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Start Afresh in the Post-pandemic Era —— 2023 Hong Kong Economic Outlook

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Since the outbreak of COVID-19 pandemic, Hong Kong's economy has fallen into a deep recession, and its GDP will record a negative growth again in 2022. Looking into 2023, risks and opportunities coexist. There are dawning signs of an end to the pandemic, and Hong Kong is resuming customs clearance with the outside gradually. Taking all internal and external factors into consideration, Hong Kong's GDP is expected to return to a positive growth in 2023, and start afresh in the post-pandemic era.

1. Hong Kong Economic Review

Since 2019, Hong Kong's GDP has recorded negative growth rates several times. Affected by COVID-19, Hong Kong's economy exhibits the following important characteristics:

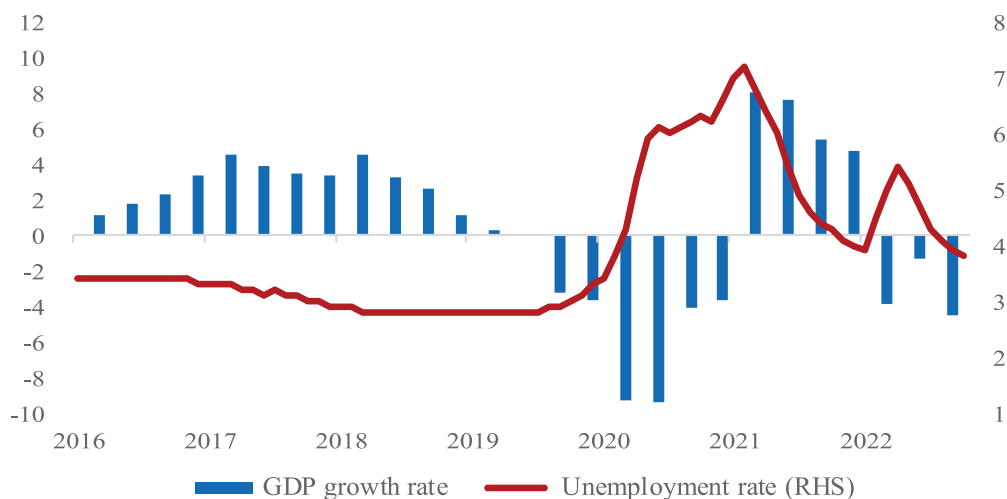
1) GDP shrinks in 3 of the past 4 years

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 after the Global Financial Crisis. Going into 2020, the rapid propagation of COVID-19 around the world made Hong Kong's economy worse. Private consumption expenditure and fixed capital formation dropped significantly. In the first half of 2020, Hong Kong's GDP contracted by about 9% in real terms, the largest half-year decline since the record. The annual GDP growth rate was -6.5%, demonstrating that the overall economy had fallen into a deep recession. In 2021, due to the weakening impact of the pandemic, strong trade activities, and low bases, Hong Kong's economy rebounded with a growth rate of 6.3%. However, the economic aggregate is still lower than that of 2019. Entering into 2022, the fifth wave of the epidemic severely hit economic activities and confidence, also hit the recovering economy again. Superimposed global geopolitical tensions and sharply tightening monetary policies by the world's major central banks, Hong Kong's annual GDP may decline by around 3%.

2) The unemployment rate exhibits an M-shaped trend

During the epidemic, all industries are in depression and the unemployment rate rises sharply. Hong Kong's unemployment rate climbed to 7.2% in February 2021, and the underemployment rate also rose to 4.0%, both hitting new highs since SARS. Moreover, the unemployment and underemployment rates cannot fully reveal the overall impact of the epidemic because many laborers withdrawn from local labor market, resulting in a decrease in the total labor force in Hong Kong. With the effective implementation of control measures, together with the introduction of a series of economic stabilization and employment protection policies by the SAR government, the unemployment rate began to decline and dropped to 3.9% by January 2022. In early 2022, the new wave of the epidemic blocked the recovery process, and contact-intensive industries had to take measures to lay off workers under strict social distance regulations. By April, the unemployment rate rose back to 5.4%. With the epidemic under control gradually since May, the unemployment rate returned to a downward path and has now dropped to around 3.7%.

Figure 1: Hong Kong GDP Growth and Unemployment Rates (%)

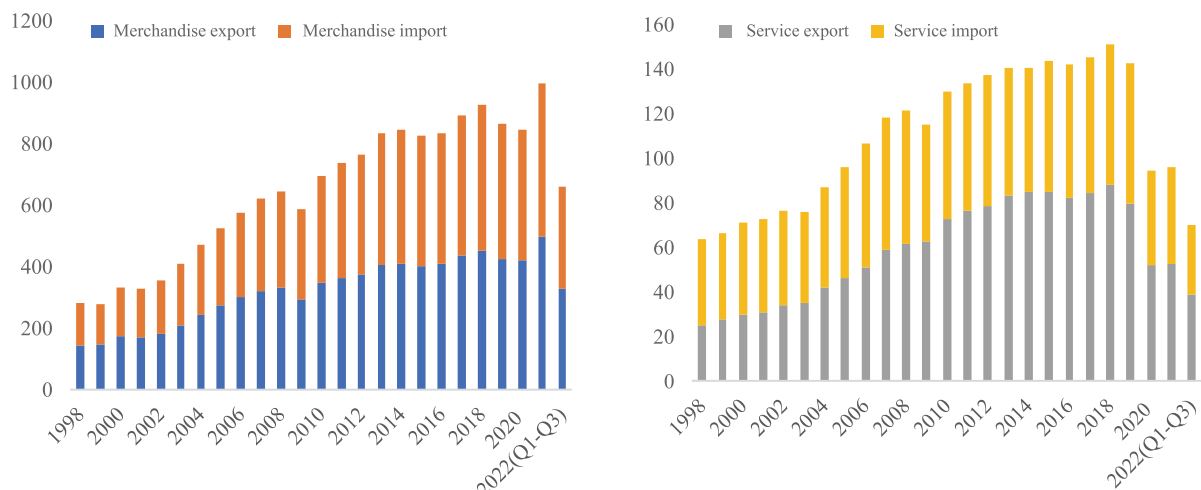


Source: Wind, BOCHK Financial Research Institute

3) Merchandise trade experiences ups and downs, while service trade shrinks sharply

Since the outbreak of COVID-19, global commodity trade has declined sharply. Mainland China took strong measures to contain the epidemic, and was the first to resume economic activities. Because of the strong trade activities in the Mainland, Hong Kong's goods trade started to recover in the second half of 2020 and recorded a growth rate of more than 18% in 2021. Moreover, the total merchandise trade in 2021 also surpassed the record high set in 2018. Entering into 2022, as the external demand slowed down and the cross-border cargos between the Mainland and Hong Kong were disrupted by the epidemic, Hong Kong's trade activities began to slow down. The total exports and imports of goods in the first three quarters fell by 3.6% and 2.8% from a year earlier, respectively. Compared with trade in goods, trade in services suffered more. The cross-border mobility restrictions froze Hong Kong's tourism industry since the outbreak of COVID-19, and cross-border transportation and business services were also sluggish. Although the YoY growth rates in some quarters were outstanding, service trade is still far below the level before the pandemic in terms of total volume, and the recovery process seems to be long.

Figure 2: Hong Kong's trade in goods and services (HK\$10 billion)



Source: HKCSD, BOCHK Financial Research Institute

4) The stock market drops and the housing market starts to fall

Since the outbreak of 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. However, the stock market suffered from the epidemic and showed a weak trend. Especially in 2022, in addition to the impact of the epidemic at the beginning of the year, increasing global inflation, rising interest rates by major central banks, geopolitical tensions, and weak market sentiments all lead to an increase in the volatility of Hong Kong stock market. The Hang Seng Index fell to 14,597 points by October, dropping more than 56% from the historical high of 33,484 before the pandemic. Residential prices in Hong Kong remained largely stable in the first two years of the pandemic, and even rose slightly. In 2022, because of multiple unfavorable factors such as repeated epidemics, declining economic growth, and rapid interest rate hikes by the Federal Reserve, the real estate market fell both in transaction volume and price. In the first 10 months, the price of private housing fell by 10.5%, returning to the level at the end of 2017; the transaction volume of private housing was 39,812, a sharp drop of 38% from a year earlier.

5) Inflation is rising steadily

Affected by the pandemic, China and the United States adopted completely different anti-epidemic policies and relief measures. They have staggered economic performances, and their inflation trends had begun to diverge. The monetary and fiscal easing policies drive the current round of inflation in the US to continue to rise. While the Chinese economy had better economic performance in the past two years because of the strict anti-epidemic measures, and its inflation is relatively stable. As a small and highly open economy, Hong Kong's inflation is affected by both the United States and Mainland China. Hong Kong's staple goods are mainly from Mainland China, while Mainland China has a good system of ensuring supply and stabilizing prices, which largely alleviated the impact of international imported inflation. Therefore, inflation in Hong Kong generally remained stable in the past few years. Netting out the effects of all Government's one-off relief measures, the underlying inflation rate was 0.6% in 2021, with 0% in the first half of the year and 1.2% in the second half. In the first nine months of 2022, the CPI in Hong Kong was 1.9%, rising steadily.

2. Opportunities and Challenges

Looking into 2023, opportunities and challenges coexist. From the perspective of the external environment, global economic growth may slow down further, while inflation is likely to remain at a relatively high level. In addition, the geopolitical tensions and continued tightening of monetary policies will all be detrimental to the Hong Kong economy. From an internal perspective, the population outflow will exacerbate the local aging trend, and technological innovation has not made breakthroughs yet. The good news is that the impact of COVID-19 begins to weaken. Currently, Hong Kong has optimized its prevention measures and basically realized interconnection with overseas countries. It is expected to achieve customs clearance with the Mainland in 2023. Adding positive factors such as officially joining the RCEP and further integrating into the overall development of China, Hong Kong is standing at a new starting point in the post-pandemic era.

1) Four major risks

The first risk is global economic growth may slow down further. The global economy declined sharply in 2020 due to the outbreak of COVID-19 pandemic. According to the data released by World Bank, the global GDP fell by 3.3% in 2020, the largest drop since World War II. In 2021, the fiscal and monetary policies launched by various countries in response to the pandemic boosted economic recovery to varying degrees. The global GDP growth rate in 2021 was 5.8%. However, in 2022, geopolitical tensions, repeated waves of the pandemic, and sharply rising inflation dragged down economic activities and confidence in many regions. In October 2022, the International Monetary Fund lowered the 2022 global economic growth forecast to 3.2%, and the World Bank also lowered the 2022 global growth rate to 2.9% in June. Looking into 2023, major economic organizations basically predict that the global economic growth rate will slow down further. Some countries in the Euro Zone may record recessions. The deteriorating external environment will continue to pose immense pressure on Hong Kong.

The second risk is the continued tightening of monetary policy under high inflation. Inflation is a keyword in 2022, and inflation in many economies rose rapidly, hitting new highs in the past three to four decades. This round of high inflation is not exactly the same as that of previous rounds. The dividends of global integration and abundant labor supply that played an important role in stabilizing inflation in the first two decades of this century have reversed. Moreover, the energy transformation and industrial chain restructuring all lead to increase in costs. The stickiness and duration of this round of rising inflation may be more severe than before. In 2023, global inflation will remain at a relatively high level with a large probability. In order to cool high inflation down, central banks in Europe and the United States tightened their monetary policies. The Federal Reserve has raised the federal funds rate by 425 basis points in 2022. According to the latest midpoint figure, further rate hikes are highly possible in 2023. Hong Kong adopts a linked exchange rate system in which the Hong Kong dollar is linked to the US dollar. The increase in US interest rates shrinks the liquidity, putting pressure on various local economic activities.

Table 1: Summary of forecasts by international organizations

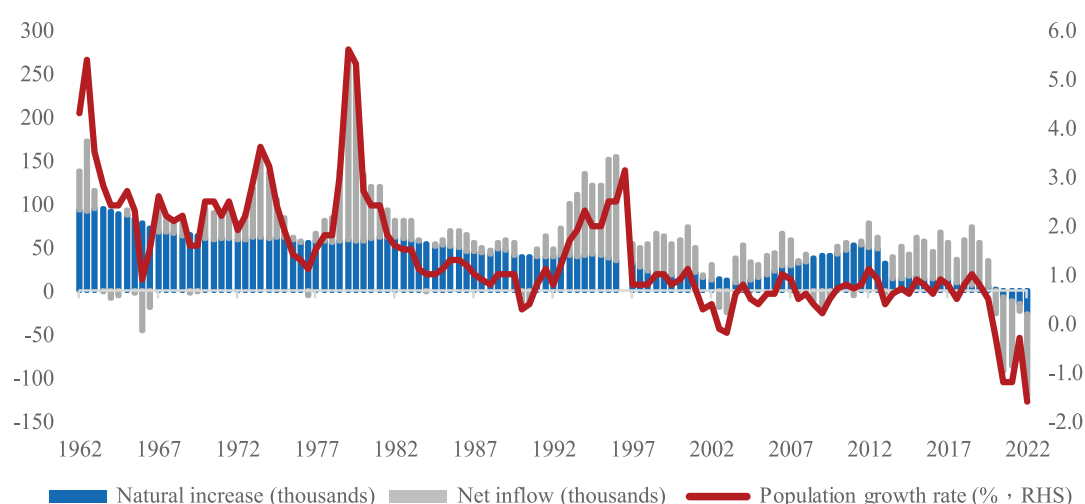
		World		United State		Euro Zone		China	
		2022	2023	2022	2023	2022	2023	2022	2023
World Bank	2022.01	4.1	3.2	3.7	2.6	4.2	2.1	5.1	5.3
	2022.06	2.9	3	2.5	2.4	2.5	1.9	4.3	5.2
IMF	2022.01	4.4	3.8	4	2.6	3.9	2.5	4.8	5.2
	2022.07	3.2	2.9	2.3	1	2.6	1.2	3.3	4.6
	2022.10	3.2	2.7	1.6	1	3.1	0.5	3.2	4.4
OECD	2022.06	3	2.8	2.5	1.2	2.6	1.6	4.4	4.9
	2022.09	3	2.2	1.5	0.5	3.1	0.3	3.2	4.7

Source: World Bank, IMF, OECD, BOCHK Financial Research Institute

The third risk is the increasing geopolitical tension. Under big-power politics, geopolitical risks continue to accumulate. Since the conflict between Russia and Ukraine at the end of February 2022, the global energy and food supply chains were disrupted. In the short term, the Russia-Ukraine conflict has little hope of relief, and its negative impact on the global economy will continue in 2023. In recent years, various black swan events triggered by geopolitics kept popping up, the adjustment of global supply chains was accelerating, and the trend of localization, regionalization, and decentralization of supply chains began to emerge. In particular, the ongoing strategic competition between China and the United States will accelerate the decoupling of global technology, which will have a profound impact on global economic growth and international financial market. Looking into 2023, Sino-US economic and trade frictions may have an opportunity to ease under the high inflation pressure, and bilateral dialogue is expected to be strengthened. However, it is still difficult to completely reverse US's containment and suppression on China, which brings negative impacts to Hong Kong's economic prospects.

The fourth risk is Hong Kong's population may continue to flow out. Affected by COVID-19, the number of immigrants to Hong Kong dropped sharply, and Hong Kong residents who had left Hong Kong were stranded in other places. Moreover, the acceleration of immigration and the aging of the population all led to a sharp decline in Hong Kong's population in past two years. In 2023, Hong Kong's population may continue to flow out. This wave of immigration is very different from the wave of immigration in 1997. Hong Kong's total population was not reduced in 1997, and many people returned to Hong Kong in later years. This round of immigration is more affected by the social incidents that have occurred in past few years. Basic livelihood issues such as housing are difficult to solve in the short term. The chances of short-term reflux by families who migrated, especially those taking their children to foreign countries for education, are relatively low. Moreover, the population decline in Hong Kong this time shows structural characteristics. The number of young and middle-aged people declined rapidly, while the elderly population did not decrease but increased. This poses a challenge to Hong Kong's long-term competitiveness.

Figure 3: Population Changes in Hong Kong



Source: Wind, BOCHK Financial Research Institute

2) Two major opportunities

The first opportunity is that COVID-19 has begun to dissipate. The pandemic has been raging around the world for nearly three years. According to the statistics released by World Health Organization, this pandemic had caused more than 650 million diagnoses and more than 6.66 million deaths worldwide as of December 14, 2022. The official data is already staggering, while the real data may be much larger due to insufficient testing and statistical lags. Currently, the pandemic is still propagating in many areas around the world. However, the toxicity of the Omicron strain has been greatly weakened after five evolutions, and the hazard of COVID-19 to the human body is also decreasing. The World Health Organization also stated that the Omicron variant mainly attacks the upper respiratory tract. Superimposed on the rising vaccination rate, it causes milder symptoms than previous variants. The sharp period of COVID-19 pandemic has come to an end in 2022, and there are dawning signs of an end to this pandemic in 2023. COVID-19's impact on Hong Kong will be weakened further, which is beneficial for Hong Kong's economic recovery.

The second opportunity is Hong Kong will achieve customs clearance with the outside in 2023. Since the outbreak of the pandemic, Hong Kong is isolated from the world, which has reduced external confidence in Hong Kong's economic development. Hong Kong also lost many business and growth opportunities. Speeding up customs clearance to attract foreign investment and consumption is the top priority for Hong Kong's economic recovery. In terms of international

customs clearance, the SAR government had adjusted the epidemic prevention and control measures for overseas visitors to Hong Kong in recent months. The overseas entry quarantine was adjusted to “0+3”, that is, only 3 days of self-monitoring and no need for mandatory hotel quarantine. In terms of customs clearance with the Mainland, Mainland China moderately relaxed epidemic prevention measures in recent days, narrowed the scope and frequency of nucleic acid testing, and also cancelled the special nucleic acid testing at ports for Hong Kong residents going to the Mainland and Macau. The number of quarantine days for Hong Kong residents going to the Mainland is “5+3”, that is, 5 days of centralized quarantine plus 3 days of home quarantine. Those may be reduced further in 2023. It is believed that in 2023, Hong Kong will eventually achieve customs clearance with the outside as the pandemic subsides.

Besides, Hong Kong had formally submitted the application to join the Regional Comprehensive Economic Partnership Agreement (RCEP) in January 2022 and is expected to become a member in 2023, which will further enhance Hong Kong’s hub position in entrepot trade and promote the development of Hong Kong’s financial, legal and other professional fields. Superimposed on Hong Kong’s further integration into the overall development of the country under the national “14th Five-Year Plan” and the spirit of the “Twentieth National Congress”, Hong Kong is standing at a new starting point for development in the post-pandemic era.

3. 2023 Economic Outlook

Taking internal and external factors into account, Hong Kong’s economy is expected to return to a positive growth in 2023, and start afresh in the post-pandemic era. In particular:

1) GDP achieves positive growth

The COVID-19 is still the most important factor affecting Hong Kong’s economy in 2023. Although COVID-19 is still difficult to eliminate completely in 2023, its impact on Hong Kong’s economy will weaken, and Hong Kong will realize customs clearance gradually. The local consumption shrank sharply in Q1 2022 because of the epidemic. In Q2 and Q3, due to the improvement of epidemic controls and the relaxation of distance restrictions, local consumption activities started to recover and returned to the level of the same period in 2021. As the impact of the epidemic weakens, local consumption is expected to return to the recovery path in 2023, and the fixed capital investment will also bottom out. It is estimated that Hong Kong’s economy will record a positive growth rate of around 2.8% in 2023.

2) The unemployment rate continues to decline

With the epidemic under control and the economy improving gradually, the unemployment rate will continue to decline in 2023. Currently, the overall unemployment rate and underemployment rate are at relatively low levels. The unemployment rates are relatively high in the construction industry, manufacturing industry, and retail, accommodation and food services industries. With the customs clearance with the outside further, industries such as retail accommodation will slowly recover in 2023, thereby driving the unemployment rate down. The latest Policy Address proposed to develop innovative technology industries and accelerate the construction of the Northern Metropolitan area, all of which are conducive to the construction and manufacturing industries. The unemployment rate is expected to fall further in 2023, perhaps hitting around 3.1% by the year end.

3) Merchandise trade remains under pressure, while service trade rebounded sharply

In the short term, Hong Kong’s merchandise trade activities will remain sluggish. First, the declining global economic growth and rising commodity prices under geopolitical tensions make external demand under pressure, which causes Hong Kong’s exports to decline. Second, the world economy is gradually normalizing, the reduction in demand for epidemic prevention merchandise and the strengthening of supply substitution will lead the export growth of the Mainland to fall, which in turn reduces the growth rate of Hong Kong’s trade activities. Third, the Mainland will be affected by the epidemic in the short term, and cross-border transportation troubles between Hong Kong and Mainland will continue to exist. It is expected that merchandise trade activities will continue to be under pressure in the first half of 2023. In the second half of the year, as the epidemic is under control and Hong Kong achieves customs clearance with the Mainland, merchandise trade activities may rebound. In terms of service trade, as Hong Kong gradually realizes customs clearance with the outside, Hong Kong’s service trade activities may rebound sharply in 2023.

4) CPI keeps relatively flat

The Mainland’s guaranteeing supply and stabilizing prices system has greatly mitigated the impact of external inflation on Hong Kong. The prices of food, energy, and durable goods are expected to rise at limited rates in 2023. Although customs clearance with the outside is conducive to pushing up the prices of Hong Kong’s real estate market, Hong Kong’s declining population will lead rents to fall rather than rise, which will also reduce the risk of high inflation. In addition, the Federal Reserve will continue to shrink monetary policy in 2023, which may exacerbate global liquidity and increase financing costs further. This will also suppress the rise of Hong Kong CPI housing items. Combining internal and external factors, it is expected that the CPI in 2023 will rise compared to 2022, but still keeps relatively flat, and the annual inflation central tendency may be around 3%.

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主要經濟指標 (Key Economic Indicators)

	2020	2021	2022/Q2	2022/Q3
一. 本地生產總值 GDP				
總量 (億元) GDP(\$100 Million)	26,757	28,454	6,681	6,899
升幅 (%) Change(%)	-6.5	6.3	-1.3	-4.5
二. 對外貿易 External Trade			2022/10	2022/01-10
外貿總值 (億元) Total trade(\$100 Million)				
總出口 Total exports	39,275	49,607	3,747	38,248
進口 Total imports	42,698	53,078	3,955	41,403
貿易差額 Trade balance	-3,422	-3,471	-209	-3,155
年增長率 (%) YOY Growth(%)				
總出口 Total exports	-1.5	26.3	-10.4	-4.4
進口 Imports	-3.3	24.3	-11.9	-3.7
三. 消費物價 Consumer Price			2022/11	2022/01-11
綜合消費物價升幅 (%) Change in Composite CPI(%)	0.3	1.6	1.8	1.9
四. 樓宇買賣 Sale & Purchase of Building Units			2022/11	2022/01-11
合約宗數 (宗) No. of agreements	73,322	96,133	3,713	56,054
年升幅 (%) Change(%)	-2.0	31.1	-48.7	-37.1
五. 勞動就業 Employment			2022/08-2022/10	2022/09-2022/11
失業人數 (萬人) Unemployed(ten thousands)	259.1	250.9	14.7	13.9
失業率 (%) Unemployment rate(%)	5.5	5.5	3.8	3.7
就業不足率 (%) Underemployment rate(%)	3.1	2.7	1.7	1.6
六. 零售市場 Retail Market			2022/10	2022/01-10
零售額升幅 (%) Change in value of total sales(%)	-24.3	8.1	3.9	-0.7
零售量升幅 (%) Change in volume of total sales(%)	-25.5	6.5	2.4	-3.5
七. 訪港遊客 Visitors			2022/11	2022/01-11
總人數 (萬人次) arrivals (ten thousands)	356.9	9.1	11.4	44.4
年升幅 (%) Change(%)	-93.6	-97.4	1098.5	441.8
八. 金融市場 Financial Market			2022/09	2022/10
港幣匯價 (US\$100=HK\$)				
H.K. Dollar Exchange Rate (US\$100 = HK\$)	775.2	779.8	785.1	785
貨幣供應量升幅 (%) change in Money Supply(%)				
M1	30.1	8.0	-15.3	-18.0
M2	5.8	4.3	1.6	1.2
M3	5.8	4.3	1.6	1.2
存款升幅 (%) Change in deposits(%)				
總存款 Total deposits	5.4	4.6	1.9	1.4
港元存款 In HK\$	6.2	1.4	-1.4	-2.8
外幣存款 In foreign currency	4.6	7.9	5.1	5.5
放款升幅 (%) in loans & advances(%)				
總放款 Total loans & advances	1.2	3.8	-1.8	-2.7
當地放款 use in HK	1.7	4.7	0.3	-0.5
海外放款 use outside HK	0.1	1.7	-6.9	-8.0
貿易有關放款 Trade financing	-6.2	14.2	-14.9	-17.8
最優惠貸款利率 (%) Best lending rate (%)	5.0000	5.0000	5.1250	5.1250
恒生指數 Hang Seng index	27,231	23,398	17,223	14,687