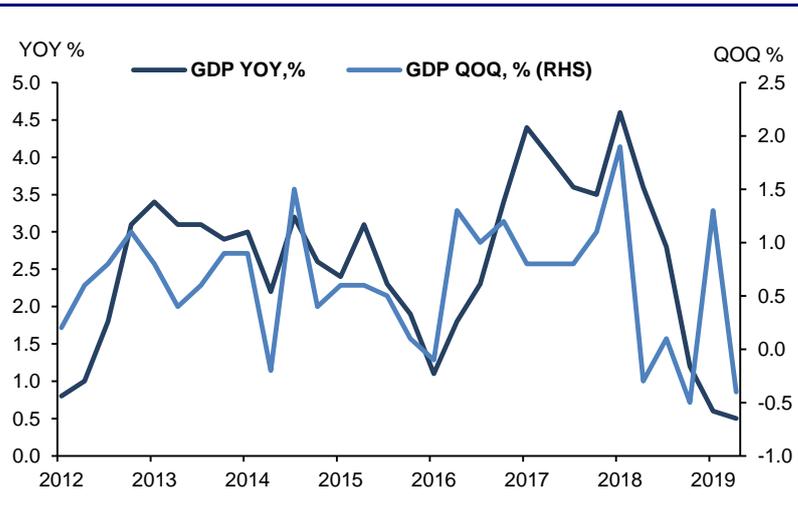


Global Markets Research
Economics – Hong Kong

2Q GDP growth weakened as domestic unrests, global trade disputes unfolded

Hong Kong second quarter GDP growth clocked in at a mere 0.5% YOY, its slowest pace observed since the Global Financial Crisis nearly a decade ago. On a seasonally adjusted quarter-on-quarter basis, real GDP also plunged more than initially estimated by 0.4% (1Q: +1.3%), a firm sign that the economy has lost momentum in the face of subdued domestic and deteriorating overseas demand. Looking ahead, outlook for the Hong Kong economy is skewed towards the downside as domestic conditions deteriorated amidst heightening political tensions. What began as a protest against the controversial anti-extradition bill in June has since then morphed into a full-fledged movement to call for greater political freedom in Hong Kong, serving as a major disruption to day-to-day activities and businesses. Alongside this, the city continues to battle weaker foreign demand as seen in the eight consecutive declines in monthly exports. Prolonged domestic unrest and global trade disputes mean that Hong Kong is facing a twofold setback, severely undermining its growth outlook in the short and medium terms. The government has slashed its 2019 growth forecast from the previously estimated 2-3% to a potential stagnation/near-stagnation of 0-1%.

Figure 1: Hong Kong GDP Growth



Source: Censtatd, Bloomberg

GDP growth continued its deceleration to slowest pace since Global Financial Crisis.

Final reading confirmed that Hong Kong economic growth weakened to its slowest in a decade as real GDP grew a mere 0.5% YOY in the second quarter of 2019 (1Q: +0.6%), a tad lower than initially estimated of 0.6% YOY. On a seasonally adjusted quarter-on-quarter basis, real GDP also plunged more than initially calculated by 0.4% (1Q: +1.3%), reversing parts of its 1Q gain, a firm sign that the economy has lost momentum in the face of subdued domestic and deteriorating overseas demand.

Private spending is losing momentum

Breaking down the headline figure by details, positive contribution from private consumption, government consumption expenditure and imports of goods were

partly offset by negative contributions from investment, and exports of goods, services and imports of services.

Private consumption expenditure (PCE) fell 0.3% QOQ (1Q: +0.9%), in line with the weak retail sales number for the past few months. YOY, personal consumption managed to post a 1.1% increase (1Q: +0.4%) and contributed to a 0.8 ppts to overall GDP growth. The YOY rebound in PCE was supported by the jump in Hong Kong residents' spending abroad (+11.5% vs -0.4%). Taking away foreigners' spending in the domestic market, residents spending in the domestic markets recorded only a marginal increase (+0.2% vs +0.4%), reflecting the locals' cautions in spending their money.

Government consumption expenditure rose 0.8% QOQ (1Q: +1.4%) leaving the annual growth rate at 4.2% YOY (1Q: +4.5%). Government spending made a 0.4% ppts contribution to overall annual growth.

Investment dipped further

Gross fixed capital formation or investment dipped by an even larger margin in the second quarter, recording a whopping 11.6% YOY (1Q: -7.0%) contraction and marking its third successive declines. Investment in building and construction (-10.6% vs -3.5%) as well as machinery, equipment and intellectual property products (-12.4% vs -1.7%) extended further decline. Overall investment subtracted 2.6ppts from the headline GDP figure. Quarterly comparison was not available for this component.

External trade weakened as exports to China fell

Unsurprisingly, international trade weakened substantially in the second quarter judging from the eighth consecutive fall in monthly exports data. Exports of goods slipped for the third consecutive quarters by 2.2% QOQ (1Q: -2.1%), leaving the annual contraction at 5.6% YOY (1Q: -3.7%) as shipments to its main trading partner China continued to fall. Services exports experienced a notable fall of 4.9% QOQ (1Q: +3.2%) and recorded its first annual contraction (-0.2% vs +0.8%) in three years.

Imports of goods dropped for the third quarters running by 3.0% QOQ (1Q: -2.3%) underscoring the continuous weakness in domestic demand for overseas merchandise. YOY, imports also extended its downward trend, slipping by another 7.0% (1Q: -4.2%). Services imports gained ground to increase 0.8% QOQ after a near stagnation in 1Q, leading the components to rebound by 1.6% YOY (1Q: -1.5%).

Economy facing double set-back amidst heightening domestic unrest and global trade uncertainties.

Looking ahead, outlook for the Hong Kong economy is skewed towards the downside as domestic conditions deteriorated amidst heightening political tensions. What began as a protest against the controversial anti-extradition bill in June has since then morphed into a full-fledged movement to call for greater political freedom in Hong Kong, serving as a major disruption to day-to-day activities and businesses. A notable example was the cancellation of all flights in and out of the city when protesters flocked to the Hong Kong International Airport and caused a massive disruption to the airport. This, alongside the occasional violence triggered have dented the SAR's reputation as a safe and stable international destination.

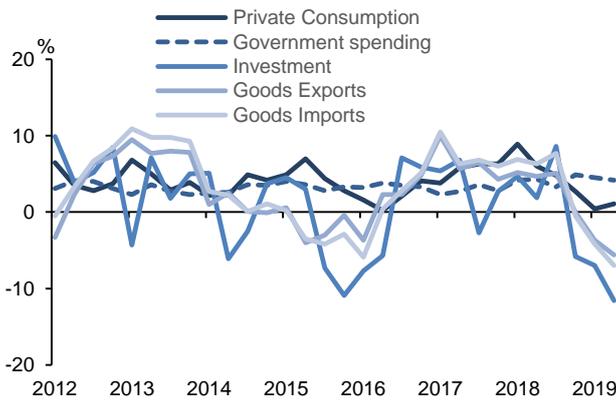
Government sees potential stagnation in 2019

Putting domestic headwinds aside, the city continues to battle weaker foreign demand especially that of its key trading partner, China. Exports have been falling for the eighth consecutive months since November last year mainly because shipment to China which made up more than 50% of total exports

continued to decline amidst softer conditions in the Mainland and protracted global trade uncertainties. A dismal global outlook is also expected to weigh on its external trade sector as growth trajectories in major economies from the US, EU, UK to Japan are likely to trend down in the short to medium term. Prolonged domestic unrest and global trade disputes mean that the city is facing a twofold setback, severely undermining its growth outlook in the short and medium terms. We are bearish of the Hong Kong's 3Q growth taking into account the ongoing domestic unrests which are not showing any signs of abating in the near term as well as the weaker external trade stemming from prolonged US-China trade disputes which are expected to carry on until next year. The Hong Kong government has slashed its 2019 growth forecast from the previously estimated 2-3% to a potential stagnation/near-stagnation of 0-1% and simultaneously announced a HK\$19.1b stimulus package to support the ailing economy.

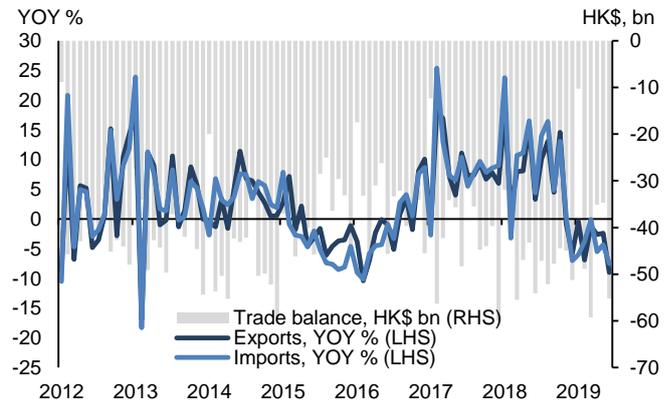
Hong Kong Overview:

Figure 2: GDP Expenditure Components



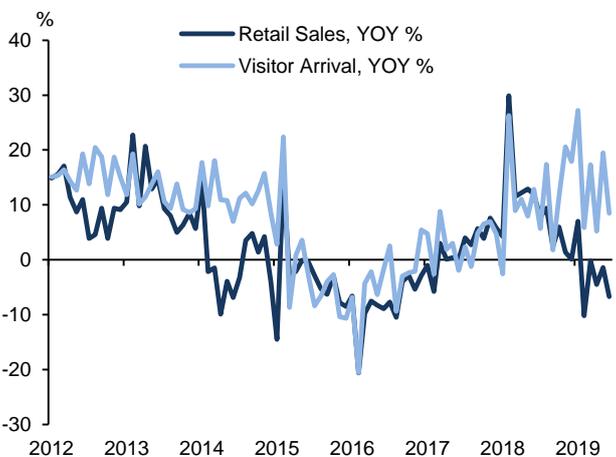
Source: Censtatd, Bloomberg

Figure 3: External Trade



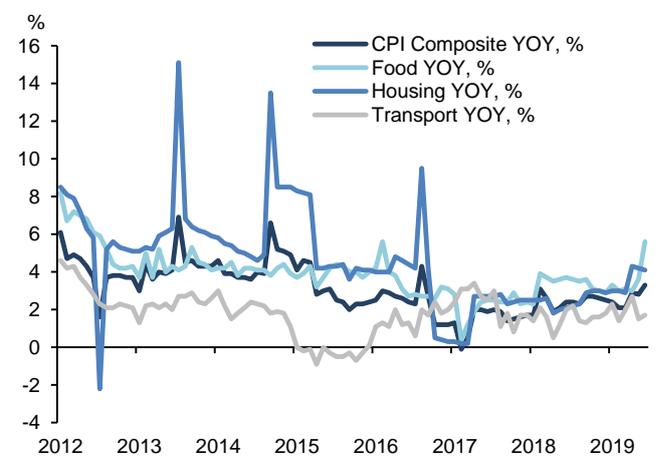
Source: Bloomberg

Figure 4: Retail Sales and Visitor Arrival



Source: Bloomberg

Figure 5: CPI and Major Components



Source: Bloomberg

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