Economic and Financial Monthly (July, 2017)

Summary

In the US, economic growth remained moderate in the first half of 2017, with the Fed announcing plans to begin balance sheet normalization "relatively soon". In Europe, the European Central Bank (ECB) has continued to be dovish and economic momentum is relatively robust. The Mainland economy grew 6.9% in Q2, exceeding expectations. In Hong Kong, the government is likely to raise its growth forecast this year, and the unemployment rate has hit a three-year low at 3.1%.

■ US: Economic growth remained moderate in 1H, with balance sheet reduction likely to start relatively soon

Economic activity was moderate in July with strong job gains and household finances (helped by stock market and home-equity gains) supporting consumer spending and driving growth. Though the International Monetary Fund (IMF) has cut growth projections for the US from 2.3% to 2.1% in 2017 because expected tax cuts and infrastructure investment policies are unlikely to be substantiated in the near term, the US met the expected second quarter annualized rate of 2.6%. However, inflation moved further from the Fed's 2% target. Core inflation rose at an annualized rate of 0.9% last quarter, the weakest increase since 2010. The Fed expects to see inflation below 2% for the next 12 months and so, in the Fed's own words, "the stance of monetary policy remains accommodative, thereby supporting some further strengthening in labor market conditions and a sustained return to 2 percent inflation". Nevertheless, the Fed has announced plans to begin balance sheet normalization "relatively soon".

Europe: ECB stays dovish

No changes were made to key interest rates or the QE program in July, as investors expected. ECB's President Draghi has expressed positive expectations for the Eurozone recovery but is still cautious about doing much with inflation and wages so low. Outright tightening is likely a long way off. Still, Eurozone growth has been much stronger than expected. The IMF has revised up growth forecasts for many Eurozone countries, including that of Germany, France, Italy, and Spain. The overall Eurozone growth projection has been revised up to 1.9% from 1.7% this year. On the other hand, the IMF has cut the UK's growth projections for 2017 to 1.7% from 2%. There has been very slow progress in regards to Brexit negotiations, as there is a lot of political uncertainty and the contentious subject of the UK's exit payment has yet to be properly addressed. However, it seems likely that the UK will seek a transitional deal that lasts until 2022 to minimize disruption to British companies and consumers, though as British policy stands now, free movement will end when the UK leaves.

Mainland China: Q2 growth exceeded expectations

In the second quarter of 2017, Mainland GDP growth hit 6.9% year-on-year, exceeding market expectations. Major economic components, such as fixed asset investment, industrial value-added, retail sales, and external trade all either stabilized or accelerated in the past few months. As a result, the IMF raised China's growth forecasts for 2017 and 2018 to 6.7% and 6.4%, respectively. The PBOC continued to focus on mitigating hidden risks in the Chinese financial system to promote sustained long-term growth. In this vein, China has announced plans to set up a financial stability development committee to ensure overall financial stability and coordinate regulations of the financial sector.

Hong Kong: The government is likely to raise its growth forecast this year

Hong Kong's unemployment rate has hit 3.1% between April and June 2017, the lowest since February 2014 due to an improvement in tourism and consumer sentiment. Hong Kong has also benefited from the simultaneous improvement of Mainland, US, European, and Japanese economies, with exports to Mainland China up 12.2%, Japan up 13.4%, and US up 0.6% in June year-on-year. Financial Secretary Paul Chan said Hong Kong's economic growth forecast may be revised up half a percentage point in August given the favorable external environment.

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