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Hong Kong Economy: Maintaining stable and relatively fast growth in 2018

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Fastest growth rate since 2011

Hong Kong economy expanded remarkably in 2017 with the average real GDP growth reaching 3.9% year-on-year in the first three quarters, the fastest pace since 2011. The strong performance was attributable to a number of factors, namely better trade performance amid a synchronized recovery among major economies globally; the relatively low base of comparison in merchandise trade, tourism and retail sectors in 2016; generally positive global economic sentiment and low interest rate environment, leading to strong equity and property market performance, and financial and business services demand; and the robust private consumption performance driven by full employment condition and positive consumer confidence in Hong Kong. The growth momentum in the first three quarters of 2017 remained largely steady with real GDP growth rate reaching 4.3%, 3.9% and 3.6% respectively. The BOCHK also raised the growth forecast for 2017 to 3.8%.

External performance reversed the downtrend over the past two years. In 2017, a number of major economies, including the US, Eurozone, Japan and Mainland China, all enjoyed a synchronized recovery. Hong Kong, as a small and open economy, also benefited from the global recovery, with exports of goods increasing 6.7% year-on-year in real terms in the first three quarters of 2017, notably above the 0.5% growth in the same period of previous year. While the growth rate of exports of goods moderated from 9.3% in Q1 to 5.5% in Q2 and Q3, largely because of the fading base effects in early 2016, the growth trend of overall external performance remained unchanged. Moreover, exports of goods to most destinations continued to post solid growth, in particular to the emerging markets like India and ASEAN countries. At the same time, the growth of imports of goods outpaced those of exports, leading to wider trade deficits.

Exports of services returned to a mild positive growth. Since the inbound tourism reached its peak in 2013 and 2014, both tourism and retail sectors have undergone a period of structural adjustment. Even though the number of visitor arrivals has already reversed its downtrend and grew 2.7% year-on-year in the first ten months of 2017, the spending pattern of inbound tourists has changed from focusing mainly on luxury goods and jewelries to more diversified products. This resulted in a lower tourism spending per capita and negatively affected the performance of inbound tourism as well as overall exports of services. After three years of adjustment, exports of travel services still declined 0.4% year-on-year in real terms in the first three quarters of 2017, whereas Q3 growth returned to a positive reading of 1.8%, the first increase after 13 consecutive quarters of decline. In addition, the global economic sentiment became more optimistic, together with the low interest rate environment, stabilizing RMB exchange rate, as well as further connection between the Mainland and Hong Kong capital markets, the Hang Seng Index reached the highest level in nearly 10 years and the daily transaction value increased to over $100 billion level. All these contributed to the 4.1% increase in financial services exports in Q3. Moreover, exports of transport services also improved moderately alongside the global economic recovery and vibrant regional trade and cargo flows. As a result, overall exports of services reversed its downtrend and posted 3.0% and 3.7% year-on-year growth in real terms in the first three quarters and Q3 respectively.

Domestic demand improved notably. Against the stronger external backdrop, the domestic demand of Hong Kong also strengthened, together with the support of full employment, and buoyant financial and property market performance. Real private consumption expenditure increased solidly by 5.3% and 6.7% year-on-year in the first three quarters and Q3 of 2017 respectively, with the latter reporting the fastest growth rate since Q2 2015. The government consumption expenditure also provided some support to the economy, with 3.5% and 4.1% growth in real terms in the first three quarters and Q3 respectively. Moreover, business confidence improved over the past year. Gross domestic fixed capital formation increased 3.7% in real terms in the first three quarters, though it recorded a slight decline of 1.7% in Q3. The decline in Q3 was due to a decrease in machinery and equipment acquisition, a volatile component. Nevertheless, building and construction expenditure accelerated, rising by 5.0% and 4.1% in real terms in the first three quarters and Q3 respectively, partially offsetting the weak performance in expenditure on machinery and equipment.

Both domestic and external factors support relatively fast growth in 2018

The global economy continues its relatively fast recovery. Without doubt, the global economic growth (between 2011 and 2017) has slowed by nearly 1 percentage point to 3.5% when compared to the period before the global financial crisis (between 2000 and 2007). However, the global economy continues its relatively fast recovery, and the momentum is expected to carry over to 2018. According to the latest World Economic Outlook released by the International Monetary Fund (IMF) in October 2017, the global economic growth is expected to accelerate by 0.1 percentage point to 3.7% in 2018. In the US, the economy maintained a moderate growth momentum with 2.2% year-on-year growth in real terms in the first three quarters of 2017. All major expenditure components, including private consumption and investment, posted positive growth. Together with the full employment condition, buoyant financial markets and stable property market performance, the US economy is expected to maintain moderate growth in 2018 despite continuous monetary policy normalization by the Federal Reserve. Meanwhile, the US President Trump proposed tax cut and infrastructure investment to stimulate the US economy. If his policies could be implemented, the overall economic growth might benefit positively amid stronger business confidence.

In the Mainland, the real GDP growth reached 6.9% year-on-year in the first three quarters. Even though its key economic indicators, such as industrial value-added, fixed asset investment and retail sales, have slowed somewhat from its peak in 1H 2017, the slowdown was mainly due to the holiday and weather-related factors, more stringent environmental protection measures as well as efforts to cut capacity, etc. Meanwhile, its economic structure continued to improve, with high-tech, equipment manufacturing and service sectors all performed strongly and will become the growth drivers ahead. Currently, stabilizing growth remains the main objective of the Mainland authorities. With the implementation of proactive fiscal policy together with prudent and neutral monetary policy, deepening supply-side reforms, and accelerating the development into a highly innovative and competitive country, the overall economic growth is likely to reach 6.5% or above in 2018.

External trade is expected to post moderate growth in 2018. Given the relatively fast recovery of the global economy, the World Trade Organization predicted that the global trade volume will increase 3.2% in 2018, roughly in line with the 3.6% growth in 2017 and notably better than the 1.3% increase in 2016. Nevertheless, the global economic performance is still somewhat weaker than the pre-crisis level. Moreover, although a full-fledged trade war between the major economies is not expected to happen, the rise of protectionism, Brexit negotiation, re-negotiation of NAFTA, and the US formal investigation into the Mainland's intellectual property policies, etc. could all affect the pace of globalization and further liberalization. Together with the geopolitical uncertainties, such as the North Korea crisis, the global trade and economic performance might be negatively affected. Therefore, it is believed that the external trade is likely to maintain moderate growth in 2018.

Exports of services will improve further. Firstly, tourism-related industry is likely to bottom out and recover gradually after three years of adjustment. In the past few years, the drop of travel services was the main negative factor affecting overall exports of services in Hong Kong. Therefore, exports of services are likely to improve if travel services start stabilizing or recovering. Secondly, exports of financial services are likely to perform well. On one hand, the sentiment of Hong Kong equity markets remains strong, together with the further connection between the Mainland and Hong Kong capital markets, cross-border financial services demand is likely to increase ahead. On the other hand, with the implementation of belt-and-road initiative and RMB internationalization, as well as the efforts by the Hong Kong SAR government and Hong Kong Monetary Authority in promoting Hong Kong's role in the belt-and-road initiative and RMB businesses, the demand for Hong Kong's financial and business services are likely to increase ahead. Thirdly, alongside the moderate growth in regional trade and cargo flows, exports of travel services will remain steady and further support the overall exports of services ahead.

Solid employment and more active fiscal policy will also support economic growth. In recent years, Hong Kong has reached full employment condition with total employment reaching 3.84 million and the unemployment rate declining to 3.0% between August and October 2017. Certain industries, such as catering, elderly care and construction, etc. have long suffered from labor shortage. With over 69,600 private sector vacancies currently, solid employment market will likely support private consumption and overall economy ahead.

The Policy Address also pointed out that the Hong Kong SAR government currently has a fiscal reserve in excess of $1,000 billion. The government is well positioned to use the accumulated fiscal surpluses, which are wealth derived from the community, wisely to benefit the community. On the premise of ensuring the health of public finance, the current administration will adopt forward-looking and strategic financial management principles in making investment for Hong Kong and relieving the people's burdens. For example, the Policy Address introduced a number of measures, such as increasing innovation and technology (I&T) investment, improving people's livelihood, as well as investing in longer-term infrastructure, etc. in order to better support Hong Kong economic growth ahead. The overall trend growth of Hong Kong might also be raised if the above measures could nurture any new growth driver in the future.

Investment performance will further improve in 2018. The global economy continues its relatively fast recovery. Hong Kong, as a small and open economy, should benefit from better global economic conditions. According to the Report on Quarterly Business Tendency Survey in Q4 2017, the corporate confidence in a number of industries has been improving. The proportion of respondents expecting their business situation to be better is higher than that of those expecting it to be worse for three consecutive quarters. Better corporate confidence could help support machinery, equipment and intellectual property investment ahead. Meanwhile, the government is actively increasing land and housing supply. Private building and construction activities are likely to increase further, with 97,000 private housing units to be available in the coming three to four years. In addition, the first phase of the engineering and construction works for the third runway system at the Hong Kong International Airport and the new development area in North East New Territories are likely to kick off in 2018, together with the expansion of public building program, public building and construction activities will also increase ahead. According to the government figures, the budget for the Capital Works Reserve Fund's expenditure will increase continuously from $91.7 billion in the fiscal year 2017/18 to $130.9 billion in 2021/22. The economic performance will likely be boosted, if the current administration decides to somewhat increase fiscal expenditure ahead.

The financial and I&T industries are likely to be the growth drivers ahead. The real growth rate of the financial and insurance industries was one of the strongest among different sectors of the economy and outpaced that of the overall economy by more than one-fold over the past five years, despite considerable volatilities in the financial markets globally. This is largely the results of Hong Kong's role as a super-connector and its development into an international financial and business services center. With the implementation of the belt and road initiative, the development of Guangdong-Hong Kong-Macau Bay Area, as well as further connection between the Mainland and Hong Kong capital markets, the financial and business services sectors of Hong Kong should have ample room of development, providing full-fledged cross-border financial and business services to companies in the Mainland and the region. The financial sector is likely to maintain solid performance in 2018.

Over the past few years, the economic value-added and employment of I&T industry also outperformed the overall economy. The Policy Address pointed out the goal to double the gross domestic expenditure on Research and Development (R&D) as a percentage of GDP from 0.73% currently to 1.5% within the current-term government's five-year tenure. For Hong Kong to catch up in the I&T race and to become an international I&T hub, the government will step up efforts in eight key areas, viz. resources for R&D, nurturing a talent pool, venture capital, scientific research infrastructure, legislation review, opening up data, government procurement and popular science education, to propel I&T development and will put in necessary resources. Specific measures include setting aside no less than $10 billion as university research funding, providing additional tax deduction for R&D expenditure incurred by enterprises, attracting top overseas scientific research institutions to establish in Hong Kong, and forming the Chief Executive's Council of Advisers on Innovation and Strategic Development, etc. in order to maintain Hong Kong's competitiveness in the global arena and enhance Hong Kong's alignment with the development of the Mainland.

Going forward, Hong Kong economy is expected to maintain a relatively fast growth in 2018, driven by the relatively fast global recovery, solid employment, low interest rate environment, buoyant asset markets performance, as well as increasing government investment, etc. The Hong Kong economy is expected to grow by around 3.0% in real terms in 2018, moderating from 3.8% in 2017 and roughly in line with the annual average of 2.9% over the past decade. On the inflation front, inflationary pressure remains subdued amid modest global inflationary pressure and moderately rising labor cost, while the slightly lower US dollar exchange rate and mild increase in rental level are expected to drive the underlying consumer price index somewhat higher to 2.2% in 2018.

Potential risk factors in 2018

Without doubt, Hong Kong economy is expected to maintain relatively fast growth in 2018. It should also be noted that the favorable base effects in 2016 are fading and there is a number of uncertainties affecting global and Hong Kong economies. Firstly, the geopolitical issues, such as North Korea crisis, Catalonia independent movement, Italian election, Brexit negotiation, the rise of protectionism, and terrorist activities, etc. will continue to threaten the financial markets and economic performance globally.

Moreover, the Federal Reserve is expected to further shrink its balance sheet and raise interest rates in 2018. Some other central banks will also follow the Federal Reserve to raise rates. The highly accommodative monetary environment around the world is also reversing gradually, which might lead to financial market volatilities, in particular the financial markets have already hit record highs for the US and other advanced economies. Any meaningful correction in the financial markets will not only affect those advanced economies but also Hong Kong, given the openness of Hong Kong and the connection between Hong Kong and global financial markets.

Furthermore, while the Federal Reserve will continue to shrink its balance sheet and raise interest rates, some capital outflows from Hong Kong could not be ruled out. Interest rates in Hong Kong might then face more pressure to rise, restraining the investment and asset market performance. Furthermore, Hong Kong property prices have also hit a record high level, any substantial correction in the property market will, no doubt, have negative impacts on Hong Kong economy. Therefore, even though Hong Kong economy is expected to maintain relatively fast growth in 2018, it should be well-prepared for any potential impacts from the abovementioned uncertainties.

主要經濟指標 (Key Economic Indicators)

一 . 本地生產總值 GDP	**2015**	**2016**	**2017/Q2**	**2017/Q3**
總量（億元）GDP($100 Million)	22,464	23,586	6,291	6,798
升幅(%) Change(%)	2.4	1.9	3.9	3.6
二 . 對外貿易 External Trade			**2017/10**	**2017/1-10**
外貿總值（億元）Total trade($100 Million)				
港產品出口 Domestic exports	469	429	37	360
轉口 Re-exports	35,584	35,454	3,310	31,124
總出口 Total exports	36,053	35,882	3,347	31,484
進口 Total imports	40,464	40,084	3,787	35,301
貿易差額 Trade balance	-4,411	-4,201	-440	-3,817
年增長率(%) YOY Growth(%)				
港產品出口 Domestic exports	-15.2	-8.5	3.2	1.5
轉口 Re-exports	-1.6	-0.4	6.7	8.4
總出口 Total exports	-1.8	-0.5	6.7	8.3
進口 Imports	-4.1	-0.9	7.9	8.7
三 . 消費物價 Consumer Price			**2017/10**	**2017/1-10**
綜合消費物價升幅(%) Change in Composite CPI(%)	3.0	2.4	1.5	1.4
四 . 樓宇買賣 Sale & Purchase of Building Units			**2017/10**	**2017/1-10**
合約宗數（宗）No. of agreements	76,159	73,004	7,063	69,056
年升幅(%) Change(%)	-6.5	-4.1	-17.5	20.3
五 . 勞動就業 Employment			**2017/7-2017/9**	**2017/8-2017/10**
失業人數（萬人）Unemployed(ten thousands)	12.9	13.3	12.8	12.4
失業率(%) Unemployment rate(%)	3.3	3.4	3.1	3.0
就業不足率(%) Underemployment rate(%)	1.4	1.4	1.1	1.1
六 . 零售市場 Retail Market			**2017/10**	**2017/1-10**
零售額升幅(%) Change in value of total sales(%)	-3.7	-8.1	3.9	1.2
零售量升幅(%) Change in volume of total sales(%)	-0.3	-7.1	3.6	1.1
七 . 訪港遊客 Visitors			**2017/10**	**2017/1-10**
總人數（萬人次）arrivals (ten thousands)	5,931	5,665	527.8	4791.4
年升幅(%) Change(%)	-2.5	-4.5	6.6	2.7
八 . 金融市場 Financial Market			**2017/9**	**2017/10**
港幣匯價(US$100=HK$) H.K. Dollar Exchange Rate (US$100 = HK$)	775.1	775.6	781	780.2
貨幣供應量升幅(%) change in Money Supply(%)				
M1	15.4	12.3	7.1	35
M2	5.5	7.7	8.8	12.1
M3	5.5	7.7	8.9	12.1
存款升幅(%) Change in deposits(%)				
總存款 Total deposits	6.7	9.1	7.5	10.9
港元存款 In HK$	10.7	9.4	13.2	19.8
外幣存款 In foreign currency	3.1	8.8	2.0	2.2
放款升幅(%) in loans & advances(%)				
總放款 Total loans & advances	3.5	6.5	15.7	21.4
當地放款 use in HK	3.5	7.4	15.1	22.3
海外放款 use outside HK	3.6	4.5	16.9	19.3
貿易有關放款 Trade financing	-16.3	0.2	8.5	4.7
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	21,914	22,000	27,554	28,246