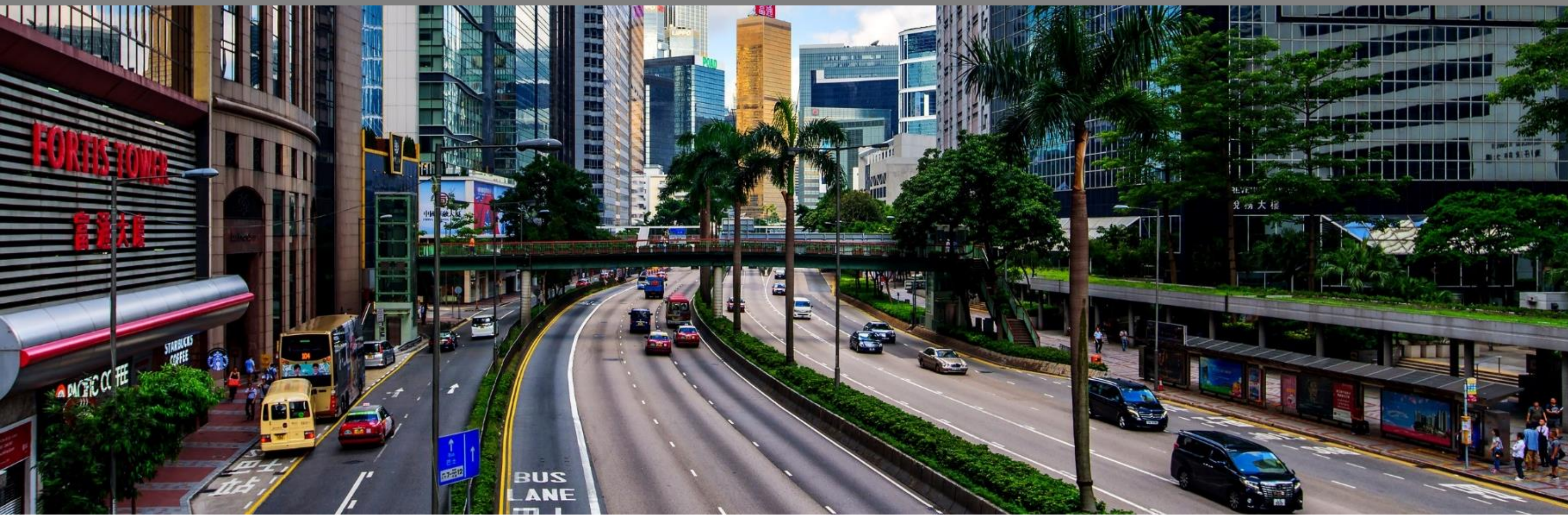
Economic Research

August 2022

*Market Monitor – Hong Kong*

# Slower-than-expected Recovery in Q2




## Hong Kong recorded another year-on-year contraction in Q2

Hong Kong's economy posted a narrower contraction in Q2, with a 1.4% decline year on year (YoY) in real terms (vs. a 3.9% slump in Q1), due to a high base of comparison, subdued recovery in domestic activity, as well as sluggish external trade and investments but avoided a technical recession as a 0.9% quarter-on-quarter rebound was recorded. Private consumption barely changed YoY as downbeat consumer sentiment partially offset the impact from an improved pandemic situations and disbursement of consumption vouchers during the quarter, and as government expenditure, which grew by 13% YoY, continued to lend support to the economy. Nonetheless, merchandise exports and investments remained sluggish, dropping 8.6% and 3%, respectively YoY in Q2, while services exports recovered somewhat, rising 1.8%. The SAR government is likely to further downgrade its annual growth forecast range of 1–2% when the revised figures are published on 12$^{th}$ August, as indicated by Financial Secretary Paul Chan Mo-Po in a media interview.

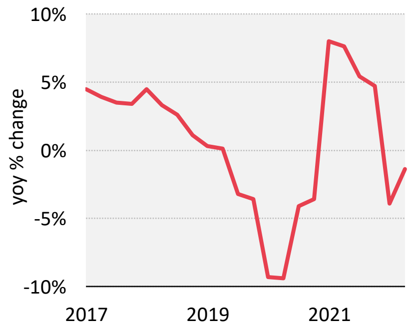
We are also revising our 2022 GDP forecast to an annual growth rate of 0.2%, down from 1.2% previously, taking into account of a slower-than-expected recovery in 1H, the deteriorating external outlook, and a faster-than-expected pace of monetary tightening around the world. The export sector faces continued challenges and the tighter financial could potentially affect property market and investment sentiment under the looming rate hike cycle. However, we still expect domestic activity to pick up in 2H if pandemic conditions remain stable and the SAR government does not tighten pandemic control measures again.

**Hong Kong's GDP shrinks by 1.4% in Q2 amid sluggish exports and investments**

**Domestic activity set to pick up with an improving jobs market, whereas external trade is clouded by the gloomy global outlook**

**Hong Kong may enter a fresh rate hike cycle soon following the US Fed's aggressive rate hikes, with an imminent hike in the prime rate expected.**

**Hong Kong GDP Growth**




Source: Hong Kong Census and Statistics Department, data as of 1/8/2022

# Economic Research

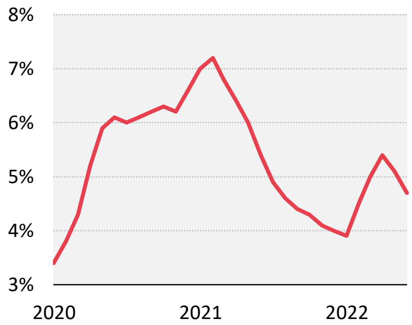


## Improving jobs market and consumption voucher scheme could support local consumer activity in the near term

The jobs market has seen a recovery, with the seasonally adjusted unemployment rate dropping from its peak of 5.4% in the February – April period to 4.7% in the April – June period. The unemployment rate is expected to fall further to an average of around 4.5% in 2022, or even below 4.0% at the year-end assuming the pandemic continues to abate.

Meanwhile, retail sales rebounded by 2.8% YoY in Q2, reversing from a 7.6% plunge in Q1, though there were still some ups and downs in the past couple of months, possibly related to the phased distribution of consumption vouchers and the still subdued confidence of local consumers. Looking ahead, retail sales and the overall consumer activity should regain some momentum with an improving jobs market as well as the disbursement of a second round of consumption vouchers in August. However, a full recovery of the local retail sector will still hinge on the course of the pandemic and whether inbound tourism returns to normal.

**Hong Kong Unemployment Rate**



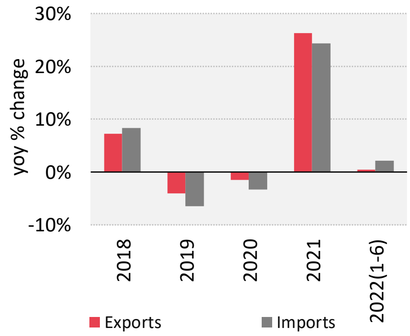

Source: Hong Kong Census and Statistics Department, data as of 19/7/2022

Inflation is heating up slightly in Hong Kong, though it remains mild compared to other developed economies as recovery in rentals remains slow. The YoY increase in the headline consumer price index climbed to 1.8% in June, up from 1.2% in May, due to the fading impact of the government's electricity charge subsidy. The overall price level rose by 1.5% in 1H and we expect the inflation rate will edge up to 1.7% in 2022 as a whole.

## Gloomier global outlook clouds external trade

Merchandise exports recorded a YoY decline of 6.4% in June and 2.3% for Q2 as a whole, reversing a 3.4% growth in the previous quarter amid a regional pandemic outbreak and stringent pandemic control measures in the mainland. Moreover, the strong rebound in external trade with major economies since the re-opening may be halted amid increasing global economic uncertainties, such as supply chain disruption, unstable food and energy supplies, elevated inflationary pressure due to the pandemic and geopolitical tensions, as well as expedited monetary policy tightening and the evolving pandemic situation. Although production and exports are gradually resuming in the mainland, Hong Kong's export sector may only see a moderate gain (partially due to higher prices) in the near term.

**Hong Kong Exports and Imports**

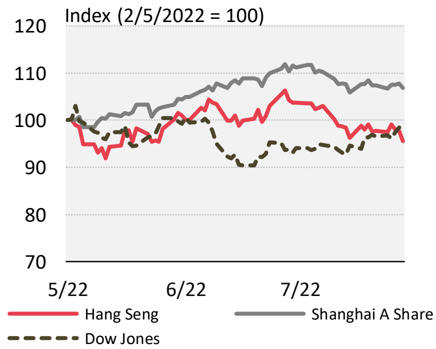



Source: Hong Kong Census and Statistics Department, data as of 25/7/2022

## Hong Kong equities stay range-bound

Hong Kong's equity markets retreated from their three-month high, weighed down by some new regulations affecting the mainland's technology sector and by owners of unfinished properties suspending their mortgage payments, in addition to a mild rebound of Covid cases in the mainland. The Hang Seng Index broadly hovered between 19,000 to 22,000 points since April and closed at 20,156.5 points on 29th July, representing a decline of 7.8% from end-June. In comparison, the Shanghai A-share index fell by 4.3 % over the same period, whereas the Dow Jones Industrial Average climbed by 7.5%.

**Stock Market Indices**



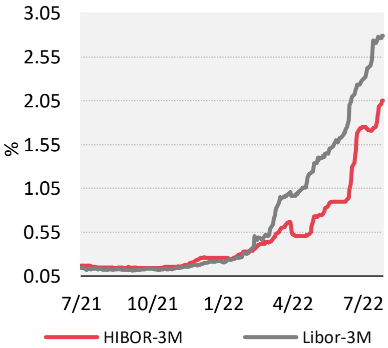

Source: Bloomberg, data as of 29/7/2022

## Increase in prime rate looms with surge in interbank rates

After a back-to-back 75 bps increase in the fed funds rate in July, while the aggregate balance again shrank to the lowest level since mid-2020 at HKD 165.2 billion, by 29th July the 1-month HKD interbank rate had climbed to 1.33% and the 3-month rate to 2.2%. As Hong Kong's liquidity condition has returned to a more neutral position with higher interbank rates, Hong Kong banks will face more pressure to raise their prime rates. We will probably see the first prime rate hike in almost 4 years soon, with a rise of at least 25 bps coming possibly in Q3, and Hong Kong's banks are expected to follow the pace of further fed funds rate hikes ahead.

According to the latest data from the Rating and Valuation Department, Hong Kong residential property prices dropped 3.4% in the first six months of 2022, while rents ceased their eight-month decline by rebounding 0.7% month-on-month in June. The imminent increase in mortgage and prime rates will likely weigh on property market sentiment in the near term, but a sharp correction is not expected amid a recovering economic performance and a steady housing policy and supply environment.

**HIBOR and LIBOR**




Source: Bloomberg, data as of 29/7/2022

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