

Samuel Tse
Economist

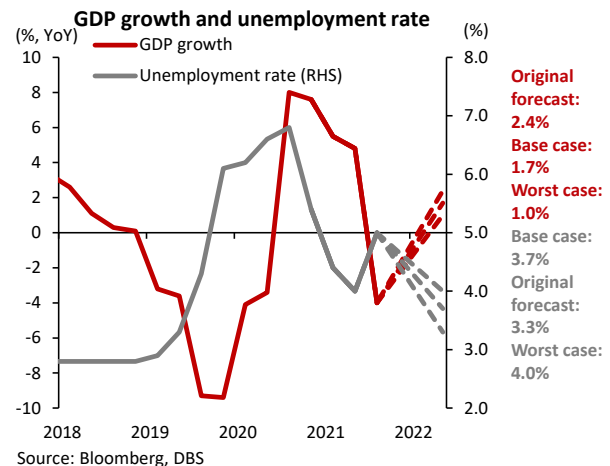


Please direct distribution queries to Violet Lee +65 68785281
violetleevh@db.com

- 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

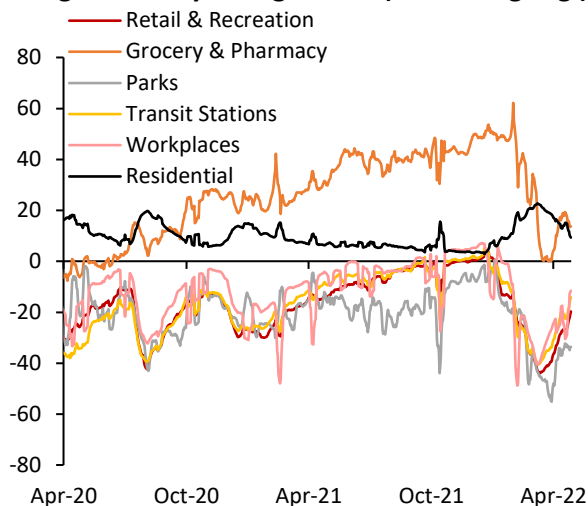
Real GDP fell by 4.0% YoY in 1Q because of stringent social distancing measures. On a seasonally adjusted QoQ basis, it declined by 2.9%, the biggest drop since COVID outbreak in 2020. As a result, our GDP forecast is downgraded from 2.4% to 1.7% despite a near-term recovery in sight.



Private consumption, which accounts for over 60% of the GDP, plunged by 5.4% YoY in 1Q22, from 5.3% in 4Q21. 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.)



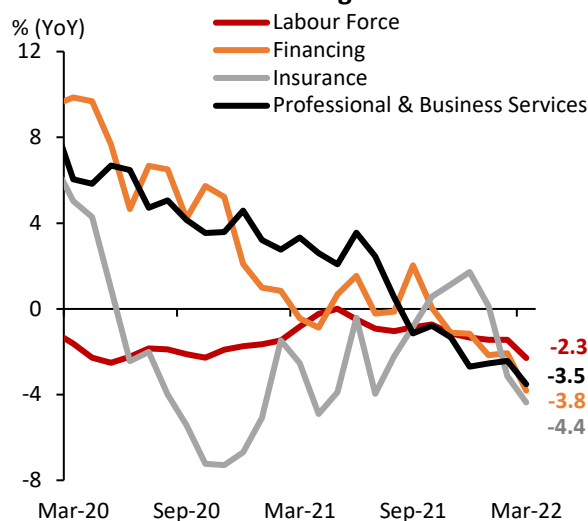
Source: CEIC, DBS

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 force growth

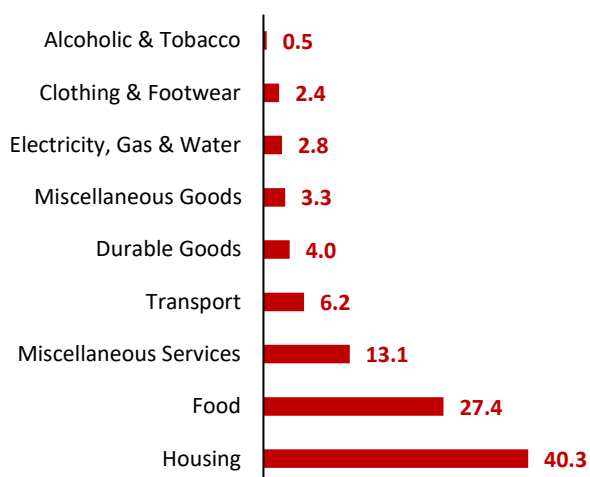


Source: CEIC, DBS

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.

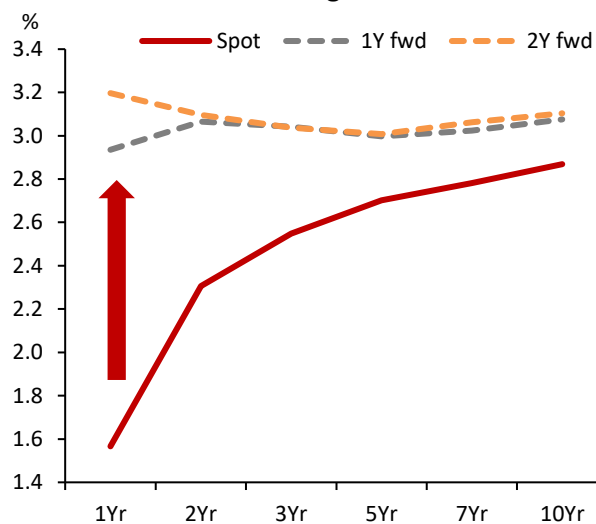
Domestic investment will remain moderate amid the rate hike cycle

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 govovies, funding needs from fiscal stimulus will elevate bond yields. The spread between Hong Kong and US 10Y govovies 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.

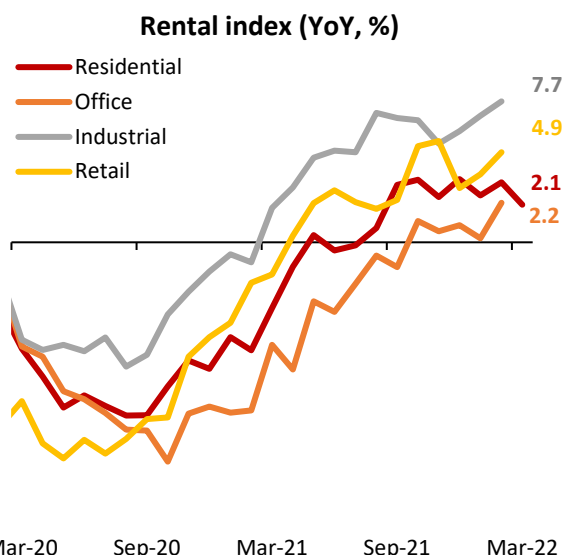
Property prices and rents to rebound

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.

As for other asset classes within the property sector, retail shop rental is expected to outperform 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%.



Mar-20 Sep-20 Mar-21 Sep-21 Mar-22

Source: CEIC, DBS

Group Research

Economics & Macro Strategy

Taimur Baig, Ph.D.

Chief Economist

Global

taimurbaig@db.com

Chang Wei Liang

FX & Credit Strategist

Global

weiliangchang@db.com

Ma Tieying, CFA

Senior Economist

Japan, South Korea, Taiwan

matieying@db.com

Nathan Chow

Senior Economist

China, Hong Kong SAR

nathanchow@db.com

Radhika Rao

Senior Economist

Eurozone, India, Indonesia

radhikarao@db.com

Chua Han Teng, CFA

Economist

Malaysia, Philippines, Thailand, Vietnam

hantengchua@db.com

Irvin Seah

Senior Economist

Singapore

irvinseah@db.com

Violet Lee

Associate

Publications

violetleeyh@db.com

Daisy Sharma

Analyst

Data Analytics

daisy@db.com

Eugene Leow

Senior Rates Strategist

G3 & Asia

eugeneleow@db.com

Duncan Tan

Rates Strategist

Asia

duncantan@db.com

Chris Leung

Chief Economist

China, Hong Kong SAR

chrisleung@db.com

Samuel Tse

Economist

China, Hong Kong SAR

samueltse@db.com

Philip Wee

Senior FX Strategist

Global

philipwee@db.com

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

GENERAL DISCLOSURE/ DISCLAIMER (For Macroeconomics, Currencies, Interest Rates)

The information herein is published by DBS Bank Ltd and/or DBS Bank (Hong Kong) Limited (each and/or collectively, the "Company"). It is based on information obtained from sources believed to be reliable, but the Company does not make any representation or warranty, express or implied, as to its accuracy, completeness, timeliness or correctness for any particular purpose. Opinions expressed are subject to change without notice. This research is prepared for general circulation. Any recommendation contained herein does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. The information herein is published for the information of addressees only and is not to be taken in substitution for the exercise of judgement by addressees, who should obtain separate legal or financial advice. The Company, or any of its related companies or any individuals connected with the group accepts no liability for any direct, special, indirect, consequential, incidental damages or any other loss or damages of any kind arising from any use of the information herein (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof, even if the Company or any other person has been advised of the possibility thereof. The information herein is not to be construed as an offer or a solicitation of an offer to buy or sell any securities, futures, options or other financial instruments or to provide any investment advice or services. The Company and its associates, their directors, officers and/or employees may have positions or other interests in, and may effect transactions in securities mentioned herein and may also perform or seek to perform broking, investment banking and other banking or financial services for these companies. The information herein is not directed to, or intended for distribution to or use by, any person or entity that is a citizen or resident of or located in any locality, state, country, or other jurisdiction (including but not limited to citizens or residents of the United States of America) where such distribution, publication, availability or use would be contrary to law or regulation. The information is not an offer to sell or the solicitation of an offer to buy any security in any jurisdiction (including but not limited to the United States of America) where such an offer or solicitation would be contrary to law or regulation.

This report is distributed in Singapore by DBS Bank Ltd (Company Regn. No. 196800306E) which is Exempt Financial Advisers as defined in the Financial Advisers Act and regulated by the Monetary Authority of Singapore. DBS Bank Ltd may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, DBS Bank Ltd accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact DBS Bank Ltd at groupres@db.com for matters arising from, or in connection with the report.

DBS Bank Ltd., 12 Marina Boulevard, Marina Bay Financial Centre Tower 3, Singapore 018982. Tel: 65-878-9999. Company Registration No. 196800306E.

DBS Bank Ltd., Hong Kong Branch, a company incorporated in Singapore with limited liability. 18th Floor, The Center, 99 Queen's Road Central, Central, Hong Kong SAR.
DBS Bank (Hong Kong) Limited, a company incorporated in Hong Kong with limited liability. 11th Floor, The Center, 99 Queen's Road Central, Central, Hong Kong SAR.