


## How does political instability impacts Hong Kong's economy and financial markets ?

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### Measuring the impact of political instability on the economy and financial markets of Hong Kong

The current political instability in Hong Kong has led to concerns over its impact on the economy and financial markets of the territory. We examine here the evidence of the impact of the two most recent, and most disruptive, periods of political turbulence in Hong Kong, the Occupy Central, 28 Sept, to 15 Dec. 2014 and the current Extradition crisis 9 June 2019 to date.

**Occupy Central** demonstrations, occupations etc were triggered by demands for wide electoral reforms and especially the method of election of the Chief Executive. The main form of the turbulence was that of the occupation of wide areas of central Hong Kong.

**Extradition** legislation permitting the extradition to China triggered, possibly, the biggest demonstration ever in Hong Kong with the political demands widening to the resignation of the chief executive as well as investigation into police actions all underlain by the simmering economic frustration of youth. Physical violence was far more widespread than that during the Occupy Central events with the protesters using “guerrilla” tactics.

### **Economic consequences of Occupy Central**

Fig. 1 shows that the impact on the stock market and forex markets during the events (red vertical lines) was effectively temporary. The HSI (blue) had started to fall before the beginning of the events, then stayed almost flat during the events, and recovered up until April-May 2015 only to decline for the rest of 2015. The USD/HKD (green) actually strengthened during the events and then stayed strong for the rest of 2015 hovering near the ceiling of 7.75 of the peg. Given that the events took place near the end of 2014 the overall quarterly, yoy % GDP growth was not impacted staying flat during 4Q.2014 and 1Q.2015. The growth pace in 2015 declined significantly in 4Q.2015 but only a year after the end of the events in 4Q.2014. (See table below)

2014 yoy %				2015 yoy %			
<b>1Q</b>	<b>3.0</b>	<b>2Q</b>	<b>2.2</b>	<b>3Q</b>	<b>3.2</b>	<b>4Q</b>	<b>2.6</b>
				<b>1Q</b>	<b>2.4</b>	<b>2Q</b>	<b>3.1</b>
				<b>3Q</b>	<b>2.3</b>	<b>4Q</b>	<b>1.9</b>

### **Economic consequences of the Extradition protests**

While, at the time of writing, the protests are continuing, it is not possible to come any concrete conclusion as to the potential economic and financial cost of these violent events. However future estimates will be hampered by the fact that the economy of Hong Kong was already on a steep decelerating path for nearly a year well before the protests took place. As the table below illustrates, virtually all-major components of GDP have been decelerating even before 3Q.2018.

(Bloomberg, all figures in yoy %)

	<b>3Q.2018</b>	<b>4Q.2018</b>	<b>1Q.2019</b>	<b>2Q.2019</b>
<b>GDP</b>	<b>2.8</b>	<b>1.2</b>	<b>0.6</b>	<b>0.6</b>
<b>Consumption</b>	<b>4.8</b>	<b>2.7</b>	<b>0.4</b>	<b>1.2</b>
<b>Investment</b>	<b>8.6</b>	<b>-5.8</b>	<b>-7.0</b>	<b>-12.1</b>
<b>Exports:gds</b>	<b>5.1</b>	<b>0.0</b>	<b>-3.7</b>	<b>-5.4</b>
<b>Exports:srcs</b>	<b>3.0</b>	<b>3.3</b>	<b>0.8</b>	<b>0.2</b>

Further estimates of the economic costs will need to separate the additional costs imposed by the disturbances given that the economy was deteriorating when the troubles began. The best it can be said right now is that, going forward to 3Q and 4Q.2019, the political troubles will worsen the deceleration of GDP growth. Signs of that are already appearing with the Nikkei/Markit confidence index falling from 47.9 (already below 50.0) in June to 43.8 in July. Retail sales growth also fell from -1.4% yoy in May to -6.7 % in June.

The financial impact of the protests remains, for now, also unclear as the data in Fig. 2 illustrate ( see vertical red line) The recent drop (to Monday 5 August) of HSI reflected, in addition to the political turbulence: (a) the recent cut in Fed rates which the markets interpreted as a bearish sign of no further easing as opposed to the start of looser US monetary policy and (b) the additional impositions of tariffs on China by the US thus reigniting the fears that the trade war is far from over. As for the USD/HKD rate, it fluctuated in the 7.80-7.83 range, mildly stronger than it was just before the troubles, but still in the “weak” range of 7.80-85 of the peg. Does this all mean that the eventual resolution of the present political uncertainties will leave the economy of Hong Kong unaffected?

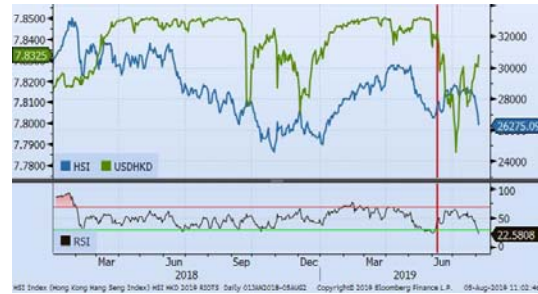
Far from it, but to use the vernacular expression “these troubles could not have come at a worse time” given also the accelerating slowdown of the economy, which had started well before the demonstrators took to the streets. Nonetheless, the truth is that for political instability to have a long-term effect it has to become a permanent factor in the economy and not a one-off blow, which has one-off consequences. It is clearly impossible to forecast whether violent protests and confrontational politics will become a permanent characteristic of Hong Kong as this will imply that the causes of these protests will have also become a permanent feature for which there is no solution.

**In sum:**The evidence from the 2014 events points to a temporary impact on the economy while the costs of the 2019 events will be distorted and even exaggerated by the deceleration of the economy nearly one year before the demonstrations started. The financial markets did weaken in 2019 and will continue to do so. The confidence factor is difficult to gauge and measure as, that too, will always involve cyclical elements as well as expectational factors which at the time of cyclical downturn will always tend to exaggerate the role and impact of political uncertainty.

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**Fig1.The HSI and USD/HKD during 2014**



**The HSI and USD/HKD during 2019**

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