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Hong Kong Economic Update – May 2015

Summary

Economy

- Hong Kong's economy grew at a moderate rate of 2.1 per cent (year-on-year) during the first quarter of this year. Growth meets market expectations. The Government expects domestic consumption will be the key driver to growth. The government maintains its forecast in February that growth will be between 1 – 3 per cent this year.

- Total exports of goods grew at a marginal rate of 0.4 per cent (yoy) in the first quarter due to weak demand in both advanced and emerging economies. Amongst HK's major trading partners, US, India, and ASEAN countries fared better than the others.

- Falling Mainland visitor numbers is putting a drag on Hong Kong's retail sales. However, domestic consumption remains strong and government is confident that domestic demand will hold up due to strong domestic fundamentals - low unemployment and low inflation.

- The rate of property rise rises increased this quarter, with prices up 5 per cent during the first quarter of this year (compared to 13 per cent across 2014). Overall, flat prices in March remained high whilst housing affordability ratio deteriorated further. Government promises that housing supply will remain top of the policy agenda.

- CASS released its latest Chinese Cities Report in May. For the first time in thirteen years, Shenzhen overtook Hong Kong and became China's most competitive city in terms of overall competitiveness. However, CASS notes that Hong Kong is a well established city, and hence remains China's most competitive city on its long-term sustainability.

Financial

- The Hang Seng Index rallied in late March and gained 5.5 per cent in the first quarter following CSRC's approval for Chinese mutual funds to purchase Hong Kong stocks via the Shanghai Hong Kong Stock Connect.

- Hong Kong has received net inflows of capital following the surge of the Hang Seng Index. The Hong Kong dollar has reached its strong-side Convertibility Undertaking of 7.75. The Monetary Authority has to defend the dollar peg by intervening the market.

- RMB business in Hong Kong grew steadily: Total RMB deposits grew 6.8 per cent in March to RMB952 billion; total remittance of RMB for cross-border trade settlement amounted to RMB616.2 billion in March, compared with RMB462 billion in February; outstanding RMB loans also grew 19 per cent, compared to end of 2014 to RMB224 billion at end of March 2015.

Economy

Hong Kong's economy grew at a moderate rate of 2.1 per cent (year-on-year) during the first quarter of this year. Whilst growth met market expectations, it dropped again this quarter, compared to 2.4 per cent (year-on-year) growth in the fourth quarter of last year. Government explained that lacklustre demand from external markets was the main drag, leaving domestic consumption the only driver to growth. The government maintains its forecast in February that growth will be between 1 – 3 per cent this year.

External demand remained weak despite talks of recovery

Chart 1 **: Total exports of goods by major markets (year-on-year rate of change in real percetage terms)**

	2015	2014				
Countries	Q1	Annual	Q1	Q2	Q3	Q4
China	-0.2	-0.7	-3.7	2.8	2.4	-4.3
US	3.3	2.7	4.2	2.9	0.2	3.8
EU	-3.5	0.6	1.2	4.4	-0.3	-2.3
Japan	-5.8	-4.5	-2.0	-1.8	-5.2	-8.4
India	12.4	16	6.8	15.3	35.6	6.1
Taiwan	-12.8	2.1	-7.9	1.2	13.6	1.7
Korea	-5.7	-1.8	0.1	1.3	4.0	-11.5
Singapore	0.4	2.1	7.9	0.3	0.3	0.6

Source: Census & Stats Dept., HKSARG

1. Total exports of goods grew at a marginal rate of 0.4 per cent in the first quarter, compared to the same period last year. Total exports decelerated further this quarter from 0.6 per cent in the fourth quarter of last year due to weak global demand exacerbated by a strong HK dollar (due to the dollar peg). In advanced economies, whilst demand in the US continued to grow (slowly), demand in the EU and Japan slid further. In emerging markets, notable growth in India and the ASEAN economies has been offset by declines in the Mainland, Korea, and Taiwan.

2. Exports of services contracted further from a decline of 0.3 per cent (year-on-year) in the fourth quarter of 2014 to a decline of 0.6 per cent (year-on-year) in the first quarter of this year. Mainland tourist arrivals and spending were the main drag to growth. Total mainland visitor arrivals during the first quarter grew only 4.9 per cent, the slowest growth since the third quarter of 2009. Mainland (overnight) visitors' per capita spending also weakened from HK$8,123 (in 2013) to HK$7,975 (in 2014) a drop of 1.8 per cent compared to a year earlier. In addition, weak trade and cargo flow slowed exports of trade-related services and transportation services. Exports of financial and business services were the only bright spot, thanks to continuous expansion of cross-border financial and fund-raising activities.

Fall in Mainland visitor arrival growth and spending cushioned by domestic consumers

3. Despite falling rate in growth of Mainland visitor arrivals and their per capita spending, domestic consumption has helped support demand. Private consumption expenditure held tight and grew solidly at 3.5 per cent during the first quarter of this year. Government said that growth was supported by stable income growth and job conditions: labour market is at full employment situation with unemployment at 3.2 per cent in April this year; inflation also remains at a low rate of 2.4 per cent in April.

4. However, retail sales dropped further to a decrease of 2.9 per cent in March, compared to a year earlier. Mainland visitor spending has affected sales in luxury goods items (such as jewellery, watches, clocks etc), which decreased 18.6 per cent; other daily consumable items such as clothing accessories and commodities in department stores also dropped 11.7 per cent and 7.1 per cent respectively.

5. By contrast, overall investment spending grew strongly by 7.3 per cent, compared to the same period last year, thanks to a rebound in machinery and equipment spending. However, government's latest Quarterly Business Tendency Survey shows that small medium sized businesses remained cautious due to uncertain business outlook.

Property Market

6. The rate of property rise rises increased this quarter, with prices up 5 per cent during the first quarter of this year (compared to 13 per cent across 2014). Overall flat prices in March exceeded the 1997 peak by 69 per cent, and the housing affordability ratio worsened further to around 64 per cent in the first quarter. The Hong Kong Monetary Authority introduced the seventh round of macro-prudential measures (with the first round in 2009) on tightening mortgage loans to cool the revived housing market.

7. The macro-prudential measures curbed revived speculative activities. Overall transactions, short-term re-sales (defined as properties owned for less than two years), and non-local individuals and non-local companies were all curbed. Trading activities hence decreased, dropping 2 per cent compared to the fourth quarter of last year. However, strong demand from homeowners remained and pushed up demand with trading transactions up 55 per cent, compared to the low base a year ago.

8. As housing supply remains high on the government's policy agenda, it is redoubling efforts to supply more flats in coming few years. By end of March 2015, 4,000 more flats were supplied leading to a total of 78,000 units this year (including flats completed, under construction, and yet to be built but construction works can start anytime). In addition, the conversion of a number of residential sites into "disposed sites" would add another 11,700 units to total supply. Finally, the government also released a total 5.5 hectares of land to increase supply and 15 sites were approved for leasing modifications.

9. Meanwhile, mortgage delinquency ratio remained at a very low rate of 0.03 per cent and the rescheduled loan ratio remained unchanged at nearly 0 per cent.

Other Developments

10. The Chinese Academy of Social Science (CASS), a Chinese government affiliated think tank, released its latest Chinese Cities Report, a survey that rank the competitiveness within cities in China in May. For the first time in 13 years, Shenzhen overtakes Hong Kong and ranked as China's most competitive city, thanks to Shenzhen's high speed development of its innovative and technology industry. Whilst Shenzhen beat Hong Kong on growth of overall competitiveness, according to CASS Hong Kong remains China's most competitive city according to its measure of long-term sustainability.

Financial

11. The Hang Seng Index gained 5.5 per cent during the first quarter. The market benefited from the strong rally in late March, following CSRC's announcement allowing China's mutual funds to purchase Hong Kong stocks via the Shanghai Hong Kong Stock Connect. Average daily turnover, dominated by sales of derivative products, rose at an active rate of 26.5 per cent in the first quarter, compared to a year earlier.

12. The rally also led to wild fluctuations (2-3 times increase of its share price within a week) of several Chinese stocks listed on the stock exchange. Markets speculated that Chinese liquidity is the most likely driver to such volatility. The Securities and Futures Commission is concerned about the volatility of these stocks and is closely monitoring the situation.

13. Fund raising activities was also volatile during the first quarter. Total equity capital raised fell sharply by 75.3 per cent (due to high base during the same period last year) to HK$81.9 billion (£6.7 billion). Total funds raised through IPOs also shrank 58.8 per cent to HK$19 billion (£1.6 billion). Mainland enterprises remained the dominant player in the Hong Kong stock market, accounting for 72 per cent of equity turnover and 50 per cent of total equity fund raised in the Hong Kong stock exchange during the first quarter of this year.

14. Hong Kong has recently (between April 9 to 24) received net inflows of capital following the surge of the Hang Seng Index noted above. The Hong Kong dollar has reached its strong-side Convertibility Undertaking of 7.75, with net inflows during this period amounting to around HK$71.5 billion (£5.9 billion). The Monetary Authority has had to intervene in the market to defend the peg to the US dollar. According to JP Morgan, whilst the US monetary policy remains the primary influence on Hong Kong's money market, China's influence is growing.

15. The strong demand for HK dollar amid a robust stock market is also reflected in Hong Kong's credit growth: loans to stockbrokers surged 3.4 times. Government explained that this is due to pick-up in IPO activities in late March. Meanwhile, loans to most other major sectors such as trade finance (+4.2 per cent), wholesale and retail trading (+0.9 per cent), and mortgage loans (+2.7 per cent) grew moderately. Overall loan for use in Hong Kong grew 5.5 per cent in the first quarter of this year over end of 2014.

16. Overall though, Hong Kong's banking sector remained resilient. All incorporated Authorised Institutions (AIs) maintained a high adequacy ratio of 16.8 per cent as at end of 2014. Asset quality of banks remained very good, with classified loans (bad loans) to total loans at 0.45 per cent and the delinquency rate for credit cards low at 0.2 per cent,

as at end of 2014. HKMA affirms that no AIs had difficulties in complying the statutory minimum ratios required by HKMA under BASEL III.

17. The second phase of implementation will include capital standards, phasing in of a Countercyclical Capital Buffer and the designation of five authorised institutions as domestic systemically important institutions. This will be implemented effective 1 January 2016.

Policy Development

18. The Hong Kong Monetary, Authority together with the Securities and Futures Commission, launched the second stage of public consultation on proposals for establishing an effective resolution regime in Hong Kong to address the risks posed by the systemically important and "too-big-to-fail" financial institutions in January this year. The consultation sought views on specific aspects of the regime such as resolution options, governance arrangements and approach to designating resolution etc. The government aims to introduce the proposal to the Legislative Council (Hong Kong law making body) by the end of this year.

19. The Stamp Duty (Amendment) Ordinance 2015 was gazetted in February for the implementation of the stamp duty waiver for the transfer of shares or units of all exchange traded funds (ETFs) as proposed in the 2014-15 Budget. Stamp duty for transfer of shares or units of all ETFs, will now be waived, under this arrangement.

RMB Business

20. RMB business in Hong Kong grew steadily.

RMB Deposits – Total RMB deposits grew 6.8 per cent in March to RMB952 billion. However, on a quarterly basis, RMB deposits dropped by a margin of 0.5 per cent compared to the last quarter of 2014. The government explained the drop was due to the net outflow of RMB from Hong Kong to the Mainland, and a net sale of RMB by corporate through banks. Meanwhile, deposits held by personal customers recorded an increase in the first quarter.

RMB Trade Settlement – Total remittance of RMB for cross-border trade settlement amounted to RMB616.2 billion in March, compared with RMB462 billion in February. RMB trade settlement transactions handled by banks in Hong Kong increased 9 per cent, compare to a year earlier, to RMB 1,626 billion in the first quarter.

RMB Financing – Outstanding RMB loans grew 19 per cent, compared to end of 2014, to RMB224 billion at end of March 2015. However, RMB bond issuance slowed further falling from RMB33 billion in the last quarter of 2014 to RMB7 billion in the first quarter of this year. Market expects the annual issuance of the sovereign RMB bonds in Hong Kong by the Ministry of Finance will help revive the offshore RMB bond market in the second half of this year. Meanwhile, RMB lending continued to grow, with outstanding amount of RMB loans increased 19 per cent to RMB223.7 billion at end of March 2014, compare to the previous quarter.

Stock Connect - Up until the end of March, demand for the southbound quota remained subdued. Daily uptake was around 40 – 45 per cent. However, since CSRC announced the approval of allowing Chinese mutual funds to purchase Hong Kong stocks through the stock connect, demand has substantially increased. The quota was fully taken up on 8 April, the first time since the pilot scheme launched in November last year. We will report further on this in the next Economic Update.

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