

Recovery with Challenges — 2021 Hong Kong Economic Outlook

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As an open economy highly dependent on the service sector, Hong Kong is suffering severely from the novel coronavirus epidemic in 2020. Its GDP shrinks the most in last 60 years and the unemployment rate rises rapidly. Looking into 2021, the widely usage of effective vaccines is going to stimulate Hong Kong's economy, and the "14th Five-Year Plan" will also bring great development opportunities. Hong Kong's GDP is expected to resume a positive growth rate by 5% in 2021, and the unemployment rate will witness an inflection point.

1. 2020 Economic Review

Under the triple negative factors of Sino-US trade frictions, global economic slowdown, and local social incidents, Hong Kong's economy experienced a negative growth in 2019, for the first time since the Global Financial Crisis. Going into 2020, the rapid propagation of the COVID-19 made Hong Kong's economy worse, with following important characteristics:

1) Economic activities shrank dramatically

Affected by the pandemic, Hong Kong's economy fell into a deep recession. In response to the spread of the novel coronavirus, many countries around the world persistently implemented restrictions on cross-border activities and social distance, which caused severe damage to the global economy. The IMF's latest release forecasted the global GDP will shrink by 4.4% in 2020, the lowest growth rate since World War II. As an open economy highly dependent on the service sector, Hong Kong suffered more. In the first half of 2020, its GDP contracted by about 9% in real terms, the largest half-year decline since record. Due to the low base in 2019, the economic decline in the second half of 2020 narrowed. However, the whole year GDP contraction will still reach around 6%, even more severe than the 2.5% during the Global Financial Crisis in 2009 and the 5.9% during the Asian Financial Crisis in 1998.

Private consumption and social investment dropped significantly. Because of the epidemic, the SAR government promulgated a series of measures to restrict cross-border mobility and social distance, carry out quarantine policies, and impose restrictions on restaurants and various entertainment venues. All those measures led to a sharp contraction in private consumption expenditure, with a cumulative decline of 11.1% in the first three quarters in 2020. Besides, local retail sales fell 27% in the first 10 months. The gross domestic fixed capital formation also fell sharply under the unfavorable business atmosphere, with a year-on-year drop of 16.2% in the first three quarters. In order to alleviate the impact of the epidemic and avoid a deeper recession, the SAR government introduced economic stimulus measures totaling more than HK\$ 300 billion.

2) Unemployment rate rose rapidly

Under the epidemic, all industries are in depression and the unemployment rate rises sharply. The seasonally adjusted unemployment rate in Hong Kong rose quickly from 3.3% in October-December 2019 to 6.3% in September-November 2020. The actual number of unemployed has reached 244,000, which nearly doubled the number of 124,000 at the end of 2019. However, the unemployment rate and the number of unemployed cannot fully reveal the overall impact of the COVID-19 because the total labor force in Hong Kong has decreased by 54,000 in 2020, mainly because many laborers have withdrawn from the labor market. Usually, the total labor force in Hong Kong should increase by 20-30 thousand in the past 11 months. Therefore, the net effect would be 70-80 thousand positions, indicating the epidemic has still eliminated nearly 200,000 jobs.

The impact of the epidemic on the job market and residents' income presents obvious structural issues. According to the data by industry, the unemployment rates in retail, accommodation and food service industry and construction industry are relatively high, with 10.1% and 10.9% in September-November 2020 respectively. And the total number of unemployed in those two industries is about 96,000, accounting for 40% of the total unemployment figure. From the perspective of income levels, the unemployment rate is negatively correlated with industry median income. The unemployment rate of high-income groups is relatively low, within which, the unemployment rates of managers and administrators, and professionals are only 3.1% and 2.7%. However, the majority of low-income earners rely on "part-time jobs" and are unable to work from home. They encountered greater employment barriers and income loss risks.

3) Merchandise trade began to recover

Hong Kong's merchandise trade has begun to recover. The Mainland China was the first to resume economic activities after containing the epidemic with strong measures, while the production capacity of many other countries was highly restricted because of the COVID-19. Therefore, the others increased their dependence on Chinese products. Mainland China's trade activities rebounded since the second quarter, and it recorded double-digit growth in the fourth quarter. Because of the strong trade activities in the Mainland, Hong Kong's merchandise trade also began to recover in the second half of 2020. According to the data released by the government, Hong Kong's merchandise trade growth rate in the third quarter of 2020 had turned to positive, with value of exports and imports increased by 3.9% and 1.8% year-on-year, respectively.

Compared with commodity trade, service trade activity is still weak. The cross-border mobility restrictions froze Hong Kong's tourism industry. The number of visitors to Hong Kong in the first 11 months of 2020 fell by 93.2% year-on-year, and the premiums of new insurance policies from Mainland visitors also decreased sharply, with a cumulative decline of 81.9% in the first three quarters. In terms of transportation services, the global economy stagnated because of the COVID-19, thus transportation activities weakened dramatically. All above dragged down the growth rate of service trade. Currently, the fourth wave of the epidemic has broken out in Hong Kong, and the number of daily confirmed cases remains high. We expect the pattern that trade in goods outperforms trade in services will continue in the fourth quarter.

4) Financial and real estate markets remained stable

The financial market is relatively less affected by the epidemic. In order to alleviate the impact of the COVID-19, Hong Kong's financial regulatory authorities and companies actively coordinated and launched a series of support measures. The operations of financial system and market are smooth basically. The

linked exchange rate mechanism is operating in an orderly manner. The Hong Kong dollar exchange rate strengthened to close to the level of strong-side Convertibility Undertaking since April, and had triggered 50 times by the end of October. The Hong Kong Monetary Authority has sold more than HK\$ 380 billion, reflecting the strong demand for Hong Kong dollars. Total deposits increased by 14.1% in the first 10 months, indicating that the market is optimistic about Hong Kong's future. In addition, the capital market also remained stable. The HKEX is expected to raise approximately HK\$ 390 billion in IPO funds in 2020, ranking second in the world with a year-on-year 24% increase.

The real estate market performance diverged. Residential prices remained roughly stable. Private residential property price in October is 0.45% higher than that in the end of 2019. However, the price and transaction volume of non-residential properties, including office, factory and retail buildings, dropped significantly. Taking private office building as an example, office prices fell by 6.1% in the first 10 months, of which Class B office building fell the most, with a sharp drop of 15.8%. According to Centaline Properties' statistics, the vacancy rate of shops in Hong Kong's five core consumer areas rose fast. Among which, the Central District is the worst, with vacancy rate around 20%. Because of the unfavorable economic atmosphere, companies are committed to reduce operating costs, which resulted in the vacancy rate hike of Class A buildings in the core areas.

2. Opportunities and Challenges

Looking into 2021, risks and opportunities coexist. On the one hand, when effective vaccines can be widely used is the most critical factor affecting Hong Kong's economy. Meanwhile, the trend of Sino-US relations after Biden took office and the stability of the global financial market in the post-pandemic era will all have an impact on Hong Kong's economic performance in 2021. On the other hand, 2021 is the first year of the "14th Five-Year Plan". If Hong Kong can integrate itself into the overall development of the country and take cooperation in all aspects, it will win huge development space.

1) Three Challenges

First, the novel coronavirus epidemic is likely to be recurrent. At present, the COVID-19 is spreading in many places around the world. Before effective vaccines are widely used, the epidemic is still the most important downside risk to Hong Kong's economy. WHO statistics showed that as of the early December, 51 vaccines have entered into clinical trials worldwide, 13 of which have entered Phase III. Hong Kong had actively participated in the vaccine purchase plan and already ordered 22.5 million doses of vaccines. The first batch of 1 million doses of inactivated vaccines produced in the Mainland will arrive in Hong Kong as soon as January 2021. Another 1 million doses of mRNA vaccines jointly produced by the United States and Germany will also arrive in Hong Kong in the first quarter. Hong Kong is expected to achieve full vaccination in the first half of 2021. However, the effectiveness of the vaccine has yet to be confirmed, and the virus may also mutate. In view of the highly infectious characteristics of the novel coronavirus, all sorts of restrictive measures are going to continue till effective vaccines are widely used. From a global perspective, massive production, distribution and injection of vaccines need some time. Hong Kong's external environment in 2021 is not favorable.

Second, the prospects of Sino-US relations are uncertain. Biden is elected as the new president of the United States and may maintain a tough attitude towards China. After Biden's victory in the election,

his primary task is to control the domestic epidemic and restart the economy. Sino-US economic and trade frictions may have a chance to ease, and bilateral dialogue is expected to strengthen. However, the trend of the United States' containment and suppression on China may be hard to reverse. It is quite difficult to cancel the previously imposed tariffs and restrictions in the short term. Meanwhile, the Biden administration may put more emphasis on the role of values, focus on repairing relations with allies, use the power of allies to pressure China, and shape the rules from the environment to labor, trade, technology, and transparency to prevent China from dominating future technology and industrial development. With the intensification of Sino-US conflict, the United States had ended Hong Kong's special trading status in 2020 and implemented a number of sanctions. After Biden comes to power, whether Sino-US relation turns around and how the US policy on Hong Kong changes remain unknown.

Third, the global financial market is fragile. The fragility of the global financial market has become a major risk threatening economic development. In response to the pandemic, many countries adopted large-scale quantitative easing policies, which caused a serious disconnect between the financial market and the real economy. With the deepening of the zero and negative interest rate pattern, global institutional investors increase their risk appetite continuously, which intensifies the risk of asset price bubbles, thus become a major issue for Hong Kong's financial stability. In addition, the level of government debt in developed countries has reached a record high, and how to achieve deleveraging in the future is full of uncertainties. If inflation in Europe and the United States rises in 2021, the central banks may have to tighten monetary policies and lead to the bursting of asset bubbles, which will trigger a financial crisis. On the other hand, after the pandemic, the development gap between developed and emerging countries is likely to widen, and some relatively more fragile emerging economies have the possibility to experience an economic crisis.

2) Two Opportunities

First, the "14th Five-Year Plan" brings various opportunities. 2021 is the first year of the "14th Five-Year" period, and Hong Kong will embrace various opportunities. The "14th Five-Year Plan" takes "high-quality development" and the construction of a "dual circulation" new development pattern as the important guiding ideologies for the next five years. The Plan regards strengthening the national strategic scientific and technological strength, enhancing corporate technological innovation capability, stimulating talent innovation vitality, implementing high-level opening-up, promoting trade and investment liberalization and facilitation, and promoting high-quality development of the "Belt and Road" as important starting points. As an international financial center and trade center, Hong Kong has huge advantages in science, innovation, R&D, and advanced service industries. If Hong Kong can integrate itself into the overall development of the country and take cooperation in all aspects, it will win various opportunities and gain more development space.

Second, the continuous strengthening of East Asian regional cooperation also benefits Hong Kong's development. After 8 years and 31 rounds of negotiations, 15 countries in the East Asia Pacific region have recently formally signed the Regional Comprehensive Economic Partnership Agreement (RCEP), marking the formation of free trade area with the world's largest population, biggest economic scale, and greatest development potential. Hong Kong has close relations with RCEP members, and the bilateral trade accounts for nearly three quarters of Hong Kong's total trade. In the context of East Asian economic integration, Hong Kong can use its unique advantages to make efforts in service trade, financial investment and other fields to help rebuild the supply chain in this region. Meanwhile, Hong Kong can expand new

supply chains and business, opening incremental space for economic development in 2021 and beyond.

3. 2021 Economic Outlook

According to IMF's latest release, the global economy is expected to experience a partial and uneven recovery after the recession, with global growth rebounding by 5.2% in 2021. We expect Hong Kong's GDP will resume a positive growth in 2021, and the unemployment rate is going to witness an inflection point. In particular:

1) Economy rebounds, H2 higher than H1

First, Hong Kong's economy will start to recover in 2021. At present, the coronavirus spread overseas has not been controlled. The number of daily infected worldwide is much higher than that half a year ago. However, the impact of the pandemic on economic activities and market sentiment has greatly reduced. With reference to what happened in the third quarter of 2020, the epidemic in Hong Kong is much more serious than that in the first half of the year. However, after deducting the base effect, the year-on-year growth rates of private consumption, investment, trade and other economic variables in Hong Kong in the third quarter improved, indicating alleviation of the recession. The negative influence of the COVID-19 on Hong Kong's economy is going to continue in 2021, but its impact is relatively controllable unless it undergoes malignant mutations. Superimposed on the boosting effect of effective vaccines, Hong Kong's economy will rebound in 2021.

From a quarter-to-quarter comparison, Hong Kong's economic performance in the second half of 2021 will be better than that in the first half. According to the current progress of global vaccine R&D and Hong Kong's procurement arrangements, Hong Kong is expected to achieve full vaccination in the first half of 2021. After that, epidemic prevention and restrictions are going to be released gradually. We expect the overall economic performance in the second half of the year will be better than that in the first half. However, the economy has little chance to experience a retaliatory rebound in 2021 because of its extremely high proportion of the service sector. Even if the entire citizens are vaccinated with effective vaccines, the recovery of the economy will lag significantly on the supply and demand sides. Our model shows that under an optimistic scenario, Hong Kong's economy is expected to record an increase of about 5% in 2021. Considering the extremely low base in 2020, the GDP in 2021 will still be lower than the level in 2019.

2) Unemployment rate drops slowly after fast rising

The unemployment rate in Hong Kong is going to rise in the first half of 2021. Past experience showed that the unemployment rate is a lagging indicator. Only 2-3 quarters after the bottom of economic growth can the inflection point of the unemployment rate appear. Hong Kong's economic growth bottomed in the second quarter of 2020, but the peak of unemployment rate has not yet appeared. The government's second round of "Employment Support Scheme" ended now. Various transitional support measures, such as tax deferral arrangement and employee salary subsidies, have been completed. In the absence of a third round employment support scheme, Hong Kong's unemployment rate may rise further in the first half of 2021, and the highest point is likely to exceed 7%.

After the usage of effective vaccines, the unemployment rate is expected to decline slowly. Unemployment rate is a slow variable. After the crisis, it is a long process for enterprises to recruit employees and carry out economic activities. Even if effective vaccines can be widely used in Hong Kong in the first

half of 2021, it is still difficult for the unemployment rate to drop immediately. In addition, from a global perspective, the massive production, distribution and injection of vaccines will need a certain amount of time. It is very hard to get rid of the pandemic globally in 2021. The external environment is severe, which will keep the unemployment rates in industries such as retail, accommodation services and airline business relatively high in 2021. We expect the unemployment rate to remain between 5% and 6% by the end of 2021. And it may need several years to return to the level before the pandemic.

3) Trade grows steadily, H1 higher than H2

We expect the Mainland's trade activity will grow strongly in 2021, which is going to drive the sustaining steady trade growth in Hong Kong. From the perspective of export, the COVID-19 is still spreading in many countries, and there will be a gap in production and consumption in overseas in the short run. In 2021, Mainland China's export is likely to maintain a high growth rate. In terms of import, the Mainland's retail market is close to that in the United States, the world's largest one. With the establishment of the "dual circulation" new development pattern, Mainland's import may accelerate in 2021. All of these will directly benefit Hong Kong. Hong Kong's foreign trade is expected to experience a sustaining steady growth in 2021, with a low single-digit growth rate throughout the year.

The current recovery momentum of trade activities in the Mainland and Hong Kong is likely to continue in the beginning of 2021. First, there is continuity in trade orders on some industries. And second, more time is needed for vaccines to be widely used around the world. Some regions where vaccines are obtained later restrict the speed of order return. With the gradual usage of vaccines in 2021, global consumption demand and capital expenditure are going to rebound, and global trade recovery comes along with economic recovery. Meanwhile, with the gradual normalization of the world economy, the reduction in demand for epidemic prevention merchandise and weakening of supply substitution may lead the export growth of Mainland to fall in the second half of 2021, which in turn reduces the growth rate of Hong Kong's trade activities. Hong Kong's foreign trade growth rate is expected to be higher in H1 than that in H2.

Appendix: 2021 Hong Kong GDP growth estimation

GDP, main components, and CPI (yoy % in real terms)						
	2016	2017	2018	2019	2020	2021
Private consumption expenditure	2.0	5.5	5.3	-1.1	-10.5	7.5
Government consumption expenditure	3.4	2.8	4.2	5.1	7.9	-2.1
Gross domestic fixed capital formation	-0.1	3.1	1.7	-12.3	-13.1	8.5
Exports of goods	1.6	6.5	3.5	-4.6	-0.8	3.7
Imports of goods	0.7	7.3	4.7	-7.3	-3.3	4.0
Exports of services	-3.5	2.8	4.6	-10.2	-36.4	10.5
Imports of services	2.0	2.0	2.8	-2.4	-35.6	9.8
Gross Domestic Product	2.2	3.8	2.8	-1.2	-6.0	5.0
Consumer Price Index	2.3	1.7	2.6	3.0	1.3	1.1

Source: Census and Statistics Department, BOC Hong Kong Financial Research Institute

主要經濟指標 (Key Economic Indicators)

一. 本地生產總值 GDP	2018	2019	2020/Q2	2020/Q3
總量 (億元) GDP(\$100 Million)	27,355	27,030	6,176	6,736
升幅 (%) Change(%)	2.9	-1.2	-9.0	-3.5
二. 對外貿易 External Trade			2020/11	2020/1-11
外貿總值 (億元) Total trade(\$100 Million)				
總出口 Total exports	41,581	40,961	3,796	35,356
進口 Total imports	47,214	45,714	4,052	38,322
貿易差額 Trade balance	-5,633	-4,753	-256	-2,966
年增長率 (%) YOY Growth(%)				
總出口 Total exports	7.3	-5.6	5.6	-2.8
進口 Imports	8.4	-8.1	5.1	-5.0
三. 消費物價 Consumer Price				
綜合消費物價升幅 (%) Change in Composite CPI(%)	2.4	2.9	-0.2	0.4
四. 樓宇買賣 Sale & Purchase of Building Units				
合約宗數 (宗) No. of agreements	79,193	74,804	7,241	65,726
年升幅 (%) Change(%)	-5.5	-5.5	8.1	-7.3
五. 勞動就業 Employment			2020/8-2020/10	2020/9-2020/11
失業人數 (萬人) Unemployed(ten thousands)	10.5	12.4	25.8	24.4
失業率 (%) Unemployment rate(%)	2.8	3.3	6.4	6.3
就業不足率 (%) Underemployment rate(%)	1.1	1.2	3.8	3.4
六. 零售市場 Retail Market			2020/10	2020/1-10
零售額升幅 (%) Change in value of total sales(%)	8.8	-11.1	-8.8	-27.0
零售量升幅 (%) Change in volume of total sales(%)	7.6	-12.3	-9.3	-28.3
七. 訪港遊客 Visitors			2020/11	2020/1-11
總人數 (萬人次) arrivals (ten thousands)	6,515	5,590	0.6	356.4
年升幅 (%) Change(%)	11.4	-14.2	-99.8	-93.2
八. 金融市場 Financial Market			2020/9	2020/10
港幣匯價 (US\$100=HK\$)				
H.K. Dollar Exchange Rate (US\$100 = HK\$)	783.6	779.3	775.2	775.2
貨幣供應量升幅 (%) change in Money Supply(%)				
M1	-0.4	2.6	44.9	71.1
M2	4.3	2.8	9.2	14.4
M3	4.3	2.7	9.2	14.3
存款升幅 (%) Change in deposits(%)				
總存款 Total deposits	5.0	2.9	8.7	14.5
港元存款 In HK\$	3.6	2.5	11.1	21.5
外幣存款 In foreign currency	6.4	3.2	6.2	7.3
放款升幅 (%) in loans & advances(%)				
總放款 Total loans & advances	4.4	6.7	7.0	11.6
當地放款 use in HK	4.0	7.1	8.0	15.6
海外放款 use outside HK	5.3	5.8	4.7	2.3
貿易有關放款 Trade financing	-7.7	-0.7	-7.4	-5.7
最優惠貸款利率 (%) Best lending rate (%)	5.1250	5.0000	5.0000	5.0000
恆生指數 Hang Seng index	25,846	28,189	23,459	24,107