

## 2020 Hong Kong Economic Outlook

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The Hong Kong's economy was hit by both internal factors and external shocks in 2019, leading to the first negative growth in ten years. The social unrest arising from the Extradition bill was regarded as the major cause for the economic downturn with a severe blow to the labor market. For 2020, the global economic growth and trade performance are expected to improve. The conclusion of China-US phase one trade deal and the clearer development in Brexit would boost investors' expectations. And a greater emphasis is placed on stabilizing growth in China to stimulate the economy from bottoming up. But, the social unrest from the Extradition bill will continue to be the major headwind for economic development in Hong Kong. The Hong Kong economy is forecast to rebound slightly in 2020 with annual GDP growth at around 1%.

### 1. 2019 Economic Review

In 2019, the Hong Kong economy suffered a severe downturn as a result from both internal factors and external shock and illustrated the following five important characteristics:

**First, the overall economy entered a recession again after ten years.** The Hong Kong economy has been heading into a downward trend since the beginning of 2019. Economic performance has declined quarter by quarter. The year-over-year GDP growth in the first half dropped sharply to 0.5% from 4.1% in a year ago. The yearly growth in Q3 even dropped to negative 2.9%, which was a severe deterioration from the first half and led to negative 0.7% growth for the first three quarters in 2019. Given that the seasonally adjusted real GDP contracted by 0.5% in Q2 and 3.2% in Q3 on a quarterly basis, the Hong Kong economy has entered a technical recession. The economic performance in Q4 is likely to worsen with a full-year GDP growth estimated to contract by 1.0-1.5%. It will be the first recession since the global financial crisis in 2009 as well as the fifth economic recession in Hong Kong based on available GDP data.

**Second, the social unrest arising from the Extradition bill was the major cause for the economic downturn.** Different from previous recessions, the current recession is mainly triggered by internal factors. The social unrest lasted for more than 6 months, causing significant damages to the tourism industry. Services export thus dropped substantially. Domestic consumption and investment spending also weakened. These dealt a huge blow to the Hong Kong economy, as it had already suffered from the slowing global economic growth and the escalation of China-US trade tensions. Visitor arrivals to Hong Kong were down by 39.1%, 34.2% and 43.7% in Aug, Sep and Oct, bringing unprecedented pressures for the accommodation, catering and retail sectors. In Oct, retail sales in Hong Kong dropped by 24.3%, the biggest slump on record. As a result, private consumption expenditure in Q3 fell by 3.4%. Gross domestic fixed capital formation also slipped by 16.3%, which was the lowest in ten years. Overall, the social unrest was estimated to drag down the Hong Kong GDP growth by 2.1%, being the main cause for the economic downturn.

**Third, the global slowdown and trade tensions affected Hong Kong's external demand.** From the perspective of external shocks, the global economic downturn and China-US trade tensions continued to depress Hong Kong's external demand. In the first nine months, export of goods was down by 5.4% in real terms and export of services was down by 4.7% in real terms. In Q3 alone, export of services fell by 13.8% in real terms, which was even worse than those of Asian

financial crisis and global financial crisis. Merchandise export in Oct dropped by 9.2% year-over-year, a larger decline than the previous nine months. The WTO predicted that global trade this year still managed to attain 1.2% growth, which suggested that the impacts of China-US trade tensions on Hong Kong were far greater than the global average.

**Fourth, financial markets operated smoothly with relatively mild impacts seen.** The financial system and markets in Hong Kong maintained effective operation. The short-term interest rates on HKD stayed steady. The Linked Exchange Rate System operated in a smooth and orderly manner. The HKD exchange rate did not touch the 7.85 weak side convertibility level, indicating the market confidence on the HKD and Hong Kong financial markets. Asset markets were broadly stable. The financial system in Hong Kong remained very solid. Impacts from the social unrest included disruptions in banking services due to attack on bank branches; downgrade on credit rating and outlook by rating agencies which affected Hong Kong's image as a global financial center; and fever businesses for the financial industry from lower bank deposits as well as contraction in tourism and retail sectors.

**Fifth, unemployment rate surged rapidly amid the significant pressure on the labor market.** The unemployment rate in Hong Kong was kept steady at 2.8% between Q4 2018 and the first half of 2019. Since then, it began to rise and reached 3.2% for Sep to Nov, which was the highest from Q3 2017. Total employed persons decreased from 3.8726 million at the end of 2018 to 3.8306 million at Sep-Nov 2019, a decrease of 42,000. In the last two years, there was an increase of 3,363 employed persons each month. Thus, it is estimated that the economic downturn affected more than 75,000 jobs in the first 10 months of 2019. It is worth noting that unemployment rate in Hong Kong was only up slightly by 0.4%. In addition to the fact that unemployment rate was a lagging indicator, an important reason for slower rise for unemployment rate is that many people exited the labor market recently, cutting the labor force by around 30,000. Otherwise, unemployment rate in Hong Kong could be at around 4% level.

## 2. 2020 Economic Outlook

Looking forward to 2020, the global economic growth is likely to improve. The IMF's latest forecast projected a 3.4% growth for the world economy for 2020, above the 3.0% for 2019, indicating a rebound in global economic growth. The WTO also expected the world trade growth to accelerate to 2.7% next year from 1.2% for 2019. It will provide support for the Hong Kong economy. That said, there are still uncertainties surrounding the Hong Kong economy. For instance, rising global trade conflicts and Europe's struggling economy will continue to bring negative impacts to the Hong Kong economy. Thus, the downward pressures remain still notable.

The US economy has entered a downward trend. The US GDP in the first three quarters increased at an annualized rate of 3.1%, 1.9% and 2.1%, evidencing a gradual slowdown. Market expectations showed that the slowdown in Q3 was milder than estimated, as the drop in corporate investment was offset by consumer spending and a rebound in exports. It eased the worries of economic recession by the financial markets. The National Association for Business Economics published a report suggesting that the slowing global growth and US trade policies caused the US GDP growth to decrease from 2.9% in 2018 to 2.4% in 2019, and further slow to 2.0% in 2020. These estimates are in line with the Fed's recent projections.

The Conservatives in the UK won an overwhelming victory in the general election and secured their biggest majority since Thatcher's 1987 election victory. The election results helped clear the way for Brexit. The UK is widely expected to announce Brexit at the end of January 2020. In the future, the focus for the UK will be how to leave the European Union. Although there is still a risk of no-deal Brexit, clearer Brexit prospects will be favorable for China and the UK as well as the UK and Hong Kong to strengthen economic and trade cooperation.

The China-US trade tensions have lasted for nearly two years. At present, both sides reached a phase one agreement. The US agreed to cancel the tariff on the US\$ 160 billion of goods which was scheduled to effect on 15 Dec, cut the tariff rates on US\$ 120 billion of goods from 15% to 7.5% (the tariffs have been in place since Sep), and keep 25% tariff rates on HK\$ 250 billion of goods. China promised to increase imports of goods and services from the US in the next two years with an additional amount of not less than US\$ 200 billion. Regarding agricultural products, China will increase its purchase of US food, agriculture and seafood, and resolve issues on non-tariff barriers. China and the US have also reached consensus on protecting intellectual property rights, technology transfer, expanding market access to financial services, exchange rate policies and transparency, and dispute settlement mechanisms.

The agreement by China and the US to avoid escalating the trade tensions has reduced the risk of deteriorating China-US relations or the decoupling of two economies. It helped stabilize investor expectations, providing a better external environment for China to promote growth and effectively mitigate the downside economic pressures. More importantly, China will take the initiative of trade negotiations as the driving force to accelerate the process of reform and opening-up and unleash its economic development potential. For the US, the deal will benefit Trump by consolidating his supporters in swing states, rising his chance for re-election. The deal can also boost growth for the election year, as the US economy has entered a downward cycle.

However, it should also be noted that the trade tensions will only be eased and never stop there. The tariffs imposed have not been fully eliminated. And, there could be different views in terms of the implementation of the deal. Furthermore, phase two negotiations are expected to be more difficult, as they will touch on some structural issues. Hence, potential tensions in the future will inevitably create new shocks for the global economy and financial markets, curbing Hong Kong's external demand.

Under the China-US trade tensions, China's economic growth continued to decline with GDP growth in the first three quarters at 6.4%, 6.2% and 6.0%. Other than the weak external demand, sluggish investment was another factor for the slowdown. In the first eleven months of 2019, the national fixed asset investment (excluding rural households) grew by 5.2% year-over-year, a flat level compared to the first ten months. Among its components, industrial investment and infrastructure investment grew by 3.7% and 4.0%. These investments had significant impacts on economic growth. Meanwhile, consumption remained stable. In the first eleven months of 2019, retail sales increased by 8.0% year-over-year. Retail sales excluding vehicle sales rose by 9.0%, which was the main driving force for growth.

The recent Central Economic Work Conference reiterated that China's economic fundamentals towards a steady growth path has remained unchanged but acknowledged that the downside pressures increased somewhat. The meeting proposed to keep the economic growth within a reasonable range in 2020, build a moderately prosperous society in all respects and successful conclude the 13th Five Year Plan. In this connection, fiscal policy will remain proactive in 2020 with a focus on tax and fee reductions. In regard to key development areas, funds will be guided to invest in advanced manufacturing, community enhancement and infrastructure projects, promoting upgrade in both industrial structure and consumption pattern. At the same time, macro-leverage ratio should be held steady with prudent control on the effects of counter-cyclical adjustments to ensure reasonable and sufficient liquidity in the financial system. Hence, the monetary policy stance is expected to remain prudent with a tendency to loosen. Targeted cuts in RRR and interest rates are expected in 2020. Given the policies to stabilize growth and easing China-US trade tensions, the China economy is likely to hold up with GDP growth expected to be around 6% in 2020.

Recently, the violence caused by the proposed Extradition bill descended but not yet fully stopped. It will continue to be the major uncertainties for the Hong Kong economy in 2020. If the

social unrest is able to gradually cool down in the coming months, tourism, accommodation, and retail industries are likely to gradually recover. In addition, the phase one trade agreement between China and the US may support the export performance for Hong Kong. Thus, there is possibility for the Hong Kong economy to bottom up. However, if the social unrest continues and the violence escalates again, it will further pressure the tourism sector and domestic consumption. In this scenario, the Hong Kong economy may slip into a severe recession with the unemployment rate surging to 5% or more.

It should be noted that the proposed Extradition bill has resulted in a deeply divided society in Hong Kong with the business environment severely affected. These are not easy to recover. Given the external influences, Hong Kong's internal deep-rooted conflicts are unlikely to be resolved in the short term, making it difficult for the HKSAR Government to govern effectively. More filibusters may also be seen at the Legco. Economic stimulus packages from the Policy Address and the Budget may be discounted. Hong Kong may still be under a difficult situation of facing both internal factors and external shocks for an extended period.

But it should also be mentioned that the Hong Kong economy still enjoy several favorable factors for stability and growth. They included development opportunities for the private sector in Hong Kong from China's stable economic growth outlook during the process of accelerating transformation as well as China's efforts in attracting foreign investment through reform and opening-up. Besides, the HKSAR Government is proactive in implementing fiscal policy, including a series of measures to support enterprises, safeguard jobs, and strengthen livelihood, as well as an increase in infrastructure spending and investment in innovation and technology. At present, four rounds of support packages were announced with an aggregate amount of HK\$ 68 billion, accounting for around 2.2% of GDP. In 2020, more initiatives are expected to offer support for enterprises and citizens.

Moreover, Hong Kong is committed to become an international financial center and a major business services hub in the region. In the future, Hong Kong is expected to gain tremendous development potential under the "Belt and Road" Initiative, the RMB internationalization, the development of Guangdong-Hong Kong-Macao Greater Bay Area, the connectivity of financial markets between the Mainland China and Hong Kong and the IPO activities by new economy companies after the amended listing rules by the HKEX.

In the first half of 2019, Hong Kong's residential property market once reached a historical high. But, in the second half, downward pressures on the global and the Hong Kong economies increased. The social unrest from the Extradition bill also dragged down the performance of the property market. Based on the figures from the Rating and Valuation Department, the private residential property prices started to decrease from the peak level in May, and dropped by 5.2% as of Oct. It was still up by 4.6% compared to end of last year. The property market rebounded slightly in Nov, after the Policy Address announced to relax the ceiling on mortgage lending. However, the stimulus effects were only temporary. The latest Centa-City Leading Index was at 179.11, lower than the level at the end of Oct. At the moment, Hong Kong's property market was still in consolidation. Considering the loosening monetary policies by major central banks, low interest rates for HKD, relatively tight housing supply and relaxed mortgage entitlements, the housing market is expected to continue a mild consolidation in 2020 and unlikely to see a huge drop in prices, as long as the HKSAR Government and HKMA maintain their policies unchanged.

Combining above factors with a low base of comparison in 2019, the Hong Kong economy is expected to rebound slightly in 2020 with full year GDP growth at around 1.0%.