Hong Kong Economy and Industry Overview

September 2013
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1. Overview of the Hong Kong Economy
Real GDP in 2012 grew unfavorably at just 1.4% YoY. Yet, growth on quarterly basis has continued to accelerate at a moderate pace after hitting the bottom in 1Q 2012.

Recent figures showed a faster economic growth, with real GDP of 2Q 2013 growing 3.3% YoY, up 0.4%pt from 2.9% YoY in the previous quarter.

In view of this, the HK government announced an upward revision for 2013 GDP growth forecast, reflecting an optimistic view in the market.

<table>
<thead>
<tr>
<th>Annual real GDP growth and nominal GDP (HKD billion)</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP Growth</td>
<td>7.4%</td>
<td>7.0%</td>
<td>6.5%</td>
<td>2.1%</td>
<td>2.5%</td>
<td>6.8%</td>
<td>4.9%</td>
<td>1.4%</td>
</tr>
<tr>
<td>Nominal GDP</td>
<td>1,412</td>
<td>1,503</td>
<td>1,651</td>
<td>1,707</td>
<td>1,659</td>
<td>1,777</td>
<td>1,936</td>
<td>2,040</td>
</tr>
</tbody>
</table>

(Source) Census and Statistics Department of HKSAR, Corporate Research Division of BTMU

<table>
<thead>
<tr>
<th>Quarterly real GDP growth (YoY growth)</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1Q</td>
<td>2Q</td>
<td>3Q</td>
</tr>
<tr>
<td>Real GDP Growth</td>
<td>7.6%</td>
<td>5.1%</td>
<td>4.0%</td>
</tr>
</tbody>
</table>

(Source) Census and Statistics Department of HKSAR, Corporate Research Division of BTMU
As for contribution to real GDP growth by expenditure components, exports of goods has remained sluggish since 2Q 2011 and takes a toll on Hong Kong economy.

On the other hand, exports of services kept growing and contributed 4.2% to overall growth in 2Q 2013.

Private consumption expenditure also maintained solid due to low unemployment rate and other favorable factors.

Looking forward, solid private consumption will be the key for Hong Kong economic growth. However, given that more experts are maintaining cautious view on external environments including Chinese economy, rapid recovery is unlikely.

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2. Hong Kong economic indicator and outlook
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Export Trends ~ Exports to China and ASEAN regions were robust

- Total exports of Hong Kong in Jul 2013 grew 10.6% YoY to HKD 305.4 billion.
- Growth recorded year on year decline for 2 consecutive months in May and June but returned to the positive side recently.

- In July, exports to China and ASEAN regions drove overall growth, rising favorably by 14.4% YoY and 11.7% YoY respectively.
- Exports to EU had continued to post negative year on year growth but turned positive in June. Growth was 6.7% YoY in July.
- Exports to Japan continued to see year on year decline. Figures in July declined sharply by 8.5% YoY.
- Looking forward, exports to China and ASEAN regions are expected to be the growth driver. However, in view that fast growth in Chinese economy is unlikely, significant increase in total exports is not expected.

(Source) CEIC, Corporate Research Division of BTMU

<table>
<thead>
<tr>
<th>Total exports</th>
<th>(HKD billion, YoY growth)</th>
</tr>
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<tbody>
<tr>
<td>Growth in export value by destinations (YoY)</td>
<td></td>
</tr>
</tbody>
</table>

(Source) CEIC, Corporate Research Division of BTMU
Inflation and Unemployment Rate — Currently healthy

- Unemployment rate in Jun-Aug 2013 (seasonally adjusted, estimated rate) remained at a healthy level at 3.3%, the same as in May-Jul 2013.
- On the other hand, consumer price grew 4.5% YoY in Aug 2013, showing an upward trend due to moderate growth in housing rental, food prices and others.
- Looking forward, the government forecasted that housing rental would continue to push up overall consumer price. Nevertheless, given that price growth in imported goods and others is slowing, and housing rental of new contracts signed in 1H only had marginal growth, inflation is expected to be moderate in the short term.

(Source) Census and Statistics Department of HKSAR, Corporate Research Division of BTMU
2. Hong Kong economic indicator and outlook

Stock Price ~ Full scale growth is unlikely

- After dropping continuously in the end of August due to Syria issue, Hang Seng Index (HSI) continued to climb in the first half of September to returned to 22,000 points due to favorable PMI in China, Europe and etc. HSI further improved to 23,000 points as the US announced to continue QE3 after the FOMC meeting.

- However, given the Chinese economy is unlikely to post fast growth as it experienced before, HSI growth is expected to be weak. Companies are likely to have improvement in performances but would be difficult to achieve full-scale growth in stock prices.

(Source) CEIC, Corporate Research Division of BTMU
2. Hong Kong economic indicator and outlook

Outlook for Hong Kong Economy ~ Moderate growth is expected amid continuous cautious view on economy

- After dropping for 5 consecutive months since Jan 2013, PMI increased by 2.1% MoM to 49.7 in Jul. PMI managed to remain at the same level at 49.7 in August but was still under 50.
- PMI of sectors related to new orders from China was particularly sluggish, registering readings below 50 for 7 consecutive months.

- The Hong Kong government, IMF and Asian development bank expect a faster growth in real GDP growth in 2013 in comparison to actual growth in 2012, giving a consensus forecast of moderate acceleration in economy.
- Recently, the Hong Kong government lifted growth forecast and some are taking a more optimistic view on growth. Nevertheless, cautious view remains the majority and rapid economic growth is not expected.

Purchasing Manager Index (PMI)
(Data compiled by HSBC from monthly replies to questionnaires sent to purchasing executives)

<table>
<thead>
<tr>
<th>Year</th>
<th>PMI</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011/1</td>
<td></td>
</tr>
<tr>
<td>2011/7</td>
<td></td>
</tr>
<tr>
<td>2012/1</td>
<td></td>
</tr>
<tr>
<td>2012/7</td>
<td></td>
</tr>
<tr>
<td>2013/1</td>
<td></td>
</tr>
<tr>
<td>2013/7</td>
<td></td>
</tr>
</tbody>
</table>

(Note) A reading of PMI over 50 indicates economic expansion while that under 50 represents a contraction.
(Source) The HSBC Hong Kong PMI, Corporate Research Division of BTMU

Hong Kong’s real GDP growth forecasts for 2013

<table>
<thead>
<tr>
<th>Organization</th>
<th>Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong Government</td>
<td>Upward revision of real GDP growth in 2013 from previous forecast of 1.5%-3.5% to 2.5%-3.5% (Aug 2013).</td>
</tr>
<tr>
<td>Hong Kong University</td>
<td>Downward revision of real GDP growth in 2013 from previous forecast of 3.5%-4.3% to 3.3%-4.1% (Jul 2013).</td>
</tr>
<tr>
<td>HSBC</td>
<td>Downward revision of real GDP growth in 2013 from previous forecast of 3.7% to 2.5% (Jun 2013).</td>
</tr>
<tr>
<td>IMF</td>
<td>Downward revision of real GDP growth in 2013 from previous forecast of 3.48% to 2.96% (Apr 2013).</td>
</tr>
<tr>
<td>Asian Development Bank</td>
<td>Downward revision of real GDP growth in 2013 from previous forecast of 3.9% to 3.5% (Apr 2013).</td>
</tr>
</tbody>
</table>

(Source) Information from various sources, Corporate Research Division of BTMU
3. Trends of Major Industries in Hong Kong
In July, retail sales value grew 9.5% YoY to HKD 40 billion. Growth in retail sales in volumes (graph on the right) slowed to 8.9% YoY in July, the first single digit growth in 2013.

Overall growth wasparticularly constrained by sales of shops selling consumers’ durables including “automobiles” and “electrical goods and photographic equipments”, which have continued to post YoY decline since May.

Sales of “jewelry, watches & clocks, valuable gifts” shops and department stores grew 31.3% YoY and 21.4% YoY respectively but such growth was a slowdown compared with previous month.

Looking forward, consumer sentiment is expected to remain solid under the support of healthy employment environment. In addition, mainland visitors, which largely affect the retail market in Hong Kong, is likely to remain increasing. The overall retail industry is forecasted to maintain stable growth.

Nevertheless, as cautious view on Hong Kong economy remains the majority, retail growth is unlikely to experience the same growth as in 2011 and is expected to slow down.

(Note) Retail sales volumes is compiled by adjusting the value of retail sales for price changes.
(Source) CEIC, Corporate Research Division of BTMU
In 2Q 2013, while total restaurant sales value increased by 4.5% YoY to HKD 23.1 billion, sales in terms of volume (Note) (graph on the right) was sluggish, growing just 0.2% YoY.

By major sectors, fast food sector saw mere growth at 0.2% YoY. Chinese restaurants declined by 2.6% YoY, recording decline for 6 consecutive quarters since 2012.

As major costs of restaurants including labor and rental are rising, some restaurant chains stepped into price increase. In fact, CPI of restaurants has continued to trend at a higher level compared with other sectors. As a consequence, Hong Kong citizens tend to cut spending for dining at restaurants.

Looking forward, as Hong Kong’s economic recovery is expected to remain slow, total restaurant sales is likely to flat year ago level.

(Note) Retail sales volumes is compiled by adjusting the value of retail sales for price changes.
(Source) Census and Statistics Department of HKSAR, Corporate Research Division of BTMU
Hotel Industry ~ Market is expected to remain robust

- Hotel occupancy in July was maintained high at 91%.
- High occupancy rate was supported by firm demand, with the number of overnight visitors trending at around +10% YoY.
- Looking forward, while the number of overnight visitors will maintain solid growth, the number of new room supply is expected to be limited despite anticipated opening of new hotel. Hotel occupancy and room rate are likely to remain high.

Hotel occupancy and room rate
(HKD, Occupancy rate)

(Note) AARR denotes to Average Achieved Hotel Room Rate
(Source) Census and Statistics Department of HKSAR, Corporate Research Division of BTMU
Residential Industry ~ Residential price is expected to see moderate downward trend

- Residential price index has trended downward after reaching the peak in February.
- This is believed to be the result of a series of government measures being imposed one by one since 2H 2012 to curb quick buy-and-sell transactions. Indeed, the number of residential transactions has continued to decrease.
- On the other hand, rental price has been rising at a modest pace.
- In the short term, in view that the government is likely to keep its stance of constraining quick buy-and-sell transactions, rise in residential price is unlikely. However, as the situation of firm actual demand from Hong Kong citizens and tight supply remains unchanged, possibility for sharp price fall is low.
- As for rental price, it is expected to rise in line with increasing demand as more people tend to rent a property instead of purchasing due to worries over price fall.
- Overall speaking, residential price may continue to soften but instead of a sharp price fall, it is expected to trend downward at a modest pace.

(Source) Rating and Valuation Department of HKSAR, Corporate Research Division of BTMU
Office Industry ~ Office rental is expected to remain high

- Office rental index continued to trend upward at high level, with index of both all grades and grade A rising 1.2% MoM in July.
- On the other hand, office price index in July grew 0.2% MoM. MoM growth slowed down as affected by stagnation in office transactions due to implementation of double stamp duty in February, etc.
- Looking forward, office price growth is expected to be minimal as affected by government measures imposed to curb property price. However, rapid price fall is unlikely due to limited supply and solid demand. Office rental is forecasted to remain high as a result.

**Office price and rental index**

(1999 = 100)

![Office Price and Rental Index Graph](attachment:image)

(Source) Rating and Valuation Department of HKSAR, Corporate Research Division of BTMU
4. Conclusion
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Outlook for Hong Kong Economy and Industry

- Hong Kong’s real GDP growth has been on an accelerating trend after hitting the bottom in 1Q 2012. Recent figures showed a continuous growth in real GDP growth rate, indicating an economic recovery although at a moderate pace.

- Performance varied according to industries. Hotel industry has maintained favorable performance amid high occupancy rate and room rate. Retail industry also continued to grow at a stable pace. In contrast, property industry was affected by government measures imposed to curb property price. Although at a modest pace, residential price has continued to fall.

- While unemployment rate is maintained at a healthy level, PMI is softening. Combined with uncertainties over global economic outlook, rapid recovery in Hong Kong economy and industry is unlikely.

- In the short term, performances of private consumption and hotel industries are expected to remain favorable. Sharp decline in property price is not expected as supported by limited supply and solid demand. As a consequence, Hong Kong economy and industry is likely to remain growing, but such growth is expected be a weak one.