

CHAPTER 1 : OVERVIEW OF ECONOMIC PERFORMANCE IN 2008

Summary

- *The outbreak of the financial tsunami has completely derailed the upturn of the Hong Kong economy since 2003. The economy still held firm in the first half of 2008, but took an abrupt turn after September. For 2008 as a whole, GDP growth averaged at 2.5%, down from 6.4% in 2007. External demand slowed markedly towards the latter part of the year amid a deepening global economic downturn. Domestic demand also lost much of its momentum since the third quarter, along with weaker consumer and investor sentiments and tighter credit markets.*
- *The global financial crisis intensified distinctly in 2008, especially after September last year. The crisis quickly moved across assets, markets and economies in an increasingly integrated world. While the concerns about a global financial meltdown reduced following the unprecedented measures taken by various governments, the impact of the financial tsunami had translated into a synchronised global economic downturn.*
- *Local labour market held up well in the first half of the year when the economy still expanded at an above-trend pace. Yet the rapid deterioration in the business situation shortly following the abrupt escalation of the financial crisis led to a rise in the unemployment rate to 4.1% in the fourth quarter from a 10-year low of 3.2% in mid-2008.*
- *Local stock market was highly volatile during most of 2008, with a very sharp decline in the two months or so after the escalation of the crisis into a full-blown financial tsunami in September. The residential property market also began to falter in the second half of 2008, after a period of much vibrancy in the preceding one and a half years. The asset market corrections, and the associated negative wealth effect, put a notable drag on consumption spending in the latter part of the year.*
- *Inflationary pressures were elevated in the first half of 2008, but receded notably in the latter part of the year, along with the retreat of global food and energy prices, the dampening effect of the Government's one-off relief measures, as well as the weaker demand conditions.*

Overall situation

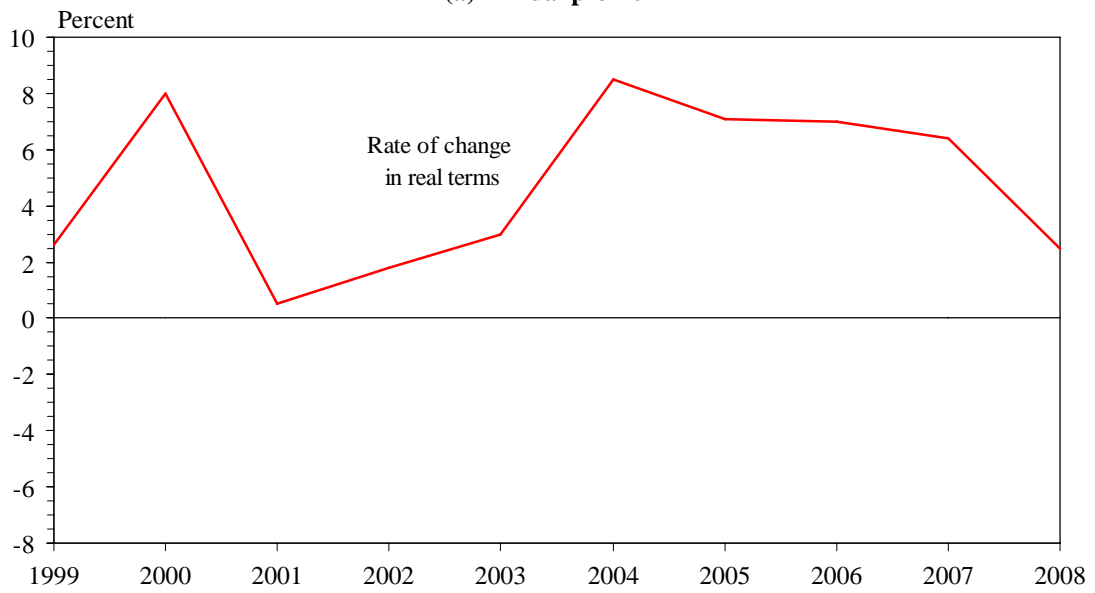
1.1 The Hong Kong economy showed a rapid moderation in growth over the course of 2008, having expanded strongly in the preceding four years. External demand slowed markedly towards the latter part of the year amid a deepening global economic downturn. Domestic demand also lost much of its momentum since the third quarter, along with weaker consumer and investor sentiment on account of the worsened income prospects and business outlook, as well as the tighter credit conditions. The unemployment rate rose markedly towards the end of the year, after falling to a 10-year low in mid-2008. Inflationary pressures were elevated in the first half of 2008, but receded notably in the latter part of the year, along with the retreat of global food and energy prices, the dampening effect of the Government's one-off relief measures, as well as the weaker demand conditions.

1.2 The global financial crisis, triggered by the US sub-prime mortgage problems in 2007, intensified distinctly in 2008, especially after the collapse of Lehman Brothers in September last year. The crisis quickly moved across assets, markets and economies in an increasingly integrated world. While the concerns about a global financial meltdown receded following the unprecedented measures taken by various governments, the impact of the financial tsunami on the real global economy began to emerge more distinctly in the latter half of last year. By the end of 2008, most advanced economies were already mired in recession, and the conditions of Asian economies also deteriorated rapidly, evolving into a synchronized global economic downturn. Being a small open economy, business activities in Hong Kong were inevitably affected.

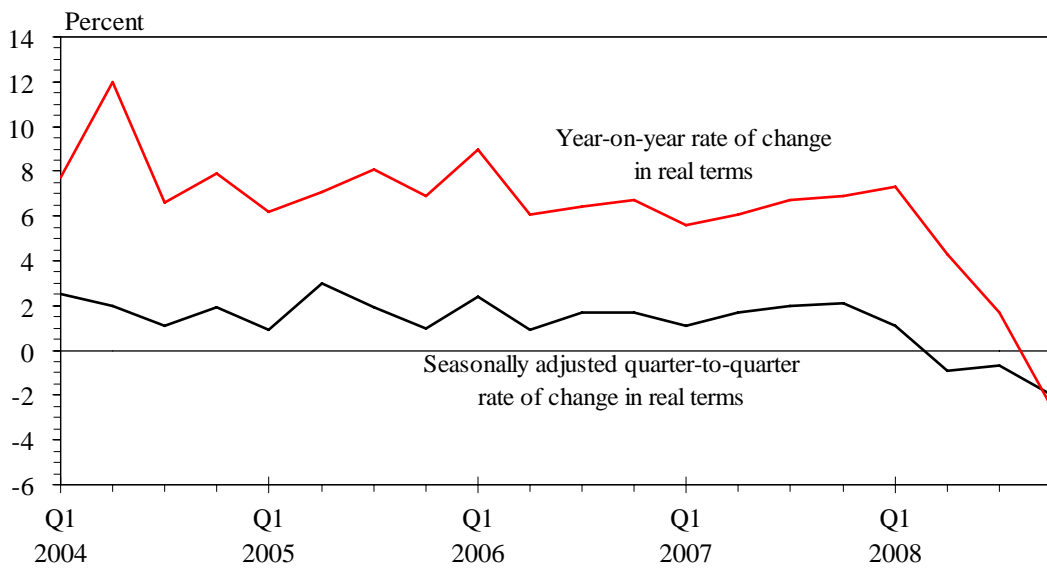
1.3 For 2008 as a whole, the *Gross Domestic Product (GDP)*⁽¹⁾ grew by 2.5% in real terms, a rapid deceleration from the strong 6.4% growth in 2007. Indicative of the rapid slowdown of economic activity, the year-on-year rate of real GDP growth decelerated markedly from the strong 7.3% in the first quarter to 4.3% in the second quarter and further to 1.7% in the third quarter. As the global downturn deepened further, the Hong Kong economy registered a contraction of 2.5% in the fourth quarter. On a seasonally adjusted quarter-to-quarter comparison⁽²⁾, real GDP expanded strongly by 1.1% in the first quarter, before declining by 0.9%, 0.7% and 2.0% in the ensuing three quarters.

Diagram 1.1 : Economy severely hit by the global financial tsunami during the year

(a) Annual profile



(b) Quarterly profile



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

	<u>2007[#]</u>	<u>2008[#]</u>	<u>2007</u>				<u>2008</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	8.5	1.8	5.3 (2.0)	7.6 (3.2)	11.3 (2.7)	9.7 (1.6)	7.6 (-0.1)	3.5 (-0.8)	* (-0.9)	-3.2 (-1.4)
Government consumption expenditure	3.0	2.0	2.5 (2.2)	3.8 (-0.7)	2.4 (0.3)	3.3 (1.1)	0.6 (-0.2)	3.2 (1.6)	2.0 (-0.2)	2.6 (1.1)
Gross domestic fixed capital formation	3.4	-0.3	0.3	6.5	-1.1	8.0	10.1	4.9	3.2	-17.3
<i>of which :</i>										
Building and construction	-0.2	0.3	-3.5	5.7	-1.2	-1.6	9.1	-0.4	-4.1	-3.6
Machinery, equipment and computer software	3.0	0.6	0.4	6.2	-3.1	8.4	5.9	6.9	10.6	-18.7
Total exports of goods	7.0	2.0	6.5 (0.1)	10.0 (2.0)	6.2 (0.6)	5.7 (2.9)	8.3 (0.8)	4.4 (0.2)	1.4 (-1.8)	-4.9 (-4.4)
Imports of goods	8.8	1.9	7.1 (*)	11.5 (3.5)	8.1 (1.0)	8.5 (3.7)	8.4 (-1.6)	4.9 (1.9)	2.2 (-1.0)	-6.4 (-5.7)
Exports of services	14.1	5.6	14.7 (6.0)	11.9 (1.8)	15.3 (3.5)	14.1 (2.7)	10.2 (1.4)	8.2 (0.2)	5.1 (0.3)	-0.2 (-1.9)
Imports of services	12.1	3.2	12.7 (3.6)	11.3 (3.9)	11.9 (1.5)	12.5 (3.4)	10.2 (0.9)	3.8 (-2.0)	1.9 (-0.3)	-2.5 (-0.9)
Gross Domestic Product	6.4	2.5	5.6 (1.1)	6.1 (1.7)	6.7 (2.0)	6.9 (2.1)	7.3 (1.1)	4.3 (-0.9)	1.7 (-0.7)	-2.5 (-2.0)
<i>Change in the main price indicators (%)</i>										
GDP deflator	2.9	1.4	1.3 (0.8)	1.7 (0.9)	3.7 (1.0)	4.7 (1.9)	2.4 (-1.2)	1.9 (0.3)	1.8 (0.7)	* (*)
Composite Consumer Price Index	2.0	4.3	1.7 (-0.1)	1.3 (0.4)	1.6 (0.8)	3.5 (2.4)	4.6 (0.9)	5.7 (1.5)	4.6 (-0.2)	2.3 (0.1)
<u>Change in nominal GDP (%)</u>	9.5	3.9	7.0	7.9	10.6	11.9	9.9	6.2	3.5	-2.6

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%.

The external sector

1.4 The external trading environment worsened over the course of 2008. The advanced economies, especially the US and the euro area, being the epicenter of the global financial crisis, were the first to enter into recession. This had quickly translated into weaker demand for exports from the emerging and developing economies. As a result, the initial economic slowdown in the advanced economies had mutated into a synchronized global downturn, taking its toll on world trade. Hong Kong's exports to the advanced economies slackened during 2008, and those to the Asian markets, including the Mainland, also deteriorated distinctly in the latter part of the year. The return to strength of the US dollar since the middle of 2008 also did not help the price competitiveness of Hong Kong's exports. Against this backdrop, total exports of goods moderated in growth during the year and registered a year-on-year decrease of 4.9% in the fourth quarter. For 2008 as a whole, *total exports of goods* rose by 2.0% in real terms, a notable deceleration from the 7.0% increase in 2007.

1.5 Exports of services likewise slowed, but to a lesser extent, over the course of 2008. As the fund-raising activities and the trading volume in the local stock market shrank notably in 2008, particularly so after the abrupt escalation of the financial turmoil towards the end of the third quarter, exports of financial services slowed distinctly in 2008 after the surge in 2007. The vibrant growth in inbound tourism was also halted in the final quarter of 2008 as the global economic slowdown weighed on the demand for travel. The slowdown in inbound tourism also had a spill-over effect on exports of transportation services. While merchanting and other trade-related services (mainly offshore trade) still held up rather well during most of 2008, there was a conspicuous deterioration in the fourth quarter of 2008 as the flows of goods trade in the Asian region shrank notably in the final months of the year. Overall, *exports of services* rose by 5.6% in 2008, notably slower than the 14.1% growth in 2007.

The domestic sector

1.6 Domestic demand held up relatively well in the first quarter, but slowed distinctly in the following three quarters of 2008. The deceleration in private consumption was particularly evident in the second half of the year, due to the negative wealth effect from the notable correction in the local asset markets, as well as the deterioration in job prospects. For 2008 as a whole,

private consumption expenditure (PCE) grew by 1.8% in real terms, in contrast to the robust 8.5% growth in 2007.

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

	Total consumer spending in the domestic market ^(a)	<i>Of which :</i>					Residents' expenditure abroad	Visitor spending	Private consumption expenditure ^(b)
		Food	Durables	Non- durables	Services				
2007 Annual	9.5	4.5	16.0	9.4	9.5	4.2	14.1	8.5	
Q1	6.2	6.1	7.5	6.0	6.1	0.6	9.4	5.3	
Q2	7.7	5.4	13.2	6.0	7.7	7.4	8.7	7.6	
Q3	12.6	7.4	22.5	11.0	12.5	3.9	15.5	11.3	
Q4	11.4	-0.2	20.3	14.0	11.5	5.1	21.7	9.7	
2008 Annual	2.5	0.8	10.7	4.8	0.7	-0.9	5.9	1.8	
Q1	7.7	3.4	18.7	11.4	5.5	6.8	8.1	7.6	
Q2	4.6	1.6	13.8	8.4	2.7	-3.7	7.9	3.5	
Q3	1.2	0.4	13.6	3.1	-1.4	-2.1	8.7	*	
Q4	-2.7	-1.9	-0.9	-2.1	-3.4	-4.1	0.2	-3.2	

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.

1.7 Overall investment posted a contraction of 0.3% in 2008, as compared to the 3.4% growth in 2007. Investment in machinery, equipment and software registered some notable growth during most of 2008, before showing a distinct decline in the fourth quarter. Meanwhile, construction activities remained sluggish. After recording a positive growth in the first quarter, expenditure on building and construction relapsed to decreases in the following three quarters. The costs of ownership transfer also trended downward as the local property market cooled down in the second half of the year. Business confidence ebbed in the latter half of the year, particularly in the face of the abrupt deepening of the global financial crisis. According to the Quarterly Business Tendency Survey conducted by the Census and Statistics Department during mid-December 2008 to mid-January 2009, large business establishments generally remained rather pessimistic on the near-term outlook.

Diagram 1.2 : The deceleration in consumer spending was particular evident in the second half of 2008

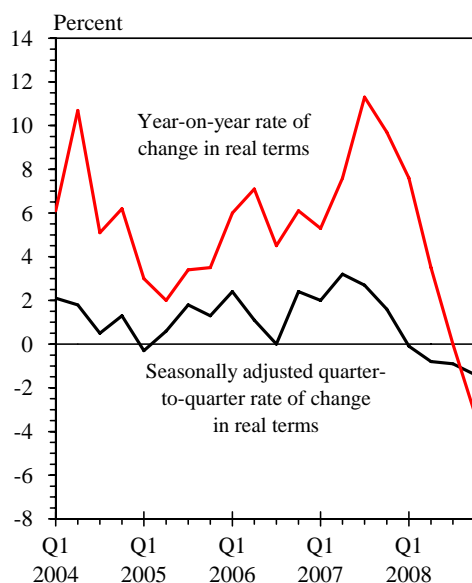
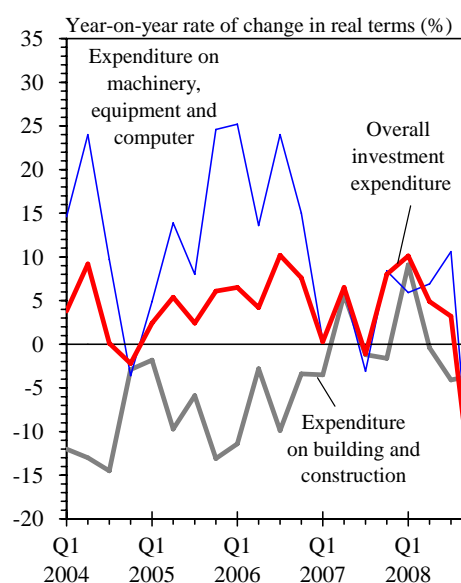


Diagram 1.3 : Overall investment posted a marginal decline in 2008



The labour sector

1.8 Local labour market held up well in the first half of the year when the economy still expanded at an above-trend pace. Yet the rapid deterioration in the business situation shortly following the abrupt escalation of the financial crisis since September 2008 led to weakened demand for labour towards the end of 2008, with notable declines in vacancies in such sectors as real estate and construction, tourism and consumption-related sector, as well as trading and logistics. For 2008 as a whole, total employment increased by an average of 1.6%, slower than the 2.4% increase in 2007. Reflecting the changing economic conditions over the course of 2008, the seasonally adjusted unemployment rate, after falling to 3.2% in June-August 2008, the lowest in more than a decade, climbed up distinctly towards the end of the year as labour demand began to recede. Labour wages and earnings, on average, continued to rise in 2008.

The asset markets

1.9 During 2008, the local stock market continued the downward adjustment that began in the latter part of 2007, as the turbulence that was triggered by the sub-prime mortgage crisis in the US in 2007 affected a wider spectrum of the global financial markets. The pace of downward adjustment was particularly acute in the two months or so after the global crisis turned into

a full-fledged financial tsunami in September. The Hang Seng Index had a nose-dive during the period, marking an annual low of 11 016 on 27 October 2008, a more than 65% fall as compared to the historic peak of 31 638 attained on 30 October 2007. The Hang Seng Index closed the year at 14 387, 48% lower than the level at end-2007, the largest annual decline since 1974. The average daily turnover shrank to \$72.1 billion in 2008, and stock market capitalisation to \$10.3 trillion at the end of the year. Fund-raising activities also receded in 2008 as the sentiments in the local stock market turned less optimistic.

1.10 The residential property market also faltered in the second half of 2008, after a period of much vibrancy in the preceding one and a half years. The much more treacherous environment in the major financial markets overseas, causing jitters in the local stock market, less optimistic job prospect, and less accommodative provision of mortgages, had contributed to the consolidation in the local property market. Transactions in residential properties tumbled sharply in the latter part of 2008, falling to 3 264 in November, the lowest in more than a decade, before moving up to 4 706 in December. For 2008 as a whole, the number of transactions in residential properties fell notably, by 22% from the stellar level in 2007. By December 2008, flat prices were around 18% off the peak in June 2008 and 12% lower than a year ago. As to rentals, they were on average 19% off the peak in July 2008 and 11% lower than in December 2007. Flat prices in December turned more stable after falling sharply in the preceding two months. It is worth noting that in terms of home purchase affordability and the extent of speculative activities, the situation in 2008 still compared favourably with that in the run-up to 1997.

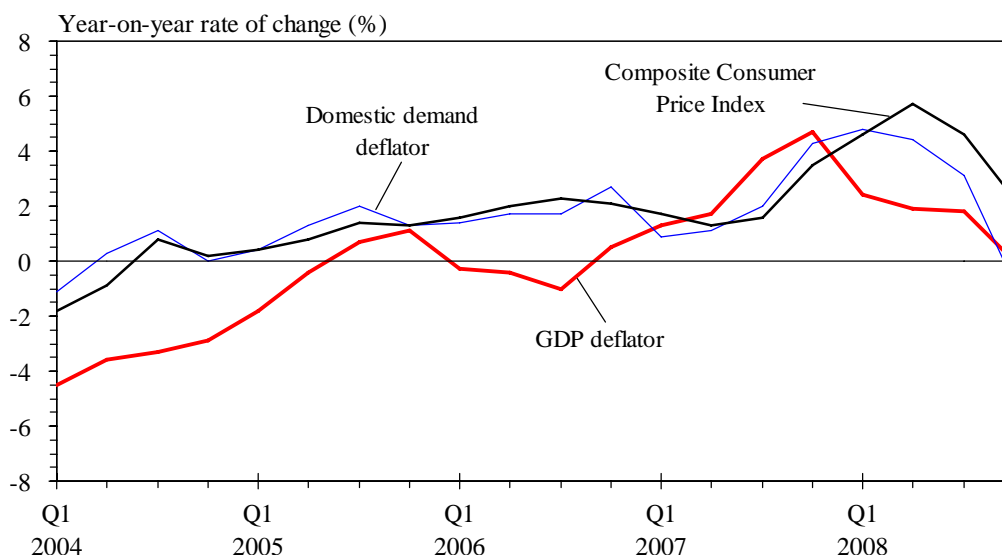
Inflation

1.11 Underlying consumer price inflation continued to rise during the first half of 2008, reflecting the earlier surges in global food and energy prices and in local private residential rentals. Nevertheless, the collapse of the commodity prices in the international markets since the middle of 2008, together with the property market correction due to the financial tsunami, reduced the inflationary pressures, thereby leading to some notable easing of the underlying inflation in the latter part of 2008. The abrupt waning of consumer sentiments towards the end of the third quarter due to the negative wealth effect and the less optimistic labour market, resulting in a weaker consumption market, was also contributory. For 2008 as a whole, the underlying Composite Consumer Price Index rose by an average of 5.6%, up

from 2.8% in 2007. Headline inflation fell more notably, thanks to the various one-off relief measures introduced by the Government (i.e. rates concession, electricity subsidy, payment of public housing rentals on behalf of low-income households, and the waiving of re-training levy). The headline Composite Consumer Price Index rose by 4.3% in 2008, compared with an increase of 2.0% in 2007.

1.12 The GDP deflator rose by 1.4% in 2008, after an increase of 2.9% in 2007. The moderate increase in the GDP deflator was attributable to the deterioration in terms of trade on the back of a slower increase in export prices than import prices. Excluding the effect of terms of trade, the domestic demand deflator rose by 2.7% in 2008, after a 2.1% increase in 2007.

Diagram 1.4 : Inflation pressures eased notably towards the end of 2008



Box 1.1

Impact of financial tsunami on small and medium-sized enterprises

The abrupt escalation of the financial turbulence in September 2008 has led to a deepening synchronized global economic downturn. It is one of the priorities of the Government to support enterprises, especially the small and medium-sized enterprises (SMEs)¹, which absorb around half of all the persons engaged in Hong Kong, in the midst of difficult times like this. To attain a better understanding on the impact of the financial tsunami on the business receipts, employment and credit situations of the SMEs, an ad-hoc weekly 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 relevant feedback information.

The consultation exercise covered ten economic sectors, including retail trade, import and export trades, restaurants, wholesale trade, transport services (mainly logistics), travel agents, financing institutions, insurance agents and brokers, real estate and construction, and business services.

According to the results of the consultation up till early February 2009, SMEs across different sectors reported significant declines in business receipts as compared with the normal situation (*Table 1*). Among the ten sectors surveyed, business situation in the logistics, real estate and construction, retail trade, import and export trades, and financing institutions had been severely hit. Results of the latest rounds suggested that business situation in logistics and import and export trades had deteriorated further, in line with the steep decline in external trade in the more recent months. But wholesale and retail trades showed some relative improvement in their business situation. The picture was in line with the recent figures on retail sales and inbound tourism.

It is worth noting that in order to minimise the respondents' burden and to compile the findings within the very short period (i.e. one week), the sampled SMEs are only asked to provide their crude assessment of the impact of financial tsunami on business receipts, employment and credit situation, without referring to their actual business data. A similar ad hoc survey on business receipts was conducted during the SARS crisis, and the reported declines from that survey when matched against the actual declines obtained from the regular survey with more comprehensive coverage indicate that the results of the ad hoc survey overstated the impact on business receipts by a considerable extent. Also, with the scope of the survey covering only the SMEs within a range of selected sectors which took up around 73% of SMEs' total employment, the results of the survey should not be treated as representing a complete picture of the business and employment situations in Hong Kong. Thus, the results of the current ad hoc survey should be interpreted with considerable caution, though they can serve as rough indicator to enable high frequency monitoring of SMEs' situations.

(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)**Table 1 Impact on business receipts as compared with normal situation**

SMEs by sectors	% decline as compared with normal situation for the week ending:-								
	28 Nov	5 Dec	12 Dec	19 Dec	26 Dec and 2 Jan	9 Jan	16 Jan	23 Jan	30 Jan and 6 Feb
Wholesale trade	-24.7	-16.0	-16.4	-16.4	-10.8	-7.6	-8.5	-6.3	-7.2
Retail trade	-24.8	-23.8	-24.2	-22.9	-23.2	-22.4	-21.9	-20.4	-18.4
Import and export trades	-17.8	-19.4	-18.3	-16.9	-18.9	-19.3	-20.9	-21.9	-19.4
Restaurants	-13.9	-14.7	-13.9	-13.1	-12.1	-13.1	-12.0	-11.3	-12.2
Logistics	-29.7	-39.0	-34.7	-36.9	-33.5	-38.5	-40.6	-37.1	-47.2
Travel agents	-15.2	-11.4	-12.2	-12.1	-12.6	-11.9	-10.6	-11.5	-11.4
Financing institutions	-23.3	-24.1	-24.5	-23.2	-20.7	-18.9	-18.5	-16.1	-20.9
Insurance agents and brokers	-9.2	-9.6	-9.4	-9.7	-9.9	-9.5	-10.0	-9.3	-9.2
Real estate and construction	-32.5	-28.9	-31.7	-31.4	-30.6	-30.4	-31.6	-28.3	-31.7
Business services	-8.9	-7.6	-8.0	-11.4	-10.9	-10.3	-10.7	-10.6	-13.5
All the above sectors	-18.5	-19.3	-18.4	-17.3	-18.5	-18.5	-19.9	-20.3	-18.6

The financial tsunami also had a notable impact on employment. In the latest rounds, the SMEs surveyed on the whole reported a decline of slightly less than 2% in employment as compared with the normal situation. More notable declines in employment were reported by SMEs in real estate and construction, logistics, business services, and restaurants (*Table 2*). The SMEs surveyed generally expected some further decline in employment in the near term.

Regarding the credit access situation, the results of the consultation exercise showed some visible improvement in the credit market conditions in the latest rounds, especially for business services, wholesale trade, real estate and construction, and to some extent restaurants. In overall terms, the proportion of SMEs reporting very tight/tighter than usual credit access fell to about 10% in the more recent weeks from slightly above 12% in late November last year (*Table 3* and *Chart 1*). One of the important measures taken by the Government to support enterprises was the setting up of the Special Loan Guarantee Scheme, which has been in full effect since mid-December last year. This timely measure should help to ease the credit access situations facing many SMEs. Nevertheless, SMEs in some harder-hit sectors, especially import and export trades, and logistics, continued to face tighter access to credit amid the increasingly adverse trading environment.

Box 1.1 (Cont'd)**Table 2 Impact on employment as compared with normal situation**

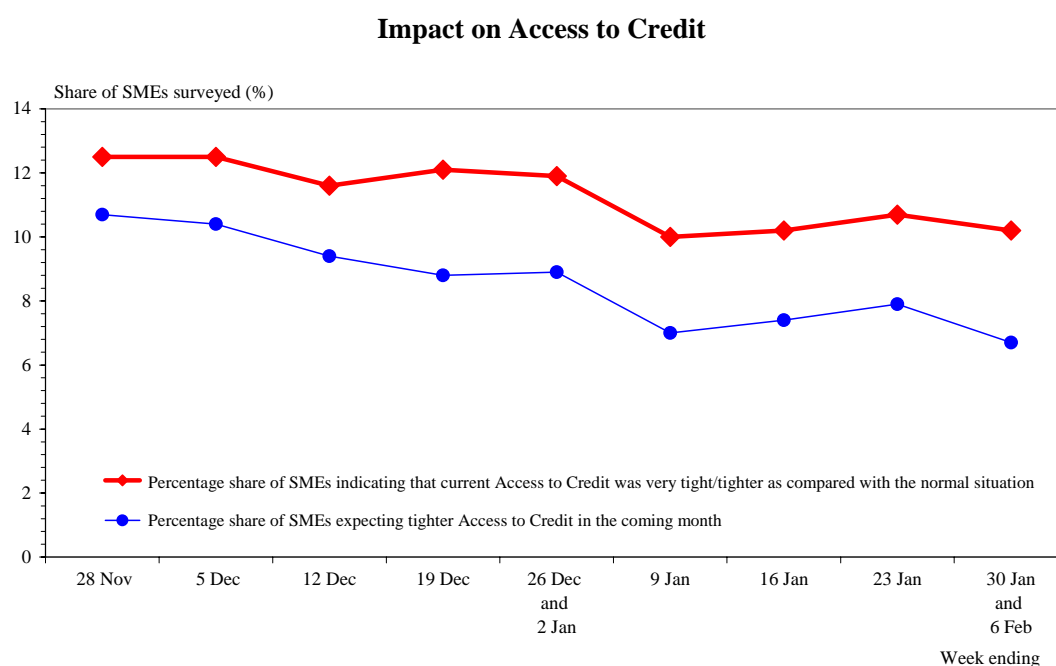
<u>SMEs by sectors</u>	% change as compared with normal situation for the week ending:-								
	<u>28 Nov</u>	<u>5 Dec</u>	<u>12 Dec</u>	<u>19 Dec</u>	<u>26 Dec and 2 Jan</u>	<u>9 Jan</u>	<u>16 Jan</u>	<u>23 Jan</u>	<u>30 Jan and 6 Feb</u>
Wholesale trade	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Retail trade	-0.6	-0.4	-0.8	-0.4	-0.6	-0.9	-0.4	-0.2	-0.7
Import and export trades	-2.3	-1.6	-0.8	-0.8	-0.9	-1.1	-0.7	-0.7	-1.1
Restaurants	-2.8	-3.1	-3.3	-2.8	-3.4	-2.9	-3.3	-3.0	-3.4
Logistics	-5.8	-6.0	-6.7	-6.7	-4.1	-4.1	-3.9	-2.8	-2.9
Travel agents	+0.5	+0.6	0.0	0.0	-0.4	0.0	0.0	0.0	0.0
Financing institutions	-0.3	-0.3	-1.0	-1.3	-0.7	-0.9	-0.7	-0.4	-1.2
Insurance agents and brokers	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real estate and construction	-7.3	-6.2	-7.6	-8	-8.1	-8.4	-8.4	-7.8	-7.9
Business services	-4.5	-2.7	-3.1	-3.2	-3.1	-3.0	-2.8	-2.9	-3.9
All the above sectors	-2.4	-1.9	-1.8	-1.7	-1.7	-1.8	-1.6	-1.4	-1.8

Table 3 Impact on assess to credit as compared with normal situation

<u>SMEs by sectors</u>	% SMEs reporting very tight/tighter credit assess for the week ending:-								
	<u>28 Nov</u>	<u>5 Dec</u>	<u>12 Dec</u>	<u>19 Dec</u>	<u>26 Dec and 2 Jan</u>	<u>9 Jan</u>	<u>16 Jan</u>	<u>23 Jan</u>	<u>30 Jan and 6 Feb</u>
Wholesale trade	12.0	9.1	9.1	9.5	10.0	5.0	5.0	5.0	5.3
Retail trade	10.0	8.5	10.1	8.5	8.8	8.0	8.0	7.1	6.5
Import and export trades	17.1	17.1	15.8	17.0	17.0	15.6	15.4	16.3	15.7
Restaurants	19.0	15.3	13.6	14.3	10.7	10.5	14.8	13.0	11.8
Logistics	0.0	15.0	5.6	11.1	11.8	11.8	11.1	16.7	17.6
Travel agents	3.3	3.6	3.6	3.7	3.8	3.7	3.6	3.6	3.7
Financing institutions	12.5	12.5	12.5	13.2	10.8	10.8	10.3	11.1	7.9
Insurance agents and brokers	15.0	11.1	10.5	5.0	10.0	10.5	5.3	10.0	5.6
Real estate and construction	11.4	11.4	8.6	9.1	5.9	2.9	5.7	5.9	5.7
Business services	5.7	5.7	5.7	6.1	6.1	0.0	0.0	0.0	0.0
All the above sectors	12.5	12.5	11.6	12.1	11.9	10.0	10.2	10.7	10.2

Box 1.1 (Cont'd)

Chart 1 Assess to credit showed some relative improvement in the more recent weeks



GDP by economic activity

1.13 The financial tsunami had a widespread impact across the real economy. Latest available figures indicated that many service sectors saw notable deceleration in net output in the third quarter of 2008. With the sentiments in the financial markets weakened considerably due to the abrupt escalation of the global financial turmoil towards the end of the quarter, financing and insurance sector experienced further deterioration to a negative growth in the third quarter. Real estates and business services also registered a negative growth as the property market cooled down. Transport and storage sector likewise moderated as trade flows receded. The consumption-related sectors (i.e. restaurants and hotels, wholesale and retail) also expanded at a slower pace as the consumer sentiment being weighed heavily by the negative wealth effect towards the end of the third quarter. For the services sector as a whole, the growth rate of net output slowed further to 1.9% in the third quarter, from 6.8% and 4.0% respectively in the first and second quarters. As to industrial sectors, both manufacturing and construction sectors posted further declines in net output.

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

	<u>2007</u>					<u>2008</u>		
	<u>2007</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>
Manufacturing	-1.5	-1.5	-2.3	-2.1	-0.3	-4.4	-4.1	-6.7
Construction	-1.1	-5.7	4.6	-1.3	-1.3	9.1	-0.6	-3.5
Services ^(b)	7.0	6.1	7.2	6.8	7.7	6.8	4.0	1.9
Wholesale, retail and import and export trades, restaurants and hotels	6.6	5.1	6.7	6.5	7.9	8.9	7.1	4.3
Import and export trade	6.0	4.6	6.4	5.7	7.1	9.6	7.7	4.9
Wholesale and retail trades	6.8	4.0	4.8	7.7	10.0	8.9	6.0	2.6
Restaurants and hotels	11.0	7.9	9.6	13.9	12.5	4.5	3.9	2.0
Transport, storage and communications	5.1	3.6	4.6	5.8	6.4	7.7	3.8	2.0
Transport and storage	5.1	3.1	4.0	6.1	7.0	8.4	3.7	1.4
Communications	5.3	6.0	7.0	4.5	3.9	4.3	4.5	4.5
Financing, insurance, real estate and business services	13.5	11.7	13.4	13.7	15.0	10.3	3.5	-0.6
Financing and insurance services	17.6	14.9	16.7	19.8	18.9	11.6	3.6	-0.8
Real estate and business services	6.4	6.2	6.6	4.5	8.3	7.8	3.3	-0.2
Community, social and personal services	1.7	2.1	1.4	1.7	1.7	0.7	1.5	1.6

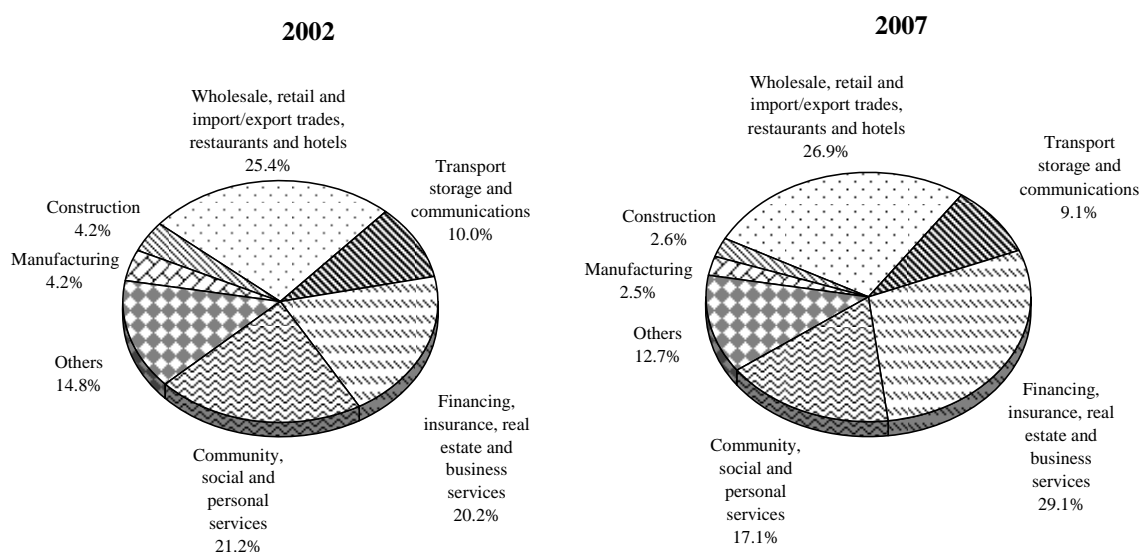
Notes : Figures are subject to revision later on as more data become available.

(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.

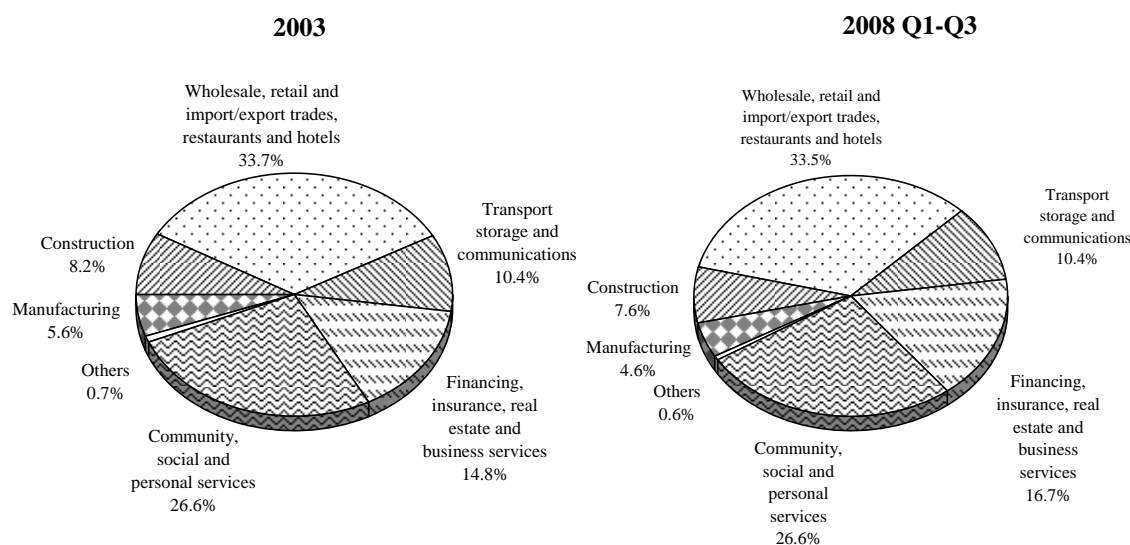
1.14 Over the past five years, the services sector continued to thrive. The on-going restructuring process towards a service-oriented economy allows Hong Kong to realize its comparative advantage, and to take advantage of the changing global economic environment as well as to meet the rising demand for high quality services from the Mainland economy and other parts of the world. Between 2002 and 2007, the contribution of the service sectors as a whole to GDP rose from 88.3% to 92.3%, while those of the manufacturing sector and the construction sector fell from 4.2% each to 2.5% and 2.6% respectively.

Diagram 1.5 : Economy becoming highly service-oriented



1.15 The Hong Kong economy has also been restructuring itself towards higher value-added and knowledge-based activities. A quality workforce which is capable of continuously upgrading the level of services remains a vital competitive edge for Hong Kong in face of the keen competition in the global marketplace. For the service sectors as a whole, the share in total employment enlarged from 85.5% in 2003 to 87.2% in the first three quarters of 2008, indicative of the flexibility of labour as Hong Kong is gearing towards a services-oriented economy. By comparison, the shares of the manufacturing sector and the construction sector shrank from 5.6% and 8.2% respectively to 4.6% and 7.6% over the same period. The transformation has been supported by the increased availability of skilled workers, as evidenced from the rise in the proportion of the workforce attaining tertiary education over the past five years from 27.2% to 31.2%.

Diagram 1.6 : Service sectors now taking up 87% of total employment*



Note : (*) These are the Composite Employment Estimates, as derived from the basic data of the General Household Survey and the Quaterly Survey of Employment and Vacancies on business establishments. Figures for 2003 refer to the annual average, while the figures for 2008 refer to the average for the first three quarters of the year.

Some highlights of economic policy

1.16 The Government is strongly committed to the principle of “Market Leads, Government Facilitates” as the guiding philosophy for its economic policy. This is well recognized by such research institute as the Heritage Foundation, which in January 2009 named Hong Kong as the freest economy in the world for the fifteenth consecutive year. In Hong Kong, the role of the Government is to create the most favourable environment so that the private enterprises can operate under a free, fair and competitive environment, enabling them to develop fully their entrepreneurship, to contribute to economic growth, to facilitate economic restructuring and to move up the value chain. This policy stance has long served Hong Kong well, and is the key factor contributing to the resilience and flexibility of the Hong Kong economy.

1.17 In response to the threat of inflation and the anticipation of an economic slowdown, the Government proactively introduced various relief measures, first in the 2008-09 Budget in February 2008 and then in mid-July 2008, with a view to reducing the burden on the livelihood of the lower income group and the less privileged arising from the run-up of inflation and to providing some stimulating impact on the economy at a time when the global economic environment was expected to worsen. These relief measures helped to lower the headline inflation effectively, especially in the latter part of the year.

1.18 Following the outbreak of the financial tsunami, the Government put forward a series of measures in the latter part of 2008 to stabilise the financial markets, support enterprises, and create employment. Indeed, the Government swiftly established the Task Force on Economic Challenges in October to assess the impact on the economy and to propose specific options to address the challenges.

1.19 In mid-October, the Financial Secretary announced two pre-emptive measures, which involved the use of Exchange Fund to guarantee repayment of all deposits held with all authorized institutions in Hong Kong, and the establishment of a Contingent Bank Capital Facility to provide addition capital to locally incorporated licensed banks when necessary. The Hong Kong Monetary Authority (HKMA) also pledged to provide liquidity assistance to licensed banks on their request through a number of temporary measures, proactively lowered the Base Rate on which the interest rates of the money borrowed by the licensed banks from the HKMA through the Discount Window are calculated, and injected Hong Kong dollar into the banking system. These actions had effectively attained the goal of stabilizing Hong Kong's financial system.

1.20 The Government also implemented measures to help ease the tight credit conditions facing the small and medium-sized enterprises (SMEs), amidst the global credit crunch. The SME Funding Schemes was expanded in October 2008. In early November, a time-limited Special Loan Guarantee Scheme was introduced, and the Scheme was substantially expanded following the announcement by the Chief Executive on 8 December 2008 after the second meeting of the Task Force on Economic Challenges. Under the expanded scheme, the Government's commitment was increased to \$100 billion, while maintaining the 70% loan guarantee.

1.21 On 8 December 2008, the Chief Executive also announced that over 60 000 jobs are to be provided through expediting infrastructure projects, advancing the recruitment of civil servants and creating temporary posts.

1.22 The Government has also worked relentlessly on the long-term development of the Hong Kong economy. It is important to raise the competitiveness of the Hong Kong economy, with a view to supporting the development of the nation, by restructuring towards higher-value-added activities, enhancing the role as an international financial centre, and further enhancing the integration with the Mainland economy, especially positioning Hong Kong strategically in the Pearl River Delta region.

1.23 The Supplement V to the Closer Economic Partnership Arrangement (CEPA) was signed in July 2008. Under the Supplement, the Central Government approved a string of services liberalization and facilitation measures for early and pilot implementation in Guangdong Province. This was echoed by the national plan issued by the National Reform and Development Commission in early January 2009, which announced that greater power of approval will be delegated to the Provincial Government of Guangdong to implement initiatives under CEPA. This should further bolster the economic integration between Hong Kong and the Pearl River Delta region.

1.24 The Central Government also rolled out a series of policy measures in helping Hong Kong to weather the financial tsunami. On 19 December 2008, the Central Government announced fourteen measures in various areas to shore up Hong Kong economy. These include: strengthening the financial co-operation between Hong Kong and the Mainland; speeding up the infrastructure projects linking the economies; spurring ahead the economic co-operation between Hong Kong and the Pearl River Delta region; providing relief to Hong Kong enterprises based in the Mainland; further liberalising the services sector in the Mainland for Hong Kong businesses; and further facilitating Mainland visitors to Hong Kong⁽³⁾.

1.25 The staunch support of the Central Government and the solid foundation of the Hong Kong economy should be supportive to Hong Kong in turning the current crisis into opportunities, and further fostering Hong Kong's status as an international financial centre and a business hub for 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.

- (3) Specifically, the 14 measures include: (1) Allow qualified enterprises to settle trade in Renminbi in Hong Kong; (2) Set up a currency swap arrangement between the People's Bank of China and the Hong Kong Monetary Authority; (3) Encourage Mainland enterprises to use Hong Kong as a financial services platform to start local and international businesses. Mainland organisations are also encouraged to set up or expand their branches in Hong Kong; (4) Support Mainland enterprises to list in Hong Kong; (5) Assist in speeding up the construction of Hong Kong-Zhuhai-Macao Bridge; (6) Support the speeding up of other selected cross-boundary infrastructure projects; (7) Endorse the "Outline of the Plan for the Development of Pearl River Delta Region" that would enhance cooperation among Guangdong, Hong Kong and Macao with a view to developing the region into a world-class metropolis circle; (8) Support Hong Kong enterprises to participate in the construction of Shenzhen Metro Line 4 with the Build-Operate-Transfer (BOT) mode; (9) Support the development of Shenzhen-Hong Kong border areas; (10) Consolidate Hong Kong's position as an international shipping centre; (11) Introduce policy measures to help SMEs, including Hong Kong-funded SMEs in the Mainland; (12) Expand further the Individual Travel Scheme; (13) Study further liberalisation measures with a view to the signing of CEPA VI as soon as possible; and (14) Ensure the stable supply of food, water, electricity and natural gas to Hong Kong.