ECONOMIC REVIEW (A Monthly Issue) December, 2015

BANK OF CHINA (HONG KONG) LIMITED Economics & Strategic Planning Department http://www.bochk.com

Hong Kong Economy Will Continue Its Moderate Growth Trend

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Another year of moderate growth in 2015

In the first three quarters of 2015, Hong Kong economy expanded 2.5% in real terms, continuing its moderate growth trend of 2.4% and slowing markedly from the 3.9% average over the past decade. This was largely due to the subdued global economic recovery, moderate Mainland's economic momentum, weak trade-related and inbound tourism activities, as well as local labour and land constraints. A 2-3% growth trend is now the new normal for the Hong Kong economy, with the characteristics of this year growth summarised as follow:

1. Weak external environment and strong US dollar exchange rate affected Hong Kong's external competitiveness. The advanced economies have yet improved from the weak recovery since the global financial crisis. The growth momentum of the US was much weaker than the past economic cycles. The Eurozone economy has yet returned to the stage of full recovery and still suffered from the aftermath of its debt crisis, with divergent performance among its member states. The Japanese economy remained stagnant in the last two quarters. The emerging and developing economies also faced intense downward pressure. Not only did the Mainland economy undergo a period of rebalancing, those commodity exporting countries, like Russia and Brazil, have even entered into recession amid the weak commodity price environment. As a result, market concern over global and Mainland economic outlook intensified, together with the rising expectation of a US rate hike, leading to sharp capital outflows from the emerging economies and significantly affecting the trade activities in the region. Moreover, the Hong Kong dollar exchange rate also strengthened notably under the linked exchange rate system, and resulted in a 2.2% contraction in real terms in Hong Kong's total exports of goods in the first three quarters of 2015 over the previous year.

2. Tourism industry slowed, negatively affecting exports of services performance. There were several reasons attributed to the weakness of inbound tourism. For example, the weaker-than-expected global economic performance, strong Hong Kong dollar exchange rate, limited new tourism hotspots, no further expansion of the individual visitor scheme of Mainland tourists, and the preference of economically better-off Mainland tourists to visit other places around the world. Against this background, the number of visitor arrivals declined 0.8% in the first ten months of 2015 over the previous year, and the number of higher spending overnight visitor arrivals declined notably by 4.0% during the same period, with the number of

overnight long-haul (including the Americas, Europe, Africa, Middle East and Australia, etc.), short-haul (not including the Mainland) and Mainland visitors declining 1.6%, 2.7% and 4.7% respectively. As such, Hong Kong's exports of tourism services declined 3.9% in real terms in the first three quarters of 2015 over the previous year, leading to a 0.1% contraction in overall exports of services during the same period.

3. Domestic demand held up well on the back of full employment. With the subdued external environment, Hong Kong's economic growth was mainly supported by resilient domestic demand over the past few years. Since the second half of 2011, the employment market has continued to be in the state of full employment. Even though there is increasing concern over lower skilled employment segment amid the more challenging global and Mainland economic outlook, weaker tourism and retail performance and the strong Hong Kong dollar exchange rate affecting Hong Kong's external competitiveness, the employment market remained largely steady and the unemployment rate stayed at 3.3% between August and October 2015, within the low level of 3.1%-3.5% since the second half of 2011. Moreover, employment income continued to grow and the monthly median household income also grew notably in real terms, in particular after the upward adjustment of statutory minimum wage rate in May 2015 and subdued inflationary pressure. The steady employment and better income prospect has, no doubt, supported Hong Kong domestic condition, with the private consumption expenditure increasing 5.2% in the first three quarters of 2015 over the previous year, higher than the 4% average in the past three years.

4. Relatively healthy asset markets also supported domestic demand, despite increasing downward pressure. This round of property up-cycle has lasted nearly 12 years, increasing more than 4.2 folds from its low in 2003. Against the background of limited supply, low interest rate environment and solid employment market, the residential property prices in Hong Kong rose 8.7% in the first ten months of this year. Moreover, the equity markets in Hong Kong followed the Mainland's buoyant performance in the second quarter, with daily turnover once increasing to a fresh record high of over HK$200 billion. As a result, the relatively healthy property and equity markets have supported domestic demand. However, following the Mainland and global financial markets correction, the equity markets in Hong Kong declined sharply in the third quarter. Together with the concern over global economic slowdown and an interest rate hike by the US Federal Reserve, the residential property prices are now facing increasing downward pressure. Fortunately, the property market is mainly driven by owner-occupiers, with the proportion of transactions at sharply discounted prices remaining low. According to the property agency data, the residential property prices declined roughly 4.8% from its peak in September to the end of November (the government data showed a decline of 1.1% in October), relatively mild compared to its huge increase over the past decade and has yet seriously affected the overall economy.

Global economy is expected to be slightly better than this year

Hong Kong is a small and open economy, which is highly sensitive to the external environment, with the exports of goods and services to GDP ratio reaching 440%. The International Monetary Fund (IMF) expected the global economic growth next year to be slightly better than this year --

increasing 3.6% in 2016, being the fastest growth rate since the 4.2% growth in 2011. The IMF also expected the advanced economies will improve next year -- accelerating by 0.2 percentage point to 2.2%, with the US economic growth reaching 2.8%, while the Eurozone and Japan will increase by 1.5% and 1.0% respectively. Meanwhile, the emerging and developing economies are also expected to recover from the sluggishness this year. Its economic growth is expected to accelerate by 0.5 percentage point to 4.5%, in particular both Russia and Brazil, which are the large commodity exporting countries, should improve from the recession this year. Nevertheless, the IMF's forecasts are normally quite optimistic, with its past projections had to be revised down subsequently.

The US economy maintained its moderate growth trend, with the average real GDP growth reaching 2.6% in the first three quarters of 2015 over the previous year. The US employment market remained strong, with the unemployment rate declining to 5.0%. The improvement of real disposable personal income, together with the stable housing market, is likely to support private consumption growth, even though the strong US dollar exchange rate and weaker than expected global economy might hurt its manufacturing industry. Going forward, the US Federal Reserve is likely to raise interest rate in its December meeting, but its pace of tightening is going to be very gradual, with no more than two to three hikes next year, amid the highly uncertain global environment. Given its upcoming interest rate hike cycle is expected to be shallow and short, the economic impact on the US economy is likely to be contained. Moreover, with the low oil prices, neutral fiscal stance, and better financial condition of the private sector, the US economy is likely to post the best performance among the advanced economies.

The Eurozone economy continued its recovery. Amid the low euro exchange rate, low energy prices, low interest rate and the European Central Bank's (ECB) quantitative easing (QE) policy, etc., the real GDP expanded 0.3% and 1.6% in the third quarter over the previous quarter and previous year respectively. However, the economic performance among different member states was mixed. Some of them were still affected by the fiscal austerity measures, while others were affected by the elevated unemployment problem. In addition, the generally low inflation rate of all major member states hindered them from achieving the ECB's 2% medium term inflation target. Against this background, the ECB decided to cut its deposit rates further and extend its QE programme to March 2017 at its December meeting, potentially supporting economic growth next year. Separately, the large influx of refugees is likely to boost the short-term growth prospect, while the long-term impact will depend on whether those refugees could be successfully integrated into the European society. Moreover, the recent terrorist attack in Paris not only likely affects local consumption and tourism activities, but also triggers potential disagreement over creating a closer European Union in the future.

Downward pressure on the Mainland economy remained. After the real GDP growth slowed to 6.9% in the first three quarters of 2015 over the previous year, most of the economic indicators still pointed to a weak momentum of the Mainland economy. The exports, industrial value-added and fixed asset investment remained subdued, and all these were attributed to the weaker than expected global economic recovery, the continuous correction of the property market, the relocation of manufacturing facilities to Southeast Asia. The flourishing performance of the newly developed sectors has yet to sufficiently offset the slowdown of the traditional sectors. Fortunately, the Mainland economy is still growing within a reasonable range, with infrastructure and service sector investment, as well as the retail sales performance holding up relatively well. This indicated that the Mainland economy is likely to stabilise gradually. Going forward, the 13^{th} five-year plan stated that the Mainland will build a moderately prosperous society by 2020. To this end, the Mainland will strive to maintain a medium to high growth rate and to double the national GDP and urban residents and rural household disposable income from its 2010 level, implying a minimum of 6.5% annual growth rate is required between 2016 and 2020. This will also involve accelerating the development of high-end manufacturing, raising consumption contribution to GDP, speeding up hukou-based urbanisation, etc. As such, stabilising growth remains a top priority for the Mainland government and it is believed that there will be more policy room to stabilise economic growth ahead.

In view of the divergent growth outlook globally, the monetary policy stance among the major central banks is likely to be diverge and the global monetary and economic outlook will be more difficult to gauge. Even though the US Federal Reserve is preparing for the normalisation of its monetary policy, its future interest rate path remains uncertain, given the market has yet reached a consensus on what constitutes a gradual rate hike cycle. In addition, the ECB and Bank of Japan will continue or even extend their QE programmes. If the US Federal Reserve raises rate in December and the ECB announced rate cut and extended its QE programme nearly at the same time, the volatility of financial markets (including foreign exchange, equity, bond and commodity markets) and the global capital flows are likely to increase notably. Those economies with weaker fundamental might face a new round of capital outflows, resulting in elevated downside risk to the global economy.

Another year of moderate growth in 2016

As mentioned above, the global economy is only expected to be slightly better than this year. The US dollar and Hong Kong dollar exchange rates will likely stay high against the background of interest rate hike, together with the continuous transformation and relocation of manufacturing activities in the Mainland, the trade performance of Hong Kong is unlikely to improve visibly ahead. At the same time, inbound tourism activities are expected to remain anemic, unless there is further expansion of the individual visitor scheme of Mainland tourists. Fortunately, the pace of decline in exports of goods and services might be alleviated, given a lower comparison base after a year of correction. It is anticipated that domestic demand will remain the growth driver of Hong Kong in 2016.

In respect of domestic demand, there are five main factors that will likely support the moderate growth of Hong Kong's domestic activities. First, the conditions necessary for rate hikes following that of the US have not been met for banks in Hong Kong. As mentioned before, the upcoming rate hike cycle in the US is likely to be shallow and short. Recalling the time after the subprime crisis, the banks in Hong Kong only cut its prime interest rate by 3 percentage points when the US Federal Reserve had cut its Fed Fund target rate by more than 5 percentage points. Moreover, Hong Kong has been attracting over HK$ 1.05 trillion of capital inflows (as measured by the changes in the aggregate balance of the banking system and the outstanding Exchange Fund bills and notes) since the major central banks launched their QE programmes. Given the ample liquidity in Hong Kong, the interbank rates here will likely remain low for an extended period. Therefore, banks in Hong Kong have the conditions not to follow the US rate hikes next year. It will help alleviate the impact of higher interest rate on the overall economy, investment and property market in Hong Kong.

Second, Hong Kong property market is only expected to consolidate modestly. The future property price movement will depend on interest rate, land supply, and the overall economic condition, etc. As mentioned above, banks in Hong Kong have the conditions not to follow the US rate hikes next year, while land supply could only be increased gradually. The shortage of housing supply problem was rather severe over the past decade which is difficult to improve in the near-term. Furthermore, the government has adopted a number of demand management measures in the past few years which can be adjusted flexibly according to different market conditions. As such, it is expected that, if there is no unexpected global financial crisis or recession, Hong Kong property prices will only be adjusted by single digit level next year. The probability of a sharp plunge is rather low, hopefully not notably affecting the private consumption performance next year.

Third, Hong Kong employment market is expected to remain stable. It is no doubt that the import-export trade, tourism and retail sectors of Hong Kong are now facing rising challenges, which will also have negative impact on their respective employment segments. However, Hong Kong has continued to be in a full employment condition since 2011, with a number of sectors such as food and beverage service activities, elderly care and construction, etc, facing the problem of labour shortage. Together with the relative high private sector vacancies over 78,000, it is believed that, unless the global economy turns sour rapidly and affects Hong Kong's economy, the probability of massive layoffs and sharp rise in unemployment rate is low. Meanwhile, given the inflationary pressure of Hong Kong will remain moderate ahead, the real employment income growth should continue to support consumption performance ahead.

Finally, the financial sector and infrastructure investment will be the main drivers of economic growth. In respect of the financial sector, Hong Kong will continue to play its unique role as the major springboard for Mainland companies to go global and foreign companies to come to the Mainland, given the advantage of 'One Country, Two Systems'. Hong Kong will continue to benefit from the opportunities arising from the further opening up of Mainland's financial markets, the financial markets connect between Mainland and Hong Kong, RMB internationalisation, the Belt and Road Initiative and the 13th five-year plan, etc. If there are more financial market liberalisation measures next year such as the expansion of Shanghai-Hong Kong Stock Connect, the launch of Shenzhen-Hong Kong Stock Connect, QDII2, etc, it is likely to attract more Mainland and foreign investment for Hong Kong and bring new opportunities to Hong Kong financial market and industry ahead.

The fiscal condition of Hong Kong government is strong, with no debt and huge fiscal reserve. Hong Kong has the condition to enhance infrastructure and building investment. The forecasted expenditure of Capital Works Reserve Fund will continue to increase from HK$ 75.4 billion in this fiscal year to HK$ 103.8 billion in the fiscal year 2019/20, increasing at an annual average of 6.6%. Therefore, infrastructure, public housing and private housing projects are likely to increase on the back of government support. The overall economy will also benefit from stronger infrastructure investment which could help pave the way for more healthy growth ahead.

All in all, Hong Kong economic growth is expected to reach 2.5% next year, roughly at the same pace of this year, given the slightly improved external environment and largely steady domestic condition. On the inflation side, the upside risk of inflation remains contained in the near-term, given the moderate global inflation, subdued commodity prices and limited local cost pressure, for example, rental. The underlying composite consumer price inflation will likely increase 2.2% next year, lower than the 2.6% this year.

Gross Domestic Product,
its main expenditure components and consumer price indicator
(Year-on-year rate of change, %)

	2011	**2012**	**2013**	**2014**	**2015 (Estimate)**	**2016 (Forecast)**
Change in real terms of GDP and its main expenditure components (%)						
Private consumption expenditure	8.4	4.1	4.6	3.2	4.7	2.8
Government consumption expenditure	2.5	3.6	3.0	3.0	3.0	3.0
Gross domestic fixed capital formation	10.2	6.8	2.6	-0.2	2.0	2.5
Total exports of goods	3.5	1.9	6.5	0.8	-2.4	1.1
Imports of goods	4.7	3.0	7.2	0.9	-2.8	0.9
Exports of services	5.5	2.2	4.9	0.9	-0.5	0.3
Imports of services	3.5	1.9	1.5	1.9	4.5	3.8
Gross Domestic Product	**4.8**	**1.7**	**3.1**	**2.5**	**2.5**	**2.5**
Change in the consumer price indicator (%)						
Underlying composite consumer price index	**5.3**	**4.7**	**4.0**	**3.5**	**2.6**	**2.2**

主要經濟指標 (Key Economic Indicators)

一 . 本地生產總值 GDP	2013	2014	2015/Q2	2015/Q3
總量 (億元) GDP($100 Million)	20,961	21,446	5,332	5,717
升幅 (%) Change(%)	2.9	2.3	2.8	2.3
二 . 對外貿易 External Trade	**2013**	**2014**	**2015/10**	**2015/1-10**
外貿總值 (億元) Total trade($100 Million)				
港產品出口 Domestic exports	544	553	36	395
轉口 Re-exports	35,053	36,175	3,160	29,428
總出口 Total exports	35,597	36,728	3,196	29,823
進口 Total imports	40,607	42,190	3,492	33,438
貿易差額 Trade balance	-5,010	-5,463	-297	-3,616
年增長率 (%) YOY Growth(%)				
港產品出口 Domestic exports	-7.6	1.7	-18.2	-15.2
轉口 Re-exports	3.8	3.2	-3.5	-1.5
總出口 Total exports	3.6	3.2	-3.7	-1.7
進口 Imports	3.8	3.9	-8.5	-3.6
三 . 消費物價 Consumer Price			**2015/10**	**2015/1-10**
綜合消費物價升幅 (%) Change in Composite CPI(%)	4.3	4.4	2.4	3.2
四 . 樓宇買賣 Sale & Purchase of Building Units			**2015/11**	**2015/1-11**
合約宗數 (宗) No. of agreements	70,503	81,489	4,736	70,865
年升幅 (%) Change(%)	-29.9	15.6	-26.7	-4.1
五 . 勞動就業 Employment			**2015/7-9**	**2015/8-10**
失業人數 (萬人) Unemployed(ten thousands)	11.84	14.95	13.6	13.2
失業率 (%) Unemployment rate(%)	3.4	3.2	3.3	3.3
就業不足率 (%) Underemployment rate(%)	1.5	1.5	1.4	1.4
六 . 零售市場 Retail Market			**2015/10**	**2015/1-10**
零售額升幅 (%) Change in value of total sales(%)	11.0	-0.2	-3.0	-2.7
零售量升幅 (%) Change in volume of total sales(%)	10.6	0.6	1.2	1.1
七 . 訪港遊客 Visitors				
總人數 (萬人次) arrivals (ten thousands)	5,430	6,077	507	4,950
年升幅 (%) Change(%)	11.7	11.9	-2.7	-0.6
八 . 金融市場 Financial Market			**2015/9**	**2015/10**
港幣匯價 (US$100=HK$) H.K. Dollar Exchange Rate (US$100 = HK$)	775.4	775.6	775	775
貨幣供應量升幅 (%) change in Money Supply(%)				
M1	9.7	13.0	20.3	15.3
M2	12.3	9.5	4.9	3.8
M3	12.4	9.6	4.9	3.8
存款升幅 (%) Change in deposits(%)				
總存款 Total deposits	10.6	9.7	7.5	6.2
港元存款 In HK$	5.1	9.3	10.8	10.8
外幣存款 In foreign currency	16.2	10.1	4.3	1.9
放款升幅 (%) in loans & advances(%)				
總放款 Total loans & advances	16.0	12.7	4.9	2.8
當地放款 use in HK	13.8	12.1	2.6	1.1
海外放款 use outside HK	21.4	14.2	10.4	6.9
貿易有關放款 Trade financing	43.8	-1.4	-20.7	-18.5
最優惠貸款利率 (%) Best lending rate (%)	5.0000	5.0000	5.0000	5.0000
恒生指數 Hang Seng index	23,306	23,605	20,846	22,640