Hong Kong: More than just a technical recession

Hong Kong has, not surprisingly, entered a technical recession. We can blame the US-China trade war and the ongoing demonstrations. With no end to the protests, the economy's future remains uncertain

Anti-government protests continue in Hong Kong

GDP falls again on a quarterly basis

Hong Kong's economy contracted by 3.2% quarter-on-quarter in the third quarter of this year and is now in a technical recession. That's defined by two consecutive quarters of negative growth. It was widely expected due to the damage done by the trade war and anti-government protests. The economy shrank by 2.9% year-on-year in the third quarter after positive growth of 0.5% YoY in 2Q19.

More than a technical recession

As the trade war is expected to linger well into 2020, and there seems to be no end to the violent protests, for the time being, Hong Kong's economy will continue to suffer from negative quarterly growth going into 2020. More companies will close, leading to a deterioration in employment. Without the protests, those affected by the trade stand-off might be expected to find jobs in the retail sector. But retailers are suffering too given the demonstrations, with redundancies and no paid leave commonplace.

The downturn in the jobs market will put extra pressure on retail sales which are already under pressure because of the loss of tourism and a decline in local consumption. We're expecting, therefore, negative quarterly growth for each quarter of 2020. And that's a real recession, not just a technical one.

As bad as the SARS epidemic?

We believe it is more appropriate to compare the current situation with what happened with the SARS epidemic in the early 2000s than with financial crises, as the nature of the damage is more on consumption and tourism than on financial activities. What we're seeing is not worse than SARS, in the sense that people mostly stayed at home during the crisis in an attempt to avoid the deadly virus.

The difference is time-scale. The protests could inflict more damage to Hong Kong's GDP as they're likely to last longer than the acute SARS outbreak.

- Tourists will only return to Hong Kong when they see things have settled. However, we can't see yet how the protests will end. Mainland tourist arrivals decreased by 35%YoY, while overall tourist arrivals have declined by more than a third in September.
- Locals will continue to spend but only in their local areas to avoid not just the protestors but the traffic jams. Retail sales were down 23%YoY in August.

Why more stimulus could be coming

The Hong Kong government has been employing stimulus measures of some HKD21 billion (USD 2.7bn) in two tranches. That's not, however, expected to be a useful boost to GDP; the money has not been targeted at the most affected businesses. We think there's more stimulus to come, but some of the relief measures need to pass through the Legislative Council. And that might not be as easy as it once was so we're not expecting any quick fix.

Fewer concerns over the HKD peg

The most talked-about topic given all this pressure is the HKD peg. Some market participants worry the peg could be under pressure if Hong Kong is no longer a place for tourists and expats. But so far, it seems that mainly only trade services and the retail sector are impacted. Financial services remain intact.

There is speculation that some people will emigrate. But let's face the fact that Hong Kong has a low tax regime. Even if some people do move away, their money is very likely to stay in Hong Kong. In short, we don't expect large capital outflows from Hong Kong.

This is an important reason why we see the HKD-linked exchange rate system as being solid, and USD/HKD will remain in the range of 7.75-7.85.

Revising our forecasts downwards

We've revised our Hong Kong GDP forecasts to reflect the contraction of the economy. The last time Hong Kong suffered full-year negative GDP growth was back in 2009 when it declined by -2.5%. We expect Hong Kong GDP to be in negative quarterly growth for 4Q19 right through to the last quarter of 2020.

GDP growth on a yearly basis is forecasted to be -5%YoY in 4Q19, and full-year growth will be -2.2% in 2019, which is close in scale to 2009's recession. Our GDP growth forecast for 2020 is -5.8%, assuming that the violent protests last the whole year.