Hong Kong’s Economy: What to Expect

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August 2019
SUMMARY

1. HONG KONG ECONOMY IS DECELERATING RAPIDLY

2. CAPITAL OUTFLOWS AS KEY RISK TO HONG KONG’S PEG TO THE USD

3. HONG KONG STILL RELEVANT FOR THE MAINLAND, AT LEAST FINANCIALLY

4. CONCLUSIONS
HONG KONG ECONOMY IS DECELERATING RAPIDLY
Hong Kong economy under pressure with worrying business sentiment

![Real GDP (%YoY)](image)

![PMI](image)

Source: Bloomberg, Natixis
Investment has collapsed in 2Q and our own proprietary sentiment measure for investment shows a worsening in July and August.

Hong Kong Investment (% YoY)

3-month moving average sentiment about investment in Hong Kong

Source: Natixis, Bloomberg

Methodology: Proprietary sentiment analysis based on GDELT big data set on media
Consumption hit by the retreat of Mainland tourists even before the worsening of social unrest

**Retail sales**

- Retail sales (% yoy, rhs)
- Local-related spending (%yoy, rhs)*
- Mainland tourists-related spending (%yoy, rhs)*

**Visitor arrivals as of June (% YoY)**

- China
- Rest of the world

Sources: Bloomberg, Natixis
* Local spendings include clothing, fuels, durable consumer goods and supermarket; Mainland-related spendings contain medicine, cosmetics, optical products, Chinese drugs, Jewelry, clocks and watches; others like food and spending in department stores are not included in both series.

Source: Natixis, Bloomberg
Trade data has also deteriorated very rapidly since the beginning of 2019, after a relatively positive end of 2018 while HK was used a gateway for China’s imports.

**External trade & logistics (%YoY)**

- **Export**
- **Imports**
- **Cargo handled by air**

**China-HK trade (%YoY)**

- **China imports from Hong Kong**
- **China exports to Hong Kong**
- **HK re-exports to China**
- **HK imports from China**

Source: Bloomberg, Natixis
Housing market decelerating rapidly in since the beginning of 2019 and with a clear worsening of sentiment since May.

Residential prices index (1999=100)

- Home sales (rhs, %YoY)
- Price index (%YoY)
- Price index (rhs)

<table>
<thead>
<tr>
<th>Year</th>
<th>13</th>
<th>14</th>
<th>15</th>
<th>16</th>
<th>17</th>
<th>18</th>
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<tbody>
<tr>
<td>Price index</td>
<td>300</td>
<td>250</td>
<td>200</td>
<td>150</td>
<td>100</td>
<td>50</td>
<td>0</td>
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<tr>
<td>Home sales</td>
<td>400</td>
<td>350</td>
<td>300</td>
<td>250</td>
<td>200</td>
<td>150</td>
<td>100</td>
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</tbody>
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Source: CEIC, Natixis

* Saleable area less than 100 m²  ** Saleable area larger than 100 m²

Sentiment about Hong Kong real estate
From the perspective of:

- HK
- Rest of the World

<table>
<thead>
<tr>
<th>Year</th>
<th>17</th>
<th>18</th>
<th>19</th>
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<tbody>
<tr>
<td>HK</td>
<td>150</td>
<td>100</td>
<td>50</td>
</tr>
<tr>
<td>Rest of the World</td>
<td>100</td>
<td>50</td>
<td>0</td>
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</tbody>
</table>

Source: Natixis

Monthly sentiment indicator calculated from three-month moving average from GDELT big data set

May, 2019
Our own measurement of business sentiment clearly shows a fast worsening in July and, even more so, in August.

3-month moving average sentiment from HK perspective in four sectors

Source: GDELT, Natixis
* Latest GDELT observation updated as of August 20th, 2019;
Methodology: Proprietary sentiment analysis based on GDELT big data set on media coverage
The recently announced fiscal package clearly not enough. More should be expected soon, which will only smoothen Hong Kong’s rapid slowdown

- The newly laid out fiscal plan of $19.1 billion is only 4% of the total fiscal expenditure or 0.7% of Hong Kong’s 2018 GDP.

- The very marginal worsening of Hong Kong’s very solid situation might actually look quite different once we take into account the expected fall in revenues from a much lower growth in 2019.

- In any event, we expect a much bigger fiscal stimulus to be implemented soon which should help the Hong Kong avoid a recession (our forecast for growth in 2019 is 0.5% with that expected additional fiscal stimulus)

![Hong Kong Fiscal Expenditure & Revenue](source: Natixis, Bloomberg)

![Hong Kong Budget Balance as a share of GDP](source: Natixis, Bloomberg)

*Rolling sum used*
CAPITAL OUTFLOWS AS KEY RISK TO HONG KONG’S PEG TO THE USD
Since August we are seeing both equity and bond outflows. Stock connect was getting into negative territory until the Southbound flows (i.e. inflows into Hong Kong from Mainland equity investors) accelerated recently.

HK capital flows (USD mn)

Stock Connect Net Capital Flow (HKD bn)

Source: EPFR, Natixis
Note: 2019 August data is only available as of August 16

Source: Natixis, Hong Kong Exchanges and Clearing, Shanghai Stock Exchange,
Demand for loans decelerating quickly and capital outflows starting. Liquidity in the banking sector no longer as ample, at least not in HKD.

**Loans (all currencies)**

- Loan to deposit ratio (%)
- Total loans %YoY (rhs)

**Hong Kong Aggregate Balance**

- Aggregate Balance (HKD mn)
- %YoY

Source: Bloomberg, Natixis
The recent HKD weakness is probably explained by capital outflows although there is not enough data to confirm that. One important sign though is that the differential between HIBOR-LIBOR has turned positive after many years in negative territory due to massive liquidity in Hong Kong.
3 HONG KONG STILL RELEVANT FOR THE MAINLAND, AT LEAST FINANCIALLY
While Hong Kong’s economic size has clearly shrunk over time compared to the Mainland, its financial relevance is undeniable. Hong Kong still serves as the Mainland key gateway to investing/funding from overseas.

**GDP of Hong Kong and Mainland China**

- **Hong Kong**
- **Mainland China**
- **Share of Hong Kong to Mainland China (%)**

**Hong Kong’s Financial Relevance to Mainland China (2010-2018)**

- **Equities**
- **Bonds**
- **Syndicated Loans**
- **Inward FDI**
- **Outward FDI**
- **RMB Settlement**

- **Share of Hong Kong in offshore financing**
- **Share of Hong Kong to the world**

N.B. Non-listed bonds are excluded from calculation. OFDI data as of 2010-2017. RMB settlement data as of 2018.

Source: Natixis, Bloomberg, People’s Bank of China, China Ministry of Commerce
Furthermore, Hong Kong’s financial system is increasingly dominated by Mainland actors.

**Assets of Mainland Chinese Financial Institutions in Hong Kong**

- **Assets (USD tr)**
- **Share of Mainland Chinese Financial Institutions (%)**

Source: Natixis, Hong Kong Monetary Authority

**Total Bank Assets by Region/Economy of Beneficial Ownership in Hong Kong**

- **Mainland China**
- **Europe**
- **Japan**
- **US**
- **Others**

Source: Natixis, Hong Kong
Last but not least, Hong Kong has been the largest offshore RMB center so far.

RMB Offshore Deposits (bn)

Source: Bloomberg, Natixis

HK interbank clearing transaction (RMB tr)

Source: CEIC, Natixis
Conclusions

- All in all, Hong Kong data has been worsening since last year and it is only going to get worse according to our own estimates of business sentiment.

- The mini fiscal stimulus recently announced is not going to stop the tsunami so more will need to come.

- The very rigid monetary regime that Hong Kong has long benefitted from, a peg to the USD under a currency board, can become a real straight-jacket even capital outflows intensify.

- Hong Kong economic woes are not only worrisome for Hong Kong but also for the Mainland as Hong Kong plays a key role for China’s overseas investment and funding, being the largest offshore center for China’s own needs.

- At a time when China itself will need to tackle pressure from capital outflows, capital outflows from Hong Kong could be especially problematic.
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