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Greater Bay Area Insight

2H outlook: Bright spots amid slowing growth

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Economics - China

- We expect Guangdong's GDP to grow 4.6% in 2H23 as the province copes with weak trade and property woes
- Encouragingly, policymakers are rolling out supportive property market measures, but any impact will take time
- Industrial investment is likely to continue to stand out, as that has yielded good results in EV and battery exports

Erin Xin
Economist, Greater China
The Hongkong and Shanghai Banking Corporation Limited

Lulu Jiang (Reg. No. S1700523070001)
Economist, Greater China
HSBC Qianhai Securities Limited

Taking a back seat

Guangdong's economy grew 5% y-o-y in 1H23, with services and consumption leading the recovery, a trend that is likely to continue. Still, this was slower than the national average and we see Guangdong growing 4.8% this year, slightly lower than the provincial government's target of 5% and our national GDP forecast of 5.3%. For Hong Kong, we expect an ongoing recovery supported by a strong labour market, a pickup in tourism and a gradual recovery in mainland China. Still, the tough external environment and elevated interest rates may continue to weigh on investment.

Trade and property investment are the biggest headwinds

Guangdong is an export-oriented economy, so the slowdown in external demand hits it hard. The province is particularly sensitive to the down cycle in global electronics. Meanwhile, a decline in property investment is putting downward pressure on its economy: property accounted more than 30% of the province's investment. We believe it will take time for both of those areas to recover, but the good news is both Beijing and local governments have been ramping up property stabilisation measures in recent months. Guangdong's emphasis on high-quality growth and its aim to build a strong manufacturing backbone will encourage industrial and infrastructure investments, partly offsetting the drag from exports and the housing sector.

Investing for the long-term and sustainable growth

The province is ahead of its peers in embracing strategic emerging industries (e.g., integrated circuits, biomedicine, new energy and new materials) and moving up the manufacturing value chain. For instance, Guangdong is set to surpass its 10% annual growth target for industrial investment in 2023, after delivering double-digit growth in prior years. This lays a good foundation for Guangdong's pursuit of high-quality and sustainable growth. In fact, investment in manufacturing has already yielded some encouraging results: Guangdong's exports in new energy products such as EV cars, lithium batteries and solar batteries soared in 1H23. Meanwhile, mainland China's membership with the Regional Comprehensive Economic Partnership (RCEP) as well as Belt and Road Initiative (BRI) countries can partly offset the impact from slower demand in key developed markets.

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The recovery continues, led by services and consumption

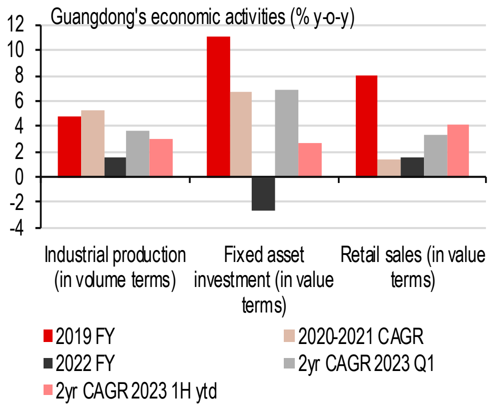
In 1H23, Guangdong's GDP growth increased 5% y-o-y, slower than the national average of 5.5%. Similar to the national trend, Guangdong's service sector grew at one of the fastest clips, with its value-added accelerating to 5.9% y-o-y year-to-date, 0.9ppts higher than 1Q23. And contact-based activities such as catering services delivered strong performances (section 2, Chart 9). We believe this outperformance in services and consumption will last (Chart 1). Overall, we expect Guangdong's GDP to increase by 4.8% this year, slightly lower than the provincial government's target of 5% and our forecast for national GDP growth of 5.3%. In 2H23, we expect Guangdong's economic growth to slow down moderately from the first half, to 4.6% y-o-y (vs. 5% y-o-y in 1H23). However, lackluster trade and property investment remain the biggest headwinds for Guangdong's economy.

Indeed, retail sales growth accelerated in April and May in Guangdong's major cities (Chart 2), which is down to several positive factors:

1. Local governments and enterprises have introduced various policies to bolster the consumption recovery. For instance, Guangdong provided subsidies for customers to trade in EV cars during May-June. Major e-commerce platforms also stepped up sales promotion efforts by distributing consumption vouchers for goods and service purchases. During 1H23, Guangdong's online retail sales at enterprises above a certain size increased by 16.1% y-o-y, way above the headline retail sales growth at 7.4%.
2. Tourism and cross-boundary traffic recovered steadily, supporting retail sales across GBA cities. During the last two public holidays (the Labor Day Holiday and the Dragon Boat Festival), a survey suggests that Guangzhou and Shenzhen ranked among the top 10 most popular destinations in short-distance travel, whereas Hong Kong was the most favored outbound option for mainland tourists (Sina.com, 25 June). Hotel bookings in Hong Kong made by mainland tourists increased by more than 18 times from a year ago during the Dragon Boat Festival. On the other hand, the number of Hong Kong residents entering Guangdong through the eight major land-based ports reached a daily average of 156,000 people in 2Q23, up 16% from the average in 1Q23.

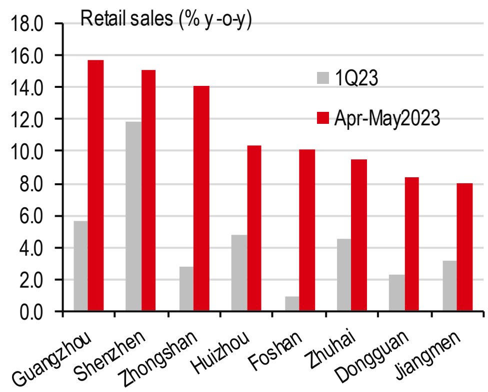
The labor market and consumer sentiment clearly need more time to heal, so aggressive spending is unlikely in the near future, particularly for durable goods like furniture and home appliances or passenger cars. However, with the latest policies rolled out by the central and local governments, we believe the positive impact from this will gradually emerge, leading to improved domestic consumption in various fields.

Chart 1: Retail sales performed better than other sectors…



Source: Wind, HSBC

Chart 2: …and the momentum accelerated further in major cities entering into 2Q23



Source: Wind, HSBC

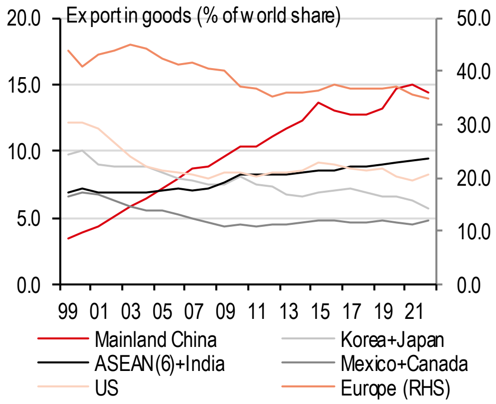
Trade and property sectors are still the main drag

Trade and property investment remain the biggest headwinds for Guangdong's economy. In 1H23, Guangdong's total exports in value terms (in USD) declined 2.9% y-o-y, similar to the national average (-3.2% y-o-y). This weak performance was partly a result of a high base as Guangdong's exports had grown by a compound average rate of 8% over the past three years. But with other exporting countries recently ramping up production after the pandemic, mainland China's export market share of world trade has started to ease from a peak in 2021, though it remains the world's largest exporting country (Chart 3). On the other hand, the slowdown in external demand, particularly from the global electronics down cycle, has affected a number of Asian economies. This has impacted Guangdong given 70% of the province's exports are in mechanical and electrical products.

The lackluster performance of the property sector has been another area adding downward pressure to Guangdong's economic recovery. New home sales quickly waned after reaching a peak in March, despite the accommodative policy environment. And secondary market transactions in the Pearl River Delta (PRD) have remained muted, with sales volumes in Jan-May accounting for only 18% of pre-pandemic levels (Chart 4). HSBC's property team also note that the property inventory levels in Shenzhen and Guangzhou are approaching all-time highs. As Guangdong is home to two tier-one cities (Guangzhou and Shenzhen), developments in the property market have important implications for private investment and sentiment. We believe prolonged weakness in the physical market could add more uncertainties to the demand recovery.

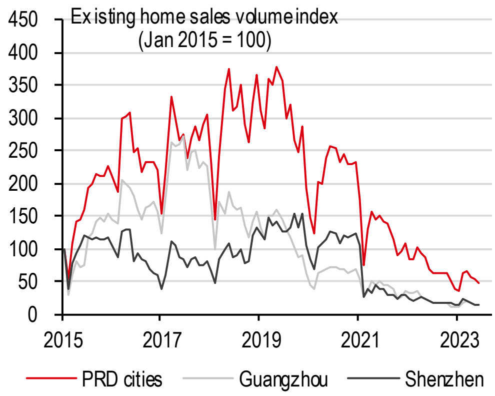
In response to the recent slump, the central government has ramped up property-related measures, from extending liquidity support to developers to adjusting down the loan prime rates (e.g. cut 10bp in June). On 21 July, the State Council unveiled newly approved guidelines around urban village renovation for 19 mega and large-scale cities (people.cn, 21 July). Prior to this, Shenzhen and Guangzhou had both announced their own targets for urban village renovation (see section 2, table 1), which suggests that the government would like to support the healthy development of the property market, leaning towards more affordable housing to offset elevated property prices and weak demand. Therefore, we do not expect property policy to be too aggressive. Nonetheless, the current policy will alleviate some of the pressure on the property market. In June, Guangdong's property investment continued to decline, but at a slower pace of 7.4% y-o-y y-t-d, up 0.8ppts from the prior month.

Chart 3: Mainland China's share of global exports eased moderately



Source: Wind, WTO, HSBC

Chart 4: PRD's secondary home sales are still subdued after a brief uptick in March



Source: Wind, HSBC

Guangdong is eyeing long-term and sustainable growth

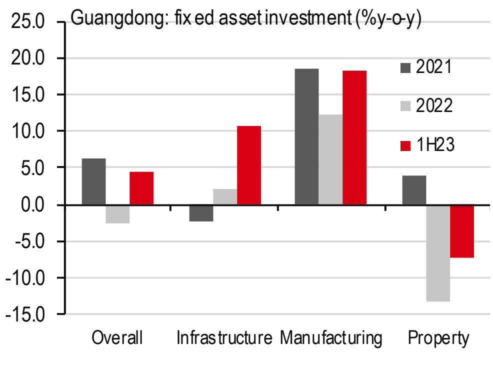
In order to sustain the recovery momentum, we believe the central government will keep policy accommodative. On the supply side, the PBoC and National Administration of Financial Regulation (NAFR) extended relief measures for property developers which had initially been unveiled last November. We see this as a first step towards rolling out incremental measures to revive housing demand. Having said that, in terms of other policy support, it is unlikely that the central government will fund large-scale infrastructure investments with excessive liquidity this time around. Instead, policies likely will focus on structural reforms in order to create new growth engines, and move the economy away from the property/infrastructure-driven model.

Guangdong's local government sent a clear message during the provincial annual economic work conference held at the beginning of this year. That is, Guangdong will promote high-quality development, rejuvenate its manufacturing sector by upgrading its industrial system and create advanced manufacturing clusters. For instance, by mid-June, the Guangdong province (excluding Shenzhen) issued RMB254.3bn of special purpose bonds, of which RMB114.5bn or 45% of the total were spent on constructing industrial parks.

And despite the challenging external environment, Guangdong hasn't held back investing in manufacturing. In fact, Guangdong will likely surpass its 10% annual growth target for industrial investment in 2023 after delivering strong growth in both 2021 and 2022 (Chart 5). The province has caught up in terms of infrastructure development this year, largely in municipal and new infrastructure projects, and far less in traditional infrastructure fields such as transportation (Chart 6).

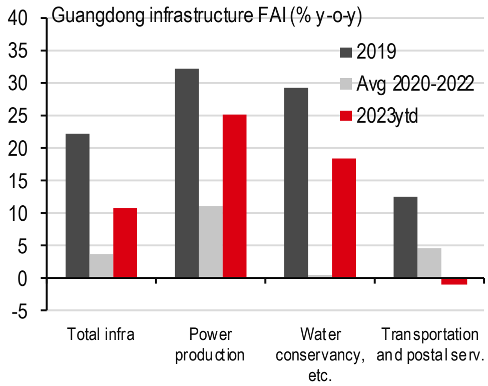
In the near term, large industrial and infrastructure investments are expected to provide a cushion for the property sector. More importantly, strong investments in the above two categories will not dissipate anytime soon. For one, the provincial government wants to shift its focus back to manufacturing and to build a more sustainable economic model. This would also, in a way, reduce the economy's reliance on the property market.

Chart 5: Softness in the property sector could be offset by industrial and infra FAI



Source: Wind, HSBC

Chart 6: The focus of infrastructure has also turned more "green" this year

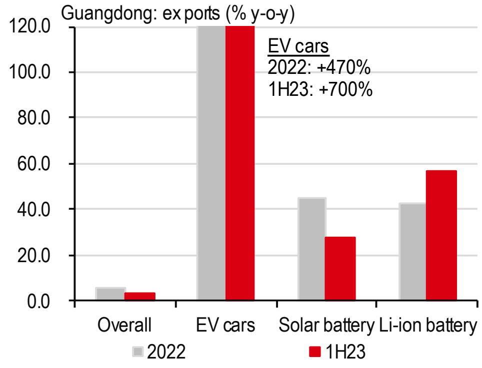


Note: total infrastructure FAI represent growth in 1H23, while the other categories represent growth in Jan-May 2023. Source: Wind, HSBC

Bright spots – new energy is a new growth engine

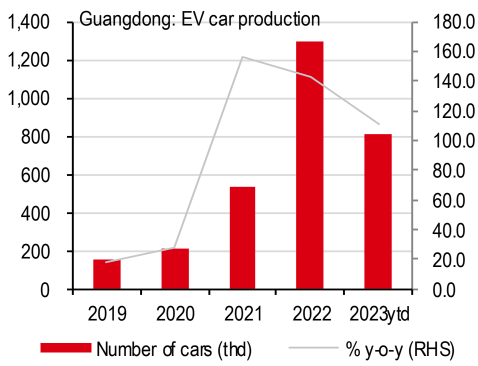
Despite the challenging recovery path, we still see some bright spots. As mentioned earlier, a number of Asian economies have been affected by the slowdown in demand for electronic products, and Guangdong is no exception. However, the province's exports of new energy products, such as EV cars, lithium batteries and solar batteries soared by seven times, 27.7% and 57% y-o-y respectively during 1H23, extending the strong momentum in 2022 (Chart 7). These products have now become Guangdong's top exports. As the global economy increasingly favors more sustainable consumption, demand for green and low-carbon products has remained strong. Therefore, we believe manufacturing products with "green elements" will play an increasingly important role for both mainland China and Guangdong's export composition, and could become the new growth engine for the manufacturing sector.

Chart 7: Green energy products are becoming the new driving force for the exports sector



Source: Wind, HSBC

Chart 8: EV car production has maintained a high growth rate



Source: Wind, HSBC

Against this macro backdrop, industry leaders in Guangdong have been adapting to the new environment, bolstering our constructive view about the region's long-term competitiveness. Here we summarize some key developments in the PRD's largest four cities (by economic size):

- **Shenzhen:** In Jan-May this year, Shenzhen's industrial value-added of the automobile sector increased by 94.0% y-o-y, compared to more than 100% growth in the same period in 2022. Within this, industrial output of new energy vehicles and charging piles increased by 163.5% and 40.6% y-o-y, respectively. Meanwhile, Shenzhen maintained strong investments in the manufacturing sector, growing 43.6% y-o-y y-t-d by May.
- **Guangzhou:** The auto sector was one of the most important industries of the city, but its development lagged behind its peers in recent years. In Jan-May 2023, the industrial value-added of the auto sector declined by 3.3% y-o-y. Nonetheless, new energy vehicle production has since ramped up, with production output for EV cars and charging piles achieving y-o-y growth of 120% and 150%, respectively. In addition to EV cars, production of industrial robots increased more than 50% y-o-y, while production of smart and green home appliances picked up by more than 40% y-o-y.
- **Foshan:** In Jan-May, Foshan's exports of high-tech products increased by 13.9% y-o-y, up 1.2ppts compared with the previous four months. Within this, exports of integrated circuits, automatic data processing equipment and components increased by 324.1% and 15.4%, respectively. EV cars, solar batteries and lithium batteries increased by 36.1 times, 137.9% y-o-y and 6%, respectively. Year-to-date, Foshan's industrial investments were up 39.2% y-o-y, above the provincial average.
- **Dongguan:** This city is one of mainland China's most important production bases for smartphones, and thus has been significantly affected by the slowdown in global demand. According to Wind, mainland China's smartphone shipments declined 2.6% y-o-y y-t-d by May, after declining 23.1% in 2022. However, three industries in Dongguan have generated solid growth this year: pharmaceutical manufacturing, food and beverages as well as textiles, and their corresponding investments were up 108.8%, 90.9% and 37% y-o-y, respectively.

We believe strong demand for green products could be an important growth stabilizer for Guangdong this year. Meanwhile, mainland China's membership with RCEP and BRI countries are also yielding encouraging results, partly offsetting the impact of slower demand from developed markets. For instance, ASEAN now has become the largest trading partner of Guangdong, accounting for 17% of total trade (vs. EU and US both at c.12%). In Jan-May, Guangdong's exports to ASEAN increased 16% y-o-y, while most of the other traditional key markets registered declines or marginal growth. Besides ASEAN, Guangdong's total trade with Russia, Central Asia, Latin America and Middle East also picked up notably by 64%, 48.4%, 11.9% and 9.2% y-o-y in Jan-May, respectively (South.cn, 19 July 2023).

Hong Kong outlook

Meanwhile, Hong Kong's economic recovery looks to be chugging along. Domestic consumption has risen after COVID-19 restrictions were lifted while there has been a pickup in tourism from mainland China. Year-to-date, retail sales have risen 21% y-o-y through May. And there are still economic positives coming through. Another round of consumption vouchers was distributed on 16 July to an estimated 6.5m people. Meanwhile, mainland Chinese tourists to Hong Kong have picked up in July to over 60% of their pre-pandemic levels. This should continue to rise, with full-year mainland China tourists back to around 50% of their pre-pandemic levels.

That said, headwinds like tepid global growth and a shift towards more services consumption has weighed on exports. The Fed is also likely to stay on hold for a while which will mean the policy rate for Hong Kong will stay elevated for some time. This likely means the recovery in asset prices, investment growth and the property sector stays relatively muted.

However, on the whole, we still expect tailwinds to outweigh the headwinds with Q2 GDP growth likely to be 3.5% y-o-y. An ongoing recovery in H2 will be supported by a strong labour market, a continued pickup in tourism demand and a gradual recovery in mainland China which will help to provide ongoing support not just for tourism, but also investment and increased business activity. We expected Hong Kong's H2 2023 GDP growth to reach 6.9% y-o-y, in part helped by a low base, with GDP growth likely reaching 5% for the full year.

Conclusion

We expect Guangdong's GDP to increase by 4.8% this year, slightly lower than the provincial government's target of 5%. For 2H23, we see growth slowing moderately to 4.6% y-o-y (vs. 5% y-o-y in 1H23). Services and consumption will continue to lead the recovery, but policy support is still needed to boost demand and confidence. The province is ahead of its peers in embracing strategic emerging industries (e.g. integrated circuits, biomedicine, new energy and new materials) and moving up the manufacturing value chain. This provides a good foundation for Guangdong's pursuit of high-quality and sustainable growth. And yet, there are still headwinds. Guangdong is an export-oriented economy, while its property prices remain at some of the highest levels among peers. This backdrop leaves it potentially vulnerable and suggests the government needs to balance achieving a sustainable growth target while avoiding relaxing restrictive property measures too far or fast.

Disclosure appendix

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