

## Pains, Difficulties, Bright Spots, and New Growth Opportunities for the Hong Kong Economy in 2021

Dr. E Zhihuan, Chief Economist

At the beginning of 2021, the Hong Kong economy has once again come to a crossroad. External and internal factors such as the fermentation of the coronavirus, US-China geopolitical tensions, and local protest events have caused the Hong Kong economy to face downward pains. The largest economic recession on record has made the existing structural problems for Hong Kong in the medium-to-long term to become apparent again. At the same time, the K-shaped recovery of the global economy and the fact that the Mainland has become the only major economy in the world that has achieved positive growth for two consecutive years will bring rare bright spots and new growth opportunities for the Hong Kong economy.

### 1. The triple shocks have caused Hong Kong to endure the worst economic downturn on record

Since 2020, the outbreak and persistence of the coronavirus pandemic has cut off personnel exchanges between Hong Kong and the rest of the world. Inbound tourism, which accounts for 3.6% of Hong Kong's GDP, has stalled. In order to control the pandemic, Hong Kong has implemented strict social distancing measures for many months, which has brought huge pressure to the retail, catering, entertainment, personal services and transportation industries, causing the real economy to deteriorate. Not long ago, the Hong Kong economy was hit successively by US-China frictions and local protest events. The United States imposed huge tariffs on China's exports, and subsequently revoked Hong Kong's status as an independent customs territory, sanctioned mainland and Hong Kong's officials, and discouraged international investors from treating Hong Kong as an international business and financial centre. In 2019, there were protest events in Hong Kong that restrained normal economic activities and tourism, leading the Hong Kong economy into recession. Political disputes over a long time in the past have hindered the long-term infrastructure and investment projects of the SAR government. The Hong Kong economy has lost important support during the downward cycle, and fell into a deep recession in 2020.

According to quarterly data, Hong Kong's real GDP contracted by an average of about 7.2% in the first three quarters of 2020, and the decline in real GDP in the third quarter narrowed to 3.5%. In the fourth quarter, the Hong Kong economy was once again hit by strict social distancing measures in response to the fourth wave of the local pandemic. For the whole year of 2020, the economy may shrink by about 5.9%, which is the same as the 5.9% decline recorded in 1998. Judging from quarterly figures, there may be economic contractions for six consecutive quarters, which will exceed the historical record of five consecutive quarters of contractions from the first quarter of 1998 to the first quarter of 1999. It will also be the first economic recession that would last for two consecutive years since record. Obviously, the current economic downturn in Hong Kong has caused practitioners in various industries to feel the deep pain, and people are eagerly looking forward for the economy coming out of the shadow of recession.

### 2. Economic downturn has intensified the difficulty of solving Hong Kong's long-term structural problems

In the first half of 2021, the coronavirus will continue to ravage the world, and there is still a certain

degree of uncertainty about whether the research, development and production of the vaccine can contain the pandemic. Countries around the world have generally strengthened disease prevention measures in response to changes in the pandemic. Cross-border exchanges continue to be restrained, thus it is difficult for the economy to recover significantly. Industries such as tourism, aviation, hotels, and catering are still facing tremendous downward pressure.

Facing a long-term economic downturn, the Hong Kong economy's structural problems, such as small, open and service-oriented, have been further exposed. For many years, Hong Kong's industrial structure has relied heavily on the service sector. Its four key industries - trading and logistics, financial services, tourism, professional services and other - accounted for 57% of Hong Kong's GDP. Among them, the percentages of finance, tourism and professional and business services have continued to expand, while the percentage of trading and logistics has declined. The scale and the economic contribution of advantageous industries such as culture and creativity, medical care, education, innovative technology, testing and certification, and environmental protection were limited. The downturn in the real economy has made it difficult for large companies such as the Cathay Pacific Airways and the Ocean Park to operate. These companies needed government capital injections to maintain their operations. Small and medium-sized enterprises and industries being directly affected by the pandemic faced even more difficulties to sustain.

The excessive uniformity of Hong Kong's industrial structure has also increased the vulnerability in the labour market. The overall unemployment rate in Hong Kong has risen rapidly from 2.8% in mid-2019 to 6.6% in October - December 2020, which is higher than the 5.5% recorded during the global financial crisis in 2008, hitting a 16-year high. Under the impact from the fourth wave of the pandemic and the completion of the Employment Support Scheme, the unemployment rate will deteriorate further. The unemployment rates in retail, accommodation and food services, and construction are among the highest, reaching 10.6% and 10.7% respectively. If the Hong Kong economy continues to be plagued by the pandemic in 2021 and fails to recover, it's possible for the unemployment rate to shoot further above the record high of 8.5% during the 2003 SARS period.

The rising unemployment rate brought by the long-term economic downturn affected citizens' confidence in the property market. The market is worried that once property prices are adjusted sharply, financial risks may arise. Historically, the period of economic downturn is often a period of risk exposure for the Hong Kong's property market. The real estate cycle in Hong Kong has rebounded rapidly after the SARS period in 2003, and has been in an upward cycle for more than 17 years. Private residential property prices in December 2020 have risen 5.5 times compared with the lowest level recorded during the 2003 SAS period, and is 1.2 times higher than the peak of the real estate bubble in 1997. The growth rate in property prices far exceeded the growth rate of household income during the same period. In 2021, as global major interest rates remain low and Hong Kong's housing supply is limited, it is not easy for property prices to undergo substantial adjustments. However, standing around the historical high, property prices could also be concerned by their own height.

### **3. Bright spots of the Hong Kong economy in 2021 and new growth opportunities for getting out of the downward cycle**

If vaccines could be adopted globally, the pandemic may become under control and the economy may restart in the second half of 2021. Major economies will show signs of rebound, driving the recovery of tourism, aviation, hotels and catering industries, bringing external support for the small open economy in Hong Kong. Foreign trade may become the first bright spot for the Hong Kong economy. In the second half of 2020, Hong Kong's exports of goods increased 3.3%, which was an improvement from the 6.9% contraction in the first half of the year.

In 2020, Hong Kong's financial market has operated normally and demonstrated resilience. The main reasons are not only that Hong Kong has a good business environment, a simple and low tax system, a free port of funds, a judicial system in line with the West, efficient financial supervision and the freest economy, but its economic and trade links with the Mainland and the interconnection of financial markets also provided Hong Kong with an internal stabilizer to deal with external shocks. In recent years, with the internationalization of the RMB, the Mainland has successively introduced Shanghai-Hong Kong Stock Connect, Shenzhen-Hong Kong Stock Connect, Bond Connect and Mainland-Hong Kong Mutual Recognition of Funds and other schemes to promote system integration and policy coordination. These schemes provided Hong Kong's financial and professional services companies with greater room for development. They also helped Hong Kong to withstand external shocks and maintain market stability. In 2020, the net fund inflow to Hong Kong's stock market through Shanghai-Shenzhen-Hong Kong Stock Connect was HK\$672.1 billion. Since 2021, the amount of fund inflow has reached 40% of the inflow in the whole year of 2020. In addition, benefiting from the return of China concept stocks and the prolonged low-interest environment, Hong Kong's financial activities maintained good performance in 2020. Since April 2020, a total fund inflow of approximately HK\$383.5 billion has been recorded, and the banking system's Aggregate Balance has risen to HK\$457.5 billion, above the historical high of HK\$426.3 billion in November 2015. The United States continues to tighten the requirements for mainland companies to list on American exchanges and restricts US investors from investing in mainland companies, which has prompted more mainland companies to return to Hong Kong for listing and conducting more investment and financing activities, promoting Hong Kong's IPO fundraising amount to the second largest in the world again. It is expected that Hong Kong's financial industry will remain active in 2021, bringing a rare bright spot to the Hong Kong economy.

In 2021, the Mainland will become the only major economy in the world to achieve positive growth for two consecutive years, maintaining its role as an important driving force of the global economic growth. From the second to fourth quarter of 2020, the Mainland's GDP grew by 3.2%, 4.9% and 6.5% in real terms respectively, and grew by 2.3% for the whole of 2020. It is expected that the economic growth of the Mainland in the first quarter of 2021 will further accelerate. In response to the changes in the international environment, the Central Authorities have proposed to accelerate the formation of a new development pattern in which the domestic and international circulation could promote each other. The initiation of a new dual-circulation economic development pattern relying on huge domestic demand, market, and further opening-up, can provide Hong Kong with new opportunities to integrate its economic development into the overall national development. And this will also become a new growth point for Hong Kong to walk out from the long-term economic downturn.

Hong Kong should seize the new opportunities from the Mainland's dual-circulation development pattern, give full play to the particularity of its key nodes in the dual circulation of domestic and external economies, enhance the overall expression of its economic value to the Mainland, and expand its own development space in the process of helping the Mainland economy reshape new advantages in international cooperation and competition.

First, to encourage more Hong Kong companies to participate in the great economic circulation in the Mainland. The mainland economy will shift from being driven by investment and exports to driven by domestic demand with consumption as the mainstay, by increasing residents' disposable income, further improving the rationality of income distribution, orderly expanding the middle-income group, and narrowing the income distribution gap. Hong Kong should proactively seize the new opportunities from the high-quality development of the mainland economy and actively participate in the Mainland's new economic development driven by domestic demand. Over the years, Hong Kong has invested heavily in the Mainland and has become the preferred channel for thousands of international investors and multinational companies

from major countries/regions to invest in the mainland market. While continuing to maintain and improve its own business environment, Hong Kong should give full play to its expertise in market philosophy and related institutional design to encourage more companies to participate in the great economic circulation in the Mainland.

Second, to promote the diversification of the Hong Kong economy and improve the quality of its economic development. In 2021, industries such as the digital economy, life and health will achieve rapid growth. The Internet and artificial intelligence will help realize seamless connections of people, property and assets, and help accelerate the process of decentralization. The Mainland accelerates to push forward the independent innovation of core technologies, promotes the development of strategic emerging industries such as the digital economy, life and health and new materials, accelerates the replacement and circulation of the technological ecosystem, regards technological innovation as a key element to promote the high-quality development of the real economy, so as to realize the transformation and upgrading of its industrial structure, to promote the industrial chains and supply chains to shift from international division of labour to domestic division of labour, and to reduce the reliance on foreign markets. Hong Kong has solid foundations and capabilities in basic scientific research and innovation, and has global leading research capabilities in the fields of biomedicine, neuroscience, genomics, vaccine technology, and stem cell technology. Hong Kong's scientific and technological innovation support system is relatively complete. It has established a highly open and international scientific research system. The protection of intellectual property rights has reached to a relatively high level in the world. It has attracted a large number of high-quality innovative talents and established an internationally leading higher education discipline system. Hong Kong can give full play to its institutional advantages and first-mover advantages mentioned above, deepen cooperation with mainland innovative enterprises, advanced manufacturing, high-end manufacturing and other industries, to promote the accelerated transformation of scientific research results into products and services that meet market needs, and jointly develop the mainland market to serve the development of innovation and technology industry. In addition, technological innovative enterprises with advantages and attractiveness should be encouraged to choose the Hong Kong market, in order to provide new growth drivers for the Hong Kong economy, to promote Hong Kong's economic transformation, and to help resolve the deep-seated contradictions and risks faced by Hong Kong.

Third, to use the offshore RMB business as a starting point, continue to enhance the influence of Hong Kong as an international financial centre. The high-quality development of the mainland economy accelerates to promote a new round of financial market opening and further improve the renminbi's status as an international reserve currency. In 2020, the RMB exchange rate rose by 6.7%. Entering 2021, the RMB exchange rate continued to strengthen, hitting the highest level since June 2018. At present, the renminbi maintains a positive interest rate differential relative to other currencies, and mainland financial assets have been included in more global financial indexes. This enhances the attractiveness of the renminbi assets to global investors and will support the RMB exchange rate to maintain a good momentum of steady appreciation. Hong Kong should continue to leverage its first-mover advantages and scale advantages on the offshore RMB hub, continue to promote the development of offshore RMB business, and boost the use of RMB in trade and investment in "Belt and Road" countries, and increase the influence of Hong Kong's financial institutions in the RMB business sector. At the same time, Hong Kong can assist the Mainland to optimize the construction of free trade zone and free trade port system, accelerate the establishment of intermediary nodes for Chinese enterprises' "going abroad" plans, attract the influential industrial leading enterprises in the Mainland to go out and invest in Hong Kong, establish overseas or regional headquarters to improve the efficiency of "going abroad". Hong Kong should seize the new opportunities of the mainland's new round of financial market opening to enhance its competitiveness as an international financial centre.

# 主要經濟指標 (Key Economic Indicators)

	2018	2019	2020/Q2	2020/Q3
<b>一. 本地生產總值 GDP</b>				
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
<b>二. 對外貿易 External Trade</b>			2020/12	2020/1-12
外貿總值 ( 億元 ) Total trade(\$100 Million)				
總出口 Total exports	41,581	40,961	3,922	39,275
進口 Total imports	47,214	45,714	4,379	42,698
貿易差額 Trade balance	-5,633	-4,753	-457	-3,422
年增長率 (%) YOY Growth(%)				
總出口 Total exports	7.3	-5.6	11.7	-1.5
進口 Imports	8.4	-8.1	14.1	-3.3
<b>三. 消費物價 Consumer Price</b>				
綜合消費物價升幅 (%) Change in Composite CPI(%)	2.4	2.9	-0.7	0.3
<b>四. 樓宇買賣 Sale &amp; Purchase of Building Units</b>				
合約宗數 ( 宗 ) No. of agreements	79,193	74,804	7,596	73,322
年升幅 (%) Change(%)	-5.5	-5.5	94.4	-2.0
<b>五. 勞動就業 Employment</b>			2020/9- 2020/11	2020/10- 2020/12
失業人數 ( 萬人 ) Unemployed(ten thousands)	10.5	12.4	24.4	24.6
失業率 (%) Unemployment rate(%)	2.8	3.3	6.3	6.6
就業不足率 (%) Underemployment rate(%)	1.1	1.2	3.4	3.4
<b>六. 零售市場 Retail Market</b>			2020/11	2020/1-11
零售額升幅 (%) Change in value of total sales(%)	8.8	-11.1	-4.0	-25.3
零售量升幅 (%) Change in volume of total sales(%)	7.6	-12.3	-4.7	-26.6
<b>七. 訪港遊客 Visitors</b>			2020/12	2020/1-12
總人數 ( 萬人次 ) arrivals (ten thousands)	6,515	5,590	0.5	356.9
年升幅 (%) Change(%)	11.4	-14.2	-99.8	-93.6
<b>八. 金融市場 Financial Market</b>			2020/10	2020/11
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	71.1	32.8
M2	4.3	2.8	14.4	6.6
M3	4.3	2.7	14.3	6.6
存款升幅 (%) Change in deposits(%)				
總存款 Total deposits	5.0	2.9	14.5	6.2
港元存款 In HK\$	3.6	2.5	21.5	6.3
外幣存款 In foreign currency	6.4	3.2	7.3	6.1
放款升幅 (%) in loans & advances(%)				
總放款 Total loans & advances	4.4	6.7	11.6	1.7
當地放款 use in HK	4.0	7.1	15.6	1.9
海外放款 use outside HK	5.3	5.8	2.3	1.1
貿易有關放款 Trade financing	-7.7	-0.7	-5.7	-4.4
最優惠貸款利率 (%) Best lending rate (%)	5.1250	5.0000	5.0000	5.0000
恒生指數 Hang Seng index	25,846	28,189	24,107	26,341