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## Hong Kong Economic Update – February 2015

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### Summary

### Economy

1. Hong Kong's economy grew 2.3 per cent in 2014 compared to 2.9 per cent in 2013. This was the third consecutive year where Hong Kong's growth fell below the ten-year trend growth of 3.9 per cent. Growth was dragged by weak demand in advanced economies. The government projects growth between 1 – 3 per cent for 2015.
2. The Financial Secretary John Tsang delivered the Budget on 25<sup>th</sup> February, where he outlined HK\$34bn (£2.8bn) of one-off giveaways out of an unexpectedly high surplus of HK\$63.8Bn (£5.5bn). He also proposed measures to support Hong Kong's existing strengths, diversify the economy and to combat Hong Kong's projected structural deficit.
3. Hong Kong's property market has revived since April last year as housing prices surged 13 per cent in 2014. Higher housing prices were led by strong ownership demand for small/medium sized flats (rose 13 per cent, yoy). Overall home prices in December 2014 surpassed the 1997 peak by 61 per cent.
4. On 27<sup>th</sup> February, the Hong Kong Monetary Authority announced the 7<sup>th</sup> round of macroprudential measures for property mortgage loans in order to stabilise the overheated (mainly small/medium sized) property market and protect Hong Kong's banking system.

## Financial

5. Hong Kong was the world's second largest (US-1<sup>st</sup>; UK-3<sup>rd</sup>) and Asia's largest IPO fund raising platform in 2014. Hong Kong raised HK\$228 billion (£20 billion) for 122 IPOs compare to HK\$169 billion (£14.5 billion) for 102 IPOs in 2013.
6. The momentum of RMB business in Hong Kong remained vibrant. RMB deposits finally exceeded RMB 1 Trillion (though this fell back in January); RMB cross-border trade settlement handled by banks in Hong Kong amounted to RMB6258.3Bn, up 63 per cent compared to 2013; RMB bank loans grew a notable 63 per cent to RMB188bn; and the issuance of RMB bonds grew sharply by 69 per cent to RMB197bn in 2014.
7. Since the launch of the Shanghai Hong Kong Stock Connect on 17<sup>th</sup> November 2014, cumulatively 24.9 per cent (RMB74.6 billion) of the aggregate quota of RMB300 billion was used on northbound trading and 4.2 per cent (RMB10.5 billion) of the aggregate quota of RMB250 billion was used on southbound trading. Trading was dominated by large-cap and AH stocks listed both in HK and Shanghai stock exchanges.

## Economy

1. Hong Kong's economy grew moderately last year at 2.3 per cent (year-on-year) compared to 2.9 per cent in 2013. This was the third consecutive year where Hong Kong's growth fell below the ten-year trend growth of 3.9 per cent. On a sequential basis, growth also slowed from 2.7 per cent in the third quarter to 2.2 per cent in the fourth quarter. Government explained that weak demand in advanced economies was the main drag to growth. Despite solid growth in domestic demand, the government anticipates more challenges this year and projects growth between 1 – 3 per cent (against market expectations between 2.6 – 2.8 per cent) for 2015.

## The Budget

2. The Financial Secretary delivered the Budget Speech on 25<sup>th</sup> February. The Financial Secretary outlined HK\$34Bn (£2.8bn) of one-off giveaways, which should represent a 1% boost to GDP growth. These measures included: tax allowances for individuals and businesses, larger tax breaks for parents, property rate waivers and additional allowance for the elderly and the underprivileged. This was built on an unexpectedly high surplus of HK\$63.8bn (£5.5bn).
3. Aside giveaways, this year's budget was built around four key themes: Diversifying Hong Kong's economy; supporting Hong Kong's pillar industries; tackling Hong Kong's limitations; and healthy public finances. The government also proposed support for service and transport sectors affected during the Occupy protest; and the establishment of a \$220bn (£18bn) Future Fund, for long-term investment to help combat the projected structural deficit that Hong Kong may face in a decade's time.

## Merchandise Exports

4. **Total exports of goods grew only 1 per cent in 2014** compared to growth of 6.5 per cent in 2013. On a quarterly basis, exports of goods declined 0.4 per cent in the fourth quarter from a growth of 4.8 per cent in the third quarter. The government explained that weak demand from EU and Japan has dragged exports, which fell notably since the second half of last year (e.g. exports to Germany fell 11.2%). The pace of this growth was further

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

Countries	2014					2013 Annual
	Annual	Q1	Q2	Q3	Q4	
China	0.5	-2.9	4.5	3.6	-3.3	4.9
US	2.9	3.9	3.1	0.4	4.6	-4.3
EU	0.6	1.2	4.3	-0.4	-2.1	-0.6
Japan	-4.3	-2.1	-1.5	-5.1	-8.2	-6.3
India	17.1	7.6	17.4	37.9	5.3	7.7
Taiwan	2.1	-5.9	0.2	13.5	0.8	-6.1
Korea	0.1	1.8	4.5	7.0	-11.4	6.3
Singapore	2.4	6.8	-0.6	2.9	0.9	2.5

Source: Census & Stats Dept., HKSARG

decelerated by slowdown in China. Meanwhile, growth momentum in merchandise exports continued in January 2015, supported by moderate growth in the US. Exports to ASEAN and other newly industrialised economies performed well too, as exports to Asia grew 7.1 per cent (led by Vietnam, the Philippines, Singapore, Thailand, and China); while UK merchandise exports grew 3.8 per cent.

5. **Exports of services** also slowed and **grew only 0.5 per cent**, compared to same period last year; this is the slowest in five years. Slower growth was dragged by exports of travel services (due to change in Mainland tourists' spending to non-luxury goods items) and exports of trade-related services, in line with the slowdown in trade growth outlined above. Exports of financial and other business services also decelerated. Nevertheless, exports of transportation services saw some improvement as cross-border passenger flow remained vibrant.

## Domestic demand

6. **Private consumption expenditure (PCE)** stayed firm and **grew modestly by 2.7 per cent in 2014**, compared to 4.6 per cent in 2013. The firm growth was supported by resilient labour market (low unemployment of 3.2 per cent in 2014), rising incomes (average wage growth of 4.2%), and positive wealth effect supported by vibrant asset growth, particularly property (see point 10 below).

7. **Retail sales (by value) disappointed in 2014.** For the whole of 2014, total value of retail sales dropped 0.2 per cent compared to last year; whilst in December 2014, sales fell 3.9 per cent (yoY). Whilst tourist visitor numbers surpassed 60 million in 2014 (12 per cent yoY increase), Mainland tourist visitors (day entry vs overnight entry) and their spending pattern (luxury items vs daily consumption items) continued to shift. Overall, sales were supported by medicines and cosmetics (+9.3 per cent), consumer durable goods (+19 per cent), optical items (+8.4 per cent), as well as drinks and tobacco (+7 per cent). However, sales in luxury items (jewellery, watches and clock, valuable gifts) dropped 13.7 per cent (year-on-year) and electrical goods and photographic equipment dropped 8.1 per cent (year-on-year) last year.

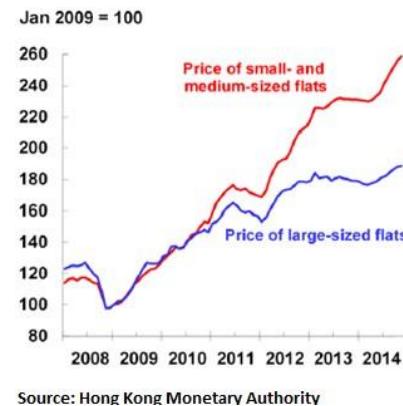
8. Meanwhile, **overall investment expenditures dropped 0.3 per cent** in 2014, the first decline in five years. The weak investment sentiment is reflected in the government's Quarterly Business Tendency Survey and the government's recent survey on small and medium-sized enterprises, which showed that business has become more cautious amid

domestic and global economic uncertainties. The decline came mainly from subdued demand in machinery and equipment acquisition, which fell 5.2 per cent last year. Yet, overall building and construction activities (grew 6.5 per cent) and government expenditure on public infrastructure works continued to support domestic consumption.

9. **CPI inflation grew 3.5 per cent in 2014**, down from 4 per cent in 2013. Looking ahead, the government expects that imported inflation will ease further this year to 3 per cent, with global inflation and international commodity prices projected to remain soft.

### Property Market

10. Hong Kong's property market has revived since April last year and **housing prices surged 13 per cent in 2014, compared to a year earlier**. The government said higher housing prices were led by strong ownership demand for small/medium sized flats (rose 13 per cent, yoy) whilst prices of large/luxury flats only went up 6 per cent (yoy). Property purchases rebounded sharply - sales transactions rose 26 per cent to 63,807 last year. Nonetheless, this is still below the long term average of 94,388 between 1994 and 2013. These transactions were dominated by sales of new homes, accounting for 53 per cent of all sales transactions. Meanwhile, strong housing demand was also reflected in the Housing Authority's launch of the presale of 2,160 new HOS flats, which had received an overwhelming 112,000 applications. As a result, overall home prices in December 2014 surpassed the 1997 peak by 61 per cent; home purchase affordability worsened to around 58 per cent in the fourth quarter; and Hong Kong ratio of average earnings to average property price hit a world record high of 15.8:1.
11. On home financing in December, compared to the month of November:
  - Mortgage applications increased 9.5 per cent to 11,079
  - Mortgage loans approved also increased 4.9 per cent
  - Mortgage loans drawn down increased 5 per cent
  - Mortgage loans for refinancing also increased 7.6 per cent to HK\$4.4Bn (£380Mn).
12. There had been rumours that property market risk was growing due to multiple refinancing on a single property by non-bank financial institutions. However, KC Chan, Secretary for Financial Services and Treasury Bureau, said that the government is closely monitoring the residential mortgage market and believes that such risk is very low. Norman Chan, Chief Executive of HKMA added that mortgage financing by non-bank financial institutions only represents less than 1 per cent or maximum HK\$9bn of all mortgages in Hong Kong's banking sector.
13. On property supply, **the government remained committed to increase flat supply**. In 2014, private housing supply increased 90 per cent to 15,700 units compared to the same period last year, the highest level in eight years. New housing starts also rose 24 per cent to 17,300 units last year.
14. However, **academics warned that despite increased supply, total supply will still fall short of forecasts**: private housing supply remains lower than Rating and Value



Department's estimate of 17,600 units; new housing starts still less than the peak of 18,600 in 2012. Academics remained sceptical whether the government could reach its supply target amid tight land supply, higher construction cost and shortages of labour in the construction industry. Nonetheless, academic projections for property prices in 2015 ranged between falls of 5 and 10 per cent this year.

15. On 19 January, HKMA issued guidance to banks on mortgage lending to property investors to raise the discount rate for counting rent as part of income from 20 per cent to 30 per cent for borrowers with rental income proof. For investors without rental income roof, the discount rate is increased from 20 per cent to 40 per cent. In addition, HKMA also issued guidelines to banks when lending to corporate identified as shell companies (i.e. corporate borrowers of companies without active business operations other than as vehicles for property holding) to ensure authorised institutions will apply more stringent maximum Loan-to-Value ratio and Debt-Service ratio to these companies.
16. On 27 February, the **government announced its 7<sup>th</sup> round of macro-prudential measures for property mortgage loans** targeting residential properties with value below HK\$7Mn (£583,000) in order to stabilise the overheated (mainly small medium sized) properties and to protect the banking system in Hong Kong. The macro-prudential measures are:
  - i. The maximum loan-to-value (LTV) ratio for self-use residential properties with value below HK\$7 million will be lowered by a maximum of 10 percentage points. (In effect this means a reduction to an LTV of 60% for all self-use properties)
  - ii. The maximum debt-servicing ratio (DSR) for borrowers who buy a second residential property for self-use will be lowered to 40% from 50%, and the stressed-DSR cap will be lowered to 50% from 60%.
  - iii. The maximum DSR of mortgage loans for all non-self use properties, including residential properties, commercial and industrial properties and car park spaces, will be lowered to 40% from 50%, and the stressed-DSR cap will be lowered to 50% from 60%.

## Policy Development

17. The Hong Kong Government and the Ministry of Commerce signed on 18<sup>th</sup> December the agreement between the Mainland and Hong Kong on "Achieving Basic Liberalisation of Trade in Services Guangdong" under the framework of CEPA (the Closer Economic Partnership Arrangement). By signing this arrangement, the Mainland agrees to open up 153 services trade sub-sectors in Guangdong, accounting for 95.6 per cent of all its services trade sub-sectors, in Guangdong, to the Hong Kong services industry.
18. On 11<sup>th</sup> December, the Hong Kong Government signed an Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income with the Government of the United Arab Emirates.
19. On 15<sup>th</sup> December, the Government launched a public two public consultations related to healthcare. Firstly on Voluntary Health Insurance Scheme (VHIS), which proposed

regulating individual indemnity hospital insurance products in the market. Secondly, on Regulation of Private Healthcare Facilities, which proposed to introduce a robust and comprehensive regulatory regime for private health facilities.

## Financial

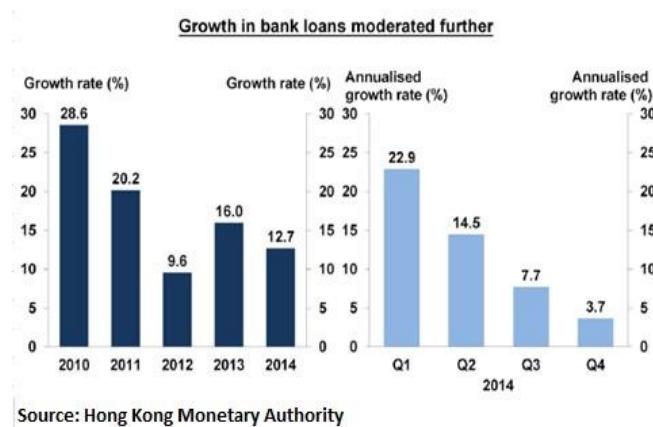
20. The Hang Sang Index (HSI) rose 1.3 per cent in 2014, behind the global indices in the US (Dow 7.5%; S&P 11.4%; Nasdaq 13.4%), Japan (Nikkei 56.7%) and Mainland (SCI 52.9%) which were supported by stronger economic recovery, weaker yen, and anticipation of supportive government policy. The HSI, by contrast, was overshadowed by uncertainties over the US Fed's tapering and China's economic outlook.

21. Nonetheless, Hong Kong was the world's second largest (US-1<sup>st</sup>; UK-3<sup>rd</sup>) and Asia's largest IPO fund raising platform in 2014. Hong Kong raised HK\$228 billion (£20 billion) for 122 IPOs compared to HK\$169 billion (£14.5 billion) for 102 IPOs in 2013. Meanwhile, the number of exchange-traded-funds (ETFs) rose slightly to 122 with daily turnover at HK\$4.7 billion, 27 per cent higher than 2013. ETFs accounted for 7 per cent of total market turnover in 2014.

22. Hong Kong remains a profitable place for banks, even though most banks' profits were dragged by slowdown in China. Hong Kong is still the core business driver for many multinational banks based here, as reported by Bank of East Asia, Hang Seng Bank, and HSBC (where over 55 per cent of its before tax profit came from Hong Kong).

23. On financial stability, Hong Kong Monetary Authority data showed that Hong Kong banks remained robust. As at end of third quarter of last year, banks' asset quality remains sound: classified loans (unpaid loans) remained at a low rate of 0.43 per cent; delinquency ratio remained very low (0.22 per cent on credit card and 0.03 per cent on mortgage loans); consolidated capital adequacy ratio for locally incorporated authorised institutions rose to 16.4 per cent (well above the international minimum of 8 per cent).

24. Credit expansion slowed in 2014 due to slowdown in loan demand, coupled with banks' strengthened risk management. Overall loan growth last year grew 12.7 per cent to HK\$7,276bn (£627bn) compare to 16 per cent in 2013. The loan-to-deposit ratio for Hong Kong dollar edged up slightly higher to 83.3 per cent compare to 82.1 per cent at end of 2013. Loans for use in Hong Kong grew 12.1 per cent last year, whilst financial / stockbrokerage related loans (19.5 per cent) and manufacturing / wholesale loans (25 per cent) remained robust. Property related loans (8.4 per cent) grew moderately. Meanwhile, growth in Mainland-related lending stabilised and grew from HK\$2,956bn (£246Bn) to HK\$3,058Bn (£255bn) at the end of the third quarter of last year.



25. HKMA is working on the implementation of the second phase of the Basel III standards with amendments to the Banking (Capital) Rules and a new set of Banking (Liquidity) Rules effective 1 January 2015. The authority also targeted to take effect the Banking (Disclosure) Rules by end of 2015.

## RMB business

26. The momentum of RMB business in Hong Kong remained vibrant, although Chinese New Year may cause distortion to regular activities:

**RMB deposits** finally exceeded RMB 1 Trillion and reached RMB1,003.6Bn at the end of 2014, an increase of 16.7 per cent from RMB860.5 Bn in 2013. However, RMB deposits fell back slightly in January to RMB981.4Bn.

**RMB cross-border trade settlement** handled by banks in Hong Kong amounted to RMB6258.3bn, up 63 per cent compared to 2013. This progress stalled a little in January, as RMB trade settlement was RMB 548Bn compared to RMB657.8bn in December 2014.

Demand for **RMB financing** grew stronger. RMB bank loans grew a notable 63 per cent to RMB188bn at end of 2014, compared to the same period last year. The issuance of RMB bonds also grew sharply by 69 per cent to RMB197Bn in 2014; whilst outstanding RMB bonds grew 23 per cent to RMB381Bn as at end of 2014.

**RMB RTGS** daily turnover has reached RMB888 billion in December 2014.

27. The Shanghai Hong Kong Stock Connect, a pilot scheme that allows investors from Hong Kong and Shanghai to trade eligible shares on both the Hong Kong and Shanghai stock exchanges was launched on 17 November 2014.

- As of 31 December 2014, cumulatively 24.9 per cent (RMB74.6 billion) of the aggregate quota of RMB300 billion was used on northbound trading (HK investors purchase A-share stocks) and 4.2 per cent (RMB10.5 billion) of the aggregate quota of RMB250 billion was used on southbound trading (Shanghai investors purchase HK-listed stocks).
- Between 17 November 2014 and 31 December 2014, the most actively traded stocks in the northbound market were large-cap stocks and AH stocks (shares listed in both the HK and Shanghai market) but traded at discount to H-shares. The most actively traded stocks in the southbound were AH stocks and Mainland private enterprises.

## **Contacts**

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