Significant economic contraction in Q3

Hong Kong’s economy recorded a worse than expected contraction in Q3 2022. Despite the government relaxing pandemic control measures and disburse another round of consumption vouchers, Hong Kong’s economic recovery was still held back by the pandemic, a rapidly tightening global monetary environment, escalating geopolitical tensions, highly volatile global financial markets, weak consumer spending and business sentiment, and other factors. From a relatively high base of comparison last year, Hong Kong’s real GDP contracted by 4.5% YoY and 2.6% QtQ in Q3 according to the advance estimates, worsening from a 1.3% YoY contraction and 1.0% QtQ growth in Q2. Among the major expenditure components, the economic contraction was mainly attributable to the weak external sector and investment performance, while domestic private consumer spending stayed largely stagnant.

Main culprits are weak external sector and investment

In Q3 2022, the global economic environment deteriorated, with the ongoing pandemic and escalating geopolitical tensions prolonging supply chain disruptions and high inflation across the globe. Major central banks in the advanced economies expedited their pace of monetary policy tightening, with the US Federal Reserve (Fed) raising interest rates by 375 bps in eight months. This led to high volatility in the global financial markets and a rapid cooling of the property markets. Against this background, the global economic outlook remains highly uncertain, and the major advanced economies are likely to enter a recession soon. Hong Kong’s external sector was undoubtedly affected, with goods exports recording a 15.5% decline YoY in real terms in Q3, further deteriorating from a 8.4% drop in Q2. Goods imports declined by a wider margin of 16.0% YoY in Q3, down from a 5.9% contraction in Q2.

Hong Kong’s economy registers a worse-than-expected contraction in Q3, likely meaning a recession for 2022 as a whole.

Weak external demand and investment were the main reasons for the contraction, while domestic demand was insufficient to offset it.

Property market faces increasing downward pressure amid rising interest rates.
In late September, Hong Kong scrapped its mandatory hotel quarantine and replaced it with “0+3” medical surveillance and self-monitoring requirements, but the impact of this on Q3 economic data was limited. Exports of services declined by 3.5% YoY in Q3, down from 2.2% growth in Q2, while imports of services fell by 4.0%, down further from a 2.4% contraction in Q2.

On the domestic front, the recovery of private consumer expenditure remained subdued, with 0.0% YoY growth in real terms in Q3, unchanged from Q2, despite the relaxation of social distancing measures, an improving jobs market, and the government disbursing another round of consumption vouchers. It is believed that local consumer sentiment is still taking time to fully recover, with the number of daily confirmed cases staying at several thousand, local interest rates rapidly rising, and the property and financial markets performing poorly.

Unlike private consumption, investment continued to see negative YoY growth in Q3, amid a highly uncertain global economic outlook, escalating geopolitical tensions, rising borrowing costs, a correction of the asset markets, etc. Gross domestic fixed capital formation declined by a sharp 14.3% YoY in Q3, down considerably further from the decline of 2.1% YoY in Q2. Together with ever tightening financial conditions and a gloomy economic outlook, this will likely dampen investment going forward. Government purchasing still recorded a 4.3% YoY growth in Q3, though slowing from 13.0% growth in Q2, possibly reflecting lower anti-pandemic spending by the government.

Going forward, Hong Kong’s economic outlook is not very bright. On the one hand, Hong Kong’s domestic economic activities and employment market are expected to recover gradually if the pandemic situation continues to stabilise and its negative impacts fade. In July – September 2022, Hong Kong’s unemployment rate declined to 3.9%, down from 5.4% in February – April 2022. Together with government support measures like the consumption voucher scheme, Hong Kong’s domestic economic activity is expected to recover modestly. On the other hand, Hong Kong’s tourism-related sector will take more time to meaningfully recover, as the mainland’s stringent cross-border restrictions remain largely unchanged. Moreover, the external environment is still highly uncertain amid ongoing geopolitical tensions, a rapidly tightening monetary environment, potential energy shortages, highly volatile global financial markets, and other headwinds, leading to greater downside pressure.

Growing impact of US rate hikes on local property market

The impact of rate hikes by the US Fed is increasingly feeding through into Hong Kong’s property sector, with a surge in Hong Kong’s interbank rates and prime rate hike. 1-month HKD HIBORs had climbed to 3.17% as of 31st October, 301 bps higher than at the beginning of 2022, while 3-month HKD HIBORs had risen to 4.59%, up 433 bps. Hong Kong’s commercial banks announced the first prime rate hike with an increase of 12.5 bps in late-September, followed by an increase of 25 bps in early November, and a further prime rate hike is expected in the coming months. Amid rising mortgage rates, property market sentiment has been significantly dampened, particularly in Q3. According to the
Rating and Valuation Department, private domestic residential prices dropped by 8.1% in the first three quarters of 2022, with a 5.2% drop QtQ in Q3. Rising interest rates, together with a gloomy global economic outlook, will likely exert downward pressure on the property market in the near term.

**Hong Kong equities plummet amid elevated uncertainty**

Over the past month, sentiment has worsened in Hong Kong’s equity market, with no clear or concrete supportive or accommodative economic measures or sectoral reforms having been announced in the immediate aftermath of 20th National Congress of the Communist Party of China. Going forward, the upcoming Central Economic Work Conference and the National Financial Work Conference could provide clearer signals and measures for future economic development and financial reform, which might help to stabilise market sentiment. The Hang Seng Index closed at 14,687.02 on 31st October, representing a drop of 14.7% from end-September and hitting 13-year low. The Shanghai A-share index declined by 4.3% over the same period, while the Dow Jones Industrial Average rebounded strongly by 14.0%.
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