



British
Consulate-General
Hong Kong

Hong Kong Economic Update – September 2014

Economy

- Hong Kong's GDP growth fell to 1.8 per cent (year-on-year) in the second quarter, the slowest growth since the third quarter of 2012. The government explains that weak tourist spending was the main drag to growth performance. Looking forward, the government revised Hong Kong's growth forecast downward to 2-3 percent for 2014.
- The residential property market rebounded slightly in the second quarter. Overall property price rose 3 per cent during the second quarter. Housing prices remained high with overall flat prices in June exceeded the 1997 peak by 44 per cent and housing affordability ratio at 54 per cent.
- Hong Kong has entered into negotiations with some other World Trade Organisation members in July on the Environmental Goods Agreement.
- The Poverty Commission released a report on "A Study on Future Development of Retirement Protection in Hong Kong". The report aims to tackle some of the issues related to Hong Kong's ageing population. Meanwhile, the public consultation on standard working hours has completed on 31 July 2014. The working group will submit the report to the government at the end of this year.

Financial

- The Hang Seng Index rallied since July amid improved market sentiment and imminent announcement of the implementation of the Shanghai-Hong Kong Stock Connect in October.
- Hong Kong becomes the second largest stock market in Asia during the first half of this year. A total of 51 IPOs listed in HK during the first half of this year, raising a total of US\$10.4 billion (£832 million). Mainland companies continued to dominate the fund raising platform with 68 per cent of total funds raised.
- The Hong Kong Monetary Authority (HKMA) injected US\$9 billion to maintain the dollar peg (under the currency board system) amid net capital inflow during July. According to HKMA, these inflows resulted from "ordinary commercial activities" and the financial system remained sound and stable.
- Hong Kong's RMB business remains active. RMB deposits grew to RMB925.9 billion in June. Market analyst expects that the Hong Kong-Shanghai Connect will help boost deposits to RMB1.3 billion by the end of this year. Hong Kong Airline is looking to launch the first dual currency IPO before the end of this year.

Economy

1. Hong Kong's economy slowed further in the second quarter of this year. GDP growth fell from 2.6 per cent (year-on-year) in the first quarter to 1.8 per cent (year-on-year) in the second quarter, the slowest growth since the third quarter of 2012. On a quarterly basis, growth declined 0.1 per cent compared to an increase of 0.3 per cent in the previous quarter. Government explained that, although merchandise exports rebounded slightly (in June), slower growth in domestic demand affected by weak tourist spending was the main drag on growth. Looking forward, weak external demand and slower growth in domestic consumption prompted the government to revise Hong Kong's growth forecast downward from 3-4 per cent to 2-3 per cent for 2014. This is in line with external estimates – e.g. HSBC downgraded its 2014 growth forecast for Hong Kong from 2.9 per cent to 2.5 per cent.

Exports of goods rebounded, but demand from advanced economies remained weak

2. **Total goods exports** rose 2.3 per cent during the second quarter, compared to the same period last year. The improvement was backed by rebounding demand from external – particularly Asian - markets especially in June (up 11.4 per cent). Exports to the US remained stable whilst exports to EU and Japan improved in the second quarter. Export growth to China and other Asian countries resumed in May and June amid improved economic environment. Latest data from July (6.8 per cent year-on-year growth) suggests this upwards trend will continue. However, government remained cautious given the weakening global outlook, driven by weak recovery in advanced economies, uncertainties arising from US' monetary policy normalisation (i.e. FED tapering) and political tensions in various parts of the world.

Total exports of goods to major markets
(year-on-year rate of change in real)

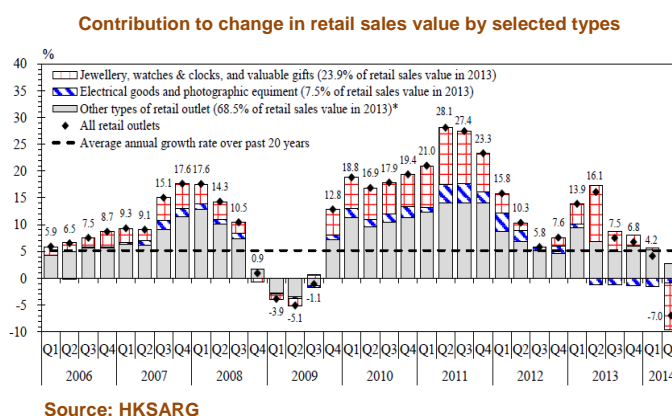
Countries	2014		2013			
	Q2	Q1	Q4	Q3	Q2	Q1
China	4.5	-2.9	2.8	2.8	6.3	8.5
US	3.1	3.9	-3.6	-1.0	-8.0	-5.0
EU	4.3	1.2	2.4	2.7	-2.5	-5.4
Japan	-1.5	-2.1	-6.2	-8.3	-5.5	-4.9
India	17.4	7.6	16.8	6.7	8.0	0.3
Taiwan	0.2	-5.9	-13.9	-7.6	-12.1	14.2
Korea	4.5	1.8	18.6	4.5	2.0	0.5
Singapore	-0.6	6.8	6.2	-0.9	0.2	5.2

Source: Census & Stats Dept., HKSARG

3. Amidst this ongoing uncertainty in advanced economies, Hong Kong is looking to diversify its trade partners by establishing a stronger trade link with ASEAN. The government hopes that a Free Trade Agreement, currently under negotiation, will facilitate greater trade and investment flows.
4. Concurrently, **exports of services also slowed sharply**: it dropped 2.3 per cent in the second quarter (year-on-year) compared to a first quarter increase of 3.3 per cent. The drop was dragged by significant decline in travel services, which fell 11.5 per cent (year-on-year) in the second quarter. In mitigation, Government suggested that the drop was partly due to the high baseline set by the brisk growth in tourist spending last year. Meanwhile other service exports - such as exports of trade related services and transportation services - fared better due to improved regional trade flows, whilst exports of financial and other business services were boosted by the expansion in cross-border financial activities.

Domestic demand weakened amid decline in visitors' spending

5. Domestic demand slowed further in the second quarter. Private consumption expenditure grew marginally by 1.2 per cent (year-on-year) in the second quarter, the first decline since the first half of 2009. Annualised total retail sales contracted sharply since April (-9.9 per cent) and continued to decelerate in both May (-3.9 per cent) and June (-6.9 per cent). According to official data, recent deterioration was driven mainly by weak sales in luxury items (jewellery, gold, watches), which dropped nearly 50 per cent (year-on-year) over the last few months and other valuable items such as electronic goods and photographic equipments. Growth in visitor numbers continued to slow in the second quarter: 9.6 per cent compared to 15.3 per cent in the first quarter of this year.



6. Whilst the decline suggested that tourist spending has strong impact on domestic consumption, the government argues that overall visitors' contribution to Hong Kong's economy amounts only to HK\$80 billion (or 3.9 per cent of HK's GDP). Local consumption – which has held up over the same period - backed by healthy labour market (July unemployment, 3.3 per cent) will remain an important driver to domestic demand.
7. Looking forward, due to this slowdown in recent quarters the government remains cautious and projects that domestic consumption will expand at a slow pace in the second half. Meanwhile, investment sentiment may also be affected as reflected in the government's latest Quarterly Business Tendency Survey. However, the government's expenditure on high level public infrastructure works will continue to sustain the economy.
8. Consumer price inflation eased further in the second quarter. Underlying inflation eased to 3.5 per cent in the second quarter from 3.8 per cent in the first quarter and down further to 3.3 per cent in July. Amid weaker growth momentum, the government forecast underlying inflation for 2014 at 3.5 per cent down from its previous forecast in May of 3.7 per cent.

Policy Development

9. Hong Kong has entered into negotiations with some other World Trade Organisation members in July on the Environmental Goods Agreement.

10. On tax transparency, Hong Kong signed an agreement with Korea in July on the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income.
11. On 20 August, the Commission on Poverty released a report submitted by Professor Nelson Chow Wing-sun and his research team titled “A Study on Future Development of Retirement Protection in Hong Kong”. The report proposes a tax on salaries between 1.5 to 2.5 per cent to be contributed by both the employer and the employee in order to fund universal pensions. Carrie Lam, Chief Secretary said that a public consultation is necessary before submitting the study to Government.
12. The public consultation on working hours has ended on 31 July 2014. The working groups will submit their reports to the Standard Working Hours Committee for further study by the end of 2014.

Property Market

13. The residential property market rebounded slightly in the second quarter. Improved sentiment strengthened by the ease of imminent US interest rate hike has stimulated demand for new homes, which were offered at discounted price compared to price of secondary market homes. Transactions rose sharply by 48 per cent to 16,011 in the second quarter, compared to the first quarter. These transaction volumes, however, remain far below the peak of 2010 – in the first half of 2010, there were over 65,000 transactions compared to less than 27,000 Jan-June 2014.
14. Overall property prices rose 3 per cent during the second quarter. Housing prices remained high with overall flat prices in June exceeding the 1997 peak by 44 per cent. The housing affordability ratio remained at a high of 54 per cent. On the rental market, flat rentals and office rentals went up slightly by 1 and 3 per cent respectively.
15. The Government continues to demonstrate its commitment to increased housing supply. During the first half of 2014, private residential units completed surged 407 per cent (year-on-year) to 7500 units; with a further 12,300 under construction. The government is tendering more residential sites for sale. Government projects that total supply of new flats in the next three-four years could reach 73,000 units.
16. The double stamp duty measure remains effective in curbing speculative activities (1.4 per cent of total transactions, compare to the peak of 20 per cent in 2010) and non-residential purchase (1.6 per cent of total transactions, compare to a high of 4.5 per cent in 2012).
17. On 15 July, the Legislative Council has finally formally passed these measures in the Stamp Duty (Amendments) Bill 2013. The bill has amended the Stamp Duty Ordinance to double the rates of stamp duty apply on property transactions. The bill will apply to all home buyers in Hong Kong except for first time home owners, who are Hong Kong permanent residents. The government also made a slight adjustment from its original proposal by extending the tax refund period for home owners

switching between flats.

18. Mortgage loans drawn down increased in June by 7.7 per cent compared to May. Among these, mortgage loan financing for primary market transactions increased by 4.1 per cent to HK\$4.8 billion (£384 million) and financing for secondary market transactions increased by 13.4 per cent to HK\$16.7 billion (£1.3 billion). Mortgage loans for refinancing increased by 4.1 per cent to HK\$3.5 billion (£280 million). Meanwhile, mortgage delinquency ratio remained unchanged at a very low level of 0.02 per cent and negative equity decreased to 30 cases at end of June from 81 cases at end of March 2014.

Financial

19. The **Hang Seng Index** regained momentum in the second quarter and rallied since July as announcements emerged on the implementation of the Shanghai-Hong Kong Stock Connect in October. Improved market sentiment was backed by improved Mainland and US economic situation, and the less imminent monetary tightening stance by the FED.
20. Nonetheless, investors remained cautious. Trading activities fell 15.9 per cent from HK\$68.3 billion in the first quarter to HK\$57.5 billion in the second quarter. Fund raising activities also slowed only with signs of pick-up in June.
21. Hong Kong was ranked fourth globally and second largest in Asia in IPO activities between January and May 2014 (UK was second). A total of **51 IPOs were listed** in HK during the first half of this year, raising a total of US\$10.4 billion (£832 million). Mainland companies continued to dominate and accounted for 68 per cent of total funds raised. Market expects mega IPO listings such as BAIC Motor, China General Nuclear Power Group, Bank of Shanghai and China Guangfa Bank will help boost IPO and trading activities in the second half of this year.
22. Since the start of July, there has been a **net capital inflow** into Hong Kong. Peter Pang, Deputy Chief Executive of the HK Monetary Authority said that a cumulative US\$9 billion (£5.4 billion) was bought in to defend the dollar peg since 1st July. Chan's analysis was that these inflows were mainly due to ordinary commercial activities such as dividend distribution by H-share companies (about HK\$200 billion), cross-border merger and acquisition deals (such as share issuance by Citic Pacific reverse acquisition (HK\$53 billion)), and the acquisition of Wing Lung Bank by Overseas-Chinese Banking Corporations (HK\$40 billion).
23. Although Pang did not rule out that some of the inflows could represent funds pre-positioning themselves prior to the launch of the Shanghai-Hong Kong Stock Connect, he argued this was unlikely to be significant because overseas investors could simply convert US dollar directly into RMB.
24. HKMA reiterated that the **Link Exchange Rate System**, which has been used in Hong Kong for over 30 years, remains an effective monetary tool to maintain financial

stability in Hong Kong.

25. The **first Islamic balanced fund** was introduced in Hong Kong on 17th June by RHB Asset Management. This is one of the first Islamic funds offered within the framework of mutual fund recognition between Malaysia and Hong Kong in 2008. As an international financial centre, the government sees demand from a diverse group of international investors for Islamic finance products in Hong Kong, and continues to promote its uptake.
26. The **Financial Services Development Council (FSDC)** released its first Annual Report on 14 July. Since its establishment in January 2013, the Council has submitted six reports to the Chief Executive, conducted research reports and participated in several financial forums and seminars. Looking forward, Mrs Laura Cha, Chairman of the FSDC, said in addition to continued collaboration with regulators on policy initiatives, the Council will put more emphasis on promoting Hong Kong's financial services industry overseas in order to enhance Hong Kong's position as a global financial centre. The two-year term of FSDC's 22 members, including the Chairman, will expire in January 2015.

RMB Business

27. Hong Kong's RMB business remains active:
28. **RMB deposits** grew to RMB936.8billion in July, up 1.2 per cent compared to June. However, growth pace of RMB deposits has been fluctuating in recent months, the first month on month drop this year was in May. Bank of China Hong Kong suggested that offshore RMB deposits will fluctuate in the long term and recent decline in RMB deposits was mainly due to drop in corporate RMB deposits. A survey by Standard Chartered also shows that worries about FX volatility (due to the end of one way appreciation of Yuan) and China's economic outlook are key concerns that hindered CNH depositors from holding RMB. Conversely, other market analysts expect that the Shanghai-Hong Kong Connect may boost deposits to RMB1.3 billion by the end of this year.
29. **RMB cross-border trade settlement** amounted to RMB532 bn in June compared to RMB 444 bn in May.
30. **Dim Sum bond** issuance reached a new high of RMB 70 billion in the second quarter. During the first half of 2014, RMB bond issuance has reached 130 billion, exceeding the annual total of RMB 117 billion in 2013. On 25 Aug, Ministry of Finance announced that it will issue 12 billion RMB bond in Hong Kong later this year.
31. **The Shanghai-Hong Kong Stock Connect programme** will launch in mid-to-late October. Market expects that the pilot programme will enhance RMB liquidity flow between the onshore and offshore market. To prepare for the launch, the Hong Kong Exchange and Clearing announced that connectivity test for the scheme has been completed and a trial with live trades will be conducted on 30th – 31st August. However, issues such as tax treatment, legal jurisdiction and infrastructure

compatibility between the exchanges remains to be solved.

32. The Hong Kong Economic Journal reported that Hong Kong Airline will launch the **first dual currency IPO** (HK dollar and RMB) on the Hong Kong stock exchange later this year. Hong Kong Airline will raise about US\$500 million (£40 million). If successfully launched, the debut will provide more RMB products for investors, especially individual subscribers.

Contacts

Kathleen Poon | kathleen.poon@fco.gov.uk | +852 2901 3249