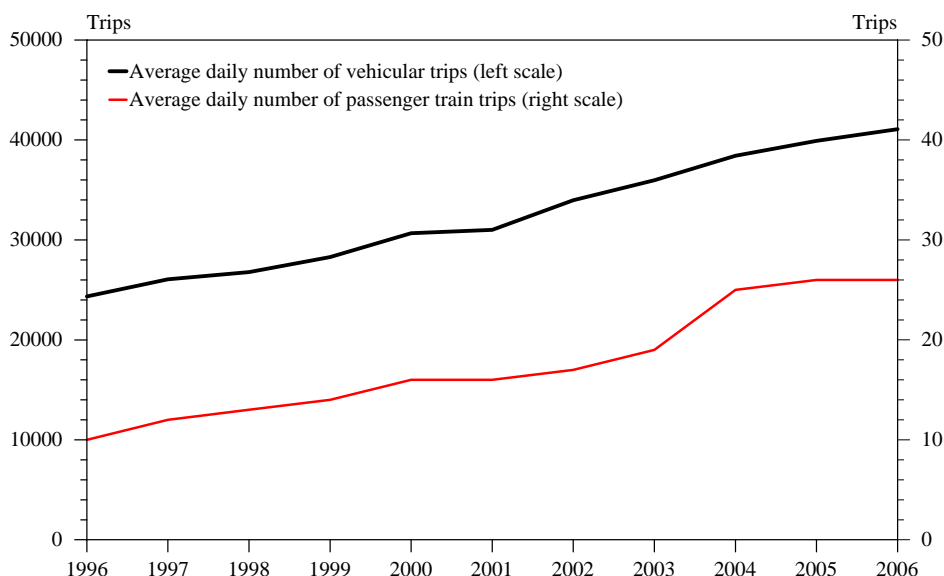
4.9 On *road transport*, Hong Kong and Guangdong are working towards commissioning the Hong Kong-Shenzhen Western Corridor, which will be the fourth vehicular boundary crossing, in mid-2007. At present, works of the Hong Kong section have been completed and those of the Shenzhen Bay Control Point are in progress. On the eastern part of the boundary, Hong Kong and Shenzhen commenced a joint study in December 2006 to establish the need, function and benefits of a new control point in Liantang/Heung Yuen Wai. The Government also embarked on an internal planning study in January 2007 to examine the planning, environmental and engineering issues related to the proposed new control point and the connecting roads within Hong Kong. The two planning studies are scheduled for completion in late 2007 and early 2008 respectively.

4.10 As regards the proposed Hong Kong-Zhuhai-Macao Bridge (HZMB), the governments of Guangdong Province, Hong Kong Special Administrative Region and Macao Special Administrative Region have already reached agreement on the alignment and landing points of the bridge, and are now tackling the outstanding issues of the feasibility study, including the locations of boundary crossing facilities and financing arrangements. The State Council has recently established the HZMB Task Force which is led by the National Development and Reform Commission to help push the project ahead. The first meeting of the Task Force was held in early January 2007.

4.11 On *rail transport*, the Sheung Shui to Lok Ma Chau Spur Line is scheduled for operation in the first half of 2007. Upon commissioning, the Spur Line would help alleviate the prevailing congestion at Lo Wu and significantly enhance the passenger handling capacity of rail crossings. As regards the Guangzhou-Shenzhen-Hong Kong Express Rail Link (ERL), it is being developed to form part of the national high-speed rail network. Through the ERL, Hong Kong will be connected to the major Mainland cities via the Beijing-Guangzhou Passenger Line, Hangzhou-Fuzhou-Shenzhen Passenger Line and the Rapid Transit System. The Hong Kong section is currently under active planning. The Kowloon-Canton Railway Corporation (KCRC) is now

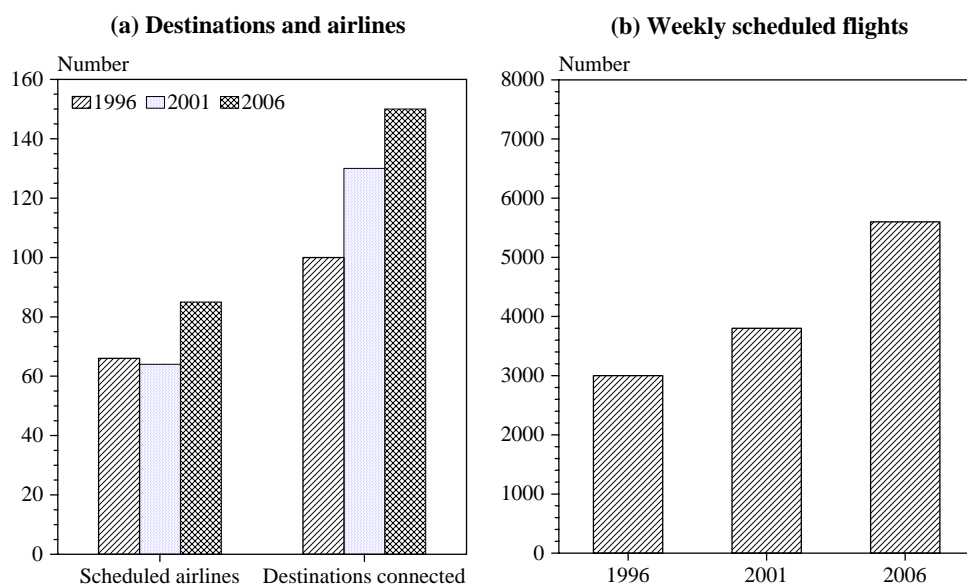
conducting the engineering and operational study, as well as the preliminary site investigation of the project. The Government will decide on the choice of corridor options for the Hong Kong section of the ERL, having regard to the Mainland's latest planning parameters and the report to be submitted by the KCRC.

Diagram 4.4 : Cross-boundary vehicular and train traffic on a distinct rise over the past decade



4.12 In respect of *air transport*, infrastructural projects worth of \$8.1 billion are due for completion in the next few years to further expand the facilities of the Hong Kong International Airport (HKIA). In December 2006, Hong Kong Airport Authority started the tendering process for a new air cargo terminal targeted for completion by 2011, and announced that it would commission a study on the technical and environmental feasibility of a possible third runway for HKIA. Infrastructure apart, the Government will work closely with the civil aviation authorities of the Mainland and Macao to optimize the use of airspace in the Pearl River Delta and open more flight paths. The Government will also keep up efforts to expand air services arrangements with our aviation partners to provide opportunities for airlines to add new routes and increase services.

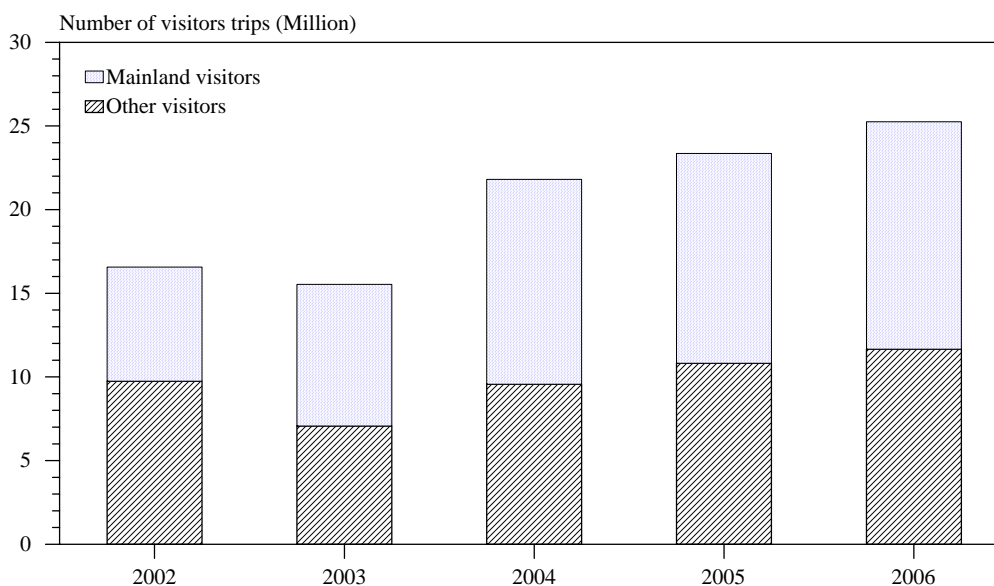
Diagram 4.5 : Progressive enhancement of flight connectivity and frequency underlying the competitiveness of Hong Kong as an aviation hub



Tourism

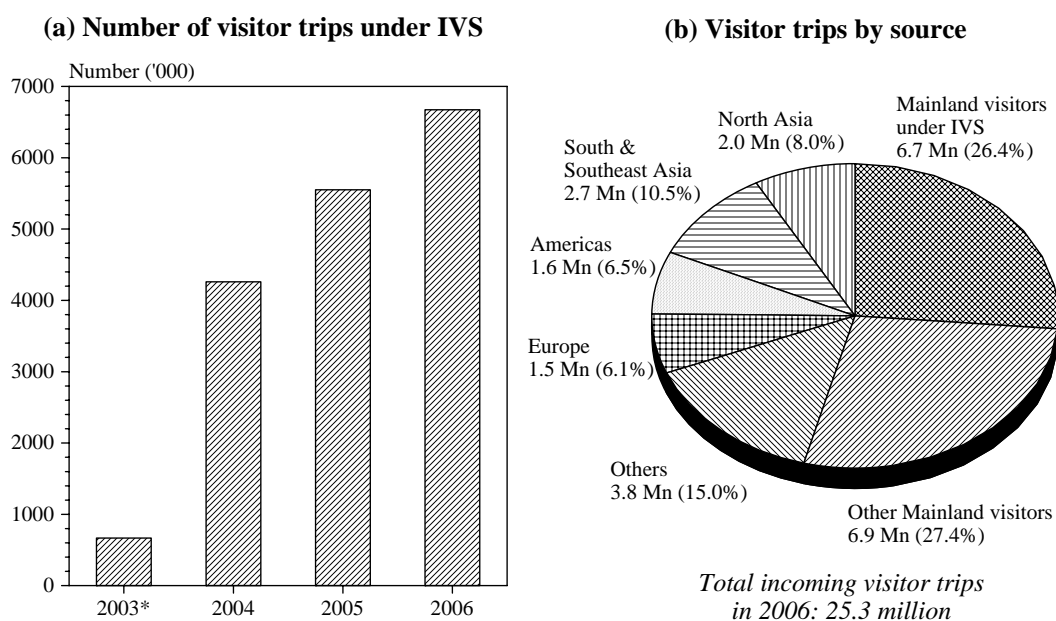
4.13 Inbound tourism advanced further in 2006. The total number of *incoming visitor trips* rose by 8.1% to a new height of 25.3 million, following an increase of 7.1% in 2005. Arrivals from the Mainland rose visibly further by 8.4% in 2006, though the growth pace moderated in the latter part of the year. The growth in arrivals from other regional and long-haul markets generally stayed solid in 2006, under the combined stimulus of global economic growth, intense airfare competition, and weaker US dollar against many currencies.

Diagram 4.6 : Incoming visitor arrivals rose to a new high in 2006



4.14 The tourism industry has continued to benefit from the Individual Visit Scheme (IVS) that enables Hong Kong to better capture the fast-growing outbound tour market in the Mainland. In 2006, the number of visitor trips to Hong Kong under the Scheme rose markedly further by 20.2% to a new high of 6.7 million, with their share in total Mainland arrivals reaching 49%. Following its further extension in January 2007⁽¹⁾, the Scheme now covers 49 cities in the Mainland with a population exceeding 250 million.

Diagram 4.7 : Around one quarter of incoming visitors to Hong Kong are now Mainland visitors under the Individual Visit Scheme (IVS)



Note : (*) IVS was first implemented in July 2003.

4.15 In recent years, Asia's tourism market has been thriving with more intra-regional and long-haul travels. The vast market potentials have induced other major destinations in the region to step up efforts for attracting tourists, thereby intensifying the competition. In order to maintain our competitiveness, the Government has been devoting concerted efforts to launch promotional programmes and uphold service standard through collaboration with the industry. Also, it has been investing heavily in tourism infrastructures. Following the opening of the Disneyland theme park in September 2005, the Hong Kong Wetland Park and Ngong Ping 360 commenced operation in 2006. Looking ahead, the redevelopment of the Ocean Park and construction of a new cruise terminal are in the pipeline.

4.16 Apart from leisure and visits to relatives/friends, the high-yield business visitor segment also constitutes an important portion of incoming visitor trips to Hong Kong, at some 24% in 2006. Increasingly, participation in convention and exhibition activities is a cause of business trips to Hong

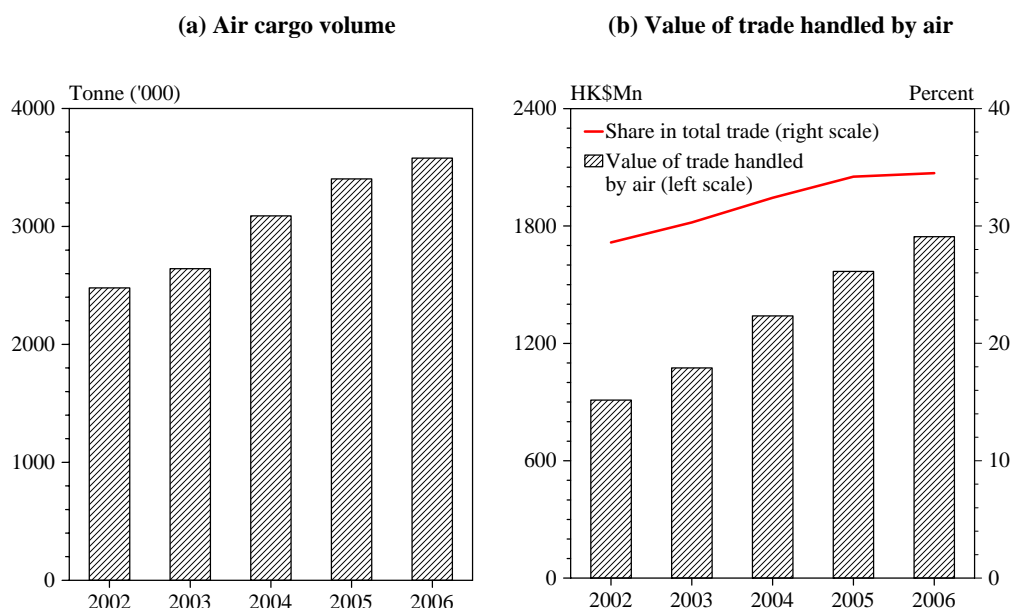
Kong. In 2006, non-domestic participants in conventions and exhibitions surged further by 11% to about 700 000. One growth impetus was provided by the new AsiaWorld-Expo (AWE) which commenced operation in December 2005. Over 40 exhibitions and events have since been held at AWE, and more than 90% of them are held in Hong Kong for the first time. To enhance Hong Kong's position as an international convention and exhibition centre, the Government is pursuing with AWE an early commencement of AWE Phase 2 project. Also it is liaising with the Hong Kong Trade Development Council on further expansion of the Hong Kong Convention and Exhibition Centre.

Logistics and maritime

4.17 The logistics sector showed a steady performance in 2006. Despite intensified competition in the region and on-going structural shift towards offshore trade, both the airport and the port recorded expansion in cargo traffic for the fifth consecutive year. This was underpinned by the sustained vibrancy in Hong Kong's external trade particularly with the Mainland. Besides, frequent services, worldwide network, efficient cargo handling system, and simple and clear customs clearance procedures continued to make Hong Kong an appealing gateway for cargoes.

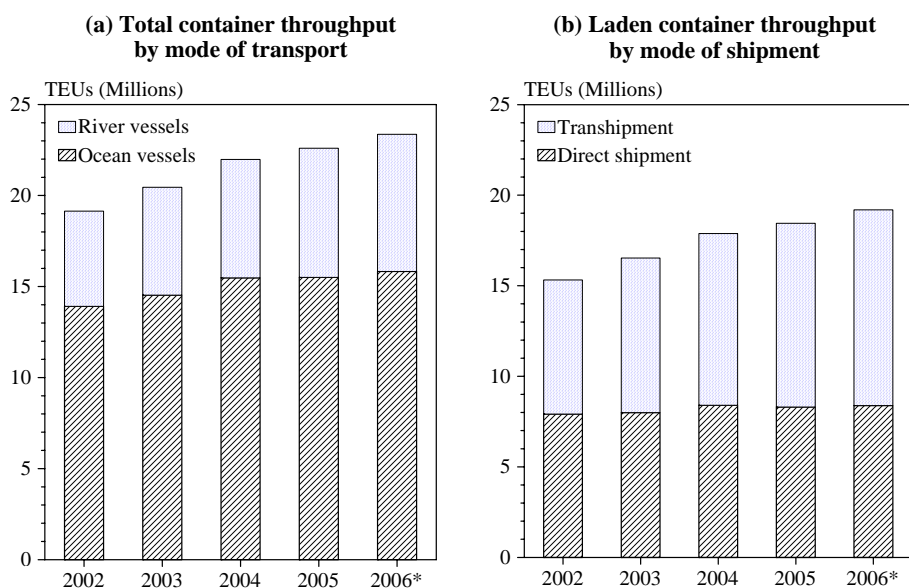
4.18 After two years of double-digit expansion, *air cargo* throughput settled at a slower yet still solid growth of 5.2% to 3.6 million tonnes in 2006. Concurrently, the value of trade (excluding transshipment cargoes) handled by air continued to rise distinctly, by 11.3%. This reflected a rising share of high-value merchandise in air freight, particularly in relation to the Mainland. Of the total value of trade (excluding transshipment cargoes) handled by air, 16.1% was either sourced from or destined for the Mainland in 2006, up markedly from the corresponding figure of 9.4% in 2001.

Diagram 4.8 : Air freight expanded further as it handled more high-value and time-critical merchandise



4.19 On *port cargo*, overall container throughput handled by the Hong Kong port went up by an estimate of 3.1% to 23.3 million TEUs in 2006, following an increase of 2.8% in 2005. Within the total, direct shipment cargo movements recorded a modest increase of 1.0% in the first 11 months of 2006, mainly attributable to a further surge in those cargo flows with the Pearl River Delta handled by the river trade vessels. Meanwhile, transshipment cargo movements expanded steadily by 6.4%.

Diagram 4.9 : River trade and transshipment activities providing the major source of growth in port traffic in 2006



Note : (*) Total container throughput for 2006 is the preliminary estimate by Hong Kong Port Development Council. Its breakdown by mode of transport and the laden container throughput by mode of shipment are crudely estimated from the profile in the first 11 months of 2006.

4.20 To cope with intensified competition in the region, there is an urge for the logistics industry to move up the value chain. An important move in this direction is greater focus towards high value-added logistics to support supply chain management instead of carriage of goods alone. In this connection, the Government has responded by implementing various measures to promote the development of e-logistics and the use of information technologies in logistics activities, such as the radio frequency identification technology. It is also assisting the industry to provide training for logistics practitioners in information technology and automation techniques (see **Box 4.1** for details).

4.21 Hong Kong's maritime industry has all along enjoyed a healthy growth amidst the expansion in local logistics activities and development of the Mainland's shipbuilding industry. As at 1st January 2007, Hong Kong Shipping Register stood amongst the top ten registers in the world, with a total tonnage of 32.5 million gross tonnage and 1 150 registered vessels. However, Hong Kong faces keen competition from other international shipping registers. It is thus necessary to continue efforts in enhancing the quality, standards and scope of our shipping registration services, train up more local talents, seek avoidance of double taxation for shipping income, and actively conduct promotion overseas.

Business services

4.22 As an international business hub and services centre, Hong Kong provides a comprehensive range of quality business services, including legal, accounting and audit, business consultancy, telecommunications, architecture and engineering, etc. In recent years, these sectors have generally flourished amidst economic upturn at home and increasing external demand especially from the Mainland. In 2006, total exports of miscellaneous services⁽²⁾ (comprising mainly professional and business services) grew further by 8.7% in real terms, following an average annual increase of 8.1% during 2000-05. Latest indications in 2005 showed that the direct contribution of the professional and business service sectors taken together to GDP and total employment in Hong Kong likewise rose to about 11%.

4.23 Under the latest package of CEPA liberalisation measures announced in June 2006, there have been further preferential treatments to Hong Kong service suppliers in a number of service areas when setting up operation in the Mainland as from January 2007. Examples are legal, construction engineering

cost consultancy, information technology, and convention and exhibition services. The measures are expected to foster expansion into the Mainland market by the sectors concerned. The business connections thus resulted would also help to reinforce the competitiveness of Hong Kong as the platform for Mainland enterprises to “go out” and also for foreign enterprises to expand into the Mainland market.

Box 4.1

Value added logistics

Logistics involves a broad spectrum of activities that mainly covers planning, implementation and control of flows of goods, services and information from the point of origin to the point of consumption. Conventionally, it features most significantly in transportation and cargo forwarding activities. Yet the landscape of the industry has gradually evolved towards greater emphasis on high value added logistics (VAL), essentially an integrative profile that incorporates processes designed to efficiently support and facilitate different elements in the supply chain. This tendency is particularly apparent for more mature logistics hubs like Hong Kong and Singapore where competitive edge has become more by service breadth and depth.

The emergence of VAL is closely related to the growing importance of supply chain management under globalisation. Global market expansion and liberalisation have extended the supply chain to cover more and more regions, as manifested by increased international procurement and marketing activities as well as offshore trade. These developments require more effective supply chain management that has to be built upon an integrative set of specialised logistics services.

Examples of specialised services in value added logistics

- Product labelling and packaging
- Light assembling between pickup and delivery
- Transportation management
- Inventory management
- Customs clearance
- Shipment consolidation
- Cargo tracking and tracing
- Supply chain consultancy

Globalisation has also led to intensified competition in the international market that boosts the demand for VAL to cope with the challenge. By enabling an effective supply chain, VAL can lower the transportation and warehousing costs substantially. Moreover, it can uplift the efficiency and flexibility in delivering different bundles of goods to different destinations with unique requirements in terms of quantity, quality and variety. Furthermore, it can help to ensure timeliness in goods delivery and replenishment that have turned more time-critical as the product cycles shorten generally.

VAL should not have prospered as much without technological support. Application of information technology, in particular, has enabled a rapid advancement in the sophistication of logistics services and their effective integration with each other. For example, the distinct improvement in information flows enabled by information technology helps to modernise the inventory management practice and facilitate its convergence with cargo tracing and forwarding activities.

Box 4.1 (cont'd)

A related development worth of note is that the sophistication embedded in VAL has bolstered the presence of independent specialised service providers. Many client enterprises, especially those in small to medium size, now opt to outsource part or entirety of their logistics activities to third-party logistics (3PL) companies. The moves are commonly triggered by limitation in internal resources or inclination to focus more on the core part of their businesses. Many of them are also attracted by the value-for-money services by the 3PL companies that excel in cost control and quality assurance through specialisation.

The economic contribution of VAL in Hong Kong is difficult to measure as its ambit cuts across different industries. Yet there is a market consensus that its development has helped our integral sector of trading and logistics to cope with keener competition in the region in recent years, and hence sustain its growth. In particular, VAL fosters the development of offshore trade as a rising source of income in this sector. Latest indications in 2005 showed that the direct contribution of the trading and logistics sector to GDP rose further to 28.6%. The value of goods involved in offshore trade managed or owned by Hong Kong companies was roughly equal to the value of our re-export trade.

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Trading and logistics sector				
Direct value added (\$Bn)	308.3	316.9	346.9	384.9
Contribution to GDP (%)	25.0	26.3	27.6	28.6
Offshore trade				
Value of goods involved (\$Bn)	1,458.2	1,666.6	1,835.8	2,087.1
Ratio to re-export in value (%)	102.0	102.8	97.0	98.7

Looking ahead, the Mainland's economic development is expected to present both opportunities and challenges for our logistics sector generally and further development of VAL in particular. On the one hand, the Mainland's robust external trade should provide vast market potentials for specialised logistics services. It is also optimistic that more opportunities would be available for the Hong Kong 3PL companies to develop VAL businesses in the Mainland as its domestic market opens up further. On the other hand, there would be keener competition from logistics service providers of other origins. Competitors also include the indigenous logistics companies in the Mainland that have chased up quickly in service standard through application of technologies and accumulation of market experience.

In order to reap the opportunities and meet the challenges ahead, the logistics industry in Hong Kong must, amongst all, sharpen its competitive edge in VAL. In addition to freight handling efficiency and capacity, continued progress in information connectivity is important. In this regard, the Government has been working closely with the industry towards harnessing the use of information technology in logistics activities. Recently, the Focus Group on Maritime, Logistics and Infrastructures under the Economic Summit on "China's 11th Five-Year Plan and the Development of Hong Kong" has recommended an action agenda to promote the application of information technology in the logistics industry. It specifically calls for joint efforts between the Government and the industry to promote the implementation of the Digital Trade and Transport Network System, run a pilot project on an On-Board Trucker Information System, and strengthen the training for logistics practitioners in e-logistics techniques, etc.

Innovation and technology

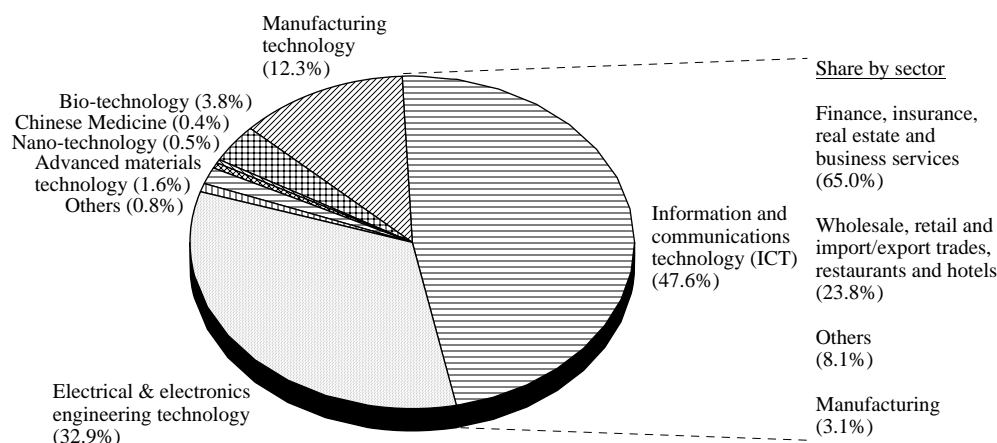
4.24 The Government kept up its efforts on promoting the development of innovation and technology in 2006. Five new government-funded R&D centres and the InnoCentre commenced operation during the year. Funding support from the Innovation and Technology Fund and the DesignSmart Initiative continued. Additional funding would be earmarked for the Hong Kong Design Centre to further promote the use of design. On-going efforts were also made to foster an innovation and technology culture through such programmes as Innovation Festival and Hong Kong Student Science Project Competition. In the area of information and communications technology (ICT), the Government is updating the Digital 21 Strategy, the blueprint for ICT development, with due regard for international developments and Hong Kong's social and economic needs⁽³⁾.

4.25 The development of innovation and technology not only matches with the restructuring of Hong Kong towards a knowledge-based economy, but also enables it to contribute to the national economic development and seize the opportunities it presents. One of the emphases under the national 11th Five-Year Plan endorsed in March 2006 is on autonomous innovation and upgrading of the overall hi-tech capability and technology level of the industries. In response, a focus group under the Economic Summit on "China's 11th Five-year Plan and the Development of Hong Kong" has proposed various initiatives for Hong Kong to grasp this opportunity to raise our innovation capacity, upgrade our technology level and promote our innovation, technology and information services to the Mainland market. Examples include more active participation in the process of development and formulation of product and technology standards in the Mainland, closer technological collaboration with Shenzhen, and promotion of Hong Kong as a premium location for data centres in the region, etc.

4.26 With the evolving opportunities and challenges in the market and the supportive policy framework, the business community in Hong Kong has more actively engaged in innovation and technology activities in recent years. Latest indications in 2005 reveal that business expenditure on in-house R&D activities rose markedly further by 22.5% to \$5.6 billion, bringing the total business expenditure on scientific and technological innovations to a new high of \$18.5 billion. The latter represented 1.3% of GDP in 2005, up from 0.5% in 2001. Of the total business expenditure on R&D, about half were related to ICT mainly undertaken by the service sectors, such as finance, trading and logistics. The other half was largely related to industrial production for the

sake of new products and improvement in production methods. Many of these activities were undertaken by Hong Kong companies with their manufacturing base in the Pearl River Delta region.

Diagram 4.10 : Industrial production apart, business expenditure on R&D are also geared to harness the use of ICT in service activities



Total business expenditure on R&D in 2005 : \$5,622 million

Notes :

- (1) See Note (3) to Chapter 3 for details on the extended coverage of the Individual Visit Scheme as from January 2007.
- (2) According to the current statistical classification, the figures here cover communications services; computer and information services; royalties and licence fees; personal, cultural and recreational services; construction services; architectural, engineering and other technical services; legal services; accounting services; business and management consultancy services; advertising and market research services etc. However, finance, insurance, transportation, travel, merchandising and other trade-related services are classified elsewhere.
- (3) The Digital 21 Strategy was first published in 1998 by the Government to set out the vision of developing Hong Kong into a leading digital city in a globally connected world. The strategy is aimed to outline how the Government, business, industry, academia and the public can work together to achieve this goal. To take account of advances in technology and changing needs of the community, the Strategy requires constant review. Previous updates were made in 2001 and 2004. Following the two-month public consultation that ended in mid-December 2006, it is aimed to finalise and publish the 2007 Digital 21 Strategy in 2007. The theme underpinning the latest Strategy is “continuing to build on our strengths through technology across the community”, with the objective of strengthening Hong Kong’s position as a world digital city.

CHAPTER 5 : THE FINANCIAL SECTOR[#]

Summary

- *The financial sector did very well in 2006 and rendered substantial growth impetus to the Hong Kong economy, thanks much to the increasing financial integration with the Mainland.*
- *The monetary conditions remained accommodative and conducive to sustained strong economic expansion. The Hong Kong dollar weakened against most major currencies along with the US dollar during the year.*
- *Reflecting the abundant liquidity in the local banking sector, interbank interest rates softened in the second half of 2006. Money supply and bank loans both expanded further in the year. Asset quality of the banking sector likewise continued to change for the better, in tandem with the strengthening economic fundamentals.*
- *The local stock market displayed a spectacular performance in 2006, boosted by enormous capital inflow, strong economic fundamentals and also hectic fund raising activities. The Hang Seng Index broke the 20 000 mark in late December, whilst the market capitalisation surpassed the \$13 trillion mark and became the sixth largest in the world at year-end. Average daily turnover also surged to a record high.*
- *Following the Economic Summit on "China's 11th Five-Year Plan and the Development of Hong Kong" in September 2006, the Focus Group on Financial Services proposed in January 2007 a policy direction of positioning and developing Hong Kong as China's international financial centre of global significance, with a view to allowing Hong Kong to contribute to the economic development and financial reform of the Mainland in a more significant manner.*

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

Overall situation

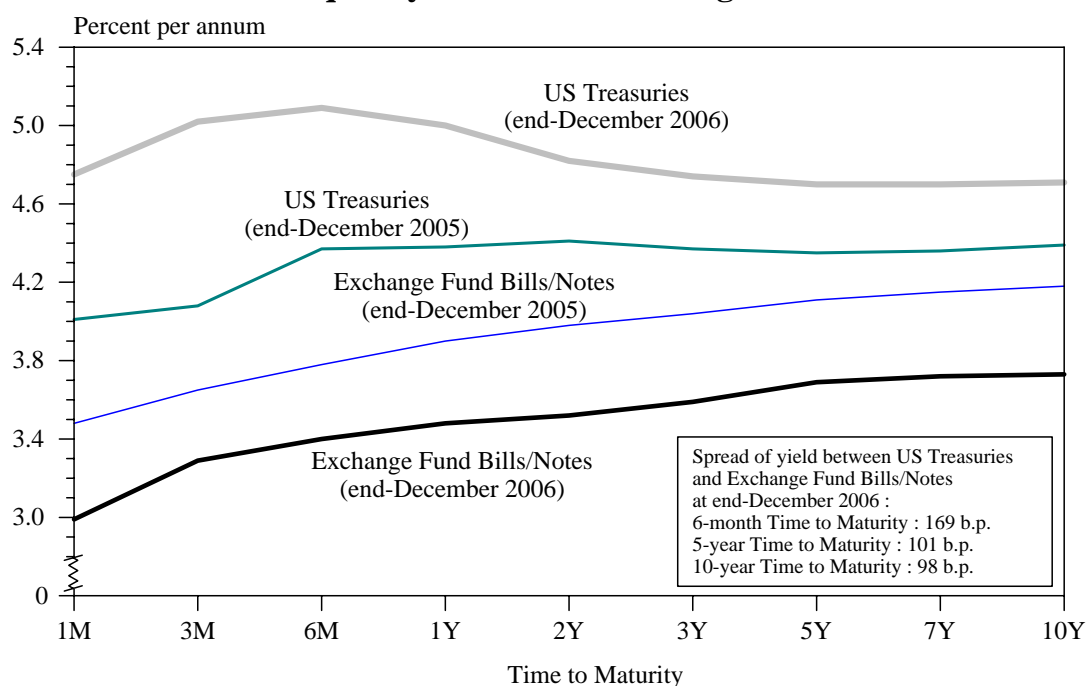
5.1 The financial sector, being one of the key growth drivers in recent years, continued to display strength in 2006 amidst the sustained economic upturn. Benefiting from the pause in US interest rate hikes and substantial funds inflow, interbank rates edged lower towards the year-end and helped to maintain largely accommodative monetary conditions for the economy to forge ahead. Bank loans grew steadily, whilst money supply registered a marked increase on the back of rising household and corporate incomes, as well as huge capital inflows. Meanwhile, the local stock market enjoyed a particularly robust performance, partly boosted by buoyant fund raising activities especially those involved initial public offerings (IPO) of new stocks which generally received enthusiastic responses. Funds raised in the debt market also increased, whilst various fund management businesses showed further notable growth, thereby providing further impetus for Hong Kong to develop into a regional bond centre as well as an asset management centre.

5.2 As a follow-up work to the Economic Summit on "China's 11th Five-Year Plan and the Development of Hong Kong", the Focus Group on Financial Services submitted its report together with the proposed Action Agenda to the Chief Executive in mid-January 2007. The Focus Group was of the view that under the "One Country, Two Systems" principle, the financial systems in the Mainland and Hong Kong should establish a complementary, cooperative and interactive relationship, and it proposed to further develop Hong Kong as China's international financial centre of global significance. In turn, this would help to raise the efficiency of financial intermediation and support the financial system reform and development in the Mainland. Specifically, the Focus Group has recommended a five-pronged strategy to pursue the policy direction: (i) to enhance the presence of financial intermediaries in the Mainland to provide financial services on location; (ii) to enhance the outward mobility of Mainland investors, fund raisers and financial intermediaries; (iii) to allow financial instruments issued in Hong Kong to be marketed in the Mainland; (iv) to enhance the capability of Hong Kong's financial system in handling financial transactions denominated in renminbi; and (v) to strengthen financial infrastructural linkages between the Mainland and Hong Kong. To put these into micro and market-specific perspectives, the proposals involve the further deepening and broadening of Hong Kong's securities market; the development of renminbi futures and options markets as well as a commodities futures market in Hong Kong; and also increased penetration of Hong Kong's insurance and asset management institutions into the Mainland markets.

Interest rates, aggregate balance and exchange rates

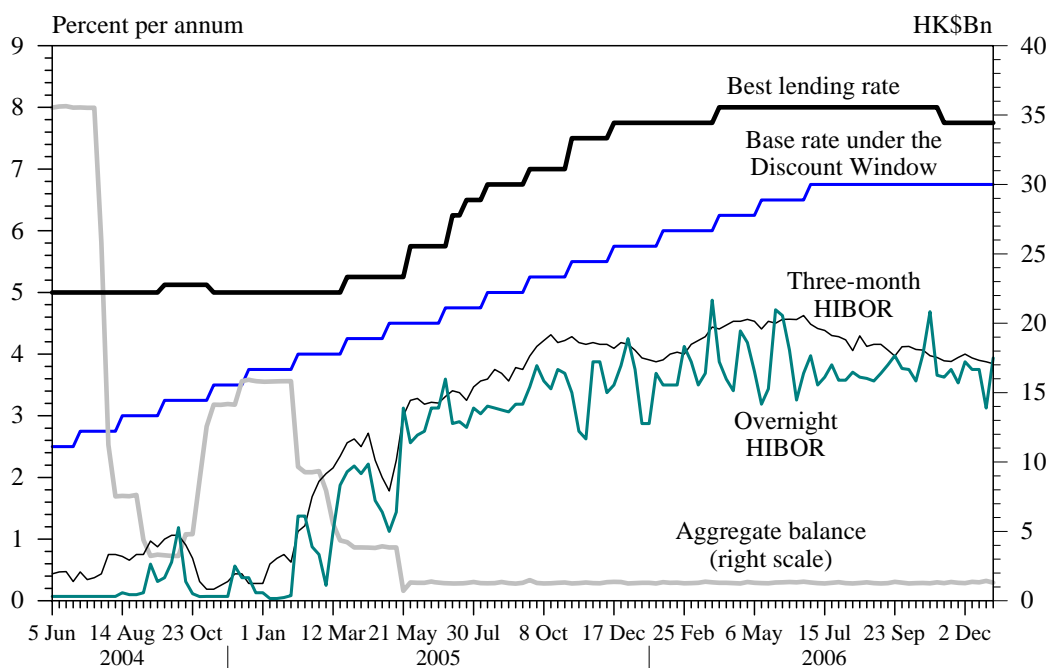
5.3 Hong Kong dollar interest rate moved up further in the first half of 2006, along with the uptrend in the US dollar interest rates. The Base Rate under the Discount Window operated by the HKMA was adjusted upward four times during the first half by a cumulative of 100 basis points to 6.75% at end-June 2006, mirroring the increases in the US Fed Funds Target Rate⁽¹⁾. Yet as a result of the pause in interest rate hikes in the US since then, the Base Rate remained unchanged in the second half of the year. However, thanks to ample liquidity in the local banking sector, Hong Kong dollar interbank interest rates moved up by a lesser extent than their US counterparts in the first half, and even fell back in the second half. As a result, the discount of three-month HIBOR over the corresponding Euro-dollar deposit rate progressively widened from 37 basis points at end-December 2005 to 99 basis points at end-June 2006, and further to 150 basis points at end-December 2006. Meanwhile, the Hong Kong dollar yield curve moved downwards during 2006 and lied further below its US counterpart.

Diagram 5.1 : The gap between Hong Kong dollar yield curve and its US counterpart widened in 2006, amidst abundant liquidity in the local banking sector



5.4 At the retail level, the deposit rates and the best lending rates showed diverse movements across different banks in 2006, reflecting the different cost structure and funding costs of the banks. Following the increases in the first quarter, the commercial banks generally kept the deposit and best lending rates unchanged during most of the year despite the ensuing increases in Base Rate by the HKMA. In the fourth quarter, some commercial banks even slashed their best lending rates and deposit rates, amidst the abundant supply of funds and increased competition in the local banking sector. Reflecting this, the composite interest rate, which indicated the average cost of funds of banks, rose from 2.88% at end-December 2005 to 3.16% at end-June 2006, but then eased back to 2.86% at end-December 2006⁽²⁾. At end-December 2006, there were still two best lending rates of 7.75% and 8% in the market. On the other hand, the Aggregate Balance remained broadly stable at around HK\$1.3 billion throughout the year.

Diagram 5.2 : Aggregate balance in the banking system remained stable, while interbank interest rates edged lower in the second half of 2006 (end for the week)



5.5 The Hong Kong dollar, having hovered near the strong side of the Convertibility Zone in the first five months of 2006, softened gradually against the US dollar from June to September, partly reflecting increased arbitrage activities given the widening US-Hong Kong interest rate differentials. Yet there was some bounce-back in the fourth quarter, amidst substantial capital inflows associated with a number of large-scale IPO activities. The spot exchange rate of Hong Kong dollar against the US dollar closed at 7.7745 at end-December 2006, compared with 7.7525 at end-December 2005. Nevertheless, the discount of the twelve-month Hong Kong dollar forward rate

over the spot rate widened notably from 255 pips (each pip equivalent to HK\$0.0001) to 977 pips over the same period, reflecting the lingering speculative pressure on further renminbi appreciation.

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. After a moderate rebound in 2005, the US dollar weakened against major currencies including the Pound Sterling and the Euro, as well as against most Asian currencies except the Japanese Yen. As a result, the trade-weighted Nominal and Real Effective Exchange Rate Indices⁽³⁾ of the Hong Kong dollar dropped by 4.5% and 3.9% respectively during 2006.

Diagram 5.3 : The Hong Kong dollar softened slightly against the US dollar, but forward spread widened (end for the week)

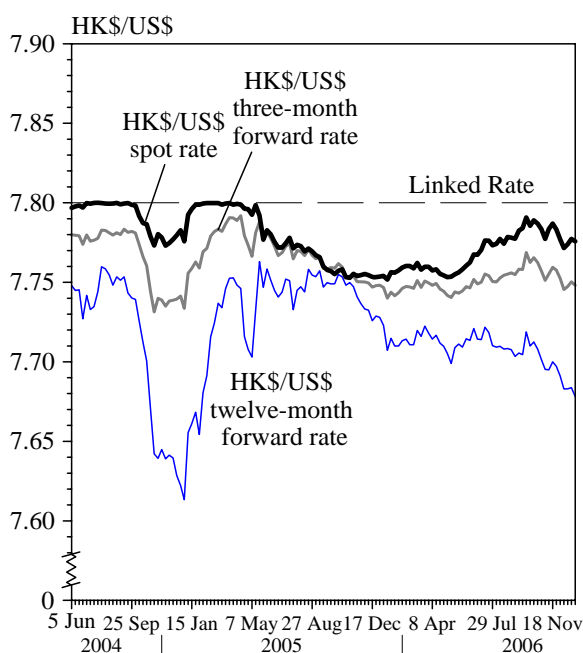
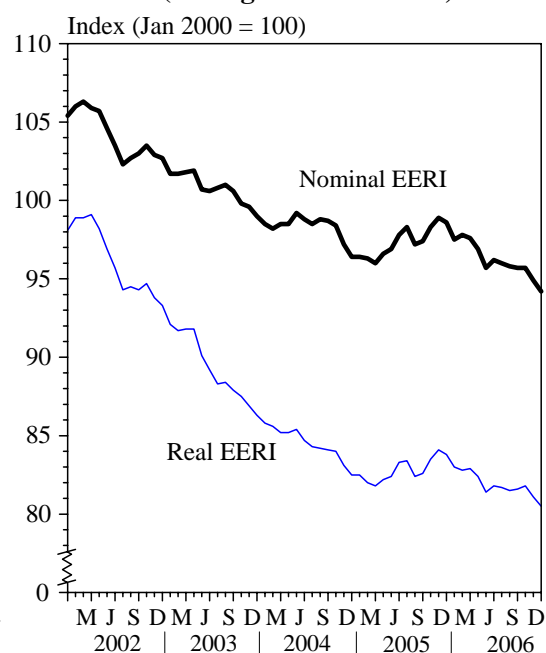


Diagram 5.4 : Trade-weighted Effective Exchange Rate Index of the Hong Kong dollar fell during 2006 in tandem with the weakening US dollar (average for the month)



Money supply and deposits

5.7 The monetary conditions remained largely accommodative in 2006, underpinning the brisk economic expansion. Both narrow and broad money supply recorded notable increases. The seasonally adjusted Hong Kong dollar narrow money supply (HK\$M1)⁽⁴⁾ leaped by 11.6% at end-December 2006 over a year earlier, reflecting increases in Hong Kong dollar demand deposits amidst buoyant fund-raising activities and hectic stock market turnover. Hong Kong dollar broad money supply (HK\$M3) rose even more, by 19.2% over the same period, along with the strong increases in savings and time deposits.

Table 5.1 : Hong Kong dollar money supply and total money supply

% change during the quarter		<u>M1</u>		<u>M2</u>		<u>M3</u>		
		<u>HK\$</u>	<u>Total</u>	<u>HK\$^(a)</u>	<u>Total</u>	<u>HK\$^(a)</u>	<u>Total</u>	
2005	Q1	-6.2	(-3.1)	-4.2	-0.3	-0.1	-0.2	*
	Q2	-6.8	(-4.6)	-5.6	0.6	0.1	0.6	0.1
	Q3	-2.8	(-2.4)	-1.6	2.9	1.8	3.0	1.9
	Q4	-0.7	(-4.9)	0.8	2.2	3.2	2.2	3.2
2006	Q1	2.5	(3.9)	1.0	5.3	3.3	5.3	3.3
	Q2	-1.0	(1.5)	1.9	2.2	2.5	2.2	2.5
	Q3	3.9	(4.2)	5.1	5.8	4.7	5.8	4.7
	Q4	5.6	(1.6)	4.5	4.8	4.3	4.7	4.3
Total amount at the end of December 2006 (HK\$Bn)		388	(380)	492	2,778	5,063	2,796	5,099
% change over a year earlier		11.4	(11.6)	13.1	19.2	15.6	19.2	15.7

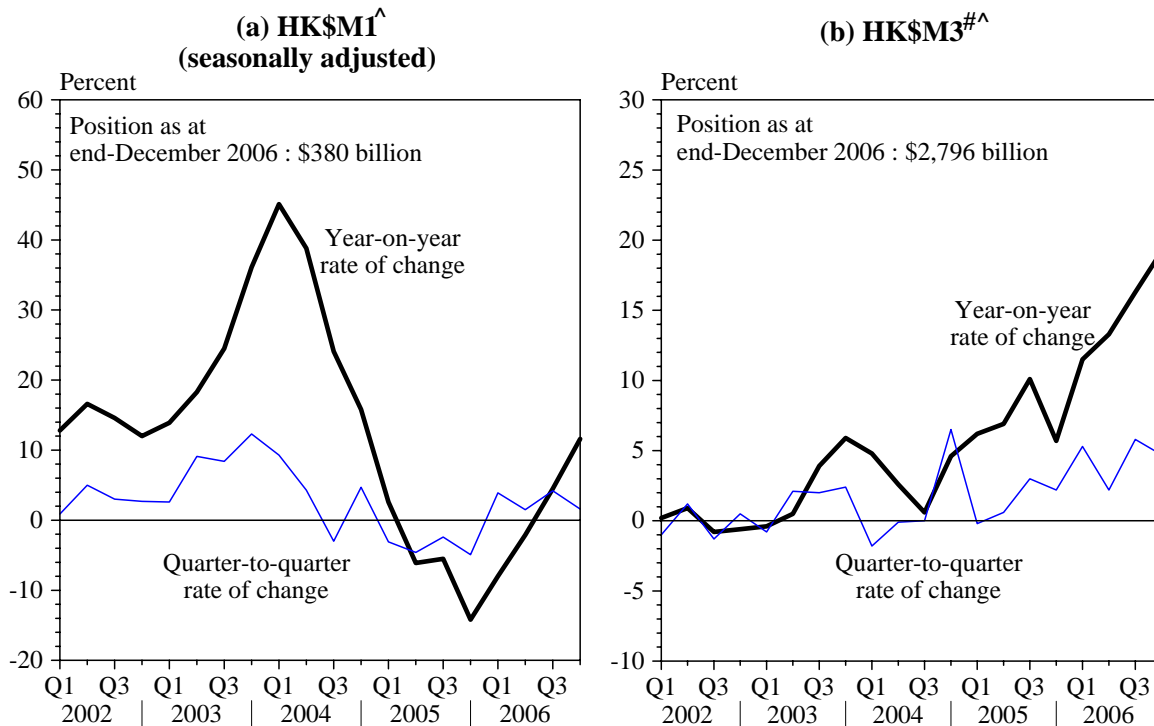
Notes : (a) Adjusted to include foreign currency swap deposits.

() Figures in brackets represent percentage changes on the basis of the seasonally adjusted series of HK\$M1. Seasonality is not apparent for the other monetary aggregates.

(*) Change of less than 0.05%.

5.8 Total deposits with authorized institutions⁽⁵⁾ expanded noticeably by 17.2% to \$4,766 billion (comprising Hong Kong dollar deposits of \$2,568 billion and foreign currency deposits of \$2,198 billion) at end-December 2006 over a year earlier, as household and corporate incomes improved amidst the sustained economic upturn.

Diagram 5.5 : Money supply expanding notably along with the strong economic expansion



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

(#) Adjusted to include foreign currency swap deposits.

Loans and advances

5.9 Total loans and advances increased by 6.7% to \$2,468 billion (comprising Hong Kong dollar loans of \$1,917 billion and foreign currency loans of \$550 billion) at end-December 2006 over a year earlier, alongside the economic expansion. Loans analysed by economic uses however displayed diverse movements. The largest increase was seen in loans to stockbrokers, reflecting the hectic stock market activity and increased borrowing to finance the subscription for IPOs. Loans for property development and investment, trade financing and financial concerns also picked up in 2006. However, the outstanding stock of residential mortgage loans declined during the year, reflecting mainly the moderated trading activity in the residential property market. As Hong Kong dollar deposits rose much faster than Hong Kong dollar loans during 2006, the Hong Kong dollar loan-to-deposit ratio decreased from 84.3% at end-2005 to 74.7% at end-2006, the lowest on record.

Table 5.2 : Loans and advances for use in Hong Kong by major usage

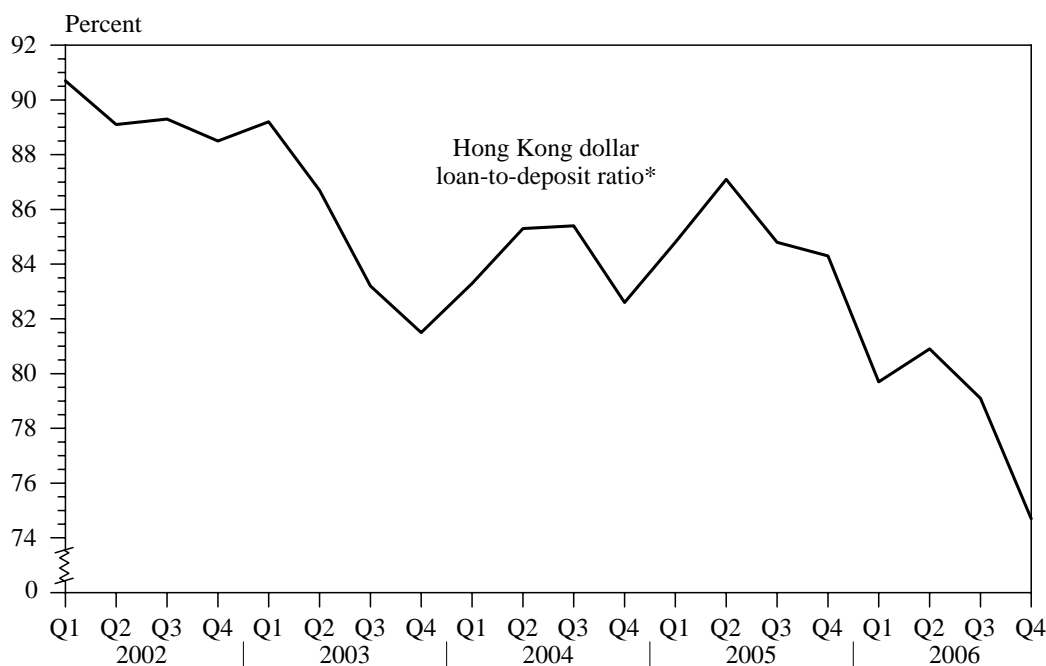
		Loans to :							All loans and advances for use in Hong Kong^(b)
		Finance visible trade	Manu- facturing sector	Whole- sale and retail trade	Building, construction, property development and investment	Purchase of residential property ^(a)	Financial concerns	Stock- brokers	
<u>% change during the quarter</u>									
2005	Q1	2.4	8.1	-0.6	4.3	0.6	-0.8	5.8	1.6
	Q2	12.6	7.4	5.9	2.7	1.1	3.4	10.9	4.0
	Q3	-1.9	-2.4	-1.6	2.1	-1.1	2.2	-7.8	*
	Q4	-3.8	6.4	-1.2	7.6	-1.3	1.0	-36.6	2.0
2006	Q1	-2.4	-1.9	0.9	0.6	-1.1	3.6	5.3	-0.3
	Q2	10.1	3.7	1.9	5.7	-0.6	-1.3	-6.0	2.8
	Q3	4.9	-5.0	0.1	-0.9	-0.5	4.9	620.6	1.5
	Q4	-4.7	-1.6	1.9	4.1	0.3	-2.5	-82.5	-1.3
Total amount at end-December 2006 (HK\$Bn)		152	104	105	492	595	185	8	2,127
% change over a year earlier		7.4	-5.0	4.9	9.7	-2.0	4.6	24.6	2.7

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 fell to its all-time low by end-2006 as deposits rose much faster than loans



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

Banking

5.10 Asset quality of the local banking sector improved further over the course of 2006, alongside the sustained economic upturn. The ratio of classified loans to total loans of retail banks fell further from 1.37% at end-December 2005 to 1.19% at end-September 2006. Over the same period, the arrears for over three months in *credit card repayment* edged up slightly to 0.40% from 0.37%. Separately, the delinquency ratio for *residential mortgage loans* remained broadly stable throughout 2006 and stood at 0.20% at end-December 2006, compared with 0.19% at end-December 2005. The consolidated capital adequacy ratio for local banks averaged at a strong level of 15.0% at end-September 2006, well above the minimum international standard of 8% set by the Bank for International Settlements.

5.11 Hong Kong has implemented the new Basel II capital adequacy framework for banks since 1 January 2007. This followed the passage of the Banking (Capital) Rules and the Banking (Disclosure) Rules in November 2006 prescribing how the capital adequacy ratio (CAR) of Hong Kong incorporated AIs shall be calculated and what information on the state of affairs, profit and loss and CAR shall be publicly disclosed under the new framework. The aim

of implementing the new framework is to align regulatory capital requirement more closely with the inherent risks of banks, and encourage banks to improve internal risk management. Adopting the latest international banking standards in this respect will contribute to the safety and soundness of the banking system in Hong Kong and help to strengthen the position of Hong Kong as a leading international financial centre.

Table 5.3 : 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)
2005 Q1	94.30	3.75	1.95
Q2	95.05	3.21	1.74
Q3	95.26	3.25	1.49
Q4	95.97	2.66	1.37
2006 Q1	95.97	2.71	1.32
Q2	96.15	2.55	1.29
Q3	96.44	2.37	1.19

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 2006, a total of 38 licensed banks were engaged in renminbi banking business in Hong Kong. Renminbi deposits with authorized institutions remained largely stable during 2006, amounting to RMB 22.7 billion yuan at end-December 2006, slightly up from that of RMB 22.6 billion yuan at end-December 2005. Over the same period, the share of renminbi deposits in total foreign currency deposits with all authorized institutions fell from 1.12% to 1.03%, mainly due to widening interest rate differentials between renminbi and other major foreign currencies.

Table 5.4 : Renminbi deposits in licensed banks

<u>As at end of</u>		Demand and savings deposits ^(b) (RMB Mn)	Time deposits (RMB Mn)	Total deposits (RMB Mn)	<u>Interest rates on^(a)</u>		Number of licensed banks engaged in RMB business
					<u>Saving deposits^(c)</u> (%)	<u>Three-month time deposits^(c)</u> (%)	
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	10,620	11,966	22,586	0.46	0.65	38
2006	Q1	10,682	11,776	22,458	0.46	0.65	39
	Q2	11,285	11,427	22,712	0.46	0.65	39
	Q3	11,355	11,264	22,619	0.46	0.65	40
	Q4	12,001	10,721	22,722	0.46	0.65	38

Notes : (a) The interest rates are sourced from a survey conducted by the HKMA.

(b) Before March 2006, figures referred to savings deposits only.

(c) Period average figures.

The debt market

5.13 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. In 2006, gross issuance of Hong Kong dollar debt expanded by \$52 billion over 2005 to \$454 billion. At end-December 2006, the total outstanding value of all Hong Kong dollar debt securities rose further by 12.7% over a year earlier to \$748 billion⁽⁶⁾. This was 2.6 times that the level a decade ago, and was equivalent to 27% of HK\$M3, or 21% of the Hong Kong dollar-denominated assets of the entire banking sector⁽⁷⁾. Around 74% of the outstanding debts were issued by the private sector and Multilateral Development Banks, while the remaining 26% were issued by the public sector, including mainly Exchange Fund papers and debt issued by the Government and statutory organizations.

5.14 In recognition of Hong Kong's sound economic fundamentals, strong financial position, as well as a noted resilience to adverse economic shocks, a number of rating agencies upgraded Hong Kong's foreign currency ratings during 2006. Following these upgrades, Hong Kong has now attained AA-category ratings by all major international credit rating agencies. These ratings are the highest that Hong Kong has achieved. Furthermore, Standard

and Poor's (S&P's) published a report in January 2007 and opined that in economic and financial terms, Hong Kong compared well with those "AAA" rated economies such as Ireland, Singapore, Switzerland, the UK and the US. According to S&P's, Hong Kong has a high-income and diversified economy, a well-regulated financial sector, an exceptionally strong net external asset position, as well as brighter economic growth prospects than most in the "AAA" category, which all underpin Hong Kong's strong credit standing. The above developments would help to lower the borrowing costs for Hong Kong companies and create a favourable environment for sustained economic growth and development.

5.15 On 10 January 2007, the State Council announced its agreement in principle for financial institutions on the Mainland, upon obtaining approval, to issue renminbi-denominated financial bonds in Hong Kong. The sale and distribution of renminbi bonds, trading, settlement and custody and pricing in Hong Kong will follow the normal Hong Kong market practices. The new business will become operational once the Hong Kong renminbi Real Time Gross Settlement (RTGS) system is established, related administrative arrangements on the Mainland are introduced and relevant clearing agreements are revised. In this connection, a supplementary memorandum of co-operation was signed by the People's Bank of China (PBoC) and the HKMA in the subsequent week to expand the relevant co-operative arrangements to cover the new category of renminbi business. The PBoC likewise announced that it would, upon having obtained approval by the State Council, expand the scope of clearing and position-squaring arrangements provided for renminbi business conducted by Hong Kong banks. The opening up of this new category of renminbi business will provide channels for returning renminbi circulating in Hong Kong back to the Mainland, thereby further promoting economic integration between the two places and reinforcing Hong Kong's position as an international financial centre.

Table 5.5 : New issuance and outstanding value of HK dollar debt securities (HK\$Bn)

		Exchange <u>Fund paper</u>	Statutory bodies/govern ment-owned <u>corporations</u>	Govern- ment <u>ment</u>	Public sector <u>total</u>	<u>AIs</u> ^(a)	Local <u>corporates</u>	Non-MDBs overseas <u>borrowers</u> ^(b)	Private sector <u>total</u>	<u>MDBs</u> ^(b)	<u>Total</u>
New Issuance											
2005	Annual	213.8	8.5	-	222.3	62.6	9.9	105.4	177.9	1.8	402.0
	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	40.9	0.7	97.6
	Q4	54.4	3.0	-	57.4	12.8	1.7	13.5	28.0	-	85.4
2006	Annual	220.5	17.4	-	237.9	44.9	21.3	147.0	213.2	3.0	454.1
	Q1	54.4	6.9	-	61.3	14.1	7.0	35.6	56.7	0.2	118.2
	Q2	55.6	3.5	-	59.1	12.0	1.2	42.0	55.2	-	114.3
	Q3	54.1	2.6	-	56.7	10.0	7.0	35.5	52.5	1.8	111.0
	Q4	56.4	4.4	-	60.8	8.8	6.1	33.9	48.8	1.0	110.6
Outstanding (period-end figures)											
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
2006	Q1	127.9	59.3	10.3	197.5	154.3	44.7	270.0	469.0	17.5	684.0
	Q2	129.3	54.0	10.3	193.6	152.9	43.3	295.3	491.5	17.1	702.2
	Q3	130.4	54.1	7.7	192.2	151.7	48.0	312.5	512.2	18.5	722.9
	Q4	131.8	56.9	7.7	196.4	147.4	52.4	332.4	532.2	19.5	748.1

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

(a) AIs : Authorized Institutions.

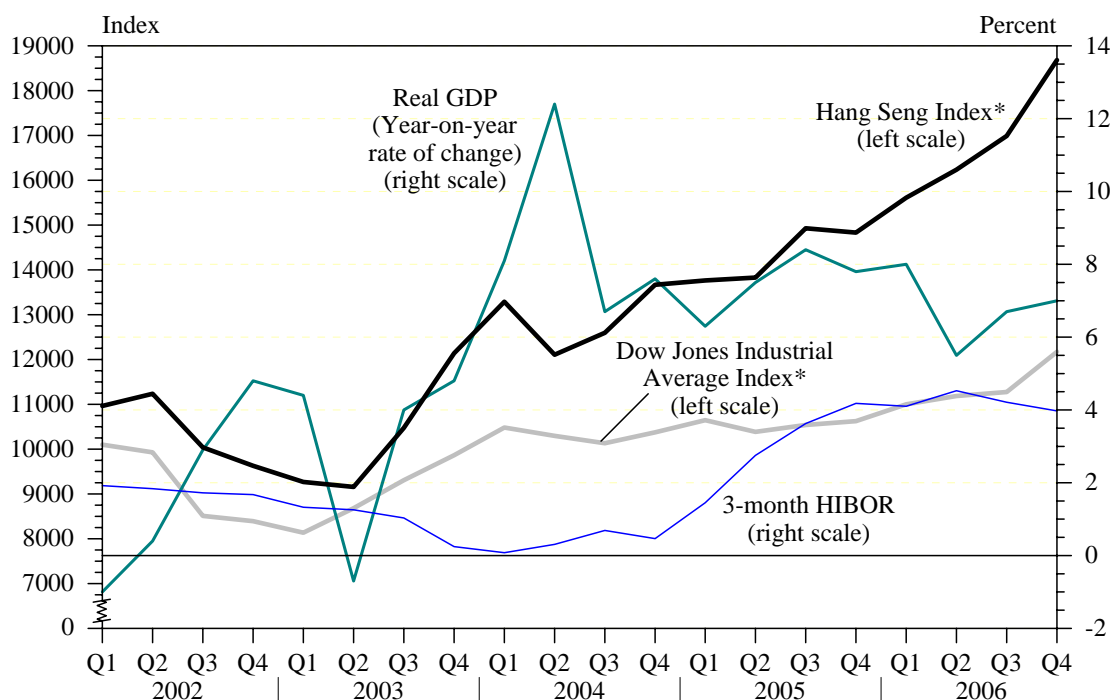
(b) MDBs : Multilateral Development Banks.

The stock and futures markets

5.16 Apart from a brief consolidation during May and June, the local stock market rode on a strong uptrend over the course of 2006, especially so towards the year-end, mainly boosted by the pause in US interest rate upcycle, increased strength of local economic fundamentals, as well as market expectations for further renminbi appreciation. These favourable factors in turn triggered substantial funds inflow into the local stock market, particularly towards Mainland-related stocks. The hectic IPO activities and the generally

enthusiastic response had rendered further boost to market sentiment. The Hang Seng Index rallied to successive record highs and broke the 20 000 mark on 28 December 2006, before easing slightly to close the year at 19 965, up by 34.2% over end-December 2005. Reflecting the buoyant trading in 2006, average daily turnover expanded markedly to an all-time high of \$33.9 billion, 85.3% higher than in 2005.

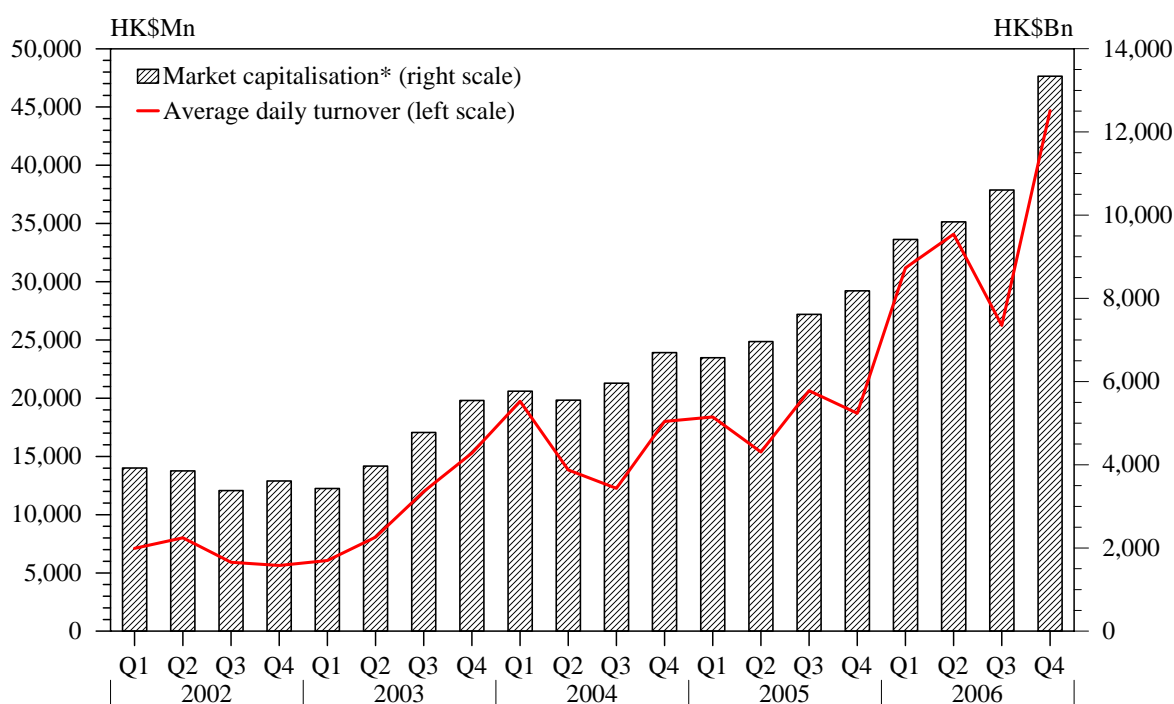
Diagram 5.7 : The stock market fared strongly in 2006, alongside the continued robust economic performance



Note: (*) Period average figures.

5.17 Market capitalisation soared to a fresh record high of \$13,338 billion at end-December 2006 (comprising \$13,249 billion in the Main Board and \$89 billion in the Growth Enterprise Market (GEM)), up 63% from a year earlier, reflecting the substantial increases in share prices and also boosted by the new listings of a number of large Mainland enterprises during the year. According to the World Federation of Exchanges⁽⁸⁾, at end-December 2006, the Hong Kong stock market was the sixth largest in the world and second largest in Asia in terms of market capitalisation. In 2006, equity capital raised through new share flotations and post-listing in the Main Board and the GEM rose markedly to \$505.9 billion⁽⁹⁾. Partly boosted by the world's ever-largest IPO for the Industrial and Commercial Bank of China in October, the total value of equity raised through IPO of new stocks in 2006 ranked second internationally, just after London.

Diagram 5.8 : Both total market capitalisation and average daily turnover in the Hong Kong stock market hit record high in 2006



Note: (*) Position at end of quarter.

5.18 Reflecting the premier position of Hong Kong as a fund-raising centre for the Mainland enterprises, in 2006, the Mainland enterprises raised a total of \$369 billion from the Hong Kong stock market, taking up 73% of the total equity raised during the period. Since January 1993, \$1,471 billion of capital had been raised by Mainland enterprises in the Hong Kong stock market, accounting for 55% of the total funds raised. At end-December 2006, there were 367 Mainland enterprises (including 141 H-share companies, 90 “Red Chips” companies and 136 private enterprises) listed on the Hong Kong stock market, accounting for 31% of the total number of listed companies. The market capitalisation of these Mainland enterprises more than doubled during 2006 and reached \$6.7 trillion, which accounted for 50% of the total market capitalisation of the Hong Kong stock market. In 2006, 60% of equity turnover in the stock market was contributed by trading of the above Mainland-related stocks.

5.19 Mirroring the buoyant trading in the spot market, *derivatives trading* was also hectic in 2006. The average daily turnover of the Hang Seng Index Futures contracts, Hang Seng Index Options contracts, H-shares Index Futures contracts, and stock options contracts all rose considerably in 2006, by averages of 28% - 146% over 2005⁽¹⁰⁾. Trading of stock futures likewise leaped from a very low base.

**Table 5.6 : Average daily turnover of derivatives contracts
of the Hong Kong stock market**

		<u>Hang Seng Index Futures</u>	<u>Hang Seng Index Options</u>	<u>H-shares Index Futures</u>	<u>Stock Options</u>	<u>Stock Futures</u>
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
2006	Annual	51 491	16 582	19 759	73 390	413
	Q1	46 638	14 287	17 436	61 863	163
	Q2	54 535	17 141	22 703	65 038	299
	Q3	50 281	16 671	16 670	66 836	553
	Q4	54 770	18 278	22 564	100 169	628
	% change from 2005 Q4 to 2006 Q4	26.5	34.4	173.8	148.5	929.5
	% change in 2006 average over 2005 average	28.1	33.1	146.2	107.4	679.2

Fund management and investment funds

5.20 The depth and breadth of investment funds managed in Hong Kong continued to increase, paving the way for Hong Kong to evolve as Asia's leading asset management centre. In 2006, gross sales of *mutual funds*⁽¹¹⁾ amounted to US\$24,339 million, up sharply from US\$14,110 million in 2005. After deducting redemptions, net sales amounted to US\$3,807 million in 2006, also distinctly above that of US\$1,209 million in 2005. Analysed by asset size, equity funds continued to take up a predominant portion, accounting for 71% of the total value of funds at end-2006. Funds managed under the *MPF schemes* likewise continued to grow notably in 2006. The aggregate net asset value of the approved constituent funds rose to \$202.4 billion at end-2006, from \$151.4 billion at end-2005⁽¹²⁾.

5.21 The hedge funds business continued to flourish in 2006, reflecting the growing popularity of this type of funds among the investors. There were 14 retail hedge funds authorised by the Securities and Futures Commission (SFC) and the net asset size of SFC-authorized hedge funds rose further to US\$1.66 billion as at end-2006, up notably from US\$1.04 billion at end-2005. The net asset size at end-2006 was 9.4 times larger than that as at end-2002, the year when the hedge funds guidelines were first issued. According to a survey by the SFC in October 2006, as at 31 March 2006, there were 296 hedge funds managed from Hong Kong by our licensed hedge fund managers. The total asset under management amounted to US\$33.5 billion. In view of the increased hedge fund activities in Hong Kong and the fact that they are not restricted by national borders, the SFC is building partnership with other regulators, whether local or overseas, as well as the industry itself to build a fair and transparent regulatory framework. Besides, the co-operation can also facilitate market and product development, maintain market confidence and promote high standards.

Insurance

5.22 The insurance sector continued to see new business opportunities on the back of the sustained economic expansion. Gross premium income from new long-term business and general business posted a further, albeit moderated, growth of 5.4% in the third quarter of 2006 over a year earlier⁽¹³⁾. Yet for the first three quarters of 2006 as a whole, there was still an appreciable increase of 13.1%. Long-term business remained vibrant, with growth impetus coming predominantly from investment-linked individual life and annuity business. This reflected partly the increase in employment income amidst the economic upturn, and also the increasing awareness of the needs for individual risk coverage and retirement planning.

Table 5.7 : Insurance business in Hong Kong (HK\$Mn)

	<u>General business :</u>			<u>Premium for long-term business* :</u>					Gross premium from long-term business and general business
	<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>	
2005 Q1	6,944	4,909	63	4,814	4,209	45	41	9,109	16,053
Q2	5,730	3,981	446	6,099	5,376	41	48	11,564	17,294
Q3	5,416	3,897	351	5,749	5,281	43	39	11,112	16,528
Q4	4,832	3,292	1,431	7,628	6,385	49	32	14,094	18,926
2006 Q1	6,795	4,881	637	4,868	7,284	37	52	12,241	19,036
Q2	5,337	3,951	723	5,360	9,195	41	38	14,634	19,971
Q3	5,894	4,024	674	4,792	6,630	58	45	11,525	17,419
% change from 2005 Q3 to 2006 Q3	8.8	3.3	92.0	-16.6	25.5	34.9	15.4	3.7	5.4

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

Notes :

- (1) 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.
- (2) In December 2005, the HKMA published a new data series on composite interest rate, reflecting movement in various deposit rates, interbank and other interest rates to closely track the average costs of funds of banks. 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.
- (3) 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.

- (4) 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.

- (5) Authorized institutions include licensed banks, restricted licence banks and deposit-taking companies. At end-December 2006, there were 138 licensed banks, 31 restricted licence banks and 33 deposit-taking companies in Hong Kong. Altogether, 202 authorized institutions (excluding representative offices) from 31 countries and territories (including Hong Kong) had a presence in Hong Kong.
- (6) The figures for private sector debt may not represent a full coverage of all the Hong Kong dollar debt paper issued.
- (7) 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.

- (8) The ranking is sourced from the World Federation of Exchanges, a global trade association for the stock exchange industry. Its membership comprises 55 stock exchanges, covering almost all globally recognised stock exchanges.
- (9) At end-December 2006, there were 975 and 198 companies listed on the Main Board and GEM respectively.
- (10) At end-December 2006, there were 42 classes of stock options contracts and 41 classes of stock futures contracts.
- (11) 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-December 2006, there were a total of 1 099 authorized-funds covered by the Survey.
- (12) There were 19 approved trustees at end-December 2006. On MPF products, 36 master trust schemes, two industry schemes and two employer sponsored schemes, comprising altogether 316 constituent funds, were approved by the Mandatory Provident Fund Schemes Authority. A total of 232 000 employers, 2.07 million employees and 285 000 self-employed persons have participated in MPF schemes.
- (13) As at end-December 2006, there were 181 authorized insurers in Hong Kong. Within this total, 47 were engaged in long-term insurance business, 116 in general insurance business, and 18 in composite insurance business. These authorized insurers come from 23 countries and territories (including Hong Kong).

CHAPTER 6 : THE LABOUR SECTOR[#]

Summary

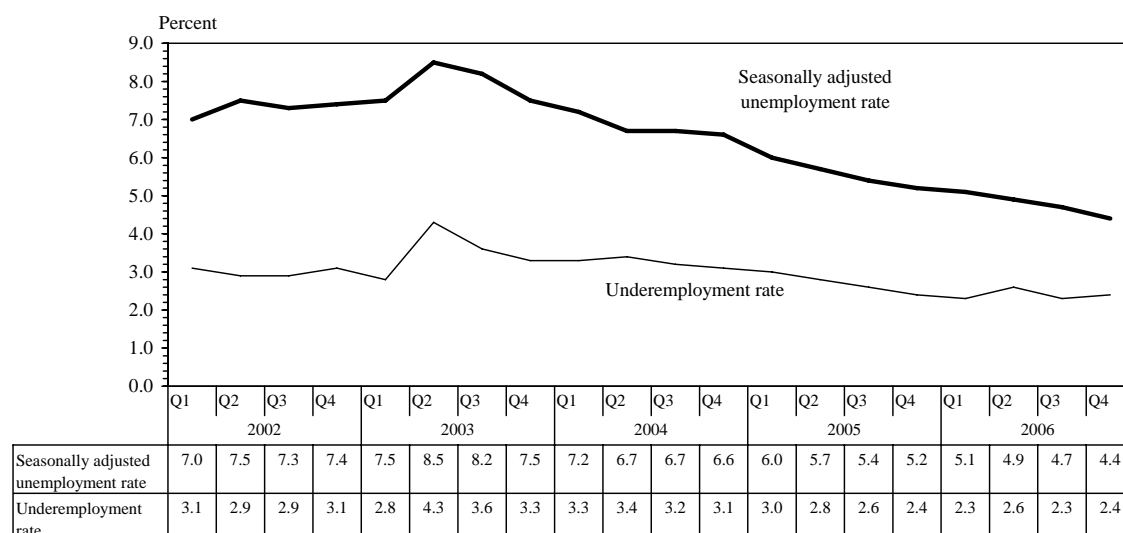
- *The labour market improved notably for the third consecutive year in 2006, when employers generally stepped up their recruitment drive to cope with the sustained surge in business activity.*
- *Total employment remained distinctly on the increase, hitting successive new highs during 2006. At the end of the year, the number of employed persons reached an all-time high of over 3.47 million.*
- *Unemployment eased visibly further, as more jobless people were absorbed into the workforce. The seasonally adjusted unemployment rate dropped to a near six-year low of 4.4% by the year-end, while the numbers unemployed fell below the 155 000 mark for the first time since mid-2001. The number of long-term unemployed persons also came down to 40 400.*
- *Labour income continued to edge up in overall terms. Yet the picture at the sectoral and occupational level remained mixed, with divergent movements in wages and earnings among various industries and job categories.*

Overall labour market situation

6.1 The labour market, having staged a visible rebound for two consecutive years in 2004 and 2005, improved distinctly further in 2006. The pattern of developments in all these three years was in fact broadly similar, which was characterised by a strong expansion in total employment, a notable decline in unemployment and a mild upturn in labour earnings. The principal factor underlying these developments was the robust economic growth since mid-2003. Labour demand was thereby boosted initially in the exports and tourism industries, and subsequently spread to the domestically-oriented sectors. With more jobs becoming available on a wider front, the unemployment rate⁽¹⁾ fell across almost all major segments of the labour market more recently. On the other hand, underemployment⁽²⁾ also decreased, albeit to a lesser extent.

(#) Figures enumerated from the General Household Survey have been revised to take into account the recent enhancements in the estimation method and the results of the 2006 Population By-census, which provide a benchmark for revising the population figures compiled since the 2001 Population Census.

Diagram 6.1 : The unemployment and underemployment situation kept improving, as the economic revival became more broad-based and entrenched



Total employment and labour supply

6.2 In 2006, employers generally turned more positive about staff recruitment as the economy maintained its strong tempo for the third straight year. *Total employment*⁽³⁾ kept surging during the course of the year, reaching a record high of 3 466 000 in the fourth quarter. This was 2.8% more than a year earlier. Employment gain over the year was concentrated among women aged 40 or above, who tended to benefit more from the increased job opportunities in sectors like the medical and sanitary services, import/export trades, retail trade, real estate, and restaurants. The job categories in greater demand were mainly those at the lower segment including workers in elementary occupations, and service workers and shop sales workers, besides associate professionals at the upper end. As for male workers, employment growth occurred largely among persons aged 20-29 and 50 or above. Most of these people were engaged in transport, restaurants, business services, and foundation and superstructure construction. Also worth noting was that there was a pick-up in growth of full-time employment⁽⁴⁾ predominantly in financing, insurance, real estate and business services, and in community, social and personal services, as business expansion in these spheres became more solid and entrenched. For 2006 as a whole, employment gained by an average of 2.1%, outstripping the 2.0% rise in 2005.

6.3 *Labour supply*⁽⁵⁾ also exhibited an accelerated increase in 2006, yet by a smaller magnitude than overall employment. In the fourth quarter, the labour force was estimated at 3 619 700, up by 1.9% over a year earlier. Much of this growth was attributable to the increased participation of women aged 40 - 59 in

the labour market, plausibly induced by the brighter employment prospects and more part-time job opportunities. At end-2006, the labour force participation rate for females was 53.0%, distinctly higher than 51.8% a year earlier, while that for males went up slightly to 71.2% from 71.0%. For 2006 as a whole, the labour force expanded by an average of 1.3%, as against the 0.6% growth in 2005.

6.4 Comparing end-2006 with the trough in mid-2003, total employment surged by 299 000 or 9.4%, much outpacing the increase of 145 900 or 4.2% in the labour force. As a result, the unemployment figures were almost halved over the period. Whereas job loss (50 800) was still seen in manufacturing, this was far outweighed by the gains observed in services (335 900) and in construction (17 500). Among the constituent sectors, the import/export trades, transport, restaurants and sanitary services, together with financing, real estate and business services, were the ones having more significant employment growth. Increased labour demand fuelled by sustained business upswing was the primary factor, although higher labour intensity of some of the sectors concerned also partly contributed. Analysed by job nature, there was a notable expansion in full-time employment by 369 600 or 14%, more than offsetting the reduction of 70 600 or 16% in part-time employment.

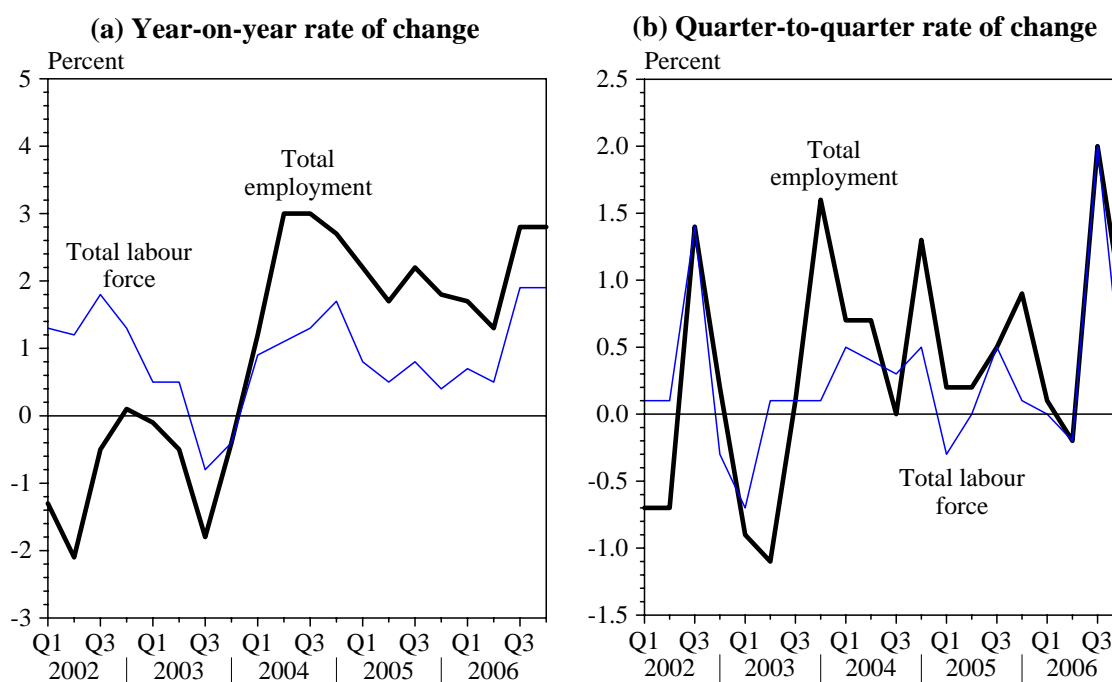
Table 6.1 : The labour force, and persons employed, unemployed and underemployed

		<u>Labour force</u>		<u>Persons employed</u>		<u>Persons unemployed</u> ^(a)	<u>Persons underemployed</u>
2005	Annual	3 538 100	(0.6)	3 340 800	(2.0)	197 300	96 300
	Q1	3 526 500	(0.8)	3 320 100	(2.2)	206 400	107 300
	Q2	3 527 900	(0.5)	3 326 300	(1.7)	201 600	98 500
	Q3	3 546 900	(0.8)	3 344 200	(2.2)	202 700	92 400
	Q4	3 551 000	(0.4)	3 372 600	(1.8)	178 400	86 800
2006	Annual	3 582 500	(1.3)	3 411 600	(2.1)	170 900	86 600
	Q1	3 552 100	(0.7)	3 375 000	(1.7)	177 100	80 900
	Q2	3 544 000	(0.5)	3 368 300	(1.3)	175 700	93 800
	Q3	3 614 100	(1.9)	3 437 100	(2.8)	177 000	84 300
	Q4	3 619 700	(1.9)	3 466 000	(2.8)	153 700	87 600
			<0.2>		<0.8>		

Notes : (a) These include first-time job-seekers and re-entrants into the labour force.
 () Year-on-year % change.
 < > % change between Q3 and Q4 (i.e. October-December).

Source : General Household Survey, Census and Statistics Department.

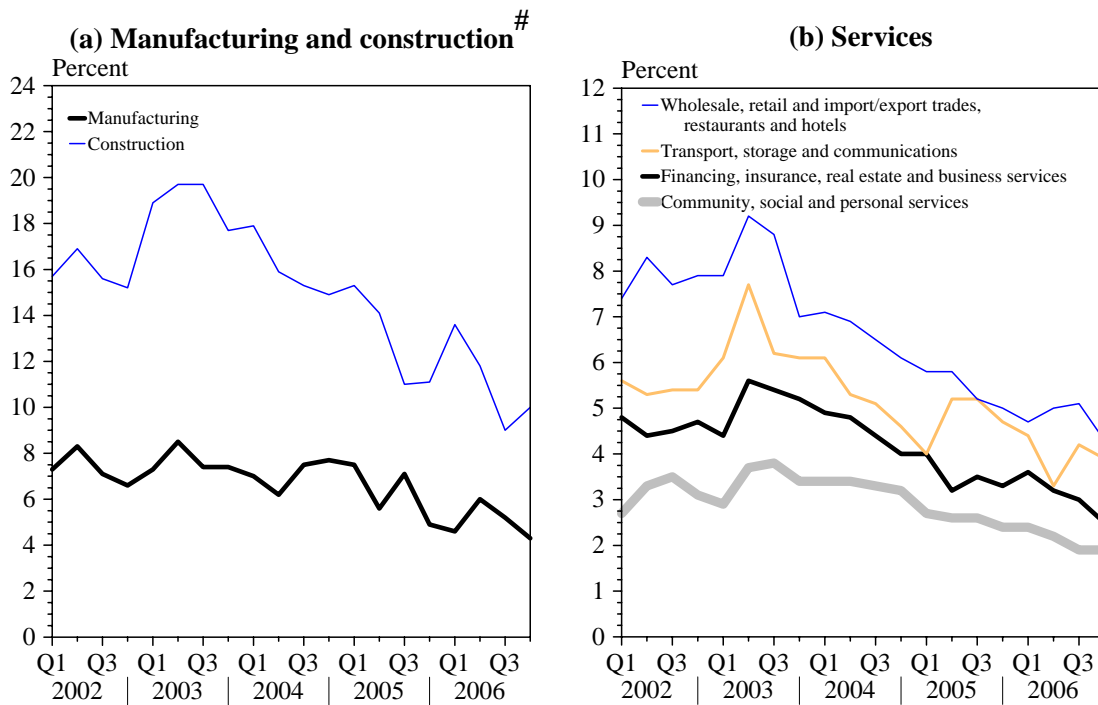
Diagram 6.2 : Both total employment and labour force expanded further in 2006, with growth in the former still outstripping the latter



Profile of unemployment

6.5 Unemployment trended downward during the course of 2006, both in absolute and relative terms. The numbers unemployed dropped to 153 700 in the fourth quarter, below the 155 000 mark for the first time since mid-2001, and the seasonally adjusted unemployment rate slipped to a near six-year low of 4.4%. While decreases were observed across various economic sectors, they varied in magnitude owing to differences in the manpower resource conditions. Construction and manufacturing were the sectors where notable declines in unemployment rate were found, from 12.9% and 6.3% in 2005 to 11.1% and 5.0% in 2006 respectively. But in the former case, the reduced unemployment was mainly caused by a pick-up in construction work on some smaller-scale projects; in the latter case, it was rather due to a reduction in the supply of manufacturing workers. As for the service sectors, the improvement in unemployment was primarily demand-driven. Within this broad group, sanitary services, restaurants and hotels, welfare and community services, and business services were the ones registering more distinct falls in unemployment rate.

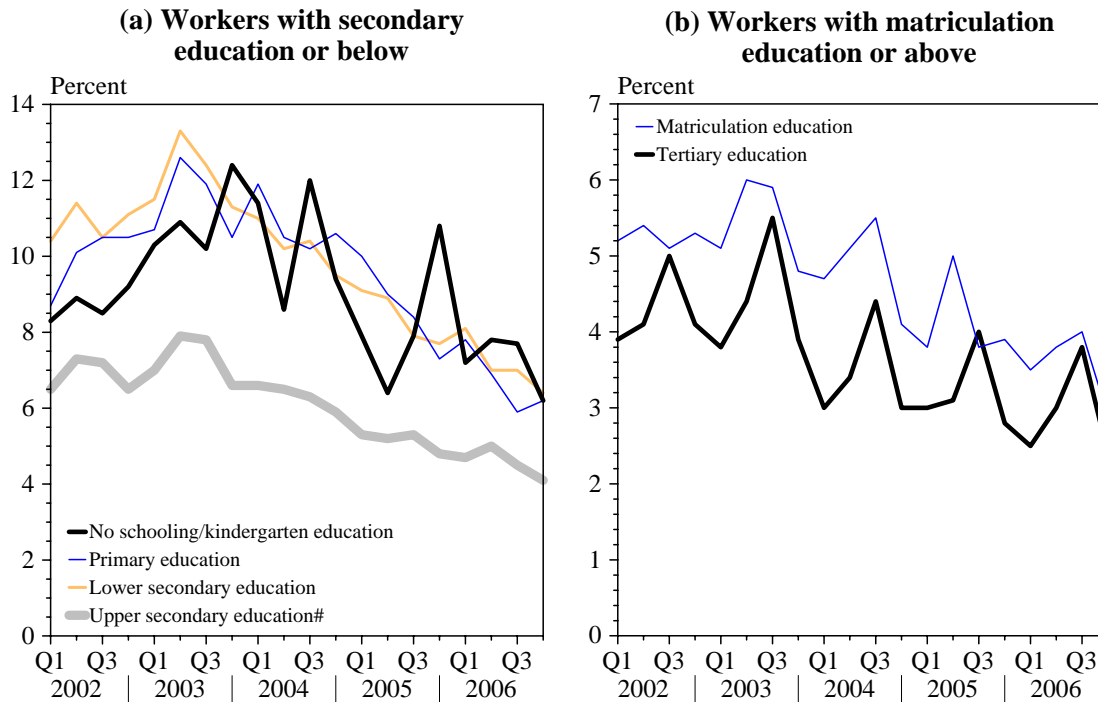
Diagram 6.3 : Unemployment rate* went down across all major economic sectors in 2006



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

(#) Including both site and non-site workers.

Diagram 6.4 : Workers with better educational attainment continued to face lower unemployment rates*

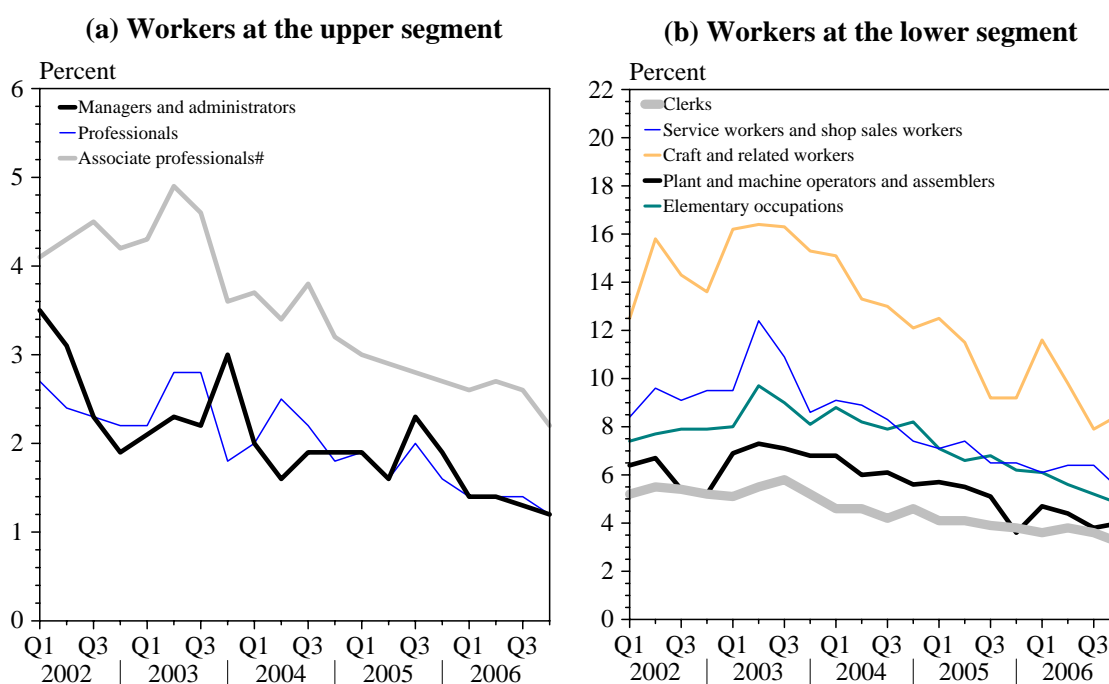


Notes : (*) Not seasonally adjusted, but including first-time job seekers and re-entrants into the labour force.

(#) Including craft courses.

6.6 Analysed by educational attainment, workers with better educational qualifications were still the group benefiting more from the improved employment situation. In 2006, the unemployment rates for persons with tertiary and matriculation education were 2.9% and 3.6% respectively, markedly below those of 5.4% and 6.7% for workers with secondary education and with primary education or below. The statistics for the more recent period showed that the fall in unemployment rate in the fourth quarter of 2006, whilst occurring across-the-board, remained most apparent among the higher-educated workers with matriculation education or above.

Diagram 6.5 : Unemployment rate* of lower-skilled workers, whilst also trending downward, remained above that of higher-skilled workers



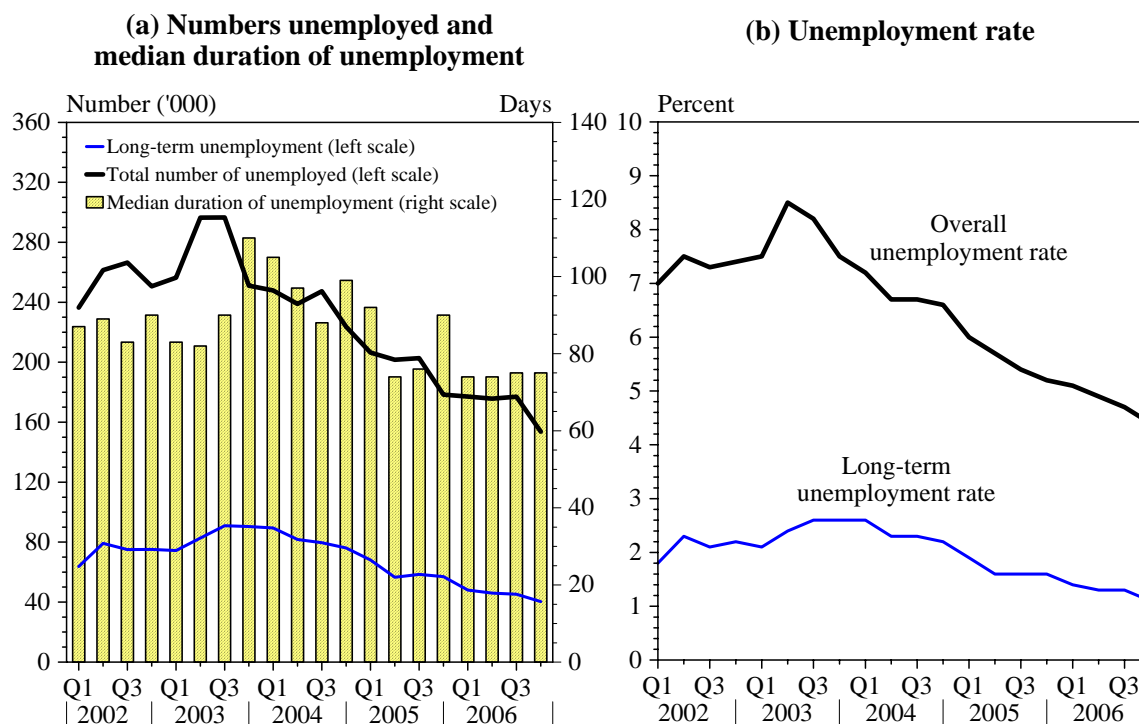
Notes: (*) Not seasonally adjusted, and not including first-time job seekers and re-entrants into the labour force.

(#) Including technicians and supervisors.

6.7 Meanwhile, a widespread improvement in unemployment was likewise seen among workers at different levels of the occupational hierarchy. Specifically, workers at the managerial and professional level recorded an average unemployment rate of only 2.0% in 2006, whereas those at the lower segment had a higher rate of 5.5%. Nevertheless, these two figures were lower than those of 2.4% and 6.4% respectively in 2005. More recently, while unemployment continued to fall in the fourth quarter of 2006, this took place largely among employees in the lower strata such as workers in elementary occupations, and services workers and shop sales workers (see **Box 6.1** for details).

6.8 The latest data also indicated that there was a distinct drop in the number of persons unemployed for six months or longer, to 40 400 at end-2006 from 57 000 a year earlier, as well as a shortening in the median duration of unemployment, to 75 days from 90 days. Long-term unemployment fell most visibly among persons engaged in the transport, storage and communications and construction sectors, those engaged in lower-end jobs like workers in elementary occupations and crafts and related workers, as well as those in the middle age with lower secondary education or below. All these changes pointed to some easing of structural unemployment over the past year or so. This is clearly an encouraging development, but the problem is far from over, in view of the still high unemployment rate for lower-skilled workers at 5.0% as against the economy average of 4.4% and more so against the 1.7% for higher-skilled workers.

Diagram 6.6 : Long-term unemployment* fell noticeably further



Note: (*) Unemployed for six months or longer.

Profile of underemployment

6.9 The underemployment situation, whilst moving along a more erratic path, also improved for the year as a whole. The underemployment numbers and rate averaged 86 600 and 2.4% in 2006, below those of 96 300 and 2.7% in 2005. Conceivably, this was due to more part-time employees having been absorbed into full-time work. Yet comparing end-2006 with a year earlier, the underemployment rate stayed unchanged at 2.4%, whilst the numbers underemployed increased slightly to 87 600 from 86 800. Analysed by economic sector and occupation, underemployment decreased more visibly among craft and related workers engaged in decoration and maintenance; plant and machine operators and assemblers in transport; and clerks in recreational services. The former two groups comprised mostly older people aged 40-59 with lower secondary education or below, and the latter group mainly the younger ones aged 20-24 with upper secondary education or above.

Box 6.1

The employment and income situation of lower-end workers* since 2003

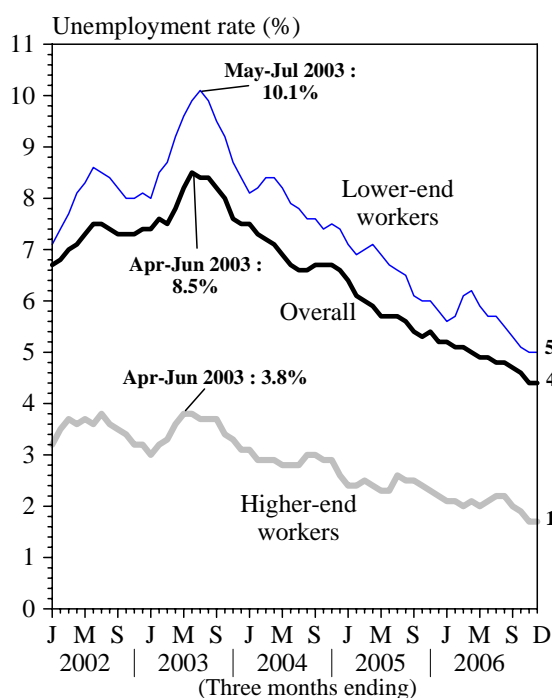
Improved labour market conditions since 2003

The current economic recovery, which began in the second half of 2003, was well sustained through to 2006. Over this period, net additional jobs totalling 299 000 had been created. The majority of them were full-time jobs, reflecting the growing confidence among employers over staff recruitment alongside the strong economic recovery. As a result, unemployment was reduced significantly by half, with the numbers falling from 307 700 to 153 700 and the rate from 8.5% to 4.4%. The underemployment rate also dropped from 4.3% to 2.4% over the same period. Average employment earnings resumed increase in early 2005, and have since remained on a modest uptrend.

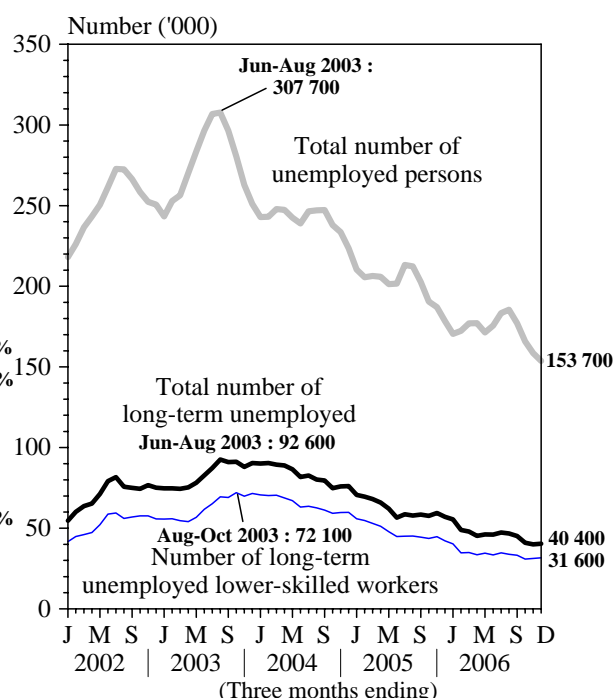
Lower-end workers benefiting markedly from employment gains

Comparing end-2006 with mid-2003, employment at the lower segment of the labour market grew by 6.4% or 135 600. Consequently, the number of unemployed workers at the lower end fell sharply by 49.5%, larger than the 46.8% drop observed for those at the upper end. The unemployment rate for the former group went down by 5.1 percentage points (from 10.1% to 5.0%), as against the fall of 2.1 percentage points (from 3.8% to 1.7%) for the latter group.

Extensive improvement in the labour market



Long-term unemployment reduced markedly



The picture regarding long-term unemployment was even more encouraging. As a significant proportion of persons unemployed for six months or longer were in the lower strata, the markedly improved long-term unemployment situation since 2003 had benefited this particular group of people more. At end-2006, 31 600 workers at the lower segment

(*) Refer to clerks, service workers and shop sales workers, craft and related workers, plant and machine operators and assemblers, and workers in elementary occupations.

Box 6.1 (cont'd)

were long-term unemployed, accounting for 20.6% of the overall unemployed population. These figures were distinctly below 72 100 and 25.7% in mid-2003. They also compared favourably with those observed for the higher-skilled workers.

Improved employment earnings at both the lower and upper ends, with no significant widening in wage differential since 2003

On labour income, there was in fact a larger increase in employment earnings among the lower-end workers (the bottom 30% of earnings distribution) than the upper-end ones (the top 30%), at 3.2% as against 2.5% between 2003 and 2006, although in absolute terms the former increase was just around \$200 as against the latter rise of around \$800.

Average employment earnings of employed persons* (\$)

	<u>Low-income group</u> ⁺	<u>High-income group</u> ⁺	<u>Overall</u>	Ratio of low-income group <u>To high-income group</u>
2003	5,000	33,400	15,600	14.8%
2004	4,800	33,600	15,500	14.2%
2005	5,100	34,200	15,700	14.8%
2006	5,100	34,300	16,100	14.9%

Notes: (*) Excluding foreign domestic helpers.

(+) Low-income group refers to workers in the bottom 30% of earnings distribution, while high-income group refers to workers in the top 30%. Due to rounding, changes in average employment earnings between 2003 and 2006 quoted in the above paragraph may not tally with those shown in the table.

As to income disparity, a major indicator is the ratio of average employment earnings of low-income workers to those of high-income workers. This ratio stood at 14.9% in 2006 and was roughly similar to that of 14.8% in 2003, suggesting no significant worsening in income disparity between the two groups over this three-year period.

Concurrently, there was an “uplifting” of the job profile more towards full-time and higher-paid jobs. Indicating this, the number of full-time jobs increased by 14.0% between May – July 2003 and Q4 2006, in stark contrast to the 15.9% decline in part-time jobs. Meanwhile, the share of full-time jobs with monthly employment income below \$7,000 shrank from 21.8% to 18.4%, whereas that for higher employment income went up from 78.2% to 81.6%. The share for full-time employees earning below \$5,000, in particular, dwindled to just 4.7%. This has to some extent helped to reduce the income gap between the higher- and lower-income workers.

Sustained economic growth still the key to improving workers’ well-being

Apparently, both the lower-end and upper-end workers had recouped a considerable part of the ground lost in the earlier economic downturn, more so in terms of increase in employment than in wages. The sustained economic growth since mid-2003 thus remains the key to improving the well-being of workers at all levels.

While clearly the lower-end workers are still subject to the influence of ongoing structural change, a recent study indicates that there has been little evidence supporting the view of a marked increase in structural unemployment in Hong Kong in more recent years (see **Box 1.2** of Half-yearly Economic Report 2006 for details). It is also observed that to no small degree the relatively high unemployment faced by the lower-skilled workers is, in fact, caused by the weakness in the construction and consumption-related sectors, which together account for 43% of the total unemployment. Thus, if the construction sector could turn around while the consumption-related sectors could improve further, the unemployment situation for the lower-skilled workers should see further improvement. This in turn might bring about a further rise in wages for the lower-end workers in due course.

Profile of employment in establishments

6.10 Insofar as business establishments are concerned, the relevant employment, job vacancies and labour income data are all available up to the third quarter of 2006 only. Comparing September 2006 with a year earlier, employment in *private sector establishments* was up by 2.3%. About 94% of this growth came from large enterprises, with the remaining 6% from small and medium-sized enterprises⁽⁶⁾. Analysed by economic sector, services continued to lead the other sectors in job growth. Within this broad group, restaurants and hotels; financing, insurance, real estate and business services; and community, social and personal services were the star performers. This was driven largely by the sustained buoyancy in inbound tourism and strengthened demand for consumer-related services, such as, asset management, medical and healthcare, and amusement and entertainment services. On the other hand, the number of workers at building and construction sites⁽⁷⁾ shrank by 6.3%, owing to continued slack in public sector projects. Employment in the local manufacturing firms also fell, by 3.7%, upon further relocation of production activities from Hong Kong to the neighbouring low-cost centres, predominantly the Pearl River Delta region. For the first nine months of 2006 as a whole, the number of persons engaged in private sector establishments grew by 2.1% over a year earlier, extending the uptrend seen in the preceding two years.

6.11 Regarding the civil service, employment continued on the decline, as government departments generally maintained tight control over staffing. In September 2006, the total number of civil servants was 1.4% fewer than a year earlier. A broadly similar decrease was recorded for the first nine months as a whole. Nevertheless, in view of the forthcoming lifting of the general recruitment freeze on 1 April 2007, civil service employment can be expected to at least consolidate in the near term.

Table 6.2 : Employment by major economic sector

	<u>2005</u>					<u>2006</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, import and export trades	581 800 (2.5)	583 100 (4.8)	579 100 (2.8)	585 300 (1.4)	579 500 (0.9)	581 200 (-0.3)	581 700 (0.4)	584 000 (-0.2)
Retail trade	221 100 (1.8)	216 000 (0.7)	224 600 (3.7)	221 700 (1.0)	221 900 (1.6)	225 900 (4.6)	229 300 (2.1)	228 600 (3.1)
Restaurants and hotels	215 400 (3.6)	210 700 (2.9)	214 500 (2.3)	214 300 (3.7)	222 300 (5.4)	221 800 (5.3)	225 800 (5.3)	226 200 (5.5)
Transport and storage	153 300 (3.6)	151 400 (4.3)	153 700 (4.1)	153 400 (3.6)	154 600 (2.6)	154 100 (1.8)	155 200 (1.0)	156 100 (1.8)
Communications	30 000 (-2.4)	29 800 (-3.6)	31 200 (0.1)	29 700 (-1.2)	29 200 (-4.9)	30 000 (0.6)	29 300 (-5.9)	29 500 (-0.7)
Financing, insurance, real estate and business services	456 100 (4.4)	447 600 (4.4)	457 200 (5.3)	455 400 (4.0)	464 400 (3.8)	468 300 (4.6)	475 900 (4.1)	480 500 (5.5)
Community, social and personal services	439 000 (4.5)	434 400 (5.4)	437 000 (4.5)	437 700 (5.3)	446 800 (2.7)	451 300 (3.9)	451 700 (3.4)	455 200 (4.0)
Manufacturing	164 700 (-2.0)	163 100 (-3.5)	161 900 (-4.5)	166 300 (-1.0)	167 400 (1.3)	161 500 (-1.0)	161 100 (-0.5)	160 200 (-3.7)
Building and construction sites	59 300 (-10.6)	65 800 (-4.8)	60 000 (-14.2)	56 800 (-12.4)	54 500 (-11.1)	54 900 (-16.5)	52 300 (-12.9)	53 300 (-6.3)
<i>All establishments surveyed in the private sector^(a)</i>	<i>2 328 700 (2.5)</i>	<i>2 310 000 (3.2)</i>	<i>2 327 300 (2.6)</i>	<i>2 328 900 (2.3)</i>	<i>2 348 700 (2.0)</i>	<i>2 357 200 (2.0)</i>	<i>2 370 400 (1.8)</i>	<i>2 381 800 (2.3)</i>
		<i><0.7></i>	<i><0.5></i>	<i><0.1></i>	<i><0.8></i>	<i><0.7></i>	<i><0.3></i>	<i><0.5></i>
<i>Civil service^(b)</i>	<i>156 500 (-2.7)</i>	<i>157 300 (-3.5)</i>	<i>156 800 (-3.0)</i>	<i>156 200 (-2.4)</i>	<i>155 500 (-1.8)</i>	<i>155 000 (-1.5)</i>	<i>154 500 (-1.5)</i>	<i>154 100 (-1.4)</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. Judges, 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.

Sources : Quarterly Survey of Employment and Vacancies, Census and Statistics Department.
Quarterly Employment Survey of Construction Sites, Census and Statistics Department.

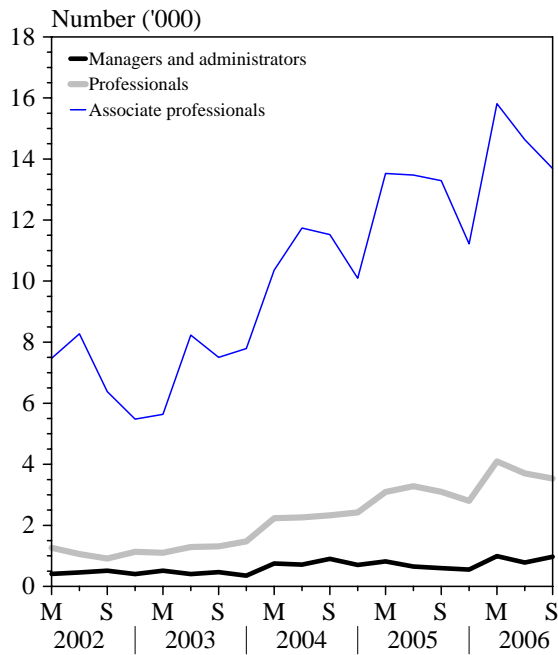
Vacancies

6.12 In September 2006, vacancies in *private sector establishments* rose marginally by only 0.1% over a year earlier to 43 600. Apart from the relatively high base in 2005, this modest growth was also due to the increased take-up of job openings during the course of 2006. When job vacancies are matched against the unemployed persons, the ratio showed some increase to 25 job openings per 100 job-seekers in September 2006, from around 22 a year earlier. While the ratio for lower-skilled jobs went up from 19 to 21, that for higher-skilled jobs rose even more from 56 to 71. Concurrently, the openings for higher-skilled work increased by 7.1%, along with a decrease of 4.4% for lower-skilled workers. As a result, job vacancies at the upper end saw a further increase in share to 42%, while those at the lower end witnessed some decline to 58%. These movements pointed to the sustained strong demand for skilled personnel, as the economy kept moving up the value chain. The sectoral breakdown revealed that the lion's share (96%) of the new vacancies came from the service sectors predominantly in the import and export trades, financing, business services and restaurants. Among the business establishments, the large-sized firms generally had greater capacity to create jobs than the SMEs for coping with the recent pick-up in business activities (see **Box 6.2** for details). For the first nine months of 2006 as a whole, vacancies in the private sector were up by 10.1%, after the 26.4% gain in 2005. As for the *civil service*, while additional vacancies were also noted, the numbers involved were small at just 2 900 in September 2006. They mainly comprised the posts being exempted from the general recruitment freeze on the ground of operational needs.

6.13 The statistics supplied by the Employment Services of the Labour Department indicated continued low growth in registered vacancies from the private sector in the fourth quarter of 2006. Specifically, the increase was just 1.3% over a year earlier. But the increase for 2006 as a whole was still impressive, by 12.7% to 479 942. On average, more than 1 800 vacancies were received per working day. Meanwhile, the department achieved 118 937 placements, up by 5.2%. The 2006 figures were all-time highs.

Diagram 6.7 : Vacancies continued to increase, with varying magnitudes for different occupations

(a) Workers at the upper segment



(b) Workers at the lower segment

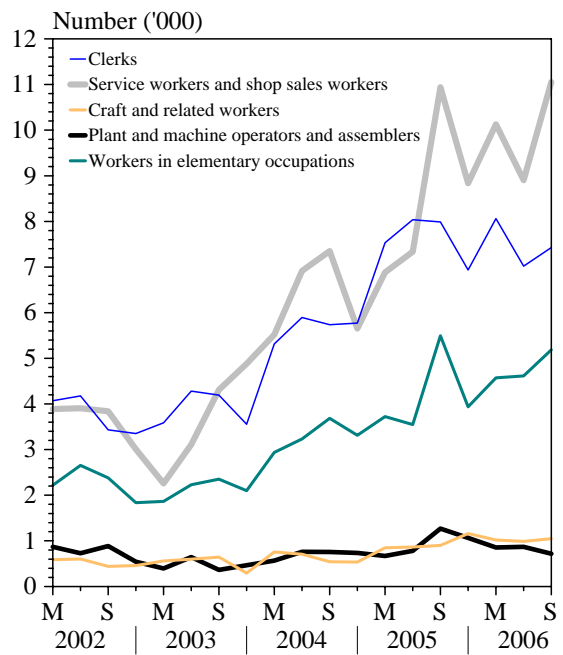


Table 6.3 : Vacancies by major economic sector

	<u>No. of vacancies</u>								Vacancy rate in Sep 2006 (%)
	<u>2005</u>					<u>2006</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, import and export trades	9 100 (20.1)	10 300 (42.4)	9 300 (7.2)	9 100 (13.4)	7 800 (21.0)	10 600 (3.0)	8 300 (-10.8)	7 800 (-14.2)	1.3
Retail trade	3 700 (40.3)	3 000 (33.7)	3 300 (35.7)	4 800 (46.8)	3 700 (41.9)	4 800 (58.7)	3 800 (17.4)	4 400 (-9.1)	1.9
Restaurants and hotels	3 400 (58.3)	2 400 (39.3)	2 700 (24.3)	4 300 (70.8)	4 100 (94.7)	4 000 (63.4)	4 000 (45.3)	5 000 (17.6)	2.2
Transport and storage	1 800 (30.3)	1 700 (36.6)	1 900 (19.2)	2 300 (38.1)	1 500 (27.5)	2 000 (20.1)	2 200 (17.5)	1 800 (-19.6)	1.2
Communications	700 (34.8)	400 (-32.7)	500 (32.3)	1 200 (48.7)	900 (108.3)	800 (93.0)	800 (52.6)	700 (-42.6)	2.2
Financing, insurance, real estate and business services	10 800 (21.0)	10 500 (21.5)	11 200 (23.8)	12 000 (28.8)	9 700 (9.7)	13 600 (29.6)	12 300 (9.6)	12 800 (6.8)	2.6
Community, social and personal services	7 100 (22.1)	6 800 (30.1)	7 200 (15.2)	8 000 (39.3)	6 600 (6.4)	7 900 (15.6)	8 100 (13.3)	9 200 (15.1)	2.0
Manufacturing	2 000 (33.3)	2 000 (33.1)	1 900 (16.2)	2 000 (28.8)	2 200 (58.6)	1 900 (-3.4)	2 000 (6.1)	1 900 (-3.7)	1.2
Building and construction sites	# (-75.7)	# (-92.7)	# (-84.7)	# (-77.3)	# (-36.4)	# (66.7)	# (*)	# (*)	*
<i>All establishments surveyed in the private sector^(a)</i>	38 800 (26.4)	37 100 (30.4)	38 000 (17.9)	43 600 (32.7)	36 500 (24.9)	45 500 (22.8)	41 500 (9.3)	43 600 (0.1)	1.8
		<5.1>	<4.5>	<13.8>	<0.1>	<3.1>	<-6.4>	<3.1>	
<i>Civil service^(b)</i>	900 (57.0)	1 500 (231.5)	1 100 (270.4)	700 (672.5)	500 (-66.9)	2 600 (76.3)	2 500 (131.6)	2 900 (308.8)	1.8

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%.

Sources : Quarterly Survey of Employment and Vacancies, Census and Statistics Department.
Quarterly Employment Survey of Construction Sites, Census and Statistics Department.

Box 6.2

Recent employment and vacancy situation of small and medium-sized enterprises

Small and medium-sized enterprises⁽¹⁾ (SMEs) are the fundamental building blocks of the Hong Kong economy. According to the Census and Statistics Department, there were 276 100 SMEs in Q3 2006, representing 98% of all the enterprises⁽²⁾ in Hong Kong. This was virtually the same as the share seen in the previous years. In terms of employment, SMEs' share was also significant at 50% in Q3 2006, though somewhat reduced from 53% in Q3 2000. Thus apparently, SMEs predominate in number and roughly match large enterprises in employment share on the local business scene.

SMEs' recent employment situation

In Q3 2006, employment at SMEs grew by only 0.2% over a year earlier to 1.2 million, smaller than the 2.3% increase in total employment. This was essentially a continuation of the trend since 2000, when SME employment mostly recorded below-average growth.

Relative to the large enterprises, employment at SMEs seemed to be more sensitive to economic cycles especially the downward phase. This was borne out by the larger reductions in SME employment in the recession years of 2001 and 2003, when there were widespread retrenchment and lay-offs of staff among such enterprises. On the other hand, during the years of economic upswing in 2000 and 2004-2006, while SME employment bounced up in tandem with the overall trend, the employment gain recorded was generally smaller than that for large enterprises. Thus comparing Q3 2006 with Q3 2000, the number of workers at SMEs actually shrank by an average of 0.9% per annum, in contrast to the average increase of 1.5% for large enterprises.

Employment by size of enterprise

	<u>SME</u>		<u>Large enterprises</u>		<u>Total</u>	
	(' 000)	% change	(' 000)	% change	(' 000)	% change
Q3 2000	1 248	2.6	1 093	6.5	2 341	4.4
Q3 2001	1 203	-3.6	1 117	2.2	2 320	-0.9
Q3 2002	1 207	0.3	1 079	-3.4	2 286	-1.5
Q3 2003	1 135	-5.9	1 081	0.1	2 216	-3.1
Q3 2004	1 148	1.1	1 128	4.4	2 276	2.7
Q3 2005	1 181	2.9	1 148	1.7	2 329	2.3
Q3 2006	1 184	0.2	1 198	4.4	2 382	2.3
Average annual % growth (Q3 2000 – Q3 2006)		-0.9		1.5		0.3

Analysed by economic sector, the wholesale, import and export trades were the sector where the highest concentration of SME employment was found, with a share of 81% in Q3 2006. This was followed by the retail trade (60%), manufacturing (59%), restaurants and hotels (42%), and financing, insurance, real estate and business services (39%).

(1) Manufacturing enterprises with below 100 employees and non-manufacturing enterprises with below 50 employees are classified as SMEs in Hong Kong. Yet establishments with the same main business registration number (BRN) and engaging in activities of the same sector are considered as one business unit for the purpose of calculating the number of SMEs. Thus, a business entity with a lot of small chain stores each employing a small number of employees are regarded as one large enterprise, instead of separate SMEs.

(2) Figures in this box are based on the data compiled from the Quarterly Survey of Employment and Vacancies, which covers only selected major sectors.

Box 6.2 (cont'd)

SMEs' recent vacancy situation

On vacancies, a total of 21 900 job openings were found at SMEs in Q3 2006, up by 1.4% over a year earlier, in contrast to the 1.2% decrease observed for large enterprises. This was partly attributable to the relatively higher take-up rate for job vacancies at large enterprises during the period.

Compared with large enterprises, growth in SME vacancies exhibited greater fluctuations in recent years, ranging from -46.9% (in Q3 2001) to 55.2% (in Q3 2004). This indicated higher flexibility of SMEs in adjusting their labour demand to the changing economic conditions.

Vacancies by size of enterprise

	<u>SME</u>		<u>Large enterprises</u>		<u>Total</u>	
	<u>Number</u>	<u>% change</u>	<u>Number</u>	<u>% change</u>	<u>Number</u>	<u>% change</u>
Q3 2000	18 900	38.4	16 800	51.0	35 800	44.0
Q3 2001	10 100	-46.9	11 200	-33.6	21 200	-40.6
Q3 2002	10 200	1.7	8 600	-23.5	18 800	-11.6
Q3 2003	11 700	14.3	9 400	10.4	21 100	12.5
Q3 2004	18 100	55.2	14 700	55.5	32 800	55.3
Q3 2005	21 600	19.2	22 000	49.5	43 600	32.7
Q3 2006	21 900	1.4	21 700	-1.2	43 600	0.1
Average annual % growth (Q3 2000 – Q3 2006)		2.5		4.3		3.4

Growth in SMEs' employment and vacancies during the current economic upturn

A comparison between Q3 2003 and Q3 2006 will show how SMEs have fared in the current economic recovery thus far, relative to the larger enterprises. Over this period, employment at SMEs went up by 48 900, much smaller than the 116 800 increase recorded for large enterprises. When matched against the total employment gain (165 700), the contribution of SMEs was estimated at 30%. The majority share of contribution (i.e. 70%) therefore came from large enterprises. This suggests that SMEs as a whole have had a smaller capacity in creating jobs than large enterprises during the current economic revival.

As for vacancies, both SMEs and large enterprises recorded substantial increases by 87.5% and 129.8% respectively over Q3 2003 – Q3 2006. Yet SMEs' contribution to the overall vacancy growth (22 500), estimated at 45%, was smaller than large enterprises', at 55%.

Thus while SMEs and large enterprises have both witnessed remarkable growth in employment and vacancies since Q3 2003, the latter played a greater part in boosting the overall labour demand in recent years.

Changes between Q3 2003 and Q3 2006

	<u>Q3 2003</u>	<u>Q3 2006</u>	<u>Change</u>		<u>Contribution to overall change</u>	
			<u>Number</u>	<u>%</u>	<u>% point</u>	<u>% share</u>
<u>Employment</u>						
SMEs	1 135 300	1 184 200	48 900	4.3	2.2	30
Large enterprises	1 080 800	1 197 600	116 800	10.8	5.3	70
<i>Total</i>	<i>2 216 100</i>	<i>2 381 800</i>	<i>165 700</i>	<i>7.5</i>	<i>7.5</i>	<i>100</i>
<u>Vacancies</u>						
SMEs	11 700	21 900	10 200	87.5	48.4	45
Large enterprises	9 400	21 700	12 300	129.8	58.0	55
<i>Total</i>	<i>21 100</i>	<i>43 600</i>	<i>22 500</i>	<i>106.4</i>	<i>106.4</i>	<i>100</i>

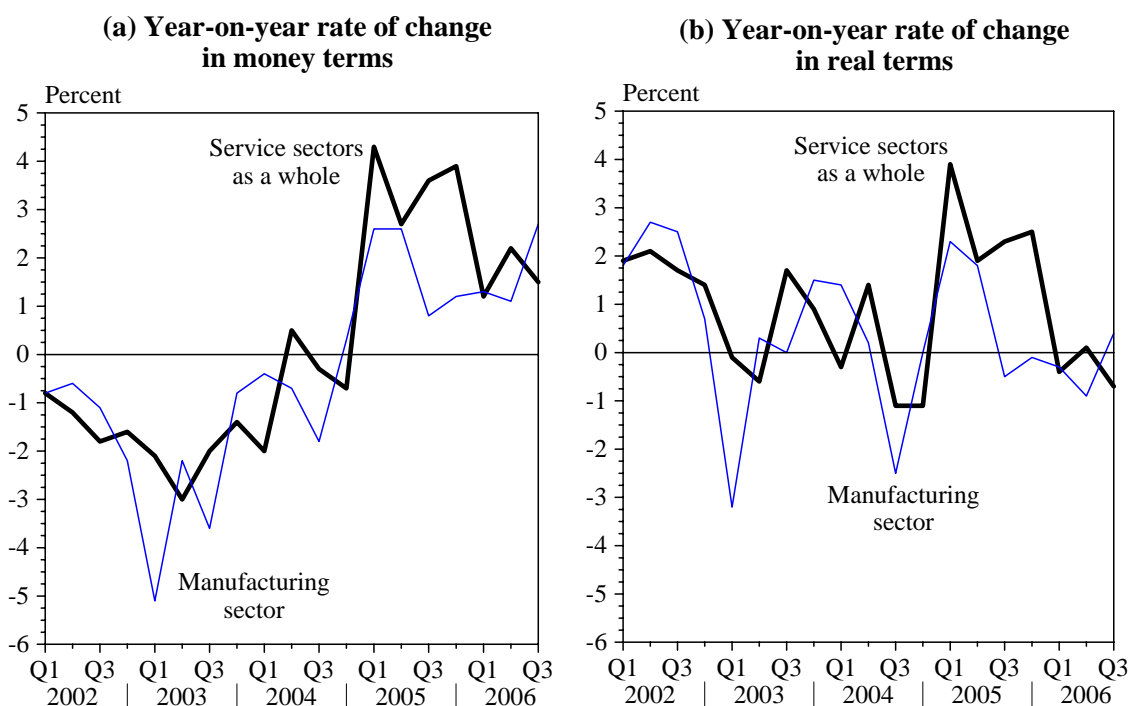
Earnings and wages

6.14 In 2006, pay pressures remained moderate in the corporate sector, despite the general tightening of labour market conditions. *Labour earnings*⁽⁸⁾, measured by payroll per person engaged in the private sector, edged up by 2.2% in money terms in the third quarter of 2006 over a year earlier. For the first three quarters as a whole, the increase was 1.9%. This was basically an extension of the mild uptrend established since early 2005. After adjusting for price change, labour earnings were marginally lower by 0.1% in real terms⁽⁹⁾ both in the third quarter and in the first three quarters of the year.

6.15 The growth in nominal payroll however displayed wide variations among different economic sectors and occupations. For example, workers in financing, insurance, real estate and business services, besides generally receiving higher payroll, had a relatively larger pay hike of 5.6% in the third quarter of 2006 over a year earlier, conceivably due to the difficulties encountered by the employers in recruiting or retaining experienced staff especially those at the upper end. By comparison, employment earnings in restaurants, transport, storage and communications, and community, social and personal services rose less by 3.9%, 2.1% and 0.2% respectively. This was partly caused by increased employment of part-time workers in telecommunications, health services, sanitary services and amusement and entertainment services. Concurrently, nominal earnings of workers in the manufacturing sector went up by 2.7%.

6.16 Latest indications pointed to a further improvement in labour income in the final quarter of 2006. The preliminary employment earnings figures compiled from the General Household Survey, together with data from other sources, all showed such a trend. Moreover, the upward adjustment in pay should have been more visible in the financial sector especially among professionals, managers and administrators engaging in occupations such as accountants, financial advisers and fund managers. This pattern was similar to that prevailing in the past couple of years.

Diagram 6.8 : Nominal earnings still on a moderate uptrend



6.17 *Labour wages*, mainly as an indicator of regular payments to employees at the supervisory level or below, also moved up moderately by 2.2% in money terms in September 2006 over a year earlier. For the first nine months of 2006 as a whole, the increase was 1.3%. The ample labour supply still existing at the lower segment of the market continued to restrain the rate of increase in wages. After adjusting for inflation, there was a slight increase of 0.3% in real terms in September 2006, but a slight decline of 0.4% for the first nine months as a whole.

6.18 Among the major economic sectors, manufacturing, personal services, and financing, insurance, real estate and business services had larger wage hikes of 4.6%, 4.8% and 3.5% in money terms. A breakdown by occupation category indicated that supervisory and technical workers, and clerical and secretarial workers had relatively larger increases in nominal wages by 2.8% and 2.5% respectively. They were also the only groups experiencing mild pay rises in real terms.

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) Figures enumerated from household data. The employed population is defined here to include 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) Workers in full-time employment refer to those working 35 hours or more during the seven days before enumeration, whilst those with hours of work less than 35 hours a week are defined here as part-time workers.
- (5) 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.

- (6) Manufacturing enterprises with fewer than 100 employees and non-manufacturing enterprises with fewer than 50 employees are regarded as small and medium-sized enterprises (SMEs) in Hong Kong. Yet establishments with the same main business registration number (BRN) and engaging in activities of the same industry sector are grouped into one business unit for the purpose of calculating the number of SMEs. Thus, a business with a lot of small chain stores each employing a small number of employees will be considered as a single large enterprise, instead of separate SMEs.
- (7) Taking into account off-site workers and related professional and support staff, employment in the entire building and construction sector actually increased by 3.2% in 2006 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.

- (8) 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.
- (9) 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

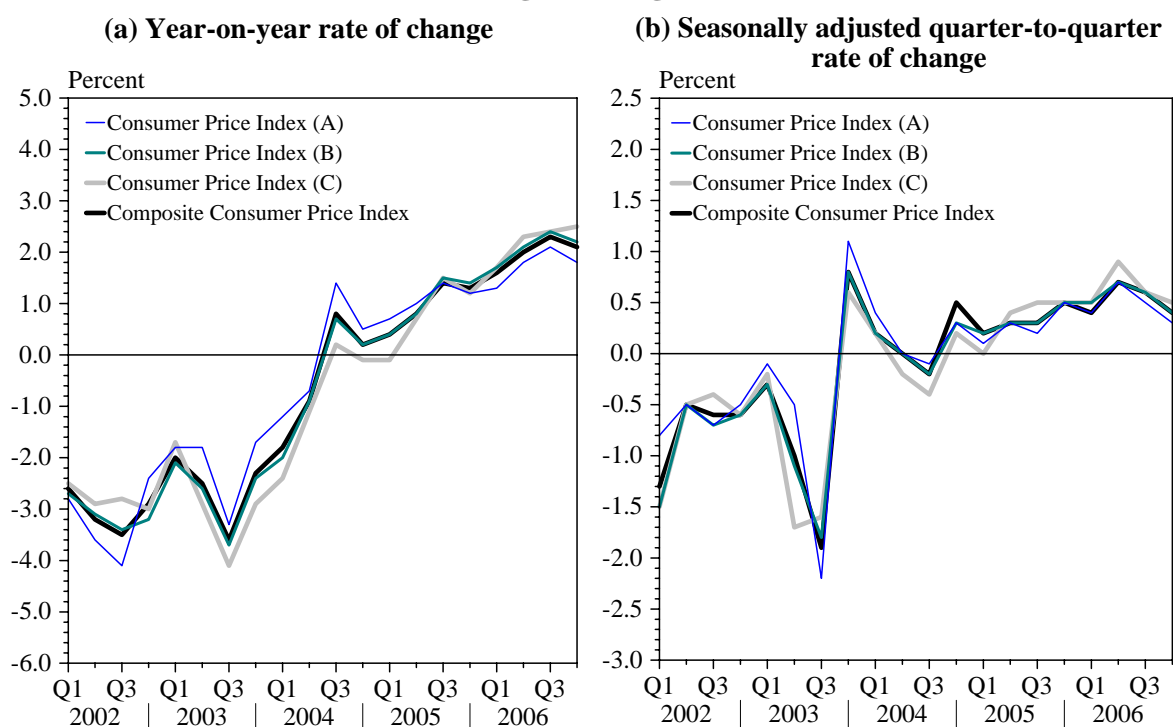
Summary

- *Consumer price inflation, while edging up during the first three quarters of 2006, remained benign through to the end of the year, averaging at a moderate 2.0% for 2006 as a whole. Inflationary pressures were generally contained, despite the brisk economic growth. The mild upward pressures from imported inflation due to the weakening Hong Kong dollar since the second quarter were largely cushioned by rapid productivity growth as well as the substantial fall in oil price and the more steady increase in housing rentals in the latter part of 2006.*
- *Domestic cost pressures stayed largely in check in 2006. There was a further decline in unit labour cost, as rapid productivity growth outweighed the impact from the moderate increases in wages and earnings. The increase in unit rental cost was also moderate in overall terms, owing to the rapid expansion in business volume as well as the largely completed pass-through from the earlier increases in rentals for retail premises.*
- *The GDP deflator, having temporarily rebounded in the latter half of 2005, recorded a marginal decline again in 2006. This was mainly due to the continued deterioration in the terms of trade, reflecting the depreciation of the Hong Kong dollar along with the US dollar since the second quarter and the surge in oil price earlier in the year.*
- *Looking ahead, imported inflation is expected to build up further along with renminbi appreciation and a weaker Hong Kong dollar. Also, there is uncertainty over a possible resurgence in oil price in the year. Yet the rapid labour productivity growth and the envisaged moderating impetus from rental rise should help to keep overall inflationary pressures in check. Various one-off measures, including the Budget measures announced for 2007/08, the public housing rental waiver in February, cut in public housing rental and the granting of government subsidy in pre-primary education, would also lower the rise in CPI to the benefit of the community at large.*

Consumer prices

7.1 Continuing the trend in 2005, consumer price inflation was on a moderate uptrend during 2006, as the earlier slack in labour market was progressively worked off upon the sustained strong economic upturn, and as the earlier rental increases increasingly showed up. Yet on the whole, local cost pressures were still contained. Wages only rose moderately in the year and were matched by an even more rapid growth in labour productivity. The rise in shop rentals was largely driven by the brisk expansion in business, and hence had not constituted a significant cost pressure on business in general. Also, the substantial easing in international oil price in the latter part of the year and the introduction of natural gas in town gas production have both helped to offset the mild pick-up in imported inflation towards the end of the year due to a weaker US dollar, the renminbi appreciation as well as higher food prices from the Mainland.

Diagram 7.1 : Consumer price inflation remained benign through to end-2006



Note : From the fourth quarter of 2005 onwards, the year-on-year rates of change in the Consumer Price Indices are computed from the new 2004/05-based CPI series. Before then, the year-on-year rates of change are computed from the old 1999/2000-based CPI series. Splicing has been applied to the indices to maintain continuity.

7.2 Reflecting these developments, consumer price inflation as indicated by the *Composite Consumer Price Index (CCPI)*⁽¹⁾ rose modestly from 1.6% in the first quarter to 2.0% in the second quarter, and edged higher further to 2.3% in the third quarter before easing back to 2.1% in the fourth quarter. For 2006 as a whole, CCPI inflation averaged at 2.0%, a still moderate rate when viewed against the high economic growth over the past three years. In 2007, overall inflationary pressures are likely to remain largely in check, as sustained productivity growth and the expected moderating impetus from rental costs are likely to provide a cushioning effect against the upside risks from a plausible weakening of the US dollar and the expected gradual appreciation of the renminbi. A number of one-off measures in the year would also push down the cost of living to the benefit of the community at large, including the Budget measures announced for 2007/08, the one-month public housing rental waiver and the subsequent cut in public housing rentals, as well as the cut in pre-primary school fees upon the granting of government subsidy in the 2007/08 school year.

Diagram 7.2 : Pick-up in inflation in 2006 largely due to pass-through of earlier rental increase

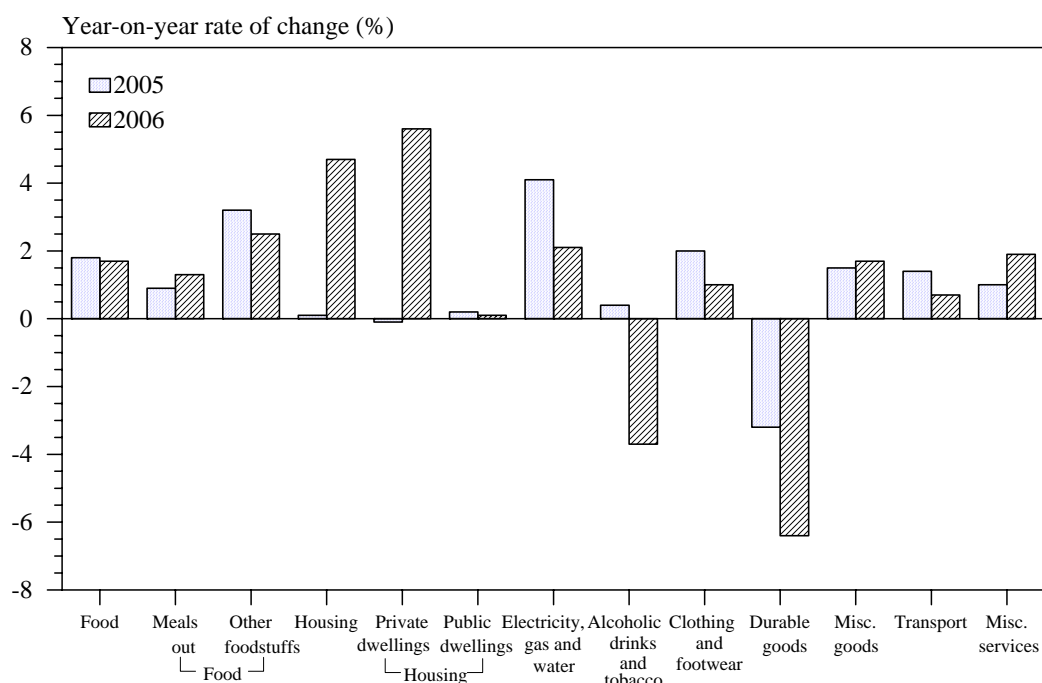


Table 7.1 : Consumer Price Indices
(year-on-year rate of change (%))

		<u>Composite CPI</u>	<u>CPI(A)</u>	<u>CPI(B)</u>	<u>CPI(C)</u>
2005	Annual	1.0	1.1	1.0	0.8
	H1	0.6	0.8	0.6	0.3
	H2	1.4	1.3	1.4	1.4
	Q1	0.4	0.7	0.4	-0.1
	Q2	0.8	1.0	0.8	0.7
	Q3	1.4	1.4	1.5	1.5
	Q4	1.3	1.2	1.4	1.2
	2006	Annual	2.0	1.7	2.1
	H1	1.8	1.6	1.9	2.0
	H2	2.2	1.9	2.3	2.4
	Q1	1.6	1.3	1.7	1.7
	Q2	2.0	1.8	2.1	2.3
	Q3	2.3	2.1	2.4	2.4
	Q4	2.1	1.8	2.2	2.5

Note: The year-on-year changes of the CPIs from the fourth quarter of 2005 onwards are from the 2004/05-based CPI series, while the ones before that are from the 1999/2000-based series. Splicing has been applied to the two sets of CPI series in order to obtain better estimates of the annual rate of change for 2005 and for the second half of 2005.

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

<u>Expenditure component</u>	<u>Weighting</u>	<u>2005</u>	<u>2006</u>	<u>2006</u>			
				<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>
Food	26.94	1.8	1.7	0.9	1.7	2.1	2.2
<i>Meals bought away from home</i>	<i>16.86</i>	<i>0.9</i>	<i>1.3</i>	<i>1.0</i>	<i>1.3</i>	<i>1.5</i>	<i>1.5</i>
<i>Other foodstuffs</i>	<i>10.08</i>	<i>3.2</i>	<i>2.5</i>	<i>1.0</i>	<i>2.3</i>	<i>3.1</i>	<i>3.5</i>
Housing ^(a)	29.17	0.1	4.7	4.2	4.9	4.8	4.8
<i>Private dwellings</i>	<i>23.93</i>	<i>-0.1</i>	<i>5.6</i>	<i>5.0</i>	<i>5.9</i>	<i>5.7</i>	<i>5.6</i>
<i>Public dwellings</i>	<i>2.49</i>	<i>0.2</i>	<i>0.1</i>	<i>0.1</i>	<i>0.1</i>	<i>0.1</i>	<i>0.1</i>
Electricity, gas and water	3.59	4.1	2.1	3.9	3.4	4.1	-2.8
Alcoholic drinks and tobacco	0.87	0.4	-3.7	-0.6	-5.9	-4.1	-4.3
Clothing and footwear	3.91	2.0	1.0	-2.0	-0.7	1.7	5.0
Durable goods	5.50	-3.2	-6.4	-5.8	-6.6	-6.9	-6.3
Miscellaneous goods	4.78	1.5	1.7	0.4	1.8	1.9	2.6
Transport	9.09	1.4	0.7	1.6	1.1	0.2	-0.1
Miscellaneous services	16.15	1.0	1.9	1.2	1.9	2.5	2.1
All items	100.00	1.0	2.0	1.6	2.0	2.3	2.1

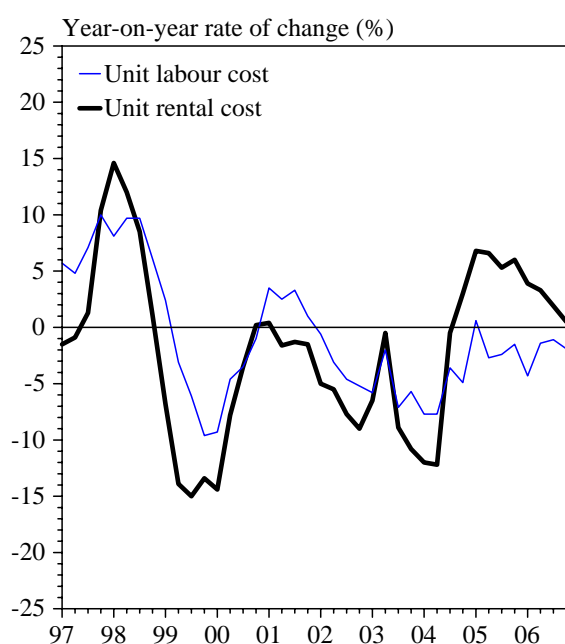
Note : (a) The housing component covers rents, rates, Government rent, maintenance costs and other housing charges. Its sub-components on private and public dwellings as presented here, however, cover rents, rates and Government rent only. Hence, the combined weighting of private and public dwellings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

Costs of factor inputs

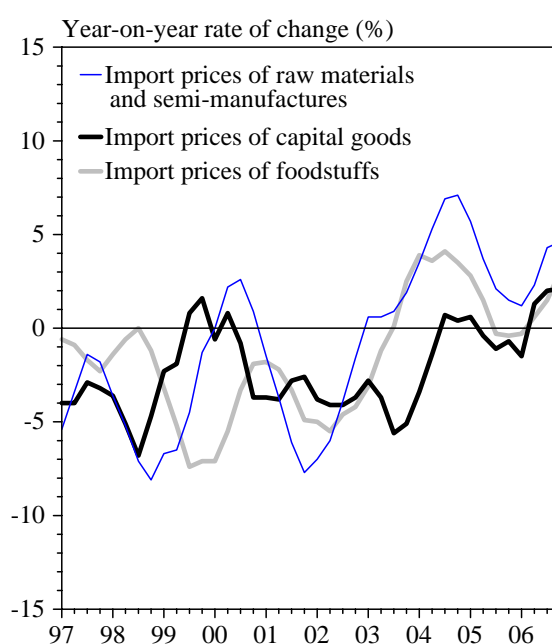
7.3 Upward pressures on *local business cost* remained largely in check. *Unit labour cost*⁽²⁾ actually went down further in 2006, thanks to the modest pressure from the wage front and the rapidly rising labour productivity. However, as the earlier slack in the labour market was progressively worked off, the decrease in unit labour cost began to narrow in the latter half of the year. As to rental costs, while office rentals were on a sustained noticeable rise all through 2006, particularly for those in the core business district, rentals for retail premises actually slowed during the year. Coupled with the rapid expansion in business turnover, the rise in unit rental cost decelerated quite markedly over the course of 2006. With the impetus from rental rise waning at a time when unit labour cost began to turn up, in overall terms the local cost pressures were thus contained through to the year-end.

Diagram 7.3 : Costs of factor inputs

(a) Domestic cost pressures remained largely in check



(b) External cost pressures went up over the course of the year



7.4 From the external front, pressures from import prices were also moderate. Imported inflation owing to the weakening Hong Kong dollar along with the US dollar was cushioned in part by the substantial fall in oil price since mid-August. *Import prices of raw materials and foodstuffs* went up over the course of the year, but the pick-up in *prices of consumer goods and capital goods* was much milder. For import prices of consumer goods in particular, they were conceivably kept down partly by the weakness of the yen, another important source of Hong Kong's imports for consumption use. Import prices of fuels rose rapidly during the first three quarters in tandem with the surge in international oil price, but with the subsequent ease-back since mid-August, they likewise slowed markedly in the fourth quarter.

**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>
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
2006	Annual	1.2	0.5	3.2	16.6	1.1	2.1
	H1	0.2	0.3	1.8	27.5	*	1.5
	H2	2.3	0.7	4.4	7.6	2.1	2.7
	Q1	-0.3	0.5	1.2	32.4	-1.5	1.0
	Q2	0.6	0.1	2.3	23.7	1.3	1.9
	Q3	1.5	0.4	4.3	13.6	2.0	2.7
	Q4	3.0	1.1	4.6	2.0	2.1	2.7

Note : (*) Change of less than 0.5%

Box 7.1

How high is imported inflation in Hong Kong ?

There has been considerable concern about the extent of imported inflation brought about by a weaker US dollar and renminbi appreciation, and its consequential impact in pushing up Hong Kong's CPI inflation. The analysis in this article suggests that while imported inflation has indeed risen in recent years, its impact on consumer price inflation is not as significant as generally perceived.

In analyzing the extent of imported inflation in Hong Kong, the following points are note-worthy:

- (1) Although the Hong Kong dollar has depreciated against the renminbi, euro and the other Asian currencies, the fall in the value of Hong Kong dollar in terms of the Import-weighted exchange rate index was only 1.3% in 2006. This was in fact much smaller than in 2003 and 2004 when the fall was 3.0% and 2.4% respectively.
- (2) The pick-up in overall import prices over the course of 2006 was mostly in the prices of raw materials and semi-manufactures and also in oil prices. The increase in import prices relevant to consumption, though also creeping up over the year, was much more modest. For food and consumer goods taken together, the increase was only 1.1% in the fourth quarter, and 0.8% for 2006 as a whole. When matched against the depreciation of the Hong Kong dollar by 3.9% and 1.3% for the same periods, it is apparent that only part of the exchange rate influence would feed through to import prices, conceivably because prices of goods worldwide are being kept down by the forces of globalization.
- (3) Import cost is just one component of total cost. As a rough indication of the extent of import content in consumption, in 2006 retained imports of food and consumer goods amounted to \$186 billion, equivalent to 22% in total consumption of goods and services in Hong Kong's domestic market. Thus, even assuming full pass-through from the increase of import prices of food and consumer goods to consumer price inflation, the rise in CPI inflation stemming from imported inflation would only be around 0.2 of a percentage point (i.e. $22\% \times 0.8\%$; including the feed-through of higher oil prices, the impact would be roughly around 0.3 of a percentage point for 2006 as a whole). In reality, full pass-through may not always occur, if part of the cost increase is absorbed by most local retailers amidst keen competition for business.

Table 1: Exchange rate influence on Hong Kong's inflation

	Annual rate of change (%)					
	Import-weighted exchange rate index of HK dollar	Import prices of foodstuffs and consumer goods ⁺	CCPI*	of which: <u>Food</u>	<u>Clothing and footwear</u>	<u>Durable goods</u>
2002	-0.4	-3.4	-3.0	-2.1	0.7	-6.3
2003	-3.0	-0.4	-2.6	-1.5	-2.7	-6.4
2004	-2.4	1.7	-0.4	1.0	6.4	-2.2
2005	-1.1	2.3	1.0	1.8	2.0	-3.2
2006	-1.3	0.8	2.0	1.7	1.0	-6.4

(+) Weighted by the respective shares of imports for local use.

(*) Figures from 2005 Q4 onwards are based on the 2004/05-based CCPI series; for earlier periods, the figures are based on the 1999/00-based series.

Box 7.1 (cont'd)

To further investigate into the extent of imported inflation in Hong Kong, a desk top exercise is undertaken to decompose consumer price inflation into its local and external components with the use of an econometric model. The structural equation takes the following form :

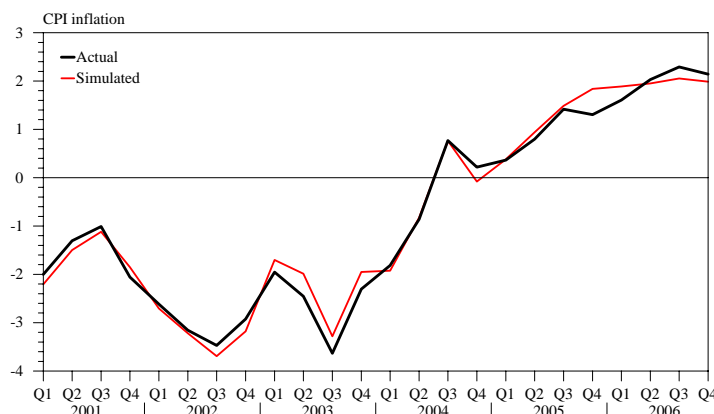
$$\dot{P}_t = f(\dot{P}_{t-1}, ULC_t, SR\dot{E}NT, YGAP, M\dot{U}VI)$$

- Where \dot{P} = Year-on-year rate of change in Composite Consumer Price Index, excluding government fees and public utility charges
- ULC = Year-on-year rate of change in unit labour cost as measured by nominal wage growth net of productivity growth
- $SR\dot{E}NT$ = Year-on-year rate of change in 8-quarter moving average of shop rental costs
- $YGAP$ = Change in output gap as proxy of the change in profit margin in the local economy. Output gap is the gap between GDP and potential output expressed as a % of potential output; the latter estimated by assuming normal intensity of usage of factors of production
- $M\dot{U}VI$ = Year-on-year rate of change in the aggregate index of import prices of food, consumer goods and fuel taken together weighted by their respective shares in the consumption basket and their respective estimated import contents

The inflation series used in the model is the rate of change in the CCPI after excluding the effects of government measures and changes in public utility charges, this being a better measure of the underlying inflation. The movements of unit labour cost and shop rentals feature as the key components of domestically generated cost pressures, while the movements of import prices relevant to CPI inflation are to gauge the extent of imported inflation. The extent of these domestic and external influences that can be passed through to the local retail price level would be reflected in a change in profit margin as proxied by the change in output gap, a key measure of the aggregate demand and supply balance in the local economy. A tourism variable is added to take on board the lift to pricing power of retailers from the tourism boost after mid-2003.

The estimation is based on quarterly data from 2000 Q4 to 2006 Q4. The independent variables in the regression model all carry the expected signs, and are all statistically significant at the 5% level, and the simulated inflation series is able to track the actual series very well, as can be seen from the chart below.

Chart 1 : The simulated inflation series tracks the actual series very well



Box 7.1 (cont'd)

The coefficients from the econometric model are then used to decompose CPI inflation into the local and external cost components, as shown in the following table:

Table 2: Decomposition of CPI inflation into local and external components[^]

Year	External				Local*	Change in government fees and public utility charges	Effect of rebasing of CPI series	Total
	Import prices of food	Import prices of consumer goods	Import prices of fuel+	Sub-total				
2002	-0.44	-0.14	-0.02	-0.61	-0.99	-1.46	0.00	-3.0
2003	-0.21	-0.20	0.07	-0.34	-2.65	0.49	0.00	-2.6
2004	0.19	0.02	0.09	0.30	-0.99	0.30	0.00	-0.4
2005	0.16	0.14	0.12	0.43	0.58	0.06	-0.10	1.0
2006	0.08	0.17	0.08	0.34	1.95	0.13	-0.40	2.0

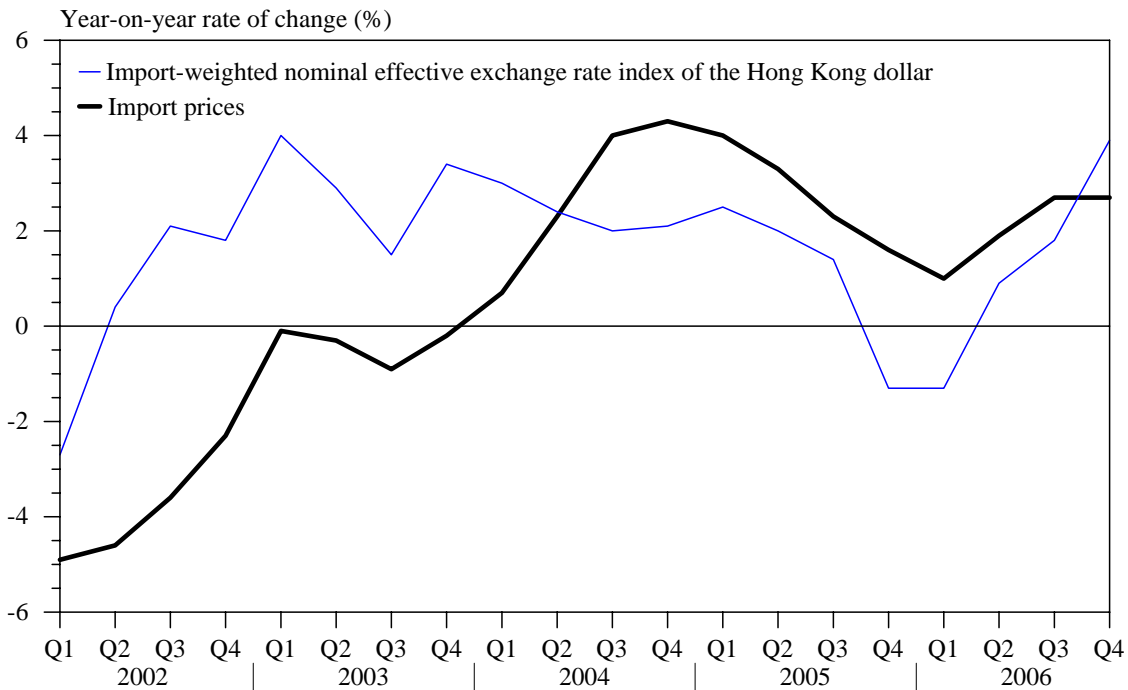
([^]) Because of the presence of a lagged endogenous variable, the decomposition analysis has back tracked all the lagged effects from the rise/decline in various cost components in the preceding 11 periods.

(+) Including the impact of higher oil prices on town gas charges; the model-based estimates here are very close to the actual impact as calculated from the energy-related components in the CCPI series.

(*) Including the lift to pricing power brought about by tourism. This is estimated to be quite insignificant over the past five years, except for 2004 when inbound tourism rebounded markedly from SARS outbreak.

If the lagged effects of the feed-through of higher import prices are also included, the model estimates are that in 2006, imported inflation contributed around 0.34 of a percentage point to the 2% CPI inflation, or roughly one-sixth of the inflationary pressures. Also, it is noteworthy that the extent of imported inflation was actually slightly lower in 2006 than in 2005, and this ties in well with the more moderate increase in import prices relevant to the consumption basket as shown in Table 1. The estimates are also close to the broad-brush estimates in Point (3), again echoing the point that the cost pressure from imported inflation is not as large as generally perceived. As the above table shows, a large part of CPI inflation in recent years was driven by local cost factors rather than external cost pressures. Further examination by cost component indicates that the bulk of the cost pressures was due to the feed-through of the rise-back in rental costs after a prolonged period of distinct decline, and also the gradual return of pricing power of retailers, and on this, the decline in unit labour cost has been rendering a useful alleviating force against the cost pressures on the local front – thanks to the rapidly rising labour productivity (for detailed analysis of productivity growth in Hong Kong, see Box 1.1).

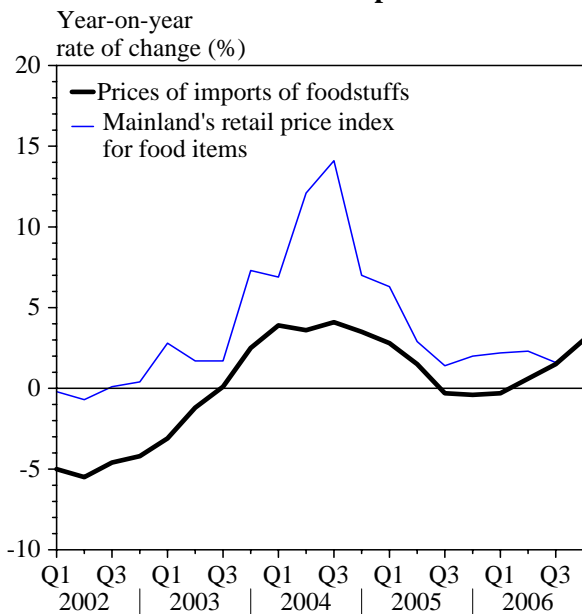
Diagram 7.4 : The recent Hong Kong dollar depreciation had pushed up import prices modestly



Note : The nominal EERI in this graph is inverted in scale for easier comprehension. An increase in the nominal EERI indicates weakening of the Hong Kong dollar.

Diagram 7.5 : Import price of fuels fell off towards end-2006, while import prices of other commodities picked up by different extents along with US dollar weakening

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



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

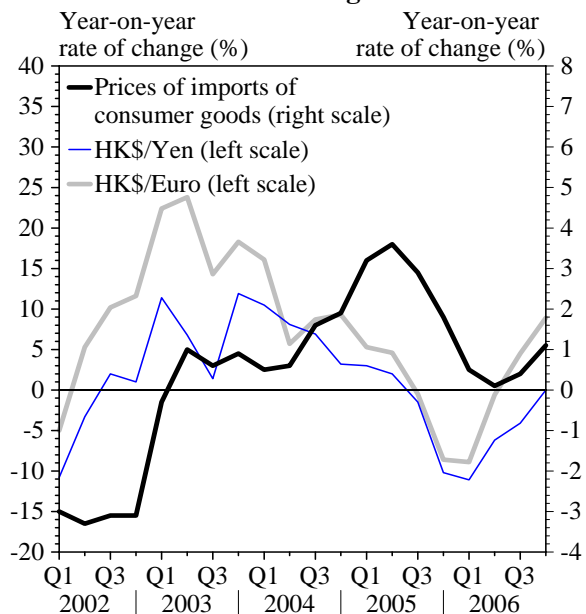
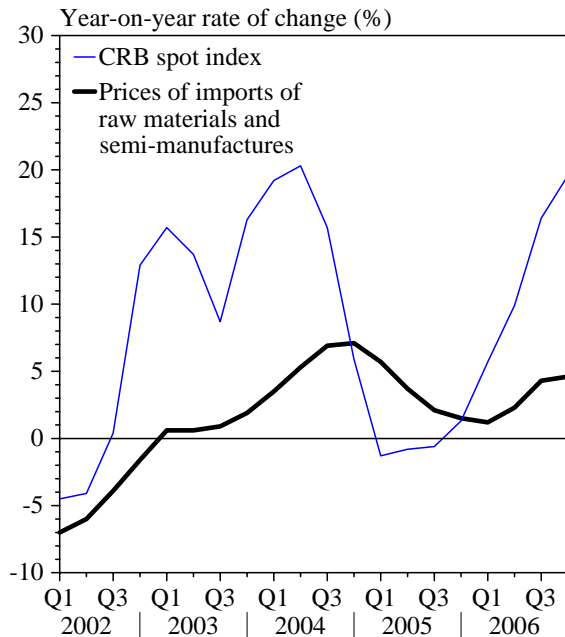
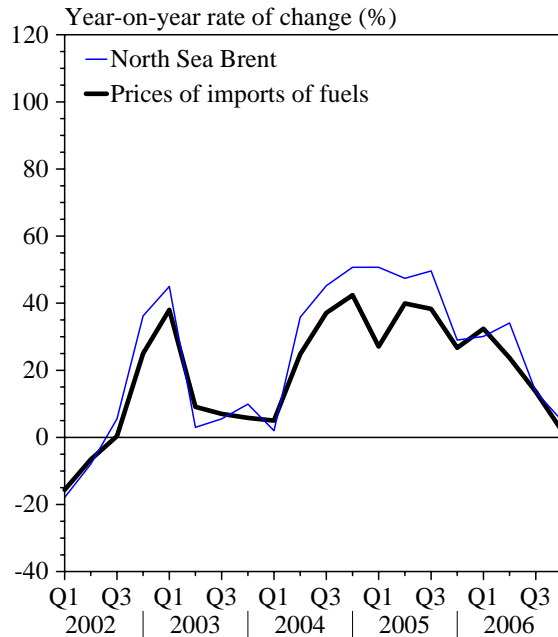


Diagram 7.5 (cont'd):

(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 The prices of local manufacturing output, as measured by the *Producer Price Index*⁽³⁾, crept up modestly over the course of the year. This partly reflected the higher import prices of raw materials in the second half of 2006. For most of the selected service sectors, output price growth was modest or even negative. The exception was the hotel sector, which saw a further surge in hotel room tariffs – thanks to the vibrant performance of inbound tourism during most part of 2006. Another notable development was the persistent fall in the prices for the telecommunications sector reflecting the keen competition and technological advancement. Also, output prices of maritime transport had declined since late 2005 and those of air transport also eased of late, indicating the highly competitive environment in these two sectors.

**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>Q1</u>	<u>2005</u> <u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>2006</u> <u>Q2</u>	<u>Q3</u>
Manufacturing	0.8	0.5	0.7	0.8	1.1	2.0	2.4	2.6
Selected services sector ^(#)								
Hotels and boarding houses	12.3	14.0	11.8	11.2	12.1	10.1	9.2	9.2
Land transport	1.0	0.9	0.4	1.3	1.5	1.0	0.6	-0.2
Maritime transport	0.4	1.6	0.2	0.9	-1.0	-3.6	-3.7	-1.7
Air transport	2.5	1.6	2.9	3.1	2.5	0.2	-0.5	-2.4
Telecommunications	-7.5	-8.2	-7.6	-8.0	-6.2	-7.5	-6.2	-4.0
Miscellaneous communications services	*	-0.3	0.1	0.1	0.1	1.5	1.4	1.3

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 After a relatively short period of modest rebound in the second half of 2005, the *GDP deflator*⁽⁴⁾, a broad measure of overall changes in prices of the economy, declined marginally again in 2006, by 0.4% over 2005. This was mainly caused by a renewed deterioration in the *terms of trade*⁽⁵⁾, a dominant item in the GDP deflator given the sheer size of trade in the Hong Kong economy. The surge in oil price in most part of 2006, coupled with the depreciation of the Hong Kong dollar along with the US dollar since the second quarter resulting in a faster increase in import prices, contributed to the worsening of the terms of trade in 2006. Excluding the terms of trade effect, the *domestic demand deflator* actually picked up slightly to a 1.9% increase in 2006, broadly in line with consumer price inflation.

Diagram 7.6

(a) GDP deflator marginally declined...

(b) ...caused by a continued deterioration in the terms of trade

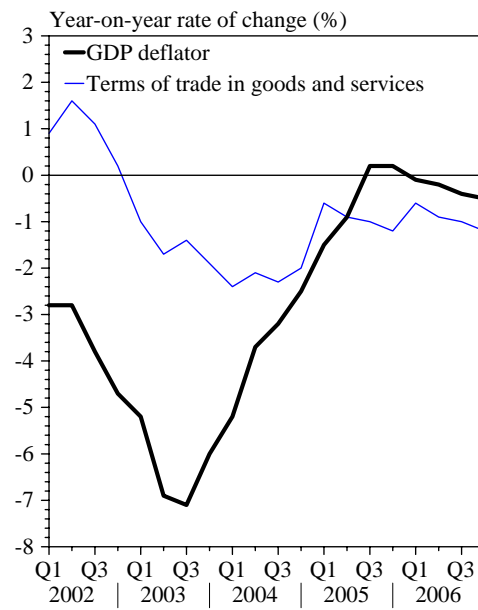
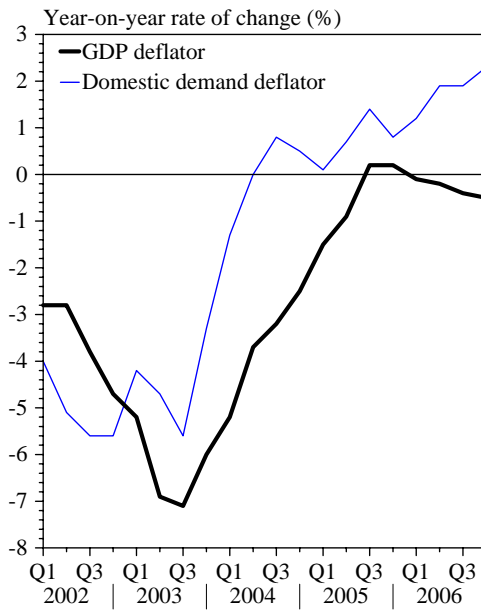


Table 7.5 : GDP deflator and the main expenditure component deflators (year-on-year rate of change (%))

	Annual [#]	2005				Annual ⁺	2006			
		Q1 [#]	Q2 [#]	Q3 [#]	Q4 [#]		Q1 [#]	Q2 [#]	Q3 [#]	Q4 ⁺
Private consumption expenditure	1.5	0.5	1.4	1.6	2.4	1.8	2.1	1.7	1.6	1.9
Government consumption expenditure	-1.6	-1.8	-1.6	-1.6	-1.4	1.4	1.3	1.3	1.4	1.2
Gross domestic fixed capital formation	0.5	1.5	1.0	1.3	-1.8	2.7	-1.5	2.6	5.7	4.0
Total exports of goods	-0.1	1.3	0.4	-0.2	-1.3	-0.5	-1.8	-0.7	-0.4	0.2
Imports of goods	1.3	2.9	1.8	0.8	*	1.4	*	1.4	1.7	2.1
Exports of services	3.7	3.1	3.1	3.2	5.0	4.2	4.3	5.3	4.9	2.9
Imports of services	1.5	2.5	2.4	1.3	-0.1	1.0	*	0.8	1.4	1.9
Gross Domestic Product	-0.4	-1.5	-0.9	0.2	0.2	-0.4	-0.1	-0.2	-0.4	-0.5
		<0.1>	<*>	<0.1>	<*>		<-0.2>	<-0.1>	<*>	<-0.1>
Total final demand	0.8	1.2	0.9	0.7	0.1	0.8	*	0.9	1.0	1.3
Domestic demand	0.8	0.1	0.7	1.4	0.8	1.9	1.2	1.9	1.9	2.3

Notes : Figures are subject to revision later on as more data become available.

(#) Revised figures.

(+) Preliminary figures.

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

(*) Change of less than 0.05%.

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 obtained from the Household Expenditure Survey. Then, by aggregating the expenditure patterns of all the households covered by the above three indices, a Composite CPI is compiled.

The expenditure ranges of the households covered in the 2004/05-based CPIs are shown below:

	<u>Approximate proportion of households covered</u> (%)	<u>Average monthly expenditure range during Oct 2004 to Sep 2005</u> (\$)
CPI(A)	50	4,000 to 15,499
CPI(B)	30	15,500 to 27,499
CPI(C)	10	27,500 to 59,999

The weightings of the various components in the 2004/05-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	26.94	32.10	27.32	20.41
<i>Meals bought away from home</i>	<i>16.86</i>	<i>18.63</i>	<i>17.65</i>	<i>13.74</i>
<i>Other foodstuffs</i>	<i>10.08</i>	<i>13.47</i>	<i>9.67</i>	<i>6.67</i>
Housing	29.17	30.54	27.70	29.66
<i>Private dwellings</i>	<i>23.93</i>	<i>22.07</i>	<i>23.89</i>	<i>26.11</i>
<i>Public dwellings</i>	<i>2.49</i>	<i>6.18</i>	<i>1.25</i>	--
<i>Maintenance costs and other housing charges</i>	<i>2.75</i>	<i>2.29</i>	<i>2.56</i>	<i>3.55</i>
Electricity, gas and water	3.59	4.84	3.37	2.45
Alcoholic drinks and tobacco	0.87	1.35	0.79	0.42
Clothing and footwear	3.91	2.81	4.28	4.67
Durable goods	5.50	4.01	5.67	6.99
Miscellaneous goods	4.78	4.68	4.76	4.91
Transport	9.09	8.07	9.05	10.35
Miscellaneous services	16.15	11.60	17.06	20.14
All items	100.00	100.00	100.00	100.00

- (2) Unit labour cost represents the labour cost per unit of output produced. It is distinct from the nominal wage index in that it will discount the effect of labour productivity growth in arriving at the labour cost measure. Technically, it refers to the product of the nominal index of payroll per person engaged and the total employment, divided by the real GDP.
- (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 2006

- 1 Jan The third phase of Closer Economic Partnership Arrangement (CEPA) between the Mainland and Hong Kong came into effect. All products of Hong Kong origin could enter the Mainland tariff free, upon the CEPA rules of origin being agreed and met. 262 additional products were added to the list of goods with CEPA rules of origin, making a total of 1 370. Moreover, Hong Kong service suppliers enjoyed preferential access to the Mainland market in 27 service areas.
- The Mainland continued to reduce its import tariffs on more than 100 items in line with the World Trade Organization (WTO) commitments. The average import tariff rate was 9.9% in 2006. After this round of tariff reduction, the Mainland basically fulfilled its tariff reduction commitments under the WTO.
- The Mainland ceased levying export duty on textile exports.
- 3 Jan The People's Bank of China (PBOC) announced further measures to improve the managed float exchange rate regime and promote development of the foreign exchange market in the Mainland. Among other measures, over-the-counter transactions were introduced in the inter-bank spot foreign exchange market on 4 January.
- 4 Jan The Heritage Foundation and the Wall Street Journal released the 2006 Index of Economic Freedom. Hong Kong was rated the freest economy in the world for the 12th straight year, followed by Singapore and Ireland.
- 6 Jan The Office of the Telecommunications Authority (OFTA) introduced a new Services-Based Operator (SBO) Licence for the provision of Internet Protocol (IP) Telephony services. The creation of SBO Licence enabled services-based operators to enter the IP Telephony services market, thereby further enhancing market competition.
- 8 Jan The Hong Kong Shipping Register reached 30 million gross tonnage.
- 9 Jan The Hong Kong Monetary Authority (HKMA) launched the CMU Bond Price Bulletin website (www.cmu.org.hk). The website provided retail investors with convenient on-line access to indicative bond prices quoted by the major banks in Hong Kong, and help promote the retail bond market in Hong Kong.
- 10 Jan The new franchised bus fare adjustment arrangement came into effect.
- 17 Jan The Government granted the approval for the further planning of the Northern Link and the Hong Kong section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link. The Kowloon Canton Railway Corporation (KCRC) was invited to proceed with further planning work of the project.
- 19 Jan HKMA announced the position of the Exchange Fund at the end of 2005. The Fund recorded an investment income of \$38.1 billion in 2005. After deducting interest and other expenses, net investment income was \$30.4 billion, of which the Fiscal Reserves' share amounted to \$10.0 billion. At the end of 2005, the Accumulated Surplus stood at \$443.2 billion.

- 23 Jan The Treasury Markets Association was established. The Association aimed to further promote the professionalism and competitiveness of the treasury markets in Hong Kong.
- 24 Jan The Housing Authority (HA)'s Subsidized Housing Committee endorsed the sale of surplus Home Ownership Scheme (HOS) flats, standing at about 16 600, from 2007 onwards. The surplus flats would be offered for sale to both public rental housing tenants and eligible households living in private housing.
- 2006
 Holders of Document of Identity for visa purposes who held smart identity cards could make use of the automated passenger clearance channels and automated vehicle clearance channels (e-channels) at boundary control points.
- 31 Jan The construction of the Deep Bay Link (DBL) in the northwest New Territories was substantially completed. The DBL, together with the Hong Kong-Shenzhen Western Corridor, would serve to meet the increasing cross-boundary traffic needs.
- A circular, issued jointly by the Mainland's Ministry of Finance and four other Ministries, announced that foreign investors (including Hong Kong, Macao and Taiwan) were allowed to make strategic investments in tradable A shares of companies which had completed share reform, or companies which had been listed after the share reform, provided that these foreign investors would acquire at least a 10% stake and hold the stock for three years.
- 1 Feb The Marine Department introduced the Annual Tonnage Charge reduction scheme for ships registered in Hong Kong.
- The Base Rate under the Discount Window operated by HKMA was raised by 25 basis points to 6.0%, following an increase of the United States (US) Fed Funds target rate by the same magnitude to 4.5%.
- 11 Feb The Revenue (Abolition of Estate Duty) Ordinance 2005 came into effect.
- 14 Feb The International Monetary Fund (IMF) released its Staff Report on Hong Kong. IMF gave a positive assessment of Hong Kong's economic performance and commended the Government's fiscal and exchange rate policies. IMF also noted the importance of Hong Kong playing an increasing role in the Mainland's financial intermediation, which Hong Kong was well-positioned to assist given its sophisticated financial infrastructure.
- 17 Feb The Legislative Council (LegCo) Finance Committee approved the equity investment by the Financial Secretary Incorporated in the DTTN Limited. The investment was made in response to industry's demand for government investment in the company to ensure the neutrality and non-exclusivity of the Digital Trade and Transportation Network System.
- 22 Feb The Financial Secretary (FS) presented the Budget for the financial year 2006-07 to the LegCo.
- FS proposed, among others, to lower the marginal salaries tax rates of the second, third and top tax bands by one percentage point from 8, 14 and 20 per cent to 7, 13 and 19 per cent respectively; and to extend the maximum number of years of deduction for home loan interest from 7 years to 10 years.

The 2005 Economic Background and 2006 Economic Prospects were published along with the 2006-07 Budget. On Hong Kong's economic outlook for 2006, the Gross Domestic Product (GDP) growth was forecast at 4% to 5% in real terms, while the Composite Consumer Price Index (CPI) was forecast to increase by 2.3%.

1 Mar The United Kingdom (UK) Foreign and Commonwealth Office presented to UK parliament the 18th Six-monthly Report on Hong Kong covering the period July to December 2005. The Report stated that the "One Country, Two Systems" principle had generally worked well in practice and that the rights and freedoms promised to Hong Kong in the Joint Declaration and the Basic Law had continued to be upheld. It also reported that bilateral trade had continued to expand healthily.

The Customs and Excise Department signed a Customs Co-operative Arrangement with the Customs Department of Thailand. The Arrangement pledged to strengthen cooperation in fighting transnational customs crimes.

2 Mar A pilot scheme was launched for opening up intellectual property in government information technology systems for commercial exploitation.

3 Mar The Commerce, Industry and Technology Bureau (CITB) commenced a three-month consultation on the proposed merger of the Broadcasting Authority and Telecommunications Authority to set up a unified regulator, namely the Communications Authority, to oversee the entire electronic communications sector. The merger proposal aimed to enhance regulatory co-ordination and efficiency, and facilitate further development of the electronic communications industry, thereby benefiting consumers. The public and the industry had responded positively. In the light of this, the Administration planned to introduce the relevant legislation into the LegCo in 2007.

6 Mar The Renminbi Settlement System was launched. Key functions of the System included a clearing and settlement system for renminbi cheques drawn on banks in Hong Kong for consumer spending in Guangdong, an automated system for remittance processing, renminbi bank card payments and renminbi position-squaring, and a real-time enquiry service for participants of the system.

9 Mar HA launched a three-month public consultation on the review of its domestic rent policy. The consultation paper set out the initial findings of the HA's Ad Hoc Committee on Review of Domestic Rent Policy. Amongst the most important reform proposals was the establishment of a more transparent and well-defined index-linked mechanism to guide future rent adjustments, both upwards and downwards, based on movements in consumer price or tenants' household income.

10 Mar The Revenue (Profits Tax Exemption for Offshore Funds) Ordinance 2006 was enacted.

The Revenue (Personalized Vehicle Registration Marks) (PVRMs) Ordinance 2005 came into effect. Under the Scheme, a vehicle owner could choose a preferred registration mark, apply to the Transport Department and use it upon approval and bidding. Three auctions were held for the approved PVRMs in September, October and December of 2006.

- 13 Mar The income and asset limits for the HA's Waiting List applicants were increased by an average of 2.7% and 1.7% respectively for 2006–07 to reflect the change in consumer price levels and private rentals in Hong Kong over the year.
- 14 Mar The Mainland's 11th Five-year Plan (2006–2010) was endorsed in the fourth session of the 10th National People's Congress. The key targets of the Plan included building a new socialist countryside, boosting optimization and upgrade of industrial structure, speeding up services industry development and promoting balanced regional development. The Plan unequivocally supported Hong Kong in the development of its services industries such as financial services, logistics, tourism and information services, and the maintenance of its status as an international centre of financial services, trade and shipping.
- 16 – 17 Mar A seminar on the Avian Influenza Preparedness for the Aviation Sector cum Contingency Exercise was held. The seminar focused on the preparedness for the Avian Influenza in the aviation sector and provided a forum for delegates from various states/territories and international organizations to share experience in the fight against Avian Influenza.
- 17 Mar The Government announced the 2006–07 Application List for the sale of Government land, which comprised 33 residential sites and 12 commercial/business sites of various sizes and at various locations.
- The Copyright (Amendment) Bill 2006 was published in the Gazette. The Bill included proposals which sought to introduce new end-user criminal liability for copyright infringement, improve the copyright exemption regime, strengthen the protection for technological measures for copyright protection, introduce rental rights for films and comic books, and further liberalize the use of parallel imports. The Bill was introduced into the LegCo on 29 March 2006.
- 20 Mar The Planning Study on the Co-ordinated Development of the Greater Pearl River Delta (PRD) Townships, carried out jointly by Guangdong and Hong Kong, commenced. Its objective was to formulate a regional planning strategy for the Greater PRD Region.
- 21 Mar The third Digital Entertainment Leadership Forum was held, where overseas experts in digital entertainment shared their vision and experience with the local practitioners.
- 21 – 24 Mar The third Corporate Registers Forum, hosted by the Companies Registry, was held. The forum provided an opportunity for Registrars of Companies or their equivalents from all over the world to meet and exchange information and experiences on the latest international developments.
- 22 Mar The fourth 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.
- The Civil Aviation Department (CAD) signed a Technical Arrangement on Aircraft Maintenance with Civil Aviation Directorate of Transport Canada for the mutual recognition of aircraft maintenance approval. This was an expansion of a previous arrangement signed in December 2005.

- 23 Mar The Pan-PRD Financial Services Forum was held by the Financial Services and the Treasury Bureau (FSTB) to enable leaders and entrepreneurs from the Pan-PRD Region to gain a better understanding of Hong Kong's financing and investment services, and encourage them to use Hong Kong as the capital formation and investment platform. At the Forum, the Chief Executive of HKMA proposed a five-pronged financial development strategy for the maintenance of the status of Hong Kong as an international financial centre.
- The Hong Kong Mortgage Corporation Limited (HKMC) announced the launch of a debut issue under the Debt Issuance Programme for a \$100 million 2-year Composite Interest Rate Notes. It was another initiative by HKMC to promote product diversification in the Hong Kong debt market.
- 29 Mar The Base Rate under the Discount Window operated by HKMA was raised by 25 basis points to 6.25%, following an increase of the US Fed Funds target rate by the same magnitude to 4.75%.
- 31 Mar The second stage consultation exercise on the Future Development of the Electricity Market in Hong Kong ended with over 17 000 submissions. The Government would finalize the post-2008 regulatory arrangements taking into account the public comments received.
- The Office of the US Trade Representative released the 2006 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.
- 6 Apr The Treasury Markets Association launched the Spot USD/HKD Fixing. The Fixing served as a benchmark for the market exchange rates of US dollar against Hong Kong dollar at 11:00 a.m. Hong Kong time and was expected to provide a reference rate for the pricing of Hong Kong dollar-linked currency products.
- 10 Apr –
23 Aug About 15 hectares of land in Tai Po and Kwai Chung were tendered out to meet the demand of land for port and logistics use.
- 11 Apr The Government announced that a non-binding Memorandum of Understanding (MOU) was signed with the MTR Corporation Limited on the structure and terms for the merger of the Mass Transit Railway (MTR) and the Kowloon-Canton Railway (KCR) systems. Under the merger proposal, KCRC would grant a service concession with an initial term of 50 years to MTR Corporation Limited to operate the KCR system. The proposed merger would bring overall benefits to the community as a whole.
- 12 Apr The Securities and Futures Commission signed a MOU with the Israel Securities Authority to facilitate cooperation on enforcement of securities laws and exchange of information.
- 13 Apr The Report on the Consultancy Study on the Local Auto-fuel Retail Market was released. The consultant concluded that there was no clear evidence of collusion by the oil companies in setting prices of auto-fuel. Nevertheless, given the inherent characteristics of the local auto-fuel market, the consultant recommended that the Government should consider preventive measures for prohibiting cartel behaviour, either through general or sector-specific competition laws.

- 14 – 15 Apr The Cross-Straits Economic and Trade Forum was held in Beijing. At the conclusion of the Forum, the Mainland announced a new package of 15 policies to boost cross-straits exchanges and cooperation in favor of Taiwan compatriots.
- 14 – 17 Apr The ICT Pavilion 2006 was held. The event provided a platform for the industry to promote their information and communications technology (ICT) products and services, and opportunity for business matching among local, Mainland and overseas companies.
- 18 Apr Standard & Poor (S&P) upgraded Hong Kong's foreign currency and local currency rating outlooks from "Stable" to "Positive". S&P also affirmed Hong Kong's long-term foreign currency and long-term local currency ratings at "AA-".
- PBOC, the Chinese Banking Regulatory Commission and the State Administration of Foreign Exchange together issued new rules allowing Mainland institutions and residents investing in offshore financial products through onshore commercial banks.
- 20 Apr The second meeting of the Mainland and Hong Kong Science and Technology Co-operation Committee was held in Hong Kong. The Committee agreed to organize various activities, such as innovation achievements exhibition and forums, and to promote technological exchange and collaboration between the Mainland and Hong Kong.
- Five new Research and Development (R&D) Centres were set up, with funding support from the Innovation and Technology Fund, to undertake industry-oriented research in technologies demanded increasingly in the PRD region. The Centres aimed to become the focal points of applied R&D and develop core competencies in the selected focus areas of automotive parts and accessory systems; information and communications technologies; logistics and supply chain management enabling technologies; nanotechnology and advanced materials; and textiles and clothing.
- 21 Apr The first batch of civil celebrants of marriages was appointed to provide greater flexibility and convenience to marrying parties.
- 27 Apr The US State Department published its ninth 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 2006. 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, and praised Hong Kong's contribution to issues of interests to the US. It also gave recognition to Hong Kong's strong support for global counterterrorism efforts.
- HA announced that the monthly and hourly charges at its car parks would be adjusted downwards, with effect from 1 June 2006, to boost occupancy rate of its 108 car parks with 27 410 parking spaces.
- 28 Apr PBOC raised the benchmark interest rate of loans with a maturity of one-year of the financial institutions by 27 basis points to 5.85%. It was the first time since 2004.

- 1 May The Individual Visit Scheme (IVS) was extended to cover six more Mainland cities, including Nanchang, Changsha, Nanning, Haikou, Guiyang and Kunming, bringing the total number of IVS cities to 44.
- 8 May The China Securities Regulatory Commission lifted the restriction, which lasted for around a year, on fund raising by enterprises in the A-share market. Listed companies could once again raise additional capital from the stock market by issuing new shares, share placement and other types of securities.
- 11 May The International Institute for Management Development once again ranked Hong Kong as the second most competitive economy in the world in 2006 and the most competitive amongst the small economies.
- The Base Rate under the Discount Window operated by HKMA was raised by 25 basis points to 6.5%, following an increase of the US Fed Funds target rate by the same magnitude to 5.0%.
- 16 – 17 May The Greater PRD Business Council Joint Investment and Trade Promotion Sub-group, in conjunction with Invest Hong Kong, organized the first private-owned enterprises study mission to Hong Kong. Over 30 delegates from Guangdong private-owned enterprises came to study the business environment and explore how Hong Kong could be used as a springboard to access the international market.
- 17 May The China Securities Regulatory Commission issued new rules and regulations governing initial public offerings (IPOs), which effectively lifted the restriction on IPOs in the A-share market. This followed the earlier measures announced in resuming fund raising activities by already listed companies.
- The First Expert Group on Co-operation in Informatisation Meeting under the Hong Kong/Guangdong Co-operation Joint Conference was held in Guangzhou. The Meeting aimed to foster co-operation between the two places.
- 18 May The Mainland's State Council announced six guidelines to cool property markets nationwide following its meeting on 17 May.
- 20 May Hong Kong Wetland Park, a world-class conservation, education and tourism facility, was opened. The Park attracted a total of over 750 000 visitors in its first six months of operation.
- 21 – 31 May FS visited New Zealand and Australia to meet with ministers responsible for trade, economic and financial portfolios as well as business leaders in the two countries to provide an update on the strong recovery of Hong Kong's economy and initiatives taken to reinforce Hong Kong's position as a leading international financial, business and tourist centre.
- 23 May The Government published the First Quarter Economic Report 2006. The Report pointed out that the Hong Kong economy sustained its strong upturn, with GDP leaping by a stronger-than-expected 8.2% in real terms over a year earlier. The strong growth momentum was underpinned by the robust growth in exports of both goods and services amidst surging intra-regional trade and vibrant inbound tourism. Locally, consumption spending picked up on the back of improving employment incomes and stronger household balance sheet and investment expenditure also maintained strong growth.

In the May update of the economic forecast for 2006, the forecast growth rate in real terms of GDP was kept at 4% to 5%, same as the forecast first released in the Budget. Meanwhile, the forecast rate of increase in the Composite CPI was lowered to 2.0%.

26 May The LegCo Finance Committee approved an allocation of \$1 billion to launch a Third Matching Grant Scheme. The Scheme was opened for application by the eight University Grants Committee-funded institutions from 1 June 2006 to 28 February 2007 to match their eligible private donations. As at end-November, over \$1.2 billion of private donations were secured by the institutions under the Scheme.

The Intellectual Property Department completed the launch of its interactive electronic services. These services enabled instant approval for renewal of registered trademarks and patents, change of particulars for owners and agents of trademark, patents and designs, extension of time of trademark applications, and registration of assignments and assents for registered marks and trademark applications.

29 May The Office of the Commissioner of Insurance (OCI) and the Office of the Superintendent of Financial Institutions Canada concluded a MOU to strengthen supervisory cooperation and exchange of information between the two regulators.

31 May The Immigration Department completed the installation of all e-channels at boundary control points.

1 Jun The OCI and the National Association of Insurance Commissioners of the US concluded a MOU to strengthen supervisory cooperation and exchange of information between the two regulators.

Bank of China Ltd, one of the four largest state-owned commercial banks in the Mainland, was listed in Hong Kong, raising equity fund of \$86.7 billion through IPO. This surpassed Hong Kong's IPO fund raising record set by China Construction Bank Corporation last year.

The Voluntary Surrender Scheme for Pig Farmers was launched to reduce the risk to public health and the threat to the environment posted by pig farming. Under the Scheme, pig farmers were encouraged to exit the trade permanently in exchange for ex-gratia payment.

2 Jun CAD signed a Cooperation Arrangement on Mutual Acceptance of Approval of Aircraft Maintenance Organizations with the General Administration of Civil Aviation of China and Macao Civil Aviation Authority. This Cooperation Arrangement, which included entire aircraft maintenance, was an expansion of a previous one signed in May 2002 that covered only aircraft component maintenance.

2 – 4 Jun A Hong Kong Special Administrative Region (HKSAR) mission led by the Chief Executive (CE) visited Guangxi. The governments of Guangxi and HKSAR agreed to strengthen cooperation in areas including tourism, financial services, aviation and exhibition.

- 4 – 7 Jun A HKSAR delegation led by CE attended the Third Pan-PRD Regional Cooperation and Development Forum and the Third Pan-PRD Trade Fair in Kunming, Yunnan. The delegation met “9+2” officials and experts and held fruitful discussions with them on ways forward of Pan-PRD cooperation.
- At the margin of the Forum, a logistics delegation led by the Secretary for Economic Development and Labour signed seven MOU on exchange and cooperation with the Yunnan Provincial Economic Commission.
- 5 – 8 Jun The 31st Annual Conference of International Organization of Securities Commissions (IOSCO) was successfully held by the Securities and Futures Commission in Hong Kong. The presence of more than 650 regulators and market practitioners from 135 jurisdictions around the world made the event the largest gathering for an IOSCO Annual Conference in recent years. During the conference, member jurisdictions reached important decisions, including a new resolution that encouraged members to examine the legal framework under which they operated and to enable the freezing of assets derived from cross-border securities and derivatives violations.
- 6 – 7 Jun The Seminar on Financial Infrastructure jointly organized by PBOC and HKMA was held in Beijing and Shanghai. The Seminar aimed at sharing experience of the financial infrastructures in the Mainland and Hong Kong, and further reinforcing co-operation between the two places on the development of financial infrastructure.
- 13 Jun An Industry Working Group on Prevention of Money Laundering and Terrorist Financing was formed. The Working Group aimed to further strengthen the banking industry’s preparedness to meet new challenges in the prevention of money laundering and terrorist financing activities, and to serve as a forum for discussing international developments on anti-money laundering and exchanging views on issues affecting the implementation of international standards and other related matters.
- 14 Jun Cathay Pacific Airways Limited (CPA) was voted the “Best Airline – Asia”, and Hong Kong Dragon Airlines Limited (Dragonair) voted, for the fifth consecutive year, the “Best Airline – China” in a large scale annual survey undertaken by Skytrax Research in the UK involving over 13 million voters of over 93 nationalities from September 2005 to May 2006.
- The Cross-straits Aviation Transport Exchange Council and the Taipei Airlines Association reached a consensus on the framework of chartered flights for festivals and special cases. The two sides also agreed to open chartered flights for emergency medical rescue, first aid and chartered cargo flights for special needs.
- 15 Jun The second E-government Conference was held to facilitate the sharing of experience of major economies in setting policies and pushing through programmes for transforming government service delivery under a citizen-centric approach. Over 100 senior government officials attended the event.
- 16 Jun The system for electronic submission of cargo manifests, which commenced operation in 2003, was fully implemented. Henceforth, manifests for ocean and river cargoes had to be submitted by electronic means.

- 23 Jun The Industry Task Force convened by the Hong Kong Association of Banks, comprising representatives from FSTB and HKMA, announced a package of recommendations to minimize the impact of branch closures on the public.
- 27 Jun The Government of the HKSAR and the Central People's Government signed the Supplement III to CEPA. From 1 January 2007, the Mainland would implement 15 new liberalization measures in 10 existing service areas. The two sides also agreed to add protection of intellectual property as a new initiative under the trade and investment facilitation (TIF) framework of CEPA, bringing the number of TIF areas to eight. In addition, with effect from 1 July 2006, the number of products with CEPA rules of origin was increased to 1 407.
- The Mobile Enterprise 2006: Conference & Exhibition was held to promote the development and adoption of mobile and wireless applications in various industries in Hong Kong.
- 28 Jun The Immigration Department launched the Quality Migrant Admission Scheme. The Scheme aimed to attract highly skilled or talented persons from the Mainland and overseas to settle in Hong Kong in order to further enhance Hong Kong's economic competitiveness in the global market. Results of the first selection exercise were announced in November 2006 with 83 applications approved in principle.
- 29 Jun The Ministry of Commerce and the Government of the HKSAR jointly organized the Mainland, Hong Kong and Macao Trade and Economic Co-operation Forum in Hong Kong to mark the third anniversary of the signing of CEPA. 600 guests from the three places attended the Forum.
- 30 Jun The Hang Seng Index (HSI) Services Limited announced the inclusion of H-share companies as HSI constituents and an increase of the maximum number of HSI constituents from 33 to 38. This was the first time that the number of HSI constituents was adjusted since the establishment of HSI in 1969.
- The Base Rate under the Discount Window operated by HKMA was raised by 25 basis points to 6.75%, following an increase of the US Fed Funds target rate by the same magnitude to 5.25%.
- 1 Jul The State Administration of Foreign Exchange of the Mainland allowed enterprises to buy foreign currencies according to their needs for foreign investments, provided that the investment projects were approved by the relevant authorities.
- The Government implemented the first phase of the five-day week scheme to reduce the pressure on government staff and to improve the quality of their family life, without impairing operational efficiency. It was expected that the scheme would have a positive impact on the community. The first phase covered more than 70 000 public officers.
- 4 Jul The Competition Policy Review Committee released its review report. Having reviewed local and overseas competition models, the Committee concluded that without appropriate legislative backing it would be difficult to combat anti-competitive practices effectively. The Committee therefore proposed that a cross-sector competition law be introduced.

- 5 Jul CAD endorsed the reclassification of Hong Kong International Airport (HKIA) to a Code 4F aerodrome for accommodating aircraft with wing span up to 80 m, following the upgrading works on essential airfield and apron facilities by the Airport Authority (AA) in preparation for the future operation of the new large aircraft Airbus A380 at HKIA.
- PBOC raised the renminbi reserve requirement ratio of deposit-taking financial institutions by 0.5 of a percentage point in response to the rapid growth of monetary and credit aggregates.
- 7 Jul Moody's upgraded Hong Kong's local currency outlook from "Stable" to "Positive". Moody's also indicated it would review Hong Kong's foreign currency rating for possible upgrade.
- 10 Jul The Customs and Excise Department, in collaboration with the Hong Kong Brands Protection Alliance, launched the Fast Action Scheme to facilitate investigation of infringing activities at large-scale exhibitions.
- 12 Jul The Government introduced into the LegCo the Unsolicited Electronic Messages Bill after careful consideration of the views received in the public consultation exercise. The Bill strived to strike a balance between containing the spamming problem and allowing the development of legitimate electronic marketing in Hong Kong. The Bill proposed that all types of commercial electronic messages, including email, fax, or pre-recorded voice messages but excluding person-to-person telemarketing calls, originating from or sent to Hong Kong, should be regulated.
- 13 Jul The Financial Reporting Council Ordinance was enacted by the LegCo, providing for the establishment of the Financial Reporting Council to investigate irregularities concerning auditors and reporting accountants of listed entities and to enquire into non-compliance matters regarding financial statements of listed entities.
- 14 Jul OFTA issued a consultation paper to solicit public views on its proposal of updating the regulatory framework to pave the way for the fixed-mobile convergent era. Issues identified in the consultation included interconnection settlement arrangement between fixed and mobile networks, the local network access charge arrangement and licensing regime, etc.
- 18 Jul Government held the first land auction of 2006-07. A residential site of 2 240 m² at Cheung Sha, Lantau Island was sold for \$30.5 million.
- FSTB launched a public consultation exercise on tax reform for some nine months.
- 19 Jul Expansion work on the Hong Kong Convention and Exhibition Centre began. The \$1.4 billion project would create 40% more exhibition space and was scheduled for completion in the first half of 2009.
- The Customs and Excise Department, in collaboration with the Intellectual Property Department, copyright owners' associations and 11 local youth uniformed groups, launched the Youth Ambassador Against Internet Piracy Scheme to combat sharing of infringing copyright materials on the Internet using the BitTorrent (BT) software.

- 20 Jul A package of measures to improve occupancy rate at the HA's retail premises in 181 public rental housing estates or HOS housing courts was endorsed. More flexible terms of letting by advertising short-term lettings through instant open tender or direct negotiations on a first-come-first-served basis were introduced.
- 25 Jul Fitch upgraded Hong Kong's long-term foreign currency rating outlook to "Positive" from "Stable". Fitch also affirmed Hong Kong's long-term foreign currency rating at "AA-" and long-term local currency rating at "AA+" with a stable outlook.
- The UK Foreign and Commonwealth Office presented to UK parliament the 19th Six-monthly Report on Hong Kong covering the period January to June 2006. The Report stated that the "One Country, Two Systems" principle had generally worked well in practice and that the rights and freedoms promised to Hong Kong in the Joint Declaration and the Basic Law had continued to be upheld. It also reported that bilateral trade had continued to expand healthily.
- 27 Jul S&P upgraded Hong Kong's foreign and local currency ratings to "AA" from "AA-", with stable outlooks. This was the highest rating that S&P had ever assigned to Hong Kong.
- HKMA published the investment results of the Exchange Fund for the first half of 2006 and the unaudited balance sheet of the Exchange Fund for the end of June 2006. HKMA earned for the Exchange Fund an investment income of \$30.7 billion in the first half of 2006. The share of investment income for the fiscal reserves placed with the Exchange Fund was \$8.7 billion. The Accumulated Surplus of the Exchange Fund recorded an increase of \$17.1 billion. At the end of June 2006, the total assets of the Exchange Fund was \$1,105.2 billion.
- At the WTO General Council meeting, the Director-General of the WTO recommended suspending the Doha Development Agenda negotiations as impasse persisted in the area of agriculture. The recommendation was accepted by WTO Members at the meeting. It would not be possible to complete the Doha Round by the end of 2006 as targeted.
- 2 Aug The Ninth Plenary Meeting of the Hong Kong Guangdong Cooperation Joint Conference was held. The two governments reached agreement on a number of issues, including major infrastructural projects, air quality improvement, control-point operation, facilitating cross-boundary flow of people and cargo, food safety and prevention of diseases. The two sides also agreed to step up co-operation in various aspects to tie in with the future development of Guangdong, and to grasp the opportunities brought about by the development under the 11th Five-Year Plan.
- 3 Aug HKMA released for public consultation a draft of the Banking (Capital) Rules, which would be the implementing Rules for Basel II.
- 9 Aug The 2006 Guangdong-Hong Kong Technology Cooperation Funding Scheme invited applications. Jointly launched by the Innovation and Technology Commission of the HKSAR 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 2006, the two sides earmarked a total of \$800 million to support applied R&D projects that would facilitate industry upgrading.

- 15 Aug The Betting Duty (Amendment) Ordinance 2006 came into effect to reform the horse race betting duty regime based on gross profit margin.
- PBOC decided to raise the reserve requirement ratio of deposit-taking institutions by 0.5 of a percentage point to strengthen liquidity management, restrain the relatively fast growth of money and credit and preserve a sound development momentum.
- 19 Aug POBC further raised the benchmark lending rates for financial institutions by 27 basis points. The benchmark interest rate of loans with a maturity of one-year was raised to 6.12%.
- 21 Aug The Government of the HKSAR and the Central People's Government signed a new Arrangement for the Avoidance of Double Taxation on Income and Prevention of Fiscal Evasion. The new Arrangement, which extended the scope of the original Arrangement signed in 1998, covered direct income earned by businesses and individuals as well as indirect income; and it ensured that the same income would not be doubly taxed in the two tax jurisdictions.
- 22 Aug The Government published the Half-yearly Economic Report 2006. The Report pointed out that the Hong Kong economy grew by 5.2% in real terms in the second quarter over a year earlier, after an exceptionally strong growth in the first quarter. Externally, exports of goods grew more moderately owing to the weaker external demand and the feeding-through of a stronger US dollar in the earlier period. Yet exports of services maintained notable growth momentum, bolstered by continued distinct growth in offshore trade and vibrant inbound tourism. Locally, consumption demand continued to hold up well alongside improving employment conditions.
- In the August update of the economic forecast for 2006, the forecast growth rate in real terms of GDP was kept at 4% to 5%, same as the forecast in the May round. GDP growth for the year as a whole was likely to be close to the upper end of the range forecast. Likewise, the forecast rate of increase in the Composite CPI was maintained at 2.0%.
- 23 Aug The first shipment of chilled pork from the Mainland was introduced to Hong Kong, thereby adding to the variety of meat available to local consumers. The chilled pork came from registered plants in the Mainland where slaughtering and meat processing procedures were strictly monitored.
- 31 Aug The MTR Corporation Limited submitted the West Island Line Revised Proposal to the Government.
- 1 Sep HKMC announced the launch of a new retail bond issue under the Retail Bond Issuance Programme, including Hong Kong dollar two-year notes, US dollar two-year notes and Hong Kong dollar 10-year zero-coupon bonds. This was the first time that a zero-coupon bond product was offered to the retail public in Hong Kong and it was also the first time HKMC issued retail bond with 10-year tenor.
- The Guidelines for Sponsors and Compliance Advisers were gazetted. The Guidelines outlined the specific eligibility criteria and ongoing requirements for sponsors and compliance advisers acting for listing candidates and listed companies. The Guidelines took effect on 1 January 2007.

HKMA released for public consultation a draft of the Banking (Disclosure) Rules. These Rules and the Banking (Capital) Rules comprised the full implementing Rules for Basel II.

3 Sep The Office of the Government Chief Information Officer (OGCIO) completed the implementation of its Central Computer Centre outsourcing initiative. This signified a major milestone of data centre outsourcing in the Government of the HKSAR, which facilitated the development of data centre service industry in Hong Kong.

6 Sep Hong Kong was ranked the fifth amongst 175 economies in the world in terms of the ease of doing business and the second most business-friendly in Asia, according to the World Bank's report on Doing Business in 2007.

A new one-stop portal, GovHK, was soft launched to the general public for trial use. To facilitate access to government information and services, GovHK clustered related content offered by different government bureaux and departments by subjects familiar to citizens, such as education and training, employment, health and medical services, transport and motoring.

The Hong Kong Economic and Trade Office in Shanghai commenced operation to promote Hong Kong's exchanges and cooperation with the eastern region of the Mainland, covering the Yangtze River Delta region and its peripheries.

7 Sep Hong Kong remained the freest economy in the world, according to the 2006 Annual Report on the Economic Freedom of the World jointly released by the Fraser Institute of Canada, CATO Institute of the US and more than 70 think tanks.

The European Commission published its eighth report on the HKSAR. The report pointed out that Hong Kong continued to enjoy a high degree of autonomy under the Basic Law and the principle of "One Country, Two Systems". It also commented, among others, that Hong Kong's economy showed strong economic growth, restoring fiscal balance for the first time since 1997.

11 Sep The Economic Summit on China's 11th Five-Year Plan and the Development of Hong Kong was held to provide a platform for the Government and all sectors of the community to discuss how Hong Kong should respond to the challenges and opportunities arising from the 11th Five-Year Plan and to come up with a set of strategic proposals.

The first H-share company, the China Construction Bank, was included as a HSI constituent stock.

11 – 13 Sep TDC organized its first large-scale solo exhibition, Style Hong Kong in Budapest Exposition, in Hungary to present innovative and lifestyle products from over 100 Hong Kong manufacturers and traders to Central and Eastern European buyers and further explore business opportunities in these emerging markets.

12 Sep A residential site of 2 076 m² at Tsing Lung Tau was sold by way of auction for \$53 million.

Specified non-permanent residents holding smart identity cards could make use of e-channels at boundary control points.

- 14 Sep The Mainland announced the adjustment of the rates of tax rebate for certain exports. Among which, the rates of tax rebate for products of industries which were high energy-consuming, high resource-consuming, and/or high pollution-generating were reduced or eliminated. The Mainland also classified products with zero export rebate into the prohibited category for processing trade. The measures took effect from 15 September 2006.
- 15 Sep The Telecommunications Authority announced its decision to put resellers of telecommunications services under the regulation of a class licensing regime with a view to ensuring level playing field in the market and enhancing consumer protection. Under the new regulatory regime, resellers would automatically become class licensees without any requirements of individual licence applications or registrations. They would be subject to the licence conditions aiming at consumer protection, such as provision of more information to the consumers.
- 15 – 16 Sep The eHealth Forum 2006 was held. The Forum drew together the policy makers and key executives from relevant government departments and agencies as well as major corporations of both healthcare and ICT industries. It was a major international event for healthcare professionals.
- 17 – 19 Sep FS participated in the IMF/World Bank Annual Meeting held in Singapore. He also took the opportunity to meet with the Minister of Finance, the Governor of PBOC and the US Federal Reserve Board Chairman.
- 18 Sep Ngong Ping 360 was opened, which brought about another brand new tourist attraction to Hong Kong. It comprised a 20-minute cable car ride offering a spectacular panoramic view of the beautiful landscape of Lantau Island, and a traditional Chinese and Buddhist themed village.
- 21 Sep The Asian-Oceanian Computing Industry Organization (ASOCIO) ICT Summit 2008 Bidding Committee, headed by the Information and Software Industry Association, won the bid for staging the ASOCIO ICT Summit 2008 in Hong Kong.
- 22 Sep The Securities and Futures Commission published the Consultation Conclusions on Possible Reforms to the Prospectus Regime in the Companies Ordinance. Implementation of the proposed initiatives would more closely align Hong Kong's public offering regime with that of other leading jurisdictions and support Hong Kong's continuing role as an international financial centre.
- 24 – 26 Sep A HKSAR mission led by CE visited Hunan. The delegation attended the First Central China Trade and Investment Expo in Changsha.
- 25 Sep The Hong Kong Digital Content Alliance was formed by 12 organizations and trade bodies of the creative industries under the Programme to Promote Legal Download of Digital Content in Hong Kong. The Alliance would implement initiatives to arouse public awareness of the importance of legal download of digital content.
- The Deposit Protection Scheme in Hong Kong started providing deposit protection. The Scheme would help strengthen public confidence in the banking system and contribute to the maintenance of financial stability.

- 26 Sep The World Economic Forum released its Global Competitiveness Report 2006–2007. Hong Kong’s ranking rose to 11th, from 14th last year.
- Results of the 2006 Annual Survey of Companies in Hong Kong Representing Parent Companies located outside Hong Kong conducted by the Census and Statistics Department showed that Hong Kong remained a magnet for international companies to oversee their regional operations. Both the total number of regional operations in Hong Kong and the number of local offices operated by overseas and Mainland companies reached all-time highs.
- 27 Sep Moody’s upgraded Hong Kong’s foreign currency rating to “Aa3” from “A1”, with “Positive” outlook. Following Moody’s upgrade, Hong Kong achieved AA-category ratings by all major international credit rating agencies. The latest ratings were also the highest that had ever been assigned to Hong Kong.
- 28 Sep The Hong Kong Economic and Trade Office in Chengdu commenced operation to promote Hong Kong’s exchanges and cooperation with the southwestern region of the Mainland, covering four of the Pan-PRD provinces and its peripheries.
- 1 Oct New measures to address risks arising from securities margin financing came into effect. The measures would help protect the investing public and provide a stronger foundation for the long-term development of the industry.
- 5 Oct A review of debt market development in Hong Kong, covering issues related to the Exchange Fund Bills and Notes programme and the three-year rule imposed on Multilateral Development Banks since 1998, was completed.
- 6 Oct The driving of the bored tunnel of the Kowloon Southern Link (KSL) along Canton Road and Salisbury Road commenced. The 3.8km long KSL would be a strategic passenger railway line linking up the West Rail and the East Rail.
- 10 Oct HKIA was voted, for the fourth consecutive year, the “TTG’s Best Airport Award”, and CPA voted the “Airline of the Year” in the TTG Travel Awards 2006.
- 11 Oct CE delivered his 2006-07 Policy Address outlining the Government’s policy direction for the coming year.
- CE announced in the Policy Address that the Government would join hands with the business community and labour sector to launch a Wage Protection Movement for cleansing workers and security guards. On environment protection, the Government would provide an incentive for the early replacement of pre-Euro and Euro I diesel commercial vehicles with Euro IV vehicles to lower the emissions of nitrogen oxide and respirable suspended particulates. Moreover, a 30% reduction in first registration tax would be given to people purchasing vehicles with low emissions and high fuel efficiency, subject to a ceiling of \$50,000 per vehicle. These initiatives were scheduled to start on 1 April 2007.
- 14 Oct The Innovation Festival 2006 was officially kicked-off. With the theme “Youth Inspires...City of Innovation”, the Festival aimed to enhance the young people’s interest in innovation and technology. The Hong Kong Youth Innovation Club was also established to nurture young talents.

- 17 Oct Hong Kong retained its position as Asia's second largest destination for foreign direct investment (FDI), according to the World Investment Report 2006 released by the United Nations Conference on Trade and Development. FDI flows to Hong Kong in 2005 reached US\$35.9 billion. On a global scale, Hong Kong ranked sixth in FDI inflows in 2005.
- 18 Oct CITB released a public consultation document on the updated Digital 21 Strategy for two months. The Strategy, updated every three years, was the blueprint for the development of ICT in Hong Kong. The finalized 2007 Digital 21 Strategy would be published within the first half of 2007.
- 23 Oct A bulk settlement service for Hong Kong dollar credit card transactions between banks participating in a credit card scheme was launched. The new service minimized settlement risk by eliminating the time gap between payments made by participating banks with net outgoing payments and payments received by participating banks with net incoming payments.
- The Intellectual Property Department and Business Software Alliance jointly launched the Business Software Certification Programme. The Programme aimed to encourage the business community to use licensed software as well as to promote the knowledge of Software Asset Management (SAM). An independent SAM contractor was commissioned to provide free SAM consultancy services to the participants. The Programme would end in mid-March 2007.
- 24 Oct The Government announced a plan to develop new cruise terminal facilities at the southern end of the former runway at Kai Tak through an open land tender. This development was important for Hong Kong to capture the growth of the cruise industry in the Asia Pacific Region, and sustain its development as a regional cruise hub. The target was to commission the first berth of the new cruise terminal in 2012.
- 24 – 27 Oct The Cable and Satellite Broadcasting Association of Asia Convention 2006 took place in Hong Kong. Over 500 senior executives from the broadcasting and telecommunications industries from the region and around the world gathered in Hong Kong for this premier broadcasting event.
- 25 Oct An Air Services Agreement (ASA) was signed between Hong Kong and Ethiopia.
- The Government launched a public consultation on the proposed spectrum policy framework with a view to formulating a more responsive and transparent radio spectrum policy. The policy aimed to enable the community to reap maximum benefits from the deployment of spectrum and to facilitate technological advances and the evolution of new business models.
- 26 Oct Oasis, the fifth Hong Kong-based passenger carrier, launched its first scheduled service between London and Hong Kong with two frequencies per week. The frequency was increased to daily since 25 November.
- The European Commission published an update on its Communication on Hong Kong proposing to further enhance the existing close cooperation between the European Union and Hong Kong on trade, economic and other areas within Hong Kong's high degree of autonomy under the Basic Law.

- 27 Oct OFTA issued a public consultation paper proposing to release radio frequency spectrum in the 850 MHz frequency band through a public auction for the provision of a mobile service using the CDMA 2000 standard. The proposal aimed at enabling the continuity of the CDMA mobile service, which was one of the major mobile service standards deployed in the Mainland and other countries, in Hong Kong to ensure that those CDMA users around the world could continue to enjoy mobile roaming service whilst visiting Hong Kong.
- The Banking (Capital) Rules and Banking (Disclosure) Rules were published in the Gazette. They were tabled before the LegCo for negative vetting on 1 November 2006.
- The Industrial and Commercial Bank of China Ltd was simultaneously listed on the Hong Kong Stock Exchange and Shanghai Stock Exchange. The IPO raised US\$21.9 billion, marking the first simultaneous listing in both the A-share and H-share markets, and also the largest IPO ever recorded in the world. The H-share portion raised \$124.9 billion (US\$16.0 billion), which also set a new record for Hong Kong's IPO fund raising history, surpassing the Bank of China listing earlier in June.
- 31 Oct With an upgrade of HKMC's local currency issuer rating to triple-A by Moody's, HKMC became the first triple-A institution in Hong Kong. The upgrade improved the ability of HKMC to promote the development of the debt and securitisation markets in Hong Kong.
- 1 Nov The Mainland promulgated the new Catalogue of Prohibited Products for Processing Trade which operationalised the arrangements concerning processing trade as announced on 14 September 2006.
- 3 Nov The Tuen Mun Ferry Terminal, designated for cross-boundary passenger ferry services, was commissioned with regular sailings between Hong Kong and Zhuhai.
- 6 Nov The Public Consultation on the Way Forward for Hong Kong's Competition Policy was launched. Building on the work of the Competition Policy Review Committee, the Government sought the public's view over a number of key issues including the need for a new regime, the scope and implementation framework.
- 7 Nov The IMF Staff Mission to Hong Kong completed its Article IV Consultation, welcoming the Government's efforts in further strengthening market infrastructure and promoting the financial integration with the Mainland. The Mission also endorsed the general policy framework of the Government, including its fiscal and exchange rate systems.
- 8 – 9 Nov The 2006 PRD Software World Forum was held in Guangzhou. The Forum aimed to promote co-operation between the software industries in the PRD region. A large number of government officials and software industry representatives from Guangdong and Hong Kong participated in the event.
- 8 – 10 Nov The Asia-Pacific Economic Cooperation (APEC) Workshop on Effective Strategies for Intellectual Property Rights Public Education was held in Hong Kong. This workshop was co-organized by the intellectual property authorities of Hong Kong, Australia and Singapore.

The 26th Asia Pacific Privacy Authorities (APPA) Forum, hosted by the Office of the Privacy Commissioner for Personal Data for the first time, was held in Hong Kong. The event brought APPA Privacy Commissioners together to discuss jurisdictional reports, and exchange views and experience on common privacy concerns within the Region.

10 Nov A large-scale joint investment promotion event, Hong Kong – Guangdong Business Conference in Paris 2006, was held by Hong Kong and Guangdong governments to promote business opportunities in the Greater PRD, Hong Kong and Guangdong for companies in France. CE and the Governor of the People’s Government of Guangdong Province led high-level delegations to join this event.

13 Nov The InnoCentre was officially opened. It was jointly run by the Hong Kong Design Centre and the Hong Kong Science and Technology Parks Corporation as a one-stop shop to bridge designers and users of design services, develop and promote different design services, and enhance the role of Hong Kong as the design hub in the region.

HKMA and Bank Negara Malaysia launched the new cross-border payment-versus-payment link between Hong Kong’s US dollar real time gross settlement (RTGS) system and Malaysia’s ringgit RTGS system to eliminate settlement risk in foreign exchange transactions between the US dollars and Malaysian ringgit. This was the first cross-border payment-versus-payment link established in Asia.

15 Nov HKIA was voted the “Best Airport in China”, and Dragonair voted, for the second consecutive year, the “Best China Airline” by subscribers of Business Traveller China in the Business Traveller China Awards 2006.

PBOC decided to raise the renminbi reserve requirement ratio of deposit-taking financial institutions by 0.5 of a percentage point to consolidate liquidity control effects.

16 Nov At the informal meeting of the WTO Trade Negotiations Committee, WTO Members agreed to resume work of all the Negotiating Groups at technical level so as to prepare the ground for the resumption of the Doha Development Agenda negotiations when the conditions were right.

17 Nov The Hong Kong Tourism Board announced an extension of its Quality Tourism Services Scheme to cover visitor accommodation service. The extension was designed to help visitors identify quality budget accommodation, while motivating operators to strive for service excellence.

18 – 19 Nov CE attended the 14th APEC Economic Leaders’ Meeting in Ha Noi, Viet Nam. Leaders reaffirmed their commitments to concluding an ambitious and balanced WTO Doha agreement without further delay. They were committed to breaking the current deadlocks on negotiations and moving beyond their current positions in key areas of the negotiations. Leaders also urged economies in other regions to match the APEC Leaders’ commitments.

Airbus launched an A380 trial flight to HKIA. Operational trial involving airport facilities and ground handling franchisees was smoothly conducted.

- 20 Nov An ASA was signed between Hong Kong and Mexico.
- 21 Nov The Government published the Third Quarter Economic Report 2006. The report pointed out that the Hong Kong economy gathered strong momentum again, with GDP expanding briskly by 6.8% in real terms in the third quarter over a year earlier. Externally, exports of goods resumed a faster growth amidst the thriving trade flows of the Mainland and the renewed weakening of the US dollar. Exports of services continued to surge along with vibrant offshore trade and buoyant financial market activities. Locally, consumption demand rose notably further on the back of upbeat consumer sentiment and an improving labour market. Investment expenditure surged underlining the strength of business confidence.
- In the November update of the economic forecast for 2006, the forecast growth rate in real terms of GDP was revised upwards to 6.5%, from 4% to 5% in the August round. Meanwhile, the forecast rate of increase in the Composite CPI was maintained at 2.0%.
- 22 Nov The presentation ceremony of the first Hong Kong ICT Awards 2006 was held at the Hong Kong Convention and Exhibition Centre. The awards aimed to recognize and promote the outstanding achievements of local ICT professionals and organizations.
- HKMA announced the revisions to the requirements in the HKMA Guideline on prevention of money laundering and terrorist financing relating to wire transfers. These revisions gave effect to Special Recommendation VII issued by the Financial Action Task Force on Money Laundering.
- 23 Nov FS officiated the groundbreaking ceremony of the Ocean Park Redevelopment Project, which would turn the Ocean Park into a world-class marine-themed attraction by phases from 2007 to 2012. The redevelopment would further enhance Hong Kong's position as a premier destination for family visitors.
- HA's Subsidized Housing Committee approved that the average selling prices for 3 056 surplus HOS flats to be offered for sale in early January 2007 were set at a 30 percent-discount of the assessed market values.
- The TD-SCDMA Service Development Centre, with sponsorship from the OGCIO, was established in Cyberport to assist the planning, supervision and execution of the Mainland initiated standards for 3G mobile communication.
- 24 Nov The Planning Department and the Shenzhen Planning Bureau signed a cooperation agreement for jointly carrying out a study to establish the need, function and benefits of developing the Liantang/Heung Yuen Wai Control Point.
- The Town Planning Board exhibited the draft Kai Tak Outline Zoning Plan No. S/K22/1 under section 5 of the Town Planning Ordinance (Cap. 131) for public inspection for a period of two months.
- 27 Nov HA endorsed the Report on the Review of Domestic Rent Policy submitted by its Ad Hoc Committee on Review of Domestic Rent Policy following a three-month public consultation. The report recommended, among other things, a new rent

adjustment mechanism enabling public rental housing (PRH) rents to move both upwards and downwards in tandem with tenants' household income. An amendment bill to replace the 10% median rent-to-income-ratio cap in the Housing Ordinance by the new rent adjustment mechanism would be introduced into the LegCo in the first quarter of 2007.

HA also decided to grant a one-off rent remission for its PRH tenants and interim housing licensees for February 2007, with the exception of those paying additional rent or licence fee. This decision was to address strong demands and expectations among some of the PRH tenants for HA to take immediate action to remit or reduce rent following conclusion of the judicial review cases and the rent policy review.

HKIA was awarded by Travel Weekly China, the trade magazine, for offering the "Best Airport Facilities".

28 Nov Two residential sites were sold by auction. The site with an area of 6 088 m² at Kowloon Tong was sold for \$1.94 billion while the other site of 16 440 m² at Ma On Shan was sold for \$3.24 billion.

1 Dec The Securities and Futures (Reduction of Levy) Order 2006 that provided for a 20% reduction of transaction levy on securities and futures trading came into force. Investors paid 0.004% in securities transaction levy.

The Mandatory Provident Fund Schemes (General) (Amendment) Regulation 2006 came into operation. The new regulation aimed to enhance protection of scheme members' interests, improve operation of the investment regulations, enhance flexibility of Mandatory Provident Fund (MPF) investments and remove undue restrictions on investment of MPF scheme funds.

HKMA announced that the LegCo completed its negative vetting of the Banking (Capital) Rules and Banking (Disclosure) Rules gazetted on 27 October 2006. The two sets of Rules, as amended by the resolutions, came into operation on 1 January 2007.

The inaugural Chairman and Members of the Financial Reporting Council were appointed for three-year terms.

3 Dec HKIA was voted the "Best Airport Worldwide" and CPA the "Best Airline Worldwide" by readers of SmartTravelAsia.com in the online magazine's Best in Travel Poll 2006.

4 – 7 Dec The 10th Annual 3G World Congress & Mobility Marketplace was once again held in Hong Kong. The event promoted the adoption and growth of 3G worldwide.

4 – 8 Dec Hong Kong played host to a prestigious global ICT event, the International Telecommunication Union (ITU) TELECOM WORLD 2006, at the newly opened Asia World-Expo. The event, organized by the ITU every three to four years, was often referred to as the Olympics of the telecommunications industry. This was the first time for the event to be held outside ITU's home-base in Geneva since its inception in 1971.

- 7 Dec CITB and the Department of Industry Canada signed a MOU on Co-operation in ICT at the ITU TELECOM WORLD 2006 to extend the effective term of the current MOU for another 5 years.
- China Aircraft Services Limited held a groundbreaking ceremony to mark the commencement of construction of its first aircraft maintenance hangar at HKIA.
- 8 Dec Supplement on China-ASEAN Free Trade Agreement was signed, which included the signing of two protocols that settled problems left in Framework Agreement on Comprehensive Economic Cooperation between China and the Association of Southeast Asian Nations (ASEAN) and Agreements on Trade in Goods.
- 11 Dec The PRC Foreign Banks Regulatory Ordinance, together with the Detailed Implementation Guidelines promulgated by the China Banking Regulatory Commission came into force. These set out a comprehensive framework on how foreign banks would be regulated after the Mainland's banking industry was fully opened to foreign competition as promised under the WTO agreement.
- 11 – 12 Dec A two-day meeting to discuss the implementation of Basel II in Asia and other supervisory priorities was held in Hong Kong. 70 representatives from 23 central banks and supervisory authorities and 21 leading commercial banks attended the meeting.
- 12 – 13 Dec The second study mission for Guangdong private-owned enterprises visited Hong Kong. Following the success of the first study mission in May, the number of delegates doubled to over 60 top executives from Guangdong private-owned enterprises.
- 13 Dec The Fifth Meeting of the Pan-PRD Joint Conference on Regional Cooperation in Science and Technology was held in Nanchang, Jiangxi. The meeting endorsed the implementation plans to take forward the proposals in the Planning Study on Pan-PRD Cooperation in Science and Technology for 2006 – 2010 and other measures to enhance technology collaboration in the region.
- 13 – 14 Dec The Aviation Medicine Expert of International Civil Aviation Organization (ICAO) evaluated HKIA and confirmed that the policies, training and communication procedures put in place at HKIA fully complied with ICAO's guidelines for preventing the spread of communicable disease through air travel.
- 13 & 15 Dec WTO Trade Policy Review of HKSAR was conducted. Hong Kong was commended once again for its open and free trade policy at the Review meeting. WTO Members also unanimously applauded Hong Kong's staunch support of the multilateral trading system and its commitment to the liberalization of world trade, in particular, the successful hosting of the WTO Sixth Ministerial Conference in December 2005. Hong Kong was subject to the Trade Policy Review once every four years.
- 14 Dec HKMA and eight credit and debit card scheme operators in Hong Kong announced the launch of a Code of Practice for Payment Card Scheme Operators to promote the general safety and efficiency of payment card operations in Hong Kong. This self regulatory approach served as an important step for the credit and debit card industry to act proactively to foster public confidence in payment card operations.

The second aircraft maintenance hangar of Hong Kong Aircraft Engineering Company Limited at HKIA was officially opened.

15 Dec HKMA launched the league tables of market makers for the Exchange Fund Bills and Notes (EFBN) for the first time. The league tables, one for Exchange Fund Bills and the other for Exchange Fund Notes, listed the ranking of the 12 market makers with the highest turnover in the respective markets over a six-month period between June and November 2006.

HKMA and Bank Negara Malaysia established a co-operative oversight arrangement to promote the safety and efficiency of the link between Hong Kong's US dollar CHATS and Malaysia's RENTAS.

18 Dec The Treasury Markets Association launched the Renminbi Swap Offer Rate Fixing in Hong Kong to serve as a market-based floating rate benchmark for Renminbi Non-deliverable Interest Rate Swaps.

The seventh meeting of the Hong Kong-Guangdong Joint Working Group on Sustainable Development and Environmental Protection was held in Hong Kong to examine the implementation of co-operation initiatives and the work plan for 2007.

19 Dec A prime residential site of 7 353 m² at the Peak was sold by way of auction for \$1.8 billion.

The Government issued a consultation paper on Copyright Protection in the Digital Environment to review if the existing legislative framework needed to be improved for more effective copyright protection in the digital environment. The consultation would end on 30 April 2007.

22 Dec An ASA was signed between Hong Kong and Kazakhstan, bringing the total number of ASAs that Hong Kong signed with aviation partners to 58.

26 Dec Earthquakes near Taiwan damaged undersea communications cables, disrupting telecommunications and Internet connections across the region. While the operations of Hong Kong's financial markets were unaffected, there were temporary disruptions to Internet connection.

27 Dec CE announced that the Central Government had decided to establish the Hong Kong-Zhuhai-Macao Bridge Task Force to help push the project ahead. The Task Force would be headed by the National Development and Reform Commission, with representatives from the Ministry of Communications, Hong Kong and Macao Affairs Office and the three governments of Guangdong, Hong Kong and Macao as members.

The second cargo terminal of Asia Airfreight Terminal Company Limited at HKIA was officially opened.

28 Dec HSI broke 20 000 points for the first time in history. Overall, the Hong Kong stock market staged a robust performance in 2006, with market turnover, IPO equity funds raised and total market capitalization all hitting record highs. The total market capitalization as at end-2006 exceeded \$13 trillion, up some 60% compared with end-2005.

OFTA issued a public consultation paper to review the existing universal service obligation (USO) arrangements. The paper proposed, inter alia, to review the scope of the universal service, the USO cost calculation arrangements and the contribution arrangement for funding USO.

29 Dec

The commencement notices for the Merchant Shipping (Local Vessels) Ordinance (LVO) (Cap. 548) and its subsidiary legislation were published in the Gazette to bring the whole set of legislation into operation on 2 January 2007. The LVO sought to consolidate provisions previously set out in different ordinances into one set of legislation dedicated for local vessels.

Leasing of land in EcoPark Phase I in Tuen Mun Area 38 commenced. The EcoPark would provide long-term land for both the recycling and environmental industries with a view to encouraging investment in advanced and cost-effective technology.

The National People's Congress (NPC) Standing Committee Members adopted resolutions to submit drafts on corporate tax law and property law to the fifth NPC full session for deliberation. The draft on corporate law set a unified income tax rate for domestic and foreign companies at 25%. Existing tax concessions granted to foreign companies would be gradually phased out, while favourable tax policies would be applied equally to both local and foreign companies. As to the draft on property law, it emphasized equal protection of private and public property.

The China Construction Bank Corporation completed its acquisition of Bank of America (Asia) Limited, which became an indirect wholly-owned subsidiary of the Bank. This signified Mainland banks' interest in extending its presence in the Hong Kong market.

31 Dec

Hongkong Post issued a set of 2006 Hong Kong Definitive Stamps in 16 different denominations, featuring wild birds in Hong Kong. This was the third set of definitive stamps since the establishment of the HKSAR.

The total net asset value of all MPF schemes reached \$195.0 billion, six years after the launch of the MPF System on 1 December 2000.

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**Table 1 : Gross Domestic Product by expenditure component
(at current market prices)**

	(\$Mn)					
	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
Private consumption expenditure	833,825	795,948	765,282	774,280	782,587	747,850
Government consumption expenditure	112,751	116,550	119,993	120,172	128,866	131,291
Gross domestic fixed capital formation	451,891	388,731	325,328	347,375	333,036	286,020
<i>of which:</i>						
Building and construction	223,264	208,235	171,930	155,441	142,651	131,752
Machinery, equipment and computer software	190,760	165,177	141,349	180,204	180,011	144,832
Changes in inventories	12,313	-15,651	-10,612	14,399	-4,060	5,660
Total exports of goods	1,455,949	1,347,649	1,349,000	1,572,689	1,480,987	1,562,121
Domestic exports	211,410	188,454	170,600	180,967	153,520	131,079
Re-exports	1,244,539	1,159,195	1,178,400	1,391,722	1,327,467	1,431,041
Imports of goods	1,589,876	1,408,317	1,373,500	1,636,711	1,549,222	1,601,527
Exports of services	286,595	262,099	276,385	315,012	320,799	347,836
Imports of services	198,424	194,245	185,174	192,427	194,180	202,494
GDP	1,365,024	1,292,764	1,266,702	1,314,789	1,298,813	1,276,757
<i>Per capita GDP (\$) @</i>	<i>210,350</i>	<i>197,559</i>	<i>191,736</i>	<i>197,268</i>	<i>193,440</i>	<i>189,315</i>
GNP	1,363,409	1,317,362	1,291,470	1,323,543	1,327,356	1,282,409
<i>Per capita GNP (\$) @</i>	<i>210,101</i>	<i>201,318</i>	<i>195,485</i>	<i>198,581</i>	<i>197,691</i>	<i>190,153</i>
Total final demand	3,153,324	2,895,326	2,825,376	3,143,927	3,042,215	3,080,778
Total final demand excluding re-exports ^(a)	2,130,313	1,952,900	1,886,191	2,045,858	1,982,896	1,923,066
Domestic demand	1,410,780	1,285,578	1,199,991	1,256,226	1,240,429	1,170,821
Private	1,233,803	1,107,816	1,014,347	1,075,654	1,053,568	985,985
Public	176,977	177,762	185,644	180,572	186,861	184,836
External demand	1,742,544	1,609,748	1,625,385	1,887,701	1,801,786	1,909,957

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>2003</u>	<u>2004</u>	<u>2005[#]</u>	<u>2006[#]</u>		<u>2006</u>		
					Q1 [#]	Q2 [#]	Q3 [#]	Q4 [#]
Private consumption expenditure	719,304	767,479	804,579	860,856	205,729	214,458	212,022	228,647
Government consumption expenditure	130,151	127,328	121,419	123,340	33,038	28,457	30,358	31,487
Gross domestic fixed capital formation	261,367	275,000	289,223	320,701	73,825	78,879	84,302	83,695
<i>of which:</i>								
Building and construction	116,419	107,658	105,964	98,696	25,589	24,168	24,212	24,727
Machinery, equipment and computer software	136,537	150,545	163,369	205,213	44,679	50,283	55,391	54,860
Changes in inventories	9,111	7,076	-4,761	-2,028	1,302	158	-3,970	482
Total exports of goods	1,749,089	2,027,031	2,251,744	2,467,357	538,460	586,741	667,228	674,929
Domestic exports	122,126	126,386	136,324	138,759	34,498	34,992	38,916	30,354
Re-exports	1,626,964	1,900,645	2,115,419	2,328,598	503,963	551,749	628,312	644,575
Imports of goods	1,794,059	2,099,545	2,311,091	2,576,340	568,261	622,110	685,797	700,172
Exports of services	362,420	429,563	495,799	562,304	128,843	129,770	150,777	152,914
Imports of services	203,400	242,507	264,237	283,899	65,770	67,912	76,172	74,045
GDP	1,233,983	1,291,425	1,382,675	1,472,291	347,166	348,441	378,748	397,937
<i>Per capita GDP (\$) [@]</i>	<i>183,334</i>	<i>190,377</i>	<i>202,941</i>	<i>214,710</i>	--	--	--	--
GNP	1,262,474	1,314,835	1,384,323	N.A.	355,219	340,819	378,986	N.A.
<i>Per capita GNP (\$) [@]</i>	<i>187,567</i>	<i>193,828</i>	<i>203,182</i>	<i>N.A.</i>	--	--	--	--
Total final demand	3,231,442	3,633,477	3,958,003	4,332,530	981,197	1,038,463	1,140,717	1,172,154
Total final demand excluding re-exports ^(a)	1,895,705	2,061,644	2,212,782	2,411,437	565,428	583,270	622,360	640,380
Domestic demand	1,119,933	1,176,883	1,210,460	1,302,869	313,894	321,952	322,712	344,311
Private	938,326	1,001,110	1,047,722	1,144,807	270,054	286,280	284,638	303,835
Public	181,607	175,773	162,738	158,062	43,840	35,672	38,074	40,476
External demand	2,111,509	2,456,594	2,747,543	3,029,661	667,303	716,511	818,005	827,843

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

(#) Figures are subject to revision later on as more data become available.

(@) Population figures since 2001 have been revised based on the results of the 2006 Population By-census available in February 2007 as the up-to-date benchmark data. Per capita GDP and per capita GNP figures from 2001 to 2005 have been revised accordingly.

(--) Not applicable.

N.A. Not available.

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

(%)

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Private consumption expenditure	6.2	-6.6	1.4	6.0	2.1	-1.0	-0.9
Government consumption expenditure	2.4	0.7	3.1	2.1	6.0	2.5	1.9
Gross domestic fixed capital formation	12.6	-7.3	-16.6	11.0	2.6	-4.5	0.9
<i>of which:</i>							
Building and construction	10.5	-2.4	-15.5	-7.6	-1.1	-1.1	-5.6
Machinery, equipment and computer software	13.1	-7.9	-18.2	27.0	6.2	-7.6	6.7
Total exports of goods	6.1	-4.3	3.7	17.1	-3.3	8.7	14.2
Domestic exports	2.1	-7.9	-7.2	7.5	-10.2	-11.2	-7.3
Re-exports	6.8	-3.7	5.4	18.5	-2.4	11.0	16.3
Imports of goods	7.3	-7.3	*	18.2	-1.9	7.9	13.1
Exports of services	-0.4	-3.5	8.8	12.1	6.4	10.9	7.9
Imports of services	3.9	1.6	-4.4	4.2	2.0	3.9	-2.1
GDP	5.1	-5.5	4.0	10.0	0.6	1.8	3.2
<i>Per capita GDP (\$) @</i>	<i>4.2</i>	<i>-6.2</i>	<i>3.0</i>	<i>9.0</i>	<i>-0.1</i>	<i>1.4</i>	<i>3.4</i>
GNP	6.0	-3.5	4.0	8.6	2.2	0.1	5.1
<i>Per capita GNP (\$) @</i>	<i>5.1</i>	<i>-4.3</i>	<i>3.0</i>	<i>7.6</i>	<i>1.4</i>	<i>-0.4</i>	<i>5.3</i>
Total final demand	6.2	-6.0	1.3	14.4	-0.6	5.1	8.1
Total final demand excluding re-exports ^(a)	5.8	-7.6	-1.7	11.3	0.4	2.0	3.5
Domestic demand	8.2	-9.2	-4.4	10.3	1.0	-0.7	0.1
Private	9.5	-9.9	-5.4	12.3	0.7	-1.0	-0.2
Public	-1.0	-3.8	2.1	-2.8	3.3	1.2	1.7
External demand	5.3	-4.3	4.4	16.4	-1.7	9.1	13.1

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

(#) Figures are subject to revision later on as more data become available.

(@) Population figures since 2001 have been revised based on the results of the 2006 Population By-census available in February 2007 as the up-to-date benchmark data. Per capita GDP and per capita GNP figures from 2001 to 2005 have been revised accordingly.

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

(%)

	<u>2004</u>	<u>2005[#]</u>	<u>2006[#]</u>	<u>2006[#]</u>				Average annual rate of change:	
				Q1 [#]	Q2 [#]	Q3 [#]	Q4 [#]	10 years 1996 to 2006 [#]	5 years 2001 to 2006 [#]
Private consumption expenditure	7.2	3.3	5.1	4.8	5.4	4.4	5.8	2.2	2.7
Government consumption expenditure	0.7	-3.1	0.3	1.1	-1.5	-1.1	2.4	1.6	0.4
Gross domestic fixed capital formation	3.1	4.6	7.9	7.3	4.5	10.3	9.5	1.1	2.3
<i>of which:</i>									
Building and construction	-11.6	-8.4	-7.2	-11.4	-4.1	-10.1	-2.6	-5.2	-6.8
Machinery, equipment and computer software	11.0	12.9	17.2	22.4	11.9	20.4	14.9	5.2	7.7
Total exports of goods	15.3	11.2	10.2	14.4	6.4	8.9	11.7	7.6	11.9
Domestic exports	2.4	7.6	2.3	44.4	25.7	-3.2	-30.4	-2.4	-1.5
Re-exports	16.3	11.4	10.7	12.8	5.3	9.8	15.0	8.8	13.1
Imports of goods	14.1	8.6	10.0	14.0	6.7	8.5	11.4	6.7	10.7
Exports of services	17.9	11.3	8.7	9.0	9.3	9.3	7.5	7.8	11.3
Imports of services	14.6	7.4	6.3	5.2	8.6	5.4	6.3	3.6	5.9
GDP	8.6	7.5	6.8	8.0	5.5	6.7	7.0	4.1	5.6
<i>Per capita GDP (\$) [@]</i>	<i>7.7</i>	<i>7.1</i>	<i>6.1</i>	--	--	--	--	3.5	5.1
GNP	8.0	5.8	N.A.	5.9	1.2	10.8	N.A.	3.8 ^	4.2 ~
<i>Per capita GNP (\$) [@]</i>	<i>7.2</i>	<i>5.3</i>	<i>N.A.</i>	--	--	--	--	2.7 ^	3.7 ~
Total final demand	12.0	8.1	8.6	11.1	6.4	7.6	9.5	5.6	8.4
Total final demand excluding re-exports ^(a)	9.2	5.9	7.1	9.9	7.2	6.0	5.5	3.5	5.5
Domestic demand	5.1	2.1	5.7	6.7	5.4	4.5	6.2	1.7	2.4
Private	6.3	3.5	7.1	9.0	6.8	5.9	6.9	2.1	3.1
Public	-1.6	-6.9	-4.0	-6.1	-5.3	-5.2	1.1	-1.2	-1.9
External demand	15.8	11.2	9.9	13.3	6.9	9.0	10.9	7.7	11.8

Notes (cont'd) : (^) Average annual rate of change for the 10-year period 1995-2005.

(~) Average annual rate of change for the 5-year period 2000-2005.

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

(--) Not applicable.

N.A. Not available.

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

	2001		2002		2003		2004		2005 [#]	
	\$Mn	% share	\$Mn	% share	\$Mn	% share	\$Mn	% share	\$Mn	% share
Agriculture and fishing	1,003	0.1	1,002	0.1	824	0.1	886	0.1	847	0.1
Mining and quarrying	174	*	136	*	116	*	72	*	100	*
Manufacturing	59,760	4.8	51,396	4.2	44,403	3.7	44,455	3.5	45,547	3.4
Electricity, gas and water	37,957	3.1	39,609	3.2	38,839	3.2	39,726	3.2	39,924	3.0
Construction	57,167	4.6	51,534	4.2	44,910	3.7	40,376	3.2	38,538	2.9
Services	1,088,211	87.5	1,091,272	88.4	1,073,941	89.3	1,130,695	90.0	1,219,239	90.7
<i>Wholesale, retail and import and export trades, restaurants and hotels</i>	<i>309,926</i>	<i>24.9</i>	<i>310,500</i>	<i>25.1</i>	<i>308,872</i>	<i>25.7</i>	<i>345,092</i>	<i>27.5</i>	<i>386,726</i>	<i>28.8</i>
<i>Transport, storage and communications</i>	<i>117,526</i>	<i>9.4</i>	<i>121,766</i>	<i>9.9</i>	<i>117,420</i>	<i>9.8</i>	<i>126,820</i>	<i>10.1</i>	<i>135,119</i>	<i>10.1</i>
<i>Financing, insurance, real estate and business services</i>	<i>251,495</i>	<i>20.2</i>	<i>247,045</i>	<i>20.0</i>	<i>251,085</i>	<i>20.9</i>	<i>266,834</i>	<i>21.2</i>	<i>294,666</i>	<i>21.9</i>
<i>Community, social and personal services</i>	<i>262,960</i>	<i>21.1</i>	<i>265,746</i>	<i>21.5</i>	<i>261,917</i>	<i>21.8</i>	<i>264,008</i>	<i>21.0</i>	<i>258,449</i>	<i>19.2</i>
<i>Ownership of premises</i>	<i>146,304</i>	<i>11.8</i>	<i>146,214</i>	<i>11.8</i>	<i>134,648</i>	<i>11.2</i>	<i>127,940</i>	<i>10.2</i>	<i>144,280</i>	<i>10.7</i>
GDP at factor cost	1,244,271	100.0	1,234,949	100.0	1,203,034	100.0	1,256,209	100.0	1,344,196	100.0
Taxes on production and imports	53,917		43,325		48,057		58,729		62,889	
Statistical discrepancy (%)	*		-0.1		-1.4		-1.8		-1.8	
GDP at current market prices	1,298,813		1,276,757		1,233,983		1,291,425		1,382,675	

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

(#) Figures are subject to revision later on as more data become available.

(*) Less than 0.05%.

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

	(%)							
	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u> [#]	<u>2006</u>		
						Q1 [#]	Q2 [#]	Q3 [#]
Agriculture and fishing	4.1	-0.7	-5.6	2.0	-1.9	-1.4	-4.4	-2.5
Mining and quarrying	-14.1	-11.1	2.2	-17.0	10.3	18.4	11.4	15.9
Manufacturing	-9.1	-10.0	-10.3	1.7	2.1	7.0	5.3	-0.6
Electricity, gas and water	1.7	3.8	1.8	2.1	2.5	-0.1	2.2	4.5
Construction	-2.2	-1.5	-4.9	-9.7	-9.2	-12.6	-4.6	-10.9
Services	1.8	2.8	4.5	10.1	8.0	9.2	7.6	8.1
<i>Wholesale, retail and import and export trades, restaurants and hotels</i>	<i>0.3</i>	<i>4.5</i>	<i>9.1</i>	<i>15.1</i>	<i>14.4</i>	<i>12.5</i>	<i>7.1</i>	<i>10.4</i>
<i>Transport, storage and communications</i>	<i>1.9</i>	<i>6.5</i>	<i>0.7</i>	<i>13.9</i>	<i>8.0</i>	<i>11.2</i>	<i>6.8</i>	<i>8.6</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>8.7</i>	<i>13.3</i>	<i>15.2</i>	<i>11.7</i>
<i>Community, social and personal services</i>	<i>4.0</i>	<i>-0.6</i>	<i>0.6</i>	<i>2.9</i>	<i>0.4</i>	<i>1.4</i>	<i>1.5</i>	<i>2.5</i>
<i>Ownership of premises</i>	<i>3.4</i>	<i>2.0</i>	<i>2.7</i>	<i>1.4</i>	<i>3.1</i>	<i>2.9</i>	<i>2.6</i>	<i>2.0</i>
Taxes on production and imports	-1.1	-0.1	3.4	13.0	1.0	3.2	7.6	3.3
GDP at constant (2000) market prices	0.6	1.8	3.2	8.6	7.5	8.0	5.5	6.7

Note : (#) Figures are subject to revision later on as more data become available.

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

(\$Mn)

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u> [#]	<u>2006</u> Q1-Q3 [#]	<u>2006</u> Q1 [#]	<u>2006</u> Q2 [#]	<u>2006</u> Q3 [#]
Current account	96,800	128,240	122,491	157,338	103,927	37,063	15,116	51,748
Goods	-39,406	-44,970	-72,514	-59,347	-83,739	-29,801	-35,369	-18,569
Services	145,341	159,020	187,056	231,562	199,536	63,073	61,858	74,605
Income	5,652	28,491	23,410	1,648	669	8,053	-7,622	238
Current transfers	-14,787	-14,301	-15,461	-16,524	-12,538	-4,262	-3,750	-4,526
Capital and financial account	-151,179	-179,086	-184,640	-182,431	-135,695	-49,186	-26,394	-60,115
Capital and financial non-reserve assets (net change)	-169,720	-171,497	-159,155	-171,752	-101,015	-37,723	-16,330	-46,962
Capital transfers	-15,686	-8,292	-2,561	-4,939	-1,672	-415	472	-1,729
Financial non-reserve assets (net change)	-154,033	-163,205	-156,594	-166,812	-99,344	-37,308	-16,803	-45,233
<i>Direct investment</i>	-60,685	63,372	-91,038	49,996	-18,368	27,362	-29,913	-15,817
<i>Portfolio investment</i>	-302,484	-264,619	-306,368	-245,017	-27,077	34,018	-78,343	17,248
<i>Financial derivatives</i>	51,563	78,288	44,319	30,502	25,131	2,275	14,544	8,312
<i>Other investment</i>	157,573	-40,247	196,492	-2,294	-79,028	-100,963	76,910	-54,975
Reserve assets (net change) ^(a)	18,541	-7,589	-25,486	-10,679	-34,679	-11,463	-10,063	-13,153
Net errors and omissions	54,379	50,846	62,149	25,093	31,767	12,123	11,277	8,367
Overall balance of payments	-18,541	7,589	25,486	10,679	34,679	11,463	10,063	13,153

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.

(#) Figures are subject to revision later on as more data become available.

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

	(\$Mn)								
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005[#]</u>	<u>2006[#]</u>	<u>2006</u>			
						Q1 [#]	Q2 [#]	Q3 [#]	Q4 [#]
Total exports of goods	1,562,121	1,749,089	2,027,031	2,251,744	2,467,357	538,460	586,741	667,228	674,929
Imports of goods	1,601,527	1,794,059	2,099,545	2,311,091	2,576,340	568,261	622,110	685,797	700,172
Visible trade balance	-39,406	-44,970	-72,514	-59,347	-108,983	-29,801	-35,369	-18,569	-25,243
	(-2.5)	(-2.5)	(-3.5)	(-2.6)	(-4.2)	(-5.2)	(-5.7)	(-2.7)	(-3.6)
Exports of services	347,836	362,420	429,563	495,799	562,304	128,843	129,770	150,777	152,914
Imports of services	202,494	203,400	242,507	264,237	283,899	65,770	67,912	76,172	74,045
Invisible trade balance	145,342	159,020	187,056	231,562	278,405	63,073	61,858	74,605	78,869
	(71.8)	(78.2)	(77.1)	(87.6)	(98.1)	(95.9)	(91.1)	(97.9)	(106.5)
Exports of goods and services	1,909,957	2,111,509	2,456,594	2,747,543	3,029,661	667,303	716,511	818,005	827,843
Imports of goods and services	1,804,021	1,997,459	2,342,052	2,575,328	2,860,239	634,031	690,022	761,969	774,217
Visible and invisible trade balance	105,936	114,050	114,542	172,215	169,422	33,272	26,489	56,036	53,626
	<5.9>	<5.7>	<4.9>	<6.7>	<5.9>	<5.2>	<3.8>	<7.4>	<6.9>

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

(#) Figures are subject to revision later on as more data become available.

() 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>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>		<u>2006</u>			
	(% change)		(% change)		(\$Mn)	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	
						(% change over a year earlier)				
All markets	5.4	11.7	15.9	11.4	9.4	2,461,027	12.1	5.4	8.4	11.9
Mainland of China	12.3	21.1	19.7	14.0	14.2	1,156,210	18.4	8.5	13.5	17.0
United States	1.0	-2.6	5.4	5.6	2.9	371,130	3.8	-0.1	0.7	7.3
Japan	-4.5	12.3	14.4	10.3	1.6	120,422	6.9	2.3	*	-2.2
Germany	-5.3	15.1	11.9	15.6	4.0	75,663	10.5	2.5	0.3	3.6
United Kingdom	-2.0	5.8	14.8	5.2	6.3	73,632	2.1	3.6	7.9	10.2
Taiwan	-2.2	22.2	16.2	2.7	3.3	52,106	4.1	-6.3	8.6	6.8
Republic of Korea	17.2	16.9	24.0	9.5	7.5	51,873	16.3	10.5	9.8	-4.3
Singapore	6.8	13.0	22.0	6.8	4.4	48,612	-1.0	-3.7	13.7	8.8
Rest of the world	3.5	7.1	17.3	13.3	8.5	511,380	10.3	5.9	6.3	11.7

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

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

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

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>		<u>2006</u>			
	(% change)		(% change)		(\$Mn)	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	
						(% change over a year earlier)				
All sources	3.3	11.5	16.9	10.3	11.6	2,599,804	13.8	8.1	10.7	14.0
Mainland of China	5.1	9.6	16.9	14.3	13.7	1,192,952	16.9	11.0	10.8	16.6
Japan	3.4	17.2	19.7	0.1	4.5	268,140	4.4	-1.1	5.1	9.7
Taiwan	7.4	8.0	22.8	9.4	15.9	194,917	19.4	18.4	20.4	7.0
Singapore	3.9	19.6	22.5	21.8	21.9	164,837	34.3	15.9	17.0	22.6
United States	-12.8	7.9	13.4	6.5	3.6	123,569	0.1	-5.0	5.1	14.7
Republic of Korea	7.3	15.0	15.0	2.6	16.1	119,647	19.8	13.1	7.7	23.8
Rest of the world	2.2	12.1	13.6	8.4	7.6	535,742	8.0	4.1	10.1	8.3

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>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>		<u>2006</u>			
	(% change)		(% change)		(\$Mn)	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	
						(% change over a year earlier)				
Overall	-9.0	2.6	14.8	7.3	16.3	680,441	22.7	18.5	14.8	10.3
Foodstuffs	0.2	1.5	8.6	3.1	4.5	53,037	4.1	8.5	4.7	1.2
Consumer goods	-5.2	-1.8	7.4	5.5	4.3	133,338	12.9	24.8	-5.5	-10.8
Raw materials and semi-manufactures	-1.6	10.7	17.6	4.2	9.6	236,571	14.3	7.9	6.8	10.1
Fuels	3.9	12.9	37.5	23.5	22.9	70,032	40.0	19.4	15.2	20.6
Capital goods	-24.9	-6.6	13.3	10.8	34.2	180,777	38.9	27.4	46.9	26.0

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>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005[#]</u>	<u>2006[#]</u>		<u>2006</u>	<u>2006</u>	<u>2006</u>	<u>2006</u>
	(% change)		(% change)		(\$Mn)		Q1 [#]	Q2 [#]	Q3 [#]	Q4 [#]
							(% change over a year earlier)			
Exports of services	8.4	4.2	18.5	15.4	13.4	562,304	13.6	15.1	14.6	10.7
Transportation	10.8	3.8	25.5	16.9	9.1	172,384	9.9	10.2	8.7	7.8
Travel	25.4	-4.4	26.1	14.2	10.8	88,713	14.0	13.1	12.8	4.5
Trade-related	9.0	12.2	12.6	10.7	11.9	181,420	12.9	11.4	13.1	10.3
Other services	-5.9	-1.4	12.7	22.9	25.4	119,787	20.2	31.5	29.3	21.2
Imports of services	4.3	0.4	19.2	9.0	7.4	283,899	5.2	9.5	6.8	8.3
Transportation	-4.7	7.8	29.4	20.3	7.8	87,739	7.1	10.1	7.0	7.3
Travel	0.8	-8.0	15.9	0.1	4.9	108,572	1.6	8.0	3.2	7.3
Trade-related	24.2	9.2	3.2	12.8	2.7	19,135	4.9	2.5	3.6	0.6
Other services	20.0	8.2	19.7	10.5	12.6	68,453	8.9	13.0	14.4	13.9
Net exports of services	14.8	9.4	17.6	23.8	20.2	278,405	24.0	22.1	23.9	13.0

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

(#) Figures are subject to revision later on as more data become available.

Table 11 : Incoming visitors by source

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>		<u>2006</u>		
						Q1	Q2	Q3	Q4
<u>('000)</u>									
All sources	16 566.4	15 536.8	21 810.6	23 359.4	25 251.1	6 226.3	5 971.0	6 374.7	6 679.1
Mainland of China	6 825.2	8 467.2	12 245.9	12 541.4	13 591.3	3 591.8	3 114.5	3 492.3	3 392.6
South and Southeast Asia	1 905.2	1 359.6	2 077.7	2 413.0	2 659.7	543.6	695.7	601.8	818.6
Taiwan	2 428.8	1 852.4	2 074.8	2 130.6	2 177.2	526.8	513.0	599.0	538.4
Europe	1 083.9	780.8	1 142.7	1 398.0	1 548.2	351.6	364.5	360.0	472.1
Japan	1 395.0	867.2	1 126.3	1 210.8	1 311.1	320.7	305.1	336.9	348.4
United States	1 000.8	683.8	1 051.7	1 143.1	1 159.0	264.0	300.2	276.4	318.4
Others	1 927.4	1 525.8	2 091.7	2 522.6	2 804.5	627.7	677.9	708.3	790.6
<u>(% change over a year earlier)</u>									
All sources	20.7	-6.2	40.4	7.1	8.1	13.8	8.4	6.7	4.3
Mainland of China	53.4	24.1	44.6	2.4	8.4	18.2	9.5	6.0	0.9
South and Southeast Asia	9.1	-28.6	52.8	16.1	10.2	8.9	12.7	10.5	8.9
Taiwan	0.4	-23.7	12.0	2.7	2.2	4.9	-0.1	4.4	-0.5
Europe	6.3	-28.0	46.3	22.3	10.7	14.0	5.5	9.4	13.8
Japan	4.4	-37.8	29.9	7.5	8.3	1.2	15.3	11.0	6.9
United States	7.0	-31.7	53.8	8.7	1.4	1.2	2.3	0.5	1.4
Others	5.9	-20.8	37.1	20.6	11.2	15.4	7.9	7.9	13.9

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

Table 12 : Property market

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Completion of new property by the private sector							
<i>('000 m² of internal floor area)</i>							
Residential property ^(a) (in units)	18 202	22 278	35 322	25 790	26 262	31 052	26 397
Commercial property	705	945	634	160	208	304	417
<i>of which :</i>							
Office space	456	737	428	96	76	166	299
Other commercial premises ^(b)	249	208	206	64	132	138	118
Industrial property ^(c)	343	300	191	62	45	29	15
<i>of which :</i>							
Industrial-cum-office premises	72	145	40	37	14	0	15
Conventional flatted factory space	181	31	4	19	30	3	0
Storage premises ^(d)	90	124	147	6	0	27	0
Production of public housing							
<i>(in units)</i>							
Rental housing flats ^(e)	16 046	14 267	26 733	40 944	47 590	20 154	13 705
Subsidized sales flats ^(e)	21 535	21 993	26 532	22 768	25 702	1 072	320
Building plans with consent to commence work in the private sector							
<i>('000 m² of usable floor area)</i>							
Residential property	1 631.4	1 472.0	1 692.8	1 142.7	1 002.5	790.0	1 038.4
Commercial property	599.0	395.7	287.5	337.5	265.0	365.3	200.0
Industrial property ^(f)	461.6	69.5	84.9	129.2	45.7	107.1	0.8
Other properties	259.2	201.5	125.8	240.2	75.0	109.3	444.2
Total	2 951.2	2 138.7	2 190.9	1 849.5	1 388.1	1 371.8	1 683.3
Agreements for sale and purchase of property							
<i>(Number)</i>							
Residential property ^(g)	172 711	85 616	77 087	65 340	69 667	72 974	71 576
Primary market	15 806	23 441	18 325	13 911	18 366	23 088	26 498
Secondary market	156 905	62 175	58 762	51 429	51 301	49 886	45 078
Selected types of non-residential properties ^(h)							
Office space	N.A.	N.A.	N.A.	1 724	1 774	1 639	1 817
Other commercial premises	N.A.	N.A.	N.A.	2 411	2 989	3 167	4 142
Flatted factory space	N.A.	N.A.	N.A.	N.A.	N.A.	3 756	3 813

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

- (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>2004</u>	<u>2005</u>	<u>2006</u>		<u>2006</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)	26 036	17 321	16 579	2 785	5 765	3 555	4 474
Commercial property	371	145	291	8	63	42	178
<i>of which :</i>							
Office space	280	34	108	1	28	36	43
Other commercial premises ^(b)	91	111	183	8	35	6	134
Industrial property ^(c)	1	17	27	15	7	4	2
<i>of which :</i>							
Industrial-cum-office premises	0	4	0	0	0	0	0
Conventional flatted factory space	1	0	0	0	0	0	0
Storage premises ^(d)	0	13	27	15	7	4	2
Production of public housing							
<i>(in units)</i>							
Rental housing flats ^(e)	20 614	24 691	4 430	2 033	2 397	0	0
Subsidized sales flats ^(e)	0	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	530.0	550.7	706.7	174.9	88.5	343.9	99.4
Commercial property	161.3	481.9	468.4	15.5	100.9	38.4	313.6
Industrial property ^(f)	16.4	35.1	23.9	1.4	13.1	8.2	1.2
Other properties	407.1	408.0	199.2	28.1	46.6	98.7	25.9
Total	1 114.8	1 475.8	1 398.2	220.0	249.1	489.1	440.0
Agreements for sale and purchase of property							
<i>(Number)</i>							
Residential property ^(g)	100 630	103 362	82 472	17 724	21 811	22 241	20 696
Primary market	25 694	15 994	13 986	1 294	3 023	5 902	3 767
Secondary market	74 936	87 368	68 486	16 430	18 788	16 339	16 929
Selected types of non-residential properties ^(h)							
Office space	3 213	3 431	2 882	649	794	670	769
Other commercial premises	7 833	7 143	4 401	1 115	1 168	1 029	1 089
Flatted factory space	5 889	6 560	7 442	1 690	2 038	1 815	1 899

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

(g) The figures are derived from sale and purchase agreements of domestic units received for registration in the Land Registry for the relevant periods. They generally relate to transactions executed up to four weeks prior to their submission for registration. Sales of domestic units refer to sale and purchase agreements with payment of stamp duty. These statistics do not include sales of units under the Home Ownership Scheme, the Private Sector Participation Scheme and the Tenants Purchase Scheme except those after payment of premium. Primary sales generally refer to sales from developers. Secondary sales refer to sales from parties other than developers.

(h) Timing of the figures for non-residential properties is based on the date on which the S&P Agreement is signed, which may differ from the date on which the Agreement is received for registration in the Land Registry.

N.A. Not available.

Table 13 : Property prices and rentals

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
<u>(Index (1999=100))</u>							
Property price indices :							
Residential flats ^(a)	163.1	117.1	100.0	89.6	78.7	69.9	61.6
Office space ^(b)	213.1	134.5	100.0	89.9	78.7	68.4	62.5
Shopping space	177.3	128.3	100.0	93.6	86.8	85.0	85.5
Flatted factory space	168.9	131.8	100.0	91.2	82.0	74.8	71.7
Property rental indices ^(c) :							
Residential flats	134.5	112.6	100.0	98.1	95.4	83.4	73.6
Office space ^(b)	156.8	135.9	100.0	98.5	101.0	85.4	74.6
Shopping space	123.5	111.2	100.0	101.3	99.4	92.9	86.4
Flatted factory space	132.5	118.1	100.0	95.4	90.3	82.7	74.9
<u>(% change)</u>							
Property price indices :							
Residential flats ^(a)	39.5	-28.2	-14.6	-10.4	-12.2	-11.2	-11.9
Office space ^(b)	13.1	-36.9	-25.7	-10.1	-12.5	-13.1	-8.6
Shopping space	32.3	-27.6	-22.1	-6.4	-7.3	-2.1	0.6
Flatted factory space	-1.5	-22.0	-24.1	-8.8	-10.1	-8.8	-4.1
Property rental indices ^(c) :							
Residential flats	13.0	-16.3	-11.2	-1.9	-2.8	-12.6	-11.8
Office space ^(b)	3.0	-13.3	-26.4	-1.5	2.5	-15.4	-12.6
Shopping space	4.8	-10.0	-10.1	1.3	-1.9	-6.5	-7.0
Flatted factory space	0.1	-10.9	-15.3	-4.6	-5.3	-8.4	-9.4

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 recomputed 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>2004</u>	<u>2005</u>	<u>2006⁺</u>		<u>2006</u>		
				Q1	Q2	Q3 [#]	Q4 ⁺
<u>(Index (1999=100))</u>							
Property price indices :							
Residential flats ^(a)	78.0	92.0	92.6	91.5	93.2	92.7	92.7
Office space ^(b)	99.3	133.0	138.9	131.0	139.5	143.0	142.1
Shopping space	119.3	149.3	153.0	151.6	154.5	152.7	153.0
Flatted factory space	88.6	125.0	157.6	144.3	154.6	163.8	167.9
Property rental indices ^(c) :							
Residential flats	77.7	86.5	91.7	89.3	90.9	92.2	94.3
Office space ^(b)	78.1	96.4	117.2	110.1	117.4	119.7	121.7
Shopping space	92.8	100.5	104.4	103.2	102.8	103.8	107.9
Flatted factory space	77.3	82.6	90.7	86.3	90.2	92.5	93.6
<u>(% change over a year earlier)</u>							
Property price indices :							
Residential flats ^(a)	26.6	17.9	0.7	1.8	-1.4	-1.0	2.9 <56.3> {-45.3}
Office space ^(b)	58.9	33.9	4.4	6.3	2.9	3.9	4.9 <140.8> {-36.8}
Shopping space	39.5	25.1	2.5	5.1	1.0	2.6	1.3 <88.9> {-20.9}
Flatted factory space	23.6	41.1	26.1	32.9	26.2	24.0	22.9 <139.9> {-3.2}
Property rental indices ^(c) :							
Residential flats	5.6	11.3	6.0	8.2	6.3	4.4	4.9 <28.2> {-32.1}
Office space ^(b)	4.7	23.4	21.6	25.5	26.5	19.9	15.5 <69.7> {-23.5}
Shopping space	7.4	8.3	3.9	6.6	3.8	0.9	4.4 <28.3> {-13.4}
Flatted factory space	3.2	6.9	9.8	6.5	9.5	12.1	10.8 <29.6> {-30.0}

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

(+) Provisional figures.

< > % change from the trough in 2003.

{ } % change from the peak in 1997.

Table 14 : Monetary aggregates

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
<u>(as at end of period)</u>							
Hong Kong dollar money supply (\$Mn) :							
M1	188,135	178,260	205,339	203,966	229,841	259,411	354,752
M2 ^(a)	1,666,419	1,828,691	1,923,481	1,987,963	1,998,774	1,984,049	2,107,269
M3 ^(a)	1,684,325	1,840,824	1,935,471	2,002,358	2,016,635	2,004,225	2,122,861
Total money supply (\$Mn)							
M1	208,093	197,666	225,156	243,847	258,056	295,650	413,423
M2	2,788,808	3,111,942	3,386,196	3,649,492	3,550,060	3,518,326	3,813,442
M3	2,871,425	3,168,199	3,434,467	3,692,753	3,594,130	3,561,852	3,858,044
Deposit ^(b) (\$Mn)							
HK\$	1,551,555	1,699,726	1,773,169	1,851,177	1,854,651	1,824,911	1,930,790
Foreign currency	1,158,728	1,300,302	1,477,448	1,676,670	1,551,852	1,492,631	1,636,227
Total	2,710,282	3,000,027	3,250,617	3,527,847	3,406,502	3,317,542	3,567,018
Loans and advances (\$Mn)							
HK\$	1,742,481	1,695,027	1,607,126	1,652,191	1,647,684	1,615,667	1,573,079
Foreign currency	2,379,189	1,609,400	1,205,784	809,259	537,301	460,659	462,000
Total	4,121,670	3,304,427	2,812,910	2,461,450	2,184,986	2,076,325	2,035,079
Nominal Effective Exchange Rate Indices							
(Jan 2000 = 100) ^{(c)(d)}							
Trade-weighted	98.0	103.4	100.9	101.7	104.7	104.0	100.7
Import-weighted	97.9	105.5	101.4	101.5	105.1	104.7	101.6
Export-weighted	98.1	101.3	100.4	101.9	104.3	103.3	99.8
<u>(% change)</u>							
Hong Kong dollar money supply :							
M1	-5.1	-5.2	15.2	-0.7	12.7	12.9	36.8
M2 ^(a)	--	9.7	5.2	3.4	0.5	-0.7	6.2
M3 ^(a)	--	9.3	5.1	3.5	0.7	-0.6	5.9
Total money supply :							
M1	-4.3	-5.0	13.9	8.3	5.8	14.6	39.8
M2	--	11.6	8.8	7.8	-2.7	-0.9	8.4
M3	--	10.3	8.4	7.5	-2.7	-0.9	8.3
Deposit ^(b)							
HK\$	--	9.5	4.3	4.4	0.2	-1.6	5.8
Foreign currency	--	12.2	13.6	13.5	-7.4	-3.8	9.6
Total	--	10.7	8.4	8.5	-3.4	-2.6	7.5
Loans and advances							
HK\$	20.4	-2.7	-5.2	2.8	-0.3	-1.9	-2.6
Foreign currency	-3.6	-32.4	-25.1	-32.9	-33.6	-14.3	0.3
Total	5.3	-19.8	-14.9	-12.5	-11.2	-5.0	-2.0
Nominal Effective Exchange Rate Indices ^{(c)(d)}							
Trade-weighted	4.3	5.5	-2.4	0.8	2.9	-0.7	-3.2
Import-weighted	5.3	7.8	-3.9	0.1	3.5	-0.4	-3.0
Export-weighted	3.2	3.3	-0.9	1.5	2.4	-1.0	-3.4

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 at end-1997 cannot be compared with those at end-1996.

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>2004</u>	<u>2005</u>	<u>2006</u>		<u>2006</u>		
				Q1	Q2	Q3	Q4
<u>(as at end of period)</u>							
Hong Kong dollar money supply (\$Mn) :							
M1	412,629	348,248	387,918	356,869	353,297	367,188	387,918
M2 ^(a)	2,208,591	2,329,669	2,777,821	2,453,240	2,506,013	2,651,516	2,777,821
M3 ^(a)	2,219,557	2,345,838	2,795,686	2,469,679	2,523,153	2,669,052	2,795,686
Total money supply (\$Mn)							
M1	484,494	434,684	491,657	438,946	447,433	470,389	491,657
M2	4,166,706	4,379,057	5,063,300	4,522,812	4,636,476	4,856,149	5,063,300
M3	4,189,544	4,407,188	5,098,709	4,551,810	4,666,865	4,886,507	5,098,709
Deposit ^(b) (\$Mn)							
HK\$	2,017,911	2,131,579	2,568,424	2,248,321	2,300,179	2,441,962	2,568,424
Foreign currency	1,848,145	1,936,322	2,197,819	1,959,835	2,029,667	2,108,527	2,197,819
Total	3,866,056	4,067,901	4,766,244	4,208,156	4,329,846	4,550,489	4,766,244
Loans and advances (\$Mn)							
HK\$	1,666,740	1,797,350	1,917,476	1,792,148	1,861,763	1,931,779	1,917,476
Foreign currency	488,964	514,637	550,417	535,632	555,727	566,351	550,417
Total	2,155,704	2,311,987	2,467,893	2,327,780	2,417,490	2,498,130	2,467,893
Nominal Effective Exchange Rate Indices (Jan 2000 =100) ^{(c)(d)}							
Trade-weighted	98.3	97.4	96.1	97.6	96.2	95.8	94.9
Import-weighted	99.2	98.1	96.8	98.2	96.8	96.5	95.6
Export-weighted	97.3	96.7	95.5	97.0	95.6	95.1	94.2
<u>(% change over a year earlier)</u>							
Hong Kong dollar money supply :							
M1	16.3	-15.6	11.4	-7.8	-2.1	4.7	11.4
M2 ^(a)	4.8	5.5	19.2	11.4	13.2	16.3	19.2
M3 ^(a)	4.6	5.7	19.2	11.5	13.3	16.3	19.2
Total money supply :							
M1	17.2	-10.3	13.1	-5.5	2.1	9.1	13.1
M2	9.3	5.1	15.6	8.6	11.3	14.4	15.6
M3	8.6	5.2	15.7	8.6	11.3	14.4	15.7
Deposit ^(b)							
HK\$	4.5	5.6	20.5	12.2	14.0	17.4	20.5
Foreign currency	13.0	4.8	13.5	6.0	10.4	14.2	13.5
Total	8.4	5.2	17.2	9.2	12.3	15.9	17.2
Loans and advances							
HK\$	6.0	7.8	6.7	5.5	5.9	9.5	6.7
Foreign currency	5.8	5.3	7.0	11.0	11.3	12.1	7.0
Total	5.9	7.2	6.7	6.7	7.1	10.1	6.7
Nominal Effective Exchange Rate Indices ^{(c)(d)}							
Trade-weighted	-2.4	-0.9	-1.3	1.5	-0.9	-1.8	-3.8
Import-weighted	-2.4	-1.1	-1.3	1.3	-0.9	-1.8	-3.9
Export-weighted	-2.5	-0.6	-1.2	1.6	-0.8	-1.9	-3.6

- 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 at end-1997 cannot be compared with those at end-1996.
- (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>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2006</u>		
					Q1-Q3 [#]	Q1	Q2	Q3 [#]
Wholesale trade	-10.7	-5.0	4.7	5.6	8.0	4.3	5.7	14.1
Retail trade	-4.1	-2.3	10.8	6.8	6.8	6.1	6.7	7.7
Import/export trade	-2.8	6.5	12.4	10.6	9.9	10.3	8.4	11.0
Restaurants	-5.4	-9.7	10.1	6.0	9.0	8.8	11.1	7.1
Hotels	-2.3	-19.7	39.4	22.1	14.8	14.7	15.4	14.4
Transport ^(a)	2.3	0.5	22.8	17.8	11.8	17.6	12.6	6.4
Storage	-19.6	-4.5	17.0	10.4	8.3	9.2	5.0	10.7
Communications	-2.6	-2.4	1.0	5.1	1.1	1.2	2.5	-0.4
Banking	-0.8	*	4.4	10.9	17.9	18.0	24.1	11.5
Financing (other than banking)	-14.3	17.3	33.2	14.3	43.7	50.8	57.2	25.9
Insurance	10.3	19.1	22.3	16.0	23.4	35.5	21.9	14.1
Real estate	-2.5	6.2	13.5	16.0	-2.4	-6.0	-5.3	4.6
Business services	-5.8	0.5	8.3	4.9	20.1	19.2	18.1	22.9
Film entertainment	-9.1	2.3	3.7	5.0	1.9	0.6	-0.7	5.8
Tourism, convention and exhibition services	10.7	-7.3	26.5	12.9	14.0	14.3	16.2	11.6
Computer and information services	5.7	5.7	20.5	23.4	13.5	21.5	-1.5	21.1

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

(#) Revised figures.

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

Table 16 : Labour force characteristics[#]

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2006</u>			
						Q1	Q2	Q3	Q4
<u>(%)</u>									
Labour force participation rate	61.8	61.4	61.3	61.0	61.3	61.1	60.8	61.8	61.6
Seasonally adjusted unemployment rate	7.3	7.9	6.8	5.6	4.8	5.1	4.9	4.7	4.4
Underemployment rate	3.0	3.5	3.2	2.7	2.4	2.3	2.6	2.3	2.4
<u>('000)</u>									
Population of working age	5 620.7	5 652.4	5 733.1	5 801.4	5 843.2	5 812.7	5 828.7	5 852.2	5 879.1
Labour force	3 474.0	3 472.5	3 515.9	3 538.1	3 582.5	3 552.1	3 544.0	3 614.1	3 619.7
Persons employed	3 220.3	3 197.4	3 276.5	3 340.8	3 411.6	3 375.0	3 368.3	3 437.1	3 466.0
Persons unemployed	253.8	275.1	239.4	197.3	170.9	177.1	175.7	177.0	153.7
Persons underemployed	103.9	121.4	114.1	96.3	86.3	80.9	93.8	84.3	87.6
<u>(% change over a year earlier)</u>									
Population of working age	0.8	0.6	1.4	1.2	0.7	0.7	0.7	0.8	0.7
Labour force	1.4	*	1.3	0.6	1.3	0.7	0.5	1.9	1.9
Persons employed	-1.0	-0.7	2.5	2.0	2.1	1.7	1.3	2.8	2.8
Persons unemployed	45.3	8.4	-13.0	-17.6	-13.4	-14.2	-12.9	-12.7	-13.8
Persons underemployed	22.4	16.9	-6.0	-15.6	-10.0	-24.6	-4.8	-8.8	0.8

Notes : (#) Figures enumerated from the General Household Survey have been revised to take into account the recent enhancements in the estimation method and the results of the 2006 Population By-census, which provide a benchmark for revising the population figures compiled since the 2001 Population Census.

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

Table 17 : Employment in selected major economic sectors

Major economic sector	2002	2003	2004	2005	2006		2006		No.
	(% change)				Mar-Sep	Mar	Jun	Sep	
					(% change over a year earlier)				
Manufacturing	-9.0	-10.3	-3.0	-2.0	-1.8	-1.0	-0.5	-3.7	160 200
<i>of which :</i>									
Wearing apparel, except footwear	-19.3	-11.6	-0.8	-4.7	-7.9	-3.7	0.3	-18.6	18 500
Textiles	-1.1	-16.8	-11.1	0.5	-3.5	-3.4	-1.6	-5.7	19 200
Electronics	-13.1	-18.9	-2.3	-4.7	-12.3	-11.9	-9.5	-14.1	12 200
Plastic products	-17.0	-19.1	-16.8	-1.3	-3.1	2.6	-4.7	-5.3	3 000
Fabricated metal products, except machinery and equipment	-14.6	-20.7	-4.9	-9.7	-3.4	-8.3	-4.5	3.4	5 700
Wholesale, retail, import/export trades, restaurants and hotels	-2.3	-3.0	2.9	2.6	1.8	1.9	1.8	1.7	1 038 800
<i>of which :</i>									
Wholesale, retail and import/export trades	-1.6	-1.9	2.1	2.3	0.9	1.0	0.9	0.7	812 600
Restaurants and hotels	-4.8	-7.3	6.0	3.6	5.3	5.3	5.3	5.5	226 200
Transport, storage and communications	-1.8	-4.4	3.7	2.6	0.9	1.6	-0.2	1.4	185 600
<i>of which :</i>									
Land transport	-0.3	0.5	-2.2	-1.5	*	-0.6	0.6	*	37 700
Water transport	1.0	-3.6	0.1	-0.3	-5.1	-3.6	-8.1	-3.5	26 100
Services allied to transport	1.1	-3.7	10.3	7.9	3.6	3.6	3.2	3.9	63 700
Financing, insurance, real estate and business services	-1.3	-1.9	3.6	4.4	4.7	4.6	4.1	5.5	480 500
<i>of which :</i>									
Financial institutions	-5.6	-6.5	1.1	4.7	5.2	4.1	4.5	6.8	134 500
Insurance	0.3	1.2	2.4	5.9	-1.0	2.3	-4.8	-1.1	29 000
Real estate	5.2	0.7	2.2	6.8	6.0	8.2	5.7	4.0	97 500
Business services except machinery and equipment rental and leasing	-1.2	-0.2	6.0	2.9	4.9	3.7	4.5	6.4	218 700
Community, social and personal services	5.9	2.9	3.2	4.5	3.8	3.9	3.4	4.0	455 200
<i>of which :</i>									
Sanitary and similar services	13.8	6.0	1.5	2.4	2.1	4.4	1.6	0.4	59 300
Education services	2.5	2.9	1.8	1.8	5.0	4.0	3.6	7.5	138 400
Medical, dental and other health services	3.2	-0.3	2.5	1.6	3.8	2.5	4.4	4.5	80 600
Welfare institutions	11.9	13.9	2.1	-0.4	2.1	2.4	4.0	-0.1	52 400
Civil Service^(a)	-3.7	-2.4	-3.8	-2.7	-1.5	-1.5	-1.5	-1.4	154 100

Notes : (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.

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

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

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u> Mar-Sep	Mar	<u>2006</u> Jun	Sep
<u>(number)</u>								
Building sites								
Private sector	40 017	33 892	33 619	31 556	31 471	32 156	30 997	31 261
Public sector ^(a)	11 727	16 183	13 325	10 135	7 907	8 312	7 822	7 588
Sub-total	51 744	50 074	46 944	41 690	39 379	40 468	38 819	38 849
Civil engineering sites								
Private sector	2 869	2 755	2 564	2 198	1 614	1 594	1 707	1 540
Public sector ^(a)	18 611	17 466	16 772	15 378	12 493	12 835	11 747	12 897
Sub-total	21 480	20 221	19 336	17 576	14 107	14 429	13 454	14 437
Total	73 223	70 295	66 280	59 266	53 485	54 897	52 273	53 286
<u>(% change over a year earlier)</u>								
Building sites								
Private sector	-1.3	-15.3	-0.8	-6.1	-1.6	-5.3	-0.9	1.9
Public sector ^(a)	-31.8	38.0	-17.7	-23.9	-26.1	-27.6	-22.0	-28.2
Sub-total	-10.4	-3.2	-6.3	-11.2	-7.7	-11.0	-6.0	-5.8
Civil engineering sites								
Private sector	9.0	-4.0	-6.9	-14.3	-33.1	-48.4	-25.2	-17.2
Public sector ^(a)	-6.6	-6.2	-4.0	-8.3	-20.9	-25.5	-28.5	-6.1
Sub-total	-4.8	-5.9	-4.4	-9.1	-22.5	-29.0	-28.1	-7.4
Total	-8.8	-4.0	-5.7	-10.6	-12.1	-16.5	-12.9	-6.3

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>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2006</u>		
Major economic sector					Q1-Q3	Q1	Q2	Q3
Wholesale, retail and import/export trades	12,500 (-1.6) <1.4>	12,300 (-1.5) <1.1>	12,400 (0.4) <0.9>	13,300 (7.3) <6.3>	13,700 (3.7) <1.7>	15,500 (2.6) <1.0>	12,500 (3.4) <1.3>	13,000 (5.3) <3.0>
Restaurants and hotels	8,700 (-4.2) <-1.2>	8,100 (-6.2) <-3.7>	8,100 (-0.1) <0.4>	8,300 (1.9) <0.9>	8,400 (0.8) <-1.1>	9,000 (-0.9) <-2.4>	8,000 (0.7) <-1.3>	8,200 (2.9) <0.6>
Transport, storage and communications	18,900 (-0.2) <2.9>	18,500 (-1.7) <0.9>	18,300 (-1.3) <-0.9>	19,200 (5.0) <4.1>	19,000 (0.8) <-1.2>	19,800 (-3.4) <-4.9>	18,700 (4.2) <2.1>	18,500 (2.1) <-0.2>
Financing, insurance, real estate and business services	18,800 (-2.2) <0.8>	18,600 (-1.4) <1.2>	18,500 (-0.1) <0.4>	19,100 (2.8) <1.8>	19,800 (5.4) <3.4>	22,200 (5.6) <4.0>	19,000 (5.0) <2.9>	18,200 (5.6) <3.3>
Community, social and personal services	19,800 (-1.3) <1.8>	18,900 (-4.7) <-2.2>	18,400 (-2.6) <-2.2>	18,000 (-2.2) <-3.1>	17,900 (-0.1) <-2.0>	17,700 (-0.4) <-1.9>	17,800 (-0.1) <-2.1>	18,200 (0.2) <-2.0>
Manufacturing	11,800 (-1.2) <1.9>	11,400 (-3.0) <-0.4>	11,300 (-0.6) <-0.2>	11,600 (1.8) <0.9>	11,700 (1.7) <-0.3>	12,900 (1.3) <-0.3>	11,400 (1.1) <-0.9>	10,900 (2.7) <0.4>
All sectors surveyed	15,300 (-1.1) <2.0>	15,000 (-1.8) <0.8>	14,900 (-0.7) <-0.2>	15,400 (3.5) <2.6>	15,600 (1.9) <-0.1>	17,000 (1.3) <-0.3>	14,900 (2.2) <0.1>	14,900 (2.2) <-0.1>

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

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

The rates of change in real terms are derived from the Real Indices of Payroll per Person Engaged. As from 2006, the Indices are derived by deflating the Nominal Indices of Payroll per Person Engaged by the 2004/2005-based Composite CPI. To facilitate comparison, Real Indices of Payroll per Person Engaged prior to 2006 have been re-scaled using the 2004/2005-based Composite CPI.

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

(%)

Selected major economic sector	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2006</u>		
					Mar-Sep	Mar	Jun	Sep
<u>(in money terms)</u>								
Wholesale, retail and import/export trades	-0.6	-1.7	-1.6	1.6	1.0	-0.3	1.6	1.6
Restaurants and hotels	-2.6	-4.1	-2.2	*	1.0	-0.1	1.5	1.6
Transport services	0.6	-1.9	-1.0	1.0	-0.9	-0.8	-1.7	*
Financing, insurance, real estate and business services	-0.8	-0.1	-0.5	*	3.2	4.0	2.0	3.5
Personal services	-1.5	-3.1	1.3	-1.5	1.3	-1.5	0.6	4.8
Manufacturing	-1.4	-2.7	-1.3	1.2	2.8	2.8	1.1	4.6
All sectors surveyed	-1.0	-1.9	-1.1	0.8	1.3	0.7	1.1	2.2
<u>(in real terms)</u>								
Wholesale, retail and import/export trades	1.7	0.4	-1.7	0.4	-0.7	-1.7	-0.3	-0.2
Restaurants and hotels	-0.4	-2.1	-2.3	-1.3	-0.7	-1.5	-0.4	-0.2
Transport services	2.9	0.1	-1.0	-0.2	-2.5	-2.2	-3.6	-1.8
Financing, insurance, real estate and business services	1.5	2.0	-0.6	-1.2	1.5	2.5	0.1	1.7
Personal services	0.8	-1.1	1.3	-2.7	-0.4	-2.9	-1.3	3.0
Manufacturing	0.8	-0.7	-1.4	-0.1	1.1	1.4	-0.8	2.8
All sectors surveyed	1.3	0.2	-1.2	-0.4	-0.4	-0.7	-0.7	0.3

Notes : The rates of change in real terms are compiled from the Real Wage Indices. As from 2006, the Indices are derived by deflating the Nominal Wage Indices by the 2004/2005-based CPI(A). To facilitate comparison, Real Wage Indices prior to 2006 have been re-scaled using the 2004/2005-based CPI(A).

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

Table 21 : Rates of change in prices

(%)

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
GDP deflator	5.6	0.2	-5.8	-5.6	-1.8	-3.5	-6.4	-3.6
Domestic demand deflator	4.5	0.4	-2.3	-5.0	-2.3	-4.9	-4.5	*
Consumer Price Indices ^(a) :								
Composite CPI	5.8	2.8	-4.0	-3.8	-1.6	-3.0	-2.6	-0.4
CPI(A)	5.7	2.6	-3.3	-3.0	-1.7	-3.2	-2.1	*
CPI(B)	5.8	2.8	-4.7	-3.9	-1.6	-3.1	-2.7	-0.5
CPI(C)	6.1	3.2	-3.7	-4.5	-1.5	-2.8	-2.9	-0.9
Unit Value Indices :								
Domestic exports	-2.4	-2.8	-2.4	-1.0	-4.7	-3.3	0.2	1.5
Re-exports	-1.5	-3.9	-2.8	-0.1	-2.0	-2.7	-1.5	1.1
Total exports of goods	-1.6	-3.8	-2.7	-0.2	-2.3	-2.7	-1.4	1.2
Imports of goods	-2.3	-4.9	-2.0	0.8	-3.1	-3.9	-0.4	2.9
Terms of Trade Index	0.7	1.2	-0.7	-1.0	0.9	1.2	-1.0	-1.7
Producer Price Index for all manufacturing industries	-0.3	-1.8	-1.6	0.2	-1.6	-2.7	-0.3	2.2
Construction Labour and Material Cost Index	9.3	7.5	1.4	1.8	0.3	-0.3	-1.0	-1.2
Tender Price Indices :								
Public sector building projects	17.6	9.1	-4.4	-13.1	-8.5	-11.7	-0.3	-1.5
Public housing projects	18.9	9.0	-3.3	-11.9	-15.1	-9.6	-10.0	3.5

Notes : (a) From October 2005 onwards, the year-on-year rates of change in the Consumer Price Indices are derived from the 2004/05-based CPI series. For the earlier periods, the year-on-year rates of change are derived from the CPIs with old base period.

(#) Figures are subject to revision later on as more data become available.

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

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

	(%)							
	2005	2006	2006				Average annual rate of change:	
			Q1	Q2	Q3	Q4	10 years 1996 to 2006	5 years 2001 to 2006
GDP deflator	-0.4 #	-0.4 #	-0.1 #	-0.2 #	-0.4 #	-0.5 #	-2.2 #	-2.9 #
Domestic demand deflator	0.8 #	1.9 #	1.2 #	1.9 #	1.9 #	2.3 #	-1.2 #	-1.4 #
Consumer Price Indices ^(a) :								
Composite CPI	1.0	2.0	1.6	2.0	2.3	2.1	-0.4	-0.6
CPI(A)	1.1	1.7	1.3	1.8	2.1	1.8	-0.2	-0.5
CPI(B)	1.0	2.1	1.7	2.1	2.4	2.2	-0.5	-0.7
CPI(C)	0.8	2.2	1.7	2.3	2.4	2.5	-0.4	-0.7
Unit Value Indices :								
Domestic exports	2.2	-2.1	-2.9	-3.9	-1.3	-0.8	-1.5	-0.3
Re-exports	1.2	1.1	-0.2	0.9	1.5	2.0	-1.1	-0.1
Total exports of goods	1.3	1.0	-0.3	0.6	1.4	1.9	-1.1	-0.1
Imports of goods	2.7	2.1	1.0	1.9	2.7	2.7	-0.8	0.7
Terms of Trade Index	-1.4	-1.1	-1.3	-1.3	-1.3	-0.9	-0.3	-0.8
Producer Price Index for all manufacturing industries	0.8	N.A.	2.0	2.4	2.6	N.A.	-0.5 ^	-0.3 ~
Construction Labour and Material Cost Index	-2.1	N.A.	-2.7	-0.6	1.3	N.A.	2.2 ^	-0.9 ~
Tender Price Indices :								
Public sector building projects	1.4	N.A.	0.4	2.0	4.6	N.A.	-0.3 ^	-4.5 ~
Public housing projects	7.7	N.A.	3.4	7.3	N.A.	N.A.	-1.3 ^	-6.5 ~

Notes (cont'd) : (^) Average annual rate of change for the 10-year period 1995-2005.

(~) Average annual rate of change for the 5-year period 2000-2005.

N.A. Not available.

Table 22 : Rates of change in Composite Consumer Price Index

(%)								
	Weight	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
All items	100.0	5.8	2.8	-4.0	-3.8	-1.6	-3.0	-2.6
Food	26.94	3.6	1.9	-1.8	-2.2	-0.8	-2.1	-1.5
<i>Meals bought away from home</i>	<i>(16.86)</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>-1.5</i>
<i>Food, excluding meals bought away from home</i>	<i>(10.08)</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>	<i>-1.7</i>
Housing ^(a)	29.17	9.2	4.7	-5.1	-8.2	-3.1	-5.7	-4.8
<i>Private housing rent</i>	<i>(23.93)</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>-6.3</i>
<i>Public housing rent</i>	<i>(2.49)</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>	<i>9.1</i>
Electricity, gas and water	3.59	5.0	1.4	-0.4	3.6	-1.9	-7.0	1.4
Alcoholic drinks and tobacco	0.87	5.6	6.6	1.2	-0.9	3.3	2.4	0.1
Clothing and footwear	3.91	8.4	-0.8	-20.6	-10.1	-4.6	0.7	-2.7
Durable goods	5.50	2.2	0.2	-6.3	-4.6	-7.1	-6.3	-6.4
Miscellaneous goods	4.78	5.4	2.6	-0.7	0.9	1.3	1.7	2.3
Transport	9.09	4.0	3.9	0.5	1.0	0.4	-0.6	-0.4
Miscellaneous services	16.15	4.5	2.7	-1.3	-0.2	0.5	-2.3	-3.2

Notes : From October 2005 onwards, the year-on-year rates of change in the Composite Consumer Price Index are derived from the 2004/05-based CPI series. For the earlier periods, the year-on-year rates of change are derived from the CPIs with old base period. The weights quoted in this table correspond to that in the new series.

(a) Apart from "Private housing rent" and "Public housing rent", the "Housing" section also includes "Management fees and other housing charges" and "Materials for house maintenance".

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

N.A. Not available.

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

	Weight	(%)								
		<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2006</u>				Average annual <u>rate of change:</u>	
					Q1	Q2	Q3	Q4	10 years 1996 to 2006	5 years 2001 to 2006
All items	100.0	-0.4	1.0	2.0	1.6	2.0	2.3	2.1	-0.4	-0.6
Food	26.94	1.0	1.8	1.7	0.9	1.7	2.1	2.2	0.1	0.2
<i>Meals bought away from</i>	<i>(16.86)</i>	<i>0.2</i>	<i>0.9</i>	<i>1.3</i>	<i>1.0</i>	<i>1.3</i>	<i>1.5</i>	<i>1.5</i>	<i>0.3</i>	<i>-0.1</i>
<i>Food, excluding meals bought</i> <i>away from home</i>	<i>(10.08)</i>	<i>2.5</i>	<i>3.2</i>	<i>2.5</i>	<i>1.0</i>	<i>2.3</i>	<i>3.1</i>	<i>3.5</i>	<i>-0.1</i>	<i>0.6</i>
Housing ^(a)	29.17	-5.2	0.1	4.7	4.2	4.9	4.8	4.8	-1.5	-2.3
<i>Private housing rent</i>	<i>(23.93)</i>	<i>-6.6</i>	<i>-0.1</i>	<i>5.6</i>	<i>5.0</i>	<i>5.9</i>	<i>5.7</i>	<i>5.6</i>	<i>-2.0</i>	<i>-2.9</i>
<i>Public housing rent</i>	<i>(2.49)</i>	<i>2.5</i>	<i>0.2</i>	<i>0.1</i>	<i>0.1</i>	<i>0.1</i>	<i>0.1</i>	<i>0.1</i>	<i>N.A.</i>	<i>1.8</i>
Electricity, gas and water	3.59	11.4	4.1	2.1	3.9	3.4	4.1	-2.8	1.9	2.2
Alcoholic drinks and tobacco	0.87	*	0.4	-3.7	-0.6	-5.9	-4.1	-4.3	1.5	-0.2
Clothing and footwear	3.91	6.4	2.0	1.0	-2.0	-0.7	1.7	5.0	-2.4	1.4
Durable goods	5.50	-2.2	-3.2	-6.4	-5.8	-6.6	-6.9	-6.3	-4.1	-4.9
Miscellaneous goods	4.78	3.6	1.5	1.7	0.4	1.8	1.9	2.6	2.0	2.2
Transport	9.09	0.4	1.4	0.7	1.6	1.1	0.2	-0.1	1.1	0.3
Miscellaneous services	16.15	-0.2	1.0	1.9	1.2	1.9	2.5	2.1	0.3	-0.6

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

(%)

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Private consumption expenditure	3.9	2.1	-5.2	-4.5	-1.0	-3.4	-2.9
Government consumption expenditure	6.4	2.6	-0.1	-1.9	1.1	-0.6	-2.7
Gross domestic fixed capital formation	6.0	-7.2	0.4	-3.8	-6.6	-10.1	-9.4
Total exports of goods	-1.9	-3.3	-3.4	-0.5	-2.6	-2.9	-2.0
Imports of goods	-1.9	-4.4	-2.6	0.8	-3.5	-4.2	-0.9
Exports of services	0.8	-5.1	-3.1	1.6	-4.3	-2.2	-3.4
Imports of services	0.7	-3.6	-0.3	-0.3	-1.1	0.4	2.6
Gross Domestic Product	5.6	0.2	-5.8	-5.6	-1.8	-3.5	-6.4
Total final demand	1.3	-2.3	-3.7	-2.7	-2.6	-3.7	-3.0
Domestic demand	4.5	0.4	-2.3	-5.0	-2.3	-4.9	-4.5

Notes : (#) Figures are subject to revision later on as more data become available.

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

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

(%)

	<u>2004</u>	<u>2005[#]</u>	<u>2006[#]</u>	<u>2006</u>				<u>Average annual rate of change:</u>	
				Q1 [#]	Q2 [#]	Q3 [#]	Q4 [#]	10 years 1996 to 2006 [#]	5 years 2001 to 2006 [#]
Private consumption expenditure	-0.5	1.5	1.8	2.1	1.7	1.6	1.9	-0.9	-0.7
Government consumption expenditure	-2.9	-1.6	1.4	1.3	1.3	1.4	1.2	0.1	-1.3
Gross domestic fixed capital formation	2.1	0.5	2.7	-1.5	2.6	5.7	4.0	-2.7	-3.0
Total exports of goods	0.5	-0.1	-0.5	-1.8	-0.7	-0.4	0.2	-1.7	-1.0
Imports of goods	2.5	1.3	1.4	*	1.4	1.7	2.1	-1.2	*
Exports of services	0.4	3.7	4.2	4.3	5.3	4.9	2.9	-0.8	0.5
Imports of services	4.0	1.5	1.0	*	0.8	1.4	1.9	0.5	1.9
Gross Domestic Product	-3.6	-0.4	-0.4	-0.1	-0.2	-0.4	-0.5	-2.2	-2.9
Total final demand	0.4	0.8	0.8	*	0.9	1.0	1.3	-1.5	-1.0
Domestic demand	*	0.8	1.9	1.2	1.9	1.9	2.3	-1.2	-1.4

