

The story for investors

This report is not about the impact of Covid on GDP growth but it is about its impact on sectors of the economies of China and Hong Kong. But to be accurate, the research is mostly about the impact of anti-Covid policies rather than of the virus per se. The analysis investigates some relatively unexplored areas of interconnections of economic sectors such as **the importance of exports to China's growth and the issue of HK's re-exports**. Similar considerations relate to **Hong Kong's service sector**, parts of which are dependent on **tourism**, especially that from China, a sector which has all but disappeared. **Hong Kong's export sector** contains an important re-exports sector also dependent on China's trade. These links also point to some investment opportunities based more on structural issues, rather than on pure recovery opportunities.

The service sectors in China and Hong Kong

Two numbers show the striking importance of the service sectors. In 2020 that sector accounted for 93.5% of Hong Kong's GDP while for China, in 2021, the figure was at 53.3%. The policies of social distancing and elimination of infection, in their most severe form, require closure of places of work, of socializing, education etc, the severity increasing with zero covid policies. In the case of **Hong Kong** we can delineate the impact of these policies on specific subsectors of services such as Wholesale and Retail (2.5% of GDP in 2020), Accommodation and Food (1.5%) and Finance and Insurance (23.3%). Aggregating the first two sectors approximates the area of Tourism (about 4.5%) measured for Hong Kong in terms of visitor arrivals. Here Covid and the attendant policies were catastrophic. In 2019 there were 55.9 ml visitors to HK of which 78.0% were from China, quantifying the significance of China to HK's Tourism. The arrival numbers fell to 3.5 ml in 2020 (77.0% from China) and then literally disappeared in 2021 with just 91,300 visitors. The impact of all this was quite clear on retail sales as Tourism in 2019 accounted for 28.7 % of all retail sales. Total retail sales fell by nearly a quarter in 2020 and most likely even more for the whole of 2021. All this also impacted confidence. (See Fig.1) 1. The case in **China** has certain similarities, but the much lesser importance of foreign tourism in the Chinese economy sheltered retail sales, which simply reflected, among others, the lockdowns in different regions. Confidence suffered as well as shown in Fig. 1.

Investment conclusions

The service sector in HK is important but its nature made it vulnerable to Covid. The exports sector is also important but both sectors are closely interlinked with China. The difference for HK is that China's economic structure is far more dependent on domestic rather than external sectors, thus introducing a dichotomy with the case of Hong Kong and its "external via China" relationships. The investment opportunities in China going forward will be dependent, mostly, on domestic sectors. For Hong Kong, the opportunities will be in sectors connected with the lifting of mobility restrictions with China, while re-exports growth might be limited by the global trade recovery rather than by China's own domestic growth.

First conclusions

Before the pandemic tourism accounted for about 4.5% of HK's GDP. However as more than a quarter of retail sales depended on Tourism, the combined impact of the near disappearance of tourists plus its importance on retail sales contributed to the shrinkage of GDP in 2020. Hence there were two "separate" impacts on consumer spending, that of the foreign component and that of the purely domestic.

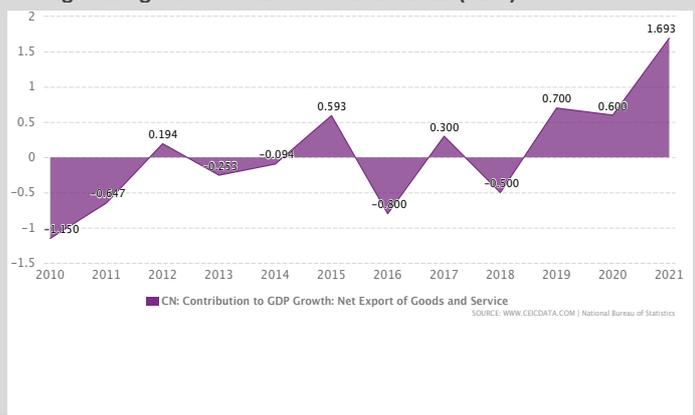
Fig 1: Retail sales China (red) HK (gr) PMI China (blue) HK (mauve) 2015-2022



## The role of the export sectors in China and Hong Kong

There are important misconceptions as to the role of exports in **China's** economic growth. This report is not the place to examine them other than to point out that exports add to GDP while imports subtract and, hence, it is the growth of their difference that yields a net positive or negative results on GDP growth. Net export growth has played a minor role in determining China's GDP as the chart in the Factbox shows. Over the period from 2010 to 2021, which registered an average annual growth rate of 7.2%, net exports contributed 45 bps to that growth, about 6.25% of the average 7.2% growth rate. The rest was contributed by consumption and investment. Exports do make, of course, a significant contribution to investment, or rather investment takes place to promote exports, but the impact of **net** exports growth to GDP growth is much smaller than popularly believed.

### Factbox: China: Net exports contributed, on average, 45 bps to the average GDP growth of 7.2% over 2010-2021 (CEIC)



The Chinese economy grew very little in 2020 at 2.3% but rebounded strongly in 2021 at 8.1%. From the point of view of HK, the fluctuations in China's exports would impact HK's growth in a more roundabout way. **Hong Kong** has got little to nothing to export with its trade being primarily imports, some of which are exported that is exports of imports, and re-exports. China plays an important role here with the so-called **outward processing trade**, both for imports and exports. This involves the exports of raw materials or semi-manufactures from or through Hong Kong to China for processing, with a contractual arrangement for subsequent re-importation to, and re-exportation from HK.

Fig 2: China Exports (red) Hong Kong re-exports (blue) 2015-2022



Source: Bloomberg

## Drawing the threads together.

Re-export trade took 22.0% of HK's total exports in 2019, 21.5% in 2020 and then fell to an estimated 11.0% in 2021. HK's GDP growth had a rocky period with a shrinkage of -1.7% in 2019, a steep drop of -6.1% and a rebound of +6.4% in 2021. HK's export trade depends to a large extent on that of China, and by proxy via China, on the growth of global trade. Consider the following points. **First** HK's retail trade and related services sectors were hit by the restrictions in travel, and in particular those with China which provided most of the tourist arrivals and, hence, of a significant part of retail sales. The economic performance of China might have been of lesser significance for HK's GDP growth than that of the simple barrier to tourist flows from the Mainland. **Second**, HK's **one fifth of export trade, re-exports**, depends not so much on the domestic demand in China, but on the global demand for Chinese exports, some of which pass in HK in the form of exports from, and imports to China via the outward processing trade. It follows that the impact of Covid, in terms of the policies which affected economic activities, was partially to share the blame for the poor performance of HK's GDP. At least the re-export trade was partially dependent on global, rather than China-specific factors and of China's own Covid restrictions. It will follow that the service sector in HK connected to retail sales, may benefit less by the recovery of China and more by the removal of mobility restrictions. While the re-export sector's recovery could be capped by limitations in the recovery of global trade, rather than by the recovery of China's own growth.

## Disclaimer

This material is prepared and issued by UCAP Hong Kong Asset Management Limited for information purposes only. This material may not be distributed to the United States, Canada, Australia or to any other jurisdiction in which its distribution is unlawful.

This material is confidential and is for information to professional investors only. Professional investor is defined in the Securities and Futures Ordinance and any rules made thereunder. If an investor is in any doubt about any of the contents of this material, the investor should obtain independent professional advice. This material does not constitute an offer, recommendation, or solicitation to buy or sell any investment or service or enter into any other transaction in any jurisdiction.

The views and opinions expressed in this material, which are subject to change without notice, are those of UCAP Hong Kong Asset Management Limited at the time of publication. Some of the information contained herein including any expression of opinion or forecast has been obtained from or is based on sources believed by us to be reliable as at the date of the publication but which it has not independently verified. There is no guarantee that any investment strategies and processes discussed herein will be effective under all market conditions and investors should evaluate their ability to invest for a long-term based on their individual risk profile especially during periods of downturn in the market. UCAP Hong Kong Asset Management Limited makes no guarantees, representations, or warranties, and accepts no responsibility or liability as to its accuracy or completeness. Expressions of opinion herein are subject to change without notice.

In addition, projections in this material reflect various assumptions of management concerning the anticipated future of the business ideas and are subject to significant business and economic uncertainties and contingencies, many of which are beyond control of the management. Accordingly, there will be no assurance that such projections will be realized. The actual results or investment return may vary from the anticipated results and such variations may be material and potential investor should bear any potential risks in respect thereof. Full description of risks associated with the product should be assessed independently including tax impact.

Members of the UCAP Hong Kong Asset Management Limited and/or their officers, directors and employees may have positions in any investment mentioned in this material (or any related investment) and may from time to time add to or dispose of any such investment.

In the case where this material is distributed in the United Kingdom by a person who is not authorized by the United Kingdom Financial Services Authority; it is only intended for persons who (i) have professional experience in matters related to investments or (ii) are persons falling within Article 49(2)(a) to (d) ("high net worth companies, unincorporated associations, etc") of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended) or to whom it may otherwise lawfully be communicated by such an unauthorized person (all such persons together being "relevant persons"). This communication must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this material relates is available only to relevant persons and will be engaged in only with relevant persons.

Investment involves risk. Past performance is not indicative of future performance. The value of any investment or income may go down as well as up and you may not receive back the full amount invested. When an investment is denominated in a currency other than your local or reporting currency, changes in exchange rates may have an adverse effect on the value, price or income of that investment. In the case of investments for which there is no recognized market, it may be difficult for investors to sell their investments or to obtain reliable information about their value or the extent of the risk to which they are exposed. Investment in any market may be extremely volatile and subject to sudden fluctuations of varying magnitude due to a wide range of direct and indirect, influences. Such characteristics can lead to considerable losses being incurred by those exposed to such markets. Potential investor should ensure they fully understand the risks associated with any investment and should consider their own investment objectives and risk tolerance level. They should make an independent assessment of the merits of pursuing any investment and should consult their professional advisors before making any investment decision.

The content of the material has not been reviewed by the Hong Kong Securities and Futures Commission ("SFC").

© Copyright. UCAP Hong Kong Asset Management Limited 2021 ALL RIGHTS RESERVED

No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, whether electronic, mechanical, photocopying, recording or otherwise, without the prior written permission of UCAP Hong Kong Asset Management Limited.