Hong Kong: Revising GDP down further

Due to more social distancing measures from Covid-19, we are revising downward Hong Kong's GDP for the second half of the year as well as our full-year forecasts

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Economy was still bad in 2Q20

GDP contracted 9.0% year-on-year in 2Q20 after a revised fall of 9.1% YoY in 1Q20. The contraction was mainly due to weak consumption from Covid-19 and social distancing measures, and that triggered a drop in investment due to a worsening economic outlook.

- Due to Covid-19, consumption contracted 14.5% YoY in 2Q20 after -10.6% YoY in 1Q20.
- Investment shrank 20.6% YoY in 2Q20 after a 15.8% contraction in 1Q20.
- Exports of goods shrank 2.1% YoY in 2Q20 less than the contraction of 9.7% to 1Q20.
- But exports and imports of services, which are mostly tourism-related services, fell 46.6% YoY and 43.5% YoY, respectively. Both were worse than the contraction of 37.4% YoY and 24.5% YoY in 1Q20, respectively.
- Government spending increased 9.8% YoY 2Q20 after an 8.8% rise in 1Q20.

Expect another bad quarter in 3Q20

Covid-19 cases have increased in Hong Kong, and there could be many sources that are hard to trace. The government has tightened further social distancing measures again since the outbreak, which the health department claimed could be due to the previous relaxation of social distancing measures.

Focusing first on the most recent social distancing measures, the number of people that can gather together is two, and all restaurants can only serve takeaways, i.e. there is no dining-in allowed and all people have to wear a mask in public areas, both outdoors and indoors.

The direct impact is a big hit to catering businesses, especially the small ones that have little flexibility when it comes to takeaways. Even if restaurants are able to arrange food deliveries, they still have to pay high rents. Construction work could also slow down until October as wearing masks outside in Hong Kong's hot summer temperatures means that workers will likely need to rotate shifts more to allow for periods of rest.

The indirect impact is that, with more cautious sentiment, consumers in general are now more reluctant to go shopping in streets and malls, and more have chosen to stay at home. This will hit most consumer-based services, e.g. hairdressing, and many physical stores though shopping online and using online food delivery services will be more common. Investment by businesses will also be very weak due to the lack of demand locally. As mentioned above, construction activities will be slow and therefore real estate investment will continue to be very weak.

With the number of Covid-19 cases continuing to rise or stay at high levels, it is very difficult to see the restart of outbound tourism activities to and from Hong Kong. Airlines, travel agencies, hotel accommodation will continue to remain in bad shape.

Re-exports and imports will continue to grow with external demand in 3Q20. But the uncertainty lies in the number of Covid-19 cases in the rest of the world.

The economy could be even worse if there is no further help from the government, as the unemployment rate is expected to rise.

Revising forecasts downward

We expect Hong Kong GDP growth to be -10% in 3Q20, -5% in 4Q20 and -8.3% for the full-year, assuming that the tight social distancing measures continue to stay in place. This assumption is based on the lesson learned from the previous relaxation of social distancing measures, which suggests that Covid-19 could spread rapidly.

The unemployment rate is expected to rise to 8% in 3Q20 from the latest 6.2% for April-June 2020 period.

The Hong Kong dollar has continued to be strong due to more capital inflows to the Mainland stock market via stock-connect and also to the Hong Kong stock market. The spot of HKD is 7.7501, on the stronger side of the HKMA's set level of 7.7500.

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