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## Hong Kong Economic Update –March 2016

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### SUMMARY

#### Economy

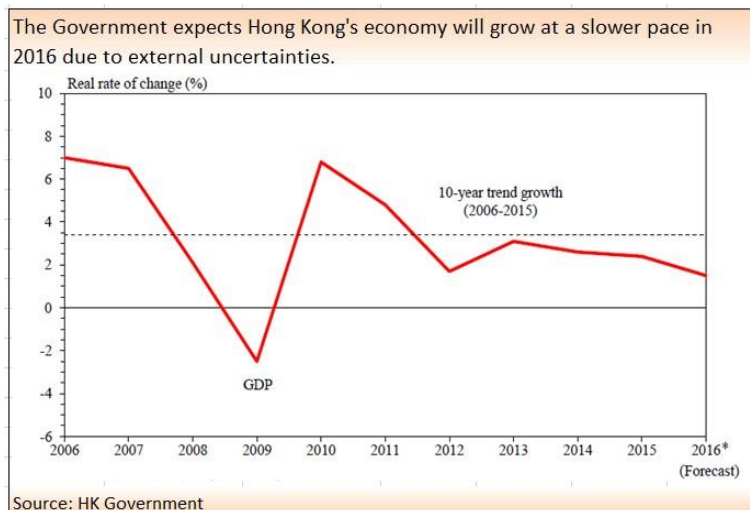
- Hong Kong's economy grew by a modest 2.4 percent in 2015, slightly better than market expectations of 2.3 per cent. Amid a weak global economy and a slowdown in China, the government project that growth will be around 1-2 per cent for 2016. The government has also revised down the forecast for trend growth between 2017 and 2020 from 3.5 per cent to 3 per cent.
- Growth has been and is forecast to be driven predominately by domestic demand, with Private Consumption Expenditure growing by 4.8 per cent in 2015. The government expects that a strong labour market, low inflation, and supportive government expenditure will continue to support domestic demand this year. Both exports of goods and services weakened compared to last year, reflecting the wider global environment, but exports of services, in particular, finance and business services provided a bright spot.
- The Financial Secretary, John Tsang, delivered his Budget for 2016-17 on 24th February. Reflecting the governments concerns about headwinds to growth this year, they announced a basket of short term relief measures, worth HK\$38.8 billion or 1.6% of GDP. The main measures were income tax reduction, increased personal tax allowance, SME financing guarantee scheme, licence and registration fee waiver, elderly and low income support. The government expects these measures will boost growth by 1.1 per cent this year.

- Prices in Hong Kong’s property market started to decline, with a 7% fall between September and December 2015. But compared to 2014, property prices still remained 2% higher at the end of 2015. Despite house prices correcting since the third quarter of last year, housing affordability ratio remained high at 62 per cent in the fourth quarter last year (well above the long term average of 46 per cent between 1995 to 2014). Given this, the government reiterated that the double stamp duty measures, which aim to reduce speculation, will remain in place.

**Financial Sector**

- Hong Kong’s banking sector remained resilient, with the capital adequacy ratio standing high at 18 per cent and asset quality remained good. The ratio of classified (bad) loans stayed low at 0.56 per cent, and loan delinquency ratio for credit card and residential mortgages also stayed very low at 0.24 per cent 0.03 per cent respectively.
- RMB business in Hong Kong eased in 2015, particularly during the second half of the year. This is reflected by the decline in RMB deposits and RMB bond issuances in Hong Kong.

**ECONOMY**



1. Hong Kong’s economy grew by a modest 2.4 percent in 2015, better than market expectation of 2.3 per cent; nonetheless this is the gloomiest government forecast since the 2008 financial crisis. On a sequential basis, GDP grew by a margin of 0.2 per cent in the fourth quarter. Inevitably, Hong Kong’s small open economy has been affected by the slowdown in China and broader global economic uncertainties. The government projected that trend growth between 2017 and 2020 will be at 3 per cent, lower than the trend growth of 3.4 per cent over the past ten years. Slackened exports demand, in both goods and services, was the main drag to growth. Meanwhile, inflationary pressure continues to ease amid weak international food and commodity prices. Overall, with stronger headwinds this year, the government project that growth will be around 1-2 per cent.

**Total Exports**

2. Total exports of goods suffered from sluggish external demand and fell 1.7 per cent, compare to a year ago; after all, growth momentum of merchandise exports has slackened since 2014 which grew only marginally by 0.8 per cent compare to a year earlier. Last year's fall was the first annual decline since 2009. Subdued economic activities in Hong Kong's key trading partners such as Japan, EU, and US (apart from China), has dragged demand, which was particularly weak during the second half of last year. Sluggish demand also spilled over to Asian markets with exports to both higher-income countries (Korea, Taiwan, and Singapore) and ASEAN countries also faced sharp decline. The only exception was India and Vietnam, where demand continued to hold up.

Total exports of goods by major markets (year-on-year rate of change in real percentage terms)

| Countries | 2015   |       |       |       |       | 2014   |
|-----------|--------|-------|-------|-------|-------|--------|
|           | Annual | Q4    | Q3    | Q2    | Q1    | Annual |
| China     | -2.0   | 0.6   | -3.5  | -4.4  | -0.2  | 0.5    |
| US        | 1.0    | -0.6  | -1.4  | 3.6   | 3.3   | 2.9    |
| EU        | -4.1   | -0.2  | -6.0  | -6.7  | -3.5  | 0.6    |
| Japan     | -3.6   | -2.8  | -1.7  | -4.0  | -5.8  | -4.3   |
| India     | 7.9    | 22.8  | 2.3   | -3.1  | 12.4  | 17.1   |
| Vietnam   | 12.1   | 5.2   | 12.9  | 18.0  | 14.0  | 2.1    |
| Taiwan    | -15.0  | -2.1  | -23.5 | -20.3 | -12.8 | 2.1    |
| Korea     | -13.4  | -14.2 | -19.1 | -13.8 | -5.7  | 0.1    |
| Singapore | -4.3   | -4.9  | -8.7  | -3.7  | 0.4   | 2.4    |

Source: Census & Stats Dept., HKSARG

3. Exports of services, which used to hold up in the past, also declined and fell 0.6 per cent last year (compare to a year earlier), the first annual decline since 1998. The slump was caused by a decline in visitor arrivals. In 2015, overall visitors arrival fell 2.5 per to 59 million, whilst Mainland visitors arrival fell 3 per cent to 45 million, compare to a year earlier. Decline in visitor arrivals has dragged demand for travel services coupled with weak visitor spending. Weak tourism growth and subdued cargo flow within the region has dragged demand for transportation services. Fortunately, demand for financial and other business services held up and helped cushioned growth, thanks to hectic fundraising and cross-border financial services activities.

## Domestic Consumption

4. Nevertheless, domestic demand, Hong Kong's dominant growth driver, remained vibrant with Private Consumption Expenditure growing at a solid rate of 4.8 per cent in 2015, compare to 3.3 per cent in 2014. The government said the buoyant consumption sentiment was backed by stable labour market condition (unemployment at 3.3 per cent or at full employment in 2015), rising minimum wage (at HK\$32.5 or £3), and continuous government consumption expenditure (grew 3.4 per cent in 2015). However, the government was cautiously optimistic and said that growth momentum has eased in the second half of last year due to the correction in housing prices, a highly volatile stock market, and slowdown in China & global economies.
5. Hong Kong's retail market slowed. Total retail sales in 2015 dropped both in value (-3.7 per cent) and in volume (-0.3 per cent) terms, compared to 2014. In December last year, retail sales value dropped 8.5 per cent whilst sales volume dropped 6.1 per cent, compared to 2014. The government explained that the slowdown in tourist visitors will remain a major headwind to Hong Kong's retail sector coupled with volatile assets markets and global economic uncertainties. Luxury goods such as jewellery, watches and clocks dropped 15 per cent in December and will continue to remain weak. Daily consumption items such as medicine and cosmetics, Chinese drugs and herbs also

dropped. Overall investment spending in terms of gross domestic fixed capital formation dropped 2.2 per cent in 2015, dragged by a decline in machinery and equipment acquisition due to cautious business sentiments.

## The Budget

6. The Financial Secretary, John Tsang, delivered his [Budget for 2016-17](#) on 24<sup>th</sup> February. The Budget reflects that Hong Kong's fiscal position remains strong thanks to the government's prudent fiscal policy stance. The Hong Kong Government estimated fiscal reserves to reach HK\$835 billion by end-March 2016, equal to 24 months of government expenditure.
7. To tackle the future problem of a possible structural deficit, the Financial Secretary has called to establish the Future Fund with the initial endowment of HK\$220 billion from the Land Fund and one-third of actual surplus in 2015-16 into the Future Fund. HKMA will be responsible for growing the Future Fund.
8. Overall the Budget was well received by the public, legislators, and local businesses. The Budget proposed a basket of tax concessions and short-term relief measures, similar to previous years, to assist the underprivileged, middle class and small medium sized businesses. The government expect the HK\$38.8Bn relief measures will stimulate GDP growth by 1.1 per cent.

Key policy measures include:

- **Small medium enterprises** - Profit reduction by 75 per cent with a maximum of HK\$20,000, Business registration waiver
- **Tourism industry** – Allocate HK\$240 million for Government and the industry to jointly launch five measures to attract new visitors (other than those from the Mainland) and enhance the industry's competitiveness in Hong Kong and around the region.
- **Individuals** – reduce salaries tax by 75 per cent for 2015-16 assessment with a maximum of HK\$20,000; increased basic allowance for personal assessment; property rates waiver; extra allowance to social and old age allowance.
- **Start-ups** – set up a HK\$2 billion Innovative and Technology Venture Fund to coinvest with private venture capital funds; expand Science Park

## Property Market

9. Prices in Hong Kong's property market started to decline, with a 7% fall between September and December 2015. But compared to 2014, property prices still remained 2% higher at the end of 2015. Developments in the property market have been affected by the US Federal Reserve's rate hike as well as lower demand from Chinese investors into the luxury property developments. Home buyers have become more cautious, with volume of transactions falling to 55,982 in 2015, much lower than the long-term average of 92,910. Nevertheless, the government remains very cautious and alive to the risk of an abrupt decline in home prices as average prices in December still exceed the previous

1997 peak by 65 per cent. With housing affordability ratio standing at a high of 62 per cent in the fourth quarter last year (well above the long term average of 46 per cent between 1995 to 2014), the government reiterated that the double stamp duty measures will remain in place.

10. Looking forward, the government expects that the property market will face more downward adjustment pressure. This is in part due to an increase in housing supply from the government's commitment to increase. On the other, continued economic uncertainties and further rate hikes by the US Federal Reserve will also put pressure on Hong Kong's property market. Market analysts expect that the property price will correct by 10-15 per cent in 2016.
11. Nevertheless, spillover risk on banks of mortgage loans going bad remain low. Mortgage loan approval grew 3.1 per cent in December last year, compare to a month earlier. Both mortgage loan delinquency ratio and loan reschedule payments remains at zero level. To mitigate the risk of future interest rate hike, mortgage borrowers have priced loans at fixed rates, which grew 5 per cent in November; compare to mortgage loans priced in both best lending rates and HIBOR, which dropped 11 per cent and 80 per cent respectively.

## **Policy Development**

12. The Chief Executive and the Governor of Guangdong Province co-chaired the 18<sup>th</sup> Plenary of the Hong Kong Guangdong Co-operation Joint Conference in Hong Kong on 9<sup>th</sup> September. In the meeting, Hong Kong and Guangdong agrees to co-operate in the implementation of the "Belt and Road" Initiative, the development of the Guangdong Free Trade Pilot Zone, which includes the liberalisation of trade in services, innovation and technology, as well as financial and professional services.
13. Hong Kong remains the world's freest economy according to the 2015 Annual Report on Economic Freedom of the World, a report jointly published by The Fraser Instituted of Canada and CATO Institute in the US.
14. The Commission on Poverty announced in October that the number of Hong Kong's population that is classed as living in poverty has decreased from 970,000 in 2013 to 960,000 in 2014 and the poverty rate has dropped slightly from 14.5 per cent to 14.3 per cent. The government said that the cash policy intervention and other poverty measures have helped to alleviate poverty.
15. The Competition Ordinance has now fully commenced since December last year. The ordinance provides a cross-sectoral competition law prohibiting anti-competitive conduct in all sectors.

## **FINANCIAL**

16. Hong Kong's financial sector has been volatile during the second half of this year, especially during the last quarter. The low interest rate environment remains despite rate hike in the US since November last year. Hong Kong's Base Rate has hiked from 0.5 per

cent to 0.75 per cent. Nevertheless, with abundant liquidity, interbank interest rate remains unchanged. The rate hike announcement has triggered a short period of capital outflow with the HK dollar spot exchange rate reaching the strong-side of the HKD/USD peg. However, with HKMA's intervention, the outflow situation has ceased and the spot exchange has now returned to its normal trading band.

17. Hong Kong's banking sector remained resilient with capital adequacy ratio standing high at 18 per cent and asset quality remained good. The ratio of classified (bad) loans stayed low at 0.56 per cent, and loan delinquency ratio for credit card and residential mortgages also stayed very low at 0.24 per cent 0.03 per cent respectively.
18. The Hong Kong Government continues to drive the growth of Hong Kong's bond market through issuance of Government bonds. The government has issued a total of HK\$20.4 billion during 2015. Following the issuance of a sukuk bond in June, the Government issued HK\$10Billion inflation-linked bonds as proposed in the 2015-16 Budget. As of end 2015, total outstanding bond issued under the Government bond programme has amounted to HK\$98.9 Billion and the two outstanding sukuk bonds at US1 Billion.
19. The Hang Seng Index (HSI) was very volatile in 2015, particularly during the second half of last year. For the whole of 2015, the HSI dropped 7.2 per cent. Nevertheless, the volatile market and cautious trading still led to daily turnover to increase by 52 per cent, compared to 2014 with trading in futures, stock options and other derivatives products still remain relatively active. In addition, Hong Kong has regained the world's top IPO fund raising platform last year with total fund raised went up by 13 per cent to HK\$263 billion and was ranked the world's eighth largest stock exchange or the fourth largest in Asia.
20. The Hong Kong Futures Exchange Limited (HKFE) and the London Metal Exchange (LME) Clearing signed a non-binding memorandum of understanding to develop the proposed "London-Hong Kong Connect". The proposed scheme will help enhance the market access of the Hong Kong's securities market and support the development of Hong Kong as a commodities trading centre. The scheme is still pending regulatory approval.
21. The Hong Kong Exchanges and Clearing introduced three more London Metal Mini Futures, where trading will be RMB denominated. The government says these commodity contracts will diversify the range of RMB products in the Hong Kong financial market Fund.

## **Policy Development**

22. Following the implementation of the Mainland – Hong Kong Mutual Recognition of Funds initiative in July, the first batch of authorised funds was announced by both the Mainland and Hong Kong regulators in December last year. The Securities and Futures Commission has approved a total of 23 Mainland funds whilst the China Securities Regulatory Commission has approved 3 Hong Kong Funds.

**RMB Business**

23. RMB business in Hong Kong eased in 2015, particularly during the second half of the year. This is reflected by the drop of RMB deposits, reduced appetite in RMB bond issuance, and a fall in the Standard Chartered Bank Renminbi Global Index (RGI).

- **The Standard Chartered RGI** shows that as at end of December, the index **fell** by 0.2 per cent in 2015, following 56 per cent growth in 2014. The bank points out that RMB depreciation, since the reform in August last year, was the main drag to appetite for RMB businesses. Market and investors alike are concerned about the depreciation of the RMB.
- **Total RMB deposits dropped** further in the last quarter with RMB deposits decreased from RMB 1,009 billion in September to RMB851 billion in December 2015. RMB deposit has dropped 15 per cent in 2015 compare to a year earlier.
- **RMB bond issuance dropped sharply** from RMB 197billion in 2014 to RMB75 billion in 2015.
- **RMB Real Time Gross Settlement (RTGS)** system transactions handled by banks in Hong Kong **rose** 29.2 per cent to RMB947 billion in 2015, compare to a year earlier.
- **RMB cross-border trade** settlement transactions handled by banks in Hong Kong **rose** 9.2 per cent to RMB6,833 billion, compared to previous year.
- **Outstanding RMB loans surged** 58.2 per cent to RMB297 billion in 2015, compare to RMB188 billion in 2014.

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