



HK's Economy Slows Down but Fundamentals Remain Sound

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Double hit by worsening external environment prompted by the escalating Sino-US trade frictions and weaker domestic demand amid asset price adjustment, Hong Kong's economy further decelerated this year. Although there are some favorable factors in the second half of the year, such as the Federal Reserve's dovish stance, positive wealth effect and the low base for comparison, uncertainties caused by trade frictions will continue to have a lasting impact. Therefore, Hong Kong's economy may continue to slow down this year.

In the first half, Hong Kong's economy experienced slow growth

Hong Kong's economy showed the following characteristics in the first half of this year.

Firstly, the overall economy experienced a marked slowdown. The Gross Domestic Product (GDP) decelerated sharply in growth, from 1.2% in real terms in the fourth quarter last year to a mere 0.6% in the first quarter this year, which is the worst performance in 10 years, and on the brink of recession. In the past thirty years, such low economic growth occurred only during the Asian financial crisis in 1997, the burst of the dot-com bubble in 2001, and the outbreak of the global financial tsunami in 2009. In the second quarter, the economy of Hong Kong remained in the doldrums, with merchandise exports and retail sales plummeting by 2.6% and 4.5% respectively in April, more than the decline of 2.4% and 1.2% in the first quarter. It is unlikely that the trend will reverse quickly in May and June. It seemed like a foregone conclusion that Hong Kong's economy would record slow growth in the first half of the year.

Secondly, both domestic and external demand weakened. Amidst rising trade protectionism, weaker external demand, and the front loading of exports, Hong Kong's overall exports fell by 2.5% in the first four months this year, sliding further from a marginal increase of 2.2% in the fourth quarter last year and registering negative growth for six consecutive months. Imports fell slightly more than exports, by 3.7 percent year on year. In terms of export market, the total value of goods exported to the United States, the Mainland, Japan and Taiwan accounted for two thirds of Hong Kong's total exports, which reinforces Hong Kong's status as a trade center. However, in the first four months of this year, exports to these markets fell by 11.0 percent, 5.2 percent, 5.5 percent and 14.9 percent respectively in nominal terms, dragging down the growth of Hong Kong's exports by 4.3 percentage points and exceeding the decline of overall exports. This indicates that negative

effect from Sino-US trade frictions has begun to emerge.

Though service exports fared better than merchandise exports, in the first quarter of this year, it increased by merely 1.1 percent in real terms, much lower than the growth of 4.9 percent in the past year and 3.3 percent in the fourth quarter last year, mainly due to negative growth in transport and financial services. Despite the sustained expansion of the tourist industry in Hong Kong (13.9 percent increase in visitor arrivals during January to April this year), the pattern of passenger consumption has changed, which was more supported by same day in-town visitors and visitors to other destinations, who contribute less to economic growth. This is also reflected in the fact that the exports of tourism services increased by only 5.6 percent in nominal terms in the first quarter, much less than the 16.8 percent increase of visitors arrivals in the same period.

Domestic demand has also lost momentum. Among the three pillars of domestic demand, private consumption, which accounts for nearly 70 percent of GDP, has fallen sharply amid the substantial fluctuation of the stock market and property market early this year, which weighed on domestic consumer confidence. In contrast to the year-on-year real growth of 5.5 percent and 8.9 percent in the past year and in the first quarter last year respectively, private consumption expenditure only showed marginal expansion of 0.2 percent year-on-year in real terms in the first quarter this year, the lowest increase since the second quarter of 2016. Investment performed even worse with gross domestic fixed capital formation falling further by 7.1 percent year-on-year in real terms in the first quarter, following a decline of 5.8 percent in the preceding quarter. This is because expenditure on acquisitions of machinery, equipment and intellectual property products were depressed amidst trade protectionism and cautious business sentiment, while growth in building and construction were also constrained by completion of some major infrastructural projects. On the contrary, government consumption expenditure, which accounts for about 10 percent of GDP, continued to grow solidly by 4.5 percent in real terms in the first quarter over a year earlier, providing stable support for economic growth.

Thirdly, labor market has remained tight and property price rebounded. Although economic growth fell to a 10-year low, the labor market stayed stable, with the seasonally adjusted unemployment rate at 2.8 percent in March-May this year, unchanged from that of October-December last year. However, the number of employed persons decreased by thousands during the period, indicating that the stable unemployment rate may be partly related to the reduction of labor supply in Hong Kong. Asset prices rebounded rapidly after six consecutive months of adjustment. According to figures provided by the Rating and Property Valuation Department, the Private Housing Price Index rose from 359.4 in December last year to 390.5 in April this year, up by a total of 8.7 percent in four months, and close to the record high of 394.8 in July last year. The Centa-City Leading Index registered 189.42 in late May, up 11.5 percent from the low level at the end of January. Thanks to the resilience of Hong Kong's property market, the asset market rebounded and climbed to

a record high again in spite of the economic downturn.

In the second half, Hong Kong economy faces challenges

In the second half of the year, Hong Kong's economy will be subject to many uncertainties, especially global economic slowdown and the Sino-US trade disputes, which will impede rapid recovery of domestic and foreign demand and bring more challenges to the economy.

On the external side, uncertainties mainly come from the slowing global economy and trade upheaval. In April this year, the IMF cut its global growth outlook for 2019 for the third time to 3.3 percent, the lowest growth since the financial tsunami. The forecast for US growth was lowered to 2.3 percent from 2.9 percent last year, while that of the Eurozone was trimmed from 1.8 percent to 1.3 percent, and that of Japan was revised up from 0.7 percent to 1.0 percent. Meanwhile, the World Trade Organization recently released its latest report, slashing global trade growth forecast for 2019 to 2.6 percent from 3.7 percent, much lower than last year's 3.8 percent. It shows that the growth rate of global trade, higher than the global economic growth rate in the past two years, would return to a low level less than global economic growth, an unusual phenomenon since the establishment of the WTO.

It is noteworthy that although the IMF and WTO cut forecasts of global economic and trade growth, they haven't taken into account the heightened trade tensions between the US and China since May. As the Chinese government rejected unreasonable demands put forward by the US, the trade dispute intensified. Then the US began to sanction China's high-tech companies such as Huawei, extending the trade war to a tech war. President Trump threatened to impose duties on the remaining US \$300 billion worth of Chinese imports, which prompted China's retaliation. In the short term, Sino-US trade frictions will likely become the norm for quite a long time, and Hong Kong, as a small open economy, will inevitably be affected.

As for the Mainland, the economy has shown great resilience since this year, despite escalating China-US trade rift. Chinese economy kicked off 2019 on a stable note, with GDP still growing by 6.4 percent in the first quarter, the same as that in the fourth quarter last year, and the quality of economic growth steadily improved. In the first five months, exports grew by 6.1 percent, close to last year's 7.1 percent, and even higher than the average of 4.7 percent in the past five years before the Sino-US trade frictions. Due to the economic slowdown in May, fixed assets investment and retail sales rose 5.6 percent and 8.6 percent respectively, slightly lower than last year's figures, indicating that the economy is still facing considerable downward pressure. In order to stabilize economic growth, the Mainland has recently stepped up policy stimulus. Local governments will be allowed to use proceeds from special-purpose bond issuance as project capital for certain infrastructure investments, mainly for railways, highways, electricity and gas-supply projects. It is expected that more stimulus measures will be introduced in the second half of the year, including further increase of fiscal expenditure, targeted relaxation of bank lending, and even required reserve ratio cuts. It is

estimated that China's GDP growth could reach around 6.3 percent this year, which will continue to support Hong Kong's economic stability.

On the internal side, one piece of positive news is that the low interest rate environment will last. The inverted US yield curve warned that a recession is coming, which prompted the Fed to adjust its monetary policy stance substantially and the market expected one or two interest rate cuts this year. Therefore, it is believed that the low interest rate environment in Hong Kong will continue, which is conducive to further stabilization of the property market. The positive wealth effect, in turn, will support investment and private consumption in Hong Kong.

Another positive factor is that Hong Kong's labor market remained in full employment, which lends support to personal consumption expenditure. The government has also introduced measures to develop the economy and boost investment, which is expected to shore up Hong Kong's economy in the second half of the year. In addition, according to the Quarterly Business Tendency Survey for the second quarter of 2019, negative sentiment on Hong Kong's business prospects has been alleviated, bolstering investment in machinery, equipment and intellectual property products. In the future, with the government's efforts to increase land supply, the construction of public and private housing will increase. As the projects of the Three Runway System of Hong Kong International Airport and the North East New Territories New Development Areas will be gradually initiated, overall domestic demand is expected to improve gradually. We should also pay attention to the possible impact of the social conflicts caused by Hong Kong's proposed extradition law revision on the economy, especially on investment demand.

The third positive factor is the steady expansion of service exports such as tourism and cross-border finance. The completion of the Guangzhou-Shenzhen-Hong Kong High-speed Rail and the Hong Kong-Zhuhai-Macao Bridge will continue to bring more visitors to Hong Kong. Although consumption pattern of visitors has changed, the significant increase in the number of visitor arrivals will also reinforce Hong Kong's tourism services. Meanwhile, exports of financial services will fare well despite the increasing volatility of the global and Hong Kong stock markets. Alibaba's secondary listing on the Hong Kong stock exchange could boost listing and trading activities, while closer connectivity between the Mainland and Hong Kong, under the Outline Development Plan for the Guangdong-Hong Kong-Macao Greater Bay Area, will attract more overseas capital and drive demand for cross-border financial activities, which will help support the overall exports of services.

Looking ahead, sluggish global demand and deterioration in Sino-US economic and strategic relations will continue to cloud Hong Kong's foreign trade performance, pulling the overall economic growth down to the lowest level since the global financial tsunami, or about 1.7 percent for the whole year. Fortunately, the positive factors mentioned above, such as full employment, low interest rate environment, stabilization of the property market, as well as greater demand for tourism and cross-border financial services, have rendered support to Hong Kong's economy. In the future, if Hong Kong can speed up the development of its innovation and technology industry by strengthening economic cooperation with the Mainland, especially with the Great Bay Area, and make great efforts to improve people's livelihood, the economy can regain traction.