



## The trend of Hong Kong economic growth in 2H 2018

Choi Wing Hung, Senior Economist

### 1. Strong performance across different economic sectors

Following robust growth in 2017, Hong Kong economy continued to grow solidly in 1H 2018, with strong performance across a number of economic sectors. For example, the relatively fast global recovery supported external trade performance, tourism sector rebounded after three years of correction, low interest rate environment supported overall stock and property markets performance, and full employment further stimulated consumer confidence and overall economic growth. In Q1 2018, Hong Kong economy recorded 4.7% growth in real terms over the previous year, the fastest pace since Q2 2011.

**External performance accelerated further.** In Q1 2018, total exports of goods accelerated to 5.2% in real terms over the previous year, compared to 3.4% growth in Q4 2017. Even though the comparison base was higher in Q1, merchandise exports recorded relatively strong performance amid accelerating global economic recovery. The implementation of tax reform and infrastructure plan in the US also stimulated stronger trade flows, manufacturing and investment activities. Therefore, Hong Kong merchandise exports to the Mainland, Asian and the advanced economies all recorded steady increases. Meanwhile, the US announced tariffs on washing machines, solar panels, steel and aluminum products, etc., and US\$50 billion worth of Chinese products, though, fortunately, has yet materially affected the trade performance globally. In addition, Hong Kong monthly merchandise trade statistics showed that the value of total exports increased 9.3% year-on-year in the first four months of 2018, indicating solid external performance.

**Strong rebound of tourism industry supported services exports recovery.** Following the mild recovery in 2017, the recovery of tourism industry strengthened further since the beginning of this year. In the first four months of 2018, the number of overall and overnight visitor arrivals increased 10.0% and 6.8% over the previous year respectively, and the value of retail sales increased 13.9%, driving the exports of tourism services to grow 11.8% year-on-year in Q1 2018, the fastest pace since Q3 2013, and the overall exports of services increased by 7.5% in real terms. Moreover, even though the global financial markets have become more volatile this year, the Hang Seng Index and average daily transaction value of Hong Kong stock markets recorded 19% and 73% year-on-year increases in the first five months of 2018 respectively. Together with the buoyant IPO activities, exports of financial services also recorded 10.7% growth in real terms in Q1 2018, the fastest pace since Q2 2015. Furthermore, growth on exports of transportation services improved further amid stronger regional trade and cargo flows in Asia.

**Domestic demand strengthened further.** Amid the relatively fast global recovery, the economic performance improved across different sectors of Hong Kong economy. Together with full employment and buoyant residential markets, private consumption recorded remarkable performance of 8.6% year-on-year growth in real terms in Q1 2018, the fastest pace since Q3 2011. Government consumption expenditure

remained largely steady, with 3.9% year-on-year growth in real terms in Q1 2018, somewhat faster than the 3.2% growth in Q4 2017. In addition, gross domestic fixed capital formation recorded 3.8% year-on-year growth in Q1 2018, after registering a 3.1% growth in Q4 2017, amid further recovery of the global and Hong Kong economies. The stronger investment performance was driven by the private machinery and equipment spending, which offset the weak machinery and equipment spending of the public sector. Meanwhile, building and construction performance held largely steady.

**Change in inventories contributed negatively to the economic growth.** In 2017 and Q4 2017, change in inventories contributed 0.5 and 0.7 percentage points of growth respectively. It contributed negatively by 0.7 percentage points of growth in Q1 2018, largely because of the higher restocking activities in the past two years.

## **2. The economic growth momentum continues ahead**

**Global economic growth is expected to accelerate slightly from 2017 level, the external outlook of Hong Kong remains cautiously optimistic.** According to the International Monetary Fund's (IMF) latest forecasts, the global economic growth is expected to accelerate by 0.1 percentage point to 3.9% in 2018. In the US, the real GDP increased by 2.8% year-on-year in Q1 2018, the seventh consecutive quarter of accelerating growth. Other economic indicators, such as unemployment rate, non-farm payrolls, industrial production, retail sales and purchasing manager indices, etc. all showed continuous expansion. Furthermore, the US economy is expected to benefit from the implementation of tax reform and infrastructure plan ahead. As such, the US economy is likely to accelerate somewhat in 2018, despite further rate hikes by the Federal Reserve.

Economic growth in Eurozone maintained its moderate pace of expansion, with a relatively fast recovery in the employment markets. However, the inflationary pressure remains subdued, together with the political uncertainties in some of its member states, such as Italy, the highly accommodative monetary policy of the European Central Bank (ECB) is expected to continue. In the Mainland, the economic growth continued its largely steady trend in Q1 2018, expanding by 6.8% year-on-year in real terms, the 11th consecutive quarter of growth between 6.7% and 6.9%. Going forward, the Mainland is expected to implement proactive fiscal policy, prudent and neutral monetary policy, as well as deepen supply-side reforms, to ensure its economy to maintain steady and higher quality growth ahead. Overall, amid relatively stable growth of the global economy, the small and open Hong Kong economy is likely to benefit ahead, as its external performance continues to post moderate growth ahead.

**Tourism recovery is likely to be a main support for services exports.** After more than 3 years of correction, the performance of inbound tourism is on its way of accelerating recovery. In the first four months of 2018, the number of overall, overnight and Mainland visitor arrivals as well as the value of retail sales, etc. all recorded notable improvement, largely supported by the global and Mainland economic recovery, stabilizing RMB exchange rate, competitiveness of Hong Kong as a shopping paradise, and low comparison base, etc. It is believed that exports of tourism services will likely accelerate further, acting as a main driver for services exports performance.

**Financial and business services exports are likely to advance ahead.** Going forward, the exports of financial services are likely to perform well ahead. On one hand, even though the global and Hong Kong financial markets have become more volatile recently, the overall stock market trading and IPO activities are likely to stay robust. Together with the further connection between the Mainland and Hong Kong capital markets and the revision of listing rules in Hong Kong, the financial activities (including cross-border activities) are expected to grow further ahead. On the other hand, with the implementation of belt-and-road initiative, Guangdong-Hong Kong-Macau Bay Area and RMB internationalization, the demand for Hong Kong's financial and business services are likely to increase. Furthermore, alongside the moderate growth in regional trade and cargo flows, exports of travel services will remain steady ahead.

**Stronger business confidence will drive investment performance ahead.** According to the Report on Quarterly Business Tendency Survey in Q2 2018, the corporate confidence in a number of industries has been improving. Better corporate confidence could help support machinery, equipment and intellectual property investment ahead. In addition, the government is actively increasing land and housing supply. Together with the kicking off of the engineering and construction works for the third runway system at the Hong Kong International Airport and the new development area in North East New Territories, the increase in building and construction activities will also lead to stronger domestic performance ahead.

**Solid employment and asset markets performance will likely support robust private consumption growth ahead.** As the current expansion enters its 9th year and many economic sectors posted relatively strong performance, the labor market of Hong Kong has already reached full employment. The unemployment rate declined to 2.8% between March and May 2018 and total employment reached a new high, being a solid support for private consumption and overall economic performance ahead.

Meanwhile, residential property prices reach fresh historic highs. Since April 2016, the residential property prices increased for 25 consecutive months. Following the 14.8% increase in 2017, the residential property prices rose further by 6.6% in the first four months of 2018. Therefore, the positive wealth effect is likely to provide support to the private consumption and overall economy ahead.

**Proactive fiscal policy will support economic growth.** With around HK\$ 1.1 trillion of fiscal reserve, the current administration is well positioned to adopt forward-looking and strategic financial management principles in making investment for Hong Kong. In February 2018, the Financial Secretary introduced measures to raise technology and innovation investment. All those measures are likely to stimulate further economic growth of Hong Kong. In addition, budget for the Capital Works Reserve Fund's expenditure will increase continuously from HK\$98.3 billion in the fiscal year 2018/19 to HK\$123.9 billion in 2022/23. With the expansion of public building program, the economic performance of Hong Kong will likely be boosted ahead.

**The Innovation and Technology (I&T) industry is likely to be the growth drivers ahead.** The Policy Address pointed out the goal to double the gross domestic expenditure on Research and Development (R&D) as a percentage of GDP to 1.5% within the current-term government's five-year tenure. Currently, the government has already implemented a number of I&T development measures, for example, the forming of the Chief Executive's Council of Advisers on Innovation and Strategic Development, the implementation of the Technology Talent Admission Scheme, setting aside HK\$20 billion for the first phase of Hong Kong-

Shenzhen Innovation and Technology Park in the Lok Ma Chau Loop, injecting HK\$10 billion into the Innovation and Technology Fund, earmarking HK\$10 billion for the establishment of two research clusters on healthcare technologies and on artificial intelligence and robotics technologies, etc. so as to maintain Hong Kong's competitiveness in the global arena.

Going forward, Hong Kong economy is likely to maintain its above trend growth in 2018, driven by the relatively fast global recovery, solid employment, relatively low interest rate environment, buoyant asset markets performance, as well as increasing government investment, etc. In 2018, Hong Kong economy is expected to grow slightly faster than that of 3.8% in 2017, above the government's medium growth forecast of 3.0% between 2019 and 2022. However, it is worth noting a number of risk factors, which, if materialize, might somewhat derail the growth momentum in 2H 2018. On the inflation front, inflationary pressure remains moderate amid steady global inflationary pressure and moderately rising labor cost, while the relatively strong economic performance and mild increase in rental level are expected to drive the underlying consumer price index somewhat higher to 2.5% in 2018.

### **3. Potential risk factors in 2H 2018**

Without doubt, Hong Kong economy is expected to maintain relatively fast growth in 2018. It should be noted that the base effects in 2H 2017 are relatively high and there are a number of uncertainties affecting global and Hong Kong economies ahead. Firstly, protectionism is rising across the globe, especially the US proposed tariffs on US\$ 50 billion worth of Chinese products (might also consider to introduce another around of tariffs targeting additional US\$ 200 billion worth of Chinese products). China also adopted retaliatory measures against the US. Going forward, with the continuous rise of China's economic power, the trade frictions between China and the US are likely to continue in the long run, which would affect the external outlook, investment confidence and financial performance of Hong Kong.

Secondly, after the Federal Reserve raised rates for the seventh time, the Hong Kong dollar exchange rate hit the weak-side convertibility level of 7.85 Hong Kong dollar for one US dollar for the first time in mid-April, signifying some capital outflows. These developments showed that Hong Kong is entering the period of interest rate normalization. Going forward, the Hong Kong dollar interest rate is likely to go up in tandem with the Federal Reserve interest rate hikes and balance sheet normalization. This is likely to cool down the positive momentum of the residential property markets. In addition, the residential property prices in Hong Kong have already hit a record high level. Any correction in the property market will, no doubt, have negative impacts on Hong Kong economy. Furthermore, the highly accommodative monetary environment around the world is also changing. If there is any unexpected change in monetary policies by major central banks around the world, the global financial markets are likely to see higher volatilities. Any meaningful correction in the financial markets will not only affect those advanced economies but also Hong Kong, given Hong Kong's close connection with the global financial markets. Finally, the geopolitical issues, such as political stability in some Eurozone countries, Brexit negotiations, and terrorist activities, etc. will continue to threaten the financial markets and economic performance globally. As a result, even though Hong Kong economy is expected to grow above trend in 2018, it should be well prepared for the potential risks ahead.

# 主要經濟指標 (Key Economic Indicators)

	2016	2017	2017/Q4	2018/Q1
<b>一. 本地生產總值 GDP</b>				
總量 (億元) GDP(\$100 Million)	23,586	25,432	7,216	6,880
升幅 (%) Change(%)	1.9	3.8	3.4	4.7
<b>二. 對外貿易 External Trade</b>			<b>2018/4</b>	<b>2018/1-4</b>
外貿總值 (億元) Total trade(\$100 Million)				
總出口 Total exports	35,882	38,759	3,302	12,730
進口 Total imports	40,084	43,570	3,772	14,498
貿易差額 Trade balance	-4,201	-4,811	-469	-1,768
年增長率 (%) YOY Growth(%)				
總出口 Total exports	-0.5	8.0	8.1	9.3
進口 Imports	-0.9	8.7	11.1	10.7
<b>三. 消費物價 Consumer Price</b>			<b>2018/4</b>	<b>2018/1-4</b>
綜合消費物價升幅 (%) Change in Composite CPI(%)	2.4	1.5	1.8	2.3
<b>四. 樓宇買賣 Sale &amp; Purchase of Building Units</b>			<b>2018/5</b>	<b>2018/1-5</b>
合約宗數 (宗) No. of agreements	73,004	83,815	7,788	37,623
年升幅 (%) Change(%)	-4.1	14.8	3.3	7.6
<b>五. 勞動就業 Employment</b>			<b>2018-2-2018/4</b>	<b>2018-3-2018/5</b>
失業人數 (萬人) Unemployed(ten thousands)	13.3	11.0	11.3	11.2
失業率 (%) Unemployment rate(%)	3.4	2.9	2.8	2.8
就業不足率 (%) Underemployment rate(%)	1.4	1.1	1.0	1.0
<b>六. 零售市場 Retail Market</b>			<b>2018/4</b>	<b>2018/1-4</b>
零售額升幅 (%) Change in value of total sales(%)	-8.1	2.2	12.3	13.9
零售量升幅 (%) Change in volume of total sales(%)	-7.1	1.9	11.1	12.3
<b>七. 訪港遊客 Visitors</b>			<b>2018/4</b>	<b>2018/1-4</b>
總人數 (萬人次) arrivals (ten thousands)	5,665	5,847	530.2	2091.1
年升幅 (%) Change(%)	-4.5	3.2	11	10
<b>八. 金融市場 Financial Market</b>			<b>2018/3</b>	<b>2018/4</b>
港幣匯價 (US\$100=HK\$)				
H.K. Dollar Exchange Rate (US\$100 = HK\$)	775.6	781.4	784.9	785
貨幣供應量升幅 (%) change in Money Supply(%)				
M1	12.3	9.8	11.0	30.2
M2	7.7	10.0	7.8	9.8
M3	7.7	10.0	7.8	9.8
存款升幅 (%) Change in deposits(%)				
總存款 Total deposits	9.1	8.7	6.9	9.2
港元存款 In HK\$	9.4	11.6	9.4	13.7
外幣存款 In foreign currency	8.8	5.9	4.2	4.6
放款升幅 (%) in loans & advances(%)				
總放款 Total loans & advances	6.5	16.1	15.0	17.1
當地放款 use in HK	7.4	15.5	15.1	18.7
海外放款 use outside HK	4.5	17.4	14.9	13.2
貿易有關放款 Trade financing	0.2	8.7	11.9	11.8
最優惠貸款利率 (%) Best lending rate (%)	5.0000	5.0000	5.0000	5.0000
恆生指數 Hang Seng index	22,000	29,919	30,093	30,808