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Summary

In 1H 2018, the US economy has yet affected by the negative impact from trade protectionism, while still supported by the implementation of tax reform, leading to faster growth momentum. The Federal Reserve is likely to continue its gradual rate hike ahead, and the Fed Funds futures implied a high probability of further rate hike in September. Unlike the US, the Eurozone economy moderated in 1H 2018. The European Central Bank then continues its highly accommodative policy stance, somewhat alleviating the downward pressure. Amid the rising trade conflicts between the US and China, the Central Government decided to implement proactive fiscal policy and prudent monetary policy, ensuring the Mainland economy to maintain its steady growth trend in 2H 2018. Hong Kong economy recorded solid growth, with strong performance across a number of economic sectors, but the downside risks increased notably, in particular the US and China trade frictions and Hong Kong dollar interest rate normalization, etc.

■ The US economy accelerated in Q2, with a high probability of further rate hike in September

In 1H 2018, the US economy has yet affected by the negative impact from rising trade protectionism, while still supported by the implementation of tax reform, leading to strong private consumption and business investment. The real GDP growth increased by 2.9% year-on-year and 4.2% in seasonally-adjusted annualized terms in Q2, accelerating from the previous quarter. Meanwhile, the labor market remained robust, with unemployment rate declined to 3.9% in July, average monthly non-farm payrolls increased by around 215,000 in the first seven months, and the average hourly earnings rose 2.7% year-on-year, likely supporting future consumption performance. Moreover, business investment will also likely to get a further boost, with the implementation of tax reform and rationalization of government regulations. As such, it is believed that the US economy will continue its moderate growth ahead, despite rising trade protectionism and ongoing monetary policy normalization. Going forward, the Federal Reserve is likely to continue its gradual rate hike ahead, and the Fed Funds futures implied a high probability of further rate hike in September.

Eurozone economy moderated, with the European Central Bank continues its accommodative monetary policy

Unlike the US, the Eurozone economy moderated in 1H 2018, with real GDP growth slowed from 2.8% year-on-year in Q4 2017 to 2.2% in Q2 2018, indicating the growth momentum has returned from a relatively fast pace to a more sustainable and moderate pace. However, trade negotiations between the US and European Union (even though both sides agreed to put further protectionist measures on hold) as well as the overall economic performance still need to be monitored closely. Meanwhile, the labor market of Eurozone improved notably, with the unemployment rate declined to 8.2% in July, the lowest level since November 2008, while the inflationary (in particular core inflation) pressure remained subdued. The European Central Bank then continues its highly accommodative policy stance, with its assets purchase program will only be completed by the year-end and the first rate hike will not be until summer 2019. Separately, the financial crisis in Turkey is still evolving, with market worries over the financial exposure of Eurozone financial institutions to Turkey, leading to a sharp decline of euro exchange rate. Nevertheless, the impact of financial contagion remains largely contained.

The US-China trade frictions intensified, with the overall economic momentum largely steady

Entering into 2H 2018, the largely steady growth trend of the Mainland economy remained unchanged, even though the purchasing managers index, industrial production and external performance faced more pressure amid rising trade frictions between the US and China ahead. Recently, the US Trade Representative (USTR) has implemented tariff targeting US$ 16 bn of Chinese imports, the second batch of its tariff measures targeting US$ 50 bn of Chinese imports under Section 301 investigation. US President also directed the USTR to consider increasing the proposed additional tariff rate on US$ 200 bn worth of Chinese imports to 25% from 10%. China is poised to impose retaliatory tariffs of 5% to 25% on US$ 60 bn worth of US imports. Even though both sides expressed their willingness to have further negotiation, but the negotiation will likely to be lengthy. Against this background, the Central Government decided to focus more on supporting growth, with the continuation of proactive fiscal policy and prudent monetary policy. Going forward, it is expected that the Mainland economy will maintain its largely steady growth trend in 2H 2018. On the other hand, the two-side volatility of RMB exchange rate increased, amid the appreciation of US dollar and elevated external uncertainty.

Hong Kong economy performed strongly in Q2, with rising downside risks in 2H

Hong Kong economy recorded solid growth in 1H 2018, with strong performance across a number of economic sectors, though there seemed to be some moderation towards the end of the quarter. The relatively fast global recovery supported external trade performance, tourism sector rebounded after three years of correction, low interest rate environment supported property markets performance, and full employment further stimulated consumer confidence, helped drive consumption and overall economic growth. Following the growth of 4.6% in Q1, the Hong Kong economy sustained strong momentum, expanding by 3.5% in Q2 and 4.0% in 1H over a year earlier. The government expects the full year growth to be 3% to 4%. Even though Hong Kong economic outlook remains cautiously optimistic, the rising trade protectionism and Hong Kong dollar interest rate normalization are the two major risk factors ahead. The impact of trade protectionism is not restricted to the external trade sector. It will also affect investment and business confidence, the supply chain and its related activities. The pessimistic expectation might also be reflected on the financial markets promptly, together with the normalization of Hong Kong dollar interest rate, likely leading to a more volatile economic and asset markets performance ahead.

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