

## CHAPTER 1 : OVERVIEW OF ECONOMIC PERFORMANCE IN 2010

### *Summary*

- *The Hong Kong economy staged a broad-based expansion in 2010, having successfully overcome the severe challenges from the global recession of 2009. Both the external and domestic sectors fared strongly in the year. For 2010 as a whole, the economy grew robustly by 6.8%, more than offsetting the 2.7% contraction in 2009.*
- *Merchandise exports sprang back sharply following the steep contraction in 2009, sustaining rapid double-digit year-on-year growth during most of 2010 and surpassing the 2008 peak by some margin. The Asian markets continued to outperform the US and EU markets, mirroring the two-speed recovery in the global economy. Although the US and EU markets also staged a rebound, exports to these markets had yet to make up for the declines in 2009. Export growth momentum tapered somewhat towards the year-end, as the growth pace of some overseas markets moderated.*
- *Exports of services maintained strong momentum across the board throughout 2010. Inbound tourism surged on strong influx of visitors from all major markets. Exports of trade-related and transportation services also grew strongly as trade flows revived markedly. Exports of financial and business services expanded sizably, supported by thriving fundraising activities and robust business conditions.*
- *The domestic sector also held up well in 2010. Private consumption expenditure was strong throughout the year, supported by improving labour market and income conditions. Investment staged a notable rebound amid sanguine business sentiments. The surge in public sector building and construction activities also supported domestic demand.*
- *The labour market saw widespread and notable improvements during 2010. Total employment rose to an all-time high in late 2010, surpassing the previous peak in early 2008. Job vacancies likewise surged. With improving labour demand, the seasonally adjusted unemployment rate came down progressively to 4.0% in the fourth quarter of 2010. Wages and earnings rose back in tandem.*
- *Local stock prices ended 2010 moderately higher than a year ago, intertwined with episodes of fluctuations caused by shifting sentiments in global financial markets. Local property market was hectic in 2010, with residential property prices rising by 20% during the year. The Government has stayed alert to the risks of housing market bubble, and has rolled out five rounds of measures*

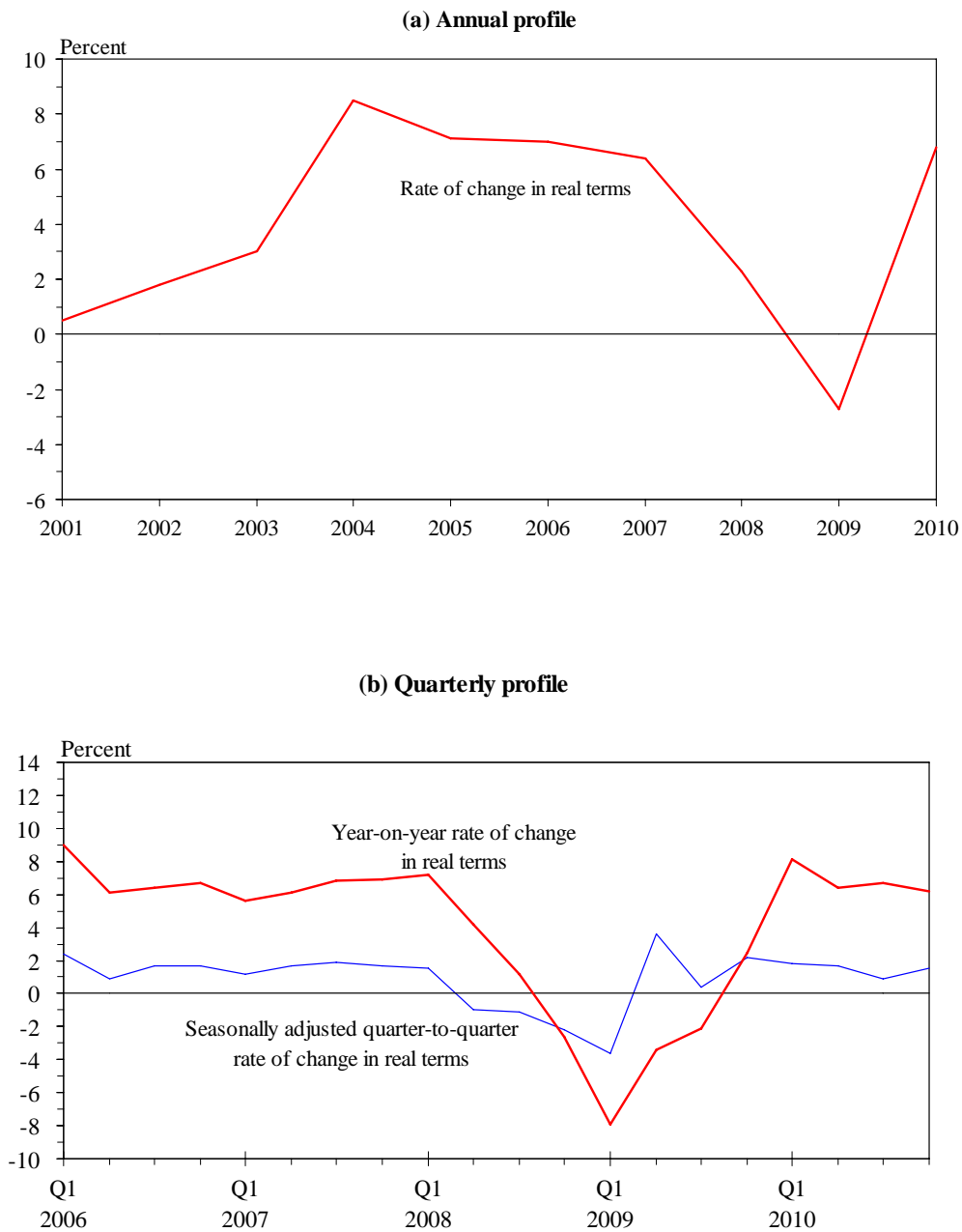
*over the course of the year to ensure healthy and stable development of the market.*

- *Inflation rose back progressively in 2010, driven mainly by higher import prices from rising global food and other commodity prices, rising inflation in import sources and a slightly weaker US dollar. Domestic cost pressures, especially from the rental front, also turned more visible alongside the robust economic conditions. In 2010, underlying inflation averaged at 1.7%, up from 1.0% in 2009. Yet the phenomenon of rising inflation also featured in many other Asian economies where economic growth was vibrant.*

## **Overall situation**

1.1 The Hong Kong economy achieved a full-fledged upturn in 2010, having swiftly emerged from last year's global recession triggered by the financial crisis. Economic activities sustained strong momentum throughout the year. Merchandise exports surged sharply in 2010, surpassing the peak in 2008 by some margin, with the performance of the overseas markets continuing to mirror the two-speed recovery in the global economy. Exports of services maintained strong growth in all four quarters. Domestic demand was also robust, thanks to the upbeat consumer sentiments amid improving job and income prospects, and to the sanguine business confidence on the back of vibrant regional economic prospects. The surge in public sector building and construction activities also contributed. However, inflation also went up gradually over the course of the year, broadly in line with the experience in many other Asian economies. In 2010, the Government introduced several rounds of measures to forestall the risk of housing market bubble arising from the exceptionally low interest rates and ample liquidity in the global financial system.

**Diagram 1.1 : The economy staged a strong upturn in 2010**



1.2 For 2010 as a whole, the *Gross Domestic Product (GDP)*<sup>(1)</sup> expanded by 6.8% in real terms, more than making up for the 2.7% contraction in 2009. On a year-on-year comparison, real GDP leaped by 8.1%, 6.4% and 6.7% respectively in the first three quarters, and by a still notable 6.2% in the fourth quarter even against a higher base of comparison. On a seasonally adjusted quarter-to-quarter comparison<sup>(2)</sup>, real GDP expanded solidly throughout the four quarters, by 1.8%, 1.7%, 0.9% and 1.5% respectively.

## **The external sector**

1.3 *Total exports of goods* sprang back sharply in 2010, up 17.3% in real terms, from the 12.7% plunge in 2009, which was triggered by the collapse in global trade flows in early 2009. As a result of the hefty surge in total exports in 2010, total merchandise exports already surpassed the peak in 2008 by some margin. The vibrant growth in the Asian markets, featured by robust industrial production and investment activities, provided the main impetus. Reviving import demand in the advanced economies also contributed, though merchandise exports to these markets had yet to return to their pre-crisis peaks in 2008. Partly magnified by a low base of comparison, the year-on-year growth of merchandise exports in the first three quarters of 2010 was particularly sizable, at 21.6%, 20.1% and 20.8% respectively in real terms. It then tapered to 8.4% in the fourth quarter, amid the effect of a higher base of comparison and slower pace of expansion in some export markets. On a seasonally adjusted quarter-to-quarter basis, merchandise exports grew strongly in the first quarter, expanded further in the second and third quarters, before showing a modest decline in the fourth quarter.

1.4 *Exports of services* leaped by 15.0% in real terms in 2010, picking up strongly from the 0.3% growth in 2009. Strong growth was maintained throughout 2010. Among the major components, inbound tourism fared strongly, driven by vibrant influx of visitors from all major markets. Exports of trade-related and transportation services, which together account for more than half of Hong Kong's exports of services, grew robustly on flourishing offshore trade as well as freight and passenger flows. Exports of financial and business services also thrived on the intensive fundraising activities and buoyant business conditions. As compared to the merchandise trade flows, the moderation in external demand towards the end of the year was less evident in service trade flows, thanks to thriving inbound tourism.

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

	<u>2009#</u>	<u>2010+</u>	<u>2009</u>				<u>2010</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	0.6	5.8	-5.7 (-0.9)	0.6 (4.9)	1.3 (0.4)	6.2 (1.6)	7.2 (0.5)	3.9 (1.3)	4.9 (1.6)	7.1 (3.2)
Government consumption expenditure	2.3	2.7	1.6 (-0.4)	2.6 (1.6)	3.3 (0.4)	2.0 (0.4)	3.3 (0.9)	2.7 (0.7)	3.1 (0.9)	1.8 (-0.7)
Gross domestic fixed capital formation	-3.9	8.1	-12.5	-13.4	1.4	11.1	8.4	16.0	0.2	8.8
<i>of which :</i>										
Building and construction	-5.5	6.7	-9.9	-6.9	0.9	-5.2	-7.0	13.5	9.6	11.5
Machinery, equipment and computer software	-3.0	6.3	-4.9	-16.6	-2.5	15.8	11.8	16.2	-6.6	6.5
Total exports of goods	-12.7	17.3	-22.7 (-14.2)	-12.8 (5.7)	-13.2 (0.2)	-2.9 (7.9)	21.6 (6.2)	20.1 (3.8)	20.8 (1.8)	8.4 (-3.4)
Imports of goods	-9.5	18.1	-20.8 (-12.5)	-12.6 (7.2)	-8.3 (4.7)	3.3 (5.6)	28.0 (7.3)	23.6 (3.7)	16.5 (-1.0)	7.4 (-2.2)
Exports of services	0.3	15.0	-5.9 (-3.5)	-4.1 (2.8)	0.9 (4.1)	9.5 (6.1)	18.3 (4.1)	17.8 (2.4)	15.7 (2.1)	9.4 (0.4)
Imports of services	-4.9	10.9	-11.1 (-4.8)	-7.1 (1.3)	-4.7 (2.3)	3.7 (5.0)	11.6 (2.5)	13.1 (2.9)	11.6 (0.7)	7.8 (1.3)
<b>Gross Domestic Product</b>	<b>-2.7</b>	<b>6.8</b>	<b>-7.9</b> <b>(-3.6)</b>	<b>-3.4</b> <b>(3.6)</b>	<b>-2.1</b> <b>(0.4)</b>	<b>2.5</b> <b>(2.2)</b>	<b>8.1</b> <b>(1.8)</b>	<b>6.4</b> <b>(1.7)</b>	<b>6.7</b> <b>(0.9)</b>	<b>6.2</b> <b>(1.5)</b>
<i>Change in the main price indicators (%)</i>										
<b>GDP deflator</b>	<b>-0.6</b>	<b>0.9</b>	<b>0.6</b> <b>(-0.4)</b>	<b>-0.4</b> <b>(*)</b>	<b>-1.9</b> <b>(-0.8)</b>	<b>-0.7</b> <b>(0.6)</b>	<b>0.6</b> <b>(0.7)</b>	<b>-0.9</b> <b>(-1.1)</b>	<b>1.8</b> <b>(1.6)</b>	<b>1.8</b> <b>(0.6)</b>
<b>Composite CPI</b>										
<b>Headline</b>	<b>0.5</b>	<b>2.4</b>	<b>1.7</b> <b>(0.3)</b>	<b>-0.1</b> <b>(-0.2)</b>	<b>-0.9</b> <b>(-1.0)</b>	<b>1.3</b> <b>(2.2)</b>	<b>1.9</b> <b>(0.9)</b>	<b>2.6</b> <b>(0.5)</b>	<b>2.3</b> <b>(-1.3)</b>	<b>2.8</b> <b>(2.8)</b>
<b>Underlying<sup>^</sup></b>	<b>1.0</b>	<b>1.7</b>	<b>3.1</b> <b>(-0.2)</b>	<b>1.2</b> <b>(-0.3)</b>	<b>-0.3</b> <b>(-0.1)</b>	<b>-0.1</b> <b>(0.5)</b>	<b>0.8</b> <b>(0.6)</b>	<b>1.5</b> <b>(0.4)</b>	<b>2.0</b> <b>(0.4)</b>	<b>2.6</b> <b>(1.1)</b>
<b>Change in nominal GDP (%)</b>	<b>-3.3</b>	<b>7.8</b>	<b>-7.4</b>	<b>-3.8</b>	<b>-4.0</b>	<b>1.8</b>	<b>8.8</b>	<b>5.5</b>	<b>8.6</b>	<b>8.1</b>

Notes : Figures are subject to revision later on as more data become available. Seasonally adjusted quarter-to-quarter rate of change is not applicable to gross domestic fixed capital formation, as no clear seasonal pattern is found for the category due to the presence of considerable short term fluctuations.

(#) Revised figures.

(+) Preliminary figures.

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

(\*) Change of less than 0.05%.

(^ ) After netting out effects of Government's one-off relief measures.

## The domestic sector

1.5 The domestic sector expanded solidly in 2010. Local consumer sentiments stayed upbeat throughout the year, supported by improving job and income prospects, as well as the better performance of the asset markets. *Private consumption expenditure* (PCE) grew notably in real terms in all four quarters of 2010. For the year as a whole, PCE grew by 5.8%, up strongly from the 0.6% growth in 2009. On a seasonally adjusted quarter-to-quarter comparison, PCE also expanded throughout 2010. Meanwhile, *government consumption expenditure* expanded steadily further in 2010, by 2.7% in real terms, following the 2.3% growth in 2009.

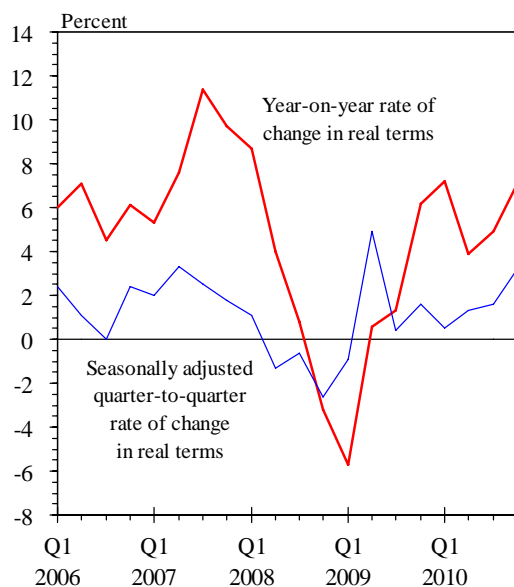
**Table 1.2 : Consumer spending by major components<sup>(a)</sup>  
(year-on-year rate of change in real terms (%))**

		<i>Of which :</i>							
		Total consumer spending in the domestic market <sup>(a)</sup>	Food	Durables	Non- durables	Services	Residents' expenditure abroad	Visitor spending	Private consumption expenditure <sup>(b)</sup>
2009	Annual	1.3	6.0	-2.7	-0.5	1.5	2.2	7.8	0.6
	H1	-1.8	4.9	-10.2	-5.8	-0.7	0.3	7.2	-2.5
	H2	4.3	7.0	4.2	4.7	3.7	4.1	8.4	3.8
	Q1	-3.3	4.2	-9.8	-5.5	-2.9	-5.9	15.3	-5.7
	Q2	-0.3	5.5	-10.6	-6.0	1.4	7.3	-1.7	0.6
	Q3	1.6	6.7	-6.0	-1.5	2.9	-1.4	1.4	1.3
	Q4	7.0	7.3	14.8	10.2	4.5	10.1	14.8	6.2
2010	Annual	8.7	3.8	28.2	14.5	4.9	4.8	29.1	5.8
	H1	8.2	3.3	28.3	13.6	4.7	4.8	28.0	5.5
	H2	9.2	4.3	28.1	15.3	5.0	4.9	30.0	6.1
	Q1	9.1	3.9	29.9	14.6	5.3	4.9	19.5	7.2
	Q2	7.3	2.9	26.5	12.6	4.2	4.8	39.0	3.9
	Q3	8.9	4.1	27.8	14.9	5.1	10.2	42.9	4.9
	Q4	9.5	4.4	28.3	15.6	4.9	-0.3	19.6	7.1

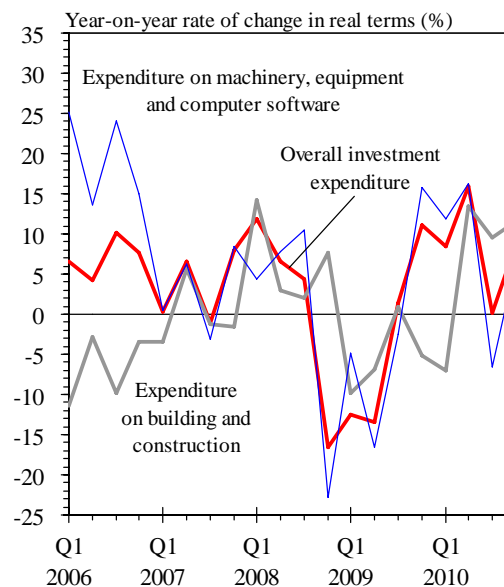
Notes : (a) Consumer spending in the domestic market comprises both local consumer and visitor spending, which are not separable from the survey data.

(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.

**Diagram 1.2 : Private consumption expenditure was strong throughout the year**



**Diagram 1.3 : Fixed investment bounced back amid return of sanguine business sentiment in 2010**



1.6 Overall investment spending in terms of *gross domestic fixed capital formation* showed a notable 8.1% growth in real terms in 2010, the fastest annual expansion after 1997. Private sector investment in machinery and equipment increased notably for 2010 as a whole, supported by growing business volumes and strong regional economic prospects. After a temporary slowdown in the third quarter, such investment picked up again in the fourth quarter. Indeed, business sentiments among large enterprises as shown by the Quarterly Business Tendency Survey conducted by the Census and Statistics Department generally stayed optimistic in 2010. On the other hand, small and medium-sized enterprises (SMEs) turned somewhat cautious in recent months in view of the still elevated level of uncertainty in the external environment (See **Box 1.1** for details of the consultation on SMEs). The surge in public sector building and construction activities, driven by the expedition of public sector works and successive implementation of large-scale infrastructure projects, was also a major supporting factor behind the rapid increase in overall investment spending. However, private sector building and construction activity was still weak in 2010.

## Box 1.1

### Diffusion indices on small and medium-sized enterprises (an update)

To gain a better understanding of the business receipts, employment and credit access situations of small and medium-sized enterprises (SMEs)<sup>(1)</sup> during the financial tsunami and the subsequent economic recovery, an ad-hoc consultation exercise has been conducted by the Census and Statistics Department on behalf of the Economic Analysis and Business Facilitation Unit since late November 2008 on a sample panel of around 500 SMEs to solicit their feedback. This note provides a further update of the results reported in **Box 1.1** in the *Third Quarter Economic Report 2010*.

From June 2010 onwards, the SMEs surveyed were asked to compare their business and employment situation with that *in the previous month*. A set of diffusion indices is accordingly compiled to indicate the general directions of change in the respondents' views on business receipts and employment compared with the prior month. It should be noted that the findings should be interpreted with considerable caution given the coverage and nature of the consultation exercise. Nevertheless, they can serve as a rough indicator to enable high frequency monitoring of SMEs' situation.

Business receipts of the SMEs surveyed, as depicted by the set of diffusion indices, showed that the overall situation held largely steady during the latter half of 2010 and improved modestly on entering 2011, with some variations for individual sectors (**Table 1**). The index on real estate saw a steep decline in November 2010, alongside the announcement of further measures against property speculation by the Government, but rebounded sharply in January 2011. The insurance sector saw notable improvement in early 2011, while import/export trades recorded some mild decline. The indices on financing institutions and business services moved into the contraction territory in December 2010, but recovered in early 2011. The others either held relatively steady or saw some improvement. In January 2011, a larger proportion of SMEs in eight out of the ten sectors surveyed reported stable or some improvement in business receipts. Separately, the results of the consultation indicated that SMEs' employment situation held largely stable in recent months (**Table 2**).

Specifically for import and export firms, from the June round onwards, their views on new export orders were sought, at weekly intervals, to have more up-to-date information on the export performance. The diffusion index on new export orders held steady at the boom-bust dividing point of 50 in November and December 2010, but retreated somewhat to 49.2 in January 2011, probably reflecting the still elevated level of uncertainty in the external environment.

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(1) Manufacturing enterprises with fewer than 100 employees and non-manufacturing enterprises with fewer than 50 employees are regarded as SMEs in Hong Kong.

**Box 1.1 (Cont'd)**

Credit access situation improved further in recent months. The proportion of SMEs reporting very tight/tighter-than-normal credit access came down successively to 2.8% in January 2011 from above 12% in late November 2008, the lowest since the consultation exercise started (*Chart 1*). Moreover, the proportion of SMEs expecting tighter credit access in the coming month had remained at zero since June 2010, while credit pricing improved further over the past few months to virtually on par with the pre-crisis situation, thanks to the accommodative monetary conditions and the Government's efforts to relieve credit strains through the enhanced and special loan guarantee schemes. With the economy on firmer footing, the special loan guarantee scheme was closed for new application at end-2010. As at the end of January 2011, some 21 100 companies benefited under these schemes, involving approved loan amount of over \$106 billion. This also indirectly helped to secure the jobs of those employed by these companies, totaling over 340 000.

**Table 1 : Diffusion indices<sup>^</sup> on business receipts**

	<u>2010</u>							<u>2011</u>
	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>	<u>Nov</u>	<u>Dec</u>	<u>Jan</u>
<i>Local segments</i>								
Restaurants	47.5	49.1	50.8	49.2	51.8	48.2	50.0	50.0
Travel	46.6	53.4	53.4	48.3	48.3	48.3	48.3	48.3
Real estate	47.0	56.1	48.5	45.6	57.4	33.8	47.1	60.6
Retail trade	43.9	50.0	50.0	51.3	50.0	50.9	49.1	50.0
Wholesale trade	47.5	47.4	47.4	47.4	52.6	55.3	50.0	50.0
Insurance	45.3	45.0	47.5	47.5	52.5	50.0	52.5	60.5
Business services	43.8	50.0	45.5	45.5	51.5	51.5	45.5	51.6
<i>External segments</i>								
Import/export trades	50.0	50.0	50.9	47.3	48.3	50.0	49.6	49.2
Logistics	52.6	44.7	42.5	44.7	44.7	47.4	50.0	50.0
Financing institutions	47.2	44.7	44.9	50.0	56.6	48.7	43.8	50.0
<b>All the above sectors*</b>	<b>47.5</b>	<b>49.7</b>	<b>49.3</b>	<b>48.1</b>	<b>49.8</b>	<b>49.7</b>	<b>49.1</b>	<b>50.4</b>

Notes: (^) The diffusion index is computed by adding the percentage of SMEs reporting "up" to one half of the percentage of SMEs reporting "same." A diffusion index reading above 50 indicates that the business condition is generally favourable, whereas an index below 50 indicates otherwise. Respondents were requested to exclude seasonal effects in reporting their views.

(\*) Weighted average using total number of SMEs in individual sectors as weights.

**Box 1.1 (Cont'd)**

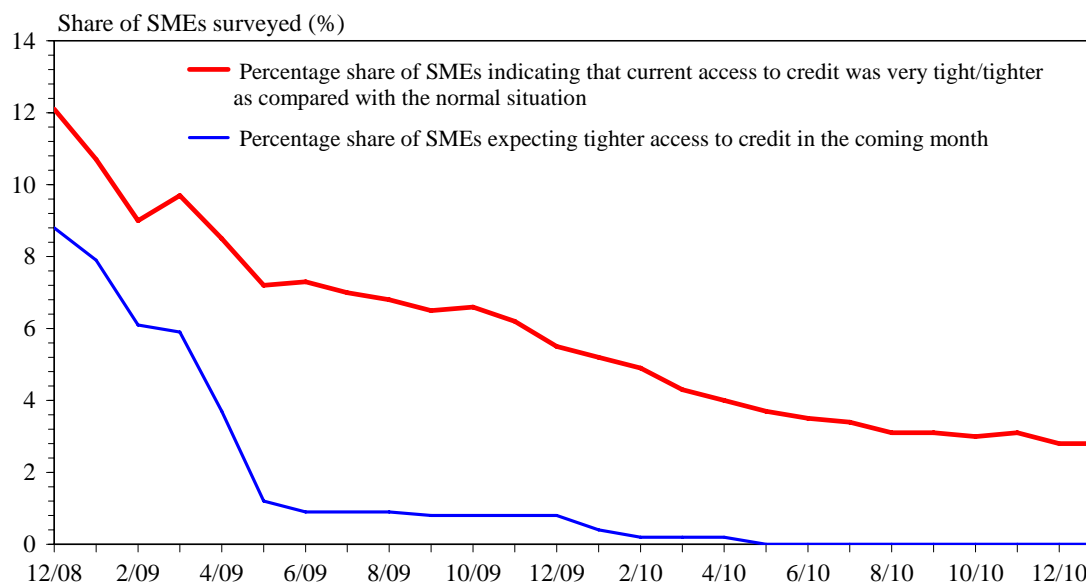
**Table 2 : Diffusion indices<sup>^</sup> on employment situation**

	<u>2010</u>							<u>2011</u>
	<u>Jun</u>	<u>Jul</u>	<u>Aug</u>	<u>Sep</u>	<u>Oct</u>	<u>Nov</u>	<u>Dec</u>	<u>Jan</u>
<i>Local segments</i>								
Restaurants	49.2	49.1	49.2	49.2	50.0	50.0	50.0	50.0
Travel	48.3	50.0	50.0	50.0	50.0	50.0	50.0	50.0
Real estate	50.0	48.5	48.5	51.5	50.0	51.5	50.0	50.0
Retail trade	50.0	49.6	50.0	50.0	50.0	50.0	50.0	50.0
Wholesale trade	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0
Insurance	54.8	50.0	50.0	50.0	50.0	50.0	52.5	55.3
Business services	48.4	53.0	48.5	48.5	50.0	50.0	50.0	50.0
<i>External segments</i>								
Import/export trades	50.5	50.0	50.0	50.0	50.0	50.4	50.0	50.0
Logistics	47.4	47.4	47.5	47.4	50.0	50.0	50.0	50.0
Financing institutions	50.0	51.3	51.3	51.3	55.3	53.9	51.3	52.6
<b>All the above sectors*</b>	<b>49.9</b>	<b>49.9</b>	<b>49.6</b>	<b>49.8</b>	<b>50.0</b>	<b>50.3</b>	<b>50.0</b>	<b>50.1</b>

Notes: (^) The diffusion index is computed by adding the percentage of SMEs reporting “up” to one half of the percentage of SMEs reporting “same.” A diffusion index reading above 50 indicates that the business condition is generally favourable, whereas an index below 50 indicates otherwise. Respondents were requested to exclude seasonal effects in reporting their views.

(\*) Weighted average using total number of SMEs in individual sectors as weights.

**Chart 1 : Access to credit improved further**



## **The labour sector**

1.7 The labour market saw a widespread improvement during 2010. Total employment resumed its uptrend, surpassing the pre-crisis peak in 2008 by the latter part of 2010. The *seasonally adjusted unemployment rate* fell successively, down to 4.0% in the fourth quarter of the year, the lowest since end-2008. The *underemployment rate* also declined steadily, to 1.8% in the fourth quarter of 2010. With employers being more keen to recruit workers, vacancies surged across many sectors. As much of the slack in the labour market was worked off in 2010, labour wages and earnings across many sectors resumed increases during the year.

## **The asset markets**

1.8 The *local stock market* ended 2010 higher than a year ago. Yet the performance during the year was intertwined with episodes of fluctuations alongside other markets worldwide. Sentiments in the stock markets waned in early 2010 on indications of exit strategies in the major economies. Then sentiments were hit by intensified concern over the sovereign debt issue in Europe in April and May. The Hang Seng Index (HSI) reached 18 986 on 25 May 2010, the lowest in 2010. Sentiments turned more bullish again in the fall of the year on another round of quantitative easing in the US (i.e. QE2). The HSI peaked in early November at near 25 000, then saw some retreat on renewed concerns over the fragile debt situation in Europe, notably Ireland. The HSI closed the year at 23 035, 5.3% higher than at end-2009. Fundraising activities were intense in 2010, amid the robust economic conditions and ample liquidity conditions. Total IPO funds raised in 2010 amounted to \$445.0 billion, 79.3% higher than in 2009, making Hong Kong again the top IPO centre in the world in 2010.

1.9 *Residential property market* was hectic in 2010, with flat prices soaring by 20%. Tight supply, combined with stronger demand alongside the robust economic recovery, and fuelled further by the environment of low interest rates amid ample liquidity, have boosted prices successively during the year. In December 2010, residential property prices surpassed the peak in 2008 by 28%, but were still 6% below the 1997 peak. With the rally in residential property prices spreading from the luxury end to mass market, affordability ratio climbed to 44.5% in the fourth quarter, approaching the long-term average of 51.3% over 1990-2009. The Government was mindful of the risks associated with a rapidly rising property market, and rolled out five rounds of measures over the course of 2010 to ensure healthy and stable development of the market. In particular, the latest round was announced on

19 November, with the focus on curbing speculative activities (See paragraph 4.4 for details). Meanwhile, rentals for flats, offices and shops all saw notable increases of 16%, 14% and 10% respectively between December 2009 and December 2010.

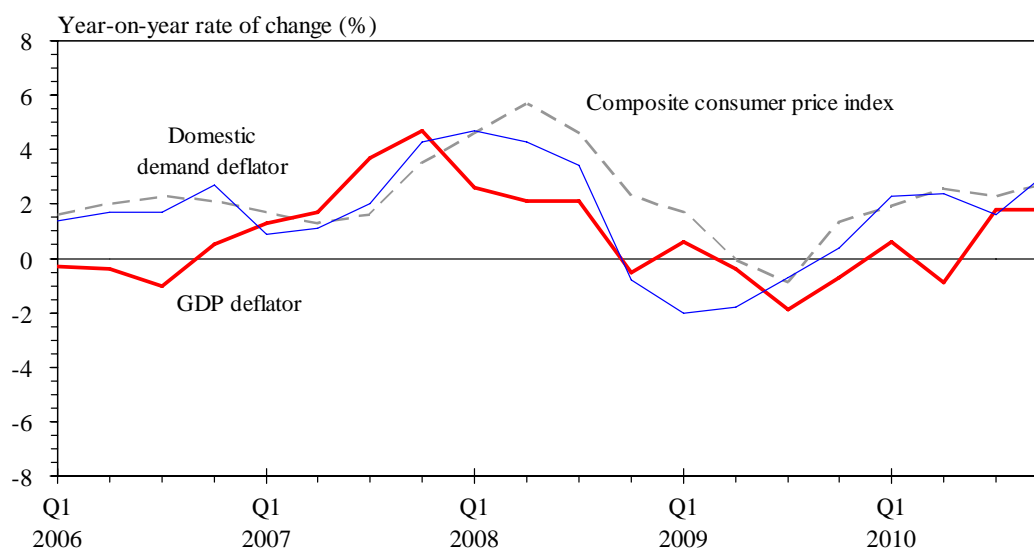
## **Inflation**

1.10 Inflation was on a gradual uptrend over the course of 2010, due mainly to higher imported inflation, resulting from the surge in global food and other commodity prices, rising inflation in supply sources, and to a lesser extent the slightly weaker Hong Kong dollar alongside the US dollar. Domestic price pressures, particularly from the rental front, also re-emerged in 2010, along with the robust expansion of the local economy.

1.11 The *Composite Consumer Price Index* (Composite CPI) rose by an average of 2.4% in 2010, faster than the 0.5% increase in 2009. Netting out the effects of the Government's one-off relief measures to give a more accurate indicator of the inflation trend, underlying Composite CPI inflation averaged at 1.7% for 2010 as a whole, up from 1.0% in 2009. While the annual increases were still relatively moderate, particularly when viewed against the vibrant economic upturn, underlying inflation turned more visible towards the year-end, mainly on higher food prices and private housing rentals. On a year-on-year comparison, underlying consumer price inflation went up progressively, from 0.8% in the first quarter of 2010, to 1.5% and 2.0% respectively in the second and third quarters, and further to 2.6% in the fourth quarter.

1.12 The *GDP deflator* rose by 0.9% in 2010, reversing the decline of 0.6% in 2009. The rebound mainly reflected the moderate reflationary phenomenon in overall price levels alongside the full-fledged economic recovery. Meanwhile, the terms of trade deteriorated slightly in 2010, amid rising import prices caused by the upsurge in world commodity prices and a weak dollar.

**Diagram 1.4 : Inflation went up progressively in tandem with the strong economic upturn**



### **GDP by major economic sector**

1.13 The services sector grew notably in the first three quarters of 2010, reflecting the robust broad-based upturn of the economy. Net output in real terms expanded by 8.4%, 5.8% and 6.8% respectively in the first three quarters of 2010 over a year earlier. Among the major sectors, import and export, wholesale and retail trades saw the fastest expansion, supported by the resurgence in global trade, vibrant commercial activity and strong consumption demand. Concurrently, the transportation and storage sector was well supported by buoyant cargo and passenger flows. The accommodation and food services sector also benefited much from the recovery in local spending and strong inbound tourism. Financing and insurance as well as professional and business services grew solidly further, thanks to the mushrooming fundraising and other financial and commercial activities. Yet real estate activity, mainly reflecting the net output of private sector developers, declined. Meanwhile, output in the manufacturing sector bounced back moderately, benefitting from the reviving overseas demand. The construction sector, after some moderate growth in the first quarter of 2010, accelerated to double-digit growth in the second and third quarters, driven by the rapid expansion of public sector building and construction works.

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

	<u>2009</u>					<u>2010</u>		
	<u>2009</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>
Manufacturing	-8.3	-10.1	-9.5	-8.6	-4.9	0.4	2.2	5.4
Construction	-7.6	-12.3	-10.5	-2.6	-4.3	3.3	21.9	21.3
Services <sup>(b)</sup>	-1.6	-6.5	-2.9	-1.1	3.6	8.4	5.8	6.8
Import/export, wholesale and retail trades	-9.4	-17.7	-12.3	-10.3	0.8	22.0	17.5	15.9
Import and export trade	-11.3	-19.9	-14.2	-12.3	-1.1	22.9	17.9	15.6
Wholesale and retail trades	1.1	-7.0	-3.0	2.0	10.6	18.2	15.8	16.9
Accommodation and food services	-11.3	-10.6	-15.1	-11.6	-8.1	8.3	9.8	7.4
Transportation, storage, postal and courier services	-5.5	-9.5	-7.8	-6.0	1.5	6.2	10.3	6.8
Transportation and storage	-5.1	-9.0	-7.3	-5.6	1.6	4.9	9.1	5.6
Postal and courier services	-12.3	-17.4	-17.8	-13.3	-2.2	34.9	35.0	31.3
Information and communications	0.9	1.1	-0.6	1.9	1.2	1.8	0.9	1.4
Financing and insurance	4.3	-7.2	2.8	8.4	14.0	9.4	0.6	7.2
Real estate, professional and business services	1.7	-2.4	0.9	4.7	3.6	2.5	1.6	0.7
Real estate	1.2	-5.0	1.9	5.4	3.6	-2.9	-3.4	-4.3
Professional and business services	2.2	*	-0.1	4.2	4.2	8.6	7.0	5.9
Public administration, social and personal services	2.8	2.5	3.1	2.6	3.0	3.9	2.8	3.3

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

(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.

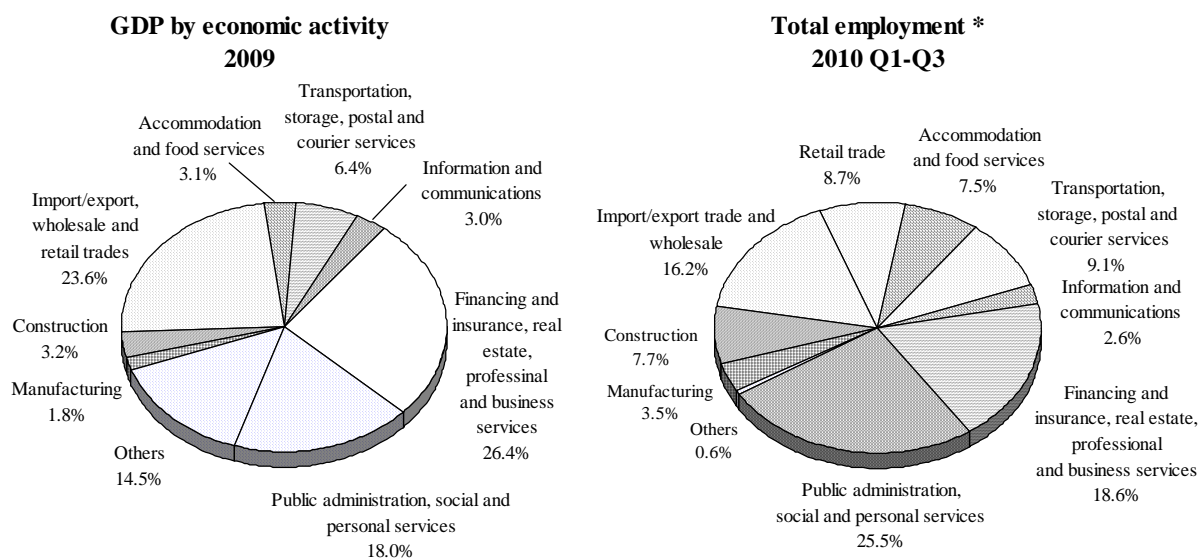
(b) In the context of value-added contribution to GDP, the service sectors include ownership of premises as well, which is analytically a service activity.

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

Starting from the reference year of 2009, statistics on GDP by economic activity are compiled based on the Hong Kong Standard Industrial Classification Version 2.0. Besides, the valuation of value added has been changed from factor cost to basic prices to follow international standard. As a result of these statistical developments, the series of the GDP by economic activity has been revised and backcasted to 2000.

1.14 The services sector is the mainstay of Hong Kong's economy, accounting for 92.6% of GDP in 2009 and 88.3% of total employment in the first three quarters of 2010. Being the key driver of overall economic growth, the services sector is where Hong Kong's competitive advantage lies, and also plays an ever-increasing role in deepening the integration with the Mainland. Hong Kong will continue to enhance its status as a global financial centre and a regional hub for business, by strengthening further the competitiveness of its four pillar industries, by promoting the growth of the six industries where it enjoys clear advantages (See **Box 1.2** on the latest statistics for the six industries in 2009) <sup>(3)</sup>, and by upgrading the quality of its infrastructure and human capital. On the latter, it is worth noting that the proportion of the local workforce with tertiary education attainment has risen steadily from 28.9% in 2005 to 31.6% in 2010.

**Diagram 1.5 : Services sector remains the mainstay of the economy**



Note : (\*) Figures refer to the Composite Employment Estimates, which are compiled based on results of the General Household Survey and the Quarterly Survey of Employment and Vacancies. Figures for 2010 are averages for the first three quarters of the year. Starting from the reference year of 2009, statistics on GDP by economic activity and employment are compiled based on the Hong Kong Standard Industrial Classification Version 2.0.

## **Some highlights of economic policy**

1.15 The Government's strategy of "stabilising the financial system, supporting enterprises and preserving employment" successfully helped to stabilise the economy in 2009 and consolidate the recovery in 2010. With the economy getting firmly back on the growth track, various relief measures introduced in emergency to counter the 2008-09 global financial crisis were allowed to expire in late 2010. As credit conditions much improved, the Special Loan Guarantee Scheme, which was introduced in December 2008 and extended three times to help enterprises secure loans and tide over liquidity problems, was closed for new application at end-2010. Likewise, the contingent Full Deposit Guarantee and the Contingent Bank Capital Facility, introduced to shore up public confidence in Hong Kong's banking system during the global financial crisis, expired as planned at end-2010. Instead, the enhanced Deposit Protection Scheme came into effect on 1 January 2011 to provide a higher protection limit of \$500,000 bank deposits.

1.16 With increasing signs that the economic recovery has taken hold, over the course of 2010, the focus of macroeconomic stance has shifted from ensuring steady recovery to containing asset market bubble risks caused by abundant liquidity in the global financial system and the super-loose monetary stances in the advanced economies. Indeed, this was a common concern for many Asian economies. The Government watched closely the risks and challenges posed by such an abnormal monetary environment, and introduced successive packages of measures in February, April, August, October and November 2010 to ensure a healthy and stable development of housing market along the four directions of increasing supply, preventing excessive leverage in mortgage lending, enhancing market transparency, and curbing speculation. By containing housing bubble risks, these stabilization measures should also help ensure sound economic fundamentals and banking sector stability, in turn conducive to macroeconomic stability.

1.17 In addition to meeting the short-term challenges, the Government has not lost sight of the need for long-term sustainable development and has strived to develop Hong Kong as a high value-added, knowledge-based economy by investing heavily in infrastructure through embarking on the construction of large-scale projects and in its people through education and training. In the longer term, these investments will boost productivity, which in turn would reduce the pressure on capacity constraint and hence help contain the risk of inflation spiral. Facilitation measures were also in good progress to promote the four traditional pillar industries and the six industries with clear comparative advantage. Moreover, the Government has sought to expand the

opportunities and create the favourable conditions for industries through strategic positioning within a regional context and leveraging on the growing economic clout of the Mainland:

- The year 2010 saw further deepening in Hong Kong's ties with the Mainland and other markets. Supplement VII to the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) was signed in May 2010. Service liberalisation measures in Supplement VII, which were implemented on 1 January 2011, have further broadened the access of local professional services to the Mainland market.
- On regional integration, the Framework Agreement on Hong Kong/Guangdong Co-operation signed in April 2010 set specific targets and development positioning for Hong Kong/Guangdong co-operation<sup>(4)</sup>. Physical linkages would be much enhanced upon the completion of the Hong Kong-Zhuhai-Macao Main Bridge and the Guangzhou-Shenzhen-Hong Kong Express Rail Link projects. All these will help expand the production capacity of the Hong Kong economy. Progress has also been made on co-operation and exchanges with Taiwan and other emerging markets. The listing of Russia's Rusal and Brazil's Vale illustrated the increasingly international focus of the financial industry.
- Hong Kong also saw major progress in developing into Mainland's offshore renminbi (RMB) business centre. The cross-border RMB trade settlement scheme was expanded in 2010 to cover wider geographical locations and more enterprises. This will reinforce Hong Kong's position as an international financial centre in the region. Indeed, significant growth was achieved in various areas, including cross-border trade settlement, deposits, bond issuance and the introduction of financial products.
- On the National 12<sup>th</sup> Five-Year Plan, the Government has been working with Guangdong Province to incorporate the most important functions and roles of Hong Kong-Guangdong co-operation into the Five-Year Plan. Given the service-oriented emphasis of the Plan, Hong Kong can make use of its competitive edge in helping to support the development of services sector in the Mainland while expanding its services industry scope and capturing opportunities in the vast Mainland market, and thus achieving mutually beneficial developments.

1.18 Hong Kong has fully emerged from the 2008-09 global financial crisis. This underlines the resilience and sound fundamentals of the economy. The Government's counter-cyclical measures have played an important role in helping to stabilise the economy and expedite the recovery. The Government will continue to uphold the principle of "Big Market, Small Government", recognising the effectiveness of market mechanism as the most efficient means to allocate resources under normal circumstances, and will ensure that the right conditions are in place for the proper functioning of the markets. Yet, as the experience in the 2008-09 global financial crisis indicated, the Government would also take decisive actions to safeguard macroeconomic and social stability to counter adverse external shocks where necessary. After all, economic vitality is the key to maintaining Hong Kong's competitiveness and prosperity. The Government will continue to be vigilant in navigating the economy through the challenges ahead.

## Box 1.2

### Economic contribution of the six industries (an update)

In 2009, the Government accepted the recommendations of the Task Force on Economic Challenges for the development of six industries where Hong Kong enjoys clear advantage. They are cultural and creative industries, medical services, education services, innovation and technology, testing and certification services, and environmental industries. To track the performance of the six industries, statistics on their value added and employment size will be useful. However, the six industries straddle different industries as defined by the current industrial classification<sup>(1)</sup>. Therefore, statistics for the six industries could not be readily compiled. In *Box 1.2* of the *2009 Economic Background and 2010 Prospects*, a set of crude estimates have been worked out by the Economic Analysis and Business Facilitation Unit in collaboration with the Census and Statistics Department (C&SD). By now, the C&SD has developed a new statistical framework for measuring the economic contribution and employment of the six industries, by taking into account relevant policy objectives, international guidelines and feedback from stakeholders. In addition, the C&SD has also made suitable enhancements to economic surveys to collect the necessary data. This article summarises the latest statistics released by the C&SD on the direct economic contribution (in terms of value added) and employment in respect of the six industries for 2008 and 2009<sup>(2)</sup>.

The value-added of the Six Industries continued to increase in 2009, by 3.0% over 2008 to \$123.9 billion, despite the global recession in that year (*Table 1*). This is in stark contrast to the decline of 2.6% in the nominal Gross Domestic Product (GDP) in 2009<sup>(3)</sup>. As a result, they outperformed the overall economy by a clear margin with their combined direct contribution to GDP rising to 8.0% in 2009 from 7.6% in 2008, indicating their strong relative competitiveness.

As for employment, the six industries together employed 394 970 persons in 2009, representing an increase of 1.7% from 388 320 persons in 2008 (*Table 2*). The six industries also fared better than the overall economy in terms of employment. In 2009, total employment in Hong Kong recorded a decline of 1.0%. As a result, the contribution of the six industries to total employment increased from 11.0% in 2008 to 11.3% in 2009.

Among the six industries, growth in the value added in 2009 was the biggest in testing and certification, thanks to the tightening of regulatory requirements in overseas markets, and the growing demand for medical testing. Growth in the value added of environmental industries was also sizable, attributable to increased businesses in waste management and environmental engineering. The value added of medical services also rose notably, amidst growing demand for medical services, including private hospitals and nursing and residential care. Innovation and technology, and education services also saw solid growth in terms of value added in 2009. Although cultural and creative industries showed a marginal decline in value added, their share in GDP actually edged up in 2009, as they still fared relatively better than the overall economy.

(1) The Hong Kong Standard Industrial Classification (HSIC) Version 2.0.

(2) For more details, see the C&SD's feature article "The Situation of the Six Industries in Hong Kong in 2008 and 2009", published in the February 2011 issue of the *Hong Kong Monthly Digest of Statistics*.

(3) To facilitate comparison of contribution of the Six Industries in the private sector as percentage of nominal GDP, GDP in terms of total gross value added is used. This is slightly different from the GDP figure commonly used, which is compiled at market price basis.

## Box 1.2 (Cont'd)

In terms of employment, education services expanded the most in 2009, followed by innovation and technology, environmental industries, medical services, and testing and certification services. Cultural and creative industries saw a small decline, but their share in total employment remained stable.

**Table 1: Value Added of the Six Industries** <sup>(a) (b)</sup>

<u>Value added at current prices</u>	<u>2008</u> <u>HK\$Mn</u>	<u>2009</u> <u>HK\$Mn</u>	<u>Annual growth rate</u>
1. Cultural and creative industries	63,080 (4.0%)	62,935 (4.1%)	-0.2%
2. Medical services	22,444 (1.4%)	24,077 (1.6%)	+7.3%
3. Education services	15,809 (1.0%)	16,386 (1.1%)	+3.6%
4. Innovation and technology	10,283 (0.6%)	10,733 (0.7%)	+4.4%
5. Testing and certification services	4,499 (0.3%)	5,090 (0.3%)	+13.1%
6. Environmental industries	4,178 (0.3%)	4,697 (0.3%)	+12.4%
<b>Six Industries</b> <sup>(c)</sup>	<b>120,293</b> <b>(7.6%)</b>	<b>123,918</b> <b>(8.0%)</b>	<b>+3.0%</b>
<b>GDP</b> <sup>(d)</sup>	<b>1,592,897</b>	<b>1,550,851</b>	<b>-2.6%</b>

Notes : Figures in brackets refer to percentages to GDP (see note (d)).

- (a) This set of estimates reflects the direct economic contribution of the Six Industries in private sector.
- (b) Strictly speaking, some of the Six Industries are service domains straddling different industries rather than individual industries. For example, innovation and technology can exist in any organisations and in any industries. But the term “industry” is still used to denote the aggregate of the economic activities concerned for the sake of simplicity and easy general understanding.
- (c) The above total for the Six Industries in the private sector is only a simple summation of the figures for individual industries. Users should note that there is some overlapping among the Six Industries.
- (d) To facilitate comparison of contribution of the Six Industries in the private sector as percentage of nominal GDP, GDP in terms of total gross value added is used. This is slightly different from the GDP figure commonly used, which is compiled at market price basis.

Main data sources: GDP by economic activity at detailed level, Annual Survey of Economic Activities, Survey of Innovation Activities, 2009 Survey of Testing and Certification Activities, Hong Kong's Domestic Health Accounts compiled by the Food and Health Bureau.

**Box 1.2 (Cont'd)****Table 2: Employment in the Six Industries<sup>(a)(b)</sup>**

<u>Employment</u>	<u>2008 Number</u>	<u>2009 Number</u>	<u>Annual growth rate</u>
1. Cultural and creative industries	191 260 (5.4%)	188 250 (5.4%)	-1.6%
2. Medical services	70 440 (2.0%)	71 990 (2.1%)	+2.2%
3. Education services	56 840 (1.6%)	62 240 (1.8%)	+9.5%
4. Innovation and technology <sup>(c)</sup>	26 090 (0.7%)	27 470 (0.8%)	+5.3%
5. Testing and certification services <sup>(d)</sup>	12 420 (0.4%)	12 610 (0.4%)	+1.5%
6. Environmental industries	31 270 (0.9%)	32 410 (0.9%)	+3.6%
<b>Six Industries<sup>(e)</sup></b>	<b>388 320 (11.0%)</b>	<b>394 970 (11.3%)</b>	<b>+1.7%</b>
<b>Total employment<sup>(f)</sup></b>	<b>3 521 400</b>	<b>3 486 900</b>	<b>-1.0%</b>

Notes : Figures in brackets refer to percentage shares to total employment (see note (f)).

(a) This set of estimates reflects the direct contribution of the Six Industries in private sector to employment.

(b) Strictly speaking, some of the Six Industries are service domains straddling different industries rather than individual industries. For example, innovation and technology can exist in any organisations and in any industries. But the term “industry” is still used to denote the aggregate of the economic activities concerned for the sake of simplicity and easy general understanding.

(c) Since innovation and technology involves significant non-routine activities, persons engaged in these activities are measured by the volume of labour input to innovation and technology in full-time equivalent terms (in terms of man-years).

(d) Figures refer to the quarterly averages of employment in the years concerned, which differ from the figures at a particular time point in the *Report on the 2009 Survey of Testing and Certification Activities* published in February 2010.

(e) The above total for the Six Industries in the private sector is only a simple summation of the figures for individual industries. Users should note that there is some overlapping among the Six Industries.

(f) Figures for total employment refer to Composite Employment Estimates.

Main data sources: Quarterly Survey of Employment and Vacancies, Survey of Innovation Activities, 2009 Survey of Testing and Certification Activities, Annual Survey of Economic Activities.

It should be noted that, as figures on the six industries are available for only two years at present, a longer time series on the performance of the industries would be needed to have a clearer picture on their long term growth trend. The Government will closely monitor the six industries. Indeed, various measures to promote the development of these industries are being implemented by the Government, as part of the efforts to move Hong Kong towards a more diversified knowledge-based economy.

## Notes :

- (1) The Gross Domestic Product (GDP) is an overall measure of net output produced within an economy in a specified period, such as a calendar year or a quarter, before deducting the consumption of fixed capital. In accordance with the expenditure approach to its estimation, GDP is compiled as total final expenditures on goods and services (including private consumption expenditure, government consumption expenditure, gross domestic fixed capital formation, changes in inventories, and exports of goods and services), less imports of goods and services.
- (2) The 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.
- (3) The four traditional pillar industries refer to financial services, tourism, trading and logistics, and producer and professional services. The six industries where Hong Kong enjoys clear advantages refer to medical services, education services, environmental industries, testing and certification, innovation and technology, and cultural and creative industries.
- (4) The framework agreement on Hong Kong/Guangdong co-operation was signed on 7 April 2010. Specific policies and measures included: (1) to promote joint socio-economic development in Hong Kong and Guangdong to create a new world-class economic zone; (2) to enhance Hong Kong's position as an international financial centre and expedite the development of financial services in Guangdong to build an international financial centre with Hong Kong; (3) to capitalise on the competitiveness of Hong Kong's service industries and Guangdong's manufacturing industries to build an advanced global manufacturing and modern services base; (4) to facilitate the flow of key factors such as people, goods, information and capital across the boundary, with a view to building an international aviation, shipping and logistics hub and a world-class modern economic circulation sphere; (5) to implement a regional ecology and environment protection regime operating at a leading level by the national standards to create a high quality living area; and (6) to promote collaborative development among Hong Kong and the Pearl River Delta cities to form a world-class metropolis cluster.