

# Hong Kong Business Forecast Report Q2 2014

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## Abstracts

### Core Views

In 2014, we remain relatively less sanguine on the back of expectations of a slowing in China's economy and a correction within the property market that will adversely affect a substantial part of Hong Kong's economy. As a result, we are maintaining our below-consensus (3.5%) real GDP growth forecast of 3.0% in 2014.

Hong Kong's property market appears to be the nascent stages of a correction, which falls in line with our expectations. While we are of the view that this is just the start of the correction and that further price declines are likely to be in order, we expect the correction to remain moderate. We highlight that the shifting of mainland investor interest out of Hong Kong, if sustained, represents a salient downside risks. However, we point out that continuing supply-side woes carry upside risks to the expected correction.

Hong Kong has been witnessing increasing incidences of costoverruns in the city's massive public infrastructure projects in recent years. This is due in no small part to the government's penchant for utilising public infrastructure spending to bolster the economy in times of a slowdown. The glut of projects in recent years has led to a labour shortage which has in turn driven up wage costs. While the recent spate of cost blowouts and a slowing economy have led to concerns regarding the city's fiscal profile, we believe that the government's fiscal prudence and the huge fiscal reserves that it has built up over the years will help it to cushion any deterioration in its fiscal position.

Hong Kong's political environment appears to be becoming increasingly divisive and we stress that if Beijing is seen to be interfering with the running of the city, Hong Kong may gradually lose its preeminence as a global financial centre.

## **Key Risks To Outlook**

Downside Risk To 2014 Growth Forecast: Should the mainland economy experience a sharper-than-expected slowdown the ripple effect on Hong Kong means that its economy would be disproportionately affected.

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### **CHAPTER 1: POLITICAL OUTLOOK**

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Tough Road Ahead Towards Universal Suffrage

While the government has taken the first step in its endeavour to achieve universal suffrage by starting a five-month public consultation on direct elections, its path towards electoral reforms is likely to be fraught with challenges. Chief Executive Leung Chun-ying's administration will have to tread carefully to ensure that the new political system pacifies both the pan-democrats, whose support it needs, as well as Beijing, whose approval it requires. Meanwhile, Hong Kong's political environment appears to be becoming increasingly divisive and we stress that if Beijing is seen to be interfering with the running of the city, Hong Kong may gradually lose its pre-eminence as a global financial centre.

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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**

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Despite Hong Kong's economy underperforming in Q313, we remain relatively constructive on its economic growth through the rest of the year as the region benefits from a transitory bounce in economy activity. Going into 2014, we remain less optimistic

on the back of expectations of a slowing in China's economy and a correction within the property market that will adversely affect a substantial part of Hong Kong's economy. As a result, we are maintaining our below-consensus (3.5%) real GDP growth forecast of 3.0% in 2014.

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Hong Kong has been witnessing increasing incidences of cost-overruns in the city's massive public infrastructure projects in recent years. This is due in no small part to the government's penchant for utilising public infrastructure spending to bolster the economy in times of a slowdown. The glut of projects in recent years has led to a labour shortage which has in turn driven up wage costs. While the recent spate of cost blowouts and a slowing economy have led to concerns regarding the city's fiscal profile, we believe that the government's fiscal prudence and the huge war chest of fiscal reserves that it has built up over the years will help it to cushion any deterioration in its fiscal position.

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Hong Kong's property market appears to be the nascent stages of a correction, which falls in line with our expectations. While we are of the view that this is just the start of the correction and that further price declines are likely to be in order, we expect the correction to remain moderate. We highlight that the shifting of mainland investor interest out of Hong Kong, if sustained, represents a salient downside risks. However, we point out that continuing supply-side woes carry upside risks to the expected correction.

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Export Weakness Still Expected In 2014 In Spite Of China's Surge

Given that re-exports comprise the vast majority of Hong Kong's overall external shipments, the city-state's trade prospects remain inextricably tied to regional and global economic conditions. In light of our expectations for the recent surge in Chinese (and, indeed, Northeast Asia) exports to falter over the coming year, we therefore believe that Hong Kong's trade outlook for 2014 is similarly underwhelming, and expect export growth for the year to decline to 7.3% from an estimated 7.6% in 2013.

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