

3. Domestic economy

Although real gross domestic product remained notably below pre-pandemic levels, the economy saw some sequential improvement in the second half of 2020, with domestic demand picking up and exports of goods expanding further. In the hope of COVID-19 vaccination normalising economic activities, the economy is expected to resume growth for 2021 as a whole following the steepest ever contraction in 2020. That said, the strength and pace of recovery is subject to a host of uncertainties, especially those surrounding the pandemic situation and vaccine rollout and efficacy. In particular, as widespread vaccination takes time, the local economy still faces considerable challenges in the early part of 2021. As such, the labour market will continue to be under stress in the near term while local inflationary pressures are expected to stay muted.

3.1 Real activities

Hong Kong's economy saw some improvement in the second half of 2020 (Table 3.A), although economic activities remained well below pre-pandemic levels. Year on year, contraction in real gross domestic product (GDP) narrowed to 3.6% in the third quarter and further to 3.0% in the fourth quarter. That said, for 2020 as a whole, real GDP declined by a record rate of 6.1%, marking an unprecedented consecutive annual decline following the 1.2% contraction in 2019. The latest sectoral GDP data also indicated that almost all major economic sectors recorded a year-on-year decline in activities in recent quarters, with consumption and tourism-related sectors seeing much steeper contractions than the overall economy.

Table 3.A
Real GDP growth

		Year-on-year growth rate (%)	Seasonally adjusted quarter-on-quarter growth rate (%)
2019	Q1	0.7	0.8
	Q2	0.4	-0.3
	Q3	-2.8	-3.0
	Q4	-3.0	-0.4
2020	Q1	-9.1	-5.6
	Q2	-9.0	-0.1
	Q3	-3.6	2.7
	Q4	-3.0	0.2

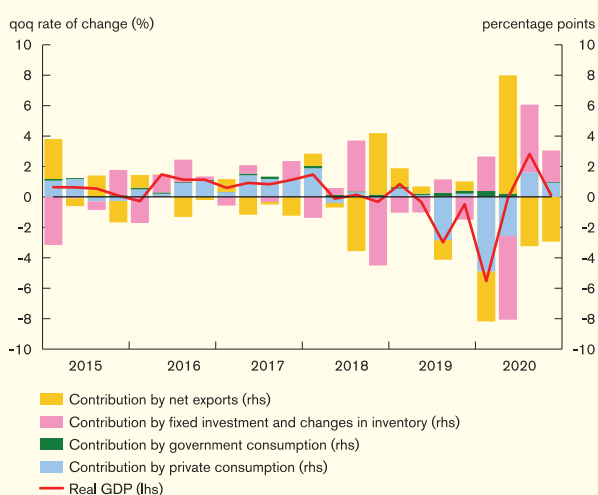
Source: C&SD.

On a quarter-on-quarter basis, real GDP has also picked up since the third quarter of 2020, arresting successive declines in the preceding five quarters (Table 3.A and Chart 3.1). Domestically, private consumption resumed positive growth in the third and fourth quarters but consumer sentiment remained weak amid recurring social distancing measures during the third and fourth waves of local infections¹⁴. Overall investment spending also grew in the second half of the year during a short-lived boost in business

¹⁴ The Consumer Confidence Index compiled by the City University of Hong Kong edged down to 57.4 in the third quarter, marking the third lowest point on record, and remained low at 64.1 in the fourth quarter.

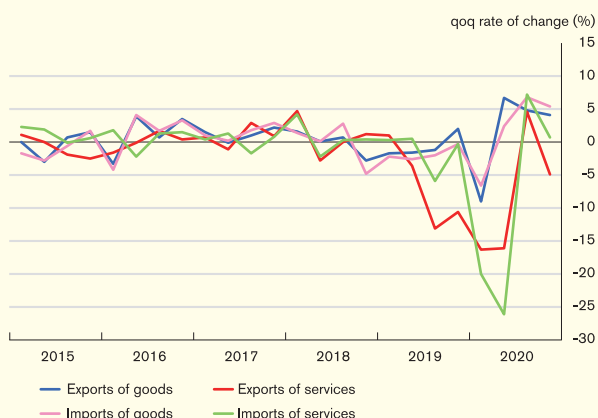
sentiment¹⁵. Partly driven by strengthened performance in exports, particularly to Mainland China, Hong Kong's merchandise trade expanded further (Chart 3.2). With global tourism still languishing, the service trade remained generally weak. Overall, net trade contributed negatively to GDP in the second half of the year, partly because merchandise exports picked up more slowly than imports.

Chart 3.1
Real GDP growth and contribution by major expenditure component



Note: Growth rates are seasonally adjusted.
Sources: C&SD and HKMA staff estimates.

Chart 3.2
Exports and imports in real terms



Note: Growth rates are seasonally adjusted.
Source: C&SD.

¹⁵ The Purchasing Managers' Index had remained in the contractionary zone (below 50) since April 2018, but it rose to 50.1 in November 2020 as the third wave of local infections stabilised, before dipping back to 43.5 in December 2020 due to the fourth wave of infections.

In response to the lingering pandemic, the Government launched two additional rounds of the Anti-Epidemic Fund (i.e. AEF 3.0 and 4.0) between September and December 2020, totaling HK\$30.4 billion, to assist industries and people affected by the epidemic and help enhance Hong Kong's anti-epidemic capabilities¹⁶. More recently, the Government also announced additional countercyclical fiscal measures in the 2021/22 Budget to revive the economy, including a one-off provision of electronic consumption vouchers worth HK\$5,000 and a Special 100% Loan Guarantee for unemployed individuals¹⁷. Together with the Banking Sector SME Lending Coordination Mechanism, the HKMA announced in March 2021 the extension of the Pre-approved Principal Payment Holiday Scheme (PPPHS) to October 2021, and repayment deferment for trade facilities under the PPPHS. These extensions are expected to help ease cash-flow difficulties faced by some corporate customers.

Hong Kong's economy is expected to see positive growth for 2021 as a whole in the hope of COVID-19 vaccination normalising economic activities, but the strength and pace of recovery is subject to a host of uncertainties, especially those surrounding the pandemic situation and vaccine rollout and efficacy. In particular, as vaccines take time to be widely adopted, the local economy still faces considerable challenges in the early part of 2021. Externally, the Mainland economy is anticipated to strengthen further and render support to Hong Kong's exports of goods and services, but the pace of recovery in other major economies will hinge on the success of their mass vaccination campaigns, which would in turn affect Hong Kong's goods

¹⁶ Measures include the procurement of vaccines and one-off subsidies to businesses and individuals in sectors most hard-hit by business closure rules related to COVID-19, such as cinemas, beauty parlours as well as sports and recreational sites.

¹⁷ Other one-off relief measures include the reduction of salaries tax and profits tax by 100% (subject to a ceiling), a subsidy of HK\$1,000 for each residential electricity account, rates concession for domestic and non-domestic properties, as well as the creation of temporary jobs under the Job Creation Scheme.

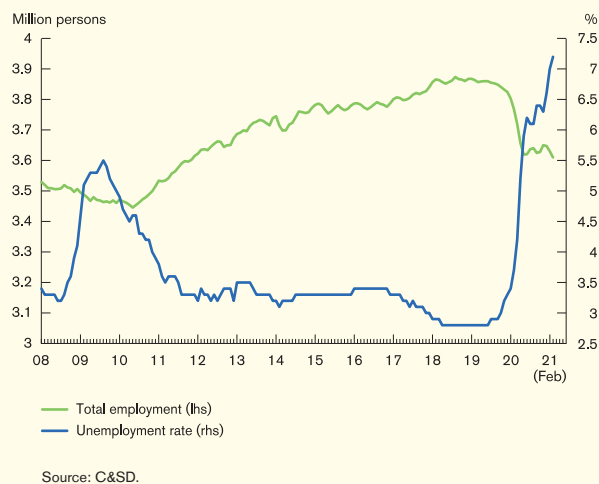
trade and inbound tourism. The Government forecasts real GDP growth for the whole of 2021 in the range of 3.5–5.5%. Growth estimates by international organisations and private-sector analysts average 4.4%.

3.2 Labour market conditions

The labour market deteriorated further in the second half of 2020 and in early 2021. The seasonally adjusted unemployment rate climbed to a 17-year high of 7.2% in February 2021 (Chart 3.3)¹⁸. The underemployment rate also rose to a post-SARS high of 4.0%. While total employment stabilised somewhat at a low level after a period of decline (Chart 3.3), official data showed that the number of vacancies continued to plunge. Labour earnings, as measured by the nominal index of payroll per person engaged, saw decelerated growth of 2.0% in the third quarter of 2020, the slowest in nearly 11 years. In response to the deteriorating labour market conditions, the Government launched the Employment Support Scheme (ESS) under the second round of the AEF to provide time-limited (i.e. June–November 2020) wage subsidies for employers to retain employees¹⁹. After the ESS ended, other targeted measures, such as one-off subsidies, were provided under AEF 3.0 and 4.0 to further support hard-hit sectors. In the near term, the labour market is expected to remain under pressure given the lacklustre economic conditions. Box 2 sheds light on the potential

impacts of Hong Kong's inbound tourism boom and bust on the local labour market.

Chart 3.3
Labour market conditions



3.3 Inflation

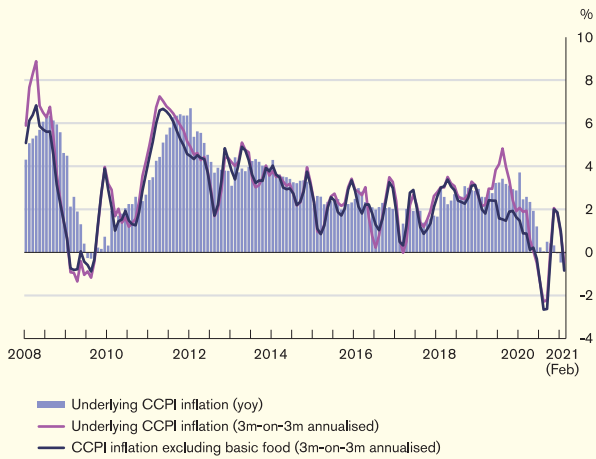
Local inflationary pressures continued to subside in the eight months leading up to February 2021. Year on year, the underlying consumer price inflation rate decelerated notably to 0.3% and 0.2% in the third and fourth quarters of 2020 respectively, and even declined to -0.5% in January and -0.1% in February 2021 (Chart 3.4)²⁰. Inflation momentum, as measured by the annualised three-month-on-three-month underlying inflation rate, also stayed mild in recent months, albeit with some fluctuations. Specifically, price pressures on basic foodstuff receded, and the cost of non-home-cooked meals went down visibly as more restaurants provided discounts for takeaways when dine-in capacities were restrained. Prices of other tradable items, such as durable goods, stayed tame. For services, the rental component of the Composite Consumer Price Index (CCPI) remained soft along with consolidating private housing rentals (Chart 3.5). Labour cost pressures also eased in recent quarters (Chart 3.6).

¹⁸ In particular, the unemployment rates of retail, accommodation, and food and beverage services soared to 9.3%, 10.1% and 15.2% respectively in September 2020, the highest since the SARS episode in 2003. Partly reflecting Cathay Pacific Airways' substantial layoffs, the unemployment rate of the transport sector also surged to 6.2% in October 2020 and further to 6.9% in January and February 2021, the highest in 17 years.

¹⁹ The wage subsidies provided to eligible employers under the ESS covered 50% of the actual wage paid to each regular employee in a specified month, with a wage cap of HK\$18,000 per month (i.e. the maximum subsidy per employee is HK\$9,000 per month). The wage subsidies are disbursed in two tranches for paying the wages of employees from June to November 2020. Employers participating in the ESS are required to undertake that they will not implement redundancies during the subsidy period and will spend all the wages subsidies on paying wages to their employees.

²⁰ Inclusive of the effects of the Government's relevant one-off relief measures, the year-on-year headline inflation rate also turned negative between July and December 2020.

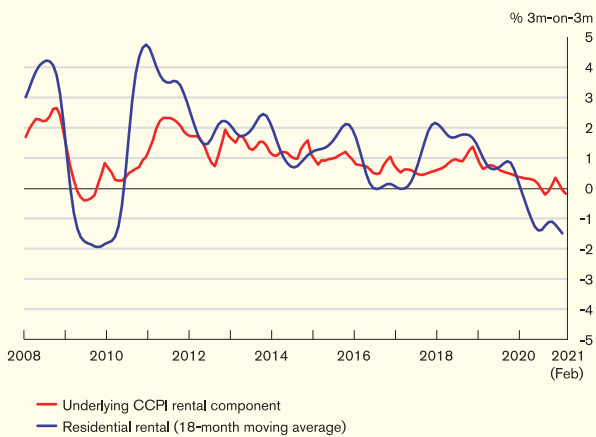
Chart 3.4
Different measures of consumer price inflation



Sources: C&SD and HKMA staff estimates.

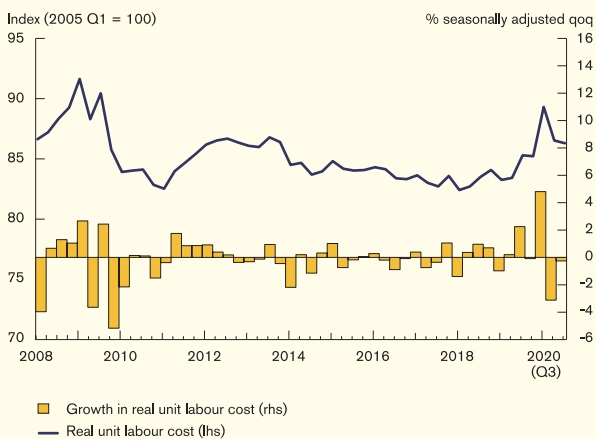
Local inflationary pressures are likely to remain subdued in the near term as global and local economic conditions are still challenging. In particular, the feed-through of an earlier decline in fresh-letting residential rentals will continue to restrain local inflation. Market consensus forecasts that the headline inflation rate for 2021 will be at a moderate level of 1.4%, and the Government projects the underlying inflation rate to be 1% and the headline inflation rate to be 1.6% in 2021.

Chart 3.5
CCPI rental component and market rental



Sources: C&SD and R&VD.

Chart 3.6
Unit labour cost



Sources: C&SD and HKMA staff estimates.

Box 2 Labour market impacts of Hong Kong's inbound tourism boom and bust

Introduction

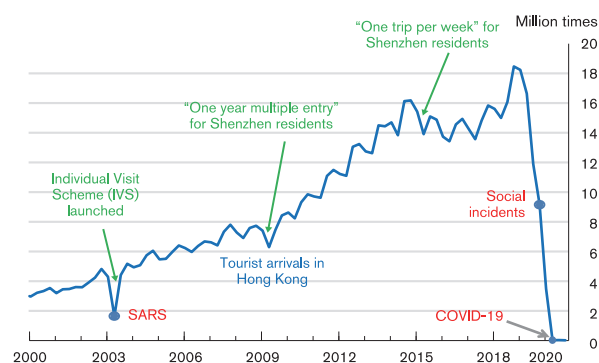
Amid the COVID-19 pandemic, Hong Kong's inbound tourism has quickly turned into a bust and there are concerns over the scarring effect of this crisis on subsequent labour market recovery. With this in mind, Box 2 provides empirical evidence on the impact of an inbound tourism boom on the Hong Kong labour market to shed light on the potential implications of the current tourism bust.

Inbound tourism over the years

Since 2000, inbound tourism has undergone drastic boom and bust cycles (Chart B2.1). Specifically, tourist arrivals moderated during the 2003 SARS epidemic, before experiencing a boom in the following years after the introduction of the Individual Visit Scheme (IVS) in July 2003. Under the initial IVS, Mainland residents could apply for an exit endorsement to visit Hong Kong in their individual capacity for up to seven days each time, and for one or two visits per year²¹. A major extension of the IVS took effect in April 2009, allowing eligible permanent residents from Shenzhen to visit Hong Kong multiple times on a single one-year multi-entry IVS Endorsement document known as the M-permit²². Since then, the number of Mainland tourists has increased substantially. Boosted by new cross-boundary infrastructures with Mainland China, inbound tourist arrivals reached an all-time high in late 2018 and early 2019²³. Later, the local social incidents halved the number of visitor arrivals in the second part

of 2019, followed by the pandemic, which has virtually brought inbound tourism to a standstill since the end of January 2020.

Chart B2.1
Tourist arrivals and relevant policies



Note: Tourist arrivals are quarterly figures.
Sources: C&SD and Hong Kong Tourism Board.

Labour market impact of inbound tourism boom

In this section, we explore the impact of inbound tourism on employment and income using the IVS-induced tourism boom as a case study. We consider the IVS launch in 2003 as an as-good-as-random economic shock since it was plausibly exogenous in its timing, and impossible to anticipate by the local population. The main data source is individual-level data from Hong Kong Population Censuses and By-censuses. Specifically, we use 5% samples from the 1996, 2001, 2006, 2011 and 2016 censuses or by-census. We also define the tourism-related sectors to include the food, retail, hotel and transport industries²⁴.

²¹ Previously, Mainland residents could only travel to Hong Kong through business visas or organised group tours.

²² Note also that in April 2015, the M-permit was replaced by the "one trip per week" Individual Visit Endorsement as Hong Kong encountered problems with its receiving capacity and parallel trading activities.

²³ The Guangzhou-Shenzhen-Hong Kong Express Rail Link commenced operation on 23 September 2018 and the Hong Kong-Zhuhai-Macao Bridge opened on 24 October 2018.

²⁴ Since a separate tourism sector is not available in the census data classification, we use the entire food, retail, hotel and transport industries as a proxy. That said, the use of the tourism-related sectors is reasonable as these sectors have been greatly buoyed by the inbound tourism boom over the past two decades.

(i) Impact on employment

We begin the analysis with a difference-in-differences (DID) framework²⁵ by comparing the employment outcomes of young workers (aged 20–40) in the treatment group with older workers (aged 41–65) in the comparison group, before and after the launch of the IVS. We assign younger cohorts to the “treatment” group because they are still in the early part of their careers and have more flexibility to make significant changes to their jobs in response to the exogenous rise in inbound tourism²⁶. As the labour market effects of the IVS-induced tourism boom can vary over time, we supplement our DID approach with an event study design, which allows us to identify time-varying treatment effects.

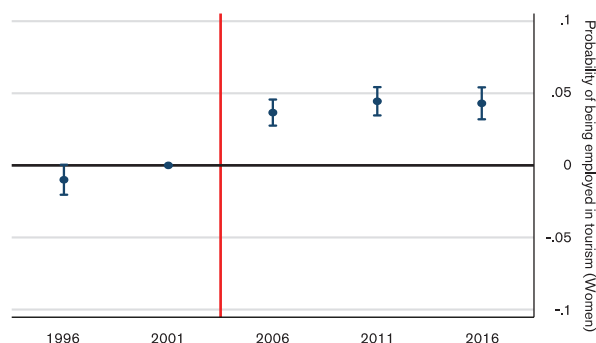
Our empirical findings suggest that relative to older cohorts, young workers, especially female and those with secondary school education, are more likely to be employed in the tourism-related sectors after the IVS launch. In particular, the effect on young females is especially prominent and persistent, staying close to five percentage points (in terms of the average difference in employment probability relative to older cohorts) from 2006 onwards (Chart B2.2).

(ii) Impact on income from main employment

We also use a similar methodology to compare the income of people employed in the tourism-related sectors (treatment) with those employed in non-tourism-related sectors (comparison). Our estimation results reveal that people employed in the tourism-related sectors experience higher income growth compared with those employed in non-tourism-related sectors

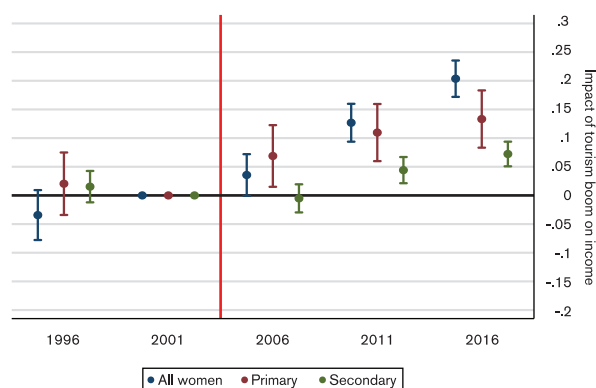
after the IVS launch. Moreover, female and less-educated workers in the tourism-related sectors saw larger and increasing growth in labour income (3–20 percentage points) compared with their peers in other sectors (Chart B2.3).

Chart B2.2
Employment impact of the IVS on women



Note: The chart shows the event study estimations of the impact of the IVS on the probability of employment in the tourism-related sectors. 95% confidence intervals are plotted. The red vertical line indicates the IVS launch event in 2003. Sources: C&SD and HKMA staff estimates.

Chart B2.3
Income impact of the IVS on female and less-educated workers



Note: The chart shows the event study estimations of the impact of the IVS on income. Blue dots are coefficients from a model using a sample of all female workers; red denotes all workers with primary education, while green denotes those with secondary school education. Sources: C&SD & HKMA staff estimates.

²⁵ Specifically, the dependent variable is a dummy variable which equals one if an individual is employed in a tourism-related sector, and zero otherwise. The main independent variable is an interaction term that indicates whether an individual belongs to the 20–40 age group and whether it is before or after the IVS launch. We also control for gender, occupation, years of education, potential experience, time trend and other factors.

²⁶ The strategy of treatment assignment based on cohort as a proxy for exposure to the policy of interest follows a large body of work in the empirical literature.

(iii) Implications

These findings are generally in line with the international experience that tourism is an important source of employment, particularly for young people, female and less-educated workers. In the case of Hong Kong, our results also echo earlier analysis²⁷ that labour market resilience increased in the lower-skilled segment as vibrant growth in inbound tourism led to strengthened demand for lower-skilled labour. As the inbound tourism boom turns into a bust, these labour groups may become more vulnerable and therefore merit close monitoring.

Concluding remarks

The IVS generated an unprecedented boom in inbound tourism in Hong Kong. As a result, younger workers, especially female and those with secondary school education, were drawn to tourism-related sectors. Moreover, female and less-educated workers in these sectors saw larger and rising growth (3–20 percentage points) in labour income compared with their peers in other sectors. These labour groups may become more vulnerable under the current tourism bust and therefore merit close monitoring. On the other hand, the pandemic is likely to have a scarring effect on global tourism and business travel, affecting unemployment for some years to come. For example, structural factors such as behavioural changes (e.g. higher risk aversion, adoption of e-commerce) and technological progress (e.g. the use of virtual conference to facilitate business operations) may have reduced demand for tourism and travel compared with the pre-pandemic period.

²⁷ See “Box 2: The tight labour market puzzle: will it remain resilient?”, *HKMA Half-yearly Monetary and Financial Stability Report*, September 2012.