Hong Kong

Outlook

	Average 10-14	2015	2016	2017	2018	2019	Forecasts 2020	2021	2022
Growth in GDP (%)	3.8	2.4	2.2	3.8	2.8	-1.2	-7.5	6.0	3.4
CPI inflation (%)	4.1	3.0	2.4	1.5	2.4	2.9	1.0	1.9	2.0
Fiscal balance (% of GDP)	3.1	0.6	4.4	5.5	2.4	-1.5	-11.7	-6.5	0.2
Public debt (% of GDP)	0.5	0.1	0.1	0.1	0.1	0.3	0.3	0.3	0.3
Reference rate (%)	0.5	0.5	0.8	1.4	2.2	2.5	0.9	0.6	0.8
Exchange rate (HKD/USD)	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8	7.8
Current account balance (% of GDP)	3.4	3.3	4.0	4.6	3.7	6.2	4.4	4.7	4.4
External debt (% of GDP)	374.8	390.0	387.7	427.2	440.5	437.8	478.7	484.1	484.5

Source: CaixaBank Research, based on data from national statistics agencies and the IMF.

- **Hong Kong is successfully coping with two major risks: COVID-19 and the institutional change brought by the new National Security Law.** Thus, the country is applying the lessons of previous pandemics to contain the current epidemic in a more timely manner than in the past. Regarding the new legal framework ushered in by the aforementioned law, despite the fact that its implications for the institutional quality of the country are unknown, thus far it has provided greater stability for the economy and it has been welcomed by investors (the peg with the dollar is stable).

- **COVID-19 economic shock.** Hong Kong is one of the economies that is handling the pandemic best, despite its trade openness and high population density, the fourth highest in the world with over 6,700 inhabitants/km². Nevertheless, the effects of the pandemic have been felt in consumption, foreign demand and, in particular, the fall in tourism. However, these negative impacts have decreased in the second half of 2020, which is likely to end with a 7.5% drop in GDP, which is expected to grow in 2021 (+6.0%), supported by the strong recovery of the Chinese economy.

- **Financial vulnerabilities.** Hong Kong has no significant financial vulnerabilities. There is practically no public debt (0.3% of GDP in 2020) and the long-term fiscal balance is in surplus, for reasons such as maintaining the peg with the dollar (the 2019-2021 three-year period should be an exception to this, warranted by the stimulus used to mitigate the effects of the pandemic). Additionally, Hong Kong also has a current account surplus (4.4% of GDP in 2020) which is among the highest of all advanced economies. Furthermore, its position as a financial hub (it is home to the world's fifth largest stock market) has been strengthened in the current crisis and, in the future, it will benefit from Chinese companies returning to the Hong Kong stock market from the markets in the US and the continued influx of Chinese banks in Hong Kong. Moreover, the higher return on assets in Hong Kong, compared to the low interest rates on bonds of the main advanced economies, is resulting in significant financial inflows.

Closing date of this edition: 6 November 2020

Outlook (continuation)

Economic policy response

- **Fiscal policy.** Hong Kong's exceptional fiscal position is allowing it to implement strong stimulus measures in 2020 and, to a lesser extent, will do so in 2021. In particular, companies are benefiting from temporary tax relief, although the tax breaks given to companies in 2020 to keep their employees will not be repeated in 2021.
- **Monetary policy.** Hong Kong's monetary authority will continue to prioritise maintaining the exchange rate peg with the dollar. This task will be made easier by the capital inflows which, as remarked above, are expected to be significant in the near future. Consequently, we expect the peg with the dollar, which is vital for the economic success of Hong Kong, to be maintained in the coming years without too much difficulty and it is likely to remain at the higher end of the range (7.75-7.85 HKD/USD).
- **Medium-term outlook.** Hong Kong is at the centre of the Greater Bay Area planned by China to stimulate growth in the region, which also includes Guangdong and Macau. It will capitalise on the region's expertise in finance, manufacturing and technology, with 70 million inhabitants and a potential GDP of 2.8 trillion dollars in 2025. Additionally, the continued influx of Chinese banks and the return of talent due to the restrictions faced by many skilled Chinese workers in the US will be other growth factors.

Main risks

Despite the reasonable short and medium-term outlook, the balance of risks is clearly skewed to the downside. In particular, these risks take several different forms:

- **Dependence on the Chinese economy**, which continues to suffer from structural imbalances (excessive public investment and insufficient private consumption, in particular), may be a source of volatility in the medium-term. This dependence is not limited to the macroeconomic sphere since, given the importance of Chinese financial flows, any financial crises in mainland China would have a significant, negative impact on Hong Kong.
- **Undesired effects of tensions between China and the US** The HKAA (Hong Kong Autonomy Act) that was approved in July 2020 by the US Congress could make it more difficult for companies from China and Hong Kong to receive dollar funding. We cannot rule out the US imposing further punitive measures on Hong Kong as a way of applying pressure on China.
- **Uncertain political and institutional future**. Although the National Security Law will have a positive impact on economic and social stability in the short-term, there continue to be underlying demands for greater civil liberties and further progression towards democracy among some citizens. Although reasonably constructive ways of handling this may be found, less positive alternative scenarios cannot be ruled out. We can also not rule out this Law ushering in a period of further institutional changes. This dynamic may cause uncertainty, which is not favourable for an economy that is largely based on having one of the world's highest quality institutional frameworks for doing business.

	Rating	Last modification	Outlook	Last modification
Standard & Poor's	AA+	22/09/17	Stable	22/09/17
Moody's	Aa3	20/01/20	Stable	20/01/20
FitchRatings	AA-	20/04/20	Stable	20/04/20

■ Indicates that the country has "investment grade".
□ Indicates that the country does not have "investment grade".