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Global Markets Research

Research Alert

Hong Kong economy contracted in 1Q22

The Hong Kong GDP growth turned negative at -4.0% y/y

Private consumption, investment and exports weakened

Revival in economic activity expected as government eased Covid restrictions.

Background

The Hong Kong economy slumped into a downturn in the first quarter after having stabilised in the previous two quarters, reflecting softer global demand and the woes related to the deterioration of the local Covid situation. Real GDP contracted by 3.0% q/q on a seasonally adjusted basis (4Q21: 0%); the economy had last shrunk in 2Q20 at the onset of the global pandemic. On a y/y basis, real GDP contracted by 4.0% (4Q21: +4.7%), marking its first such decline since end-2020.

Private consumption, investment and exports dragged on GDP

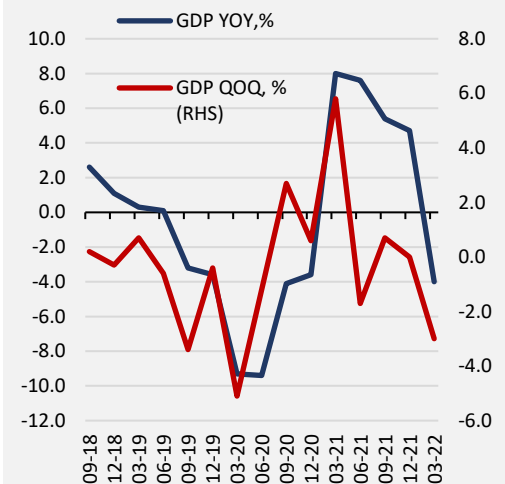
In the first quarter, the fifth wave of the Covid-19 virus broke out and the local authority's responding move to tighten restrictions severely weakened domestic demand. Private consumption shed 3.5ppts from the headline GDP growth and was 5.5% y/y lower compared to a year ago. Investment fell substantially by 8.4% y/y (-1.4ppts) as Covid measures disrupted businesses and weighed on sentiment.

International trade took a serious hit as exports of goods and services slumped 4.5% y/y and 2.8% y/y respectively. Imports of goods and services also saw concurrent declines of 5.9% y/y and 3.4% y/y. The period coincides with the sharp fall in exports to Mainland China while shipments to the US, EU and other major Asian markets saw moderate growth. This came as the global economy experienced a general slowdown in demand amid the broad-based increase in inflation that was made worse by the Russian invasion of Ukraine in late February. Mainland China's adherence to zero Covid policy further exacerbated the situation, given that it remains Hong Kong's main export destination (55-60% of total trade in 1Q22). Exports to China fell by a whopping 12.8% y/y in March (Feb: +1.1%) while exports to other countries were down by 2.3% y/y in the same month (Feb: +0.6%).

Economic reopening suggests imminent economic revival

The Hong Kong SAR government trimmed its 2022 growth forecast to 1-2%, down from the 2-3.5% range in the February projections. The downward revision is consistent with the softer global growth forecasts in the wake of the Ukraine-Russia conflicts and persistently high inflation worldwide. Hong Kong is on track to further ease its social distancing policy this week as the fifth virus wave began subsiding in April with the number of cases largely ranging at 200-300 in May, thus paving the way for domestic economic revival in the second half of 2Q22. The S&P Global Hong Kong PMI turned around to 51.7 in April after recording three sub-50 or contractionary readings in a row. Accordingly, the rebound in business sentiment showed local businesses turning more hopeful in the

Figure 1: Quarterly & Yearly GDP Growth



Source: Bloomberg

Figure 2: Exports Trend in Recent Months



Source: Bloomberg

medium term as demand may soon pick up in the absence of stringent restrictions. The government maintained the 2022 underlying inflation forecast at 2%, as it expects local inflation to be milder compared to the external price pressure. Nonetheless, headline inflation began to creep up in recent months despite staying below 2% and could further erode consumer purchasing power this year. The expected increase in interest rates also serves as another roadblock to consumer spending recovery as Hong Kong's largest banks are bound to follow in the footsteps of the Federal Reserve to raise their prime rates. On the external front, the main driver remains China's Covid policy given its direct implication on Hong Kong's export sector as well as the indirect effect it could create on the global supply chain.

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