Zero-Covid strategy threatens Hong Kong's growth prospects for 2022

Having its border with mainland China reopened is crucial for increasing economic activity in Hong Kong

Hong Kong's zero-Covid strategy has hurt its economy

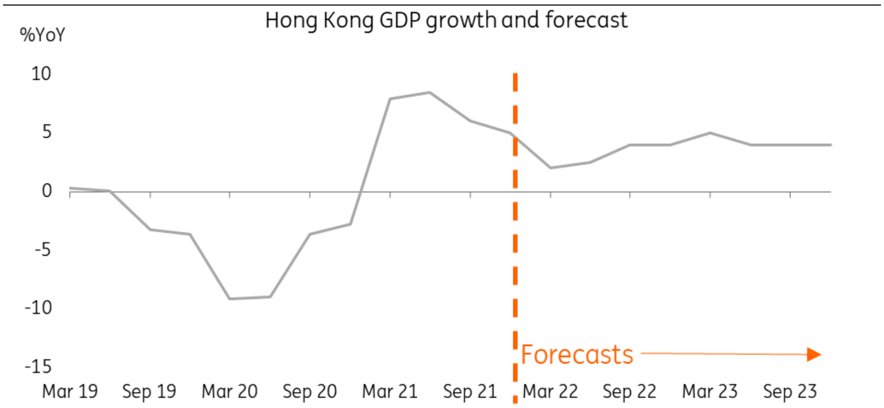
The outlook for Hong Kong is mixed in 2022

There is a chance that the border between Hong Kong and mainland China will reopen with a limited quarantine period if Covid cases subside. This should increase economic activity in Hong Kong. Further border-opening measures depend on the infection rate of Covid in both Hong Kong and mainland China.

Unfortunately, the new year started off with a new Covid wave and a tightening of social distancing measures. Activity in 1Q22 is going to be affected by this. The government still has the scope to hand out subsidies to some of the most affected industries, but handing out a new round of consumption vouchers looks very uncertain.

As the port in Shenzhen's Yantian is affected by Covid from time to time, some logistics throughput has been re-routed via Hong Kong, which helps port throughput in Hong Kong from falling further during global freight delays.

GDP growth is expected to be more moderate at 3.3% for 2022 compared to 6.3% in 2021 (which was mainly a base effect phenomenon). Growth prospects very much depend on Covid. Hong Kong is a service-based economy and does not have manufacturing activity, which is positive in the current supply chain disruption environment. Goods and food are delivered as normal, as many of those come from mainland China.



Source: Hong Kong Census and Statistics Department, ING

Hong Kong's job market facing challenges

The jobs market is again going to face challenges from the tightening of Covid measures from mid-January. Many people will be living on 80% of their usual wages from government subsidies if their industries are affected by social distancing measures. Covid could spread again even if this wave subsides. Consequently, the jobs market will remain fragile, so there is a pessimistic outlook for catering businesses and other retail sales.

The wealthy aren't immune to this uncertainty, either. The stock market index fell 14% in 2021, while home rentals fell nearly 10%, which means lower incomes for people living on rental income. This may continue in 2022 as zero-Covid measures have deterred some expats from staying in Hong Kong, leading to a fall in demand for rental apartments.

Retail sales and unemployment

Source: Hong Kong Census and Statistics Department, ING

Hong Kong as an international financial centre is its biggest strength

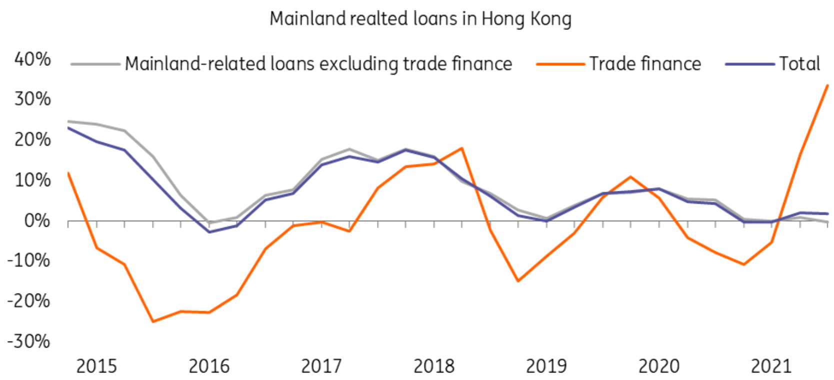
Loan growth is expected to pick up this year. The loan-to-deposit ratio went up to 85.74 in November 2021 from 82.60 in May. Loans overdue by more than three months were 0.5% of total loans at the end of 3Q21, which was quite flat during the year, but up from 0.46% at the end of 2020. We expect past-due loans to be flat for most of 2022 if social distancing measures don't continue for another quarter.

Some banks in Hong Kong have lent to mainland real estate borrowers. They should have made provisions. Overall, mainland-related loans (non-trade finance) contracted by 0.2%Year-on-Year in 3Q21. This fall is due to the real estate developer default events on the mainland. We expect that mainland-related loans will pick up gradually in 2022 when the real estate developer default issues fade.

Domestically, loans for residential mortgages increased between 2020 and 2021, as the property market partially recovered. This demand comes from both self-use and investments.

Trade finance related to mainland China increased 34% in 2021, which was the result of both a strong yuan and the low interest-rate environment in Hong Kong. This should continue at least for 1H22. But as the China-HK interest rate gap will gradually narrow in 2022, growth in trade finance might not keep up this pace.

Mainland related loans in Hong Kong



Source: HKMA, ING

Mainland related non-trade finance loans contributed over 90% of overall Mainland related loans in Hong Kong in 2021

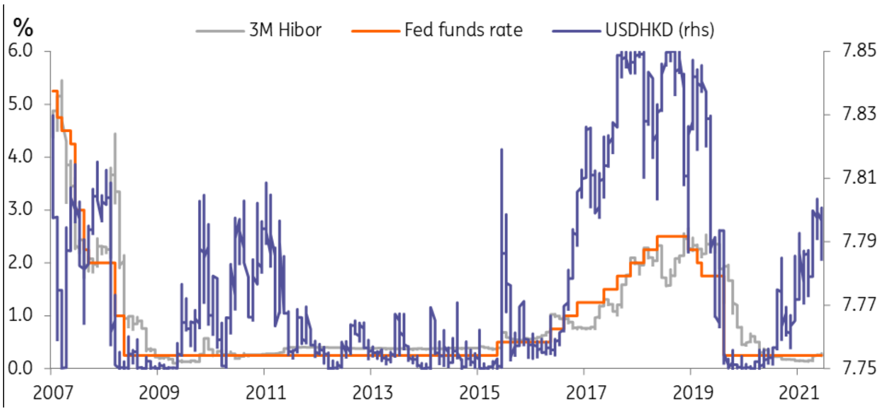
Government subsidies should reduce the number of business liquidations

In terms of the financial markets, mainland China's real estate developer defaults have not fuelled any big market moves in Hong Kong, illustrating that only a few financial institutions are involved in the default events.

In mid-January, the government provided subsidies for some industries affected by the latest Covid wave, which should reduce the number of business liquidations. The government still has ammunition to hand out more subsidies this year if the Covid wave persists, though it is hard to imagine that the government will be able to hand out the same size of subsidies if Covid lingers for years. The approved government subsidies for Covid are HKD250bn, which is around 8.7% of GDP in 2021. The government had used up 80% of this at the time of writing.

Delivery services and online shopping will be the main spending channels. This at least helps the retail industry to some extent.

The linked exchange rate system



Source: CEIC, ING

Fed funds rate affects the HKD and the HKD interest rates

Fiscal and monetary policies and the HKD exchange rate

Fiscal spending is going to increase because of Covid. Another round of HK$250 billion of Covid relief government spending is unlikely, but a smaller amount between HK$50 billion to HK$100 billion is still possible, and is also more manageable for the government.

For monetary policy, HKD interest rates will follow their USD counterpart closely. As the Fed hikes, HKD interest rates will rise and the HKD should approach USDHKD 7.85 as the US dollar strengthens.

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