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http://www.bochk.com

Author: Wilson Chong
Email: wilsonchong@bochk.com
Tel: +852 282 66192

Contact: Ms. Chan
Email: ccchan@bochk.com
Tel: +852 282 66208

Hong Kong's Economy Begins the Year on a Stabilizing and Recovery Path

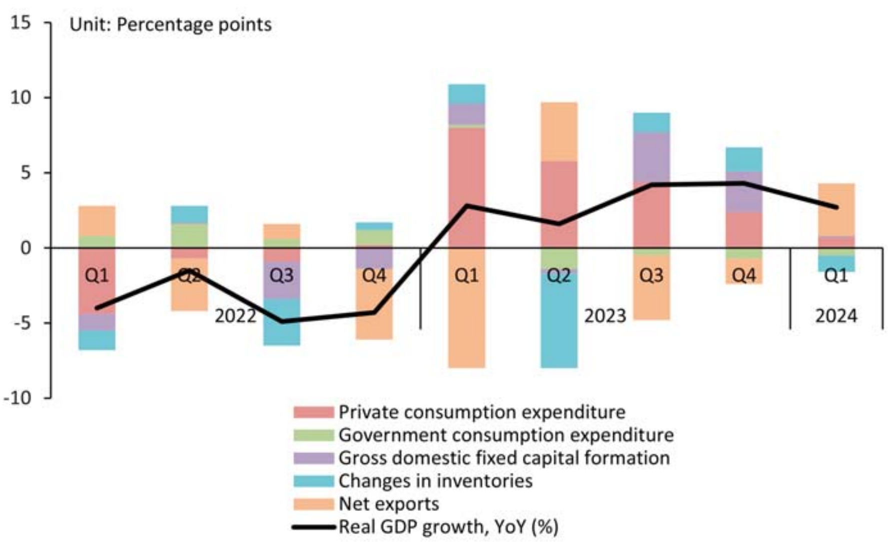
Wilson Chong, Senior Economist

Hong Kong's economy grew by 2.7% year-on-year in the first quarter of 2024, moderating from the 4.3% growth in the fourth quarter of 2023, and broadly in line with the 10-year average level of 2.9% before the Covid pandemic. As the local economy emerged from the impact of the pandemic, the real gross domestic product (GDP) in the first quarter reached HK$728.6 billion, virtually returning to the high levels of 2019.

I. Net Exports as the Main Growth Driver as Global Trade Environment Improved

By GDP component, net exports became the main contributor to economic growth in the first quarter, driving growth by 3.5 percentage points (Figure 1). Following seven consecutive quarters of contraction, merchandise exports returned to growth in the fourth quarter of last year (+2.8%) and accelerated further in the first quarter of this year (+6.8%), partially benefiting from the low base effect as a 19.1% decline in exports of goods was registered in the same period in 2023. In terms of markets, the top-performing major export destinations were Thailand (+38.8%), the United Arab Emirates (+20.8%), the Mainland (+20.2%), Vietnam (+17.7%) and India (+12.9%). Regarding commodities, exports of electrical machinery, apparatus and appliances, and electrical parts thereof, which accounted for nearly half of Hong Kong's total exports, increased by 13.7%. Meanwhile, exports of services continued to grow (+8.4%), albeit at a slower pace than the double-digit growth in the fourth quarter and the whole of last year. In particular, exports of travel services climbed by 40.4% in the first quarter of 2024 thanks to the continued rebound in visitor arrivals, contributing to a 10% increase in exports of transport services. However, the high interest rate environment continued to weigh on Hong Kong's investment and fundraising activities, with exports of financial services falling by 6.1%, the fifth consecutive quarterly decline.

Figure 1: GDP growth and contribution of its components



Source: CEIC, Hong Kong Financial Research Institute of Bank of China

An improvement in the global trade environment has provided support to Hong Kong's export performance. With inflation levels in major advanced economies cooling down from their peaks and the economy showing greater resilience than previously expected during the interest rate hike cycle, the chances of a hard landing have been reduced. This has resulted in higher real incomes, boosting demand for consumer goods. At the same time, demand for capital goods has also increased. Emerging and developing economies has maintained solid growth, reinforcing the positive sentiment of international organizations. According to the World Trade Organization's (WTO) Global Trade Outlook and Statistics report released in April, global trade in goods is expected to improve considerably and grow by 2.6% this year, after contracting by 1.2% last year. Despite these positive economic developments, some potential risk factors cannot be overlooked. Geopolitical conflicts, economic fragmentation, shipment disruptions, and increased trade barriers could create uncertainty for trade growth. The WTO found that trade between geopolitical blocs has grown 4% more slowly than trade within these blocs since the outbreak of the Russo-Ukrainian war, suggesting that geopolitical disputes are accelerating the fragmentation of the global economy. According to data from the Global Trade Alert, the number of new trade restrictions in the world was 3,200 in 2022 and 3,000 in 2023, much higher than the 1,100 in 2019.

At present, Hong Kong SAR has signed eight Free Trade Agreements (FTAs) with the Mainland, New Zealand, the European Free Trade Association (EFTA) countries, Chile, Macao SAR, ASEAN, Georgia and Australia, involving a total of 20 economies. These agreements have created more favourable conditions for Hong Kong enterprises to enter the Mainland and international markets, thereby enhancing the competitiveness of their products and services. The current FTA network, however, does not cover any Middle East countries, and the Hong Kong SAR Government is actively exploring the market and strengthening trade with them. Hong Kong's role as a super-connector will be strengthened if it is able to secure accession as soon as possible to major multilateral trade agreements such as the Regional Comprehensive Economic Partnership (RCEP), the world's largest free trade agreement covering the 10 ASEAN countries, Mainland China, Japan, Korea, Australia and New Zealand. Hong Kong's accession to RCEP will further promote economic cooperation with the region, expand market size and business opportunities, and increase its participation in the global supply and value chains.

II. Slower Private Consumption Expenditure Growth amid Changes in Consumption Patterns

It is worth noting that private consumption expenditure, which had been an important driver of Hong Kong's economic growth in the preceding four quarters, grew by a mere 1% in real terms in the first quarter of this year. Its contribution to economic growth declined from 5.1 percentage points in 2023 to only 0.7 percentage points. Private consumption expenditure is calculated by adding the consumption expenditure on goods and services in the domestic market to the expenditure of residents abroad, subtracting the expenditure of non-residents in the domestic market. While visitor spending in Hong Kong surged by 41.5% in the first quarter of 2024, total consumer spending in the domestic market grew only marginally by 0.2% (Table 1). This reflects a phenomenon that some local residents spent less domestically and more in the Mainland and overseas (+60.9%).

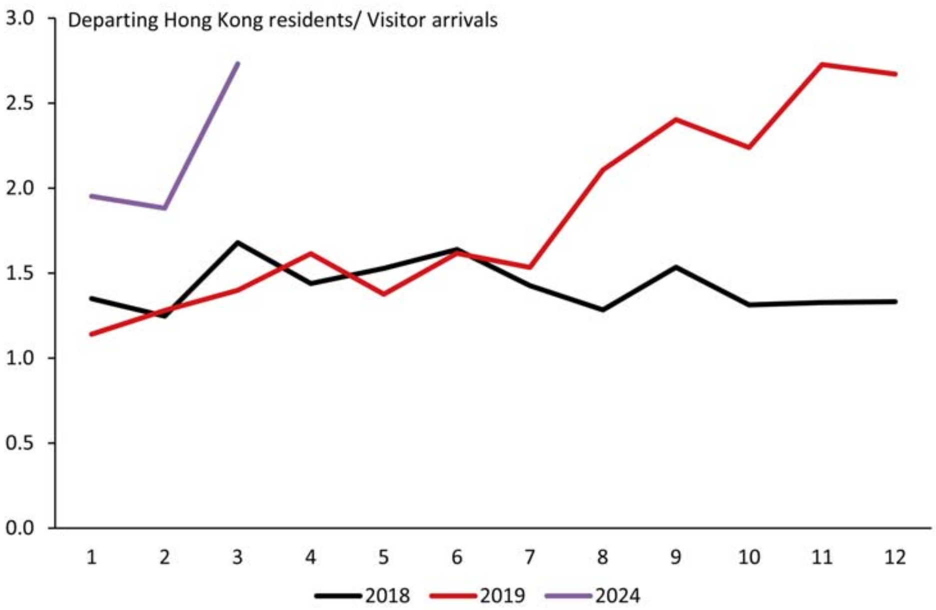
Table 1 : Consumer spending by major component (year-on-year rate of change in real terms (%))

		Total consumer spending the domestic in market	Residents' expenditure abroad	Visitor spending	Private consumption expenditure
2023	Q1	14.2	317.7	485.0	13.0
	Q2	9.6	411.4	736.5	8.4
	Q3	7.7	381.7	740.6	6.7
	Q4	4.6	179.8	300.5	3.5
2024	Q1	0.2	60.9	41.5	1.0

Source: Census and Statistics Department

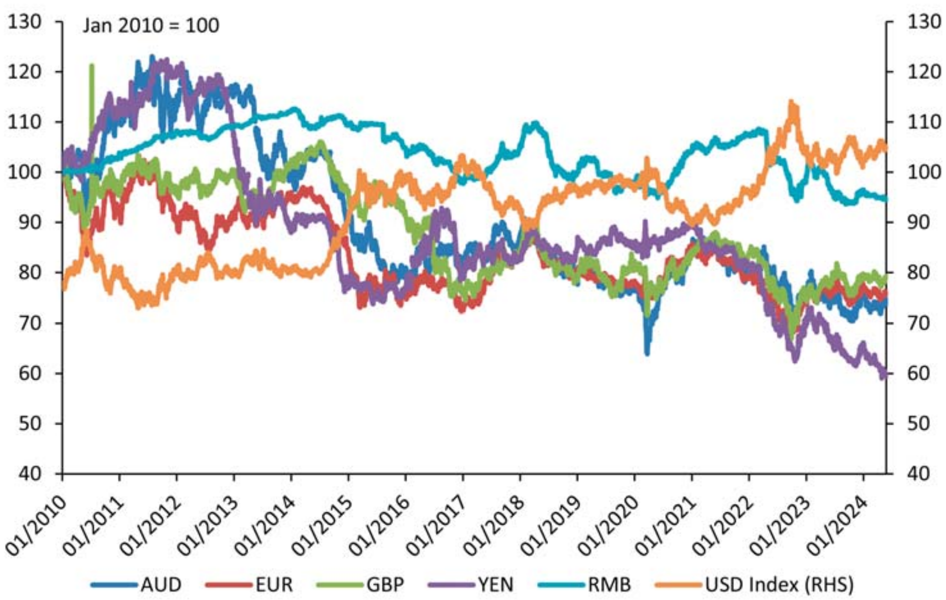
In addition, the ratio of Hong Kong residents departing from Hong Kong to visitor arrivals is currently higher than that before the pandemic (Figure 2). In the first quarter of this year, the average ratio was 2.2, meaning that for every visitor arriving in Hong Kong, 2.2 Hong Kong residents departed via land, sea and air boundary control points. This compares to 1.4 and 1.3 in the same period of 2018 and 2019, respectively. The increase was partly attributable to the relatively strong Hong Kong dollar, which is pegged to the US dollar, against other major currencies under the US interest rate hiking cycle (Figure 3). The stronger Hong Kong dollar has reduced the city's attractiveness to tourists from the region as a destination while simultaneously increasing the incentives for Hong Kong residents to travel and spend money outside the city. In comparison, Singapore borders Malaysia to the north, and some residents go to Malaysia for leisure during holidays, while many Macao residents also choose to spend money in the Mainland such as neighbouring Zhuhai. However, the corresponding ratios for these two places are only 0.5 and 1.1, respectively. As such, Hong Kong, as a tourist city, needs to enhance its attractiveness and improve its consumption experience to retain tourists and residents spending money in the city. Specifically, Hong Kong can attract more quality and specialty brands to operate in the city, thereby providing consumers with more diversified variety of goods and services and enhancing consumer stickiness. Additionally, by improving the quality of goods and services and enhancing consumer protection, Hong Kong could increase consumer satisfaction and the willingness of consumers to make repeat purchases.

Figure 2: Ratio of departing Hong Kong residents to visitor arrivals (by month)



Source: CEIC, Hong Kong Financial Research Institute of Bank of China

Figure 3: Major currencies against Hong Kong dollar

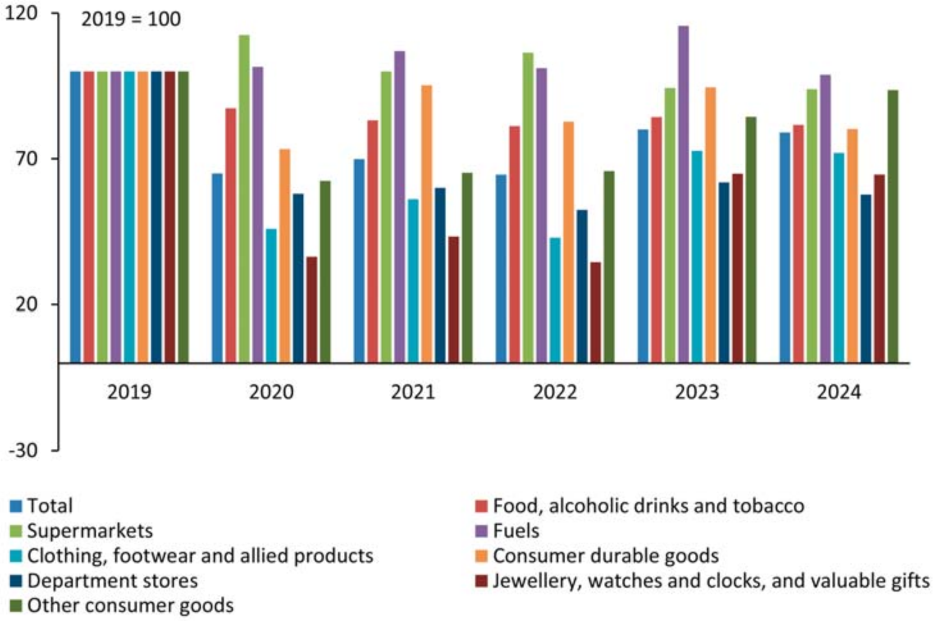


Source: CEIC, Hong Kong Financial Research Institute of Bank of China

The aforementioned factors, coupled with a changing consumption pattern of Mainland visitors, who now place greater emphasis on in-depth tours and cultural experiences, resulted in a weaker retail performance in the first quarter of this year, with the total value of retail sales falling by 1.3% year-on-year. The overall retail market has yet to return to the pre-pandemic levels (Figure 4), with retail sales in the first quarter of this year at 79% of the corresponding period in 2019. Jewellery, watches and clocks, valuable gifts and department stores, which are more sensitive to visitor spending, lagged behind, with their performance at 65%

and 58%, respectively, of that of the corresponding period in 2019. With the US Federal Reserve expected to start its interest rate reduction cycle later this year, the US dollar and Hong Kong dollar exchange rates will become more affordable to tourists, which will be beneficial to retail spending. In addition, the number of Mainland cities under the Individual Visit Scheme (IVS) has further increased from 8 to 59 and Hong Kong will continue to host a series of major events in the second half of the year, which will help stabilize the retail performance.

Figure 4: Retail sales performance in the first quarter



Source: CEIC, Hong Kong Financial Research Institute of Bank of China

III. Public Finances Entered a Consolidation Period, with a Focus on Cutting Expenditure

The decline in government consumption expenditure eased to -3% in the first quarter of this year from -5.2% in the previous quarter, dragging down economic growth by 0.5 percentage points. Expenditure on goods and services fell more sharply by 6.3%, representing drops for the fourth consecutive quarter. Since 1997, there have only been two years in which government consumption expenditure has made a non-positive contribution to economic growth in Hong Kong: in 2005 and 2023. Last year, this was mainly due to a sharp drop in related expenditure following the end of the pandemic, while in 2005, the government faced fiscal pressure and needed to aggressively cut back on expenditure. To improve the sustainability of public finances, the Financial Secretary announced in the 2024-25 Budget in February this year that the Government would adopt a “fiscal consolidation strategy to narrow our fiscal deficit progressively towards achieving the goal of restoring fiscal balance”. This departs from the fiscal stance of “moderately liberal” in the 2023-24 Budget and “expansionary” in the 2022-23 Budget. Under the Productivity Enhancement Programme, the Government will reduce recurrent expenditure by a total of 3% in the three financial years starting from 2024-25. Simultaneously, the Government is reviewing the operation mode of “the $2 Scheme” and the “Public Transport Fare Subsidy Scheme”. It will continue to implement its target of zero growth in the civil service establishment, containing it at a level no higher than that at end-March 2021. The civil service establishment is expected to be around 194,000 posts at end-March 2025, representing a cumulative reduction of around 2,000 posts. With the Budget focusing on cost-cutting and the consolidation of public finances spanning over several years, it is expected that government consumption expenditure will hardly become a major driving force for economic growth this year.

IV. Investment Edged Only Marginally as Higher Interest Rates Persisted for a Longer Period

Gross domestic fixed capital formation, which reflects investment spending, edged by 0.3% year-on-year in the first quarter of this year, a sharp decline from the 17.5% rise in the fourth quarter of last year, contributing only 0.1 percentage point to economic growth. Generally speaking, investment spending is more sensitive to the economic environment than household and government spending. Faced with persistently high interest rates and rising financing costs that discourage companies from expanding and upgrading equipment, investment sentiment has remained cautious. Moreover, last year’s 11.1% rebound in investment following the end of the pandemic also led to a high base of comparison. Private sector’s spending on machinery, equipment and intellectual property products fell by 32% year-on-year (Table 2).

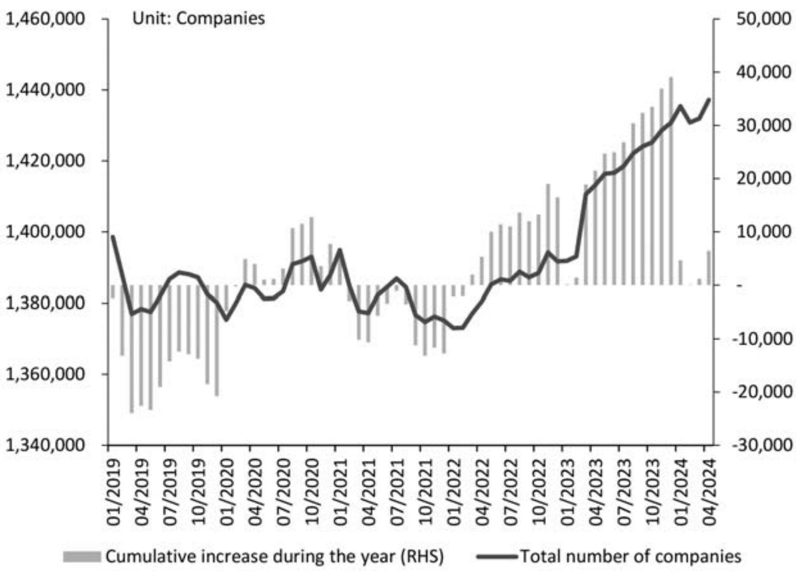
Table 2: Gross domestic fixed capital formation by major component (year-on-year rate of change in real terms (%))

		Building and construction			Machinery, equipment and intellectual property products		
		Total	Private sector	Public sector	Total	Private sector	Public sector
2023	Q1	0.7	6.5	-5.0	25.4	38.9	10.7
	Q2	8.0	16.4	-2.3	-17.1	-24.2	11.9
	Q3	16.0	21.1	8.9	42.0	53.7	13.5
	Q4	6.1	12.8	-1.3	43.7	58.4	9.1
2024	Q1	11.3	22.2	0.7	-15.0	-32.0	10.0

Source: Census and Statistics Department

At its interest rate meeting between 30 April and 1 May, the US Federal Reserve decided to leave interest rates unchanged at a 23-year high of 5.25% to 5.5%. Although Chairman Jay Powell stated that a rate hike at the next meeting was unlikely, he also indicated that it may take longer than originally expected to feel more confident that inflation will continue to move toward the 2% target level, suggesting that interest rates could remain at higher levels for longer. Nevertheless, the market expects that by the end of this year, the federal funds rate is likely to be cut once and the investment sentiment is expected to improve. Additionally, as of April this year, the total number of local companies registered under the Companies Ordinance stood at 1,437,191, an increase of more than 6,400 from the end of last year (Figure 5) and 4.3% higher than the same period in the year before the pandemic. The increase would provide some support to Hong Kong's gross fixed capital formation.

Figure 5: Total number of companies and cumulative increase during the year



Source: CEIC, Hong Kong Financial Research Institute of Bank of China

V. Corporate Inventory Declined but Expected to Improve in the Second Half of the Year

In the first quarter of this year, the changes in inventories dragged down economic growth by 1.1 percentage points. This metric refers to the value of physical change in the inventories of work-in-progress, raw materials and all kinds of goods held by business enterprises, reflecting the difference between production and sales. When production exceeds sales, unsold products increase inventories and contribute positively to GDP growth. In contrast, when firms sell more than they produce, they need to run down some of their inventory to meet their customer demand, which contributes negatively to GDP growth. The destocking by firms in the first quarter may be related to the aforementioned weaker consumer demand. Due to factors such as changing consumption patterns, firms may be adopting a wait-and-see approach or adjusting their sales strategies, before deciding on the need to replenish their inventories. With expectations of a gradual recovery in private consumption and the retail market, the contribution of inventory changes to economic growth is projected to improve in the rest of the year.

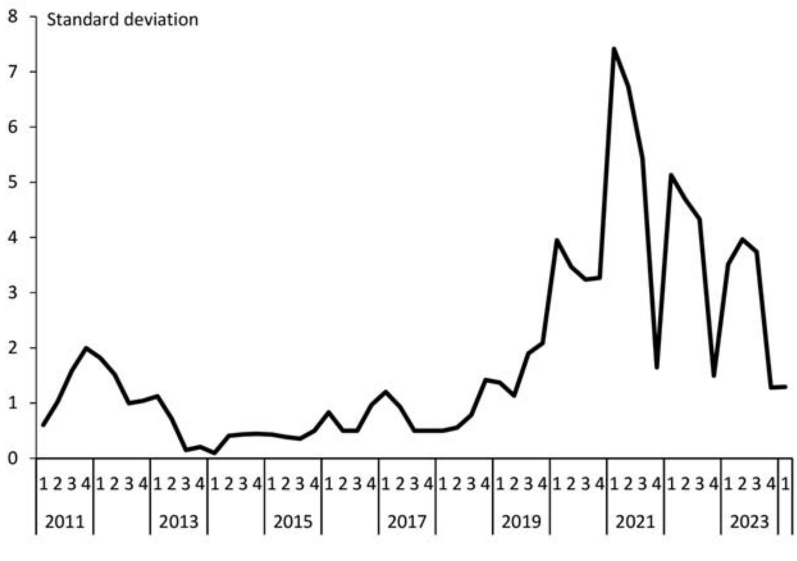
VI. Unemployment Rates at Low Levels and Talent Schemes Help Fill Labour Market Vacancies

Hong Kong's unemployment rate stood at low levels, with the seasonally adjusted rates at 3.0% in the first quarter of this year. With the recovery of Hong Kong's economy, the demand for workers by enterprises has increased. However, the labour market supply remains relatively tight, with the size of the labour force shrinking by about 5% from the peak of 4 million in August 2018 to the current level of about 3.81 million. The reduction in labour force has undermined businesses' ability to fully grasp opportunities arising from the return to normalcy. For example, the tourism and aviation industries have not yet been able to fully restore their capacity to receive tourists and carry passengers due to manpower shortages, which has hindered Hong Kong's post-pandemic recovery to a certain extent. To address the problem of manpower shortages, the Government has introduced and optimized various talent admission schemes in recent years. As of the end of the first quarter of this year, about 110,000 talents have come to Hong Kong through various talent schemes, with around 62,000 applications under the "Top Talent Pass Scheme" approved. In November last year, the Government conducted a follow-up survey on those who had arrived in Hong Kong on visas for more than six months, and the results showed that 54% of the talents had already taken up employment. The employment of these talents will directly boost Hong Kong's economic performance. The focus in the future will be on improving the relevant supporting measures to further enhance the effectiveness of these schemes.

VII. Growth Stabilizing with Recovery Trend Set to Continue Throughout the Year

The pace of economic growth in Hong Kong has stabilised. During the pandemic, growth was subject to significant uncertainty, with considerable quarter-to-quarter variations. This resulted in a larger-than-normal increase in the standard deviation, which measures dispersion (Figure 6). A higher standard deviation reflects a larger gap between the data values and the mean, indicating a more volatile economic growth. In the first quarter of this year, the standard deviation of the rolling four-quarter period dropped significantly from 7.4 in the first quarter of 2021 to 1.3, suggesting that the dispersion between the economic growth in the recent four quarters and the average value has narrowed significantly. This indicates that the economic growth has stabilised recently. Looking ahead to the year as a whole, the main growth driver will be net exports. Assuming that the US Federal Reserve will cut interest rates once by the end of this year, private consumption expenditure and gross domestic fixed capital formation are expected to gradually stabilize, contributing positively to economic growth. Moreover, as uncertainties associated with the pandemic dissipate, expectations of a steadier economic path will also be favourable to consumer sentiment and corporate investment decisions, leading to a gradual build-up in inventory. In the meantime, high interest rates will continue to weigh on economic growth rates to a certain extent, with geopolitical conflicts and trade protectionism increasing uncertainty surrounding economic recovery. Overall, as the impact of the pandemic dissipates, Hong Kong's economic growth is stabilising. The performance for the full year should not be significantly different from that of the first quarter, and is expected to meet the Government's full-year real growth forecast of between 2.5% and 3.5%.

Figure 6: Standard deviation of Hong Kong's quarterly economic growth (rolling 4 quarters)



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Author:

Wilson Chong: Senior Economist at Hong Kong Financial Research Institute of Bank of China. His main research areas focus on Hong Kong’s economy and development policy.

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主要經濟指標 (Key Economic Indicators)

	2021	2022	2023	2024/Q1
一. 本地生產總值 GDP				
總量(億元) GDP($100 Million)	28,680	28,090	29,816	7,697
升幅(%) Change(%)	6.5	-3.7	3.3	2.7
二. 對外貿易 External Trade			**2024/1-4**	**2024/4**
外貿總值(億元) Total trade($100 Million)				
總出口 Total exports	52,360	48,138	14,360	3,787
進　口 Total imports	52,113	48,586	15,292	3,889
貿易差額 Trade balance	247	-448	-932	-102
年增長率(%) YOY Growth(%)				
總出口 Total exports	18.7	-13.9	11.9	11.9
進　口 Imports	17.2	-13.2	6.9	3.7
三. 消費物價 Consumer Price				
綜合消費物價升幅(%) Change in Composite CPI(%)	1.6	1.9	1.7	1.1
四. 樓宇買賣 Sale & Purchase of Building Units				
合約宗數(宗) No. of agreements	96,133	59,619	22,483	9,880
年升幅(%) Change(%)	31.1	-38.0	-9.2	71.7
五. 勞動就業 Employment			**2024/1-2024/3**	**2024/2-2024/4**
失業人數(萬人) Unemployed(ten thousands)	20.3	16.3	11.2	11.4
失業率(%) Unemployment rate(%)	5.2	4.3	2.9	3.0
就業不足率(%) Underemployment rate(%)	2.6	2.3	1.1	1.1
六. 零售市場 Retail Market			**2024/1-4**	**2024/4**
零售額升幅(%) Change in value of total sales(%)	8.1	-0.9	-4.7	-14.7
零售量升幅(%) Change in volume of total sales(%)	6.5	-3.4	-6.4	-16.5
七. 訪港遊客 Visitors				
總人數(萬人次) arrivals (ten thousands)	9.1	60.5	1,462.0	339.1
年升幅(%) Change(%)	-97.4	561.5	100.1	17.3
八. 金融市場 Financial Market			**2024/3**	**2024/4**
港幣匯價 (US$100=HK$) H.K. Dollar Exchange Rate (US$100 = HK$)	779.8	780.8	782.5	782.4
貨幣供應量升幅(%) change in Money Supply(%)				
M1	8.0	-20.7	-5.8	-3.0
M2	4.3	1.6	3.4	5.5
M3	4.3	1.6	3.4	5.6
存款升幅(%) Change in deposits(%)				
總存款 Total deposits	4.6	1.7	0.2	2.2
港元存款 In HK$	1.4	0.7	0.7	0.5
外幣存款 In foreign currency	7.9	2.6	-0.2	3.7
放款升幅(%) in loans & advances(%)				
總放款 Total loans & advances	3.8	-3.0	0.8	-1.0
當地放款 use in HK	4.7	-0.2	0.8	-0.6
海外放款 use outside HK	1.7	-10.0	0.7	-2.3
最優惠貸款利率(%) Best lending rate (%)	5.0000	5.6250	5.8750	5.8750
恒生指數 Hang Seng index	23,398	19,781	16,541	17,763