

For Discussion on
6 December 2019

**JOINT MEETING OF
PANEL ON COMMERCE AND INDUSTRY,
PANEL ON ECONOMIC DEVELOPMENT,
PANEL ON FINANCIAL AFFAIRS,
PANEL ON INFORMATION TECHNOLOGY AND BROADCASTING**

**Economic Impact of the Recent Social Incidents and
Changes to the External Environment on Hong Kong**

Introduction

In the past six months, the Fugitive Offenders and Mutual Legal Assistance in Criminal Matters Legislation (Amendment) Bill 2019 caused controversies in the society. Apart from demonstrations, processions and assemblies, there was a series of violent incidents. Some radical acts, including illegal blockage of the airport and roads, vandalism of rail, public transport infrastructure and shops, occupation of university campuses, various uncooperative actions and escalating act of violence, have affected not only the personal safety and daily life of the general public, but also Hong Kong's international image, raising concerns on whether Hong Kong is still a safe city. So far 40 countries have issued advice on travelling to Hong Kong. Impact of the series of violent conflicts has spread to all business sectors. Among them, tourism, retail and catering industries have borne the brunt, facing unprecedented challenges with business plummeting.

2. In addition to internal challenges, the Hong Kong economy has also been affected by unstable external environment. With the volatile trade negotiation between the Mainland and the United States (US), gradual slowdown of economic growth in major economies and ever-changing geopolitical environment around the world, the global economy is facing notable downward pressure. Many international organisations have repeatedly adjusted downward their forecasts for global economic growth next year. Hong Kong, being an external oriented economy, is inevitably affected by uncertain external factors.

Overall Economic Situation

3. The performance of Hong Kong's external trade has been weak since the fourth quarter 2018, as the global economy entered a synchronised slowdown with escalated China-US trade tensions. Consumption and investment sentiment has also been affected. The Hong Kong economy only grew mildly by 0.5% year-on-year in the first half of 2019.

4. The recent local social incidents and violent conflicts added further strains and dealt an additional and severe blow to the already weakening economy. The economy saw an abrupt deterioration and contracted by 2.9% in the third quarter from a year earlier, its first year-on-year decline since the Great Recession of 2009. On a seasonally adjusted quarter-to-quarter comparison, real GDP contracted for two consecutive quarters, indicating that the economy has entered a recession. Considering the actual outturn of a 0.6% contraction in the first three quarters of 2019 and the persistent downward pressures, the Government forecast the economy would contract by 1.3% for 2019 as a whole, the first annual decline since 2009.

5. The protests and assemblies with intensifying violence in the past few months have kept visitors away, taken a heavy toll on local consumption demand and seriously dampened economic sentiment. Visitor arrivals fell sharply by 26.0% in the third quarter, and the fall enlarged to over 40% in October. With exports of travel services plummeting by 32.2% year-on-year in real terms, exports of services deteriorated sharply and plunged by 13.8%, the biggest decline since the second quarter of 2003. A number of sports and other events of various scales were postponed or cancelled, including Hong Kong Tennis Open, Hong Kong Wine & Dine Festival and Hong Kong E-Prix. These events were very successful and popular among local residents and visitors when they were held in Hong Kong in the past. Their postponement or cancellation has impacted negatively on Hong Kong's economy, especially our tourism industry.

6. Private consumption expenditure weakened sharply and fell by 3.4% year-on-year in real terms in the third quarter, its first year-on-year decline since the first quarter of 2009. The decline was mainly attributable to the serious disruptions to the tourism- and consumption-related sectors caused by the local social incidents and violent conflicts. The business situation of many sectors such as hotel, retail and catering turned very austere. Average hotel room occupancy rate was only about 60% in recent months, down noticeably by more than 20% from a year earlier. Retail sales volume fell visibly by 19.5% year-on-year in the third quarter, almost on par with the record fall in the third quarter of 1998. Restaurant receipts deteriorated sharply in the third quarter

and registered a year-on-year decline of 13.6% in volume terms, the largest decline since the outbreak of SARS in the second quarter of 2003. With no signs of improvement in their business situation thus far, it could be said that these sectors have entered a “chilly winter”.

7. On the other hand, the results of all establishment surveys indicated that business sentiment has turned very pessimistic in recent months. According to the results of the Census and Statistics Department (C&SD)’s Quarterly Business Tendency Survey conducted during early September to mid-October, business sentiment among large enterprises in Hong Kong worsened markedly. The proportion of large enterprises expecting a weaker business situation in the fourth quarter of 2019 as compared to the third quarter outweighed the proportion of those expecting a better situation by 25 percentage points, representing a sharp deterioration from the net balance of negative 8 percentage points in the previous round and the worst reading since the second quarter of 2009. The overall diffusion index for the current business situation of SMEs compiled by C&SD still hovered around the record-low in recent months and stayed sharply below the 50 divide. The sentiment for retail, catering and logistics sectors was particularly gloomy. As various external and domestic headwinds inflicted considerable uncertainties on near-term business prospects, expenditure on acquisitions of machinery, equipment and intellectual property products plunged by 26.6% year-on-year in real terms in the third quarter, and led to a fall of 16.3% in overall investment spending, representing a further widening from its 10.8% decline in the preceding quarter.

8. The labour market eased as economic conditions worsened. The seasonally adjusted unemployment rate edged up to 2.9% in the third quarter of 2019 and increased further to 3.1% in August – October, after staying at 2.8% for five quarters since the second quarter of 2018. The underemployment rate also rose to 1.2% in August – October. The unemployment rates in consumption- and tourism-related sectors saw more visible increases. Specifically, the unemployment rate of the food and beverage service activities sector rose sharply by 1.8 percentage points from a year earlier to a six-year high of 6.1%, while that of the retail sector also increased by 0.7 percentage point to 4.5%, the highest level in two years. As the business environment remains very difficult for many sectors, the unemployment rate will face immense upward pressure in the near term.

9. Nevertheless, we have not seen any notable outflow of capital thus far. Hong Kong’s institutional strengths and core competencies are still recognised by many international rating agencies and think tanks. However, should demonstrations involving violence persist, it would have a far-reaching impact on our economy and business environment and make the recovery

process for Hong Kong more difficult.

Financial System

10. In face of challenges on both internal and external fronts, Hong Kong's financial markets have inevitably become volatile. Hong Kong's financial system has withstood crises in the past. Our resilient regulatory regime enables Hong Kong to cope effectively with market volatility. Different facets of Hong Kong's financial system have been functioning smoothly and orderly so far. At the same time, the core competencies of Hong Kong as an international financial centre remain well in place. Article 112 of the Basic Law safeguards the free flow of capital within, into and out of Hong Kong. Our simple and transparent taxation system, effective infrastructure, sound financial regulatory regimes and rule of law, as well as quality professional services lay the foundation for Hong Kong as an international financial centre.

11. The Government and financial regulators have been staying vigilant, closely communicating with each other and monitoring the market situation, with a view to safeguarding financial stability. As regards the money market, the Hong Kong dollar exchange rate has stayed steady. The Linked Exchange Rate System has served as the cornerstone for Hong Kong's monetary and financial stability over the past 36 years, and has been operating smoothly. The HK\$4.2 trillion worth of Exchange Fund, together with a Hong Kong dollar monetary base that is supported by highly liquid US dollar assets, provide a powerful line of defence for Hong Kong's monetary and financial stability. There has been no noticeable outflow of funds from the Hong Kong dollar or from the banking system based on the latest statistics on deposits and money supply. The Hong Kong Monetary Authority (HKMA) will continue to closely monitor changes in the foreign exchange market and the local money market, and maintain the stability of the Hong Kong dollar exchange rate through the Linked Exchange Rate System.

12. Hong Kong's banking system is robust with ample liquidity. The interbank market continues to operate orderly. According to the latest data, major banks' average liquidity coverage ratio was about 153% (second quarter of 2019), and the industry's average capital adequacy ratio was about 20% (end-Jun 2019), both figures are well above the international standards. The HKMA will provide liquidity support to banks if necessary.

13. The Securities and Futures Commission has been closely monitoring the securities market. The trading and clearing operations of the Hong Kong

stock and derivatives markets have been performing in an orderly manner in spite of the increasing market volatility. The Insurance Authority has also been closely monitoring the insurance market to ensure the authorised insurers are financial sound.

14. Moreover, financial regulators have conducted stress tests, and the results indicate that even in extremely adverse situations, banks, intermediaries in the securities sector and insurers will still be able to meet the relevant regulatory requirements.

15. Individual international rating agencies have recently adjusted downward Hong Kong's credit rating or outlook while another affirmed Hong Kong's credit rating. Regardless of the difference in their rating actions, these agencies have generally affirmed that Hong Kong's strong fiscal capacity and ample buffers in the financial system will help the city weather shocks. We will strive to sharpen Hong Kong's attractiveness as an international financial centre through a multi-pronged approach.

Innovation and Technology

16. With our strong research and development (R&D) capabilities, world-class universities, advantage as an international and market-oriented economy, robust legal system and intellectual property protection regime etc., coupled with the efforts of the Government in promoting innovation and technology (I&T), it should be an excellent time for Hong Kong's I&T development. However, the recent external environment and the social situation in Hong Kong have brought uncertainties to R&D work and business development, inevitably imposing a negative impact on the I&T development in Hong Kong.

17. The ability to attract and bring together the world's top scientific research talent, R&D institutions and technology enterprises is of paramount importance for an economy to become an international I&T hub. However, in light of the recent situation, there are signs showing that some overseas I&T enterprises and talent have concerns about coming to Hong Kong for development in the short term. Some of the I&T enterprises and talent currently in Hong Kong also incline to re-examine their local development plan. From June to October this year, the number of quotas involved in the applications received by the Innovation and Technology Commission for admitting technology talent under the Technology Talent Admission Scheme has dropped significantly, indicating that enterprises are turning cautious in their

business planning and strategies in recruiting overseas or Mainland talent. Moreover, according to the Hong Kong Science and Technology Parks Corporation (HKSTPC) and the Cyberport, it is increasingly difficult for technology companies to recruit non-local high-end technology talent. Some companies have suspended their local business expansion and recruitment plans. Some which had previously indicated interests in admission to the “Advanced Manufacturing Centre” and “Microelectronics Centre” in the industrial estates have re-examined their development plans. Local and overseas venture capital funds have gradually adopted a more conservative attitude towards investing in local start-ups, affecting the development of technology start-ups. With violence escalating, some overseas and Mainland researchers as well as students of engineering and technology fields have temporarily left Hong Kong.

18. In addition, the social incidents and violent conflicts in recent months have also affected the government’s measures to promote smart city and I&T culture. The smart lamppost project aims to collect city data (such as weather and traffic conditions) and drive smart city development. However, some of these devices were vandalised with varying degrees of damage during protests involving violence, and one supplier has even decided to withdraw from the project. On I&T culture, some I&T events originally scheduled to be held in Hong Kong have been cancelled as a result of the situation in recent months.

19. To help the industry and enterprises counter the uncertain economic environment, the Government and public organisations have launched a series of measures to support the I&T enterprises and start-ups. These include advance disbursement of partial funding from the Enterprise Support Scheme, the Technology Voucher Programme, the Re-industrialisation and Technology Training Programme, and the Patent Application Grant; the freezing of fees of the Standards and Calibration Laboratory and the Hong Kong Accreditation Service; the provision of a six-month 50% rental concession for tenants and start-ups by HKSTPC and Cyberport; and the offer of concessionary discounts for small and medium enterprises (SMEs) and start-ups in regard of the services of the Hong Kong Productivity Council. We hope that these measures will help reduce the operating costs of technology companies and start-ups and help them sail through the storm.

Measures to support SMEs and people

20. The Government understands the pressure borne by SMEs and members of the public amid an economic downturn. We have been closely monitoring the impact of the social incidents and violent conflicts on various

business sectors, and have been in close communication with the trade to provide appropriate support.

21. To assist the trade in dealing with impact brought by China-US trade tensions, the Government has announced and implemented a number of short-term targeted measures since June last year. Such measures include enhancing various funding schemes for SMEs to assist the trade in market promotion and development of the Mainland and the Association of Southeast Asian Nations (ASEAN) markets; extending the application period of the special concessionary measures under the SME Financing Guarantee Scheme (SFGS) and introducing additional support measures to further alleviate the financing burden of local enterprises¹; strengthening protection for Hong Kong exporters affected by US tariff measures through the Hong Kong Export Credit Insurance Corporation, as well as helping the trade to develop market and production base through the Hong Kong Trade Development Council.

22. In response to the changing economic situation, the Government has since August announced a series of measures to support enterprises, safeguard jobs and relieve people's burden, with a commitment of more than \$21 billion. The details of these measures are as follows:

- (a) injecting an additional \$1 billion into the Dedicated Fund on Branding, Upgrading and Domestic Sales (BUD Fund) and double the cumulative funding ceiling per enterprise under its Mainland Programme to \$2 million² for supporting enterprises to explore development opportunities;
- (b) injecting \$1 billion into the Export Marketing and Trade and Industrial Organisation Support Fund to double the cumulative funding ceiling for each enterprise under the SME Export Marketing Fund to \$800,000;
- (c) extending the application period of the special concessionary measures under the SFGS (i.e. 80% guarantee product) and the validity period of the three enhancement measures introduced in 2018 to 30 June 2022;

¹ Including (i) reducing the guarantee fee rates by 50%; (ii) increasing the maximum facility amount from \$12 million to \$15 million; and (iii) lengthening the maximum loan guarantee period from five years to seven years.

² In the 2019-20 Budget, the Financial Secretary announced an injection of \$1 billion into the BUD Fund, extension of its geographical coverage to all economies with which Hong Kong has signed free trade agreements (FTAs), and an increase in the cumulative funding ceiling per enterprise to \$2 million for FTA markets. Together with the measures announced by the Financial Secretary in August 2019, the total injection into the BUD Fund will be \$2 billion and the cumulative funding ceiling per enterprise will be increased to \$4 million.

- (d) introducing a new arrangement under the SFGS and the SME Loan Guarantee Scheme where enterprises may apply for principal moratorium for a maximum of 12 months, during which only interest payments have to be made;
- (e) introducing a new loan guarantee product under the SFGS, under which 90% guarantee will be provided for approved loans to help smaller-sized enterprises, business with relatively less operating experience as well as professionals seeking to set up their own practices to obtain financing;
- (f) Exploring room for increasing or expediting minor works projects both to meet public needs and to create more employment opportunities for the construction sector;
- (g) Implementing a fee review moratorium on government fees and charges set on a cost recovery basis with immediate effect until December 31, 2020;
- (h) waiving 27 groups of government fees and charges for 12 months to benefit a wide range of sectors from maritime, logistics, retail, catering, tourism, construction, to agriculture and fisheries and etc.;
- (i) offering 50% rental concession for six months for most short term tenancies of government land for community and business use under the Lands Department, public market stalls leased by the Food and Environmental Hygiene Department, catering establishments, retail stores, supermarkets, superstores, shopping malls, vending machines and fee-paying public car parks leased by the Government Property Agency, public cargo working areas leased by the Marine Department, stalls/facilities in the four wholesale markets managed by the Agriculture, Fisheries and Conservation Department, operators of fee-paying public car parks, catering establishments, and retail premises under the Leisure and Cultural Services Department (LCSD), tenants of the Tuen Mun EcoPark, and hire charges of facilities of civic centres managed by the LCSD;
- (j) reducing fees of short-term waivers and temporary waivers issued to most waiver holders for varying the terms of land grants for community and business use by 50% for six months;
- (k) reducing the rental for short-term tenancies of government land for fee-paying public car parks and harbourfront recreational or event

venues under the Lands Department by 50% for six months;

- (l) providing fuel subsidy for the transport trade for six months or a one-off fuel subsidy;
- (m) providing a one-off survey fee subsidy for local commercial marine vessels;
- (n) working with the Hong Kong Tourism Board (HKTB) and the Travel Industry Council of Hong Kong (TIC) in launching the Travel Agents Incentive Scheme to incentivize travel agents to secure more travellers. In addition, TIC has waived travel agents' annual membership fees and registration fees for Mainland inbound tour groups. HKTB has waived the trade's participation fees for joining travel trade shows and travel missions organised in the Mainland and overseas, and membership renewal fees under the Quality Tourism Services Scheme. For trade practitioners, TIC will provide subsidies for tourist guides for completing the Continuing Professional Development Scheme;
- (o) increasing the reductions of salaries tax, tax under personal assessment and profits tax for the Year of Assessment 2018/19 from 75% to 100%, subject to a ceiling of \$20,000;
- (p) providing a one-off electricity charge subsidy of \$2,000 to each residential electricity account;
- (q) providing an extra allowance to social security recipients, equal to one month of the standard rate Comprehensive Social Security Assistance (CSSA) payments, Old Age Allowance, Old Age Living Allowance or Disability Allowance. Similar arrangements will apply to recipients of the Working Family Allowance and individual-based Work Incentive Transport Subsidy;
- (r) paying one month's rent for lower income tenants living in the public rental units of the Hong Kong Housing Authority (HA) and the Hong Kong Housing Society (HKHS);
- (s) providing a one-off living subsidy for low-income households not living in public housing and not receiving CSSA (commonly known as the "N have-nots") through the Community Care Fund; and
- (t) providing a subsidy to kindergarten, primary and secondary day-school students in Hong Kong at \$2,500 per head in the 2019/20 school year to

alleviate parents' financial burden in defraying education expenses.

23. Moreover, public bodies including the HA, the HKHS, the HKSTPC, the Cyberport, the Airport Authority Hong Kong, as well as the MTR Corporation, have earlier responded to the Government's appeal by announcing rental concessions to provide relief for their tenants. The Construction Industry Council has waived the registration fees for construction workers. Meanwhile, targeting the unemployed and under-employed in trades suffering from the economic downturn, the Employees Retraining Board, entrusted by the Government, launched the "Love Upgrading Special Scheme" in October 2019 to offer free integrated skills enhancement training and provide these individuals with special allowances with a view to upgrading their skills for self-enhancement and re-entering the employment market as early as possible.

24. To strengthen banks' support to SMEs, the HKMA has reminded banks to provide funding support to SMEs as far as their credit policies and risk management principles allow. The HKMA has also established the Banking Sector SME Lending Coordination Mechanism, and banks agreed to adopt various measures to alleviate the financial burden of SMEs, such as making good use of the recent reduction in countercyclical capital buffer requirement by the HKMA to support SMEs, clarifying the regulatory requirements on credit risk management with a view to facilitating banks' arrangements such as deferral of principal payment or loan extension. The HKMC Insurance Limited also made a number of enhancements to the SFGS to assist SEMs in improving their liquidity.

25. The Government will continue to monitor developments and maintain close communication with the trade. Additional support measures will be introduced as and when necessary.

Hong Kong Human Rights and Democracy Act of the US

26. Under "one country, two systems", the Basic Law confers on Hong Kong a unique status. Article 116 of the Basic Law stipulates that the Hong Kong Special Administrative Region is a separate customs territory and Article 151 provides that Hong Kong may, using the name "Hong Kong, China", participate in such international organisations as the World Trade Organization (WTO) and the Asia-Pacific Economic Cooperation as a separate member.

27. Hong Kong's unique status is not granted unilaterally by any other country, but is conferred by the Basic Law. Hong Kong's unique status is well recognised and respected by the international community. Our economic and

trade status is on par with other WTO members, and we are making use of this capacity in the international economic and trade arena to establish mutually beneficial relations with our trading partners around the world.

28. In respect to Hong Kong, the US enacted in 1992 the US-Hong Kong Policy Act (the Policy Act) which set out its policy and principled positions towards Hong Kong. The relevant law is an act of the US itself but not an international or bilateral agreement. Over the years, in accordance with the Policy Act, the US has been respecting Hong Kong as a separate customs territory, and has on this basis established mutually beneficial bilateral economic and trade relations with Hong Kong. The US is Hong Kong's fourth largest merchandise trading partner in the world³, while Hong Kong is the US' tenth largest export market. Over the past ten years, the US has been enjoying the largest trade surplus with Hong Kong among its global trading partners, valued at US\$33.8 billion in 2018 alone. In 2017, the US was the seventh major source of inward direct investment into Hong Kong and the ninth major destination of outward direct investment from Hong Kong. Moreover, there are 1 344 US companies in Hong Kong, of which 278 are regional headquarters. These figures demonstrate the close and reciprocal bilateral relation between Hong Kong and the US.

29. The enactment of the Hong Kong Human Rights and Democracy Act (the Hong Kong Act) by the US is unnecessary and unwarranted. The Hong Kong Act unnecessarily interferes in the internal affairs of Hong Kong, and does not help ease Hong Kong's situation. The uncertainty caused by the Hong Kong Act will inevitably affect the confidence of international investors and companies in Hong Kong, but at the same time will damage the mutually beneficial relationship between the two places and the US' interests in Hong Kong. The actual impact of the Hong Kong Act on Hong Kong will depend on the specific measures and changes adopted by the US Administration. The Government will closely monitor development on the matter.

Conclusion

30. The Government's priority is to stop violence and restore law and order as soon as possible, which is also the key for the economy to regain growth momentum. The Government has devoted additional resources and strengthened inter-departmental coordination to tackle the current difficulties,

³ If the ASEAN and the European Union (EU) are taken as single trading entities, the US is Hong Kong's fourth largest merchandise trading partner, after the Mainland, ASEAN and EU.

including work coordination and dissemination of information. Once our society returns to calmness, we will, in collaboration with different sectors of the community, including the relevant organisations, chambers of commerce and professional bodies, promote Hong Kong overseas and in the Mainland and implement measures as appropriate to rebuild international confidence in Hong Kong.

Financial Secretary's Office
Office of the Government Economist
Commerce and Economic Development Bureau
Financial Services and the Treasury Bureau
Innovation and Technology Bureau

November 2019