

# CHINA ECONOMIC OUTLOOK

## Stronger start, weaker end to 2024

- **Overview** – China’s economy has regained some strength recently. We expect this to continue into 2024, on the back of support from fiscal policy and a further pick-up in household spending. But with property construction likely to continue to decline and exports set to do the same, the recovery will lack momentum. Growth will have dropped below 4% by the end of the year.
- **Consumer Spending** – Consumers will help drive the continuing economic recovery in the first half of 2024, but spending growth will remain slower than was the norm a few years ago.
- **Investment** – Total investment has been sustained in the face of a collapse in the property sector by strong investment in manufacturing and in infrastructure. Manufacturers are likely to scale back expansion plans next year but the state will continue to drive growth, and the drag from property may ease.
- **External Demand** – China’s exporters have slashed prices to support global market share this year, but won’t be able to continue doing so in 2024. If global demand weakens, as we expect in the coming months, the recent support that exports have given to the economy will turn into a drag.
- **Monetary Policy** – The recent reversal of the dollar provides space for the People’s Bank to resume monetary easing. But officials are concerned that a return to relying on credit expansion to generate GDP growth would add to financial vulnerabilities and they will act cautiously.
- **Fiscal Policy** – A rare mid-year relaxation of budget constraints will sustain into 2024 the support that fiscal policy has been giving to growth during 2023.
- **Inflation** – A continued economic recovery plus the reversal of food price deflation should lift consumer price inflation clear of zero over the next few months, though it will remain low.
- **Property Sector** – Policy interventions have so far failed to put a floor under the crisis in the property sector. But with support continuing to be expanded, we expect a cyclical rebound in sales in 2024.
- **Hong Kong** – The return of visitors will remain a sizeable tailwind into next year. But with the city having lost some of its global appeal and mainland growth in structural decline, Hong Kong’s economy is unlikely to ever return to its pre-protest path.

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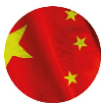
# Key Forecasts Table

**Table 1: Key Forecasts**

% y/y, average over period (unless otherwise stated)	Quarterly					Annual			
	2023		2024			2022	2023f	2024f	2025f
	Q3	Q4f	Q1f	Q2f	Q3f				
<b>China</b>									
<b>Domestic Sector</b>									
Official GDP	4.9	5.1	3.9	4.5	4.3	3.0	5.0	4.5	4.0
CE China Activity Proxy	6.8	9.6	6.1	4.3	4.6	-3.5	8.0	4.5	3.0
Industrial Production	4.5	3.5	3.5	3.0	3.5	3.5	4.0	4.5	4.0
Fixed Asset Investment	1.6	5.1	5.0	4.8	5.4	5.1	3.4	5.0	4.3
Retail Sales	4.0	13.0	6.0	8.0	9.0	-0.2	8.5	8.0	8.5
Surveyed Urban Unemployment (%)	5.2	5.0	4.9	4.8	4.9	5.6	5.2	4.9	5.1
<b>External Sector</b>									
Goods Exports (US\$, % y/y)	-9.5	-8.0	-16.0	-18.0	-15.5	7.0	-6.0	-14.0	1.5
Goods Imports (US\$, % y/y)	-8.5	-7.5	9.0	0.0	-4.0	0.5	-7.5	1.0	1.0
Goods Balance (% of GDP, SA)	4.0	3.0	2.0	2.0	1.5	4.5	4.5	1.5	1.5
Current Account (% of GDP, SA)	2.0	0.5	-0.5	-0.5	-0.5	2.0	1.5	-0.5	-0.5
<b>Prices</b>									
Consumer Prices	-0.1	0.0	0.7	0.9	1.3	2.0	0.5	1.0	1.5
Core Consumer Prices	0.8	0.9	1.3	1.2	1.2	0.9	0.8	1.2	1.4
Producer Prices	-3.3	-3.4	-3.1	-1.9	-1.3	4.0	-3.0	-1.5	-0.5
<b>Fiscal and Monetary</b>									
General Budget Bal. (% of GDP, SA) <sup>†</sup>	-4.0	-5.9	-5.6	-5.1	-4.8	-4.7	-4.6	-5.1	-4.3
CE Aug. Fiscal Bal. (% of GDP, SA)	-10.8	-11.6	-11.2	-10.9	-8.8	-13.2	-11.9	-10.2	-8.5
Money Supply (M2) (eop)	11.5	11.2	10.3	10.3	9.9	12.0	12.3	10.3	9.6
Aggregate Financing (eop)	9.3	10.2	9.4	9.8	9.8	9.6	10.2	9.7	8.3
Aggregate Financing (eop, % of GDP)	298	297	303	306	306	284.0	297.0	306.0	312.0
<b>Policy Rates (end period, %)</b>									
7D PBOC Reverse Repo Rate	1.80	1.70	1.60	1.60	1.60	2.00	1.70	1.60	1.60
1Y Loan Prime Rate (LPR)	3.45	3.35	3.25	3.25	3.25	3.65	3.35	3.25	3.25
1Y MLF Rate	2.50	2.40	2.30	2.30	2.30	2.75	2.40	2.30	2.30
RRR (major banks)	10.50	10.25	10.25	10.25	10.25	11.00	10.25	10.25	10.25
<b>Markets (end period)</b>									
CSI 300 Index	3,821	3,800	3,900	4,000	4,100	3,872	3,800	4,200	4,900
3M SHIBOR (%)	2.30	2.20	2.10	2.10	2.10	2.42	2.20	2.10	2.10
2Y Gov't Bond (%)	2.27	2.20	2.10	2.10	2.10	2.34	2.20	2.10	2.10
10Y Gov't Bond (%)	2.68	2.60	2.50	2.50	2.50	2.85	2.60	2.50	2.40
RMB/USD	7.30	7.10	7.10	7.00	6.90	6.95	7.10	6.80	6.50
<b>Hong Kong</b>									
GDP	4.1	5.1	1.2	3.8	5.0	-3.5	3.5	4.0	3.5
Hang Seng Index ('000, eop)	17.8	17.5	18.2	18.9	19.6	19.8	17.5	20.3	23.3
HKD/USD (eop)	7.83	7.80	7.80	7.80	7.80	7.81	7.80	7.80	7.80

<sup>†</sup>prior to year-end adjustments from government funds; \*% of GDP; \*

Sources: CEIC, Refinitiv, WIND, Capital Economics



# Overview

## Stronger start, weaker end to 2024

- China’s economy has regained some strength recently. We expect this to continue into 2024, on the back of support from fiscal policy and a further pick-up in household spending. But with property construction likely to continue to decline and exports set to do the same, the recovery will lack momentum. Growth will have dropped below 4% by the end of the year.
- China’s economy faltered during the summer, contracting outright on our China Activity Proxy measure. (See Chart 1.) It has regained that ground recently, though we continue to believe that growth over the past couple of years has been far weaker than the pre-COVID trend or than the official GDP figures show.
- The recent improvement can be attributed in part to household spending. Retail sales have accelerated as consumer confidence has rebounded. (See Chart 2.) There aren’t any sizeable excess savings for households to spend in China – they didn’t receive fiscal transfers during the pandemic – and many will be feeling poorer with house prices falling and equity markets in a rut. But the savings rate is still a little higher than it was in 2019. (See Chart 3.) If sentiment continues to improve, households should feel comfortable spending more of their income, giving consumption a further boost. And the labour market is relatively tight: the unemployment rate is now lower than its average in the five years before the pandemic.
- The government in October took the rare step of announcing an adjustment to the current year’s budget to ensure that fiscal support didn’t dry up. That was rapidly followed by a surge in bond issuance. (See Chart 4.) A sizeable chunk of the proceeds have not yet been spent. We expect these funds to be channelled into infrastructure and other public investment projects over the next few months.

Chart 1: CE China Activity Proxy & Official GDP (2019 = 100, seasonally-adjusted)

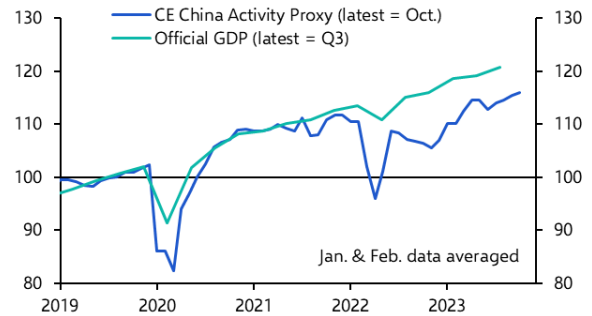


Chart 2: Consumer Confidence & Retail Sales

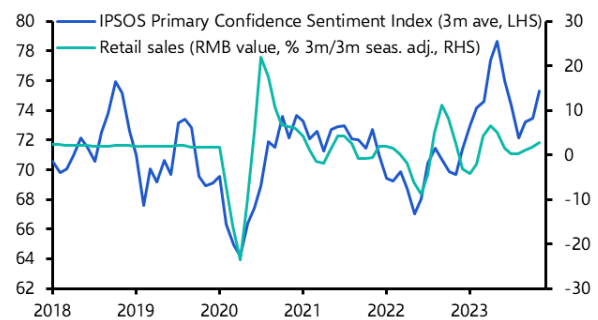


Chart 3: Household Savings Rate (% , seasonally-adjusted)

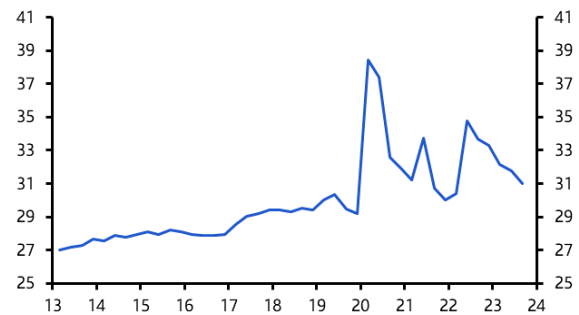
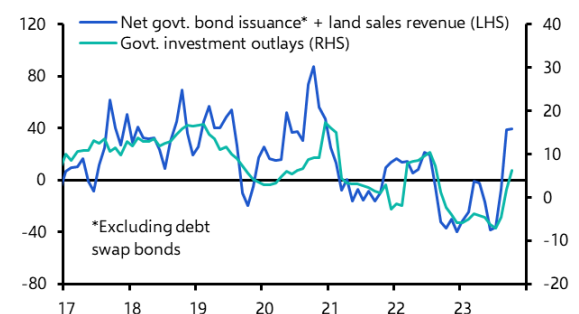
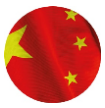


Chart 4: Govt. Investment vs Revenue from Borrowing & Land Sales (3m % y/y)



Sources: CEIC, Refinitiv, WIND, Capital Economics



# Overview (continued)

## Stronger start, weaker end to 2024

- Manufacturers have benefitted over recent months from an under-appreciated export boom. By cutting prices, China’s exporters have been able to push shipment volumes to record highs. (See Chart 5.) But price cuts aren’t a sustainable means of shoring up demand in a weakening global economy. We expect export volumes to fall next year.
- Efforts to boost property sales have not succeeded so far but they continue to be expanded (see Chart 6) and we think that they will gain traction over coming months. That should lift some of the gloom around China’s economic prospects. But a sales rebound probably wouldn’t translate into stronger construction activity. More likely, sales revenues will help speed up project completions so that overall activity still falls.
- Monetary easing has played a much smaller role than fiscal policy in recent economic support efforts. One reason is that the PBOC has been pre-occupied with preventing the renminbi from weakening much beyond 7.3/\$. The recent reversal of the dollar has given the PBOC some respite, and we expect policy rates to be lowered soon. But policymakers are still wary of stoking another credit boom, and we expect only 20bp of cuts by mid-2024.
- There is good reason for this caution. While China’s growth has disappointed this year, there isn’t much evidence of substantial slack in the economy that forceful stimulus could address. Instead, it seems that China’s sustainable growth rate *has slowed*. (See Chart 7.) That’s a final reason to believe that faster growth over the next few months won’t be sustained. We forecast that China’s economy will start 2024 growing around 6% y/y on our CAP measure but that growth will have decelerated to below 4% by the end of the year. (See Chart 8.)

Chart 5: Goods Exports (\$, 2019 = 100, seasonally-adjusted)

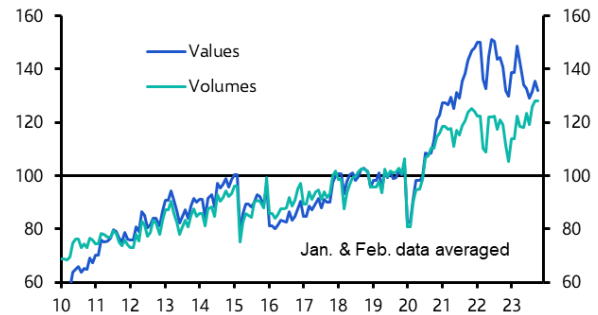


Chart 6: Minimum Downpayment Required\* (% , 35 city average)

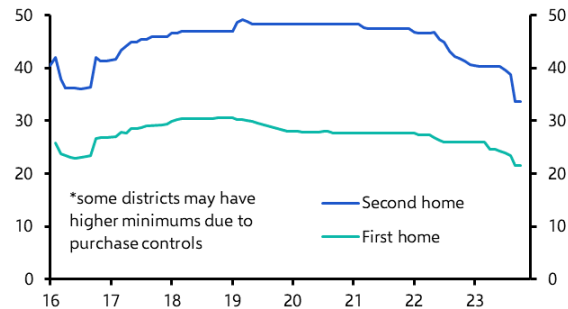


Chart 7: CE China Activity Proxy (% y/y)

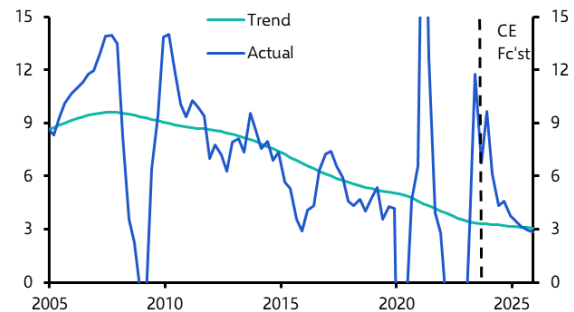
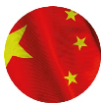


Chart 8: Capital Economics China Activity Proxy & Official GDP (% y/y)



Sources: CEIC, Refinitiv, WIND, Capital Economics



# Consumer Spending

## Households driving the recovery

- Consumers will help drive the continuing economic recovery in the first half of 2024, but spending growth will remain slower than was the norm a few years ago.
- Recent added momentum in retail spending seems to be linked to an improvement in sentiment. (See Chart 9.) That improvement has also helped push the savings rate down further.
- If further shocks to confidence can be avoided, the stage is set for a continued modest rebound in household spending. Households are still saving 2% more of their income than they did before the pandemic. The savings rate could still fall further. We expect unemployment to remain low in 2024, though it is likely to rise again in the second half of the year as the economic recovery fades. (See Chart 10.)
- That said, China's retail sector is on a weaker trajectory than many had thought likely a few years ago. The initial surge in spending when zero-COVID controls were abandoned soon petered out. For the beleaguered restaurant industry, spending has now fallen for six months in a row.
- If overall retail spending had continued at the pre-pandemic pace, it would be 20% higher now. (See Chart 11.)
- While a revival in confidence should help in the near-term, the broad weakness of household consumption relative to many expectations is more deeply-rooted: China's trend rate of growth has slowed and, with it, the rate of income growth. For workers in urban areas in particular, even with unemployment low, incomes are rising at a much slower rate than they were a few years ago. (See Chart 12.)

Chart 9: Consumer Confidence & Retail Sales

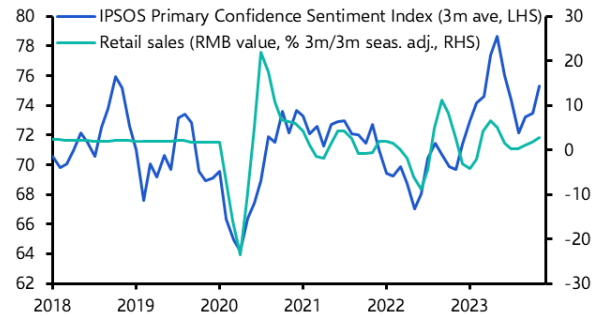


Chart 10: Surveyed Urban Unemployment Rate (%)

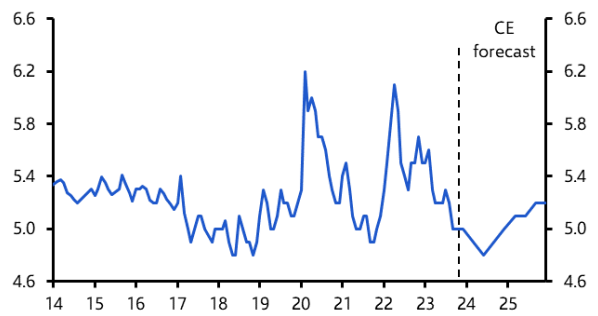


Chart 11: Retail Sales (RMB value, Dec. 2019 = 100, seasonally-adjusted)

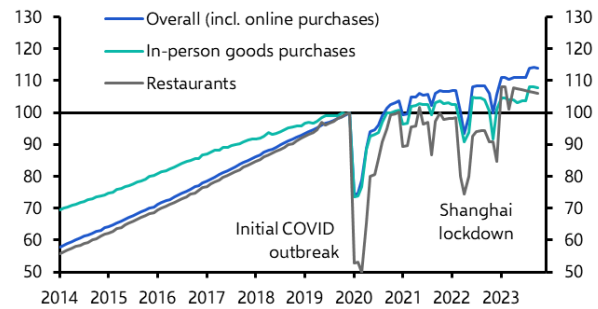
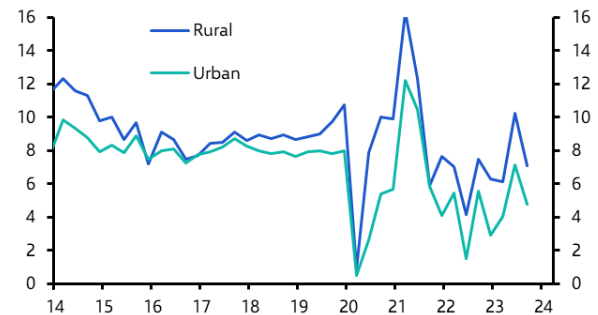
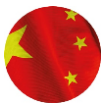


Chart 12: Per Capita Income (nominal, % y/y)



Sources: CEIC, Refinitiv, Capital Economics



# Investment

## Foreign investment is holding up better than many think

- Total investment has been sustained in the face of a collapse in the property sector by strong investment in manufacturing and in infrastructure. Manufacturers are likely to scale back expansion plans next year but the state will continue to drive growth, and the drag from property may ease.
- There are stark differences in investment patterns across sectors. Real estate developers continue to draw back spending. (See Chart 13.) Even if property sales bottom out, as we expect in 2024, the volume of floor space under construction is unlikely to increase. (See Chart 14.) Developers will focus on steering projects to completion.
- By contrast, investment in manufacturing has continued at a reasonably rapid pace recently. This doesn't seem sustainable. Finished goods inventories are high and disinflationary pressure in manufacturing *is building*. The other area of recent strength has been infrastructure investment, which we do expect to continue into 2024. Government investment spending has been running at record levels recently and will continue to be supported by the recent fiscal expansion. (See Chart 15.)
- Business surveys suggests that firms with global interests are increasingly looking to shift some operations out of China. For China, the threat is not so much that this weakens investment – foreign firms drive only a small part of it – but that a conduit for new technology is lost. That said, we think that many are reading *too much* into recent data showing that foreign direct investment has turned negative. This is mostly because firms are shifting financial reserves abroad to achieve higher returns. Fixed investment by foreign firms has corrected after a surge during the pandemic but is still in line with the pre-pandemic trend. (See Chart 16.)

Chart 13: Fixed Investment (Dec. 2019 = 100, seasonally-adjusted)

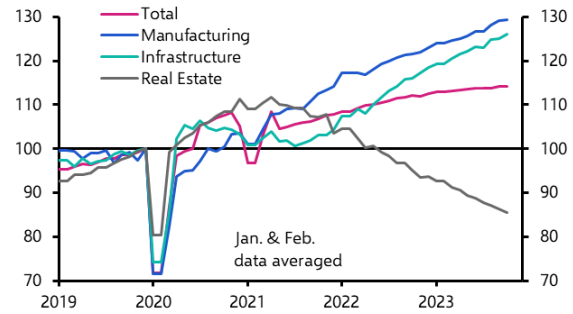


Chart 14: Residential Real Estate Activity (12m ave.)

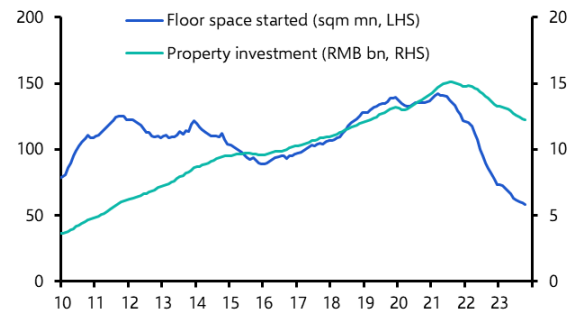


Chart 15: Fixed Investment Funded with State Budget (% of trend GDP, seasonally-adjusted)

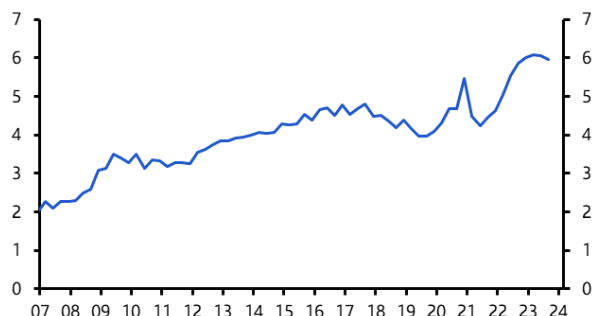
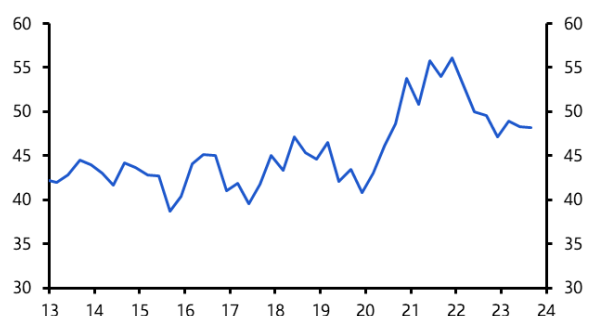
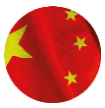


Chart 16: Fixed Investment by Foreign Firms (\$bn, seasonally-adjusted, excl. firms from Hong Kong, Macau & Taiwan)



Sources: CEIC, Capital Economics



# External Demand

## Price-cutting exporters face tougher demand outlook

- China’s exporters have slashed prices to support global market share this year, but won’t be able to continue doing so in 2024. If global demand weakens, as we expect in the coming months, the recent support that exports have given to the economy will turn into a drag.
- China’s goods exports have been running below their levels a year ago in dollar terms for the past six months. (See Chart 17.) But they are performing better than this might suggest. Dollar export revenues are still above the pre-pandemic trend in China, as they are in much – but not all – of the region. (See Chart 18.)
- A surge in auto exports, which could continue into 2024, has helped keep revenues high: in October, auto export revenues were up by a fifth on a year earlier. Volumes were up by half.
- But the wider export sector has also engaged in aggressive price-cutting that has helped it to further expand global market share. China’s export volumes recently returned to record highs. (See Chart 19.)
- That strength is probably not going to be sustained. China’s export prices have been cut 16% in dollar terms since the end of last year and 12% in renminbi terms. As a result, exporters’ net profit margins have fallen near to the lowest they have been since at least 2010, excluding the initial pandemic lockdowns.
- Without price cuts to give them a boost, exports won’t be able to escape the gravitational pull of weaker global demand. Export volumes are likely to be lower for much of next year than they are today. (See Chart 20.)

Chart 17: Goods Export Values (\$, % y/y)

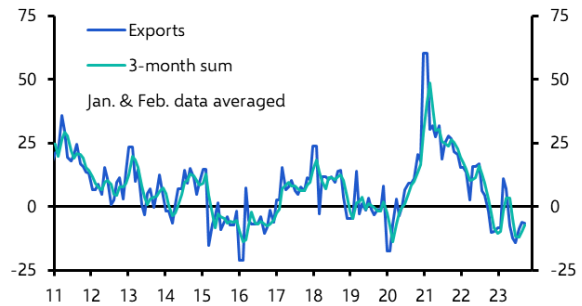


Chart 18: Goods Export Values (\$, seasonally-adjusted, Dec. 2019 = 100)

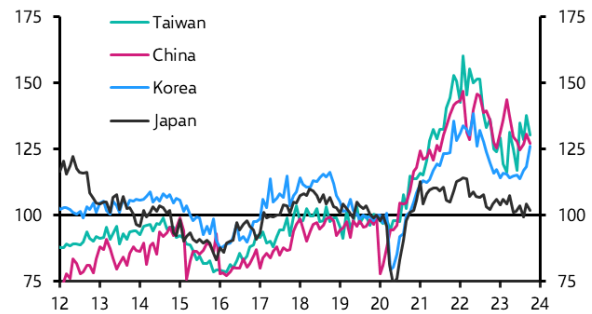


Chart 19: Goods Export Volumes (3m average, seasonally-adjusted, Dec. 2019 = 100)

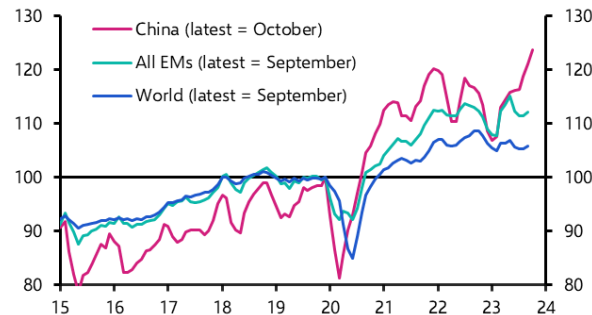
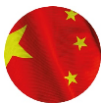


Chart 20: China Exports & DM GDP (volumes, % y/y)



Sources: CEIC, Refinitiv, CPB, Capital Economics



# Monetary Policy

## Breathing room to loosen

- The recent reversal of the dollar provides space for the People’s Bank to resume monetary easing. But officials are concerned that a return to relying on credit expansion to generate GDP growth would add to financial vulnerabilities and they will act cautiously.
- The strength of the dollar has constrained the PBOC’s willingness to lower policy rates despite economic weakness from the middle of this year. Instead, it has intervened to prevent the renminbi weakening much past 7.3/\$ – the spot rate closed within 1% of that level for three consecutive months until mid-November. Since then though, US yields have fallen and the renminbi has strengthened. (See Chart 21.) We think the PBOC will take advantage of the respite to lower rates again soon.
- But we’re only expecting a further 20bp of cuts in total. (See Chart 22.) Officials still appear cautious about financial risks in the face of the inexorable rise in outstanding credit. (See Chart 23.) For the same reason, we don’t expect major easing quantitative easing either. The net result is that outstanding credit growth is likely to barely accelerate at all. (See Chart 24.)
- The caution implicitly reflects a realisation that China’s trend growth rate – and its capacity to put credit to effective use – has slowed.
- A continued slowdown in productivity growth is one reason to expect interest rates in China, unlike in many of major economies, to be lower over the next few years. Another is that the credit boom of the last 15 years has left many firms with high debt and many financial companies saddled with non-performing assets. Low interest rates, sustained by financial repression, will be needed to facilitate the resolution of these problems without triggering a financial crisis.

Chart 21: Renminbi Exchange Rate & China-US Yield Spread



Chart 22: Policy Rates & the RRR (%)

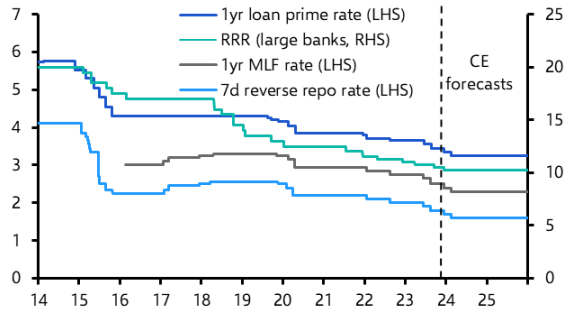


Chart 23: Broad Credit Outstanding (% of GDP, SA)

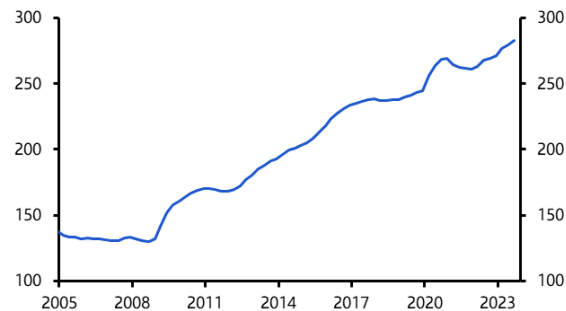
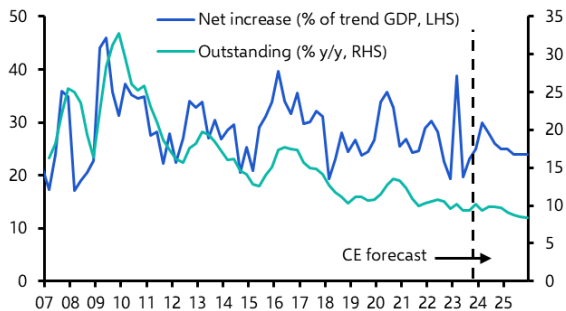
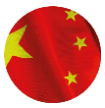


Chart 24: Broad Credit (PBOC’s AFRE measure)



Sources: CEIC, WIND, Capital Economics





# Fiscal Policy

## Continued growth driver

- A rare mid-year relaxation of budget constraints will sustain into 2024 the support that fiscal policy has been giving to growth during 2023.
- It is very rare for the finance ministry to be given permission to borrow more than was agreed in the budget in March. The RMB1trn (0.8% of GDP) of extra bond issuance [agreed in October](#) was the first such mid-year increase since 2008. The norm is for the official deficit to come in well below the original projection. As things now stand, this year's deficit will be well above and the largest in decades. (See Chart 25.)
- Loosening was needed to prevent the economy tumbling over a fiscal cliff since both central and local governments had front-loaded their spending to earlier in the year. (See Chart 26.) In addition, [efforts to rein in](#) the activities of local government financing vehicles (LGFVs) had resulted in a tightening of off-budget spending. (See Chart 27.)
- These off-budget activities explain why the finance ministry remains rather cautious. Even with the additional loosening, this year's official deficit will be smaller than 4% of GDP. But on a broader measure, encompassing local government and LGFV budgets, the deficit is over 10% of GDP. Similarly, overall government debt is around twice as large as the official budget figures show. (See Chart 28.)
- By our estimates, a large share of the proceeds of the new bonds have not yet been spent. When they are, over the next few months, it will be investment projects, including [public housing](#), that benefit. The net result though is that this will sustain the support that fiscal policy has already been giving to the economy rather than add to it.

Chart 25: General Government Deficit (% of GDP)

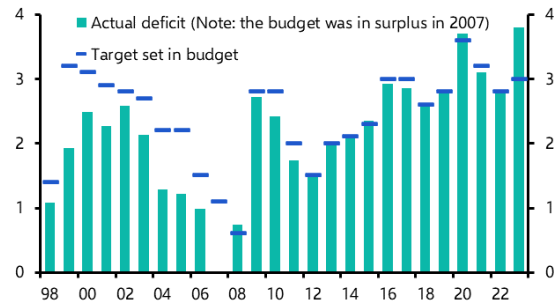


Chart 26: New Chinese Government Bond Issuance (excl. debt swap bonds, RMB trn)

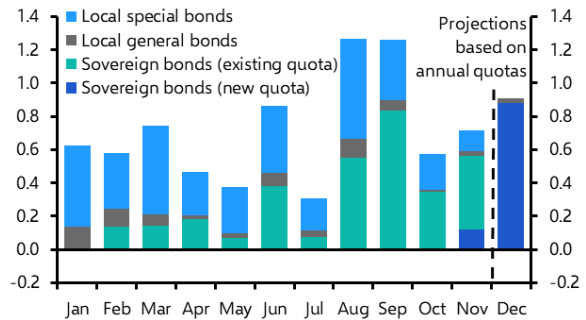


Chart 27: Government & Quasi-Fiscal Net Bond Issuance (% of trend GDP, seas.adj.)

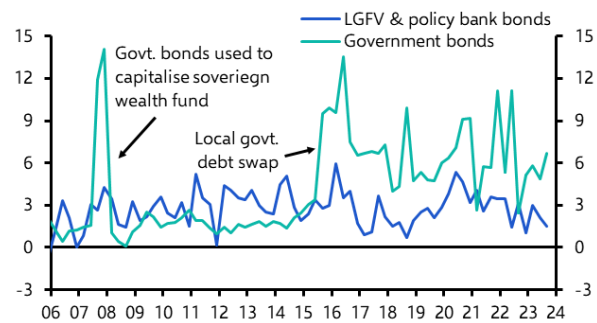
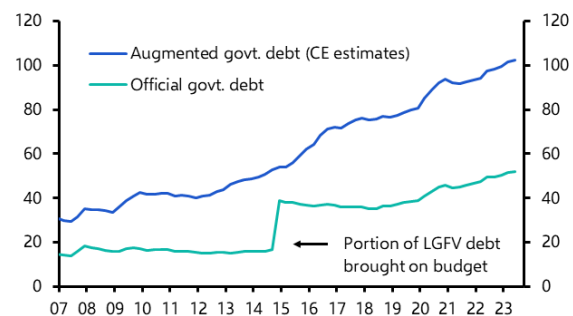


Chart 28: Government Debt (% of GDP)



Sources: CEIC, WIND, Capital Economics



# Inflation

## Exiting deflation

- A continued economic recovery plus the reversal of food price deflation should lift consumer price inflation clear of zero over the next few months, though it will remain low.
- Consumer price inflation has dipped below zero twice recently. The main driver has been a plunge in pork prices – down 30% y/y in October. Without that drag, the headline rate would actually have been rising steadily recently. (See Chart 29.)
- Even so, the inflation rate excluding pork almost never dropped below 1% in the decade before the pandemic, but it has been there since early in the year. That underlines the weakness of demand relative to supply.
- This is most evident in manufacturing, where firms ramped up capacity substantially during the pandemic, largely for export, and are now slashing export prices. (See Chart 30.) Domestic goods price inflation has stalled.
- By contrast, domestic services inflation has been rising this year as the economy pulled out of the torpor that marked the last months of zero-COVID. Even on this measure though, inflation is subdued relative to the pre-pandemic norm. (See Chart 31.)
- Looking forward, if we’re right that the slow ongoing recovery will continue until around the middle of 2024, core inflation should trend higher. And food price inflation should soon swing back into positive territory. Deflation concerns will fade. But continued high investment means that they won’t go away altogether: disinflationary pressure will remain strong in manufacturing and the headline inflation rate is likely to remain below 2%. (See Chart 32.)

Chart 29: Consumer Prices (% y/y)

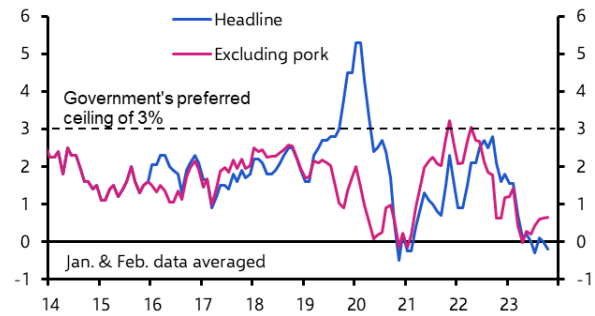


Chart 30: China Goods Export Prices (\$, 2010 = 100)



Chart 31: Consumer Prices (% y/y)

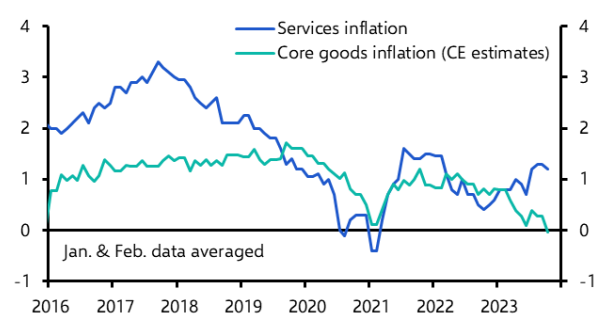
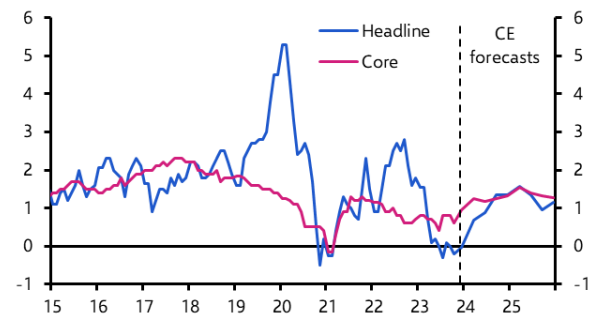
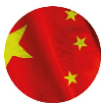


Chart 32: Consumer Prices (% y/y)



Sources: CEIC, CPB, Capital Economics



# Property Sector

## Small cyclical rebound the best that can be hoped for

- Policy interventions have so far failed to put a floor under the crisis in the property sector. But with support continuing to be expanded, we expect a cyclical rebound in sales in 2024.
- Official efforts to stabilise the sector have encompassed moves to encourage purchases and also to shore up developer finances. Downpayment requirements have been lowered, restrictions on purchases continue to be relaxed across the country and mortgage rates have fallen to record lows. (See Chart 33.)
- Meanwhile, banks have been told to **lend more** to developers. Contrary to a **widely-held belief** that policymakers are engineering a shift in financing from developers to manufacturers, they are trying to ensure that credit to developers keeps flowing. (See Chart 34.)
- None of this has so far stopped residential sales from continuing to slide. (See Chart 35). But with sales now half their level at the peak, and affordability improving as prices decline (see Chart 36), we think that continued policy loosening should lead to a recovery soon.
- That said any recovery will be small in comparison with the fall that has happened.) Property’s appeal as an investment asset for wealthy families has suffered a major knock. Underlying residential demand is in long-term decline.
- Similarly, we’re not expecting a turnaround in sales to feed much of a pick-up in construction activity. Improved cashflow would help developers complete ongoing projects. But given the poor medium term outlook for demand, developers won’t ramp up project starts. Against this backdrop, a larger share of home-building activity will be driven by **the state**.

Chart 33: Mortgage Interest Rate for First-time Buyers (%)

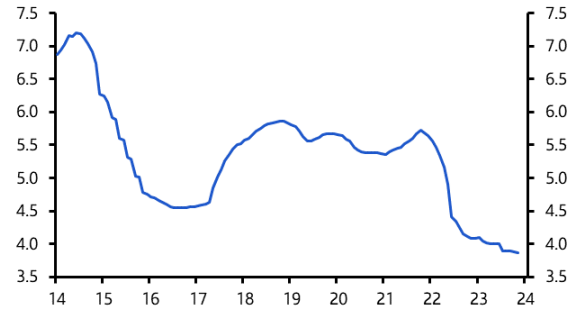


Chart 34: Net Change in Bank Loans to Developers (RMB bn, seasonally-adjusted)

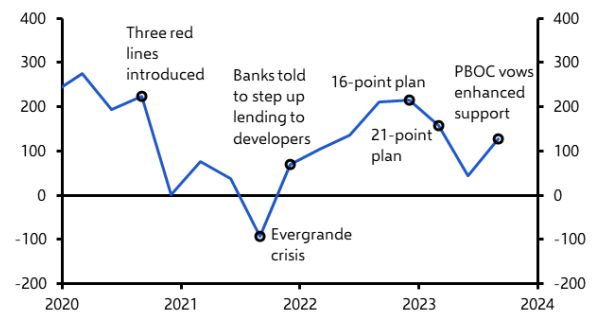
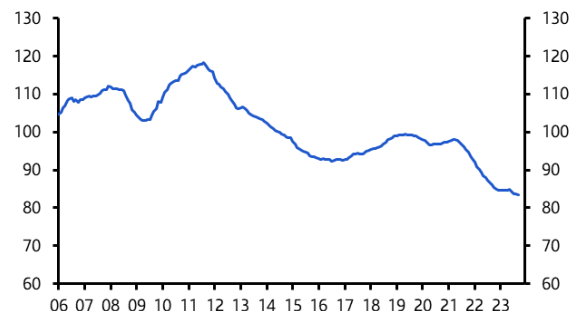


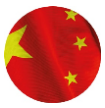
Chart 35: New Home Sales (million square-metres, seasonally-adjusted)



Chart 36: Price-to-Income Ratio (12m moving average, Apr. 2014 = 100)



Sources: CEIC, Beike, Capital Economics



# Hong Kong

## Tourists to provide near-term boost but trend growth has fallen

- The return of visitors will remain a sizeable tailwind into next year. But with the city having lost some of its appeal and mainland growth in structural decline, Hong Kong's economy is unlikely to ever return to its pre-protest path.
- At the end of Q3, the economy was 5% smaller than it was on the eve of the 2019 protests and 15% below its pre-protest trend. This weakness has two main sources. First, the labour force is 5% smaller than on the eve of the protests. Second, tourist arrivals are still down 40% from their peak. There are some wider drags from higher interest rates and a cooling housing market. But these are more modest and GDP per worker excluding net services exports remains broadly in line with its pre-protest trend. (See Chart 37.)
- The outlook therefore rests heavily on the degree to which foreign visitors and workers return to the city. After surging earlier in the year, visitor arrivals have levelled off recently. (See Chart 38.) But we think the recovery will resume before long, helped by a cyclical upturn on the mainland. We are also starting to see some renewed expansion of the labour force. (See Chart 39.) Coupled with monetary loosening as the Fed cuts rates, this should underpin solid growth of 4% next year.
- The medium-term outlook is less bright. Hong Kong was previously able to offset demographic headwinds by attracting MNCs, along with the jobs and foreign talent they bring. But the city has lost some of its appeal to foreign firms and workers. And while it will continue to attract investment and migrants from the mainland, the structural slowdown in the wider Chinese economy means this will be less of a prop than it once was. The city's long-term growth is unlikely to exceed 2%. (See Chart 40.)

Chart 37: Hong Kong GDP (Q1 2019=100, seas. adj.)

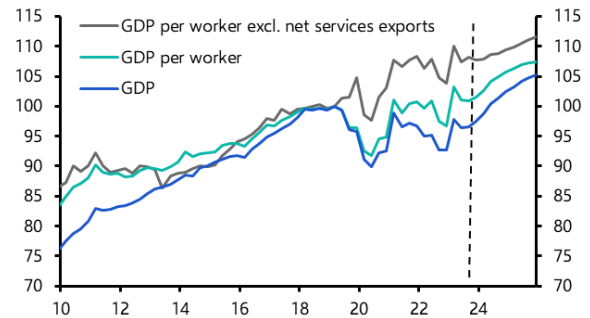


Chart 38: Hong Kong Passenger Arrivals Breakdown (millions, seas. adj., 3m ave.)

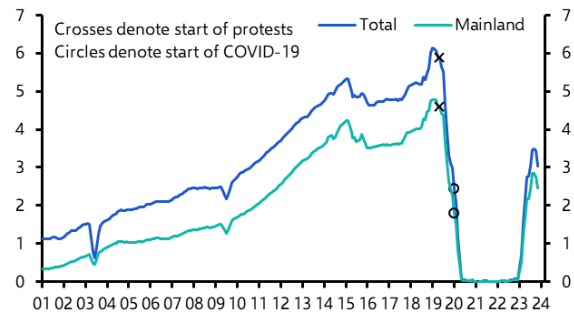


Chart 39: Hong Kong Labour Force (millions, seas. adj.)

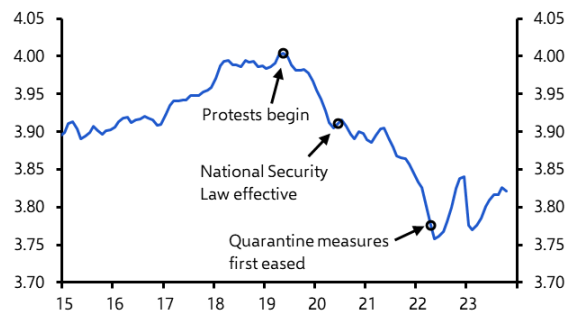
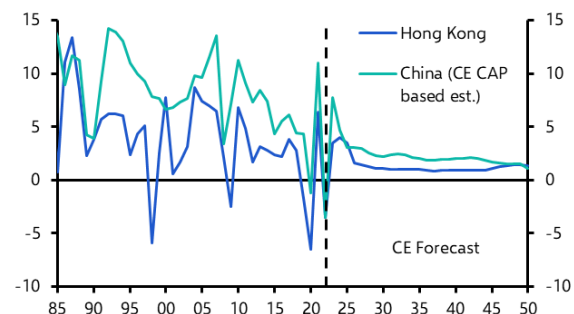
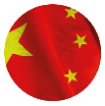


Chart 40: Hong Kong & China GDP (% y/y)



Sources: CEIC, Refinitiv, Capital Economics



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