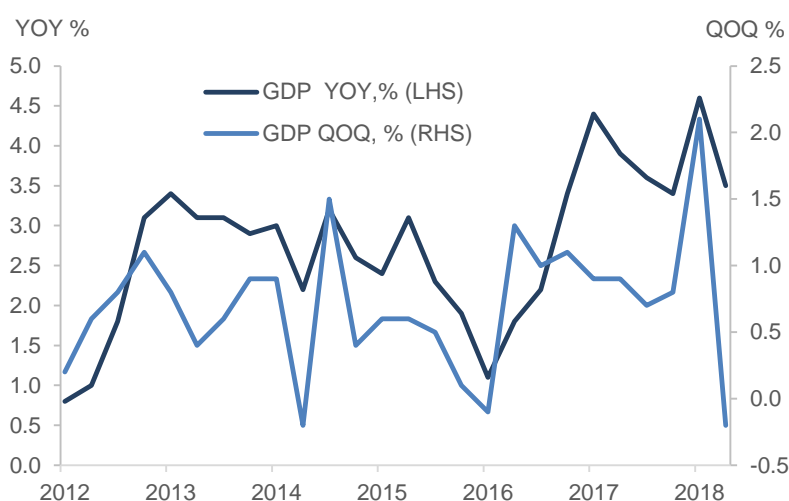


Global Markets Research
Economics – Hong Kong

2Q GDP growth normalized to 3.5% YOY

Hong Kong's GDP growth slowed more than expected to increase 3.5% YOY in the second quarter of 2018 following a faster gain in the preceding quarter. The weaker growth matched our initial expectation that the higher showing in 1Q was partly assisted by a seasonal upswing and hence likely to normalize. We are of the view that the slowdown in China and its ongoing trade spat with the US as well as rising domestic interest rates could pose downside risk to the Hong Kong economy. That said, growth is expected to be in expansionary mode albeit at a moderating pace and in line with the government's forecast of 3%-4%.

Figure 1: Hong Kong GDP Growth



Source: HKMA and Bloomberg

GDP growth eased from the high level in 1Q to 3.5% YOY in 2Q

Hong Kong real GDP growth tapered off to 3.5% YOY in the second quarter (1Q: +4.6% revised) normalizing from an upbeat first quarter which saw growth surged to a 7-year high. The pullback turned out to be bigger than expected as a Bloomberg survey had earlier placed consensus estimate at 3.9% YOY. On a quarter-on-quarter seasonally adjusted basis, growth contracted 0.1% QOQ (1Q: +2.1%).

All expenditure components saw softer expansion except for government spending

Performance across components generally softened with the exception of government spending which increased 4.4% YOY (1Q: +3.9%). Household spending grew 6.1% (1Q: +8.8%) whereas investment slowed substantially, growing a mere 0.4% YOY (1Q: +4.2%).

Exports slowed in 2Q as shipments to China normalized in June

Exports of both goods and services slowed as well, each registering a growth rate of 4.4% (1Q: +5.2%) and 6.1% (1Q: +7.9%), partly attributed to the sharp drop in June exports growth to 3.3% YOY as exports to China corrected in that particular month following a surge in May (Jun +3.3% YOY vs May +15.9% YOY).

Growth hinges on China and is expected to moderate

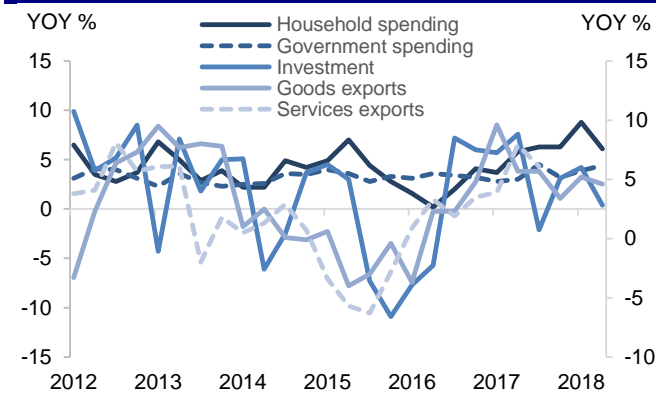
Retail sales growth continued to hold up since February 2018 registering a double digit growth for five consecutive months supported by higher visitor arrivals. Latest release shows that retail sales growth clocked in at a solid 12.0% YOY (May: +12.9%) but we expect growth to normalize gradually and moderate going forward as the low base effect in 2Q wears off.

Looking ahead, outlook on Hong Kong hinges largely on China as it exports 55% of its goods and services to the mainland on average. The spillover effect brought about by the projected slowdown in China as a result of its deleveraging efforts could be further compounded by its ongoing trade dispute with the US. This could potentially hurt demand for Hong Kong goods which are re-exported by China to other countries.

The domestic economy is experiencing rising interest rates as well since the HKMA pegs its currency to the US dollar effectively importing monetary policy from the Fed. Higher rates pose downside risk to its burgeoning property sector where prices remained very much elevated. Nonetheless, the economy is expected to remain in expansionary phase albeit at a moderating pace going forward. The Hong Kong government has maintained its 2018 growth forecast at 3-4% taking into account the stronger growth in 1Q18.

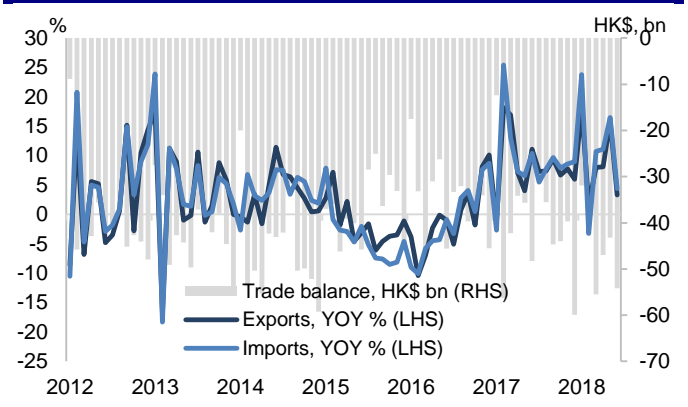
Hong Kong Overview:

Figure 2: GDP Expenditure Components



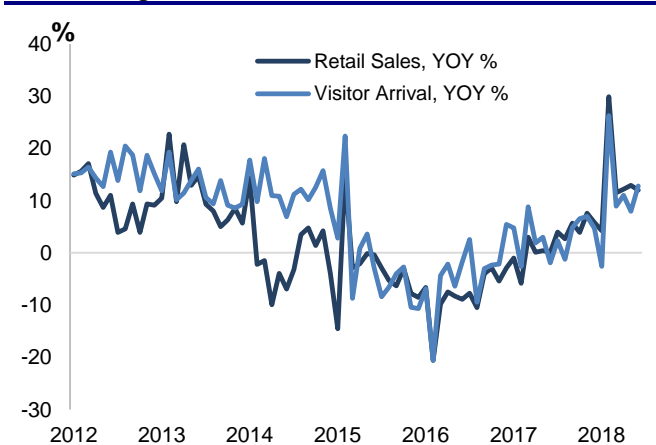
Source: HKMA and Bloomberg

Figure 3: External Trade



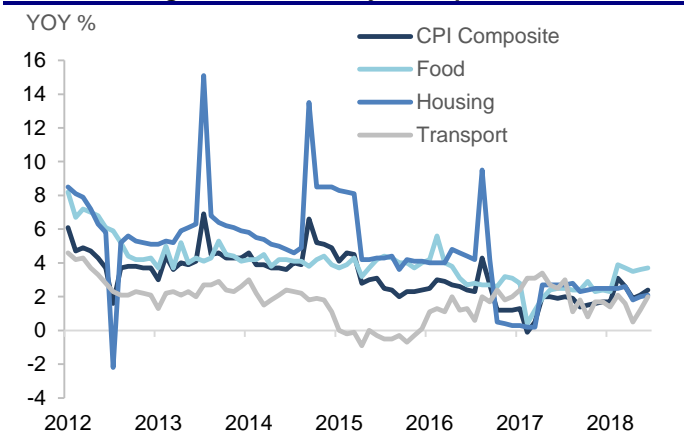
Source: HKMA and Bloomberg

Figure 4: Retail Sales and Visitor Arrival



Source: HKMA and Bloomberg

Figure 5: CPI and Major Components



Source: HKMA and Bloomberg

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