



Hong Kong's Economic Outlook and Opportunities from the National Policies

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Since the beginning of 2018, Hong Kong's economy has held up fairly well. The real GDP increased by 4.6% in the 1st quarter. The expansion momentum carried over into the 2nd quarter with a yearly growth of 3.5%. Overall, the economy grew by 4% in real terms in the 1st half of 2018, which was roughly in line with the growth pace in the same period of 2017. It was also the highest growth rate since 2011. While the economic expansion accelerated further, the growth components were getting relatively balanced. Both external demand and domestic consumption remained strong or even booming in the 1st half of the year. Total export of goods grew by 5.2% in real terms in the 1st quarter and 4.6% in the 2nd quarter. Private consumption expenditure jumped by 8.8% in real terms in the 1st quarter with another increase of 6.1% in the 2nd quarter. In addition, investment spending remained stable at an elevated level, and the HKSAR Government's fiscal position continued to be solid; the labor market kept buoyant with the unemployment rate edging down to a low of 2.8%; the overall inflation pressure was moderate at around 2%. Based on an array of data, the Hong Kong economy is currently in favorable conditions, while a higher and faster growth is mainly constrained by supply side related to labor and land.

Trade frictions as the biggest uncertainty

Looking ahead, at present, the biggest uncertainty facing the Hong Kong economy is the global trade disputes raised by the United States (US), the China-US trade friction in particular. Due to the uncertain prospects for exports, Hong Kong companies face certain difficulties in taking orders, pricing and business development. The China-US trade frictions will have a material impact on the Hong Kong economic activities, also affect the business confidence. It can be seen from three levels:

1. Trade. In 2017, Hong Kong handled US\$45 billion worth of re-exports between the Mainland China and the US, accounting for 9% of Hong Kong's total exports and 4% of total trade. Of this, US\$36 billion of re-exports were from the Mainland China to the US, and US\$900 million of re-exports were from the US to the Mainland China. As the US has imposed a 25% additional tariff on US\$50 billion of Chinese imports, the affected Hong Kong re-exports to the US is estimated at about HK\$46.5 billion, accounting for 16.6% of Chinese re-exports to the US through Hong Kong in 2017. If another round of 25% additional tariff is imposed on US\$200 billion of Chinese imports, the affected value of Hong Kong re-exports to the US is estimated at about HK\$83.6 billion, accounting for 29.8% of Chinese re-exports to the US through Hong Kong in 2017. The trade concerned from the two tariff lists would total around HK\$130 billion, accounting for 46.3% of Chinese re-exports to the US through Hong Kong in 2017.

2. Economic Growth. Based on preliminary estimates, the first round of tariffs between China and the US, in which both sides enacted a 25% additional tariff on US\$50 billion worth of trade, would affect the Hong Kong annual economic growth rate by 0.2-0.3%. If the US slaps another 25% tariff on US\$200

billion of Chinese imports, there would be additional 0.6-0.8% of impacts on Hong Kong's economic growth, bringing the total impacts to 0.8-1.1%.

3. Industry structure. The structural impacts arising from the uncertain outlook would hinge on Hong Kong's counter-measures and the flexibility of Hong Kong companies to cope with the uncertainty in receiving orders. The influences at the structural areas include: the intermediary functions of Hong Kong; the direction of industry transfer and economic transformation; and the changes in the functions and roles of Hong Kong in reshaping of the value chains.

In addition to trade factors, since the US will continue to raise interest rates, there will be greater upward pressures on the Hong Kong dollar's interest rate trend, which will restrain Hong Kong's asset market and investment sentiment. The market generally expects that Hong Kong's economic momentum will slow down in the 2nd half of the year.

There are quite a number of steady growth drivers

Fortunately, there are many favorable factors supporting the continued expansion of the Hong Kong economy in the short to medium term. For instance, the expected commencement of the high-speed railway and the Hong Kong-Zhuhai-Macao Bridge in the 3rd quarter of the year will bring a sustained boost to people flows and goods flows to Hong Kong. The MTR expects that passenger flows will reach 80,000 per day after the launch of the high-speed railway and gradually increase over the next few years, underpinning the growth of Hong Kong tourism and the retail sector. The fiscal position of Hong Kong is solid after years of rising surpluses. With over HK\$1 trillion of fiscal reserve, the HKSAR Government can implement a proactive fiscal policy and help companies overcome difficulties amid an external market with increased uncertainties, support domestic demand and maintain the stability of local job market. Besides, the recent amendments and implementation of the Hong Kong Listing Rules have removed the barriers for the Hong Kong Stock Exchange to attract new economy companies to list in Hong Kong. The new arrangements are expected to increase more than HK\$50 billion per annum of financing business in the Hong Kong stock market, which will stimulate the long-term development of the Hong Kong capital market. The free trade agreement signed between Hong Kong and ASEAN at the end of 2017 is conducive to foster economic and trade relations between the two economies. In 2017, bilateral trade between Hong Kong and ASEAN was HK\$936.8 billion, accounting for 11.4% of Hong Kong's total trade. ASEAN is Hong Kong's second largest trading partner after the Mainland China. The Hong Kong-ASEAN Free Trade Agreement covers trade in goods, trade in services, economic and technological cooperation, intellectual property rights, etc. Its implementation will provide more convenience for Hong Kong enterprises to enter the ASEAN market, thereby Hong Kong's function as a base for Chinese capital to invest in ASEAN will be strengthened.

In the 2017 Policy Address, the Chief Executive of HKSAR proposed a positioning to develop Hong Kong into an international innovation and technology center. In order to promote the development of innovation and technology, the HKSAR Government has set aside HK\$50 billion in the 2018/19 budget, focusing on investment in the development of biotechnology, artificial intelligence, smart city and Fintech. It is expected that the HKSAR Government will further increase investment and introduce supporting measures for the development of innovation and technology, such as talent admission, taxation, and scientific and technological cooperation with other regions. The success of these proposals will give new impetus to Hong Kong's economic growth.

Opportunities from Policy factors

In the long term, the development and upgrading of the Mainland economy is based on a strong endogenous momentum, which will hardly be interfered or blocked by external forces. With the continued reform, opening up and development, the Mainland economy will provide many opportunities for Hong Kong. These can be summarized into four areas:

1. A new round of in-depth and widespread market liberalization

On 10th April, President Xi Jinping delivered a keynote speech at the Boao Forum for Asia, committing four new measures for opening up China markets, including significantly broadening market access; creating a more attractive investment environment; strengthening intellectual property rights protection; and actively expanding imports. Subsequently, the People's Bank of China announced six measures which technically went into effect immediately to further open up the financial sector, these included: (1) Removing the foreign equity restrictions on banks and financial asset management companies with an equal treatment for domestic and foreign-funded institutions; and simultaneously allowing foreign banks to set up branches in the Mainland China; (2) Relaxing the upper limit on foreign ownership in securities, funds, futures, and life insurance companies to 51%, with the cap being phased out over three years; (3) Scrapping the requirement that at least one domestic shareholder of joint venture securities firms have to be a securities company; (4) To further improve the access mechanism between stock markets in the Mainland China and Hong Kong, daily quotas for stock connect schemes were increased quadruple from 1st May this year, in which the daily northbound quota for each of Shanghai Connect and Shenzhen Connect was increased from 13 billion yuan to 52 billion yuan. The daily southbound quota to buy Hong Kong stocks was increased from 10.5 billion yuan to 42 billion yuan for Shanghai Connect and Shenzhen Connect respectively; (5) Allowing qualified foreign investors to operate insurance brokerages and insurance assessment business in the Mainland China; (6) The businesses scope of foreign insurance brokerage companies was expanded to the same level as that of their Chinese counterparts. The new liberalisation measures exceeded expectations, and will provide Hong Kong investors and companies opportunities to enter the Mainland market for diversification in investment, operations and business transformation. This will be particularly true for those in the finance, securities and insurance businesses.

2. Enormous potential for import trade and domestic consumption

With a population roughly 400 million middle-income group in the Mainland China, the potential for domestic demand is great. In 2016, outbound spending by the Mainland Chinese tourists reached 1.2 trillion yuan. Significantly tariff reductions, holding of import trade affairs in Shanghai, and the active expansion of imports, on one hand, can bring immediate and significant improvements in product quality to satisfy the needs of consumption upgrading and transformation. As a result, some overseas consumption may be converted into domestic demand. Meanwhile, import demand is conducive for China to sign bilateral or multilateral free trade agreements with more countries or regions to stimulate growth in bilateral trade and enhance international economic and trade relations. The import of high-quality products would also be conducive for the balanced development of foreign trade, reducing the reliance on exports for economic growth. Therefore, the enormous import and consumption demand formed in the Mainland China will provide Hong Kong a long-term growth momentum on tourism, retail, finance, logistics and other services.

3. Belt and Road Initiative provides Hong Kong companies opportunities to enter new markets

There are obvious differences between the enterprises following the Belt and Road (B&R) initiative to enter new markets and those following the “Marshall Plan” for global investment after World War II: (1) The B&R investments are long-term international initiatives proposed by the Chinese government in response to the needs of worldwide development and the development interests of various countries; (2) The B&R investments are enterprise-led, and operated on commercial principles, mainly funded by development finance, considering comprehensive and long-term benefits rather than short-term gain or profit first; (3) An important aspect of B&R investments is that they are based on a model of co-consulting, co-sharing and co-utilizing, seeking to achieve a diversified cooperation and development. For example, China’s investment in Pakistan’s Gwadar Port is adopting an integrated development and operation model of Port-Industrial Park-City-Railway (PPCR). This model can also be suitably applied for investments and projects of the China-Myanmar Economic Corridor which is currently under exploration. Furthermore, the public-private partnership (PPP) development and operation model would be also beneficial for the establishment of long-term cooperation between the investors and the investees.

These innovative investment and operation models are conducive to Hong Kong investors to follow the B&R investments to enter new markets, exploring the businesses opportunities brought by the infrastructure investment and operations. The opportunities would be available in areas such as manufacturing, property development, hotels, design, retail, e-commerce, and so on.

4. The development of Greater Bay Area provides opportunities for industrial upgrading and transformation

The development of Greater Bay Area (GBA) will facilitate deeper industrial cooperation among Hong Kong, Macao and the Pearl River Delta region. In the future, under the concept of GBA, the city cluster can integrate resources, enhance complementary strengths, and coordinate development, giving full play to regional synergies, elevating regional competitive advantages, and taking a greater role in the national economic development and opening up. As the world’s freest and most open economy with a strategic location in the Asia-Pacific time zone, Hong Kong is a hub in various functions such as finance, trade, shipping and information. At present, Hong Kong is also a prime location for multinational companies to set up their regional headquarters in the Asia-Pacific region. Thus, Hong Kong will have a unique role to play in the development of the Greater Bay Area.

The inclusion of Hong Kong and Macao would be conducive for the Greater Bay Area to develop as the most open, market-oriented and globalized cooperative systems in the country. With the support from the national level, Guangdong, Hong Kong and Macao can jointly build a number of powerful centers with global influence and development status, such as an international financial center based on coordinating development; an international trade and shipping center laid in networks connection; and a technology center for R&D, innovation, and manufacturing. In the construction of the International Innovation and Technology Center, Guangdong, Hong Kong and Macao can jointly increase investment in science and technology parks to attract both overseas and Mainland high-tech flagship firms to set up base in the GBA and collaborate on R&D, intellectual property rights protection, procurement of raw materials, technology financing, as well as management and operations of innovation and technology industry. In particular, Hong Kong-Shenzhen-Dongguan can work together to create a high-tech corridor, forming an upstream and downstream high-tech value chain that links the world.