

Economic situation in second quarter of 2018 and latest GDP and price forecasts for 2018

The Government released today (August 10) the Half-yearly Economic Report 2018, together with the preliminary figures on Gross Domestic Product (GDP) for the second quarter of 2018.

The Deputy Government Economist, Mr Adolph Leung, described the economic situation in the second quarter of 2018 and provided the latest GDP and price forecasts for 2018.

Main points

- The Hong Kong economy sustained strong momentum in the second quarter of 2018, expanding by 3.5% over a year earlier, following the growth of 4.6% in the first quarter. Riding on the robust global economy, external demand remained sturdy, though there seemed to be some moderation towards the end of the quarter. Domestic demand also expanded visibly. Labour market conditions stayed favourable, while inflation was still moderate. On a seasonally adjusted quarter-to-quarter comparison, real GDP decreased slightly by 0.2% in the second quarter of 2018 against a high base of comparison created by the 2.1% surge in the preceding quarter.
- Total exports of goods grew solidly by 4.6% year-on-year in real terms for the second quarter as a whole, with most major markets recording further growth. Exports of services expanded notably by 6.1% year-on-year in real terms, with the momentum maintained for all major components. In particular, inbound tourism continued to register double-digit growth. However, external uncertainties increased markedly in the latter part of June, as the US escalated trade tensions with the Mainland.
- Domestic demand remained strong in the second quarter. Private consumption expenditure grew significantly by 6.1% year-on-year in real terms as favourable labour market conditions continued to underpin consumer sentiment. Overall investment expenditure recorded further growth of 0.4% year-on-year in real terms, supported by the solid growth in machinery and equipment acquisition, notwithstanding some declines in building and construction activity.

- The labour market tightened further in the second quarter. The seasonally adjusted unemployment rate edged down to 2.8%, the lowest level in more than 20 years, while the underemployment rate stayed unchanged. Total employment saw further solid growth. Wages and earnings continued to register broad-based gains in real terms.
- The local stock market was range-bound during most of the second quarter, before posting declines in the second half of June when market sentiment was swayed by the US' escalated trade conflicts with the Mainland and expectations of faster US interest rate hikes. The residential property market stayed buoyant during the second quarter, with flat prices rising further amid active trading.
- Looking ahead, the current momentum of the global economy, if continued, will render support to Hong Kong's external demand. On current indications, the Mainland economy would maintain a medium-high growth pace this year, and the US economy should remain strong given the boost from the tax reform. However, sustained trade tensions between major economies would increase the downside risks to the global economy. The US' trade conflicts with the Mainland, in particular, could weigh on global economic sentiment as well as trade and investment activities, possibly putting a damper on Hong Kong's exports in the period ahead. Moreover, the global financial and asset markets could become more volatile upon further tightening of financial conditions across advanced economies, particularly in the US.
- Domestic demand should remain largely resilient in the remainder of the year. Consumer sentiment may turn less sanguine in the wake of the increased external uncertainties, but should still be supported by favourable job and income conditions. However, local investor sentiment might feel the pinch should the US-Mainland trade conflicts intensify further. Indeed, various surveys suggested that local business sentiment had turned slightly more cautious most recently.
- Considering the strong year-on-year growth of 4.0% in the first half of the year, and in view of the increased external headwinds, the forecast real GDP growth for 2018 as a whole is maintained at 3-4% in the current round of review. The Government will continue to monitor closely the development of the various external uncertainties and their implications for the local economy.
- Inflationary pressure stayed moderate in the second quarter, though building up somewhat amid strong economic conditions. While the

temporary factors that led to a faster increase in prices in the first quarter subsided, the underlying consumer price inflation stayed unchanged at 2.4% in the second quarter. Several major components in the consumer price index saw accelerated increases. In view of the edging up of global inflation and continued feed-through of earlier rises in fresh-letting residential rentals, consumer price inflation is likely to go up somewhat in the months ahead compared to the situation in the first half of the year, but should stay within a moderate range for 2018 as a whole. Taking into account the actual outturns so far this year, the forecast rates of underlying and headline consumer price inflation for 2018 as a whole, at 2.5% and 2.2% respectively, are maintained in the current round of review.

Details

GDP

According to the preliminary data on GDP released today by the Census and Statistics Department, GDP grew strongly by 3.5% in real terms in the second quarter of 2018 over a year earlier, after the growth of 4.6% in the preceding quarter (revised from the preliminary estimate of 4.7%), marking the seventh quarter of growth above the trend growth rate of 2.7% per annum in the past 10 years. For the first half of 2018 as a whole, real GDP expanded by 4.0% over a year earlier. On a seasonally adjusted quarter-to-quarter comparison, real GDP decreased slightly by 0.2% in the second quarter of 2018 against a high base of comparison resulting from the 2.1% surge in the preceding quarter (revised from the preliminary estimate of 2.2%) (see Chart).

The figures on GDP and its major expenditure components up to the second quarter of 2018 are presented in Table 1. Developments in different segments of the economy in the second quarter of 2018 are described below.

External trade

Total exports of goods grew solidly by 4.6% in real terms in the second quarter over a year earlier, after the growth of 5.2% in the first quarter. External merchandise trade statistics showed that growth was robust in April and May before showing some deceleration in June. Most major markets recorded continued growth in the second quarter. Exports to the US picked up further and those to the European Union continued to register solid growth amid the robust final demand there. Meanwhile, on the back of strong manufacturing and trading activities in the region resulting from the robust global economy, exports to many Asian economies registered further growth. Specifically, exports to the Mainland continued to grow visibly, while exports to many major emerging markets in the Association of Southeast Asian Nations also registered growth of varying degrees. As for the higher income Asian economies, exports to Singapore grew strongly, and exports to Japan and Korea recorded modest growth, though those to Taiwan dipped slightly. More recently, there was some slowdown in growth or declines in exports to some Asian markets. It remains to be seen how the escalation of trade conflicts between the US and the Mainland would affect the global economy and Hong

Kong's exports in the coming months. On a seasonally adjusted quarter-to-quarter basis, total exports of goods decreased slightly by 0.4% in real terms in the second quarter, after a surge of 3.1% in the first quarter.

Exports of services expanded notably by 6.1% year-on-year in real terms in the second quarter, following the 7.9% growth in the previous quarter. All major service components attained growth. Exports of travel services continued to register double-digit growth, supported by a notable growth in visitor arrivals and increase in per capita spending. Exports of financial services and exports of business and other services expanded further, thanks to frequent cross-border financial and commercial activities. Exports of transport services also showed a moderate increase amid active regional trade flows. On a seasonally adjusted quarter-to-quarter basis, exports of services decreased by 3.2% in real terms in the second quarter, having surged by 5.2% in the preceding quarter.

Domestic sector

Domestic demand remained strong in the second quarter. Private consumption expenditure continued to grow significantly, by 6.1% in real terms over a year earlier, following the 8.8% growth in the first quarter. Favourable labour market conditions, and to a lesser extent positive wealth effect, continued to underpin consumer sentiment. On a seasonally adjusted quarter-to-quarter comparison, private consumption expenditure decreased by 0.6% in real terms in the second quarter, after a sizeable increase of 3.3% in the preceding quarter. Government consumption expenditure grew steadily by 4.4% in the second quarter over a year earlier, up from the 3.9% growth in the preceding quarter.

Overall investment spending in terms of gross domestic fixed capital formation rose further by 0.4% in real terms in the second quarter over a year earlier, though decelerating from the 4.2% growth in the preceding quarter. Machinery and equipment acquisition recorded solid growth, thanks to strong private sector spending on the back of robust economic conditions. Meanwhile, overall building and construction activity, which is inherently volatile, declined somewhat.

The labour sector

The labour market tightened further in the second quarter, with the seasonally adjusted unemployment rate edging down to 2.8%, the lowest level in more than 20 years, while the underemployment rate stayed unchanged at 1.0%. Total employment saw further solid year-on-year growth. Against this backdrop, wages and earnings continued to register gains in real terms, with appreciable increases for lower-income workers.

The asset markets

The local stock market was range-bound during most of the second quarter, before posting declines in the second half of June when market sentiment was swayed by the US' escalated trade conflicts with the Mainland and expectations of faster US interest rate hikes. The Hang Seng Index closed

the second quarter at 28 955, down by 3.8% from a quarter earlier. On August 9, the Hang Seng Index closed at 28 607.

The residential property market stayed buoyant in the second quarter. The number of residential property transactions increased from 15 000 in the first quarter to 18 900 in the second quarter. Overall flat prices rose by 5% between March and June, while the index of home purchase affordability worsened to around 74% in the second quarter. Overall flat prices in June exceeded the 1997 peak by 125%. Between March and June, flat rentals went up by 2%. Shop and office rentals rose by 1% and 2% respectively over the same period. On June 29, the Government introduced six new housing initiatives, aiming at making subsidised sale flats more affordable, increasing supply of subsidised housing units and enhancing support for transitional housing supply, and encouraging more timely supply of first-hand private flats.

Prices

Overall inflation pressure stayed moderate in the second quarter of 2018, though building up somewhat amid strong economic conditions. Local cost pressures were largely contained, as the sustained improvement in labour productivity kept labour cost pressure in check on a unit cost basis, and rental costs faced by businesses remained moderate thus far. However, the effects of the uptrend in fresh-letting residential rentals over the past year or so continued to feed through. External price pressures, while still rather moderate, inched up amid the mild acceleration of inflation in some of Hong Kong's major import suppliers and to a lesser extent the hike in international oil prices in recent months. While the temporary factors that led to a faster increase in prices in the first quarter subsided, the underlying consumer price inflation, which nets out the effects of the Government's one-off relief measures, remained unchanged at 2.4% in the second quarter. Due to the upward adjustment in the ceiling of the Government's rates concession, the headline consumer price inflation came down slightly to 2.1% in the second quarter, compared to 2.4% in the first quarter.

Latest GDP and price forecasts for 2018

Looking ahead, the current momentum of the global economy, if continued, will render support to Hong Kong's external demand. On current indications, the Mainland economy would maintain a medium-high growth pace this year, and the US economy should remain strong given the boost from the tax reform. However, sustained trade tensions between major economies would increase the downside risks to the global economy. The US' trade conflicts with the Mainland, in particular, could weigh on global economic sentiment as well as trade and investment activities, possibly putting a damper on Hong Kong's exports in the period ahead. Moreover, the global financial and asset markets could become more volatile upon further tightening of financial conditions across advanced economies, particularly in the US.

Domestic demand should remain largely resilient in the remainder of the year. Consumer sentiment may turn less sanguine in the wake of the increased

external uncertainties, but should still be supported by favourable job and income conditions. However, local investor sentiment might feel the pinch should the US-Mainland trade conflicts intensify further. Indeed, various surveys suggested that local business sentiment had turned slightly more cautious most recently.

Considering the strong year-on-year growth of 4.0% in the first half of the year, and in view of the increased external headwinds, the forecast real GDP growth for 2018 as a whole is maintained at 3-4% in the current round of review (see Table 2). The Government will continue to monitor closely the development of the various external uncertainties and their implications for the local economy. For reference, the latest forecasts by private sector analysts mostly range from 3.3-4.0%, averaging around 3.7%.

On the inflation outlook, in view of the edging up of global inflation and continued feed-through of earlier rises in fresh-letting residential rentals, consumer price inflation is likely to go up somewhat in the months ahead compared to the situation in the first half of the year, but should stay within a moderate range for 2018 as a whole. Taking into account the actual outturns so far this year, the forecast rates of underlying and headline consumer price inflation for 2018 as a whole, at 2.5% and 2.2% respectively, are maintained in the current round of review (see Table 2).

The Half-yearly Economic Report 2018 is now available for online download, free of charge at www.hkeconomy.gov.hk/en/reports/index.htm. The Report of the Gross Domestic Product, Second Quarter 2018, which contains the GDP figures up to the second quarter of 2018, is also available for online download, free of charge at the homepage of the Census and Statistics Department, www.censtatd.gov.hk.