12 May 2023

Hong Kong GDP upgrade

Bouncing back

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Economics - Hong Kong

- The strong start to the growth recovery is set to gain further ground in the coming quarters …
- … as local demand broadens and visitor flows increase, offsetting headwinds from goods trade and high interest rates
- We lift 2023f GDP growth to 5.0% (from 3.8%), due to a more front-loaded recovery, while adjusting 2024f growth to 2.5% (from 2.9%)

The rebound. Hong Kong's economic recovery is off to a strong start. First-quarter GDP growth accelerated to 2.7% y-o-y, or 5.3% q-o-q. The pace of the rebound is being driven by a strong revival in local consumption, which rose 12.5% y-o-y in Q1, as well as a recovery in the number of mainland Chinese visitors. We expect these tailwinds to remain strong in the coming quarters, helping to lift GDP growth for this year to 5.0%, up from our previous forecast of 3.8%. The recovery should continue to broaden in 2024, though off a higher base, leading us to adjust our GDP growth forecast to 2.5% (down from 2.9%).

Consumption comfort. Local consumption has been boosted by the shift to the full normalisation of activity after the pandemic. Discretionary purchases and services have benefited the most, having been the most depressed categories during the pandemic. We expect this trend to continue as the consumption recovery chugs on. Meanwhile, the further distribution of consumption vouchers (in April and July) will provide an added boost. The strong labour market should also help to lift consumer confidence and sustain the economy's momentum this year.

The tourists are back. The number of mainland Chinese visitors to Hong Kong has picked up significantly since the beginning of the year. As of end-April, numbers had returned to about 50% of pre-pandemic levels, up from only 6% in January. This is likely to increase further as transport links are restored and the economic revival in mainland China strengthens. We expect mainland Chinese visitor numbers to reach two-thirds of pre-pandemic levels this year, implying a significant ramp-up in the coming months. We think the combination of sustained local consumption momentum and strong tourism demand will see retail sales climb 25% this year, up from our previous forecast of 15%.

Headwinds versus tailwinds. Downward pressures still weigh on the economy. Weak global demand may keep goods trade muted while high interest rates could continue to dampen investment. However, we expect the reopening and recovery to more than offset these pressures. The normalising flows of people, trade, and business between mainland China and Hong Kong provide an added cushion: land trade is rebounding, the property market is showing some improvement, and business confidence is rising.

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Hong Kong rebounds

- Q1 GDP growth was up 2.7% y-o-y, far ahead of consensus
- The strong start to the year is set to gain further ground in the coming quarters …
- … as local demand broadens and visitor flows increase, offsetting headwinds from goods trade and high interest rates

Getting a head start

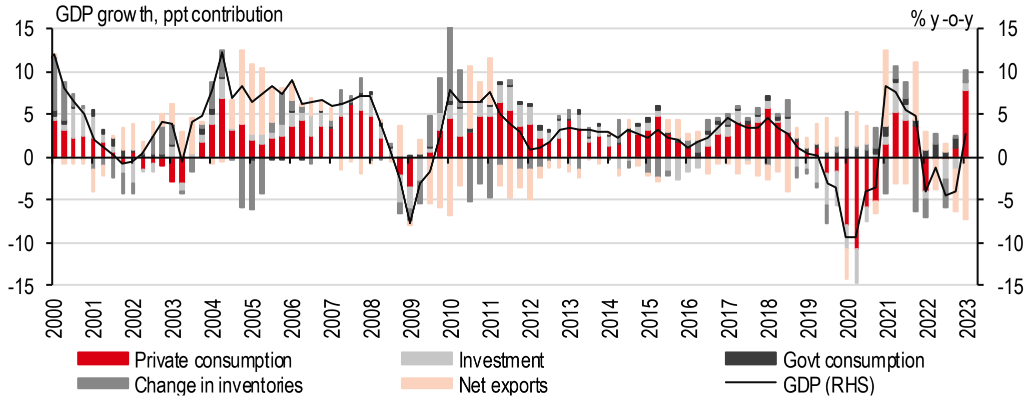
Hong Kong's recovery is well under way. Q1 GDP growth rose by 2.7% y-o-y, far exceeding consensus as the consumption recovery helped to push forward growth. The boost from the stronger Q1 alone led to a 0.6ppt increase in our full-year GDP forecast, while we expect the more front-loaded recovery and stronger momentum will continue this year. We now see growth reaching 5.0% this year, from our previous estimate of 3.8%, on the back of stronger domestic demand, tourism flows and a brighter outlook for mainland China. The broadening recovery will lead to a higher base, and we adjust our 2024 forecast to 2.5% (from 2.9%).

Table 1. HSBC GDP forecast changes

Hong Kong	Q1 2023	Q2 2023f	Q3 2023f	Q4 2023f	Q1 2024f	Q2 2024f	Q3 2024f	Q4 2024f	2023f	2024f
GDP, % y-o-y, new	2.7	3.5	6.7	7.1	2.5	2.3	2.5	2.6	5.0	2.5
GDP, % q-o-q, new	5.3	1.0	0.4	0.3	0.8	0.8	0.6	0.5	n/a	n/a
GDP, % y-o-y, old	*0.5*	*2.1*	*5.8*	*6.4*	*3.9*	*2.7*	*2.7*	*2.5*	*3.8*	*2.9*
GDP, % q-o-q, old	*3.0*	*1.9*	*0.9*	*0.6*	*0.5*	*0.7*	*0.9*	*0.4*	*n/a*	*n/a*

Note: n/a = not applicable
Source: HSBC forecasts

Chart 1. Hong Kong's GDP rebounded in Q1, but there is still room for the recovery to gather strength in the coming quarters

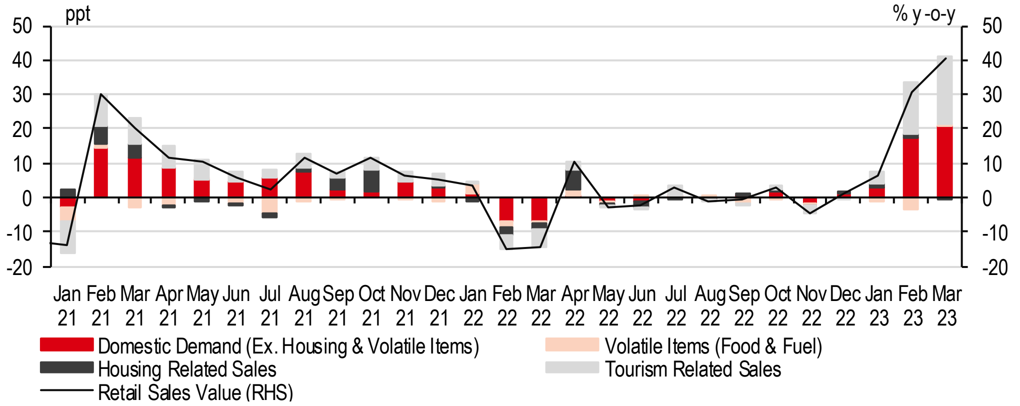


Source: CEIC, HSBC

Demand makes a comeback

Hong Kong's demand recovery has occurred at a swifter pace than expected following the removal of the remaining COVID-19 restrictions. In Q1, retail sales rose by 24% y-o-y, with sales jumping by over 40% in March alone, driven by increased purchases of discretionary purchases, such as clothing and jewellery sales. The consumption recovery is being driven on two fronts: local demand and tourism.

Chart 2. Hong Kong's retail sales are being driven by two engines



Source: CEIC, HSBC

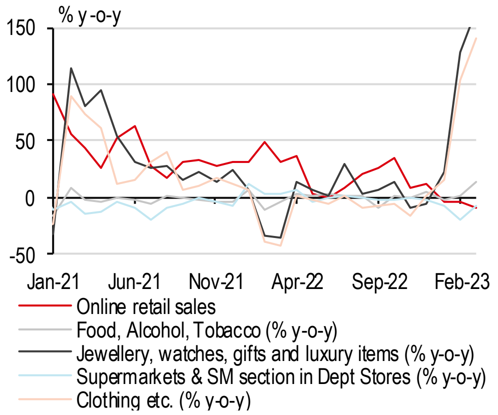
Local demand – tailwinds from the reopening

Domestic consumption growth rebounded to 1 2.5% y-o-y

Domestic consumption growth rebounded to 12.5% y-o-y in Q1, the first double-digit increase in over a decade (since Q2 2011). This was driven by the relaxation of local COVID-19 restrictions. They were eased significantly at end-2022 with the removal of the requirement for health code scanning (29 December) and have since been fully lifted with the end of mask-wearing requirements since 1 March. This helped to facilitate the recovery of services activities, related goods products, and improve the outlook for retailers.

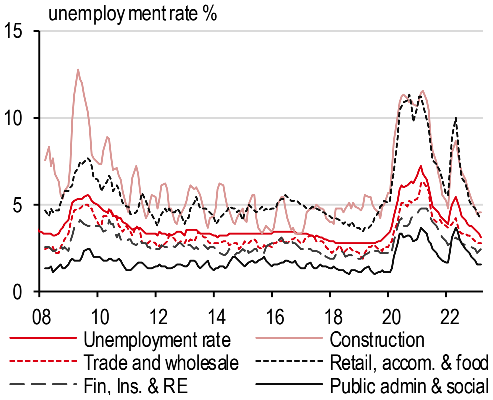
Yet even as the local recovery gathers pace, there is a divergence in terms of which areas of consumption are benefitting from pent-up demand (Chart 3). We are seeing an increased preference for more offline and discretionary purchases, while some items like supermarket sales, which were boosted during the pandemic, are losing steam. This ties in with similar trends seen globally as other economies entered the post-pandemic world: a clear rotation towards more services consumption and away from goods consumption. Online retail sales have also contracted since January 2023.

Chart 3. Retail sales by category show a divergence in the consumption recovery



Source: CEIC, HSBC

Chart 4. Labour market strength will help fuel domestic consumption



Source: CEIC, HSBC

We see strong reasons for local consumption to continue to gather pace

Nonetheless, the pace of the overall local recovery has been speedy, and we see strong reasons for local consumption to continue to gather pace. The further distribution of local consumption vouchers will support spending, with one tranche delivered on 16 April and the remaining one coming on 16 July. We estimate the direct spending of these consumption vouchers to be equivalent to around 1% of GDP, or c9% of 2022 retail sales.

Furthermore, the ongoing strength of the labour market will provide support for consumption and allow consumer confidence to stay elevated. The unemployment rate has since fallen to 3.1% as of March 2023, below the pre-pandemic level of 3.3% at end-2019 (Chart 4). Overall, we expect local consumption to rise by 9% this year, led by a revival in services demand.

The tourists are back

The other main tailwind for Hong Kong's recovery is the revival in mainland Chinese visitors. Since the beginning of the year, the reopening of cross-boundary travel has been faster than expected in terms of the pace of lifting of restrictions. This has led to a significant pick-up in visitor numbers, from just 6% of pre-pandemic levels in January to over 40% by the end of March. This has already been reflected in the retail sales data as demand for tourism-related products shot up in February and March (Chart 2).

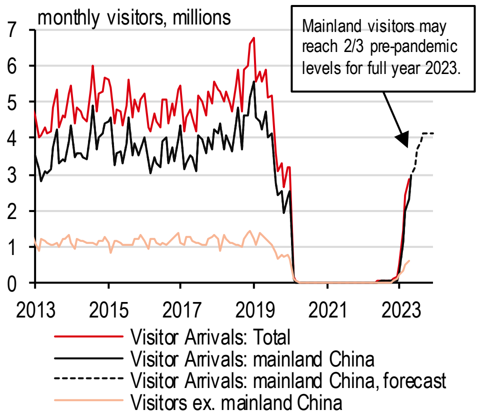
There is still more room to grow. The recent Labour Day holiday saw over 625k mainland Chinese visitors come to Hong Kong during the five-day period (29 April-3 May), a spike that is likely to help to further boost consumption. The daily average in the weeks prior was c75k vs c125k during the holidays. However, the overall level is still only 63% of the 2019 level for the same period, so there is room for the mainland Chinese visitor numbers to continue to improve. We estimate that they will reach two-thirds of pre-pandemic levels for the full year, implying a significant ramp-up in visitors in the coming months (Chart 5).

Fuelled by the broadening of the economic recovery in mainland China

This increase will be fuelled by the broadening of the economic recovery in mainland China and the restoration of transport links. Long-haul high-speed rail routes were fully restored from 1 April. Meanwhile, China's Civil Aviation Administration expects 89% of Hong Kong's flight capacity to be restored to 2019 levels – 1,716 flights/week in 2023 vs 1,927 in 2019 – during the summer and autumn this year (CAAC, 25 March 2023). Streamlined customs approvals will also help. Starting on 15 May, mainland residents can apply for visas to visit Hong Kong for group travel or visit relatives working or studying in Hong Kong again (Xinhua, 11 May 2023).

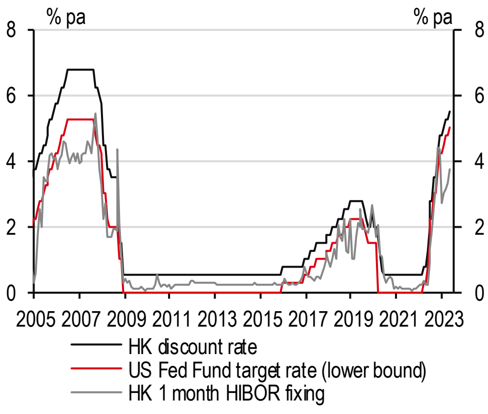
Hong Kong's retail sales in the first quarter rose by 24% y-o-y, with an astounding 40.9% growth in March. The twin tailwinds from rebounding local demand and tourism are likely to stay strong. We expect retail sales to rise 25% y-o-y in 2023, up from our previous forecast of 15%.

Chart 5. Mainland Chinese visitors set to reach 2/3 of pre-pandemic levels this year



Source: CEIC, HSBC

Chart 6. Monetary conditions have tightened on the back of US Fed hikes



Source: CEIC, HSBC

One more hike, and then a pause

Monetary conditions will likely remain tight throughout 2023

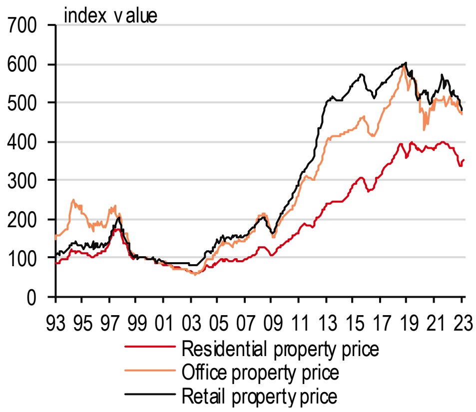
The other side of Hong Kong's demand recovery is investment. On this front, we expect that monetary conditions are likely to remain tight throughout 2023. Following the May US Federal Reserve's decision for another 25bp hike, the HKMA has increased the base rate by 25bp, to 5.50%, moving in lockstep due to the Linked Exchange Rate System between the HKD and the USD. Our US economist Ryan Wang expects one more 25bp hike, due at the next meeting in June, before pausing until Q2 2023 on account of still sticky price pressures, particularly in services.

The higher base rate is also impacting local lending rates. HIBOR has moved up significantly since the beginning of this Fed hiking cycle (one-month reached 4.53% as of 11 May 2023 vs 0.22% in the beginning of March 2022). Also, in response to the recent May US Fed hike, local lenders hiked their prime rate further. We think local rates are likely to remain elevated on the back of the higher policy rate moves for some time, which may keep the investment revival more muted. Local rates may also face further upward pressure due to increased demand for the HKD on the back of an increase in IPOs, a revival in Hong Kong and mainland China's macro conditions, as well as decreases in the aggregate balance.

On the property front, demand has picked up

On the property front, there has been a pick-up in demand. The price index for residential property has seen consecutive monthly increases since January (though it remains down y-o-y) (Chart 7). The increase in both local demand, as well as from mainland China and new arrivals (such as through talent programmes), should help to buoy the property market further. Our Hong Kong equity strategist, Raymond Liu, forecasts an 8% rise in residential housing prices this year.

Chart 7. Hong Kong residential property prices have seen a modest rebound



Source: CEIC, HSBC

Chart 8. Goods trade may benefit from a recovery in overland trade

Source: CEIC, HSBC

While pressures persist due to the tightness of monetary conditions, we expect them to be outweighed by the tailwinds of a stronger economic recovery and reopening. This should help lead to a stabilisation of the property sector, as well as improved business confidence, which, in turn, should lead to higher capex.

Most of the drags from investment in 2022 stemmed from weaker private spending on machinery, equipment and computer software, which fell 23.8% y-o-y in real terms. However, we should see an improvement this year. Already, investment has seen a noticeable bounce, with gross fixed capital formation rising 5.8% y-o-y in Q1, its first positive growth since Q3 2021, though off a low base. Overall, we expect investment to grow c10% this year following the 7.7% contraction in 2022.

Demand-pull inflation could become a risk

We forecast inflation to pick up to over 2.5% by the end of the year

We forecast inflation to pick up to over 2.5% by the end of the year (up from 1.9% in Q1) on the back of some recovery in the housing market, as well as an increase in local and tourism-related demand. That said, the tight labour market may also push up wages, particularly in lower end services. The unemployment rates in the construction industry and retail, food services and accommodation have recovered to pre-pandemic levels. Combined with strong demand for both services and goods amid the reopening, this could push up price levels across categories.

Goods trade to remain weak, but normalisation of land crossing provides a cushion

Hong Kong is a key exporting economy, with exports and imports of goods each accounting for over 150% of GDP. This makes it particularly susceptible to shifts in global demand, which is likely to stay muted this year. Still-high inflation, elevated interest rates and the preference for more services consumption relative to goods consumption should keep global demand for goods soft this year.

That said, Hong Kong's trade sector also faced a significant setback last year with the implementation of restrictions on land crossings to and from mainland China to limit the spread of COVID-19. However, the lifting of these restrictions provides a modest cushion for goods trade this year. Hong Kong's land trade accounts for about 40% of total trade. Already, trade turnover via the land channel has rebounded to 64% y-o-y in March, though this was helped by the low base due to the COVID-19 restrictions last year (Chart 8).

While the resumption of land crossings should facilitate normal trade operations, the broader slowdown in global demand is still likely to weigh on Hong Kong's goods trade. We expect exports and imports of goods will still contract this year, though at a much more muted pace than last year. The resumption in travel (both outbound and inbound) is likely to help provide support for trade of services, offsetting the still weak goods trade. Overall, we expect flat growth for exports and muted growth for imports (1.3%) this year.

Disclosure appendix

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