

# Economic situation in second quarter of 2019 and latest GDP and price forecasts for 2019

The Government released today (August 16) the Half-yearly Economic Report 2019, together with the revised figures on Gross Domestic Product (GDP) for the second quarter of 2019.

The Government Economist, Mr Andrew Au, described the economic situation in the second quarter of 2019 and provided the latest GDP and price forecasts for 2019.

## Main points

- \* The Hong Kong economy continued to face significant downward pressure, expanding only modestly by 0.5% in the second quarter of 2019 over a year earlier, slightly slower than the 0.6% growth in the preceding quarter. The economic conditions in the first half of the year were the weakest since the recession in 2009. External demand contracted in the second quarter amid softening global economic growth, intensifying US-Mainland trade and technology tensions and the resultant slowdown in manufacturing and trading activities in Asia. Domestic demand stayed sluggish as subdued economic conditions and various headwinds weighed on local economic sentiment. On a seasonally adjusted quarter-to-quarter comparison, real GDP decreased by 0.4% in the second quarter after an expansion of 1.3% in the preceding quarter.
- \* Total exports of goods weakened further to show an enlarged year-on-year decline of 5.6% in real terms in the second quarter, with a particularly sharp fall in June. Merchandise exports to most major markets recorded declines of varying degrees. Exports of services declined slightly by 0.2% after expanding modestly in the preceding quarter.
- \* Domestic demand remained sluggish. Private consumption expenditure only grew modestly by 1.1% year-on-year in real terms in the second quarter as consumer sentiment stayed cautious in the face of various headwinds and the weakened economic outlook. Overall investment expenditure fell markedly by 11.6%, reflecting continued contraction in building and construction activities and worsening business sentiment.
- \* The labour market was largely stable despite weaker economic conditions. The seasonally adjusted unemployment rate and the underemployment rate held steady at low levels of 2.8% and 1.0% respectively in the second quarter. Overall wages and earnings of low-income workers saw further real improvement.
- \* The local stock market was volatile during the second quarter, as sentiment was swayed by the twists and turns in US-Mainland trade relations and evolving expectations of US interest rate cuts. The residential property

market remained buoyant in April, but showed signs of softening in May and June. For the quarter as a whole, transactions showed a notable increase. Flat prices rose by 4% during the quarter, notwithstanding some consolidation in June.

\* Looking forward, global economic growth should soften further in the near term. US-Mainland trade tensions have escalated further in August, as the US announced to impose a 10% additional tariff on the remaining US\$300 billion worth of Mainland products (the additional tariffs on about half of these products will take effect on September 1 and those on the rest in mid-December) and designated the Mainland as a currency manipulator. Although the two sides agreed to resume high-level negotiations shortly, it would still be difficult for the two sides to reach a trade deal in the near future given their deep differences across a range of issues. Other prevailing external uncertainties, such as the possibility of a no-deal Brexit and geopolitical tensions in the Middle East, also warrant attention. In the face of the difficult economic environment, many major central banks have lowered interest rates or shifted to a more accommodative monetary stance, but these measures are unlikely to completely offset the impacts of various headwinds. As such, Hong Kong's export performance should remain sluggish or even weaken further in the months to come.

\* Domestically, private consumption and investment sentiments will continue to be affected by subdued economic conditions and mounting headwinds. The recent local social incidents, if continued, will cause significant disruptions to inbound tourism and consumption-related economic activities, further dampen economic sentiment, and even hurt the reputation of Hong Kong as an international financial and business centre. Latest surveys for large enterprises and small-and-medium-sized enterprises all showed that local business sentiment has turned pessimistic in recent months.

\* Taking into account the much worse-than-expected actual outturn of 0.5% year-on-year growth in the first half of 2019, and considering the substantial downside risks, the real GDP growth forecast for the year as a whole is revised downwards from 2-3% in the May round of review to 0-1% in the current round. The Government will continue to closely monitor developments on both the external and local fronts, and their implications for the local economy and employment.

\* Underlying consumer price inflation went up somewhat to 2.9% in the second quarter, mainly driven by surging pork prices caused by disruptions to the supply of fresh pork in May and June. Price pressures on other major consumer price index components were largely moderate. Going ahead, overall price pressures should remain largely contained in the rest of 2019 amid the earlier easing in fresh-letting residential rentals, modest global inflation and sluggish local economic growth. Yet, considering that pork prices will likely stay elevated for some time until the resumption of normal fresh pork supply, the forecast rate of underlying consumer price inflation for 2019 as a whole is revised upwards from 2.5% in the May round of review to 2.7% in the current round. Likewise, the forecast rate of headline consumer price inflation for 2019 as a whole is revised upwards from 2.5% to 2.6%.

## Details

### GDP

According to the revised data on the GDP released today by the Census and Statistics Department, GDP expanded only modestly by 0.5% in real terms in the second quarter of 2019 over a year earlier (revised from the advance estimate of 0.6%), slightly slower than the 0.6% growth in the preceding quarter. For the first half of 2019 as a whole, real GDP expanded by 0.5% over a year earlier. On a seasonally adjusted quarter-to-quarter comparison, real GDP decreased by 0.4% in the second quarter (revised from the advance estimate of -0.3%) after an expansion of 1.3% in the preceding quarter (Chart).

The latest figures on GDP and its major expenditure components up to the second quarter of 2019 are presented in Table 1. Developments in different segments of the economy in the second quarter of 2019 are described below.

### External trade

Total exports of goods weakened further to show an enlarged year-on-year decline of 5.6% in real terms in the second quarter of 2019, after a 3.7% decrease in the preceding quarter. External merchandise trade statistics showed that the decline was particularly noticeable in June. Analysed by major market, exports to the US registered a double-digit fall in the second quarter, and those to the EU weakened markedly to record a modest decline. As the softer global economic environment and US-Mainland trade tensions continued to put strains on manufacturing and trading activities in Asia, exports to many Asian economies, including the Mainland and Japan, recorded declines of varying degrees. On a seasonally adjusted quarter-to-quarter basis, total exports of goods fell by 2.2% in real terms in the second quarter, further to the decline of 2.1% in the first quarter.

Exports of services declined slightly by 0.2% year-on-year in real terms in the second quarter after expanding modestly by 0.8% in the preceding quarter. Exports of travel services only showed moderate growth as strong growth in visitor arrivals was largely offset by weaker per capita visitor spending. Meanwhile, exports of financial services rose moderately as cross-border financial activities continued to expand. Amid an uncertain global economic environment, exports of business and other services continued to decline. Exports of transport services also fell further as a result of subdued regional trade and cargo flows. On a seasonally adjusted quarter-to-quarter basis, exports of services declined by 4.9% in real terms in the second quarter, having increased by 3.2% in the first quarter.

### Domestic sector

Domestic demand stayed sluggish in the second quarter of 2019. Private consumption expenditure grew modestly by 1.1% year-on-year in real terms after a 0.4% increase in the preceding quarter. Consumer sentiment was cautious in the face of weakened economic conditions and various headwinds. Nevertheless, residents' expenditure abroad recorded strong year-on-year

growth, partly supported by the late arrival of the Easter holidays (which started in mid-April this year but in late March last year). On a seasonally adjusted quarter-to-quarter comparison, private consumption expenditure decreased by 0.3% in real terms in the second quarter, after expanding by 0.9% in the first quarter. Meanwhile, government consumption expenditure continued to grow solidly by 4.2% in real terms in the second quarter over a year earlier after a 4.5% growth in the preceding quarter.

Overall investment spending in terms of gross domestic fixed capital formation fell markedly by 11.6% year-on-year in real terms in the second quarter, after a 7.0% decline in the preceding quarter. Within the total, expenditure on acquisitions of machinery, equipment and intellectual property products dropped by 12.4% as uncertainties surrounding both global and local economic prospects resulted in much weaker business sentiment. Expenditure on building and construction continued to contract, by 10.6%. Spending by both the private and public sectors shrank, with the latter reflecting the completion of some major infrastructure projects.

### The labour sector

The labour market was largely stable in the second quarter of 2019 despite weaker economic conditions. The seasonally adjusted unemployment rate and the underemployment rate held steady at low levels of 2.8% and 1.0% respectively. Overall wages and earnings of low-income workers saw further real improvement. However, labour demand in some sectors, such as import/export trade, construction and retail, showed some preliminary signs of softening.

### The asset markets

The local stock market was volatile during the second quarter. The Hang Seng Index (HSI) rose further in April, but fell visibly in May as sentiment was hit by the re-escalation of US-Mainland trade tensions. It recouped some lost ground in June as the market then perceived a reduced risk of further worsening of US-Mainland trade relations and increasingly expected US interest rate cuts. The HSI closed at 28 543 at end-June, 1.8% lower than at end-March. On August 15, the HSI closed at 25 495.

The residential property market remained buoyant in April, but showed signs of softening in May and June. While the tight demand-supply situation and rising expectations for US interest rate cuts provided support to the market, sentiment turned more cautious following the re-escalation of US-Mainland trade tensions in May. The number of residential property transactions, in terms of the total number of sale and purchase agreements for residential property received by the Land Registry, increased by 49% over the preceding quarter to 20 657 in the second quarter, the highest since the third quarter of 2012. Yet, trading returned to a moderate level in June after reaching hectic levels in April and May. Flat prices rose by 4% during the quarter, but the increases in April and May were followed by a decline in June. Flat prices in June 2019 exceeded the 1997 peak by 128%. The index of home purchase affordability (i.e. ratio of mortgage payment to median income of households living in private housing, assuming 30% down payment and tenor

of 20 years) remained elevated at around 73%. Meanwhile, flat rentals rose by 2% during the second quarter. As for non-residential properties, rentals for retail premises and flat factories increased by 1% and 2% respectively, while office rentals were little changed.

## Prices

Underlying consumer price inflation went up somewhat in the second quarter. Underlying consumer price inflation, which nets out the effects of the Government's one-off relief measures, climbed from 2.7% in the first quarter to 2.9% in the second quarter, mainly driven by surging pork prices caused by disruptions to the supply of fresh pork in May and June. Price pressures on other major consumer price index components were largely moderate. Locally, the private housing rental component of consumer price inflation recorded a narrower increase in the second quarter, as the earlier easing in fresh-letting residential rentals continued to feed through. On business costs, while wages and earnings went up further amid a still-tight labour market, continued labour productivity gains have helped contain the increase in unit labour costs. Commercial rental cost pressures also held largely moderate as economic growth stayed soft. External price pressures continued to ease against the backdrop of weaker global economic performance and the appreciation of the Hong Kong dollar along with the US dollar vis-à-vis other major currencies over the past year. Headline consumer price inflation went up by a larger extent from 2.2% in the first quarter to 3.0% in the second quarter. Apart from higher pork prices, the lower ceiling of the Government's rates concession in the new financial year which began in April also contributed to the faster increase.

## Latest GDP and price forecasts for 2019

Looking forward, global economic growth should soften further in the near term. US-Mainland trade tensions have escalated further in August, as the US announced to impose a 10% additional tariff on the remaining US\$300 billion worth of Mainland products (the additional tariffs on about half of these products will take effect on September 1 and those on the rest in mid-December) and designated the Mainland as a currency manipulator. Although the two sides agreed to resume high-level negotiations shortly, it would still be difficult for the two sides to reach a trade deal in the near future given their deep differences across a range of issues. Other prevailing external uncertainties, such as the possibility of a no-deal Brexit and geopolitical tensions in the Middle East, also warrant attention. In the face of the difficult economic environment, many major central banks have lowered interest rates or shifted to a more accommodative monetary stance, but these measures are unlikely to completely offset the impacts of various headwinds. As such, Hong Kong's export performance should remain sluggish or even weaken further in the months to come.

Domestically, private consumption and investment sentiments will continue to be affected by subdued economic conditions and mounting headwinds. The recent local social incidents, if continued, will cause significant disruptions to inbound tourism and consumption-related economic activities, further dampen economic sentiment, and even hurt the reputation

of Hong Kong as an international financial and business centre. Latest surveys for large enterprises and small-and-medium-sized enterprises all showed that local business sentiment has turned pessimistic in recent months.

Taking into account the much worse-than-expected actual outturn of 0.5% year-on-year growth in the first half of 2019, and considering the substantial downside risks, the real GDP growth forecast for the year as a whole is revised downwards from 2-3% in the May round of review to 0-1% in the current round (Table 2). The Government will continue to closely monitor developments on both the external and local fronts, and their implications for the local economy and employment. For reference, the latest forecasts by private sector analysts range from 0-2.7%, averaging around 1.5%.

On the inflation outlook, overall price pressures should remain largely contained in the rest of 2019 amid the earlier easing in fresh-letting residential rentals, modest global inflation and sluggish local economic growth. Yet, considering that pork prices will likely stay elevated for some time until the resumption of normal fresh pork supply, the forecast rate of underlying consumer price inflation for 2019 as a whole is revised upwards from 2.5% in the May round of review to 2.7% in the current round (Table 2). Likewise, the forecast rate of headline consumer price inflation for 2019 as a whole is revised upwards from 2.5% to 2.6%.

(The Half-yearly Economic Report 2019 is now available for online download, free of charge at [www.hkeconomy.gov.hk/en/situation/index.htm](http://www.hkeconomy.gov.hk/en/situation/index.htm). The Report of the Gross Domestic Product, Second Quarter 2019, which contains the GDP figures up to the second quarter of 2019, is also available for online download, free of charge at the homepage of the Census and Statistics Department, [www.censtatd.gov.hk](http://www.censtatd.gov.hk).)