

Hong Kong, China

The economy's sensitivity to a downturn in global trade and financial markets, as during 2008–2009, was again in evidence in 2011 when it slipped from robustness to worrying signs of another slowdown. Although 2012 began with a lift in the world outlook, Hong Kong, China's merchandise exports are expected to languish and its overall growth to slow sharply. Provided overseas markets pick up, however, a rebound should be experienced in 2013.

Economic performance

This economy had a mixed year of *yin* and *yang*. While it slowed to 5.0% for the full year (from 7.0% in 2010), growth momentum of 7.6% at the start of the year moderated progressively to only 3% by the end. Further, moderating growth in the People's Republic of China (PRC) was a concern, compounded by the reemergence of the eurozone sovereign debt crisis and faltering demand in advanced economies.

The dominant source of growth for Hong Kong, China was domestic demand. Private consumption expenditure increased by 8.6%, buoyed by strong employment and rising real incomes (Figure 3.10.1). Retail sales and visitor spending went up by 18% and 25%, powered by a jump in tourist arrivals.

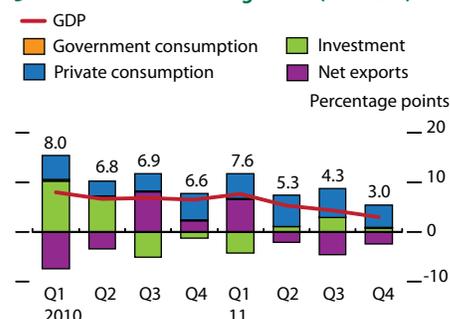
The other potential sources of growth—government consumption, investment, and net exports—made little impact. Government consumption increased by 2% and investment by only 1%. Investment actually fell in the first quarter but recovered during later quarters, led by machinery and equipment acquisition and public sector works. Merchandise exports rose much less rapidly than in 2010 and slightly less than merchandise imports, such that net exports subtracted from growth in 2011. This outcome was in marked contrast to the first quarter, when the net export position was strongly positive.

Accounting for nearly 90% of output, services set the pace for the economy as a whole. Professional and business services grew strongly, as did services related to tourism and cross-border commercial and financial services. Trade-related and transport services, however, slipped with the slowdown in merchandise trade.

Full employment characterized much of the economy. Unemployment fell to 3.3% by year-end, underemployment was less than 2%, and job vacancies surged. Wages and earnings scored their biggest gains since the mid-1990s, boosted by the tightness in the labor market and the introduction of a statutory minimum wage (Figure 3.10.2).

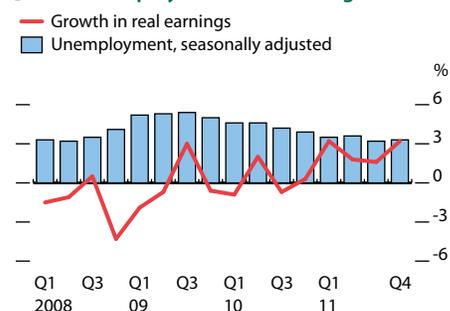
Inflation climbed sharply, to 5.3% from 2.3% in 2010, due to domestic cost pressures and imported inflation (notably for food and

3.10.1 Contributions to growth (demand)



Source: Census and Statistics Department. <http://www.censtatd.gov.hk/> (accessed 14 March 2012).

3.10.2 Unemployment and earnings



Source: Census and Statistics Department. <http://www.censtatd.gov.hk> (accessed 28 March 2012).

oil) (Figure 3.10.3). Housing prices stabilized in the second half but showed steep appreciation (7.2%) for the year as a whole. Government interventions, such as increased land supply and restrictions to mortgage availability, helped cool the property market (Figure 3.10.4).

Macroeconomic policy focused on investing in the future, as well as fighting inflation and the risk of an asset bubble. Fiscal policy helped low-income groups deal with the rising cost of living, especially food and housing-related costs, as these account for two-thirds of such groups' overall spending. Measures to moderate the cost of living included electricity subsidies and rate concessions on property taxes and public housing rentals. Netting out the effects of the government's one-time measures, underlying inflation rose at the same rate as headline inflation.

Fiscal policy for FY2011 (1 April–31 March 2012) was consolidative. Expenditure was up 22% and revenue 15%, with the result that the budget surplus narrowed to 3.5% of GDP (from 4.5% in FY2010).

Monetary policy reflected the pegged exchange rate to the United States (US) dollar and the accommodative policy of the US Federal Reserve, including low interest rates that helped maintain strong domestic demand. Similar to the US dollar, the nominal trade-weighted effective exchange rate index of the Hong Kong dollar depreciated by 2.4% in December from a year earlier.

Trade activity was deflated by the eurozone crisis, the sluggish US economy, and disruptions to global supply chains resulting from Japan's earthquake in March. Merchandise exports rose (in nominal terms) by only 11.2%, or less than half the rate of the previous year. Although the PRC accounts for over half of Hong Kong, China's exports and reexports of goods, slackening demand in the advanced markets became increasingly evident in Asian markets (Figure 3.10.5).

Services exports increased by 14%, a sharp deceleration from the gain of 23% the previous year. Tourism boomed but transport and trade-related services weakened appreciably. Despite the 20% slump in the Hang Seng index during 2011, the economy retained its rank as the world's top initial public offering center.

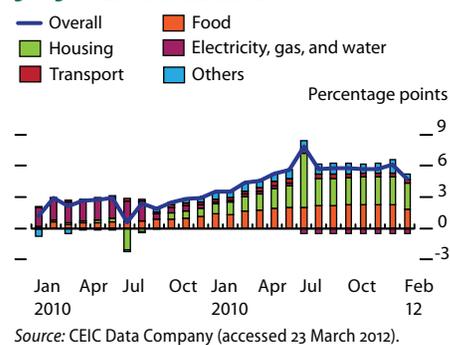
Merchandise imports climbed by 12%, again around half the rate of 2010. Retained imports, which account for one-fourth of total imports, increased by 16%, reflecting strong domestic demand and tourist spending.

Hong Kong, China continued to have a large current account surplus, equivalent to 5.1% of GDP. The positive balance for trade in services more than offset the deficit in trade in goods. The capital account was negative, with heavy portfolio investment outflows. Net foreign direct investment was substantially positive, despite outflows in the latter part of the year. Official reserves increased by US\$16.7 billion to US\$285.4 billion.

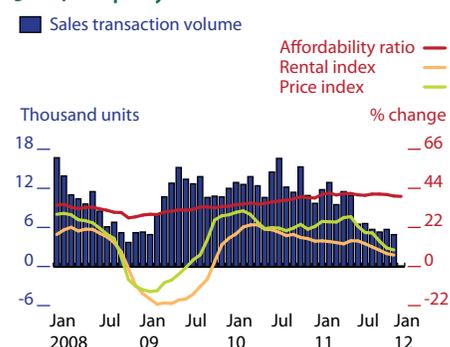
Economic prospects

The economy is highly open and trade dependent, hence growth is critically dependent on conditions of its major economic partners. The business outlook is uncertain and growth of only 3.0% is forecast for Hong Kong, China in 2012, well below the 5-year average before the global financial crisis. The forecast for 2013 is much stronger, with growth of 4.5%. This is premised on a continued, gradually improving US economy,

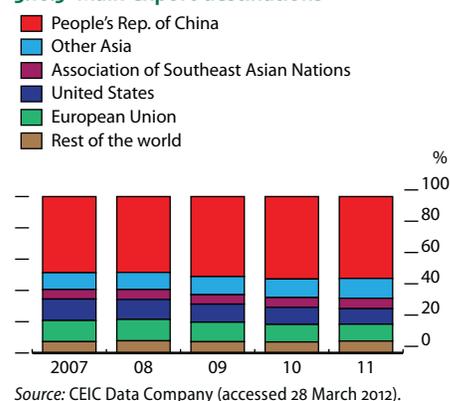
3.10.3 Sources of inflation



3.10.4 Property indicators



3.10.5 Main export destinations



easing of the eurozone crisis, and slowing but still strong growth of the PRC economy.

Private consumption will remain the main source of stimulus, supported by full or near full employment and continued income growth. A decline in investor confidence is expected to cause investment to slow sharply in 2012 but then to strengthen in 2013 as the global outlook improves. Net exports are projected to be negative in the first half of 2012—a drag on economic growth—before becoming positive toward year-end.

Most of the four “pillar industries”—financial services, tourism, trade and logistics, and producer and professional services—are expected to continue expanding at a healthy rate, abetted by the PRC. Trade and logistics, however will slow in 2012 as a result of weak growth globally.

During the forecast period Hong Kong, China will continue to deepen its economic integration with the PRC through the Closer Economic Partnership Agreement and Pan-Pearl River Delta region platforms, and continue to expand its role as an international financial and trade center. It will also continue to expand its yuan business, supported by measures that encourage citizens of the PRC to invest in Hong Kong, China stocks, that allow repatriation of the yuan, and that increase yuan-denominated bond issuance in the territory (Figure 3.10.6).

Growth of tourism will provide an important injection to the economy, helping offset weakness in the trade and logistics sector. Visitor arrivals from the PRC surged by 24% to 28.1 million in 2011, accounting for 67% of the total (Figure 3.10.7).

External trade is expected to remain sluggish in 2012. In view of weak external demand, merchandise exports will show little growth and could even decline if the PRC, US, and European Union experience an unexpected setback. Since advanced economies account for close to 30% of East Asia’s total export value, their import demand directly bears on demand for Hong Kong, China’s exports. Service exports should remain buoyant, aided by tourism and the growth of professional services to the PRC. The current account surplus is forecast to narrow to the equivalent of 5.0% of GDP in 2012 and 2013.

Average annual inflation is expected to decline to 3.8% for the year as a whole, reflecting more stable food prices and lower commodity prices, except for oil. Also, the short-term price effects of government intervention in rental housing will have worked through, with a consequent drop in the housing component in the inflation index. Inflation is expected to drop further in 2013, to 3.3%, as food and housing prices continue to stabilize.

Fiscal policy is being realigned, from fighting inflation to ensuring stability of employment and income growth. For FY2012 (ending 31 March 2013), six priority areas have been identified for budget support and government action: supporting enterprises; preserving employment; caring for people; stabilizing the financial system; increasing land supply; and strengthening social capital.

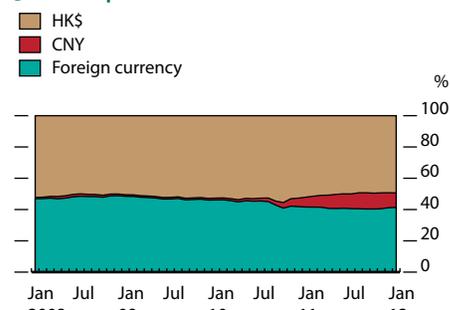
The 2012 budget indicates increased government expenditure of 7.5%, but a decrease in revenues in part because of one-time reductions in taxes on profits and salaries, waiving of business registration fees, and halving charges for import and export declarations. A budget deficit of

3.10.1 Selected economic indicators (%)

	2012	2013
GDP growth	3.0	4.5
Inflation	3.8	3.3
Current account balance (share of GDP)	5.0	5.0

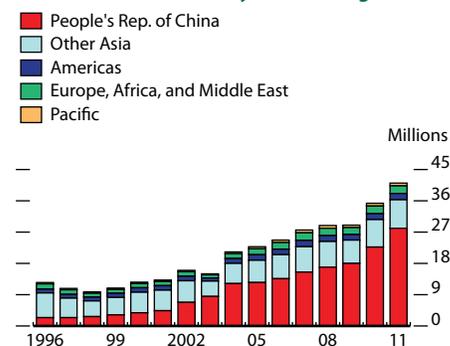
Source: ADB estimates.

3.10.6 Deposits



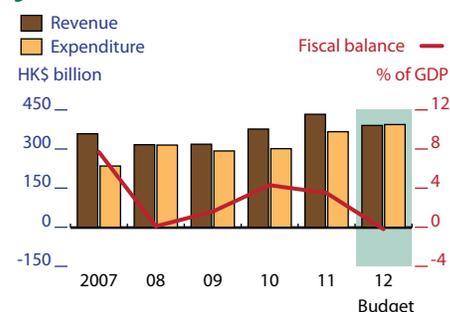
Source: CEIC Data Company (accessed 20 March 2012).

3.10.7 Tourist arrivals by area of origin



Source: CEIC Data Company (accessed 22 March 2012).

3.10.8 Fiscal indicators



Source: Hong Kong Monetary Authority, 28 March 2012.

about 0.2% of GDP is forecast (Figure 3.10.8). The government has a large accumulation of reserves in various funds established under the Public Finance Ordinance, projected to total HK\$658.7 billion by the end of FY2012 (ending 31 March 2013), or the equivalent of 34% of GDP.

Monetary policy will continue to track closely that of the US Federal Reserve, so as to maintain the currency peg with the US dollar. Low interest rates will parallel those in the US, helping to stimulate growth during the weak global environment.

The main risk to the forecast for Hong Kong, China is the possibility of a marked slowdown of the PRC economy. A jump in oil prices could also be highly disruptive of global recovery.

Policy challenge—more equitable income distribution

Hong Kong, China has one of the highest degrees of income inequality among “very high human development countries,” according to the *Human Development Report 2010*. Singapore ranks closely behind. Both economies compare more to developing than to developed countries.

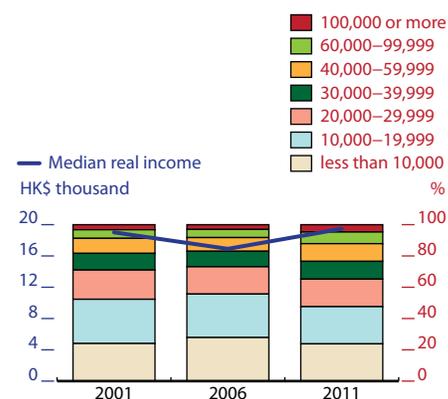
Initial results from the 2011 Population Census for Hong Kong, China provide more up-to-date information on income distribution. There was a decline in the absolute number of low-income households and a general increase in the number of households with high incomes (Figure 3.10.9). In real terms, the median income of households increased by an estimated HK\$2,564 from 2006 to 2011. Even then, the median income of HK\$19,472 in 2011 was just a few hundred Hong Kong dollars more than what it was a decade earlier. Further analysis of the census and other data is needed to better discern recent income distribution trends in Hong Kong, China.

Government expenditure for social services as a percentage of GDP has varied slightly over the past decade. Government expenditure for education was equivalent to 4.0% of GDP in 2000 but 3.6% in 2011. Expenditure on health declined from 2.5% of GDP to 2.4%. Social welfare expenditures, however, increased from 2.1% to 2.3%. The 2012 budget, which includes taxation and other forms of relief for low-income groups (e.g., public housing rental waivers), shows higher provision for social spending as a share of GDP except for housing and community amenities (Figure 3.10.10).

Strains on social services are illustrated by the long queue for public rental housing. Applicants for public rental apartments totaled 152,000 in FY2010, with an average waiting time of 2 years. According to a 2011 report by the Civic Exchange, the lowest income groups experienced deteriorating social services, housing, and employment conditions.

Conservative fiscal management and substantial accumulation of reserves allow for the provision of greater government expenditure for social services and housing—an effective means of reducing income inequality. The sound fiscal position provides scope for strategic government intervention in addressing the income distribution issue.

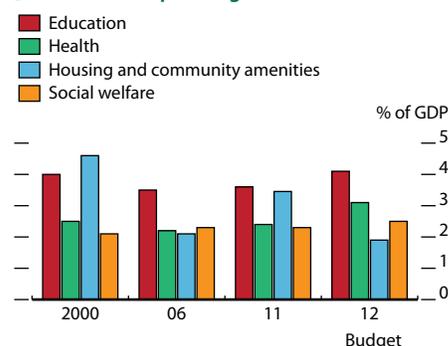
3.10.9 Household distribution by monthly income



Note: Income is in HK\$.

Source: Census and Statistics Department. 2011 Population Census. <http://www.census2011.gov.hk/en/main-table.html>

3.10.10 Social spending



Note: Housing and community amenities refer to the policy area groups on housing, community and external affairs, and environment and food.

Sources: The Government of the Hong Kong Special Administrative Region. The 2012–2013 Budget. www.budget.gov.hk. Hong Kong Monetary Authority. 3 April 2012. Asian Development Bank. Statistical Database System. sdb.sadb.org (accessed 22 March 2012).

3.10.2 Gini coefficients, 2000–2010, selected economies

Japan	0.249
Korea, Rep. of	0.316
Canada	0.326
Australia	0.352
China, People's Rep. of	0.415
Singapore	0.425
Thailand	0.425
Hong Kong, China	0.434
Philippines	0.440

Source: Human Development Report 2010.