



Hong Kong's Economic Outlook for 2015

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I. Economic performance in 2014 weaker than expected

In the first three quarters of the year, Hong Kong's economy grew 2.4%, underperforming the 2.9% rate of expansion in the same period last year and lagging far behind Singapore and South Korea, where growth rates ranged between 3.3% and 3.5%. In the fourth quarter, growth may decelerate further due to the "Occupy Central" movement. In 2014, GDP is expected to expand by only 2.2%, far lower than the 4.5% average in the past 10 years. There are three major reasons for this underwhelming performance.

First, recovery of external demand has been rather tepid. In the developed world, Europe is struggling to gain momentum, while Japan has slipped into yet another recession. In emerging markets, Chinese growth has weakened, while Russia and Brazil's economies are plagued by various troubles. As global growth slowed, the IMF revised its estimate for 2014 to 3.3%, noticeably lower than the 3.7% projection at the beginning of the year. WTO's latest forecast of global trade growth was also drastically reduced from 4.7% to 3.1%, considerably weaker than the 5.3% average of the past two decades. External demand apparently remains anemic.

Under this backdrop, in the first 10 months, Hong Kong's exports grew only 3.8%, similar with the level of the same period last year but far lower than the 9.9% average in the past four years. Hong Kong's exports to Mainland China increased only 2.5%. In the first three quarters, exports to the European Union grew 3.5%, while exports to Japan contracted 0.8%. Such modest figures reflect subdued demand from major economies. Due to a sharp decline in gold exports, in the first three quarters, merchandize exports as a component of GDP increased only 1.4%, far weaker than the 7% growth in the same period last year and dragging GDP growth down by 1.4 percentage points. Meanwhile, as a result of sluggish tourist consumption, service exports grew only 1.1%, much lower than the 5.8% growth registered in the same period last year and further weakening the contribution of external demand to Hong Kong's economy.

Second, the slowdown in domestic demand has been more severe than expected. Both

personal consumption and fixed capital formation slid. In the first three quarters, the value and volume of retail sales contracted 0.4% and 0.3%, respectively. In contrast, these two indicators averaged 16.0% and 12.9%, respectively, in the past four years. Even after stripping out the effects of weak tourist spending, domestic consumption remains sluggish. In the first three quarters, real personal consumption expenditure grew 2%, compared with a 4.6% expansion in the same period last year. Meanwhile, fixed capital formation decreased 2.3%, considerably weaker than the 2.4% growth in the same period last year and an average of 7% in the past four years. As a whole, domestic demand's contribution to economic growth was estimated to be only 1.8 percentage points, less than half of that in the same period last year.

An important reason of the underwhelming performance of domestic demand is waning wealth effect. Hong Kong's domestic demand is closely correlated with property prices. From 2010 to 2013, private residential prices surged 82%, while annual growth of domestic demand averaged 5.3% and outperformed GDP growth. Property prices stabilized in the first half of the year before rising again in the second half. However, price increase in the first three quarters was still less than the average in the past four years. Prospective rate hikes in the U.S. further weakened the wealth effect. Another culprit is the precipitous decline of 7.5% in the first three quarters in private-sector machinery and equipment investments, which alone lowered GDP growth by two percentage points.

Third, the Occupy movement severely impacted Hong Kong's retail, tourism, hospitality, and transport industries as well as many facets of the society. This movement may lower fourth-quarter GDP growth by 1.5 percentage points and annual growth by 0.4 percentage points.

II. External demand to improve moderately in 2015

Hong Kong's economic performance in 2015 will first hinge on developments in external demand. The tepid and uneven global recovery will continue into next year. Nevertheless, there will be a number of new features.

First, the global economy and international trade will improve moderately. The IMF expects that global growth in 2015 will come in at around 3.8%, stronger than the average for the past three years. However, as a result of declining potential growth, surging debt levels, and elevated unemployment, the global economy could enter a phase of "New Mediocre", coined by IMF managing director Lagarde. Economic growth in this phase will be weaker than the 4.7% average from 2000 to 2007. Moreover, international trade will be unlikely to stage a strong rebound. The WTO expects that growth in international trade next year will increase from 3.1% to 4%, which would still lag behind the 5.3% average in the past two decades.

Nonetheless, in 2015, global growth may manage to approach the lower bound of the range between 4% and 5% that characterizes normal expansion. Meanwhile, international trade will likely accelerate and outperform economic growth, which would reverse the unusual trend of trade being weaker than global GDP. Looking ahead, the significant progress made by WTO members on facilitating free trade and the proliferation of regional free trade zones will help expand trade volume and boost Hong Kong's external demand.

Second, the divergence in growth between the developed world and emerging markets will continue to narrow. As a result, external demand will become less uneven. According to the IMF's projections, next year, growth in advanced economies will reach 2.3%, 0.5 percentage points greater than this year. Developing countries will grow 5%, also slightly faster than the 4.4% rate in 2014. The ratio of growth rates in the developing world over the developed world will decrease from 4.25 times in 2012 to 2.17 times, the lowest level in over a decade. Relatively balanced global growth suggests that Hong Kong's external demand will become more diversified.

The U.S. economy will remain a bright spot in the developed world. U.S. GDP growth reached 4.9% in the second quarter and 3.9% in the third quarter, the strongest pace of growth for a 6-month period in over a decade. In the meantime, PMI and consumer confidence remain elevated, while unemployment declined to 5.8%, the lowest level since the financial crisis. Furthermore, emerging industries such as new energy, the Internet, biomedicine, and 3D printing will help boost growth. However, overall economic performance will still be weaker than normal due to a number of headwinds coming from fiscal tightening, lower quality of jobs, stagnant real income, and interest rate normalization. We expect U.S. growth to come in at 2.6%, slightly stronger than the average during the recovery since 2009. Hong Kong's exports to the U.S. contracted by 2.1% in 2013 but increased 1.9% in the first 10 months of 2014. In 2015, growth in exports to the U.S. may accelerate to around 4%, lending a hand to Hong Kong's external demand.

The Euro-zone's economy is still sluggish. GDP grew 0.8% in the first three quarters compared with the same period last year, which marked a turnaround from contraction in the past two years. However, the recovery remains uneven with significant divergence among member states. Moreover, declining PMI and CPI readings signal recession risks. In the future, the ECB may launch a series of monetary measures including quantitative easing to counter deflationary pressure and stimulate growth. Moreover, the European Commission recently unveiled a 300 billion euro investment package. As a result, Euro-zone growth may speed up somewhat to 1.2%. It is worth noting that Hong Kong's exports to Europe have been outperforming those to the U.S. in spite of weaker European fundamentals. If this trend persists, European demand may offer Hong Kong opportunities.

In 2014, GDP growth in emerging markets was dragged down by Russia and Brazil and may come in at only 4.4%, the weakest performance since the financial crisis. The IMF predicts that acceleration in India and rebound in Brazil will help emerging market growth to speed up to about 5%. However, Russia may remain mired in recession due to the Ukraine crisis and the plunge in oil price. As a whole, emerging markets may not be able to meaningfully improve Hong Kong's external demand.

Third, the effects of economic restructuring in Mainland China on Hong Kong may become increasingly pronounced. In the first three quarters of the year, China's GDP growth slowed to 7.4% due to headwinds stemming from weak external demand, sliding real estate investment, and severe excess capacity. In the first 10 months, fixed asset investment increased 15.9%, 4.2 percentage points lower than the same period last year and dragging down GDP growth by 0.7 percentage points. Apparently, the slowdown in investments is the main reason of growth deceleration. As for retail sales, although the 12% nominal growth rate is a tad weaker than the 13% figure recorded in the same period last year, growth adjusted for inflation has been relatively stable. Furthermore, the increasing importance of service consumption implies that the contribution of overall domestic consumption to economic growth has actually gone up. The exports sector expanded by only 5.8%, 2 percentage points lower than the same period last year. China's international trade is highly unlikely to meet the target for 2014. That being said, as rampant "fake" trades last year did not represent real growth, the contribution of net exports in 2014 should not be weaker than that in 2013.

In order to stabilize growth, China has resorted to measures including ramping up infrastructure investment, accelerating urbanization, targeted monetary easing, and interest rate cuts. In 2015, China will strive for growth stabilization and economic restructuring by increasing expenditures in infrastructure and subsidized housing. In addition, household registration reform may be expedited to boost domestic consumption, and more free trade zones may emerge to promote trade and investment. In the realm of monetary policy, rate cuts and RRR cuts cannot be ruled out. In the meantime, China's economy is undergoing a number of structural transformations. The service sector has leapfrogged the manufacturing sector, while urban population has surpassed rural population. In addition, general trade has exceeded processing trade, which would help increase value added. Next year, consumption will likely remain stable, investment growth may continue to slow, and exports may rebound 7%. As a result, GDP growth may come in at 7.2%. As for inflation, even though both CPI and PPI are sliding, deflation risks may have been overblown.

III. Projection of Hong Kong's economic growth in 2015

Hong Kong's economic performance in 2015 will likely be constrained by domestic

demand, the key to which remains changes in property prices. Under the linked exchange rate mechanism, interest rates in Hong Kong will move in tandem with those in the U.S. Hong Kong's real estate market, being extremely sensitive to interest rates, will probably enter a downturn, crimping consumption, investment, and domestic demand. In the public sector, government projects have been hampered by appropriation applications. In the last legislative year, the government had planned to apply for HK\$43 appropriations for new projects, but LegCo approved only HK\$3.6 billion. In the current legislative year, the government plans to apply for appropriations amounting to HK\$71 billion. If the bills were not passed on time, infrastructure expenditure and public investment would be curtailed. That said, Hong Kong's labor market is still close to full employment, household income growth remains healthy, and residential construction is picking up. Thus, domestic demand will manage to eke out a moderate increase in 2015.

If Hong Kong managed to shake off the impact of non-economic incidents, the rebound in external demand and a favorable base for comparison should help GDP growth accelerate to 2.8%, stronger than the 2.2% increase this year but still weaker than the 4% potential growth rate.

Hong Kong's underlying inflation declined from a peak of 5.3% in 2011 to 4% last year and slowed further to 3.5% in the first 10 months of the year. Due to looming pressure on property prices and the plunge in oil price, Hong Kong's inflation may drop below 3% in the second half of next year. The current cycle of inflation being driven by ever higher property prices is nearing an end. If prices and rents of small residential units began to weaken, the inflation being experienced by the grassroots would also ease.

Estimates of Hong Kong's GDP growth in 2015 (%)

Item	2014	2015
Personal consumption expenditure	1.8	1.6
Government consumption expenditure	2.9	2.5
Fixed capital formation	-2.0	-1.8
Total exports	4.1	5.2
Service exports	1.3	3.0
Gross domestic product	2.2	2.8
Underlying inflation	3.4	3.2
Unemployment (at year end)	3.3	3.4

主要經濟指標 (Key Economic Indicators)

一. 本地生產總值 GDP	2012	2013	2014/Q2	2014/Q3
總量 (億元) GDP(\$100 Million)	19,644	20,372	5,179	5,765
升幅 (%) Change(%)	1.5	2.9	1.8	2.7
二. 對外貿易 External Trade	2012	2013	2014/10	2014/1-10
外貿總值 (億元) Total trade(\$100 Million)				
港產品出口 Domestic exports	588	544	44	465
轉口 Re-exports	33,755	35,053	3,273	29,874
總出口 Total exports	34,343	35,597	3,317	30,339
進口 Total imports	39,122	40,607	3,816	34,691
貿易差額 Trade balance	-4,778	-5,010	-498	-4,351
年增長率 (%) YOY Growth(%)				
港產品出口 Domestic exports	-10.4	-7.6	-1.5	3
轉口 Re-exports	3.2	3.8	2.7	3.8
總出口 Total exports	2.9	3.6	2.7	3.8
進口 Imports	3.9	3.8	5.6	4.3
三. 消費物價 Consumer Price				
綜合消費物價升幅 (%) Change in Composite CPI(%)	4.1	4.3	5.2	4.3
四. 樓宇買賣 Sale & Purchase of Building Units			2014/11	2014/1-11
合約宗數 (宗) No. of agreements	115,533	70,503	6,457	73,911
年升幅 (%) Change(%)	6.2	-29.9	27.6	14.6
五. 勞動就業 Employment	2012	2013	2014/7-2014/9	2014/8-2014/10
失業人數 (萬人) Unemployed(ten thousands)	12.45	11.84	13.3	12.9
失業率 (%) Unemployment rate(%)	3.2	3.2	3.3	3.3
就業不足率 (%) Underemployment rate(%)	1.5	1.4	1.5	1.5
六. 零售市場 Retail Market	2012	2013	2014/10	2014/1-10
零售額升幅 (%) Change in value of total sales(%)	9.8	11.0	1.4	-0.2
零售量升幅 (%) Change in volume of total sales(%)	7.2	10.6	4.3	0.1
七. 訪港遊客 Visitors				
總人數 (萬人次) arrivals (ten thousands)	4,862	5,430	521	4,987
年升幅 (%) Change(%)	16	11.7	12.6	12.1
八. 金融市場 Financial Market	2012	2013	2014/9	2014/10
港幣匯價 (US\$100=HK\$)	775.05	775.4	776.4	775
H.K. Dollar Exchange Rate (US\$100 = HK\$)				
貨幣供應量升幅 (%) change in Money Supply(%)				
M1	22.2	9.7	13.1	16.5
M2	11.1	12.3	12.2	12.1
M3	11	12.4	12.3	12.2
存款升幅 (%) Change in deposits(%)				
總存款 Total deposits	9.3	10.6	11.4	11.9
港元存款 In HK\$	11.7	5.1	9.9	10.7
外幣存款 In foreign currency	7	16.2	12.8	12.9
放款升幅 (%) in loans & advances(%)				
總放款 Total loans & advances	9.6	16.0	12.7	13.7
當地放款 use in HK	7.1	13.8	12.5	13.7
海外放款 use outside HK	16.5	21.4	13.1	13.5
貿易有關放款 Trade financing	10.2	43.8	3.9	3.8
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	22,933	23,998