Box 1.1

A brief review of economic downturns in Hong Kong

The Hong Kong economy recorded the deepest ever year-on-year contraction of 8.9% in the first quarter of 2020 due to the COVID-19 outbreak in most parts of the world. Over the past two decades or so, Hong Kong experienced three other episodes of economic contraction. This note compares the current economic downturn with those three episodes.

Nature of shocks

As a small and open economy, economic cycles in Hong Kong are closely linked to the ups and downs of the global economy. Hence, it is no surprise that economic recession in Hong Kong is often triggered by external shocks. The 1997-98 Asian Financial Crisis (AFC) and the 2008-09 Global Financial Crisis (GFC) started as a financial crisis originated elsewhere. In both cases, deep worries about systemic risks in the financial systems elsewhere sparked regional or global credit crunch, leading to a collapse in global financial markets and a severe demand shock. The initial impact on the Hong Kong economy was huge downward pressure through trade and financial channels, which eventually also spilled over to domestic demand.

Regarding the economic contraction during 2003, the primary trigger was the outbreak of Severe Acute Respiratory Syndrome (SARS), which deterred tourists and disrupted local economic activities that require people-to-people contact. It is however worth noting that the downturn in 2003 was preceded by a prolonged period of economic slack amid successive external shocks, including notably the dotcom bubble burst in late 2000 and the 911 incident in 2001[(1)].

For the current episode, economic contraction began in the third quarter of 2019, as the local social incidents with violence dealt a severe blow to an economy already dampened by a synchronised global economic slowdown amid US-Mainland trade tensions. The COVID-19 outbreak then saw the economic recession deepen at an unprecedented pace in the first quarter of 2020.

The impact of COVID-19 on the Hong Kong economy has been across-the-board. In the early stage of the outbreak, the spread of the disease and the stringent anti-epidemic measures imposed in the Mainland and Hong Kong seriously disrupted regional supply chains and related trading activities as well as a wide range of economic activities in Hong Kong. As the disease spread swiftly to most parts of the world in March, many governments implemented travel bans, imposed city and regional lockdowns and closed non-essential businesses to curb the spread of the disease. This led to a sharp contraction of economic activity worldwide and prompted sharp corrections of global financial markets, thereby reducing external demand for Hong Kong's goods and services and dampening economic sentiment.

Depth and length of economic contraction

The external shocks were very severe in both the episodes of the 1997-98 AFC and the 2008-09 GFC. The former was the worst regional financial crisis in Asia, and its epicentre was close to us. The latter was a full-fledged global financial crisis stemming from the subprime mortgage problems in the US, the largest economy in the world. The year-on-year contraction of Hong Kong's real GDP ran as deep as 8.3% in the third quarter of 1998 and 7.8% in the first quarter of 2009 respectively at the peak of these two crises ***(Chart 1)***. As the two shocks were economic in nature, the damage gradually faded after decisive measures were implemented to fix the financial systems and aggressive monetary and fiscal responses were implemented to bolster demand. In both episodes, the Hong Kong economy came out of the doldrums after four to five consecutive quarters of contraction.

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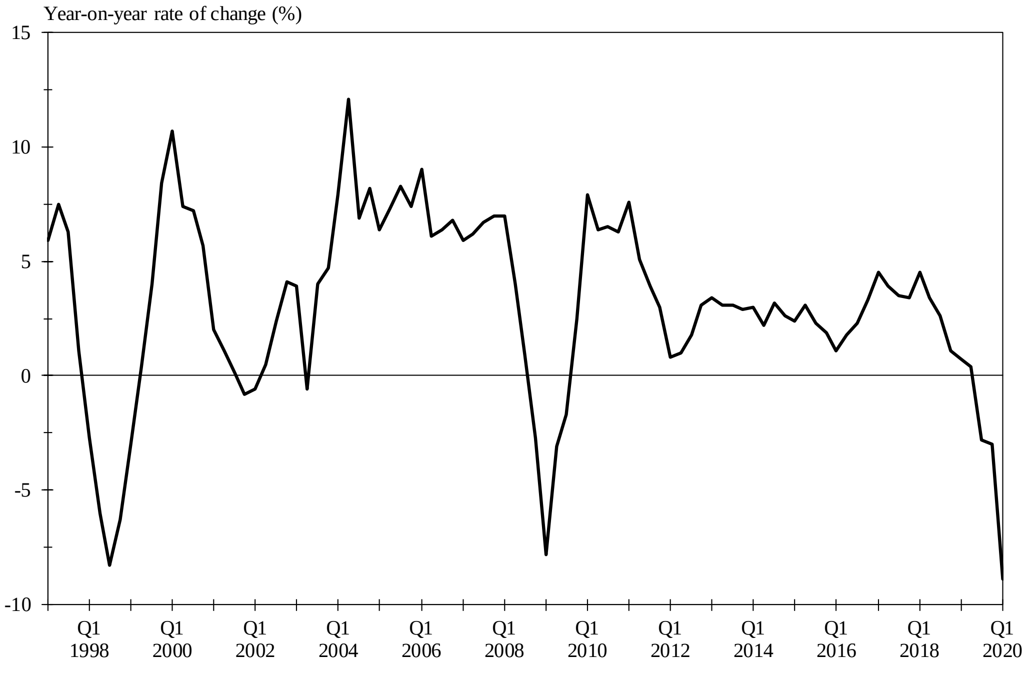
(1) Before the SARS outbreak in 2003, the Hong Kong economy had shown mild year-on-year contraction for two consecutive quarters from the fourth quarter of 2001.

Box 1.1 (Cont'd)

Similar to the SARS episode of 2003, the current shock originated from a disease. Yet, SARS was a regional epidemic, which mainly affected some regions of China, whereas its impact worldwide was limited. Moreover, the epidemic vanished gradually as the summer for the region approached. The adverse impacts on regional or global economic growth momentum and regional supply chains were limited. Indeed, Mainland's and global economic growth picked up somewhat to 10.0% and 4.3% respectively in 2003. As a result, the Hong Kong economy shrank for only one quarter, by 0.6% year-on-year in the second quarter of 2003. With the support of vibrant external demand and the launch of the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA), the economy staged a robust recovery in the second half of the year.

The negative shock engendered by the COVID-19 outbreak is enormous. The levels of disruptions and the range of economic activities affected in Hong Kong all surpassed the worst situation experienced during 2003 SARS outbreak. Both exports to the Mainland and re-exports of Mainland origin dived in the first two months of 2020 as the Mainland's consumption and production activities were seriously hampered. As the disease spread to most parts of the world in March, it also led to a sharp contraction of the global economy and weighed on Hong Kong's external demand. Given the unprecedented nature of the pandemic, the duration of the current economic downturn is subject to high uncertainties, hinging critically on evolving global public health and economic situations.

Chart 1: Real GDP growth in Hong Kong



Industries that were hard hit

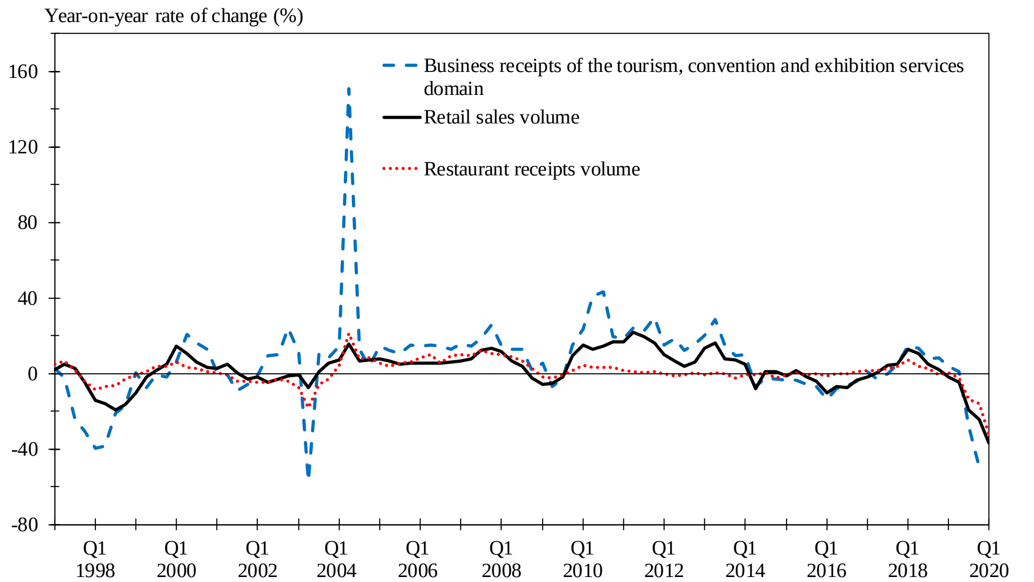
Both the 1997-98 AFC and the 2008-09 GFC took a heavy toll on the financial sector. Business receipts of banking and financing plummeted during both episodes. In view of the severity of these two shocks, their negative spill-overs to domestic demand were rather visible. Hence, many other industries also came under notable pressure.

The dent to the Hong Kong economy during the 2003 SARS outbreak was mainly concentrated in the tourism- and consumption-related sectors. Both inbound and outbound tourism suffered drastic declines. Business receipts of the retail, accommodation and food services all registered visible falls.

Box 1.1 (Cont'd)

For the current episode of economic contraction, at the beginning tourism- and consumption-related sectors were the main victims of the local social incidents with violence. Business receipts of the tourism, convention and exhibition services domain tumbled by an average of 39.7% in the second half of 2019 from a year earlier ***(Chart 2)***. With the onslaught of COVID-19, the impact was felt across most sectors, though the tourism- and consumption-related sectors were particularly hard hit. Inbound tourism came to a standstill in February and March, with the year-on-year fall in visitor arrivals enlarging visibly to 80.9% for the first quarter as a whole. Outbound tourism likewise fell drastically amid travel bans and border controls implemented by governments around the world. Meanwhile, the year-on-year decreases in retail sales volume and restaurant receipts volume widened from 21.9% and 14.9% respectively in the second half of 2019 to 36.9% and 32.3% in the first quarter of 2020, both the steepest for a single quarter on record. Against the background of seriously disrupted regional supply chains and related trading activities, goods exports and imports fell by 9.9% and 11.0% respectively in real terms in the first quarter of 2020 from a year earlier. Other sectors, including education and construction, also felt pains of varying extent in the face of the unprecedented threat of the COVID-19 pandemic.

Chart 2: Tourism- and consumption-related economic indicators in Hong Kong



Note: Retail sales and restaurant receipts statistics compiled before the fourth quarter of 2005 and business receipts of the tourism, convention and exhibition services domain statistics compiled before the first quarter of 2006 followed the Hong Kong Standard Industrial Classification (HSIC) Version 1.1, while the statistics compiled afterwards followed the HSIC Version 2.0.

Conclusion

In sum, the shock arising from the COVID-19 pandemic is unique in its combination of nature, severity, scope, length and also degree of uncertainty when compared with the past shocks. The Government has swiftly rolled out relief measures of unprecedented scale to preserve the vitality of the economy and relieve people's financial burdens. These measures should be able to help both companies and individuals endure the current hardship, and facilitate the economy to recover once the pandemic is well contained.