



Hong Kong's Economic Growth Likely to Accelerate in the Second Half

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I: External and internal demand has slowed recently

This year, Hong Kong's economic growth continues to recover slowly, which is quite similar to that of last few years in general but with some new features listed below:

First is economic growth slowdown. 1Q2014 GDP merely grew by 2.5% YoY annualized, which is lower than that of annual and fourth quarter growth rate in 2013(Both 2.9%YoY). This figure is worse than that of Singapore, South Korea and Taiwan, besides, Hong Kong's economic growth shows a different trend compared with them. This is causing growing concern that whether Hong Kong has reversed the momentum of economic recovery, or whether the economic vitality and competitiveness will be further weakened.

Second is lower than expected external demand and market structure changed as well. In the first four months of this year, the total volume of exports only edged up 0.1% YoY. This figure is much lower than that of corresponding period last year(5.3%YoY) and the average growth in 2013(3.6%YoY). Moreover, apart from March, the figures are all negative. In the meantime, the real growth of total exports compiled under the GDP grew slightly at 0.5% YoY in 1Q2014, which is much lower than that of average growth in 2013(6.6%YoY). Moreover, containers handled by the port of Hong Kong increased only 1%YoY compared with a year earlier, but air cargo edged up 5%YoY. Due to the weak exports of goods, exports of services also slowed to 3.1%YoY annual growth, still lower than average growth rate in 2013(5.5%YoY). Moreover, the re-export business, which accounted for 25% of total exports of services and other trade-related services, even fell 0.2%YoY. However, thanks to the flourishing tourism industry, the overall exports of services still made substantial contribution to economic growth.

Sluggish trade performance was driven by weak demand from Asian markets, with exports to mainland China declining. In the first quarter of this year, total exports to Asia unexpectedly decreased 0.5%YoY, while the decline in April further worsened to 1.6%YoY. Thus in the first four months, exports to Asia was down by 3.9%, which outstripped the 3.5%YoY fall of total exports growth rate. Among them, Hong Kong's exports to mainland China fell 1.5%YoY in the first four months of this year, which dragged down the growth of total exports by 3.4% and also accounted for 95% of exports decline. However, in the first four months, exports to the U.S. increase slightly by 0.2%, compared with 2.1% decline last year. Meanwhile, exports growth to EU accelerated from 0.4% in 2013 to 2.4% in 1Q2014, which indicated Hong Kong's exports could benefit from improving the U.S. and Eurozone economy. This is the most significant structural change of exports in 2014.

Third is that private consumption expenditure slowed and domestic demand weakened as well. This year, Hong Kong's domestic demand weakened significantly: 1Q2014 real private consumption expenditure grew by 2%YoY, which is lower than corresponding period last year (4.3%YoY). Moreover, private consumption expenditure contributed 1.4% to overall GDP growth, but its contribution is only half of that of last year. Moreover, the growth of investment spending, adding 0.7% to overall GDP growth, has slowed as well, and was lower than the average performance last year. In general, domestic demand accounts for 2.6% of total GDP growth in 1Q2014, which is less than that of last year(3.9%). In other words, weak domestic demand reduced GDP growth by 1.3%, which indicates that economic growth slowdown is due to weak domestic demand.

II. External demand will likely improve in second half

We believe that the economic outlook in the second half will primarily depend on improving the external demand. For one thing, it depends on the mainland China economy and Hong Kong exports to mainland China performance; for another, it also depends on the demand from advanced countries, Such as Europe and the U.S.

1. Mainland China's economy expected to stabilize

Affected by scant global demand and internal problems, mainland China's economic growth momentum gradually weakened. 1Q2014 GDP growth rate dropped to 7.4%YoY, which is lower than that of last year (7.7%YoY). In the first four months, the growth of retail

sales, investment and industrial production were all decelerating. In particular, exports decreased 2.3%YoY, which indicated that China's economy officially entered a new stage of restructuring. However, the economy is undergoing some positive changes as well, such as, (1) Total volume of exports decreased from January to April in 2014, but general exports with higher value added increased more. (2)The service industry grew faster than manufacturing industry, and the service industry to GDP ratio in 1Q2014 is 1.1 % higher than that of last year. (3) The growth of residents' real income is faster than that of GDP, the urban-rural income gap has narrowed, and energy consumption per ten thousand yuan GDP decreased. All these show that Chinese restructuring has made substantial progress.

In order to ensure smooth restructuring with steady growth, the state council approved three fine-tuning measures. Such as introducing preferential tax rates to SMEs, speeding up shantytown renovation, acceleration railway construction in Central and Western China and targeted RRR cut. These mini-stimulus policies have certain effect on stabilizing economic growth. Both manufacturing and non-manufacturing PMI index rose for a second straight month. Moreover, as the current reform has entered implementation stage, it is expected that more reform would be released in the second half. More stimulus policies, such as transformation of government functions, tax and system reforms and other related measures will be introduced, and further economic growth will benefit from those policies. Moreover, the cancellation of administrative examination and approval as well as promotion of mixed ownership economy could ensure steady economic growth. Moreover, the reform of the household registration system and infrastructure construction would expand domestic demand. Local government being allowed to issue bonds could reduce credit risk. Furthermore, central government will increase the intensity of targeted stimulus policies. Authorities will rein in its shadow banking system, and meanwhile, in order to inject more liquidity to the market, the possibility of cutting RRR across the board cannot be ruled out. We expect that mainland China economy will be stable and on the rise in the coming half year, and annual GDP growth will maintain at around 7.5 % YoY in 2014.

Furthermore, the stabilization of mainland China's economy will have an immediate impact on Hong Kong's economic growth. For one thing, Hong Kong's expand exports to mainland China will have more room to grow. Meanwhile, excluding the distortion of fictitious trade, the volume of Hong Kong exports to mainland China is probably growing at 5%YoY or more. For another, more mainland China enterprises raise financing through Hong Kong, which could strengthen Hong Kong's service outputs momentum. However, it should be noted that

self-guided tours have peaked, so the slowdown in tourism consumption will have a negative impact on service exports in the second half.

2. Europe and U.S. demand will continue to improve

In the second half, demand from developed countries, such as Europe and the U.S. will continue to expand. IMF has increased its global economic growth rate forecast from 3.6% to 3.7%, mainly due to advanced economies easing the pace of fiscal austerity and monetary easing. Recently, U.S. manufacturing PMI and non-manufacturing PMI both are above 50, the unemployment rate is trending downward, housing prices increase 10% and large enterprises' earning is growing with a lot of cash on hand. All these signals indicate that economic growth in second half will be better than the first half year in 2014. So U.S. economic growth forecast has been raised from 1.9% to 2.1%. Moreover, supported by domestic demand and exports, the euro zone economy has grown for four consecutive quarters. Moreover, the euro zone composite PMI is consistently improving, which is helpful to economic recovery. And we expect that euro zone GDP will rise 0.9%YoY in 2014. Recently, the volume of exports from Hong Kong to Europe and the U.S. has returned to positive growth and the growth is likely to accelerate in the second half, which will help to improve overall external demand.

Therefore, external economic performance is expected to improve barring any geopolitical crisis or major shift in U.S. monetary policy. And external demand will strengthen economic growth and contribute 0.5% to 1% to GDP growth.

3. Domestic demand will stabilize after adjustment

After the adjustment in the first half of the year, the negative effects that had held back domestic demand growth were abating. Several positive factors will support Hong Kong's economic growth, such as:

First is housing price change. Affected by cutting back on purchases of bonds, U.S. market liquidity is reducing; interest rate will rise gradually. Moreover, housing supply will jump to 17.6 thousand units in 2014, so the property market is under pressure. But it also should be noted that Hong Kong's labor market still maintain full employment, which supports mortgage payment ability. Moreover, future interest rate will inevitably go higher, but it is still at a relatively low level and the probability of property sell-off remains low. Therefore, Hong Kong

property market won't drop dramatically in 2014, and the annual decline will be within 10%. This may put pressure on domestic demand, but the effect is not significant.

Second is the retail sector. Recently Hong Kong's retail industry has three consecutive months of contraction, and retail sales value in April dropped nearly 10%YoY, which is the lowest record since the financial crisis. Although it is related to the sharp slowdown in tourist consumption, but the sales growth rate of durable goods and department stores also dropped 12.1%-24.5%YoY. However, as the labor market and income remain stable, local residents' retail sales volume can keep steady and support private consumption's growth.

Third is the labor market. In 1Q2014, Hong Kong's seasonally adjusted unemployment rate fell to 3.1%, a 16 year low and has been at full employment. It is estimated that the labor market will be relatively tight in the second half, especially high demand for low-skilled labor. As nominal GDP growth in 1Q2014 is still higher than that of last year and the statutory minimum wage will increase, we expect salary and income will continue to improve in the second half, which has positive impacts on consumption growth.

The last is investment spending. Due to a sharp slowdown in machinery and equipment purchase, the overall nominal growth of investment spending in 1Q2014 was lower than that of last quarter. But the overall building and construction expenditure still increased significantly. The current ten major infrastructure projects are in full swing, and the estimates of expenditure on infrastructure construction in year 2014/2015 is around 70.8billion HKD. As private sector building construction activity is rebounding, future construction spending will continue to increase, supporting overall investment growth.

As a result, the factors influencing Hong Kong's future domestic demand will remain stable, it is estimated that the contribution of consumption and investment on the economy should maintain at the same level of the first half. But for the whole year, the pull of domestic demand on economic growth will be weaker than that of last year.

4. Future economic growth is expected to accelerate

To sum up, since economic performances of advanced countries continue to improve, Hong Kong external demand will be likely bottoming in the second half of the year. Moreover, external demand will become the main driving force of the local economy. Besides, domestic

demand is expected to stabilize, we expect Hong Kong's GDP growth rate will significantly accelerate in the second half of the year, and the annual economic growth rate will reach around 3.3% YoY, which is same as the prediction at the end of last year.

However, the growth rate is still lower than the past ten years trend growth rate, which means that Hong Kong's economic performance is still worse than normal level. This is because the global economy is still recovering slowing, and is also due to Hong Kong's internal structure problem. For one thing, Hong Kong's economy including investment, consumption, fiscal revenue and employment is influenced by the fluctuation of property price. This phenomenon not only exacerbated economic fluctuation but also undermines the long-term growth dynamics. For another, lack of technological innovation and high value-added industries results in a lack of new growth engine. Last month, IMD announced the global competitiveness ranking in 2014, Hong Kong's ranking dropped to fourth place, out of the top three for the first time in ten years. The ranking of economic performance, government efficiency, enterprise efficiency and infrastructure all dropped. Therefore, in the near future, unless significant changes of economic structure appeared, around 3% economic growth rate will be the new normal in Hong Kong.

The fact that Hong Kong's public employment quality and income level has not risen is mainly due to slow economic restructuring. To solve this problem, structural adjustment is needed to make Hong Kong gradually get rid of excessive dependence on real estate price. In the coming future, in order to improve the competitiveness of Hong Kong, economic restructuring, high value-added industries development, new cooperation between Hong Kong and mainland China, forward-looking population and education policies are needed to achieve this goal. Such reforms require long-term efforts but are imperative.

主要經濟指標 (Key Economic Indicators)

一. 本地生產總值 GDP	2012	2013	2013/Q4	2014/Q1
總量 (億元) GDP(\$100 Million)	19,644	20,372	5,801	5,300
升幅 (%) Change(%)	1.5	2.9	2.9	2.5
二. 對外貿易 External Trade	2012	2013	2014/4	2014/1-4
外貿總值 (億元) Total trade(\$100 Million)				
港產品出口 Domestic exports	588	544	49	176
轉口 Re-exports	33,755	35,053	2,808	10,855
總出口 Total exports	34,343	35,597	2,857	11,031
進口 Total imports	39,122	40,607	3,410	12,815
貿易差額 Trade balance	-4,778	-5,010	-553	-1,784
年增長率 (%) YOY Growth(%)				
港產品出口 Domestic exports	-10.4	-7.6	8.1	1.1
轉口 Re-exports	3.2	3.8	-1.7	0
總出口 Total exports	2.9	3.6	-1.6	0.1
進口 Imports	3.9	3.8	2.4	2.1
三. 消費物價 Consumer Price			2014/5	2014/1-5
綜合消費物價升幅 (%) Change in Composite CPI(%)	4.1	4.3	3.7	4
四. 樓宇買賣 Sale & Purchase of Building Units				
合約宗數 (宗) No. of agreements	115,533	70,503	6,785	26,785
年升幅 (%) Change(%)	6.2	-29.9	28.3	-22.3
五. 勞動就業 Employment	2012	2013	2014/2-2014/4	2014/3-2014/5
失業人數 (萬人) Unemployed(ten thousands)	12.45	11.84	12.1	12.1
失業率 (%) Unemployment rate(%)	3.2	3.2	3.1	3.1
就業不足率 (%) Underemployment rate(%)	1.5	1.4	1.4	1.5
六. 零售市場 Retail Market	2012	2013	2014/4	2014/1-4
零售額升幅 (%) Change in value of total sales(%)	9.8	11.0	-9.8	0.7
零售量升幅 (%) Change in volume of total sales(%)	7.2	10.6	-9.5	1.2
七. 訪港遊客 Visitors				
總人數 (萬人次) arrivals (ten thousands)	4,862	5,430	475	1,945
年升幅 (%) Change(%)	16	11.7	10.9	14.2
八. 金融市場 Financial Market	2012	2013	2014/3	2014/4
港幣匯價 (US\$100=HK\$)	775.05	775.4	775.7	775.3
H.K. Dollar Exchange Rate (US\$100 = HK\$)				
貨幣供應量升幅 (%) change in Money Supply(%)				
M1	22.2	9.7	9.5	10.6
M2	11.1	12.3	12.1	12.5
M3	11	12.4	12.2	12.5
存款升幅 (%) Change in deposits(%)				
總存款 Total deposits	9.3	10.6	10	10.8
港元存款 In HK\$	11.7	5.1	6.7	8.4
外幣存款 In foreign currency	7	16.2	13.3	13.2
放款升幅 (%) in loans & advances(%)				
總放款 Total loans & advances	9.6	16.0	18.9	18.1
當地放款 use in HK	7.1	13.8	17.8	16.4
海外放款 use outside HK	16.5	21.4	21.9	22.2
貿易有關放款 Trade financing	10.2	43.8	35	23.8
最優惠貸款利率 (%) Best lending rate (%)	5.0000	5.0000	5.0000	5.0000
恆生指數 Hang Seng index	22,657	23,306	22,151	22,134