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Hong Kong

Political & policy issues to watch

CE Carrie Lam starts her five-year term

... can she ease HK into China?

Two decades after regaining Hong Kong, China is keen to reset its relationship with the special administrative region (SAR), and that may well include 'modifying' from the "one country, two systems" formula that was to guide HK for at least 50 years from 1997. President Xi may signal that shift during his HK visit to celebrate the 20th anniversary of the handover, and to officiate at the swearing-in of Chief Executive (CE) Carrie Lam. Xi will also visit two potent and very expensive symbols of HK's growing integration with China, the HK-Zhuhai-Macau bridge and HK-Guangzhou rail link. Carrie Lam's challenge will be converting tighter infrastructure ties into tighter political ties, even though many HKers prefer a smaller Beijing presence.

... and will she push unpopular China integration policies?

While Carrie Lam campaigned on introducing fresh faces to replace the unpopular administration of retiring HK leader CY Leung, the Lam cabinet looks a lot like the last one; it largely combines incumbents and ex-civil servants. Potential new nominees were reluctant to serve or failed to get Beijing's approval. That likely reflects the difficulty that her administration will have in meeting Beijing's requirements and retaining broad local support. Policies that will test her new administration include an imminent decision on locating immigration facilities for the fast rail link, Beijing's apparent desire for another attempt at passing a national security law and reviving national education at HK schools.

Commercial integration is moving fast

Carrie Lam may not have to do much to speed HK's integration with China as that's a process well underway in the market; mainland firms are rapidly building strong positions in HK's property and financial sectors. They are partly filling a gap left by Western firms, some of which find HK expensive and less central to their China/Asia strategies. But HK also is emerging as a base for fast-growing teams that are driving China's outbound firms.

Outlook for the market

A strong Q1

... so, we've lifted our forecast

With an unexpectedly strong jump in HK's growth rate to 4.3%yoy in Q1'17, we've raised our forecast to 3.2% growth this year and 3.1% in 2018, up from 2.9% and 2.8%. Export volumes surged 8%yoy in Q1, and strong growth looks set to continue with a 6% increase for the year, before easing to 3% growth in 2018. An 18%yoy surge in capex for public sector construction pushed total fixed investment growth up 9.6%yoy in Q1.

Consumers recover

... but tourist spending is weak

Consumer demand also improved in Q1'17, rising 3.7%yoy after 1.8% growth in full 2016. So, we've nudged up our forecast, with full year growth now put at close to 3% in both 2017 and 2018, close to the 4.8% average for the decade to 2015. But tourism remains weak, and retail sales growth slumped to 0.3%yoy (in current prices) in April. This has been a story of fewer mainland tourists (down 1.4% for the year to April) spending less (per capita spending by mainland overnight visitors fell 8.2% in 2016).

A dangerously expensive property market

HK's average home price in May jumped by 24%yoy, making the city the most expensive for property in the world – and vulnerable to an array of events that could trigger a tumble. Some price correction is inevitable over 2017-18; at present, we assume mild deflation. Meanwhile, the administration aims to lift private home completions to 20,000+ units a year through to 2018, from 11,000pa over the last decade. This, along with public housing and infrastructure works, should accelerate fixed investment growth to 5-6% in 2017 and 2018, from 2.4%pa in the decade to 2016.

A weak HK\$ for now

Since the start of 2017, the HK\$ has been pushed from 7.75 to 7.80 against the US\$, which is the mid-point of its fixed trading band. If it moves out to 7.83, the HKMA will intervene to tighten liquidity to support the HK\$, which will put pressure on local banks to raise their mortgage rates – something they've been loath to do so far.

	2014	2015	2016	2017	2018
GDP, real growth, %	2.8	2.4	1.9	3.2	3.1
Composite CPI (04/05), year average, %	4.5	3.0	2.4	1.5	2.2
Discount window base rate, % year end	0.50	0.75	1.00	1.50	2.00
HK\$ to US\$1, year average	7.75	7.75	7.76	7.83	7.83

Sources: 2013-2015 from Censtat, HKMA, and CEIC; 2016-2017 estimates by IMA Asia.

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