

Hong Kong Business Forecast Report Q1 2015

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Abstracts

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Core Views

Hong Kong's economy slowed yet again in Q214, with real GDP growth coming in at a disappointing 1.8% year-on-year (y-o-y). Owing to dual headwinds from China as well as the teetering domestic property market, we have downgraded our 2014 and 2015 real GDP forecasts to 2.5% and 3.3% respectively, from 3.0% and 3.7% previously.

We continue to expect the nascent correction in Hong Kong property prices to continue over the course of 2015. However, the correction is likely to be relatively mild, with price declines in the range of 10-15% within the realm of possibility. Some upside risk to this forecast will remain in play as long as the city-state's supply side woes, although the rising likelihood of monetary tightening in the US in 2015 is clouding the medium-term outlook. While Hong Kong's fiscal position remains on a sound footing, the potential for a normalisation of interest rates in the US could pose a challenge to the government. On the one hand, government revenues will be hit by the subsequent fall in property prices in the city-state.

As cooling measures are withdrawn, this will also hit revenues. However, we expect such measures to remain in place for the time being, and see Hong Kong running a small fiscal surplus in 2015. Hong Kong's democratic reform process, the cornerstone of which is meant to entail the introduction of universal suffrage by 2017, has become an increasingly contentious issue over recent months. We do not expect a satisfactory solution to the process in the near-term, as Beijing's model for 2017 elections does not fit with that of Hong Kong's pro-democracy contingent. Following major demonstrations in October 2014, further flare-ups are highly possible.

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Domestic Politics

Occupy Central Losing Steam As Beijing Asserts Will

Beijing's August decision that candidates for Hong Kong's Chief Executive position will need to be approved by a roughly 1,200-member committee confirms our view that the city-state is no longer politically autonomous from the mainland. While democracy activists have carried out large-scale protests over the matter, we believe that the movement will lose momentum over the long-run, and that it will not seriously undermine long-term commerce or social stability in the country.

Table: Political Over view

Long-Term Political Outlook

Benign Outlook Despite Democratic Reform Uncertainty

While we believe Hong Kong will remain at or near the top of our political risk ratings table over the next decade, a number of risks could lead to rising political instability. The sluggish pace of democratic reforms will continue to cause anger among pro-democracy supporters, and there is the potential for large-scale public protests. A lack of affordable housing and rising income inequality also could pose threats to social stability.

CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

BMI Economic Risk Index

Economic Activity

Protests A Growing Economic Threat As Beijing Stands Firm

The rapid escalation in the scale of Hong Kong's pro-democracy protests has surpassed our expectations, and both political and economic risks in the country have risen as a result. While we expect a largely peaceful

outcome, the threat of a further escalation and the potential for the use of force by Hong Kong law enforcement presents downside risks to our real GDP growth forecast of 2.5% for

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Hong Kong's economy slowed yet again in Q214, with real GDP growth coming in at a disappointing 1.8% y-o-y. Owing to dual headwinds from China as well as the teetering domestic property market, we have downgraded our 2014 and 2015 real GDP forecasts to 2.5% and 3.3% respectively, from 3.0% and 3.7% previously.

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Monetary Policy

HKD Stable Despite Political Risks

Despite the recent flare in political risk owing to pro-democracy protests, the Hong Kong dollar has remained largely stable, and we do not expect that the Hong Kong Monetary Authority (HKMA) will need to intervene heavily in the market to maintain the currency's peg.

Meanwhile, we also believe that the HKMA will look to leave its macroprudential measures largely unchanged over the near-term, as still-buoyant property prices balance out risks of a property correction amid the rising global interest rate environment.

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Port Outlook Improves Despite Downside Trade Risks

We have revised up our outlook for throughput at the port of Hong Kong on the back of data for the first four months of 2014. Hong Kong plays a major role in the global container shipping supply chain but last year a month-long strike, its exposure to the weak demand outlook for the major consumer markets, increased competition and the move of Chinese manufacturing away from the coast hit the port hard. The facility lost its coveted position as the world's third-largest container port to Shenzhen.

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Integration With Mainland Key To Growth

Hong Kong's long-term outlook remains reasonably bright. While a developed economy, increased cooperation between Hong Kong and China offers a unique opportunity for the Special Administrative Region to benefit from the Mainland to further drive economic growth. We therefore expect Hong Kong to resume its strong economic expansion over the coming years and average 3.7% real GDP growth over the next decade. However, Hong Kong needs to maintain its competitive edge or risk being overshadowed by fast-rising Chinese cities.

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