Economic Research Department

BBVA

Hong Kong

GDP Observatory

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Domestic demand propels 4Q09 GDP higher, as the authorities seek to cool the property market

- Hong Kong's Q4 GDP rose at a faster-than-expected pace of 2.6% year-on-year (yoy), well ahead of the market consensus of 1.5% yoy (BBVA: 1.2% yoy), bringing the 2009 full-year outturn to a contraction of 2.7%. On a quarter-on-quarter basis (qoq, seasonally adjusted), GDP grew 2.3% (non-annualized), up from 0.4% in the last quarter (Chart1). The strong outturn is consistent with better-than-expected GDP data elsewhere in the region, including recent Q4 figures for China (10.7% yoy), Taiwan (9.1%), Thailand (5.8%), and Malaysia (4.5%), among others.

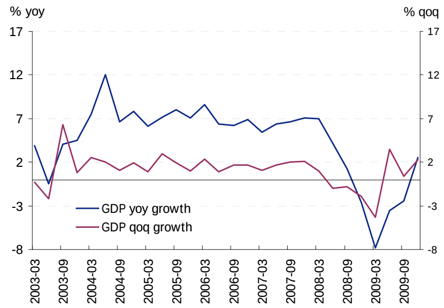
- Domestic demand served as the main driver of Q4 growth in Hong Kong, offsetting a negative contribution from net exports (Chart 2). By component, private consumption grew by 4.9% yoy, contributing 2.8 percentage points to GDP growth, and investment surged by 34.8%yoy, adding 6.1 percentage points. Government spending slowed to 1.7% in Q4 from 2.9% in the last quarter, only contributing 0.1 percentage points.

- Domestic demand has been underpinned by improvements in the labor market (the seasonally adjusted unemployment rate for Nov-Jan fell to 4.9% from 5.3% in Q3) and by positive wealth effects from the rise in the property and stock markets. Retail sales increased rose by 12.8% (yoy) in Q4.

- On the trade front, Hong Kong's external sector also improved in 2009Q4. Demand in mainland China and the rest of Asia has propelled export growth to positive territory (yoy) since November (although mom performance has been positive since mid-2009), and the contraction of exports to advanced economies, such as the US and EU, has slowed (Chart 3). On a month on month basis, total merchandise exports (comprising re-exports and domestic exports) accelerated to 10.2% in December from 8.5% in November thanks to the improvement in global demand, while total imports maintained 8-10% growth during recent months (Chart 4). For 2009 as a whole, total merchandise exports and imports recorded decreases of 10.2% and 9.1% respectively.

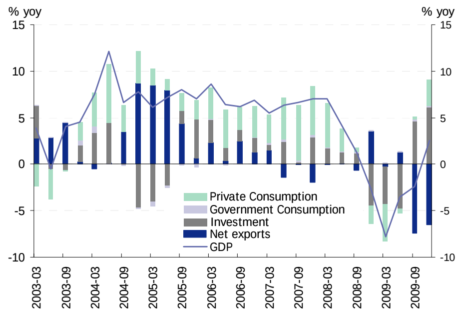
- Inflationary pressures remained subdued. The composite consumption price index (CCPI) in January 2010 rose by only 1.0% yoy, smaller than 1.3% in December 2009. And the underlying CPI, which nets out the effects of all Government's one-off relief measures, barely moved, compared with the 0.3% yoy increase in December 2009 (Chart 5). It should be noted, however, that the decrease in inflation rates were mainly caused by the high comparison base last year, when the Chinese New Year was in January, rather than in February as this year. Going forward, we expect inflation to pick up somewhat as the economic recovery gains momentum (see below).

Chart 1: Real GDP growth



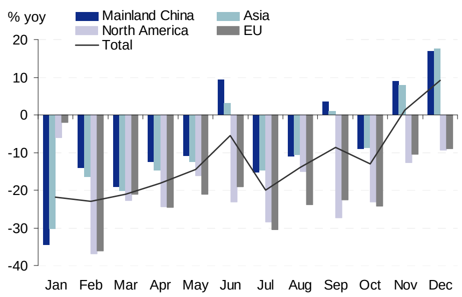
Source: Census and Statistics Department, HKSAR.

Chart 2: GDP growth by contribution



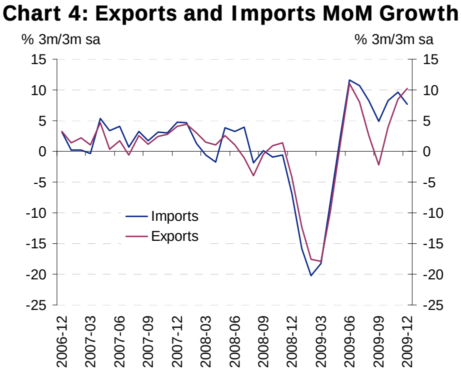
Source: CEIC and BBVA ERD estimated.

Chart 3: Hong Kong exports by destination (current prices)



Source: CEIC.

Chart 4: Exports and Imports MoM Growth



Note: Seasonally adjusted rolling growth of 3 months / previous 3 months. Source: CEIC.

- Looking ahead, we expect the economy to continue expanding at a steady pace in the coming quarters. The quarterly business tendency index,[1] a leading indicator of short-term real activity, points to stronger growth in 2010 Q1 (Chart 6). On the external side, further regional strength, especially from China, as well as an improving global outlook should benefit Hong Kong's trade sector. On the domestic front, improved business sentiment and labor market conditions should support continued recovery in domestic demand.
- We expect the Hong Kong economy to expand by 4.5% yoy in 2010 (Chart 7), in line with the latest official forecast of 4%-5%. Our projection for underlying CPI is 3.3%, somewhat higher than the official forecast of 1.5%.

Budget Highlights

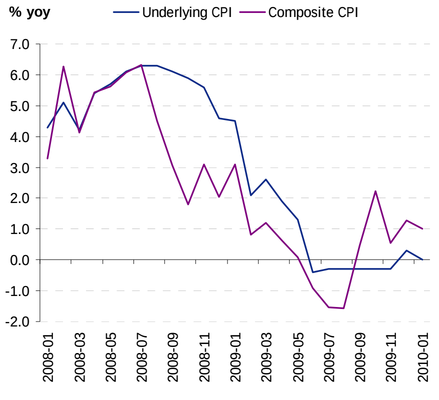
The new 2010-11 budget (fiscal year April-March) was announced yesterday. It features initiatives to assist low income segments of the population and measures to cool the soaring property market, which the authorities fear could lead to a bubble--property prices are now above pre-crisis levels, and have increased by 25% in the past year (Chart 8).

- The budget forecasts a $25.2 billion deficit in the consolidated account for 2010-11 (1.5% of GDP). This compares with an expected surplus of $13.8 billion for 2009-10 (0.8% of GDP), although the original budget had forecast a deficit of $39.9bn.
- Fiscal policy should therefore continue to support recovery. The government plans to increase infrastructure spending, promote priority industries, redevelop old areas, improve public healthcare, education, and social assistance for the needy.
- The budget includes further one-off relieve measures, including tax cuts and rebates amounting to nearly $20 billion. A 75% personal income tax reduction, capped at HK$6,000, compared to 100% and HK$8,000 last year. Waiver of "rates" (a property tax) is to continue, capped at HK$1,500/quarter, same as last year.

Measures to cool the property sector include:

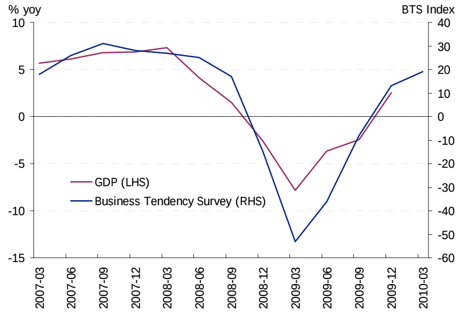
- An increase in the supply of land for development, hike in stamp duty on property (luxury apartment) sales above $20 million, and steps to curb excessive mortgage lending. Specifically, stamp duty on homes selling for more than HK$20 million will rise to 4.25 percent from 3.75 percent, effective from April 1. From last October, the down-payment requirement for luxury properties was increased from 30 to 40 percent.
- The measures are similar to steps taken in mainland China, where the down payment requirement for second home purchases was doubled to 40% in January, following the re-imposition of a sales tax for real estate selling within five years last December. Last week, Singapore imposed a new stamp duty on homes sold within one year of purchase and capped the maximum housing loan at 80 per cent of the property value.

Chart 5: Inflation (CCPI)



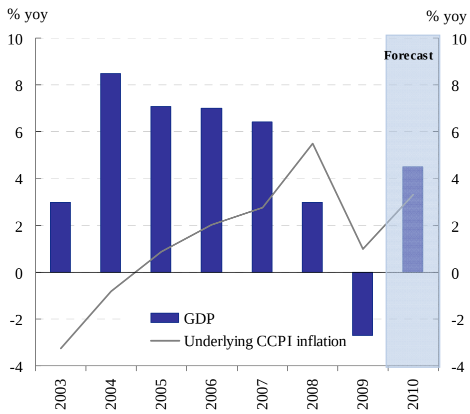
Sources: CEIC.

Chart 6: Business Tendency Survey



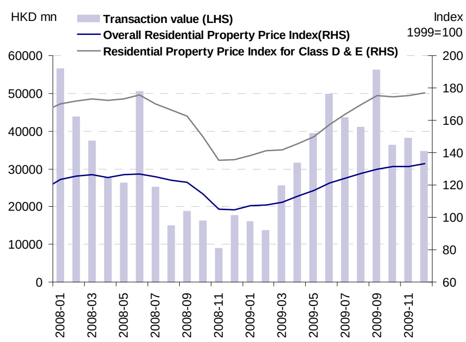
Sources: CEIC.

Chart 7: GDP and Inflation Forecast



Source: BBVA estimates

Chart 8: Property Price and Transaction



Note: Class D - saleable area of 100 m2 to 159.9 m2; Class E - saleable area of 160 m2 or above.
Source: CEIC

[1] The survey by the Hong Kong census and statistics department aims to collect views on business expectations from the senior management of prominent establishments in various sectors with a view to assessing the near-term economic performance of the local economy.