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Greater Bay Area Insight

Recovering, but more policy support needed

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Economics - China

- Guangdong's service sector has ramped up quickly as mainland China reopened, but exports may take more time
- Consumption recovery in sight as catering sales jumped; we recently raised HK 2023e GDP growth to 5.0% (from 3.8%)
- Financial services are a key driver of GBA's development

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Service sector leads the recovery. Guangdong started the year strongly with the service sector growing 5% y-o-y (compared to 4% headline GDP growth). Meanwhile, Hong Kong's growth jumped 2.7% y-o-y, after shrinking 4.1% in 4Q22, on the back of a consumption revival. We recently revised up our Hong Kong GDP growth forecast to 5.0% this year. Driven by mainland China's reopening, business activity in the Greater Bay Area (GBA) has quickly ramped up, including cross-boundary traffic with Hong Kong and Macau. We, therefore, remain constructive about the GBA's economic recovery in 2023. A more stable property market could further improve consumer confidence and, as such, willingness to spend. On the other hand, external factors continue to pose headwinds for the region, potentially slowing the recovery in production growth and exerting near-term pressure on the labour market.

Industrial and infrastructure investment accelerating. At the beginning of 2022, the Guangdong government pledged that it would build a higher quality manufacturing industry. Since then, a series of measures has been rolled out, including a RMB1trn package to support key provincial projects this year. The policy tailwind is evident in the latest round of economic data: Guangdong's overall industrial investment rose nearly 30% in 1Q23. In addition, infrastructure investment played catch-up this year, aided by strong financing support. We believe Guangdong is in a good position to sustain solid FAI growth at above 5% in 2023.

Financial services are critical. As mainland China shifts towards higher quality growth and emphasises technology self-reliance, the GBA can leverage its technology and manufacturing industries to unlock more opportunities. Financial services are a key driver to such a transformation. Indeed, the sector has become increasingly important in Guangdong's economy. For 2023, the provincial government pledged that it would add RMB4trn of new credit to support high-quality economic development. Together with Hong Kong – which is the established international financial centre in the region – the financial services sector can play a critical role in developing the GBA into an international innovation and technology hub. Most recently, Hong Kong, in collaboration with the PBoC, launched Swap Connect for Northbound flows on 15 May, as the city continues to play a unique role of linking global investors with mainland China's financial market.

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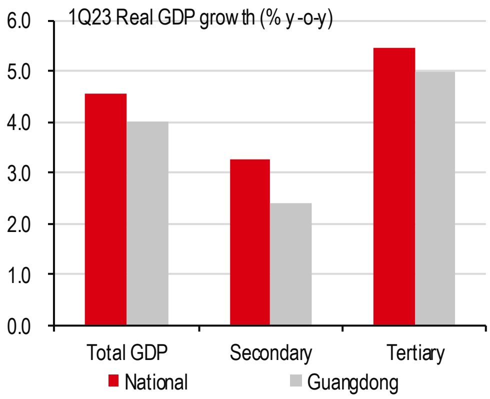
Guangdong 1Q GDP data: service sector led the recovery

In 1Q23, Guangdong's GDP increased by 4% y-o-y, double the 1.9% y-o-y pace in 2022. The tertiary sector was a key growth driver, with added value increasing by 5.0% y-o-y (Chart 1) and contributing 3.0ppts to headline GDP growth (vs. just 0.7ppts in 4Q22). During 1Q23, accommodation and catering services accelerated by 13.9% y-o-y, the fastest category among all the service sectors. Meanwhile, transportation, warehouse and postal services increased by 0.6% y-o-y, a rebound from a 5.6% contraction in 2022. Guangdong also saw a nearly 50% y-o-y increase in passenger volume, as well as a more than 30% y-o-y increase in catering revenue in 1Q23. All in all, recent data indicates a rapid recovery in contact-based services.

Guangdong's secondary industry also improved, though at a slower pace. Production for the mining sector was a major drag in 1Q23, falling notably by 11.9% y-o-y. The improvement in manufacturing production overall was mild compared to last year (1.2% in 1Q23 vs. 1.3% in 2022, as per Chart 2). Based on the available data, autos appeared to be a soft spot (0.7% y-o-y in 1Q23 vs. 20.8% y-o-y in 2022), partly attributed to the high base last year. The pace of growth pace for advanced manufacturing, such as electrical machinery, also accelerated (9.7% y-o-y in 1Q23 vs. 2.7% y-o-y in 2022). The key driver for the secondary industry was electricity and heat production, which increased 7.1% y-o-y, up 1.8ppts from 2022.

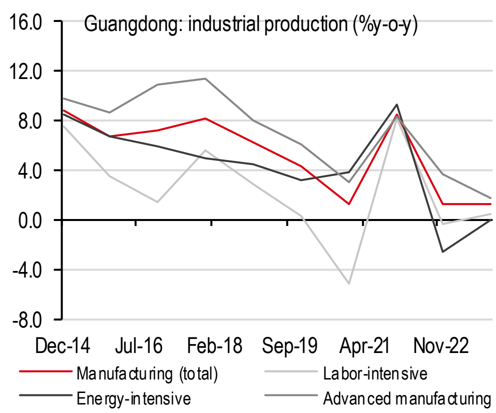
Similar to nationwide data, Guangdong started the year with particularly strong service activity. The service sector now accounts for 55% of Guangdong's economy, which is nearly 9ppts higher than it was 10 years ago. Clearly, it became a large drag on the economy last year amid the pandemic. But with mainland China's reopening, there has been a quick ramp-up in business momentum, including cross-boundary activity with Hong Kong and Macau; hence, we are constructive about the regional economic recovery in 2023. External demand remains a headwind, and, hence, there will be a slower comeback for manufacturing production.

Chart 1: GDP growth lagged the national average, mainly due to secondary industry…



Source: Wind, HSBC

Chart 2: …and likely driven by mining and manufacturing production



Source: Wind, HSBC

Hong Kong 1Q GDP rebounded quickly, led by consumption

Meanwhile, Hong Kong's economy snapped back as growth rose by 2.7% y-o-y (or 5.3% q-o-q), largely beating expectations. The stronger recovery momentum led us to recently revise up our GDP forecast for this year to 5.0%. The rebound has been underpinned by pent-up demand following the economy's reopening and the lifting of pandemic-related restrictions. Both local demand and tourism-related demand have seen a strong recovery from a low base, but we still see further room for the recovery to run. Local demand will be supported by a strong labour market and additional rounds of consumption vouchers (c1% of GDP, distributed in April and July). Tourism demand is also likely to continue to pick up as transportation links are restored and the issuance of entry permits returns to normal. Mainland Chinese visitors to Hong Kong reached about 50% of their pre-pandemic levels in April, though we expect as demand increases, this can rise to about two-thirds of the pre-pandemic levels for the full year. The consumption revival will help to more than offset ongoing headwinds from weak global goods demand and still elevated interest rates, which will allow Hong Kong's economic recovery to broaden out in the coming quarters.

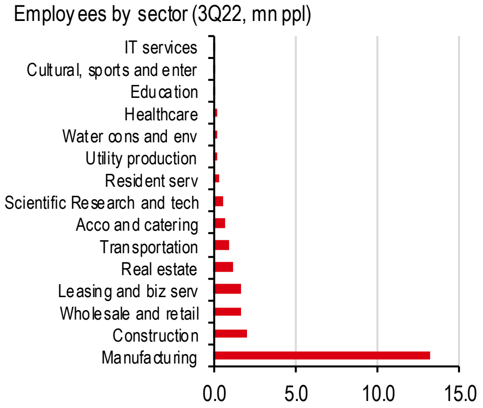
Consumption recovery on track, but more policies needed to sustain the momentum
In the first quarter, retail sales of consumer goods in Guangdong increased 5.1%, up 3.5ppts compared with full-year 2022 growth. Among the major categories, sales in catering surged 31.4% in 1Q23 (vs. -4.1% y-o-y in 2022), while the growth rate for consumer staples, such as food and medicine, climbed more than 10%, faster than the rate in 2022. On the other hand, sales of communications equipment eased to 5.6% y-o-y growth in 1Q23 from 9.9% y-o-y in 2022.

Mainland China's reopening has provided a favourable backdrop for a consumption recovery. Contact-based services, represented by catering and tourism, have seen a notable improvement, demonstrated by the Golden Week travel rush. We recently revised up our China 2023 GDP growth forecast to 6.3% (from 5.6%) to reflect the solid consumption recovery in 1Q23.

However, to achieve a broad-based and sustainable recovery, several elements need to play out. The labour and property markets need to stabilise, and ultimately the confidence needs to return as well. Therefore, more policy support is crucial. First, employment pressure remains acute, particularly for the youth. In Guangdong's case, the manufacturing sector plays a vital role in the local labour market. According to the Statistics Bureau, Guangdong's manufacturing sector employed 13.2m people at the end of 3Q22 (Chart 3), accounting for 54.5% of all enterprises above a designated size (excluding financial institutions). With manufacturing production growing at a relatively low pace, given slower external demand, we expect labour demand will need more time to recover compared to general services. Therefore, policies favouring the manufacturing sector, especially SMEs, are likely to be extended.

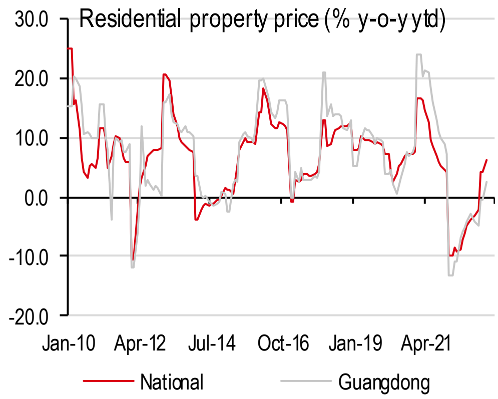
Aside from external demand, signs continue to emerge that the property market is stabilising. By the end of March, Guangdong's home prices increased 2.6% y-o-y, ending the consecutive declines seen over the past 14 months (Chart 4). Housing sales also picked up in 1Q23, suggesting that the measures supporting the property market and rolled out since late last year have started to feed through to activity data. As the policy environment is likely to stay accommodative until the recovery really takes off, we expect nationwide property investment to stabilise and record annual growth of nearly 4% y-o-y this year. In April, we continue to see city-specific policy measures being rolled out in Guangdong, which should lend support to housing demand.

Chart 3: Manufacturing accounted for more than 50% of Guangdong employment



Note: only above designated size (excl. financial institutions) are included. Source: Wind, HSBC

Chart 4: Property prices have risen for the first time since January 2022



Source: Wind, HSBC

Heightened policy focus on industrial and infrastructure investment

In 1Q23, Guangdong's fixed asset investment (FAI) increased by 7.4% y-o-y, up 10.0ppts from 2022. Much of this is because, at the beginning of 2023, the provincial government pledged that it would build a stronger and higher quality manufacturing industry, and since then has launched a series of measures to promote industrial investments, including a RMB1trn package to support key provincial projects this year. Such a shift in focus is reflected in the latest economic data: Guangdong's overall industrial investment increased by 29.4% in 1Q23 (up 19.1ppts from 2022). Among which, investment in high-tech manufacturing and advanced manufacturing rose 35.1% and 30.5%, respectively, in 1Q23. In the meantime, infrastructure investment has also caught up this year. In 1Q23, investments in public utilities accelerated, rising 30.1% y-o-y (vs. 8.8% y-o-y in 2022), while investments in railway infrastructure stayed elevated at 23.3% y-o-y (vs. 23.5% y-o-y in 2022). An acceleration in both industrial and infrastructure investment will likely provide a buffer for property investment that continues to contract (Chart 5).

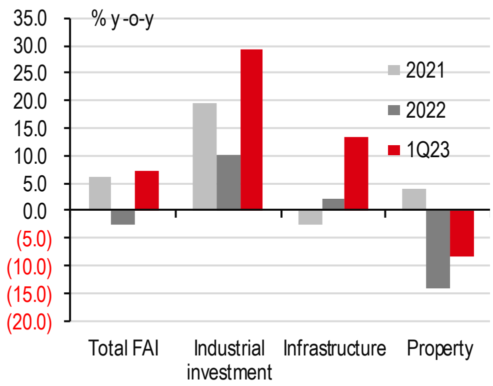
From a financing perspective, Guangdong is in a solid position to sustain strong FAI growth this year. In 1Q23, new total social financing (TSF) for Guangdong reached RMB1.5trn, an historical high and accounting for 10.3% of the national aggregate. Policies have clearly directed financial resources to several key sectors. For instance, loan growth in manufacturing (+39.1% y-o-y), infrastructure (+15.7% y-o-y), technology SMEs (+25% y-o-y) and green projects (+49.5% y-o-y) all came in higher than headline loan growth (13.3% y-o-y) in 1Q23.

Meanwhile, Guangdong issued RMB141bn of local government bonds in 1Q23, among which, RMB127bn were special purpose bonds (SPBs), the second-largest amount of 31 provincial-level administrations. So far this year, proceeds from SPBs have been mainly used to fund industrial parks, transportation infrastructure and social services. In early 2023, Guangdong pre-allocated RMB297.5bn of its SPB quota (21jingji, 10 February), accounting for nearly 70% of actual new issuance in 2022. We, therefore, expect new SPB issuance will be largely concentrated in 1H23 and will support infrastructure projects throughout the year.

Guangdong has long been a role model for mainland China's manufacturing sector and a key export centre. After reaching a peak in 2006, its reliance on exports has fallen gradually (Chart 6). The share of processing exports within Guangdong's overall exports has declined steadily to about 26% in 2022, from more than 40% in 2015. On one hand, this reflects ongoing manufacturing upgrades, though it also speaks to domestic demand-driven sectors that have grown their share in recent years. Having said that, manufacturing remains a pillar of the economy for Guangdong. In 2022, Guangdong's industrial GDP accounted for 12% of the national aggregate. Among major industrial sectors, we find that advanced manufacturing – which includes electronic goods, machinery, and autos − now accounts for almost 56% of manufacturing value-add, up 10ppts from 10 years ago.

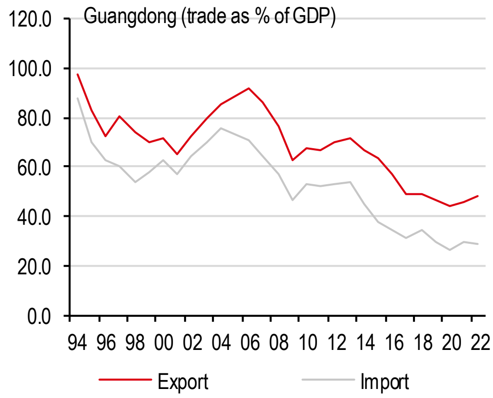
In the near term, we expect the major headwind to be slower external demand, particularly demand for electronic products that Guangdong has a comparative advantage in. In the longer term, industrial upgrading and technology advancements will help the manufacturing sector to achieve higher productivity and quality growth. In fact, Guangdong has already started to shift its focus and direct more resources to industrial sectors. We expect industrial investment to keep growing, helping to offset comparatively subdued property investment. Guangdong's total FAI growth will likely exceed 5% this year, compared to a contraction of 2.6% in 2022.

Chart 5: Guangdong kept up a strong pace in industrial investment…



Source: Guangdong Statistical Bureau, Wind HSBC

Chart 6: …as the province gradually reduces its reliance on exports



Source: CEIC, HSBC

The financial sector, a new growth engine for the region

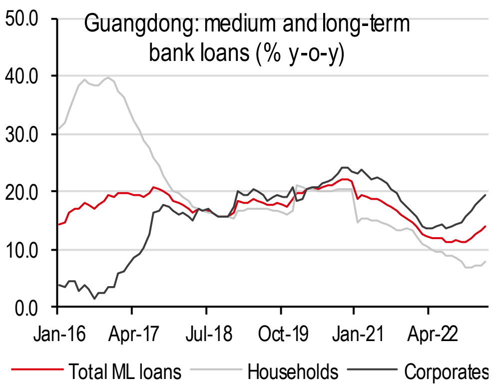
The financial services sector has grown to become an important growth engine for Guangdong. Even during the pandemic years (2020-2022), the value-add of Guangdong's financial services saw annual growth of 7.6%, much faster than the average headline GDP growth of 3.7%. In 2022, the value-add of financial services reached RMB1.18trn, contributing one-third of provincial GDP growth. Guangdong also became the first province among domestic peers to reach over RMB1trn in value-add in financial services. Together with Hong Kong, an established financial market, the value-add of the GBA has surpassed USD250bn in 2021. In terms of its GDP proportion, financial services account for 12.9% of GDP for the GBA, exceeding the 10% for the Tokyo Bay Area, while gradually approaching some of the world's largest financial centres, such as the San Francisco Bay Area and the New York Bay Area at 15% and 18.9%, respectively (Southcn, January 2023).

The financial sector has also provided solid support for Guangdong's real economy. Medium- and long-term loans in Guangdong have increased steadily since November 2022, primarily due to the corporate sector (Chart 7). In particular, medium- and long-term loans to manufacturers increased 41% y-o-y YTD, accounting for 60% of total loans to the corporate sector, reflecting a notable improvement in the business sentiment. Strong growth was also seen in green loans, which have expanded 48% y-o-y YTD and accounted for 13.8% of overall bank loans.

At the beginning of the year, the provincial government pledged to add RMB4trn in new credit to support high-quality economic development in 2023, of which RMB3trn will come from bank credit and another RMB1trn from direct financing (Southcn, 11 February). The goal is to achieve more than 10% growth in TSF this year (vs. 9.6% in 2022), with new credit to manufacturing and technology innovation sectors to reach RMB1trn each this year. These targets are generally in line with Guangdong's policy emphasis on industrial investment during the five-year plan period, and, as such, we believe demand for financial services will remain strong.

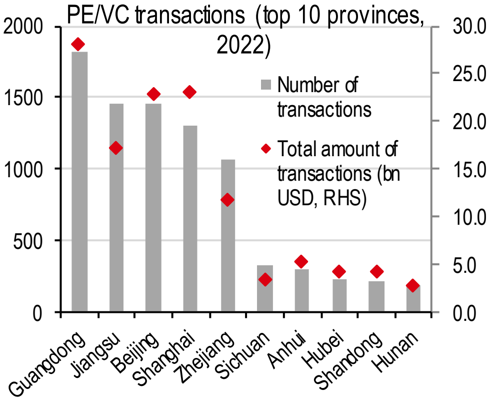
With mainland China focusing more on technology self-reliance, this offers new opportunities for the GBA to utilise its advantages in technology and manufacturing. And, most importantly, as it is deeply entwined with Hong Kong, the GBA's local authorities have in recent years sought to encourage two-way financial flows and regional integration. In 2022, the so-called "18 measures" were unveiled, aimed at jointly developing Shenzhen and Hong Kong's VC industry, followed by more measures in 2023 to promote high-level financial market opening. These are all meaningful developments and have been welcomed by business and individual investors. According to data published by CVSource, Guangdong was the most active PE/VC province in 2022 (Chart 8). It was home to 1,822 PE/VC transactions last year with a total transaction size of USD28.1bn. Nationwide, IT and information still attracts the most PE/VC capital, but investments in high-end manufacturing have climbed the ladder to rank as number two in terms of total transaction size.

Chart 7: Guangdong corporates' ML bank loans steadily picked up



Source: Wind, HSBC

Chart 8: Guangdong had the most active PE/VC transactions among peers in 2022



Source: CVSource, HSBC

Meanwhile, alongside Hong Kong's reopening after the pandemic, the city's government has looked to leverage its comparative advantage as a high-end financial services provider, as well as a gateway for mainland China business investment and trade flows. This is achieved through launches and expansions of connect programmes (which open up onshore and offshore investments). Most recently, Hong Kong, in collaboration with the PBoC, announced it would launch Swap Connect for Northbound flows from 15 May (PBoC, 5 May). Other areas under consideration include broadening existing programmes, such as adding a RMB counter for Stock Connect (which will facilitate the trading of securities listed in both RMB and HKD with an application submitted in March), as well as expanding the connect programmes to insurance products, such as through the possible launch of an Insurance Connect.

Hong Kong's financial sector is also aiming to support long-term growth drivers in technology innovation and green development. Since 31 March, Hong Kong's stock exchange has announced specific listing requirements (which are less restrictive, e.g. no profit requirements) for specialist technology companies in certain fields, which will help to facilitate their listings (HKEX, 24 March). On the green front, Hong Kong is bumping up its climate disclosure requirements, which bring it more into alignment with frontier international standards. The HKEX has proposed mandatory climate disclosures for listed companies, which would be required from 2025. This will help to increase transparency and bolster Hong Kong's position as a green finance centre.

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