HONG KONG

DIFFICULT NORMALISATION OF ECONOMIC GROWTH

The Hong Kong economy is struggling to recover from the series of shocks experienced between 2019 and 2022. Following political and institutional upheavals in 2019 and 2020, the territory was severely affected by the health crisis up until last year. In 2023, activity is recovering, but Hong Kong is now facing the weakening in external demand and, above all, significant tightening of monetary conditions. The rise in interest rates since March 2022 has impacted domestic demand, particularly through its effects on the property market. Fiscal policy, meanwhile, remains resolutely expansionary.

ECONOMIC REBOUND AFTER FOUR YEARS OF SUCCESSIVE SHOCKS

Hong Kong's economic growth averaged -1.3% per year in 2019-2022 (vs. +2.7% per year in 2012-2018). This poor performance has stemmed from an accumulation of shocks: local protests and institutional change in 2019-2020, the pandemic shock and the strict Covid policy applied until mid-2022, the loss of investor confidence, rising US-China tensions and external trade disruptions, and the rapid tightening in monetary conditions since Q2 2022.

Economic growth is rebounding from last year's weak base. It is currently projected to reach 3.8% in 2023 and then gradually slow to 2.4% by 2026. Activity has been normalising in recent months, as border controls and mobility restrictions were lifted both in Hong Kong from about mid-2022 and in China from late 2022. Private consumption had the biggest contribution to real GDP growth in H1 2023 (Chart 1). It has been boosted notably by the reopening of borders with the Mainland and the return of tourists, improving labour market conditions and fiscal support measures. Retail sales volumes rebounded by 18.2% year-on-year (y/y) in H1 (after a contraction of 3.4% in 2022).

After almost three years with very few visitors, Hong Kong's inbound travellers have returned gradually since H2 2022. In August 2023, Hong Kong hosted 4.1 million tourists (84% of which were Chinese), which is still well below the pre-protest, pre-Covid level (Hong Kong had 5.4 visitors a month on average in 2018). Activity in the tourism sector is expected to continue to recover in the coming months, even if Chinese households remain cautious. This will continue to support the economic growth recovery: before the Covid crisis, spending by tourists accounted for about a third of Hong Kong's total retail sales, and tourism represented an estimated 4.5% of GDP.

The labour market is recovering gradually. The unemployment rate has returned to its pre-pandemic level: it stood at 2.9% in August 2023, down from 4.3% in August 2022. Meanwhile, real wages rose again by +1.5% y/y in H1 2023 after they remained on a slight downward trend in the previous two years.

Spending of households and enterprises has also been supported by the government's still accommodative policy stance, with the introduction or the extension of fiscal and credit-relief measures (consumption vouchers, tax reductions, extension of loan repayment deferrals and low-interest financing schemes, etc.).

However, the economic rebound remains difficult, as highlighted by the new contraction of real GDP in quarter-on-quarter terms registered in Q2 2023. Activity is constrained by the tightening in monetary conditions as well as the downturn in global trade and China's sluggish momentum of the post-Covid growth rebound. Both exports and imports of goods declined meaningfully in the first eight months of 2023 (by -12% and -10% y/y respectively in USD value). As of Q2 2023, real GDP had not yet recovered its level of four years ago; this may not occur before 2024.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-6.5	6.4	-3.5	3.8	2.7
Inflation, CPI, year average, %	0.3	1.6	1.9	2.0	2.4
Budget balance / GDP, % (1)	-9.2	0.0	-6.6	-3.5	-2.5
Government debt / GDP, %	4.4	5.9	7.8	9.2	10.5
Current account balance / GDP, %	7.0	11.8	10.5	9.8	9.5
Forex reserves, USD bn	492	497	424	420	415
Forex reserves, in months of retained imports	46.6	47.7	42.6	41.0	40.0
Forex reserves, in months of imports	16.2	12.6	11.9	11.1	10.1

TABLE 1

(1) FISCAL YEAR FROM APRIL 1ST OF YEAR N TO MARCH 31ST OF YEAR N+1
e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

HONG KONG: CONTRIBUTION TO REAL GDP GROWTH

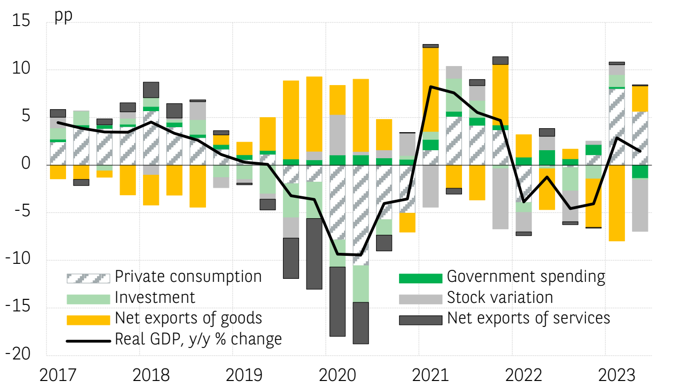

CHART 1 SOURCE: CENSUS AND STATISTICS DEPARTMENT, BNP PARIBAS:

SHARP TIGHTENING IN MONETARY CONDITIONS

Hong Kong's monetary policy follows that of the US given its Currency Board regime. As a consequence, its base rate soared from 0.5% to 5.75% between March 2022 and August 2023 (Chart 2). It is presently projected to be stable until Q1 2024 and then start to decline slowly. Unlike in the US, Hong Kong's inflation remains low given the persisting slack in the economy. Consumer price inflation averaged 1.9% y/y in the first eight months of 2023, and it has declined slightly since May. This means an even sharper tightening in monetary conditions than in the US.

Tighter financial conditions have weighed heavily on domestic demand due to the contraction in bank loans (-4.5% y/y in August 2023), higher debt servicing costs, and the downturn in the property market. Domestic investment grew by only 3.2% y/y in H1 2023 in spite of post-Covid rebound effects.

Since the end of 2021, the real estate market has undergone a significant correction: average property prices have fallen by 14% and total sales volumes by almost 40%. The correction is likely to continue in the short term as monetary and credit conditions remain tight. Moreover, the crisis in China's real estate sector also probably affects Hong Kong's own market through confidence effects and Hong Kong developers' lower investment appetite.

FISCAL POLICY DECISIVELY ACCOMMODATIVE

The government has kept an accommodative fiscal policy stance since 2019, with the implementation of large, one-off stimulus measures such as health spending, temporary employment schemes and direct support to enterprises and households.

As a result, general government spending and fiscal deficits have reached record high levels since 2020. After more than a decade of fiscal surpluses (3.0% of GDP on average in 2009-2018) and moderate spending (18% of GDP on average), the government posted a small deficit of -0.6% of GDP in the fiscal year FY2019/20 (extending from April 2019 to March 2020). Then the deficit soared to 9.2% of GDP in FY 2020/21, with spending reaching 30% of GDP. The deficit returned to 0.0% in FY2021/22, helped by the economic rebound, but it rose again to 6.6% in FY2022/23 (with spending amounting to 28.4% of GDP) and is projected at 3.5% in FY2023/24.

Notwithstanding larger fiscal deficits, the government's solvency and liquidity position remains very strong. The government has used its fiscal reserves to fund the recent deficits. These reserves have fallen by 30% since end-2018, but this significant reduction follows years of policy discipline and accumulation of fiscal savings. Therefore, fiscal reserves remain a comfortable buffer: they amounted to HKD 763 bn as of June 2023, still equivalent to 26% of GDP and 13 months of government spending (vs. 38% of GDP and 26 months in 2018). In addition, the government's debt is moderate and largely covered by its assets, and only a very small portion of it has been issued for direct budget funding.

The government thus keeps a good capacity to deal with fiscal challenges in the medium term. Its budget may remain in small or moderate deficit in the coming years. In particular, structural spending measures will be needed to improve housing affordability (notably through enhanced public housing for lower-income households) and social protection, address climate change and energy transition issues as well as strengthen Hong Kong's economic growth prospects.

HONG KONG: MONETARY TIGHTENING

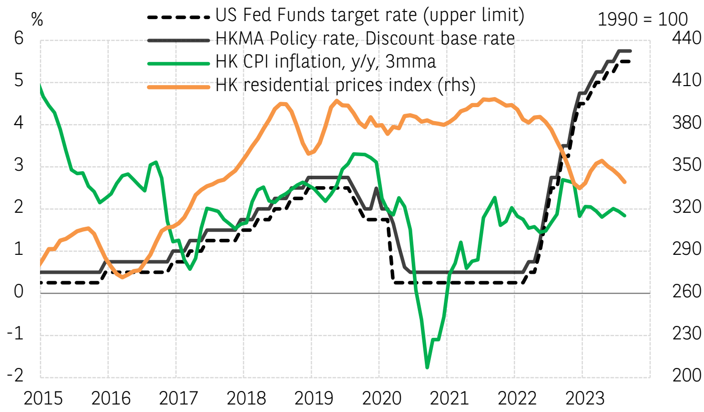

CHART 2 SOURCE: HKMA, CSD, FEDERAL RESERVE BOARD US, BNP PARIBAS

On the positive side, economic prospects continue to be well supported by Hong Kong's sound macroeconomic fundamentals (with solid public and external accounts), disciplined fiscal and monetary policies, and very high-quality and well-regulated services sector. Economic growth is also closely and increasingly dependent on China's economic performance and financial market dynamics. The development of the Guangdong-Hong Kong-Macau Greater Bay Area through increasing infrastructure and commercial links further enhances Hong Kong's territorial and economic integration with the Mainland.

On the negative side, Hong Kong's investment ratio has fallen in recent years (to 16.5% of GDP in H1 2023 from 21.8% in H1 2018) and demographic trends have been worrisome (talent shortage, decline in the labour force, ageing population), which points to a lower economic growth potential. In order to intend to address these issues, the Hong Kong authorities plan to multiply measures to attract investments and talents. They have recently launched a plan and a new investment fund to promote local innovation, digitalisation and technology development.

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