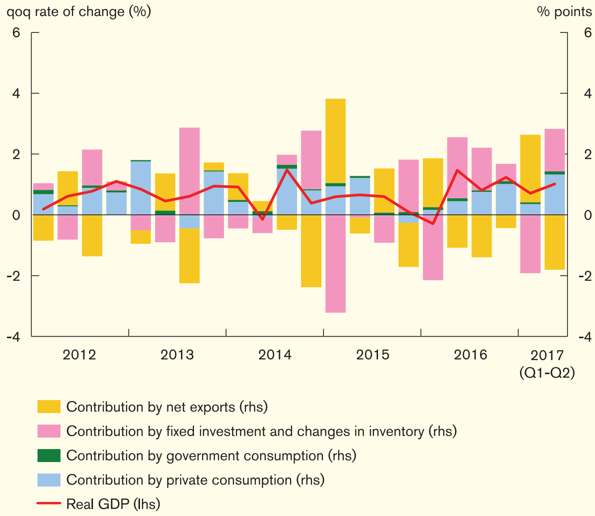
3. Domestic economy

The Hong Kong economy sustained its growth momentum during the first half of 2017 underpinned by the strength in domestic demand. Growth momentum in the second half is expected to be slightly slower but still solid amid a higher comparison base. This outlook is subject to various uncertainties including those from US monetary policy normalisation and heightened geopolitical tensions. Local inflationary pressures are likely to stay moderate with soft imported inflation and a stable increase in local costs in the near term.

3.1 Real activities

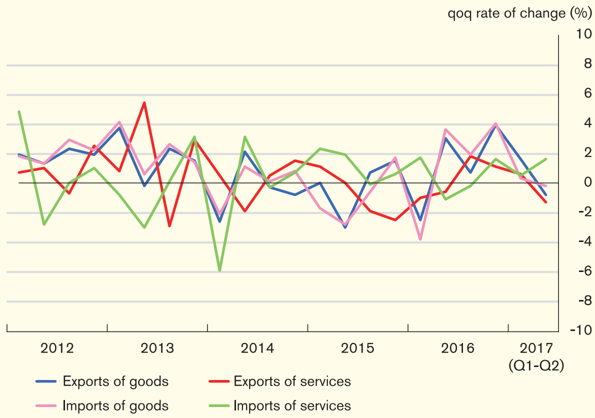
The Hong Kong economy maintained its sequential growth in the first half of 2017. On a seasonally adjusted quarter-on-quarter basis, real Gross Domestic Product (GDP) grew by 0.7% in the first quarter and 1.0% in the second, similar to the average growth rate of 1% over the preceding two quarters (Chart 3.1). Compared with the second half of 2016, private consumption held up well and continued to be one of the major contributors to GDP growth. The resilience in private consumption was partly attributable to robust job and income conditions as well as sanguine consumer sentiment. As building and construction activities remained active and capital expenditure picked up on improving business sentiment, overall investment spending revived towards mid-2017. On the external front, Hong Kong's exports of goods recorded four successive quarters of brisk growth before moderating somewhat in the second quarter (Chart 3.2). Exports of services fell back due in part to reduced demand for tourism-related services. Growth in imports of services continued amid strong travel interest among residents. Overall, net exports contributed positively to GDP growth in the first quarter, but turned into a drag on growth in the second.

Chart 3.1
Real GDP growth and contribution by major expenditure components



Sources: C&SD and HKMA staff estimates.

Chart 3.2
Exports and imports in real terms



Source: C&SD.

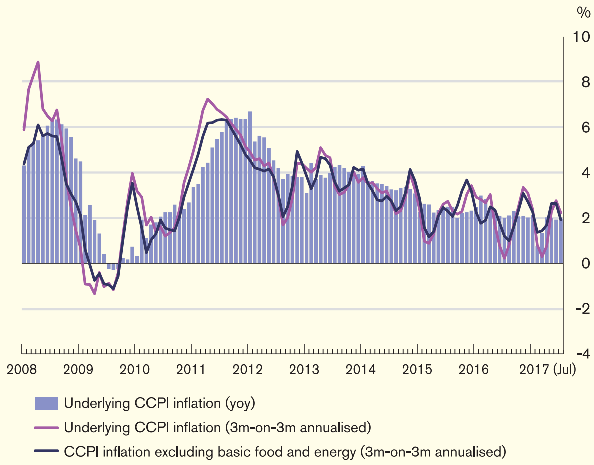
The favourable economic growth created more jobs in the first half of the year. Total employment rose by around 0.9% during the period, to over 3,800,000, led by increases in public administration, the social and personal services sector, and the retail, accommodation and food services sector. As real output growth outweighed employment growth, labour productivity improved cyclically as a result.

In the second half of the year, the Hong Kong economy is expected to sustain its growth momentum, albeit at a slightly softer, but still solid pace, amid a higher comparison base in the first half. Externally, the gradual recovery in world economic growth, international trade flows, global manufacturing activities and visitor arrivals in Hong Kong should continue to benefit Hong Kong's export performance. Domestically, private consumption is likely to hold up, underpinned by the resilient labour market. As for fixed investment, improved economic conditions will stimulate capital spending, while rising private housing supply in the primary market will support building and construction activities. For 2017 as a whole, the Government, taking into account the solid data in the first half, has revised upwards its range forecast of real GDP growth to 3–4% from 2–3% as announced earlier in February. Private-sector analysts have also recently adjusted upwards their growth forecasts to an average of 3.3%. That said, this growth outlook is subject to various uncertainties in the external environment as highlighted in the previous chapter, as well as Mainland's economic performance and the pace of recovery in inbound tourism.

3.2 Inflation and unemployment

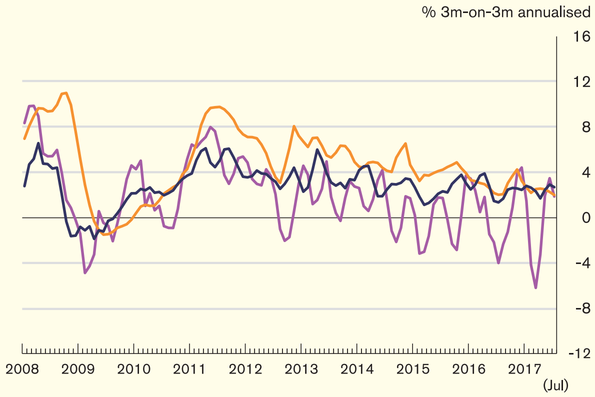
Local inflationary pressures stayed moderate in the first half of 2017, although the sequential momentum has been accelerating in recent months. On a year-on-year comparison, the underlying composite consumer price index (CCPI) picked up to 2.0% in the second quarter from 1.4% in the first quarter (Chart 3.3). Inflation momentum, as measured by the annualised three-month-on-three-month underlying inflation rate, also rose from 0.8% in April to 2.2% in July. The stronger inflation momentum was mainly driven by price increases in tradables (Chart 3.4) as their price inflation turned positive to 2.4% in the three months ending July from a negative territory in the preceding three-month period. Growth in the housing rental component of the CCPI remained soft in the first half of 2017 amid the feed-through of the earlier moderation in private residential rentals (Chart 3.5).

Chart 3.3
Different measures of consumer price inflation



Sources: C&SD and HKMA staff estimates.

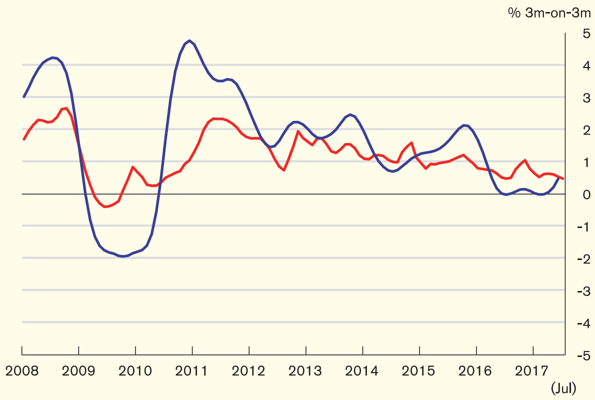
Chart 3.4
Consumer price inflation by broad component



— Tradables
— Housing rentals
— Services (non-tradables excluding housing rentals)

Sources: C&SD and HKMA staff estimates.

Chart 3.5
CCPI rental component and market rental

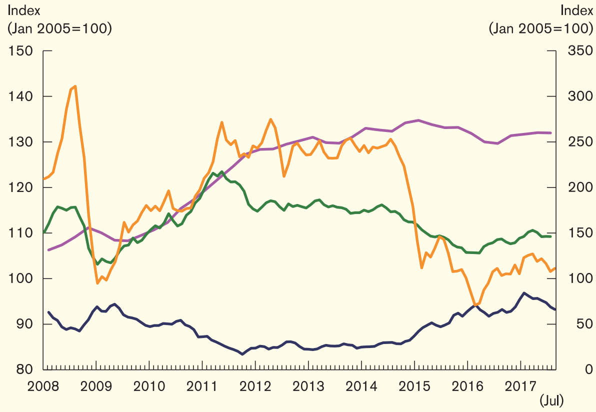


— Underlying CCPI rental component
— Residential rental (18-month moving average)

Sources: C&SD and Rating and Valuation Department.

In the near term, inflationary pressures are likely to be limited on the back of low imported inflation and moderate rises in local costs. Despite the recent rebound, external price pressures are expected to stay contained amid the mild recovery in global commodity prices (Chart 3.6). Domestically, notwithstanding the tightness in the labour market, with the seasonally adjusted unemployment rate easing from 3.4% in 2016 to 3.2% in the first half of 2017 (Chart 3.7), growth in labour costs has been modest in recent quarters. Real payroll per person rose by 1.2% in the fourth quarter of 2016 and 0.6% in the first quarter of 2017 (Chart 3.8). As the output gap is estimated to remain close to zero in the second quarter of 2017, local inflationary pressures are expected to remain tame. On the whole, the annual year-on-year inflation rate in 2017 is expected to ease, with the Government forecasting an annual underlying inflation rate of 1.8%, down from 2.3% in 2016.

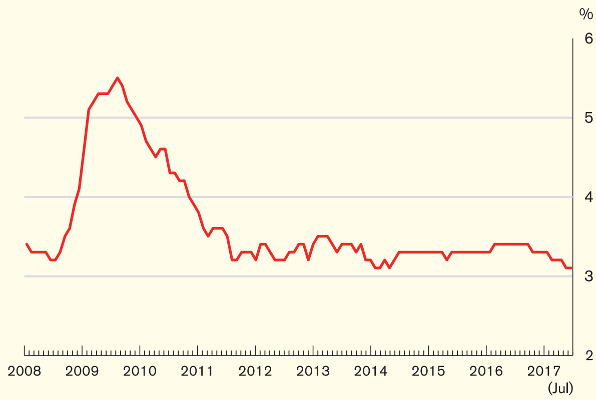
Chart 3.6
Commodity and import prices



— Oil price (rhs)
— Unit value index of imports (lhs)
— World non-fuel commodity price (rhs)
— HKD NEER (lhs)

Sources: C&SD and IMF.

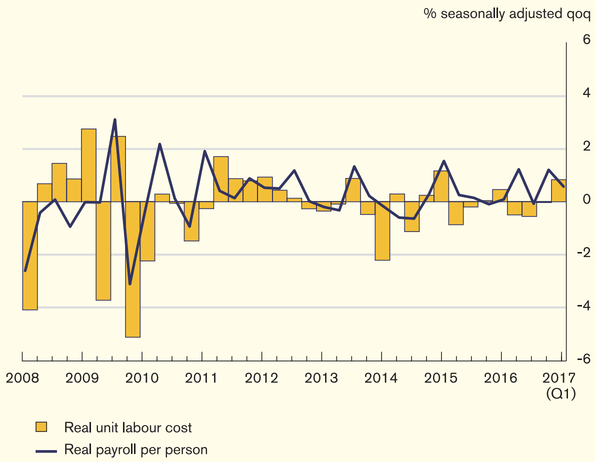
Chart 3.7
Unemployment rate



— Unemployment rate

Source: C&SD.

Chart 3.8
Unit labour cost and payroll per person



Sources: C&SD and HKMA staff estimates.

The risks to inflation outlook are tilted to the upside. The recent recovery in inbound tourism, if strengthened further, could render extra support to business performance and wage growth in retail-related industries in the period ahead. Although the upward momentum in residential property prices has shown some signs of softening since early July, the still low mortgage interest rates and stable labour market conditions could continue to support the property market and rentals in the near term. All these factors, if materialised, could bolster inflation momentum in the near term.