



Reasons and Prospects of the Adjustment of Hong Kong's Retail Sector

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It is a “freezing winter” for Hong Kong’s retail sector in this spring season. The value of retail sales for the first three months dropped significantly by 12.5% from a year ago. The decline of 20.6% YoY in February was the largest monthly contraction in the past 17 years and even worse than the troughs during the SARS period and the Financial Crisis in 2008. The value of retail sales for jewellery, watches and clocks, and valuable gifts, which reflect tourist spending, plummeted by 32.5%. Meanwhile, the retail sales for department stores, which used to grow in past Lunar New Years, also declined by 20.7%. The developments of the retail sector are hardly promising in the short-term, and its prospects warrant a closer look.

I. The waning attractiveness of shopping paradise

The potential of Hong Kong as a “Shopping Paradise” had been unleashed since the launch of Individual Visit Scheme after SARS. Tourist shopping became a growth engine for the retail sector, which enjoyed a golden decade with increasing number of inbound tourists and shopping expenditure. The number of visitor arrivals surged from 15.54 million in 2003 to 60.84 million in 2014 for an increase of 45.30 million during the period. Mainland arrivals mainly for shopping purposes surged from 8.47 million to 47.25 million and accounted for 86% of the entire increase, providing Hong Kong’s retail sector with a source of strong growth.

Due to the lack of direct statistics on inbound tourist shopping, we estimate the consumption amount by adding up such items as retail gross margin, costs of goods, etc. which are provided in “Tourism Satellite Account for Inbound Tourism of Hong Kong”. The value of inbound tourist shopping grew considerably from HKD 33.5 billion in 2003 to HKD 197.2 billion in 2014, with an average annual growth rate of 11.1%. In the past 11 years, tourist shopping accounted for 51.1% of Hong Kong’s retail sales growth. In other words, it provided more than half of growth momentum.

Hong Kong’s tourism industry has entered an adjustment period since 2015. Both the number of inbound tourists and average consumption per tourist declined. The statistics show that the number of inbound tourists persistently decreased since June of last year and dropped by 2.5% for the whole year. Moreover, domestic spending by overnight visitors, the main source of spending, dropped even more. As a result, the value of retail sales has decreased for 13 months in a row with increasingly large contractions. In particular, the number of inbound tourists plummeted 13.6% for the first quarter of this year, heaping more pressure on the retail sector.

It is worth nothing that the drop of inbound tourists is mainly due to the substantial decline of Mainland visitors. For the first 3 months of this year, Mainland visitor arrivals dropped by 15.1% YoY, or 1.86 million,

exceeding the decline of 1.69 million in overall visitor arrivals. Excluding Mainland visitors, inbound tourists from other regions still recorded a growth of 5.4%. Hence, sluggish performance in Hong Kong's retail sector is the result of a significant drop in Mainland visitors and their spending, which is due to the following three reasons.

The first reason is political disturbance. Once upon a time, Mainland visitors shopped in Hong Kong not only because of the availability of reasonably priced quality goods, but also because it was considered a fashionable trend. However, a small fraction of local people treated Mainland visitors roughly or even chased them out in recent years. Such despicable acts have seriously damaged Hong Kong's international reputation as a "Shopping Paradise", deterring many visitors.

The second reason is due to policy measures. There is insufficient supply of related goods and services due to the lack of development in Hong Kong's tourism infrastructure. As a result, rental and price levels climbed consistently, triggering dissatisfaction from local residents. The government imposed purchase limits on some goods. Furthermore, "multiple-entry" Individual Visit Endorsements policy for Shenzhen residents has been amended to "one trip per week". Such policy measures have had huge impacts on visitor arrivals. According to the latest figures from Hong Kong Immigration Department, inbound visitor arrivals with "multiple-entry" visa was 6.315 million between April 13 last year and end of March this year, a decline of 8.47 million or 57.3% from a year ago, accounting for 20% of total Mainland visitor arrivals during the period.

The third reason is due to changing shopping patterns. In recent years, countries such as Japan and South Korea relaxed travel visa application for Chinese visitors. In addition, the prices of goods in those countries are relatively low because of favorable exchange rates and production costs, luring Mainland residents to shop abroad. According to China National Tourism Administration and World Travel & Tourism Council, the number of Chinese visitors traveling abroad more than doubled to 120 million in the past 5 years. Offshore spending by Chinese visitors reached USD 215 billion last year, soaring 53% from 2014 to the first place worldwide. This is a stark contrast with the gloom in Hong Kong. Thanks to surging Chinese visitors, Japan's tourism income coming from foreign visitors grew 49% last year. Iceland also recorded an increase of tourism income of almost 20%. In Singapore, spending by Chinese visitors accounted for more than half of total tourist spending.

Furthermore, online shopping has developed rapidly. Mainland residents, in particular the young generation, are able to purchase desirable overseas products via the internet. Also, duty free shopping malls have been built in surrounding areas, reducing the need of Mainland residents to come shop in Hong Kong.

To sum up, tourist shopping accounted for more than half of the strong growth of the retail sector over the last 10 years. The proportion of tourist spending to the value of Hong Kong's retail sales soared from less than 20% to about 40%. As a result, Hong Kong's retail sector is highly dependent on tourist expenditure, the plunge of which is a main culprit of the current doldrums. The various political and economic factors that affect tourist shopping are structural and will not be reversed in a short period of time. The adjustment of Hong Kong's retail sector will be prolonged and difficult.

II. Wealth effect constraining domestic consumption

As was mentioned above, the other half of Hong Kong's retail sales growth is determined by domestic factors such as economic performance, labor market conditions, income growth, and property price movement. The most crucial factor is wealth effect in response to volatility in asset markets including property and equity markets. Rising property and equity prices generate positive wealth effect and encourage domestic consumption, and vice versa. There had rarely been any exception in the past.

Hong Kong's private residential prices climbed 13.9% YoY on average during the 4-year period between 2004 and 2007. Meanwhile, the Hang Seng Index was up 21.9% annually. Soaring asset prices helped private consumption expenditure grow 6.3% annually in real terms, and total spending on goods by domestic residents grew 6.8% annually. During the global financial crisis between 2008 and 2009, Hong Kong's private residential prices once dropped by more than 17%, while the Hang Seng Index plummeted from a peak of 31,958 points to a trough of 11,344 points. As a result, private consumption expenditure and spending by domestic residents only grew about 1% and 1.8%, respectively, during the two-year period. During the five-year period between 2010 and 2014, the Hang Seng Index only climbed 1% each year, but private residential price surged 16% annually. In the meantime, private consumption expenditure grew 5.3% annually, and spending by domestic residents also grew 9.4% annually on average. Clearly, wealth effect in response to the volatility in asset market is crucial to domestic spending.

Hong Kong's property prices peaked in October of last year and declined 11.7% as of the end of March of this year. The Hang Seng Index even dropped by 24.3% since the second half of last year, further undermining domestic demand. The real growth of private consumption expenditure slowed to 5.3% in the fourth quarter from an average growth rate of 5.3% in the first three quarters of last year. The growth rate slowed further to 1.1% in the first quarter of this year, reflecting the vulnerability of domestic consumption. The value of sales of consumer durable goods, including motor vehicles and parts as well as furniture and fixtures, dropped considerably by 25%, far worse than the overall performance. The value of sales of clothing, footwear and allied products also decreased by more than 10%. The negative impact of wealth effect on the retail sector has clearly emerged.

It is worth noting that the deteriorating retail sector will have a relatively large impact on Hong Kong's economy and labor market. According to data from Census and Statistics Department, the value-added generated by the retail sector soared from HKD 26 billion to HKD 90.7 billion between 2004 and 2014. Meanwhile, its proportion to GDP almost doubled from 2.1% to 4.1%, contributing about 0.28 percentage point to GDP growth annually. If the value of retail sales for this year drops by 5%, GDP growth will be lowered by 0.4 percentage point. Meanwhile, retail sector employment declined to 338,600 payrolls in the fourth quarter of last year. The latest unemployment rate for retail sector was up 0.5 percentage points to 5.1% from a year ago, higher than the overall unemployment rate of 3.4%. If the adjustment in the retail sector continues, retailers may decide to close shops and cut their headcounts further. The possibility of more lower-income people being unemployed cannot be ruled out, posing a challenge to social stability.

III. Improvement measures

The retail sector has rolled out a number of measures to cope with the downturn. Hong Kong Commerce and Industry Association organized quite a few "All Shopping HK" events last year, attracting more than

3,000 participating retailers in the hope of reversing the plunge in retail sales. Large-scaled chain stores promote their products through mobile apps such as WeChat and Alipay. They also attempt to boost sales by offering discounts and rewards. The government budget of this year has allocated a portion of funds to Hong Kong Tourism Board for promotions to attract inbound tourist shopping. These measures include reshaping Hong Kong's tourist image through new videos, kicking off a new round of advertising in short-haul markets and promoting "Quality & Honest Tour" in the Mainland. These measures should be recognized even though it is difficult to reverse the weakness in the retail sector immediately.

In the future, a new impetus of growth for Hong Kong's retail sector should come from a comprehensive upgrade of the tourism industry as well as quality and personnel improvement of overall shopping service and value added. The specific measures are as follows.

Firstly, it is necessary to regain and enhance Hong Kong's reputation as a "Hospitable City" as soon as possible. According to some relevant surveys, Hong Kong's retail sector still enjoys a number of advantages including good international image, plentiful product sources, reliable product quality, ample funding and experiences, and frequent economic exchange with the Mainland and surrounding areas. However, enhancing Hong Kong's reputation as the 'Hospitable City' is a prerequisite to unleashing these advantages. This can be done by launching more targeted promotional events to advertise Hong Kong's attractiveness as a "Shopping Paradise". Furthermore, unfriendly behaviors towards inbound visitors should be stopped. To enhance Mainland visitors' confidence in shopping in Hong Kong, some of the persistent problems plaguing the tourism industry, such as forced shopping, should be resolved as soon as possible.

Secondly, more tourist shopping facilities should be built to help upgrade retail services. In addition to the current border shopping mall in Lok Ma Chau, more facilities should be built in Sha Tau Kok, Shenzhen Bay, Liantang or Heung Yuen Wai region to divert Mainland visitors. Moreover, e-commerce has become a catalyst for consumption growth in the Mainland. The sales value of online shopping exceeded RMB 1 trillion in the first quarter of this year, while the sales value of physical products sold online accounted for more than 10% of total retail sales. Retailers in Hong Kong should prioritize research and development in e-commerce business in order to better serve the shopping needs of Mainland and overseas residents. At the same time, staff education and training should be strengthened to enhance retail service quality.

Thirdly, the lack of local brands is a problem that needs resolving. Based on the survey statistics from the Census and Statistics Department, in the past few years, the cost of goods sold accounted for 63% to 67% of the total value of goods sold to tourists in Hong Kong, and most of the goods were imported from abroad. If these goods were produced in Hong Kong, Hong Kong's GDP would be boosted by more than HKD 100 billion by realizing the potential of "made in Hong Kong" and encouraging more tourist spending. In the future, Hong Kong should strive to drive re-industrialization and actively create local brands by harnessing technology and innovation. In the meantime, brand promotion and product sales need to be improved to attract more visitors worldwide to Hong Kong.

In addition, policy measures regarding regulations on purchases and visits for Mainland residents should be reviewed and modified regularly. In particular, policy arrangement for Shenzhen residents should be reviewed to improve the flexibility and convenience of traveling to Hong Kong for shopping or business, providing Hong Kong's retail sector with a larger market and customer base.

主要經濟指標 (Key Economic Indicators)

一．本地生產總值 GDP	2014	2015	2015/Q4	2016/Q1
總量 (億元) GDP(\$100 Million)	21,946	22,464	6,448	5,904
升幅 (%) Change(%)	2.6	2.4	1.9	0.8
二．對外貿易 External Trade	2014	2015	2016/3	2016/1-3
外貿總值 (億元) Total trade(\$100 Million)				
港產品出口 Domestic exports	553	469	36	97
轉口 Re-exports	36,175	35,584	2,718	7,697
總出口 Total exports	36,728	36,053	2,754	7,794
進口 Total imports	42,190	40,464	3,224	8,769
貿易差額 Trade balance	-5,463	-4,411	-470	-975
年增長率 (%) YOY Growth(%)				
港產品出口 Domestic exports	1.7	-15.2	-10.7	-15.2
轉口 Re-exports	3.2	-1.6	-7.0	-6.7
總出口 Total exports	3.2	-1.8	-7.0	-6.8
進口 Imports	3.9	-4.1	-5.8	-8.2
三．消費物價 Consumer Price				
綜合消費物價升幅 (%) Change in Composite CPI(%)	4.4	3.0	3.0	2.9
四．樓宇買賣 Sale & Purchase of Building Units			2016/4	2016/1-4
合約宗數 (宗) No. of agreements	81,489	76,159	5,613	14,473
年升幅 (%) Change(%)	15.6	-6.5	-9.8	-49.8
五．勞動就業 Employment			2015/12-2016/2	2016/1-2016/3
失業人數 (萬人) Unemployed(ten thousands)	14.95	12.2	12.1	13.0
失業率 (%) Unemployment rate(%)	3.2	3.3	3.3	3.4
就業不足率 (%) Underemployment rate(%)	1.5	1.4	1.3	1.4
六．零售市場 Retail Market			2016/3	2016/1-3
零售額升幅 (%) Change in value of total sales(%)	-0.2	-3.7	-9.8	-12.5
零售量升幅 (%) Change in volume of total sales(%)	0.6	-0.3	-8.8	-11.3
七．訪港遊客 Visitors				
總人數 (萬人次) arrivals (ten thousands)	6,084	5,931	421	1,374
年升幅 (%) Change(%)	12.0	-2.5	-4.3	-10.9
八．金融市場 Financial Market			2016/2	2016/3
港幣匯價 (US\$100=HK\$)				
H.K. Dollar Exchange Rate (US\$100 = HK\$)	775.6	775.1	777.6	775.4
貨幣供應量升幅 (%) change in Money Supply(%)				
M1	13.0	15.4	15.9	7.0
M2	9.5	5.5	4.9	3.5
M3	9.6	5.5	4.9	3.6
存款升幅 (%) Change in deposits(%)				
總存款 Total deposits	9.7	6.7	6.8	5.4
港元存款 In HK\$	9.3	10.7	9.4	3.8
外幣存款 In foreign currency	10.1	3.1	4.5	7.0
放款升幅 (%) in loans & advances(%)				
總放款 Total loans & advances	12.7	3.5	1.4	-1.4
當地放款 use in HK	12.1	3.5	2.1	-1.8
海外放款 use outside HK	14.2	3.6	0	-0.4
貿易有關放款 Trade financing	-1.4	-16.3	-20.6	-20.9
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	23,605	21,914	19,112	20,777