



It will be hard for the economy to keep its growth momentum

Why Hong Kong will run out of growth momentum

Hong Kong's economic figures at the start of the year looked too good to be true, but experts knew better than to believe the rosy numbers.

When the Hong Kong economy beat growth expectations in the first quarter of 2017 (1Q17), it was tempting to think that the territory had found its footing. But analysts were quick to shoot down such hopes of a strong, sustained recovery this year. Hong Kong's expansion is widely expected to be constrained in the coming quarters by still-soaring property prices at home and a slowdown in mainland China — and this is despite the bright outlook on electronics exports led by consumer electronics, wearables, and virtual reality gear.

“Whilst high frequency indicators showed that the recovery in Hong Kong's economy continued in 1Q17, this pickup is unlikely to be sustained for the rest of 2017,” says **Chua Han Teng**, senior analyst, Asia country risk and financial markets, BMI Research. “Hong Kong continues to be significantly vulnerable to the structural economic slowdown in the mainland Chinese economy due to their increasingly tight linkages in areas such as trade and tourism. A pullback in aggressive fiscal spending

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and a slightly tighter monetary policy will act as a drag on the mainland Chinese economy, and consequently, Hong Kong,” he explains.

This gloomy forecast came after Hong Kong posted strong gross domestic product (GDP) growth in 1Q17 driven by mainland China-related retail spending — which improved over months and recorded the first yearly growth since early 2015 — and re-exports.

Alicia Garcia Herrero, chief economist, corporate & investment banking for Asia Pacific at Natixis, says the better-than-expected performance in 1Q17 was a cyclical spike. For robust growth to persist,

the territory must first need to tackle daunting issues, foremost of which is cooling the property market. “All in all, Hong Kong's rebound in external trade and retail sales are mainly cyclical,” she says. “With structural issues lingering, it will be hard for the HK economy to keep its growth momentum beyond a few quarters. Moody's recent sovereign downgrade may even make it more short-lived,” she adds, pointing to Moody's lowering of Hong Kong's rating in late May following a downgrade on China's sovereign rating.

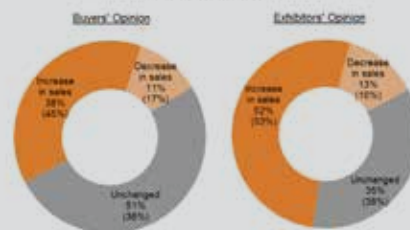
“1Q17 data was set on the back of favourable base, but this statistical benefit will wane in the coming quarters, thus explaining our slower GDP forecasts for the remaining quarters of the year,” says **Adrienne Lui**, analyst at Citi. In explaining the stronger-than-expected 1Q17, she says domestic demand was more robust than high frequency data were suggesting. Both private and government consumption had risen on the back of fiscal spending and a recovery in jobs and wages.

Property market intervention

Still, a more convincing rebound will require a solution to Hong Kong's soaring property prices. Residential prices further accelerated by 17.8% YoY in March, which has prompted the Hong Kong Monetary Authority to push out more tightening measures.

Herrero says taming the property market remains an uphill battle for the government, but such prudential measures, together with reduced outflows from China, should keep the property market in check for the rest of 2017. Meanwhile, Chua says Hong Kong's extremely overvalued property

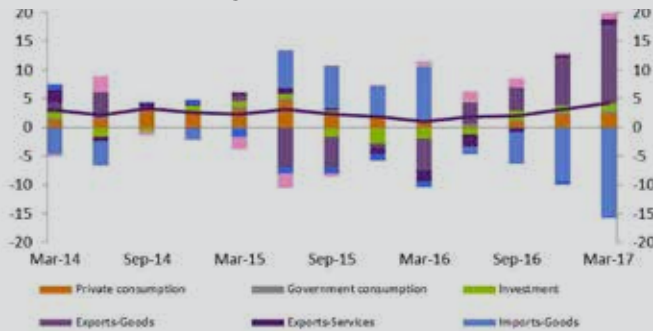
Market outlook for 2017



Note: Figures in brackets correspond to opinions from the Electronics Fair held in October 2016

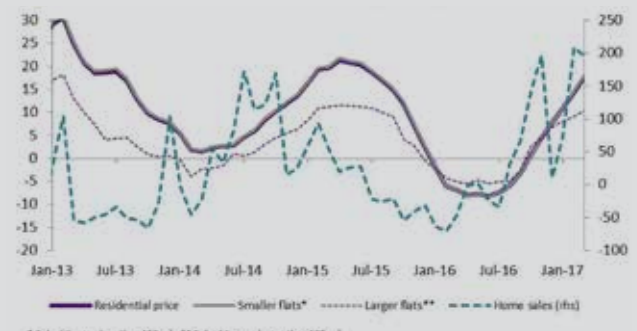
Source: HKTDC Survey

Contribution to GDP growth (% YoY)



Sources: Bloomberg, Natixis

Property Indicators, Residential price index (% YoY)



Sources: Bloomberg, Natixis

sector is likely to face headwinds from rising interest rates and efforts by the government to increase housing supply and curb speculative activity.

Should the new property measures turn out to be effective, the Hong Kong economy should start chugging along faster in the coming years. The electronics sector is also seen as a potential catalyst for an exports-led recovery. In 1Q17, exports continued to rebound as the global economy improved, and electronics industry players are particularly optimistic, projecting a spike in demand for smartwatches and audio-visual wares.

Electronics market elation

“With the electronics market remaining optimistic, audio-visual and digital entertainment items will be the next products worth noting,” says Hong Kong Trade Development Council (HKTDC) Research after it surveyed electronics industry players at the recent Hong Kong Electronics Fair 2017.

“Consumer electronics continue to be the items with the best growth prospects in 2017. Smartwatches remain the products with the greatest potential among wearable electronic items. The market of smart home applications also appears promising for the next two years,” it adds.

The majority or around 89% of the buyers and 87% of the exhibitors surveyed expected sales to rise or remain unchanged in 2017, revealing a very positive demand outlook. More than half or 52% of the respondents expect an increase in sales in 2017.

“The survey findings reveal that market confidence on the global electronics market outlook for the

rest of 2017 remains positive,” says HKTDC Research.

Mobile phone demand

Industry sentiment remains positive towards overseas markets, with the traditional markets of North America and Western Europe, and the emerging markets of the Chinese mainland and countries included in the ASEAN shown to be the most promising. More than half or 54% of respondents rated North America as having the best growth prospect for sales of electronics in 2017 among traditional markets, followed by Western Europe (51%), Japan (41%), Taiwan (40%) and Korea (40%).

Among emerging markets, the Chinese mainland was rated as the most promising market for 2017, with 57% of respondents considering it as “promising” or “very promising,” followed by ASEAN countries (41%), the Middle East (30%), and India (30%). “On the whole, the Chinese mainland, North America, and Western Europe remain the top three overseas markets with the best growth prospects for sales of electronics in 2017,” says HKTDC Research.

A third of the more than 500 respondents were based in Hong Kong. Nearly half of the buyers counted mainland China as their major selling or export market, whilst around half of the exhibitors pointed to Western Europe and North America as their major selling or export markets. Hong Kong will also need to be attuned to the shifting demands in electronics. Demand for mobile phones is showing signs of decline, and industry players are

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looking at electronic accessories and digital entertainment as the new dominant drivers of growth.

Consumer electronics surge

Electronic/electrical accessories remain the products with the best growth prospects in 2017, according to 20% of respondents in the HKTDC Research survey, followed by audio-visual products (12%), digital imaging (9%), home appliances (9%), and electronic gaming (9%).

Virtual/augmented reality ears or headsets have the greatest market potential in the next two years among all audio-visual and digital entertainment items, with nearly half or 46% of respondents agreeing to this assessment.

Other promising items for electronics manufacturers and exporters in the next couple of years include audio-visual items with connectivity to the smart home (20%), ultra-high-definition TVs with “smart TV” features (16%), wearable action cameras (16%), internet TV boxes (15%), and video game consoles (14%). “The growth prospects of mobile devices and related accessories continue to be viewed as less promising compared to previous survey results,” says HKTDC, after only 6% of respondents rated them with the highest sales growth prospects of 2017.

“After rapid growth in recent years, demand for mobile devices has now levelled off. The great majority of respondents suggested that consumers’ appetites are turning to new generation audio-visual and digital entertainment items,” it adds.