



Causes of Sluggishness in Hong Kong's Private Consumption Expenditure

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This year, Hong Kong's economic growth continues to decelerate, with real GDP growth in the first two quarters coming in at 2.6% and 1.8% respectively, slower than last year's full year growth of 2.9%. More importantly, private consumption expenditure (PCE) registered even slower growth of 1.5% and 1.2% for the same period, a combination rarely seen in the current recovery cycle. Now that Hong Kong's economy is well developed, and private consumption expenditure accounts for about two thirds of the overall economy, its slower growth not only means that it fail to drive the economic recovery, it actually becomes a drag unlike before. Such a phenomenon seems to contradict the low unemployment rate of 3.3% (very close to the lowest of this cycle), the record high residential property price, the zero interest rate environment and ample liquidity. Therefore, its causes warrant close examination.

Decelerating growth in private consumption expenditure

Growing by only 1.5% and 1.2% in real terms during the first two quarters of this year, private consumption expenditure contributes 1.0 and 0.8 percentage points to the quarterly GDP growth respectively, a contribution ratio of only 38% and 44%. Such ratios are significantly lower than private consumption expenditure's share in the overall economy, marking its weakest performances of any two consecutive quarters since the economic recovery starting in 2010.

During the first three quarters of 2010, growth in private consumption expenditure was 7.5%, 3.8% and 5.1% respectively, also slower than the real GDP growth of 7.9%, 6.4% and 6.5% for the same period. However, the implication was more to the optimistic side because the stronger economic growth was driven more by the goods exports (growing by more than twenty percent) and services exports (growing by close to twenty percent) due to their low comparison bases a year ago. Growth in private consumption expenditure itself was healthy. Since then, private consumption expenditure only grew slower than GDP in 3Q13, with a small gap of 0.3% (2.7% vs. 3.0%). This further highlights the sluggishness in private consumption expenditure during the first half of this year in both absolute and relative terms.

Between 4Q08 and 3Q09, impacted by the sub-prime crisis and financial tsunami, private consumption expenditure in Hong Kong decelerated significantly before plunging into

negative territory, which led to four quarters of GDP contractions as well. The same pattern was repeated between end 2001 and beginning 2002, and mid-2003, suggesting that if growth in private consumption expenditure fails to maintain pace and begins to lag overall growth, barring any meaningful pickup in goods and services exports as offsets, the Hong Kong economy will likely run into stalemate sooner or later, with recession becoming a distinctive risk. This pattern can be traced back to the Handover.

Therefore, in view of the inability of growth pickup in the US, Europe and Japan in the foreseeable future, the slowing Chinese economy, the modest recovery in Hong Kong's goods exports, and possible decline in our services exports due to less tourists spending, if growth in private consumption expenditure further decelerates from the current less than 2.0%, the Hong Kong economy as a whole may be unable to make headways. Under the worst case scenario, should private consumption expenditure slip into decline, recession risk may loom for the Hong Kong economy. Then the question is why private consumption expenditure has become so weak and what course it will likely to take in the near future.

Decline in consumer confidence and sentiment

Currently, the unemployment rate in Hong Kong stands at 3.3%, very close the low of 3.1% recorded in this recovery, a level considered to be close to full employment. And total employment continues to make new high. Meanwhile, residential property price is at record high. In July and August this year, Hong Kong's banking system recorded capital inflows of more than HKD70 billion, pushing the overall liquidity to new records. Although the Hong Kong stock market indices are nowhere near making record highs, they are not in a bear market for sure. And since April, market expectations have been high on the upcoming Shanghai and Hong Kong stock link. Under such circumstances, it is unusual to see private consumption expenditure run out of steam early.

In the US, measures of consumers come from the Conference Board's Consumer Confidence Index and University of Michigan's Consumer Sentiment Index. In Hong Kong, counterparts can be found in the Consumer Confidence Index and Consumer Sentiment Index compiled by the Centre for Quality of Life at the Chinese University of Hong Kong's (CUHK). The Consumer Confidence Index draws from surveys on household finances in the coming year, Hong Kong's business environment in the coming year, and Hong Kong's economic conditions in the coming five years. The Consumer Sentiment Index adds inputs from two more surveys of current household finances and current major consumption decisions. The surveys are conducted quarterly.

In the third quarter of this year, CUHK's Consumer Confidence Index declined to 72.3, and its Consumer Sentiment Index declined to 81.9, both at the lowest levels so far this year, with the former very close to the low of 70.9 recorded in 4Q11 since the recovery and the latter close to the low of 75.2 respectively. Prior to the sub-prime crisis and financial tsunami in 2008, both indices were north of 110. And since the recovery started in 2010, they went as high

as above 97. But since mid-2011, the Consumer Confidence Index stayed below 80 and the Sentiment Index stayed below 90. They move in sync with private consumption expenditure, whose growth in 2010 and 2011 were also rather robust at 6.1% and 8.4% respectively. Then in the following two years, the moderation in consumer confidence and sentiment coincided with private consumption expenditure growth moderating to 4.1% and 4.3% respectively. And in this year, private consumption expenditure growth further decelerates to less than 2.0%.

In the latest survey, consumers who are optimistic about their household finances and Hong Kong's business environment in the coming year as well the general economic conditions in the next five years are clearly in the minority, with declining proportion. On the other hand, the proportion of consumers feeling worse off about their current household finances is on the rise. The consistent factor that optimistic consumers remain the minority suggests lost momentum in private consumption.

Economic prospects and income factor

It is understandable that Hong Kong consumers are growing uneasy about economic prospects. After all, the economic recovery has entered the fifth year. Aside from the decent growth of 6.8% and 4.8% recorded in 2010 and 2011, growth decelerated to 1.5% and 2.9% in the following two years, and further to 2.6% and 1.8% for the first two quarters of this year, significantly slower the ten year average of 4.5%. Now that the recovery is in the fifth year, growth will unlikely to reaccelerate barring any substantial stimulus, which is nowhere to be found. On the contrary, the political situation adds new uncertainty.

Hong Kong is a small and open economy. Its underperformance in the past couple of years had something to do with the influential US and Chinese economies. First of all, although the US adopted zero interest rates and quantitative easing measures, its economic recovery has been far from satisfactory. Annual growth averaged 2.2% only from 2010 to 2013, lower than its trend growth of 3.0%. Actually, none of those four years recorded growth at or above 3.0%. Due to the improvements in its labor market, the Federal Reserve still decided to ease its QE program at the end of 2013 until they ended it altogether in October this year. The market universally expects the Fed to begin to raise interest rates starting mid-2015. Given Hong Kong's Peg exchange rate regime, this means our interest rates will begin to rise sooner or later without the benefits from a strong US economic recovery. Such a combination hardly gives Hong Kong consumers strong boost to their confidence and sentiment.

In China's case, its economic growth was high at 10.4% and 9.3% in 2010 and 2011 before decelerating to 7.7% in both 2012 and 2013. For the first three quarters of this year, real growth came in at 7.4%, 7.5% and 7.3%, continuing to moderate. Without major external crisis, such sluggish growth was indeed worrisome in China's standards. The growth trajectories for the US and Chinese economies argue that optimism will be in shortage regarding our own medium to short term economic prospects.

Besides economic prospects, another important factor affecting consumer confidence and sentiment is income prospect. Even though Hong Kong's per capita GDP rose to another record of HKD295701 in 2013 and is expected to rise further this year, its growth rate slowed to 3.9%, the slowest in this recovery. And further deceleration is expected for this year. And although nominal wages for all industries grew by 4.5% in the middle of this year from a year ago, its pace of growth also halved from the peak of 9.9% recorded in 2011. Inflation adjusted real wages grew only 0.7% for the same period, also substantially slower than the 4.4% in 2011. Since 2H12, its growth rate has never exceeded 1.0%. Therefore, even though household incomes are still increasing, there is still a lot to be desired about its pace. Now that the labor market approaches full employment with little room for further improvement, it is believed to impact expectations of household incomes and major consumption decisions.

The property market factor

The decreasing wealth effects from the residential property market are another headwind to private consumption expenditure's growth. On the surface, this development seems to have contradicted the record high property price. But since the HKSAR Government introduced Special Stamp Duty (SSD) in 2010, Buyer's Stamp Duty (BSD) in 2012, and Ad valorem Stamp Duty (AVD) in 2013, the red hot local property market began to cool down. Transactions began to contract since 2Q13. And at the end of 2013 when making forecasts of 2014, almost all market participants forecasted price decline. The differences were in the degree of decline. Yet, residential property price bucks the expectations and continues to rise this year, up 6.4% in August from end 2013. Nevertheless, the single digit increase for the second year in a row (7.7% in 2013) is in stark contrast to the surge in previous years. Transactions contract more noticeably since 2Q13 under those measures aimed at curbing demands. In 2013, transactions and their dollar value were down 39% and 30% respectively from the previous year, with further decline of 13% and 14% in 1H14.

Under such circumstances, wealth effects from record high residential property price are believed to be compromised. Firstly, heightened transaction costs result in much subdued transactions. In some months, transactions were down by 60 to 70 percent when compared to normal times. As a result, related consumptions on household electricity equipment, furniture, etc., are down as well. Secondly, heightened transaction costs result in first time buyers or new flats dominating the subdued transactions. For example, from 2Q13 to 2Q14, transactions involving flats priced at HKD10 million or more accounted for only 10% of the total. New flats are believed to be the main components. Transactions involving flats priced at HKD5 million or less accounted for 65% of the total, with the rest being priced in-between. Under such a structure, even though prices are at record high, first time buyers will find it difficult to turn it into new purchasing power. For new flat buyers, it will be costly for them to cash in their paper profits. And since the stamp duty measures largely drive out investors, speculators and foreign buyers, the much reduced liquidity also dampens the wealth effects from record high price. Thus, the end to the struggle in Hong Kong's private consumption expenditure is nowhere in sight in the near future.

主要經濟指標 (Key Economic Indicators)

一. 本地生產總值 GDP	2012	2013	2014/Q1	2014/Q2
總量 (億元) GDP(\$100 Million)	19,644	20,372	5,174	5,309
升幅 (%) Change(%)	1.5	2.9	1.8	2.6
二. 對外貿易 External Trade	2012	2013	2014/9	2014/1-9
外貿總值 (億元) Total trade(\$100 Million)				
港產品出口 Domestic exports	588	544	42	422
轉口 Re-exports	33,755	35,053	3,278	26,603
總出口 Total exports	34,343	35,597	3,320	27,024
進口 Total imports	39,122	40,607	3,824	30,886
貿易差額 Trade balance	-4,778	-5,010	-504	-3,862
年增長率 (%) YOY Growth(%)				
港產品出口 Domestic exports	-10.4	-7.6	-5.5	3.5
轉口 Re-exports	3.2	3.8	4.6	3.9
總出口 Total exports	2.9	3.6	4.5	3.9
進口 Imports	3.9	3.8	6.3	4.1
三. 消費物價 Consumer Price				
綜合消費物價升幅 (%) Change in Composite CPI(%)	4.1	4.3	6.6	4.2
四. 樓宇買賣 Sale & Purchase of Building Units			2014/10	2014/1-10
合約宗數 (宗) No. of agreements	115,533	70,503	7,967	67,454
年升幅 (%) Change(%)	6.2	-29.9	71.4	13.5
五. 勞動就業 Employment	2012	2013	2014/6-2014/8	2014/7-2014/9
失業人數 (萬人) Unemployed(ten thousands)	12.45	11.84	13.6	13.3
失業率 (%) Unemployment rate(%)	3.2	3.2	3.3	3.3
就業不足率 (%) Underemployment rate(%)	1.5	1.4	1.4	1.5
六. 零售市場 Retail Market	2012	2013	2014/9	2014/1-9
零售額升幅 (%) Change in value of total sales(%)	9.8	11.0	4.8	-0.4
零售量升幅 (%) Change in volume of total sales(%)	7.2	10.6	6.6	-0.3
七. 訪港遊客 Visitors				
總人數 (萬人次) arrivals (ten thousands)	4,862	5,430	475	4,466
年升幅 (%) Change(%)	16	11.7	10.2	12
八. 金融市場 Financial Market	2012	2013	2014/8	2014/9
港幣匯價 (US\$100=HK\$)	775.05	775.4	775	776.4
H.K. Dollar Exchange Rate (US\$100 = HK\$)				
貨幣供應量升幅 (%) change in Money Supply(%)				
M1	22.2	9.7	14.8	13.1
M2	11.1	12.3	15.2	12.2
M3	11	12.4	15.4	12.3
存款升幅 (%) Change in deposits(%)				
總存款 Total deposits	9.3	10.6	13.9	11.4
港元存款 In HK\$	11.7	5.1	14.1	9.9
外幣存款 In foreign currency	7	16.2	13.7	12.8
放款升幅 (%) in loans & advances(%)				
總放款 Total loans & advances	9.6	16.0	14.1	12.7
當地放款 use in HK	7.1	13.8	13.5	12.5
海外放款 use outside HK	16.5	21.4	15.3	13.1
貿易有關放款 Trade financing	10.2	43.8	5.5	3.9
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	24,742	22,933