Hong Kong's Economy: What to Expect

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GROUPE BPCE

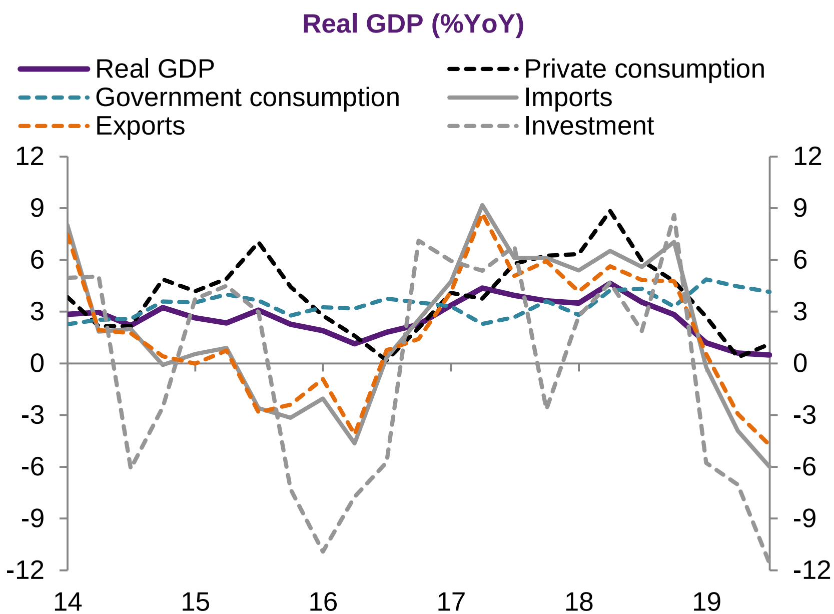
SUMMARY

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

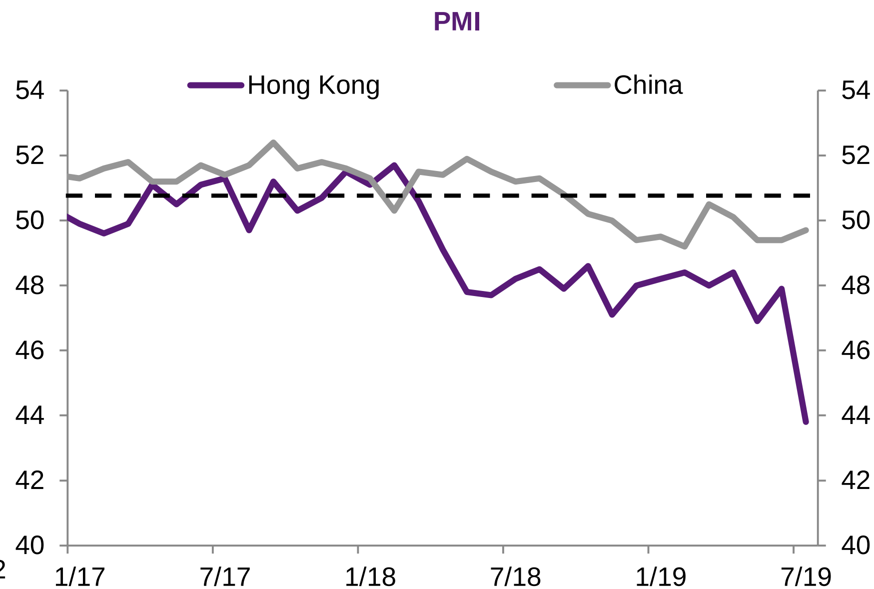
1

HONG KONG ECONOMY IS DECELERATING RAPIDLY

Hong Kong economy under pressure with worrying business sentiment



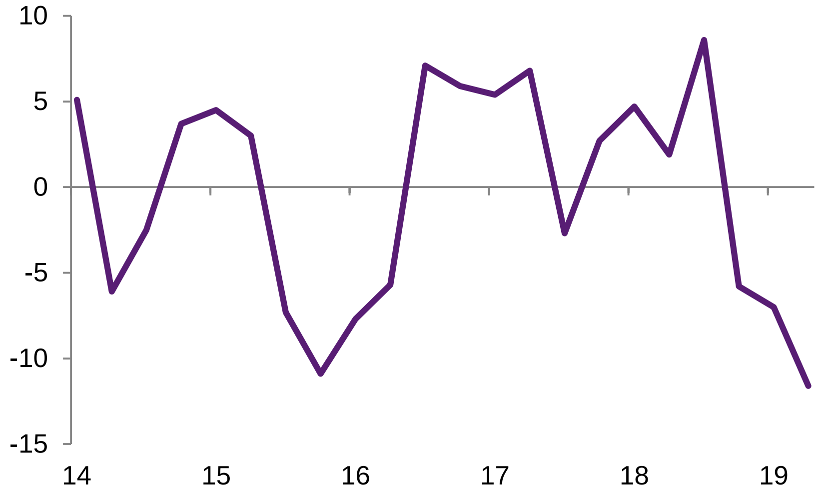
Source: Bloomberg, Natixis



Source: Bloomberg, Natixis

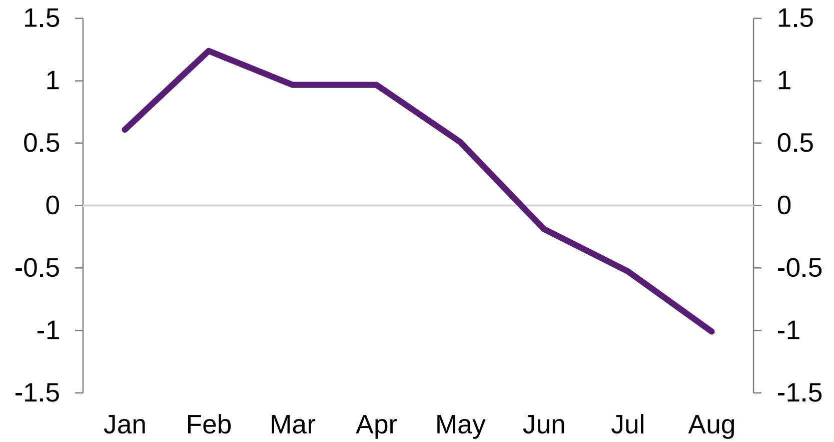
Investment has collapsed in 2Q and our own proprietary sentiment measure for investment shows a worsening in July and August

Hong Kong Investment (% YoY)



Source: Natixis, Bloomberg

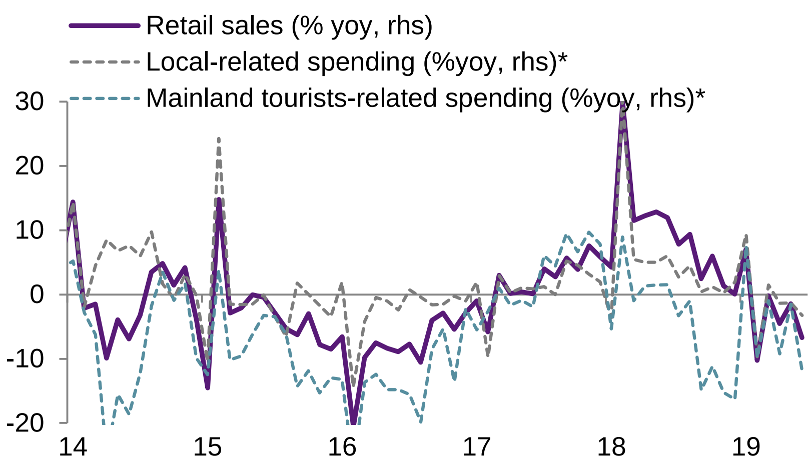
3-month moving average sentiment about investment in Hong Kong



Source: GDELT, Natixis
Methodology: Proprietary sentiment analysis based on GDELT big data set on media

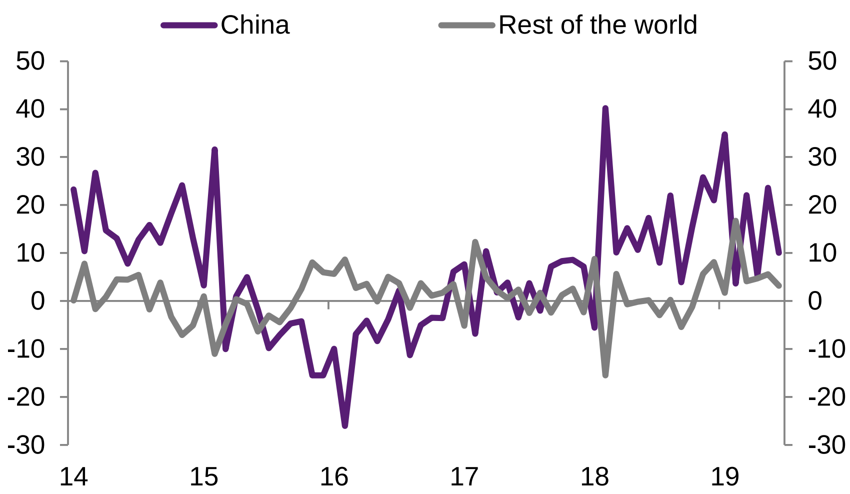
Consumption hit by the retreat of Mainland tourists even before the worsening of social unrest

Retail sales



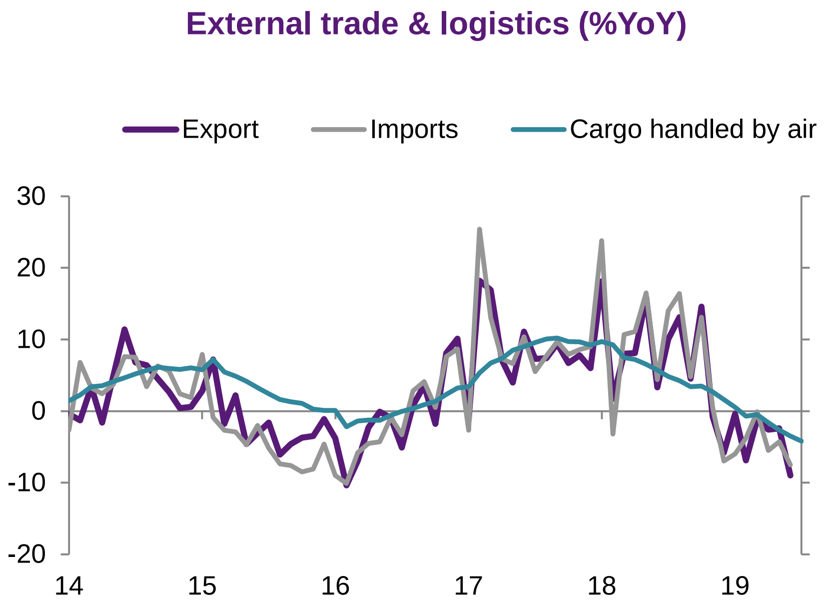
Sources: Bloomberg, Natixis
* Local spendings include clothing, fuels, durable consumer goods and supermarket; Mainland-related spendings contain medicine, comestics, optical products, Chinese drugs, Jewelry, clocks and watches; others like food and spending in department stores are not included in both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

Visitor arrivals as of June (% YoY)



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

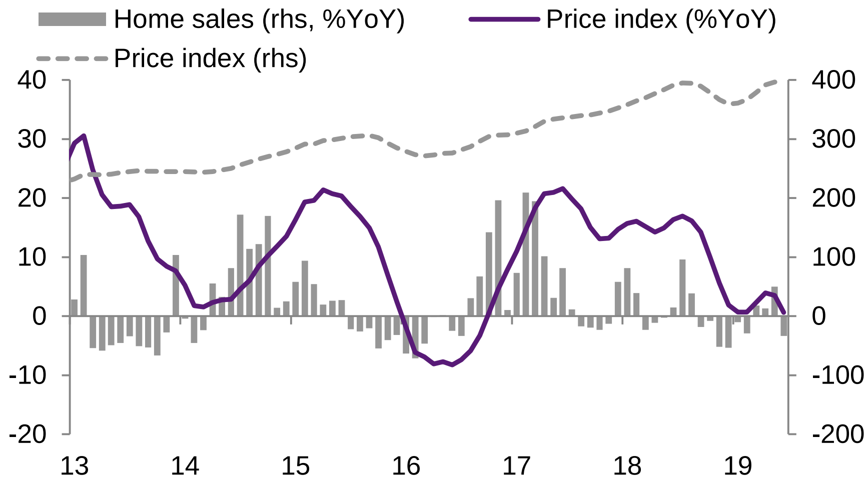


Source: Bloomberg, Natixis

Source: Bloomberg, Natixis

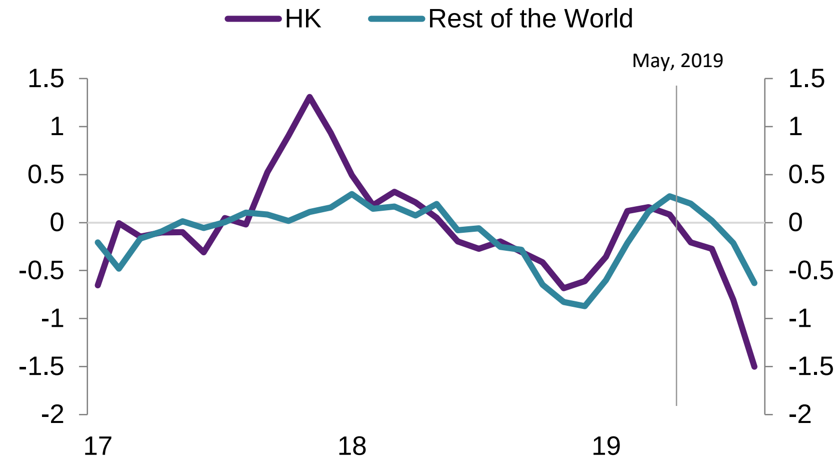
Housing market decelerating rapidly in since the beginning of 2019 and with a clear worsening of sentiment since May

Residential prices index (1999=100)



Source: CEIC, Natixis
* Saleable area less than 100 m^2 ** Saleable area larger than 100 m^2

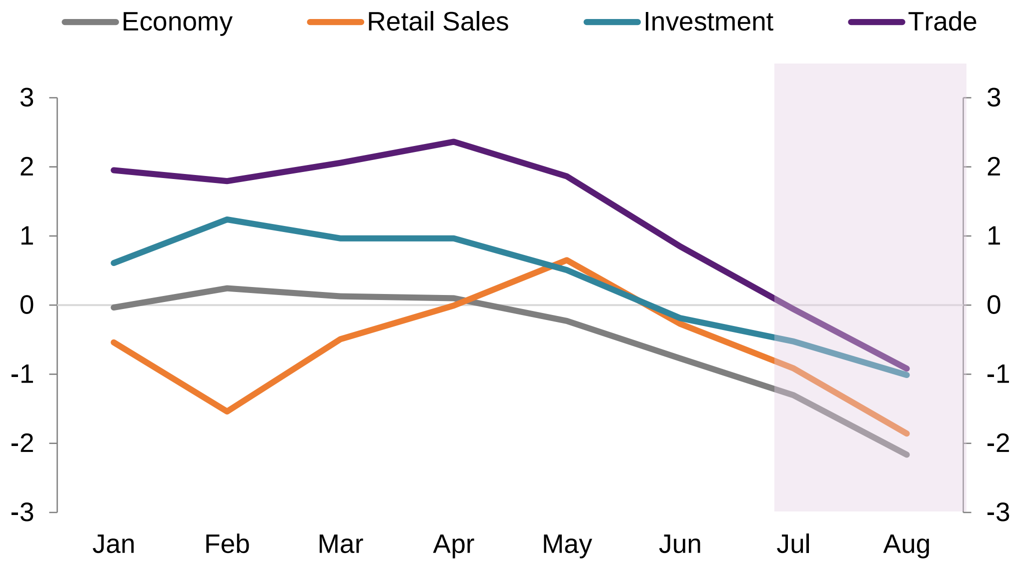
Sentiment about Hong Kong real estate From the perspective of:



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

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

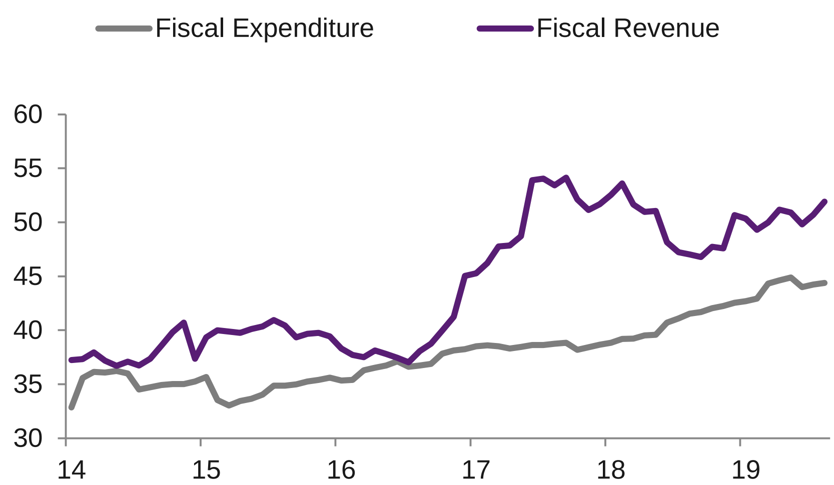


Source: GDELT, Natixis
* Latest GDELT observation updated as of August 20th, 2019;
Methodology: Proprietary sentiment analysis based on GDELT big data set on media coverage

The recently announced fiscal package clearly not enough. More should be expected soon, which will only smoothen Hong Kong's rapid slowdown

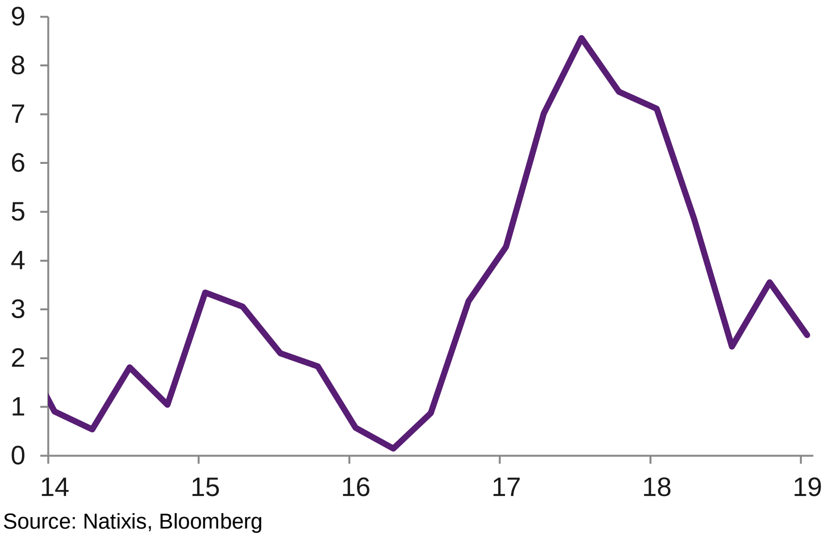
- The newly laid out fiscal plan of $19.1 billion is only 4% of the total fiscal expenditure or 0.7% of Hong Kong's 2018 GDP.
- The very marginal worsening of Hong Kong's very solid situation might actually look quite different once we take into account the expected fall in revenues from a much lower 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 (HKD billion, 12mma)



Source: Natixis, Bloomberg

Hong Kong Budget Balance as a share of GDP (%)

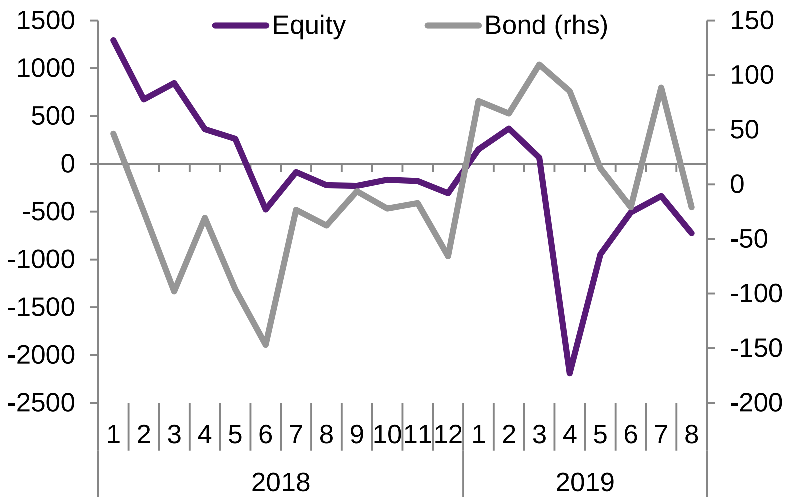


Source: Natixis, Bloomberg
*Rolling sum used

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

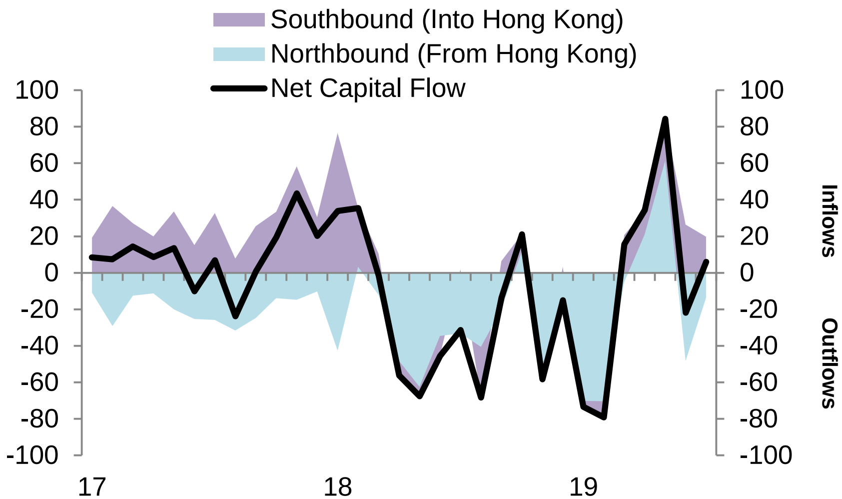
Since August we are seeing both equity and bond outflows. Stock connect was getting into negative territory until the Southbound flows (i.e. inflows into Hong Kong from Mainland equity investors) accelerated recently

HK capital flows (USD mn)



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

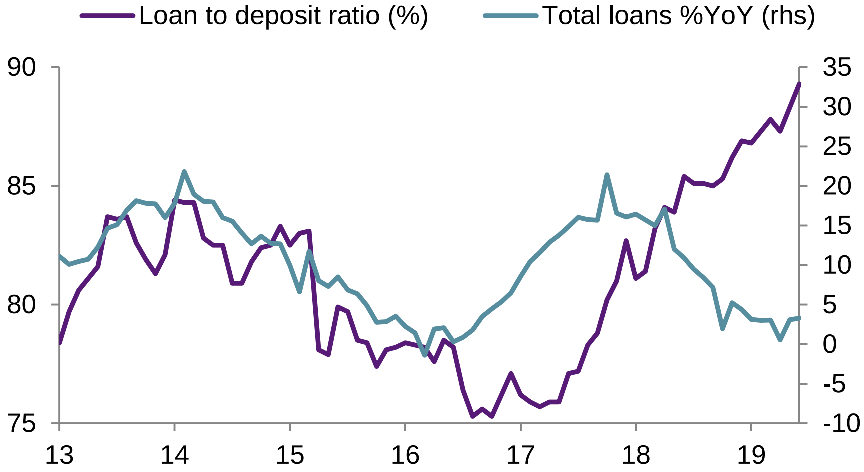
Stock Connect Net Capital Flow (HKD bn)



Source: Natixis, Hong Kong Exchanges and Clearing, Shanghai Stock Exchange,

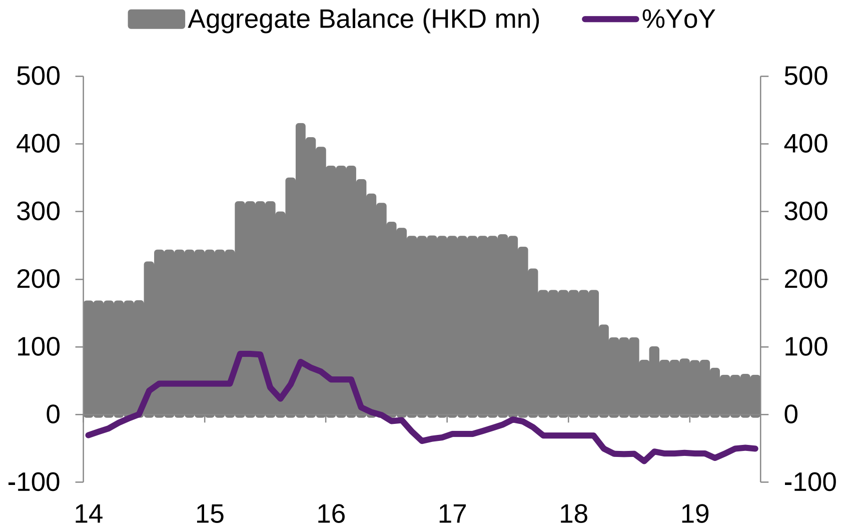
Demand for loans decelerating quickly and capital outflows starting. Liquidity in the banking sector no longer as ample, at least not in HKD

Loans (all currencies)



Source: Bloomberg, Natixis

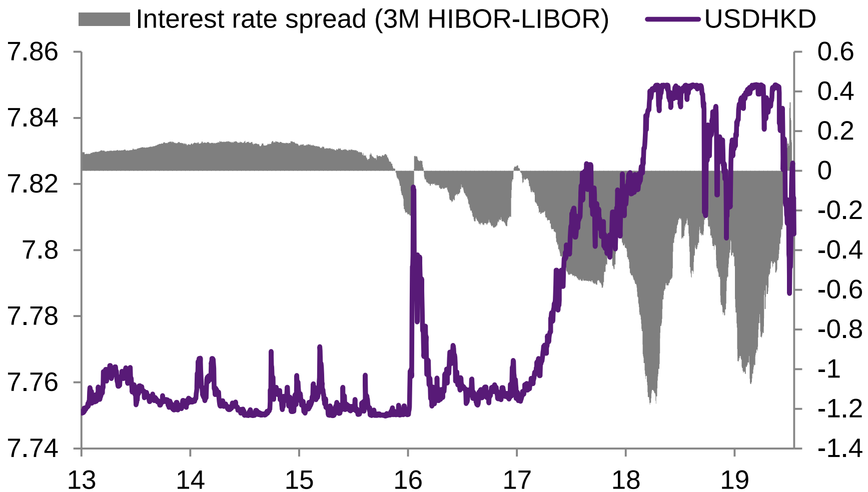
Hong Kong Aggregate Balance



Source: Bloomberg, Natixis

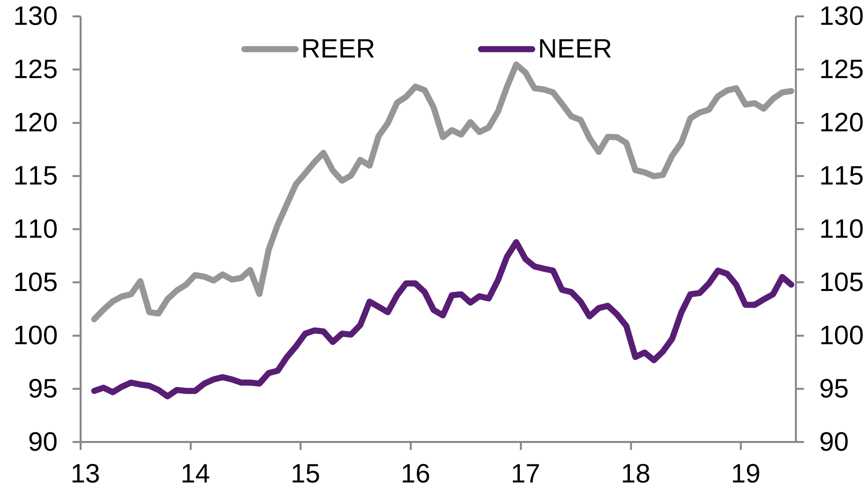
The recent HKD weakness is probably explained by capital outflows although there is not enough data to confirm that. One important sign though is that the differential between HIBOR-LIBOR has turned positive after many years in negative territory due to massive liquidity in Hong Kong

HKD and Interest rate spread



Source: Bloomberg, Natixis
Last observation as of August 20, 2019

REER and NEER



Source: Bloomberg, Natixis

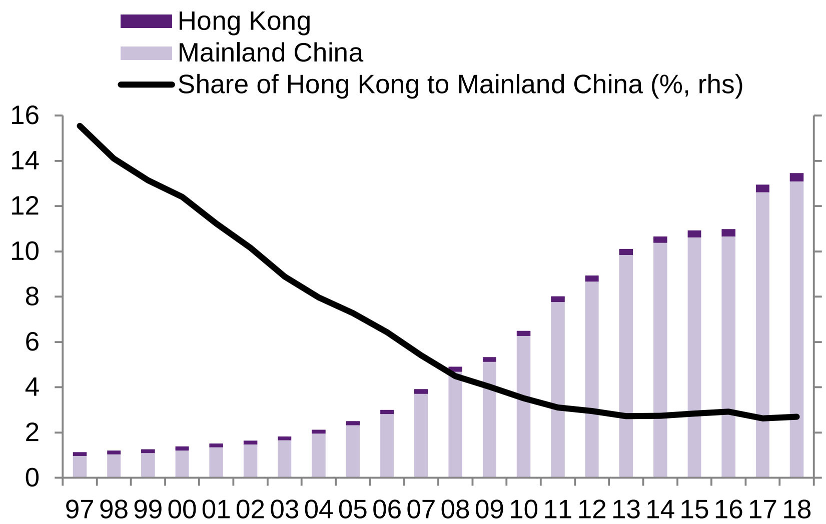
NATIXIS
BEYOND BANKING

3

HONG KONG STILL RELEVANT FOR THE MAINLAND, AT LEAST FINANCIALLY

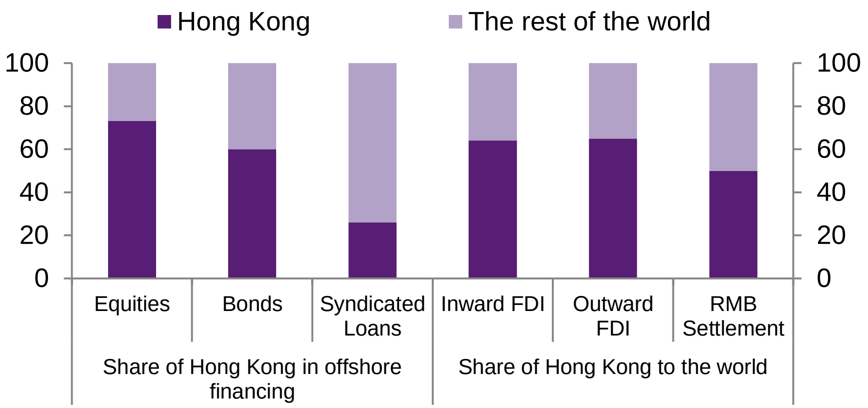
While Hong Kong's economic size has clearly shrunk over time compared to the Mainland, its financial relevance is undeniable. Hong Kong still serves as the Mainland key gateway to investing/funding from overseas

GDP of Hong Kong and Mainland China



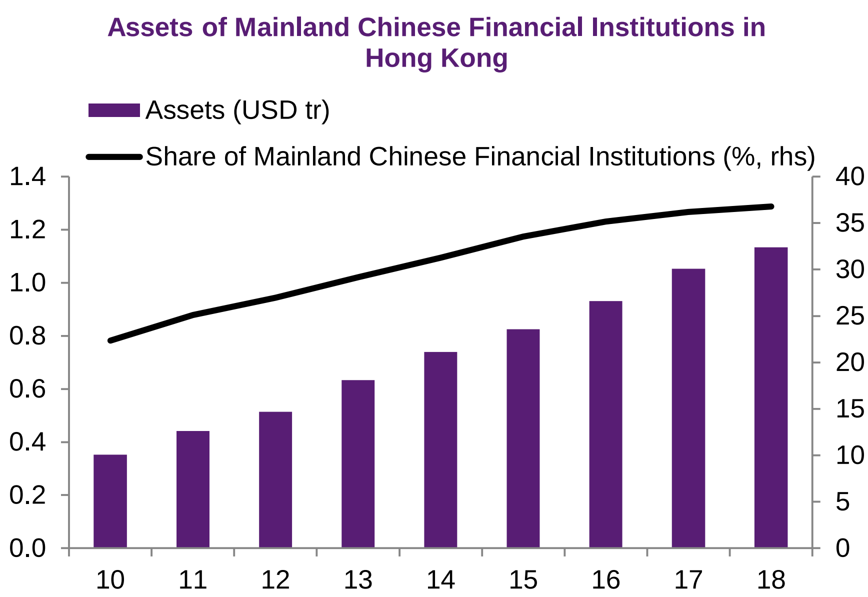
Source: Natixis, Bloomberg

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

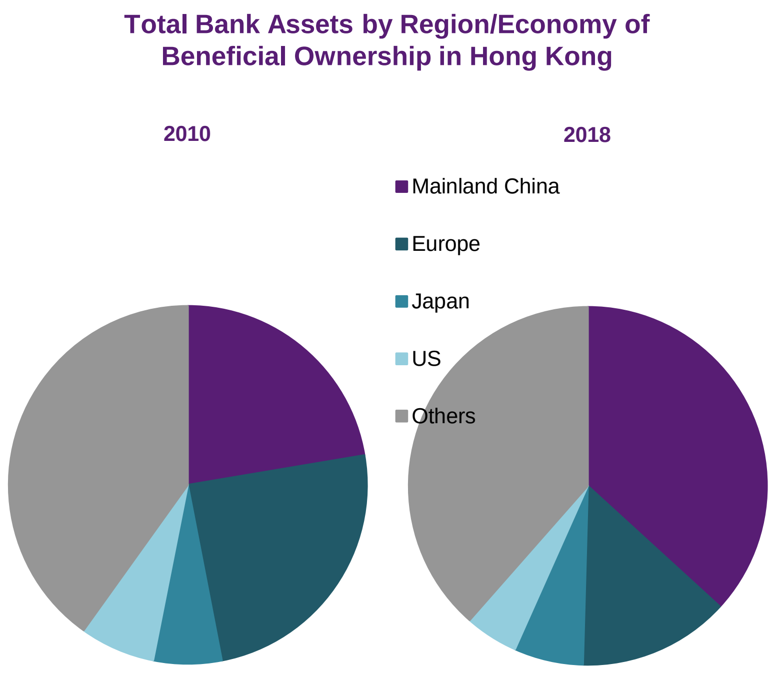


N.B. Non-listed bonds are excluded from calculation. OFDI data as of 2010-2017. RMB settlement data as of 2018.
Source: Natixis, Bloomberg, People's Bank of China, China Ministry of Commerce

Furthermore, Hong Kong's financial system is increasingly dominated by Mainland actors.

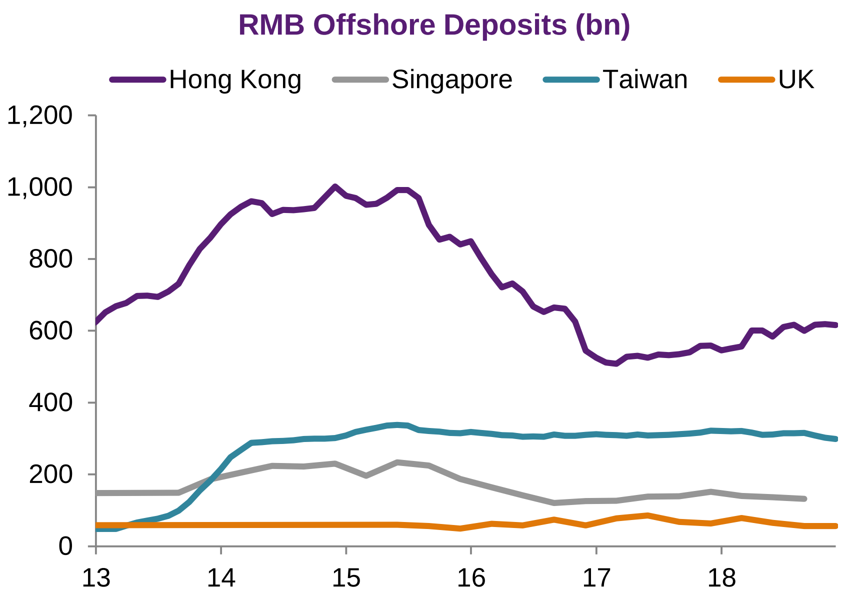


Source: Natixis, Hong Kong Monetary Authority

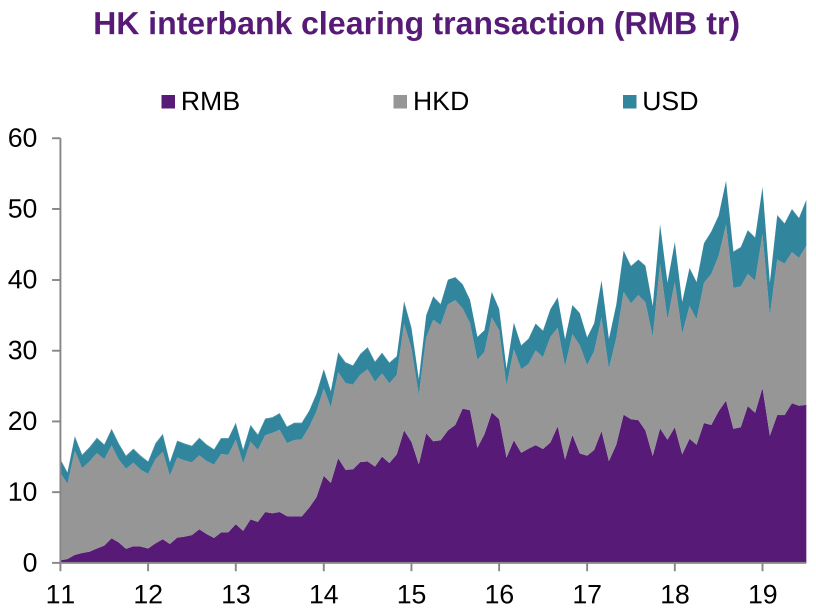


Source: Natixis, Hong Kong

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



Source: Bloomberg, Natixis



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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