Intellectual Exchange

Looking Beyond The Retail Boom in Hong Kong

19 July 2013
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- Roles of local consumers and inbound tourists
- Future prospects of retail sector
Structure and performance of Hong Kong retail industry
Last decade witnessed an impressive growth in Hong Kong’s retail sector

- Between 2001 and 2012, the value of retail sales grew by 142%, while the volume of retail sales rose by 100%.
- Since 2009, the pace of volume has been lagging behind that of value growth. This divergence was of essence of product mix variations as well as higher inflation over the last few years.

Source: Census & Statistics Department of HKSAR, Hang Seng Bank
Hong Kong’s retailers have outperformed its regional peers by a substantial margin

![Retail Sales Value Graph](image)

Source: Reuters EcoWin, Hang Seng Bank
The sector has experienced a broad-based gain over the past decade or so, with outlets for jewelleries growing at the fastest pace.

### Retail Sales Value
(by retail outlet, HKD million)

<table>
<thead>
<tr>
<th>Category</th>
<th>Cumulative Growth (2001 - 2012)</th>
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<tbody>
<tr>
<td>Fuels</td>
<td>40.9%</td>
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<tr>
<td>Food, alcoholic drinks and tobacco</td>
<td>57.2%</td>
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<td>Supermarkets</td>
<td>80.2%</td>
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<tr>
<td>Other consumer goods</td>
<td>125.7%</td>
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<td>Consumer durable goods</td>
<td>141.9%</td>
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<td>Department stores</td>
<td>143.4%</td>
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<tr>
<td>Clothing, footwear and allied products</td>
<td>147.8%</td>
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<tr>
<td>Jewellery, watches and clocks, and valuable gifts</td>
<td>354.5%</td>
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<td><strong>Total</strong></td>
<td><strong>141.6%</strong></td>
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</table>

**Source:** Census & Statistics Department of HKSAR, Hang Seng Bank
In terms of value, jewellery, watches, clocks and valuable gifts also emerged as the largest segment in the retail industry.
With a shift in the product mix to higher end segment, gross profit margin and net profit margin for the retail industry reaches level unseen before.

Against this favourable backdrop, retailers are competing mostly by converting potential consumers to customers, rather than with each other.

Gross Profit Margin and Net Profit Margin for Retail Industry*  
*Gross Profit Margin = (Sales - Cost of Goods Sold)/Sales  
Net Profit Margin = (Sales - All Costs)/Sales  
Source: Census & Statistics Department of HKSAR, Hang Seng Bank
Retail industry comes up as the fifth largest contributor to the local economy

- Out of all industries, retail trade comes up as the fifth largest contributor to the Hong Kong economy, adding HKD75.1 billion to the city’s output in 2011.

- Not only was it contributing much to the economy, its economic significance has grown over time:
  - Its share to GDP rose from 2.4% in 2000 to 3.9% in 2011.

Source: Census & Statistics Department of HKSAR, Hang Seng Bank
This sector is highly intensive with over 40% of its value added accruing to workers in the industry.

**Labour Intensity**
(no. of employed persons per HKD million of value added)

- Financial & Insurance: 0.7
- Construction: 1.1
- Import & Export Trade: 1.2
- Transport, Storage, Postal & Courier: 1.4
- Information & Communications: 1.5
- Real Estate, Prof & Business Services: 2.1
- Retail: 3.4
- Manufacturing: 3.6
- Wholesale: 3.9
- Accommodation & Food Services: 4.0

Source: Census & Statistics Department of HKSAR, Hang Seng Bank
The sustained expansion of this labour-intensive industry has brought with it ample employment opportunities

- Despite significant challenges brought about by 2008/09 global financial crisis, the share of retail employment has been rising.

- 260,000 people were employed in the retail industry as of the end of 2012, representing 9.8% of total employment.

Source: Census & Statistics Department of HKSAR, Hang Seng Bank
A thriving retail industry is crucial for more reasons

- **Positive spillover effects:** being in proximity to the customers, it ensures a good flow from producers to the consumer and is thereby the principal route to market for many other sectors

- **Foster human capital accumulation:** it provides a route into employment for school leavers and the young unemployed

- **Encourage labor force participation:** as a source of employment to people who often want to work non-standard hours

- **Alleviate structural unemployment:** for job seekers who have been made redundant or find themselves highly skilled in a struggling industry, retail industry also offers a opportunity for retraining
What are the reasons for the thriving retail industry

- **Tourist spending**
  - Inflow of tourists, particularly those from mainland China who prefer to spend money on shopping rather than staying at luxury hotels

- **Domestic consumption**
  - Income effect – increases in employment and wages
  - Wealth effect – gains in property and stock prices
The city has seen a rise in tourists presence over years.
Spending pattern of inbound visitors: then and now

- Inbound tourists are spending nearly 70% of their budget on shopping.
- Proportion of spending on other items (e.g. accommodation and dining) has been reduced over time.

Source: Hong Kong Tourism Board, Hang Seng Bank
Retail sector still relies on local residents, although visitor spending has become an more important driver of retail sales growth

- Using tourists’ shopping expenditure as a proxy, we can estimate retail spending by visitors and local residents respectively.
- Our estimates show that visitor spending has contributed 35.5% of the sales, more than twofold increase in the past twelve years.
- Residents still determine most of the demand for retail goods and services. Their spending accounts for 64.5% of total retail sales in 2012.
Local residents have spent HKD287 billion last year, 77.4% higher than what it was in 2001.

Source: Census & Statistics Department of HKSAR, Hang Seng Bank estimates
Behind the upbeat domestic demand lies a healthy labour market

$$\Delta \text{Retail Sales} = \Delta \left( \frac{\text{Retail Sales}}{\text{Labour Income}} \right) + \Delta \left( \frac{\text{Labour Income}}{\text{Employment}} \right) + \Delta \text{Employment}$$

**Nominal Wage Index**
(rebased to 2001 Q4 = 100)

**Total Employment**

Source: Census & Statistics Department of HKSAR, Reuters EcoWin, Hang Seng Bank
Income effect explains about half of the growth in retail sales by local residents, the other 50% could be attributed to other factors

- Our analysis shows that
  - Income effect explains about 50% of the gains in retail sales
    - Employment gains (+13.9%) and wage growth (+24.5%) added 38.4 percentage points to 77.4% increase in resident spending growth for 2001-2012
  - Other effects:
    - Changes in other factors, including wealth gains, negative real interest rates, expectations and aging population etc., explain the other 50% of domestic retail sales gains
Wealth effects associated with rising asset prices were at play

- Net housing and financial wealth elasticity of consumption are estimated to be around 0.18 and 0.12, respectively (HKMA 2013)
- On that premises, one may calculate that the advance in net housing and financial wealth contributed about 11.2 pps and 6.0 pps to resident spending growth during 2001-2012
- Structural factors such as ageing population, negative real interest rate, credit expansion and reduced unemployment volatility also supported resident spending

**Net Housing and Financial Wealth***

(HKD million)

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<tr>
<th>Year</th>
<th>Net Housing Wealth</th>
<th>Net Financial Wealth</th>
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*Net housing wealth is obtained with household’s housing asset minus residential mortgage liabilities
Net financial wealth is estimated by retail investors’ holding of equity minus credit card advance and other personal loans

Source: Rating & Valuation Department, HKMA, Hang Seng Bank estimates
Future prospects of retail sector
Hong Kong should witness continued rapid growth in tourist arrivals, driven by rising affluence and favourable demographic factors in the region.

**Total Visitor Arrivals**

2013 - 2017 CAGR: 13%

Source: Reuters EcoWin, Hang Seng Bank estimates
Less encouraging is the signs of moderation in medium- to long-term economic and income growth.

Source: Census & Statistics Department of HKSAR, Hang Seng Bank estimates.
What are the micro and macro implications?

- Asian consumers propensity to spend will help spur growth in retail sales in medium term.
- Income effect will continue to exert positive influence on retail sector, though impacts from wealth effect will likely be moderated.
- We project low mid-teens growth for retail sales over the next five years.
- If our forecasts materialise, annual retail sales would be running at around HKD806.6 billion by 2017, versus HKD445.5 billion in 2012.
What are the micro and macro implications? (con’t)

- Relative size of Hong Kong retail industry is set to catch up with other advanced economies

![Retail Sales Value (% of GDP, 2012)](chart1)

![Retail Sales Value Per Capita (USD, 2012)](chart2)

Source: Reuters EcoWin, Hang Seng Bank
What are the micro and macro implications? (con’t)

- The low value added per worker in the retail sector reflects the high labour intensity as well as the comparatively low skill levels.

- Structural effect related to a shift of employment from high value added sector to low value added sector could cause a gradual slowdown in GDP growth.

- One of the key challenges ahead is how to improve productivity growth in the retail sector to offset this structural effect.

Source: Census and Statistics Department of HKSAR, Hang Seng Bank estimates
What are the micro and macro implications? (con’t)

- **Competition will become more sophisticated**
  - Consumer discretionary sector is expected to outperform the rest of the market, bolstered by aspirational demand by Asian consumers
  - Competition among retailers will become more sophisticated as visitors seek more organized formats and greater exposure to global brands
  - It is also likely to observe higher degree of market concentration as available real estate saturates the market

- **Further demand for store space**
  - Branding, loyalty and private label is gaining importance. Establishing physical presence is an effective way to reduce brand confusion and spread awareness about product capabilities
  - With a promising business prospect, retailers’ appetite for the store space remains strong. We estimate an additional demand of 950,000 sq.m. of store space over the next five years
  - The supply shortfall would lay the ground for a favourable retail property market in medium-term
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