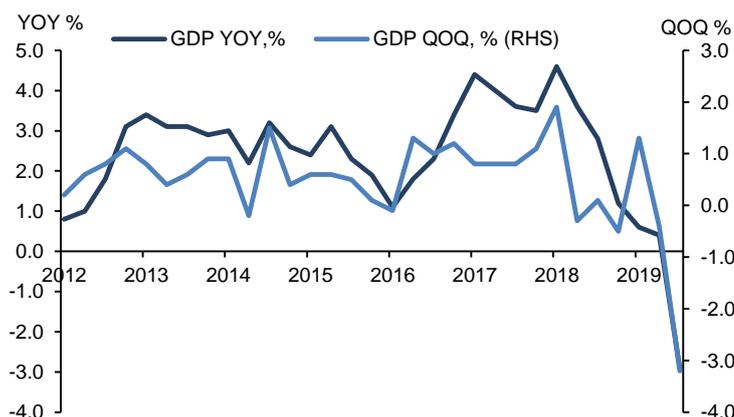


Global Markets Research
Economics – Hong Kong

Economy slumped into recession as protests, slower global trade weighed

Hong Kong economy slipped into technical recession for the first time since 2009 as real GDP registered its second back-to-back contraction (-3.2% vs -0.5% QOQ) in the third quarter of 2019. YOY, real GDP recorded a decline of 2.9% (2Q: +0.4%) following two flattish quarters, also its first annual contraction since a decade ago, during the tail end of the Global Financial Crisis (GFC). Prolonged domestic unrests continued to weigh down household spending and investment while weaker external demand took a toll on its international trade sector. Looking ahead, the current state of commotion is unlikely to subside in the near-to-medium term, gradually stripping Hong Kong of its former status of being a politically stable regional financial hub. Social instability alongside the almost non-existent growth in global trade suggest that Hong Kong is likely to experience another contraction in the fourth quarter. The government has now slashed its 2019 GDP growth forecast from 0-1% (updated in August) to a negative 1.3% YOY and pledged that it will continue to closely monitor the situation and “introduce measures as necessary to support enterprises and safeguard jobs”.

Figure 1: Hong Kong GDP Growth



Source: Censatd, Bloomberg

Economy slumped into technical recession

Censat’s final report confirmed that Hong Kong economy has slumped into a technical recession as the seasonally adjusted real GDP slipped further by 3.2% QOQ in the third quarter of 2019 (2Q: -0.5%) to mark its second back-to-back contraction this year.

Compared to the same period last year, real GDP also slipped by 2.9% YOY (2Q: +0.4%), its first contraction since ten years ago during the tail end of the global financial crisis, as the regional financial hub mired in domestic unrests that show no signs of abating alongside weaker Chinese demand that has severely hit its external trade sector.

Private spending is losing momentum

Looking at the component contributions to the YOY change, private consumption subtracted 2.2pts from the headline index, alongside negative contribution by investment (-3.5pts), inventories change (-1.9pts) and goods exports (-11.9pts) and services exports (-4.3pts). These offset the positive contributions by government consumption (+0.6pts), goods imports (+19.5pts) and services imports (+0.9pts).

Private consumption, investment and exports dragged down overall index.

Private consumption expenditure (PCE) fell 4.1% QOQ (2Q: -0.1%), not a major surprise as personal spending gave way to protests that had led to major disruption to the retail sector. YOY, PCE slipped 3.4% (2Q: +1.3%) led by a broad-based decline across spending in food, consumer goods and services that cumulatively made up a 7.8% YOY loss in domestic market consumption. Foreigners' spending in the domestic market which was not part of the PCE component plunged by a whopping 31.7% YOY (2Q: +1.1%), as visitors had largely avoided visiting the city as protests took a more violent take.

Government consumption expenditure rose 2.5% QOQ (2Q: +0.6%) leaving the annual growth rate at a faster 5.9% YOY (2Q: +4.0%). Breakdown on government spending was not available.

Notably, gross fixed capital formation or investment extended further contraction and by a larger margin of 16.3% YOY in the third quarter (2Q: -10.8%), marking its fourth back-to-back decline. Businesses significantly cut their investment in building and construction (-5.7% vs -9.3%) and especially in purchases of machinery, equipment and intellectual property products (-26.6% vs -12.1%) in the face of deteriorating business outlook. QOQ comparisons are not available for this component.

External trade was dealt a severe blow by weak global trade

Weakness in the international trade sector persisted in the third quarter with exports of goods declining albeit at a lesser magnitude by 0.6% QOQ (2Q: -2.0%). YOY, goods exports dropped 6.2% (2Q: -4.1%). Services exports dropped 12.5% QOQ (2Q: -5.8%) leaving the annual contraction at 13.9% YOY (2Q: -0.8%).

Imports of goods dropped 1.9% QOQ (2Q: -2.8%) and 10.0% YOY (2Q: -5.2%) reflecting the lack of demand for overseas merchandise. Services imports slumped 4.7% QOQ (2Q: +0.5%) and registered a 4.2% YOY decline (2Q: -0.2%)

Protests are unlikely to subside in near-to-medium term

Hong Kong growth outlook turned gloomier as protests entered a new phase of violence in the past two weeks and showing no signs of abating in the near-to-medium term. Unlike the 2014 Umbrella Movement that took place for approximately three months, what started as a controversial anti-extradition bill in June has since then morphed into a full-fledged anti-government and anti-China protest to call for greater political freedom. Accusations of police brutality have further triggered a string of violent clashes that led to the tragic death of several protesters. Disruption to day-to-day business is a given, in fact the entire tourism industry took a huge blow as multiple international events from business conferences, to theater shows and sports tournaments have been cancelled as protests took a violent turn, leaving hotel rooms unoccupied in popular districts. More than 30 countries have issued travel warnings on Hong Kong and Chinese visitors which make up majority of its tourists turned away due to anti-protestors

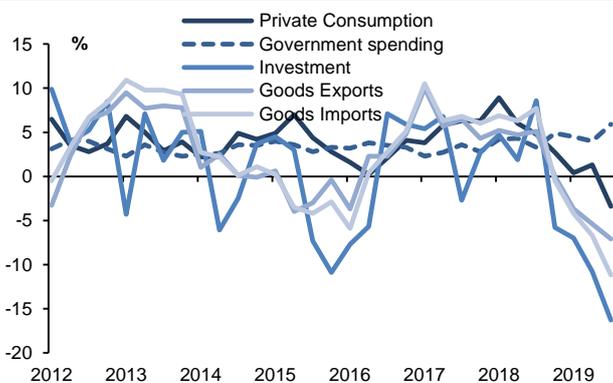
sentiment. Retail sales that has been weak since the start of the year, saw record plunge in August (-23% YOY) and extended further contraction in September (-18% YOY).

Government cut 2019 forecast to -1.3% YOY

On the external front, its heavy reliance on Chinese demand continued to weigh on exports which has recorded eleventh consecutive month of decline since November last year. Shipments to China continued to make up more than 50% of total exports and China continued to purchase lesser goods compared to a year ago. To no one's surprise, demand from other trading partners was similarly poor as proven by contracting shipments in a generally challenging external environment. Looking ahead, the current state of commotion is unlikely to subside in the near-to-medium term, gradually stripping Hong Kong of its former status of being a politically stable regional financial hub. Social instability alongside the almost non-existent growth in global trade suggest that Hong Kong is likely to experience another contraction in the fourth quarter. The government has now slashed its 2019 forecast from 0-1% to a negative 1.3% YOY and pledged that it will continue to closely monitor the situation “introduce measures as necessary to support enterprises and safeguard jobs”.

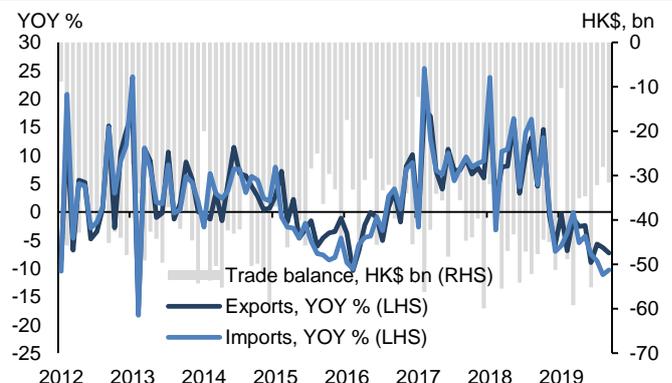
Hong Kong Overview:

Figure 2: GDP Expenditure Components



Source: Censatd, Bloomberg

Figure 3: External Trade



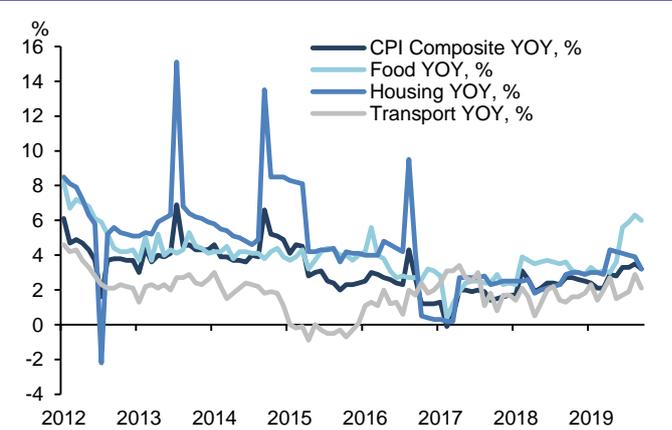
Source: Bloomberg

Figure 4: Retail Sales and Visitor Arrival



Source: Bloomberg

Figure 5: CPI and Major Components



Source: Bloomberg

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