Economic Research

June 2021

Market Monitor – Hong Kong

Domestic consumption needs time to recover

Unexpected over-performance in the first quarter

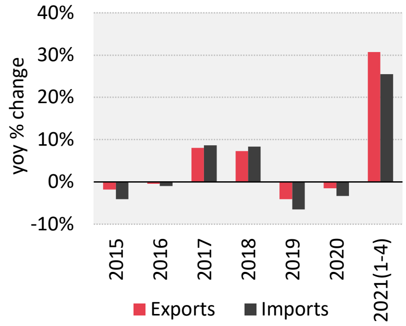
Hong Kong revised its Q1 economic growth to 7.9% year-on-year, ending six consecutive quarters of contraction. Comparing Q1 2021 to Q4 2020, the economy grew by 5.4% in Q1, significantly up from the 0.5% increase seen in the previous quarter. However, if compared with the 9.1% contraction seen in the same quarter last year, the economy has yet to recover its pre-pandemic level. Nonetheless, the growth exceeded the market's 3% to 4% forecast.

Hong Kong's economy is mainly driven by exports, which rose by a rapid 30.8% annually in the first 4 months. This was due to mainland China's strong export sector, which previously absorbed more orders when other countries suffered from lockdowns and restricted manufacturing and production, as well as global demand for anti-pandemic materials. The global economic revival driven by the Chinese and US economies is now benefitting Hong Kong's export sector.

In contrast, private consumption rose by a lacklustre 1.6% year-on-year. If compared with the same period in 2019, it shrank by a disappointing 4.8% annually, while business investment fell by 5.8%. This shows an uneven economic recovery, with private consumption still weak. Many industries, especially the retail and catering industries, are still weathering the storm. Hong Kong's unemployment rate in the February-April period was 6.4%, down from 6.8% in the previous 3-month average. It is expected to slide lower in the next one to two months. However, there were still about 247,500 people unemployed in April, a high level compared to 112,000 in the same period before the epidemic. It will likely take some time before we will see a significant drop in the unemployment rate.

- **Hong Kong's economy rebounded at an unexpected rate in Q1, but hasn't yet returned to its pre-crisis level.**
- **Economic recovery is uneven. The export sector is strong, but private consumption is weak.**
- **Recent worries about inflation around the world may drive up residential property prices further.**

Hong Kong Exports and Imports



Source: Hong Kong Census and Statistics Department, data as of 27/5/2021

Domestic consumption needs time to recover

The retail industry is expected to remain difficult in the first half of this year. Retail sales in March were HK$27.6 billion, an increase of 20.1% year-on-year, mainly due to a low base of comparison. Online retail sales accounted for 7.7% of the total. In the first quarter of this year, retail sales increased by 7.5% from the same period last year, which was 30.2% less than sales in the first quarter of 2019. With few tourists and a closed border amid the pandemic, the retail market is set to remain weak.

Policies such as "travel bubbles" and an exemption for mainlanders arriving in Hong Kong from compulsory quarantine are expected to be of only limited help for Hong Kong's retail sector. For instance, the "travel bubble" only involves Singapore, but even this scheme has been temporarily suspended after a volatile epidemic situation in the city state. Meanwhile, mainland travellers exempted from compulsory quarantine in Hong Kong are still subject to quarantine restrictions when they return to the mainland. Therefore, for the time being, the Hong Kong market is relying mainly on local consumption.

Over the past decade or so, Hong Kong's tourism industry has experienced a rapid expansion, creating a large number of lower-skilled jobs in retail, catering, and accommodation. These jobs accounted for 14.2% of the total employment in Hong Kong, and are among the sectors hardest hit by the epidemic.

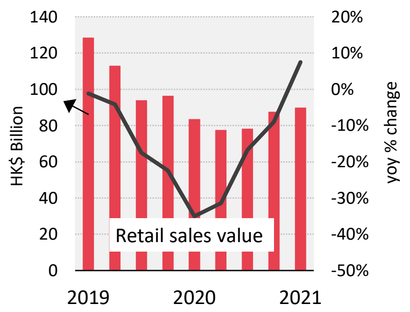
In contrast, the financial industry has remained relatively unscathed. Many financial institutions can enable employees to work remotely and can move to digital channels to minimise the impact of Covid-19 on daily operations. But the financial sector is less labour intensive, and accounts for only 7.6% of Hong Kong's total employment, not enough to offset the adverse impact. The government is actively encouraging citizens to get vaccinated, hoping to resume cross-border travel with mainland China in order to help retail businesses and other tourism-related industries start to return to normality.

By 30th May, about 1.36 million people had received at least one dose of vaccine, or about 18% of the population. About 1 million people had received the second dose. Hong Kong's vaccination rate was higher than for Asia as a whole (at 5.9%), but much lower than Europe's 31.4%. This shows that Hong Kong's vaccination rate needs time to accelerate, as people are still concerned about vaccination side-effects.

Business sentiment remains positive

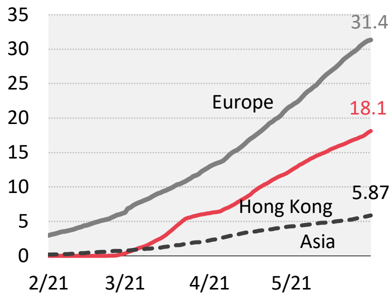
On the other hand, business activity stayed stable. Markit's Hong Kong Purchasing Managers' Index (PMI) stayed in expansionary territory for 3 consecutive months, and eased slightly to 50.3 in April, down from 50.5 in March. Meanwhile, starting in Q2, a three-year long of decline in output came to an end, while the private sector increased hiring for the third consecutive month, continuing an ongoing expansion in domestic business activity.

Hong Kong Retail Sales (Quarterly)



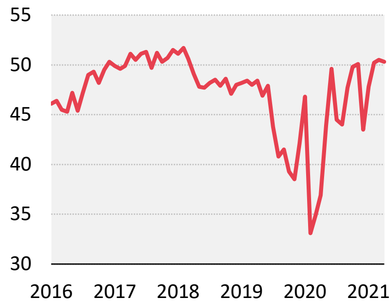
Source: Hong Kong Census and Statistics Department, data as of 15/5/2021

Share of People Receiving Covid-19 Vaccine (%)



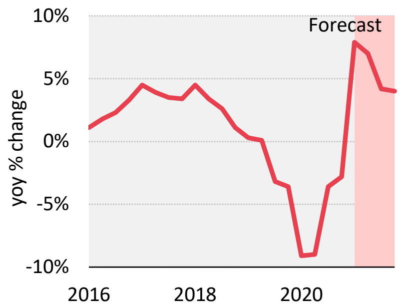
Source: Our World in Data, data as at 1/6/2021

Hong Kong Purchasing Managers' Index



Source: Markit, data as of 21/5/2021

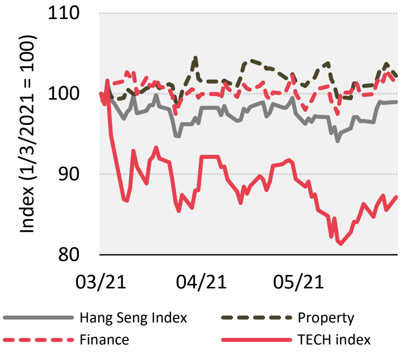
Hong Kong GDP Growth



Sources: Hong Kong Census and Statistics Department; BEA Economic Research Department, data as of 18/5/2021

With an improving epidemic situation in Hong Kong, social distancing measures are expected to be gradually relaxed, and in the meantime exports will continue to perform well. These factors point to a gradual economic recovery. With a much better than expected Q1 economic growth, we have revised our full-year forecast to 5.8%. However, due to different bases of comparison, the growth rate in the second half of the year will be lower than that in the first half. Meanwhile, the inflation rate forecast remains at 1.5%.

Stock Market Indices



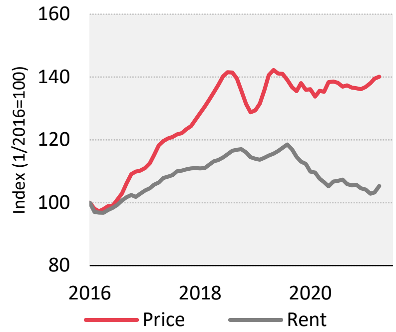
Source: Bloomberg, data as of 31/5/2021

Asia's pandemic situation and inflation fears weigh on equity market

Hong Kong's equity market was hampered by a worsening pandemic across Asia, as well as inflation fears triggered by a faster-than-expected US interest rate hike, with technology stocks particularly affected. Hong Kong's technology stocks fell 2.5% from end-April to end-May, and continued to be the main drag on Hong Kong's equity market, making it one of the worst performers globally since February.

The Hang Seng Index closed at 29,151.8 points on 31st May, 2021, representing a rise of 1.5% from the end of April. In comparison, the Shanghai A-share index rose by 4.9% over the same period, while the Dow Jones Industrial Average rose by 1.9%.

Housing Price and Rent Indices



Source: Rating and Valuation Department, data as of 29/5/2021

Continual rise in property prices

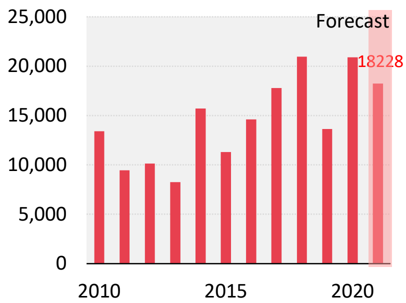
As of end-April, the property price index released by the Rating and Valuation Department (RVD) was at 390.8, up 2.9% from end-2020. The upswing was mainly led by larger apartments, with a 4.7% rise in prices for flats of 160 sqm or above from end-2020.

According to the Centaline Agency, property prices have risen further. By 23rd May, property prices had risen 4.7% year-to-date, the highest level since October 2019. This was just 3.1% below the peak level seen in June 2019, immediately before the major social unrest of that year.

The market expects that the US Federal Reserve may start raising interest rates in the second half of 2023. At present, Hong Kong's market is flooded by ample liquidity, keeping the 1-month interbank rate (which is related to the mortgage rate) at a low level. Meanwhile housing supply is still tight. According to a forecast by the RVD, private housing supply will diminish to 18,228 units this year, down from 20,888 units last year. With worries about a high inflation around the world lowering purchasing power, asset prices could rise further.

However, Hong Kong still has an elevated unemployment rate, together with a number of other economic uncertainties, including Asia's volatile pandemic situation, the US-China relationship, and rising emigration. Buyer sentiment is bound to be negatively affected. We therefore expect Hong Kong's residential property prices to rise only moderately in 2021.

Hong Kong Residential Unit Completions



Source: Hong Kong Rating and Valuation Department, data as of 18/5/2021

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