Economics

DBS Flash

HKSAR: Downgrading GDP forecast

Economics/FX/rates

Group Research May 4, 2022

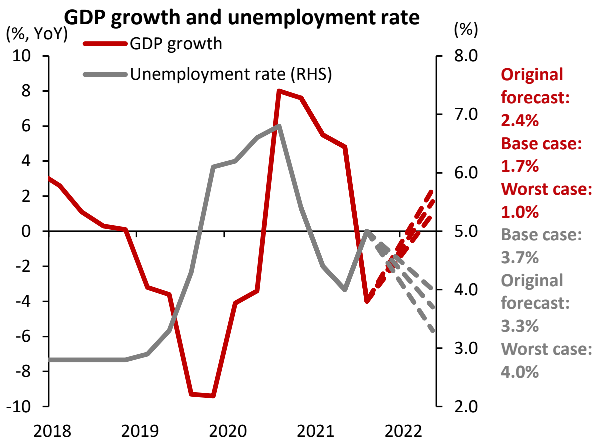
Samuel Tse
Economist

Please direct distribution queries to Violet Lee +65 68785281
violetleeyh@dbs.com

- *Real GDP in 1Q22 fell by 4.0% YoY and 2.9% QoQ.*
- *A recovery in consumption is in sight, on a further relaxation in social distancing measures from tomorrow.*
- *External trade underperformed from global supply-chain disruptions and moderating demand from its major trading partners.*
- *The unemployment rate will start retreating but the dwindling pace of the labour force remains alarming.*
- *Rising interest rates will hamper the recovery in investment.*
- ***Implication to our forecasts:***
  - *Downgraded 2022 GDP forecast from 2.4% to 1.7%.*
  - *Revised the unemployment rate forecast from 3.3% to 3.7% by end-2022.*
- ***Implications to our investors:***
  - *1M-HIBOR to reach 2.25% by end-2022.*
  - *Residential prices to return to end-2021 levels.*
  - *Growth of retail shop rentals to outpace other types of premises.*

Downgrading the GDP forecasts

Real GDP fell by 4.0% YoY in 1Q because of stringent social distancing measures. On a seasonally adjusted QoQ basis, it declined by 2.9%, the biggest drop since COVID outbreak in 2020. As a result, our GDP forecast is downgraded from 2.4% to 1.7% despite a near-term recovery in sight.

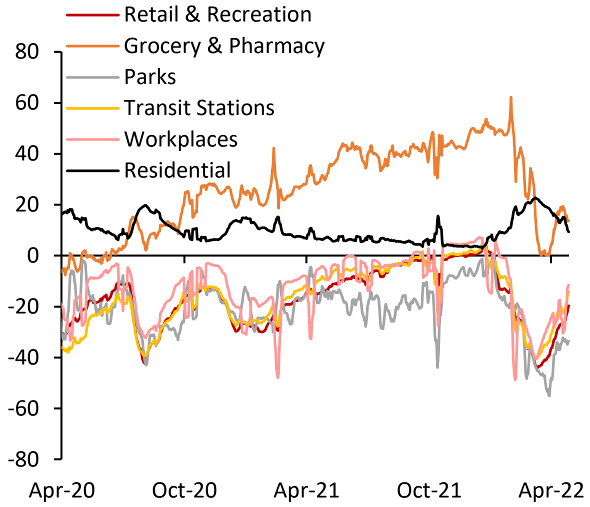


Source: Bloomberg, DBS

Private consumption, which accounts for over 60% of the GDP, plunged by 5.4% YoY in 1Q22, from 5.3% in 4Q22. Retail sales dropped by 4.9% YoY in Jan-Feb. However, a rebound is in sight. Even before relaxation of social distancing measures on 21 April, mobilities in retail & recreation premises, transit stations, parks, and workplaces have already started improving. Yesterday's further relaxation of the social distancing policy measures (groups of 8 will be allowed for in-restaurant dining starting from tomorrow) will boost consumption. Likewise, retail sales will rebound on the issuance of HKD66bn (18.7% of retail sales value in 2021) cash vouchers.

According to the HKSAR Government, they could boost GDP by 1.2% points. **Yet, re-opening of border hitherto is not in-sight.** After all, tourist spending accounts for around 30% of total retail sales during pre-COVID.

Google Mobility Change Index (7D moving avg.)

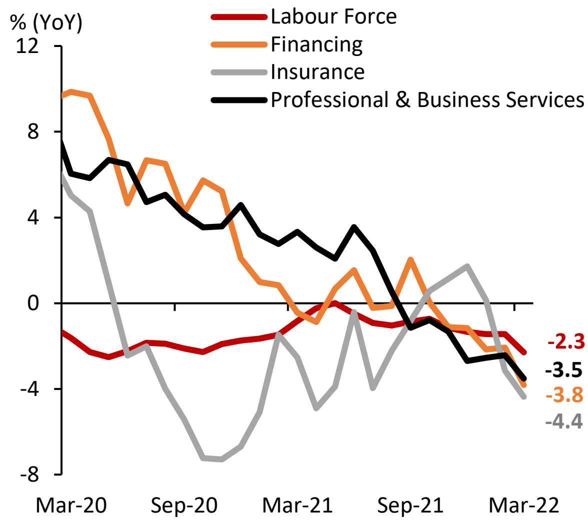


Source: CEIC, DBS

Flight bans (currently down to 7 days) have stressed the supply chain on the external front. Exports and imports of goods fell by 4.5% YoY and 5.9% in 1Q, compared to 13.5% and 9.9% in the previous quarter respectively. The cargo capacity of one of the giant airlines dropped by 28.4% YoY in March. It is now 63.2% below its pre-COVID level. Logistics costs are elevated, consistent with the widening spread between trade in value and volume terms. That said, shipping service providers are taking the profits while import/export trading companies' margins are squeezed.

Also, the severe lockdown in Mainland China will negatively impact re-export in the months ahead. Large-scale contact tracing systems and isolation measures leave shipping and logistics sectors understaffed. China's industrial production and exports have already slowed in March. Leading indicators such as Manufacturing PMI and oil refinery run rate pointed to lacklustre production ahead. Exports to Mainland China dropped by 12.8% YoY in March. Meanwhile, rising energy prices have already dampened global economic growth. US GDP declined by 1.4% QoQ (annualized) in 1Q.

Labour forece growth

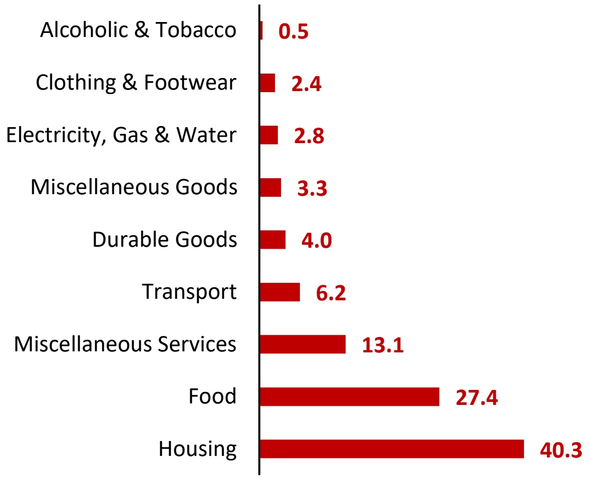


Source: CEIC, DBS

The labour market will improve. The jobless rate rose from 3.9% in 4Q21 to 5.0% in 1Q22. Amongst all, retail, accommodation and food services saw the most noticeable increase, from 5.5% to 8.9%. That of construction also jumped from 5.2% to 8.0%. With the ongoing recovery, **the unemployment rate is expected to ease to 3.7% by the end of this year**.

Yet, the labour force has continued to shrink. The total workforce fell further by 2.3% YoY in 1Q or a loss of 194,900 crews compared to the peak in 2Q19. The reduction was across-the-board. That of financing and professional business services fell more substantially than the headline figure. Such an outflow of higher-skilled labour will dampen the long-term competitiveness of the regional financial center. Thanks to the shortened quarantine period and improving COVID condition in April, a net outflow of residences narrowed as passenger arrivals rebounded to over 1,000 per day. Yet, this does not conclude the end of the outflow of labour. Around 1,500-2,500 residents depart from the airport per day.

CPI Weighting (%)



Source: CEIC, DBS

Inflation to rise moderately

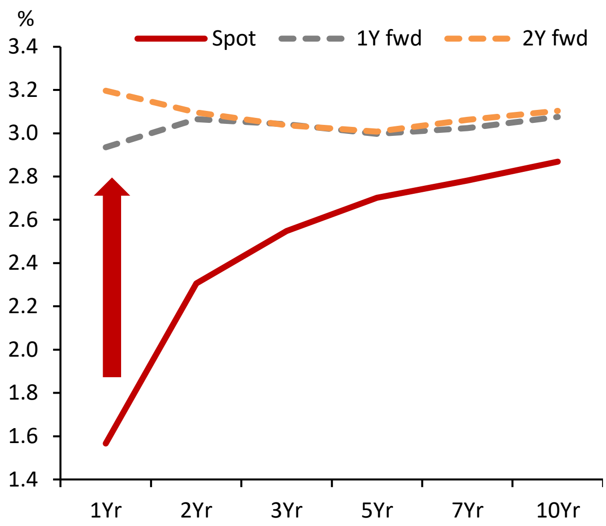
CPI advanced by 1.7% YoY in March to conclude 1Q average inflation at 1.5%. It will likely accelerate on shortened food supply amid zero-COVID policy in China. Food prices charged up by 4.6% in March. Recovering economic conditions and issuing cash vouchers will boost the prices of discretionary items such as durable goods and clothing & footwear ahead. Inflation will be largely manageable at 2.2% for 2022 on average. Compared to other developed markets, HKSAR is lesser affected by the soaring energy prices. Power-related items only account for 9% of the whole CPI basket. Recovery in residential rent (40.3% of CPI basket) will partially offset weaker demand due to emigration.

Domestic investment will remain moderate amid the rate hike cycle

The gross domestic fixed capital formation (investment) component of GDP dropped further by 8.3% YoY in 1Q22 from 0.6% in 4Q21. Performance of machinery investment was weak amid sluggish economic conditions. Likewise, property investment plunged as construction activities halted. Rising interest rates will contain investment. In our view, the Fed Fund Target rate will increase from 0.50% to 2.50% by the end of this year. To stabilize the HKD, which is currently trading at around 7.84-7.85 against the USD lately, HKMA will soon have to issue Exchange Fund Bills and Notes or buy HKD to extract liquidity in the market. Given experience from the previous rate hike cycle, the Aggregate Balance will likely drop to around HKD50bn from the current level (HKD338bn) when the Fed Fund Target Rate hits 2.50%. As such, deposits will probably grow slower than loans in 2022, as reflected in the modest M2 growth of 1.0% YoY in March. 1M-HIBOR is expected to reach 2.25% by end-2022. The 12M-HIBOR has already leapfrogged from 0.43% in early-Jan to 2.09% lately.

On the Hong Kong govvies, funding needs from fiscal stimulus will elevate bond yields. The spread between Hong Kong and US 10Y govvies yields has narrowed to around 20bps lately. Compared to the last rate hike cycle, the spread could widen to -120bps. Going forward, the yield will likely reach 2.80% by end-2022. Structural flattening will continue, with the 2Y and 5Y yields expected to reach 2.80% by end-2022.

HKD Sovereign Curve



Source: Bloomberg, DBS

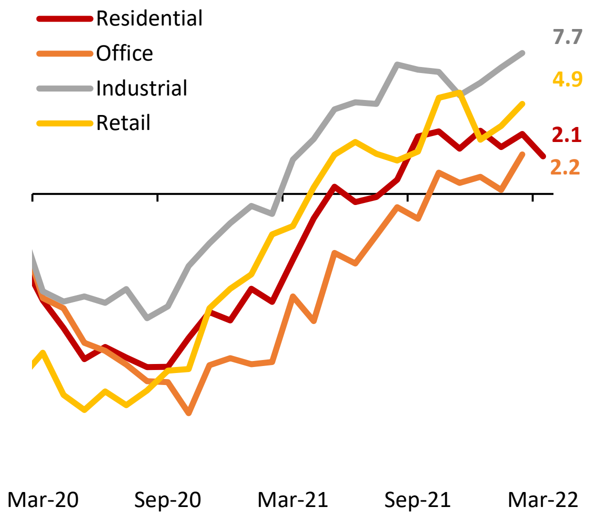
Last week, the first government inflation-linked 3Y Retail Green Bond was opened for subscription. With inflation likely staying moderated, total return will likely be contained at the guaranteed yield of 2.50%. Compared to other fixed-income investments with same tenor (e.g., yield of 3Y UST rose to around 2.90%), the return is not particularly attractive. Institutional investors' interest in absorbing it in the secondary market is likely to be muted.

Property prices and rents to rebound

Headline price on the secondary market has already rebounded by 2.1% in the past 4 weeks. No. of top 10 mass estates transactions rose by 21.2% MoM. This group's flat-hunting activities were red-hot, which stayed elevated at a 6-month high of 568 over the past weekend. For the primary market, no. of transactions rose by 6.8 times MoM to 1,029. The Valuation Index from major banks rebounded from 36.28 in Feb to 63.16 in Apr, indicating banks' increasing risk appetite.

Yet, the overall residential price is expected to stay flat for the year. Negative spillover from the stock market is a prime concern. A faster-than-expected rate hike will also keep the magnitude of the rebound at bay. In the latest Budget, Financial Secretary Paul Chan proposed to raise the loan-to-value ratio for residential properties worth HKD8-10mn from 80% to 90%. Yet, the impact on demand could be muted. Under the new scheme, a potential homeowner must earn monthly income of over HKD85,000 to fulfil the stress test. This compares to the median employment earnings of HKD20,000 (excluding foreign domestic helpers) and median household income of HKD29,100.

Rental index (YoY, %)



Source: CEIC, DBS

As for other asset classes within the property sector, retail shop rental is expected to out-perform other types of premises. It rose by 4.3% YoY in Feb. The recovery in consumer sentiment is likely to fuel more optimism. Meanwhile, the downward pressure on office rentals is apparent, which grew only by 2.2% YoY in Feb. With increasing supply in various business districts, vacancy rates have hovered above 9% since 2021. This compared to the pre-COVID level of 4.8%.

Group Research

Economics & Macro Strategy

Taimur Baig, Ph.D.
Chief Economist
Global
taimurbaig@dbs.com

Chang Wei Liang
FX & Credit Strategist
Global
weiliangchang@dbs.com

Ma Tieying, CFA
Senior Economist
Japan, South Korea, Taiwan
matieying@dbs.com

Nathan Chow
Senior Economist
China, Hong Kong SAR
nathanchow@dbs.com

Radhika Rao
Senior Economist
Eurozone, India, Indonesia
radhikarao@dbs.com

Chua Han Teng, CFA
Economist
Malaysia, Philippines, Thailand, Vietnam
hantengchua@dbs.com

Irvin Seah
Senior Economist
Singapore
irvinseah@dbs.com

Violet Lee
Associate
Publications
violetleeyh@dbs.com

Daisy Sharma
Analyst
Data Analytics
daisy@dbs.com

Eugene Leow
Senior Rates Strategist
G3 & Asia
eugeneleow@dbs.com

Duncan Tan
Rates Strategist
Asia
duncantan@dbs.com

Chris Leung
Chief Economist
China, Hong Kong SAR
chrisleung@dbs.com

Samuel Tse
Economist
China, Hong Kong SAR
samueltse@dbs.com

Philip Wee
Senior FX Strategist
Global
philipwee@dbs.com

Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).