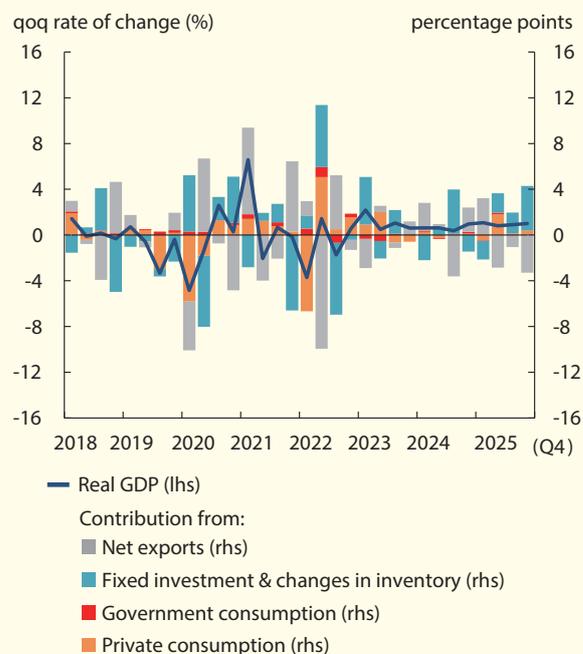# 3. Domestic economy

3.1 Real activities

The Hong Kong economy continued to grow at a robust pace in the second half of 2025, with real GDP growing by 3.7% year on year in the third quarter and 3.8% in the fourth quarter (Table 3.A). On a seasonally adjusted quarter-on-quarter basis, real GDP growth edged up to 0.9% in the third quarter, and rose further to 1.0% in the fourth quarter. For the full year 2025, real GDP expanded by 3.5%, marking a notable acceleration from the 2.6% growth recorded in 2024.

Table 3.A
Real GDP growth

		Year-on-year growth rate (%)	Seasonally adjusted quarter-on-quarter growth rate (%)
2024	Q1	+2.9	+0.6
	Q2	+3.0	+0.6
	Q3	+2.1	+0.4
	Q4	+2.5	+1.0
2025	Q1	+3.1	+1.1
	Q2	+3.2	+0.8
	Q3	+3.7	+0.9
	Q4	+3.8	+1.0

Source: Census and Statistics Department (C&SD).

Chart 3.1
**Real GDP growth and contribution by major expenditure component**

Note: Growth rates are seasonally adjusted.
Sources: C&SD and HKMA staff estimates.

During the review period, economic growth was supported by robust export expansion and a recovery in domestic demand (Chart 3.1). Externally, goods exports rose significantly on the back of strong demand for tech products amid the ongoing A.I. investment boom (Chart 3.2). Exports of services demonstrated resilience, underpinned by vibrant cross-border financial market activities and steady growth in inbound tourism[20]. Domestically, private consumption continued to pick up, as consumer confidence improved alongside rising asset prices. Meanwhile, investment spending strengthened notably amid easing trade tensions and improving financial conditions.

Chart 3.2
Export and import volume

Index (2019 =100)

- Exports of goods
- Imports of goods
- Exports of services
- Imports of services
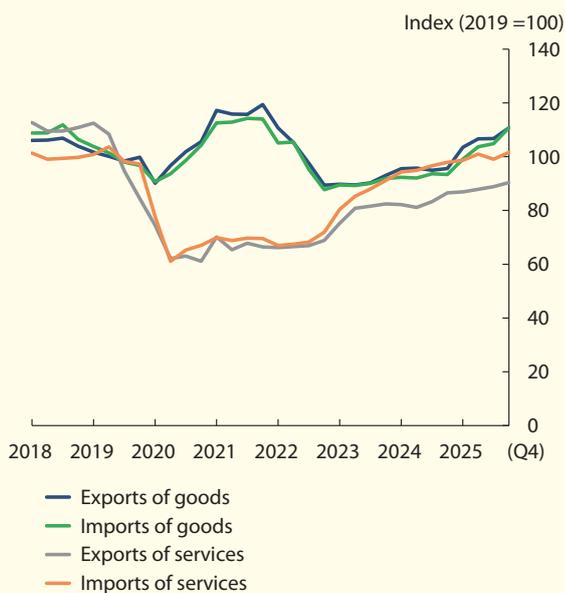
Note: The data are seasonally adjusted.
Source: C&SD.

Looking ahead, the Hong Kong economy is expected to expand moderately in 2026. Merchandise exports[21] are expected to benefit from the ongoing A.I. investment boom, and the China-US trade truce. Meanwhile, inbound tourism is poised for steady growth, driven by the continued hosting of mega events and the Government's various initiatives to revitalise the tourism sector. These developments, along with strong financial market activities, are likely to further strengthen services exports. Domestic demand is also expected to pick up. Specifically, private investment[22] is likely to gain momentum amid improved business sentiment following the China-US trade truce, while private consumption may stabilise further as increased asset prices may help boost consumer sentiment.

For 2026 as a whole, the Government projects real GDP growth in the range of 2.5% to 3.5%[23]. However, this growth outlook is subject to various risks and uncertainties as discussed in the previous chapters, particularly those related to the ongoing geopolitical tensions, the sustainability of the A.I. investment boom, evolving global trade policies and the US policy rate path. Specifically, the direct impact of the energy shock triggered by the military conflict in the Middle East is expected to be manageable, given Hong Kong's service-oriented nature, low oil-intensity structure, and relatively low weight of energy components in the consumer price index basket. However, the ultimate impact hinges on the duration and scope of the conflict. A prolonged conflict could heighten financial market volatility and potentially disrupt global growth and trade, posing headwinds to the Hong Kong economy.

---

[20] Visitor arrivals into Hong Kong reached 49.9 million persons in 2025, equivalent to 89% of the 2019 level.

[21] For the first two months of 2026 combined, the value of merchandise exports increased by 29.6% year on year.

[22] The Purchasing Managers' Index has remained in the expansionary zone (above 50) for seven consecutive months since August 2025.

[23] The latest private-sector analysts' consensus forecast on Hong Kong's real GDP growth for 2026 averaged at 2.8%.

3.2 Labour market conditions

The labour market remained relatively soft, with the unemployment rate holding steady at 3.8–3.9% since September 2025, up from the range of 3.1–3.2% in early 2025. The size of the labour force remained below its pre-pandemic level and has declined marginally from its recent peak in August 2025 (Chart 3.3). Notably, the LFPR has declined in recent years, particularly among the youth. Box 3 examines the potential drivers behind this trend. Looking ahead, labour demand is expected to remain broadly stable. However, structural shifts in the economy may continue to pose challenges for certain sectors. The Government will continue to strengthen Hong Kong's talent pool through a range of initiatives to support ongoing economic transformation and address labour shortages in targeted industries.

Chart 3.3
Labour market conditions
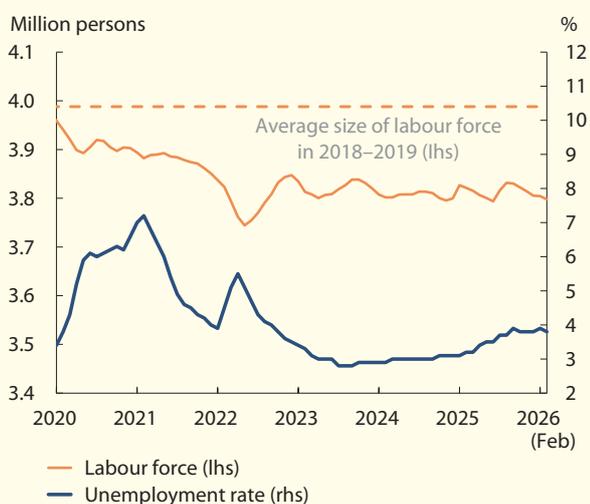
Note: The unemployment rate is seasonally adjusted.
Source: C&SD.

3.3 Inflation

Consumer price inflation has remained modest over the past few months. On a year-on-year basis, the underlying composite consumer price index rose by approximately 1.0% in the third quarter and 1.1% in the fourth quarter of 2025, and by 1.3% in the first two months of 2026[24] (Chart 3.4). Looking ahead, the increase in housing rentals in previous quarters will gradually feed through to inflation, while the energy shock triggered by the military conflict in the Middle East could pose upward pressure on import prices. However, overall inflation is expected to remain contained, as energy components account for a relatively small share of the consumer price index basket, while other domestic cost pressures are anticipated to remain mild, supporting a stable inflation outlook. The Government projects the underlying and headline inflation rates to be 1.7% and 1.8%, respectively in 2026[25].

Chart 3.4
Underlying consumer price inflation and its drivers

Sources: C&SD and HKMA staff estimates.

---

[24] Data for the first two months are averaged to remove the year-on-year change fluctuation due to the different timing of the Chinese New Year.

[25] The market consensus forecasts for the headline inflation rate for 2026 is 1.7%.

Box 3
Understanding the evolution of youth labour force participation rate in Hong Kong

Introduction

The LFPR, defined as the proportion of the working-age population who are either employed or actively seeking employment, is a key indicator for tracking the labour market conditions from a supply-side perspective. In Hong Kong, despite occasional short-term fluctuations, the overall LFPR[26] has generally shown a downward trend over the past four decades, with the decline accelerating in recent years (Chart B3.1).

Chart B3.1
Overall LFPR and LFPRs among selected age groups in Hong Kong

Participation rate (%)

— Aged 15–19
— Aged 20–24
— Aged 65 and above
— Overall
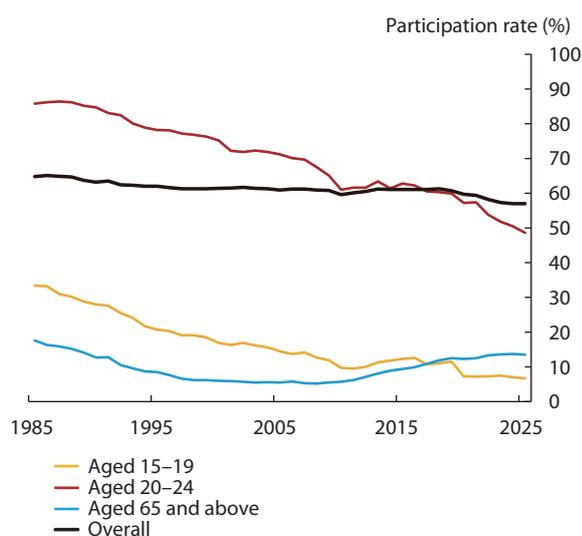
Source: C&SD.

This long-term decline reflects primarily local structural demographic changes, including population aging and persistently low birth rates. However, a closer examination of the data reveals divergent trends across age groups. The LFPR of the elderly (i.e. aged 65 and above) has bottomed out in the early 2000s and has persistently increased since 2008, contributing positively to the overall LFPR. In contrast, the LFPRs among the youth aged 15–19 and 20–24 have dropped significantly. Between 1985 and 2005, participation among those aged 15–19 and 20–24 declined by 18.9 percentage points (ppts) and 14.6 ppts, respectively. Over the subsequent two decades, from 2005 to 2025, these declines continued, with further reduction of 7.8 ppts and 22.6 ppts, bringing the LFPR for these age groups to 6.7% and 48.6% respectively by 2025. Notably, the decline in the 20–24 age group has accelerated in recent years. This downward trend in youth LFPR is not unique to Hong Kong, as similar trends have also been observed in other economies, such as Singapore and South Korea.

This box explores the potential factors underlying the decline in youth LFPR[27] in Hong Kong using a cohort-based model developed by Fallick and Pingle (2007)[28]. As detailed in the next section, the model breaks down the evolution of age-specific LFPR into effects from observed time-varying determinants and other unobserved influences captured by age and cohort effects. This approach enables a clear understanding of life-cycle labour force behaviour and how participation patterns have shifted across generations and over time.

Methodology and data

The cohort-based model captures age effects by assuming that an individual's propensity to participate in the labour force varies systematically across the life cycle. Participation tends to be higher during prime working ages, while it is relatively lower among younger individuals and those approaching retirement. Apart from age effects, the model also assumes

---

[26] Refers to the LFPR including foreign domestic helpers. The trend remains consistent with that of the LFPR excluding foreign domestic helpers at both aggregate and disaggregate levels.

[27] Since most individuals aged 15–19 are engaged in education, this study focuses on youth aged 20–24.

[28] For details, please see Fallick, B., & Pingle, J. F. (2007). A cohort-based model of labor force participation. *Finance and Economics Discussion Series*, Board of Governors of the Federal Reserve System.

the existence of cohort effects, which capture unobserved factors influencing the propensity to participate among individuals in the same birth cohort. For example, men born in 1976 may on average exhibit a higher likelihood to work than those born in 2004. Beyond age and cohort effects, three additional time-varying factors are included in our model as independent variables to capture the following effects: business cycle[29], educational attainment[30] and fertility[31].

Following Balleer et al. (2009)[32], we use the log odds of LFPR as the dependent variable. This measure captures the relative likelihood of labour force participation versus non-participation, and allows meaningful comparison of the estimated results across different age and gender groups on a consistent scale.

The demographic data are obtained from the General Household Survey and the Demographic Statistics Section of the C&SD. Given the constraints on degrees of freedom and the focus of this study on younger generations, the model covers only cohorts born between 1976 and 2004. These groups correspond to seven five-year age groups, covering individuals aged 15 to 49.

Model estimation

Following the literature, we estimate the model using the seemingly unrelated regression (SUR) approach[33]. The main empirical results are presented in Chart B3.2. Panel A shows an inverted U-shaped relationship between age and LFPR, with notable differences by gender. For males, LFPR remains relatively high after the age of 20. In contrast, female LFPR peaks at the age of 30–34 and declines notably thereafter, stabilising from the age of 40 onward.

Panel B displays the cohort effects, which show a persistent decline in the propensity to participate in the labour force across successive birth cohorts for both males and females. This suggests that younger generations are increasingly less willing to enter or remain in the labour market. According to the literature, this shift can be attributed to factors such as evolving social norms, changing cultural attitudes toward work, and increasing household wealth.

Panel C highlights the significant negative impact of educational attainment on youth LFPR, suggesting that higher educational attainment significantly drags down the likelihood of youth entering the labour force, except for females aged 25–29. The adverse effect of educational attainment on the odds of LFPR is notably more pronounced among males. Our findings align with the C&SD's survey results, which indicate a substantial increase in the share of youth aged 20–24 enrolled in full-time education in recent years. In tandem, among youth in the same age group who are not in full-time education, LFPR has remained high. This suggests that factors other than pursuing education have had a relatively limited influence on youth labour force participation.

---

[29]   The business cycle is measured by the contemporaneous value and the two lags of the output gap. In particular, the output gap is estimated by the HKMA based on four methods, namely (1) the production function approach; (2) the Hodrick-Prescott filter; (3) the Kalman filter; and (4) the IMF multivariate filter. For details, refer to Cheng, M., L. Chung and I. Yu (2011), "On the Estimation of the Output Gap of Hong Kong", *HKMA Occasional Paper* 03/2011.
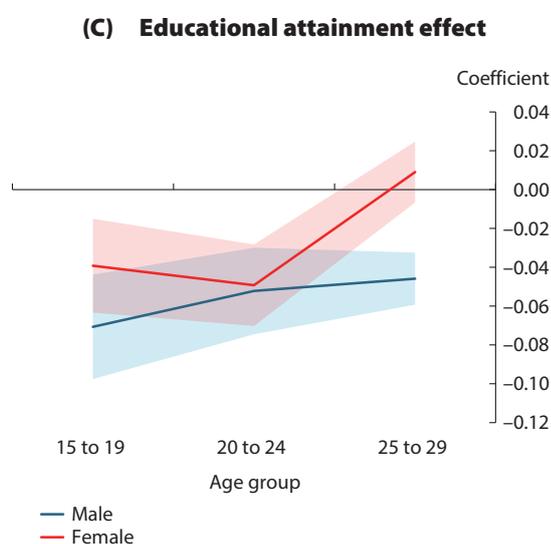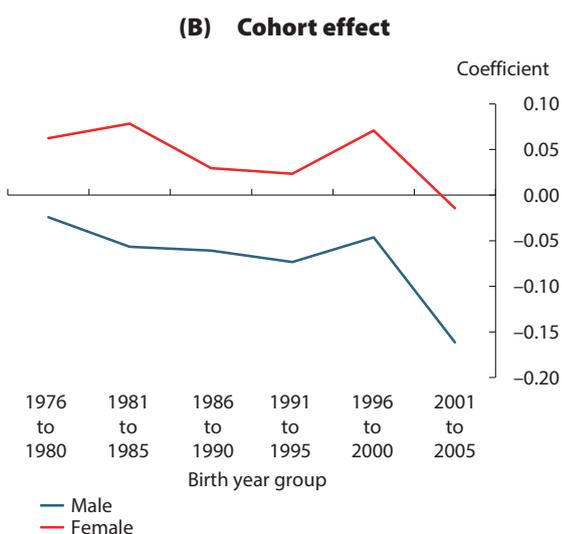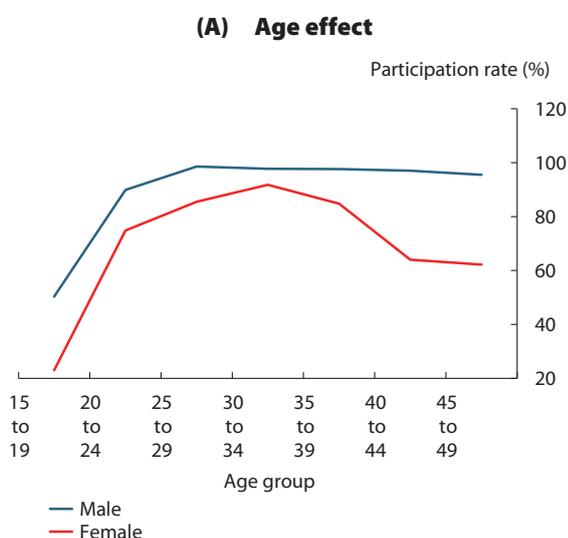
[30]   Educational attainment is represented by the share of employed individuals aged 25 and above who have ever attained a post-secondary degree. This variable is only included in the equations for the three youngest age groups (i.e. 15–19, 20–24 and 25–29).

[31]   Fertility is captured by the total fertility rate, and is included only in the equations for females aged 20 to 39, the ages during which fertility is most likely to occur.

[32]   For details, see Balleer, A., Gómez-Salvador, R., & Turunen, J. (2009). Labour force participation in the euro area: a cohort based analysis (No. 1049). *ECB Working Paper.*

[33]   In particular, we use the SUR approach to estimate the system of equations for seven age groups simultaneously, with separate models for males and females. The cohort effect is constrained to be identical across age groups within each generation.

Chart B3.2
Estimated effects for age, cohort and educational attainment

(A)   Age effect

Participation rate (%)

Age group

— Male
— Female

(B)   Cohort effect

Coefficient

Birth year group

— Male
— Female

(C)   Educational attainment effect
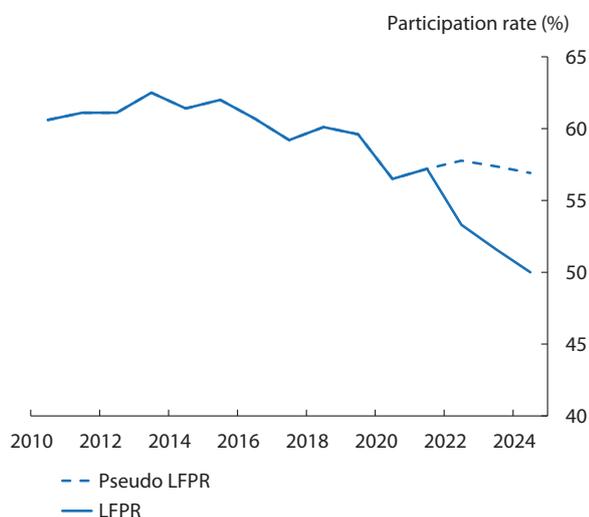
Coefficient

Age group

— Male
— Female

Sources: C&SD and HKMA staff estimates.
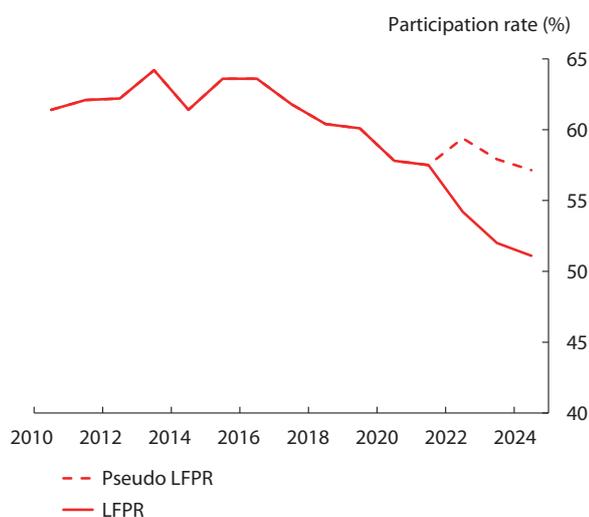
Counterfactual analysis on educational attainment

Building on the above findings, we conduct a counterfactual analysis to estimate the potential youth LFPR under a scenario in which educational attainment is held constant at its 2010–2021 average for the period 2022 and beyond. The results suggest that the LFPR among youth aged 20–24 during 2022–2024 would have been, on average, 5.7 percentage points higher for both males and females (Chart B3.3). This implies that rising educational attainment has been a key factor contributing to the observed decline in youth LFPR in recent years. Since full-time students are less likely to be employed or actively seeking work, pursuing higher education often postpones labour force entry. As a result, increasing educational attainment arithmetically leads to a decline in LFPR.

Chart B3.3
Counterfactual analysis on youth LFPR

(A)   Male

Participation rate (%)

- - - Pseudo LFPR
—— LFPR

(B)   Female

Participation rate (%)

- - - Pseudo LFPR
—— LFPR

Sources: C&SD and HKMA staff estimates.

The upward trend in youth pursuing higher education can be attributed to two factors. First, a shrinking youth population resulting from declining birth rates, combined with the increased availability of post-secondary education programmes, has increased access to higher education. Secondly, the growing propensity of youth to pursue higher education may reflect rising labour market demand for higher-skilled workers, and a shift in youth's career preferences toward higher-skilled and knowledge-intensive occupations.

Concluding remarks

To conclude, our analysis shows that an increasing share of young people remaining in or returning to education has been a key driver behind the recent decline in the LFPR among those aged 20–24. Looking ahead, while prolonged years in education may weigh on youth LFPR, the human capital accumulated through enhanced education should help improve local productivity, foster sustained economic growth, and support Hong Kong's ongoing transition towards a knowledge-based economy. In parallel, the Government's various talent admission and development programmes introduced in recent years could help strengthen the workforce and address skilled labour shortages in targeted industries. Yet, due to the limited number of available control variables, our model may not fully capture all factors influencing labour force participation. Nevertheless, a series of robustness checks and the evidence from the C&SD's surveys consistently reinforce the main findings of this study. Separately, given the rapid pace of technological advancement, the impact of A.I. on labour market also warrants close monitoring.