

Hong Kong Business Forecast Report Q3 2014

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Abstracts

Core Views

The Hong Kong economy narrowly eclipsed our expectations for 2.8% growth in 2013, notching a 2.9% full-year expansion on the back of 3.0% year-on-year growth in Q413. Nevertheless, we remain decidedly below consensus (3.7%) with our 2014 real GDP forecast of 3.0%, with expectations for the ongoing slowdown in China as well as the nascent correction in the Hong Kong property market to take a toll on broader economic activity.

We continue to expect the nascent correction in Hong Kong property prices to continue over the course of 2014. That said, we maintain that 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, including the government missing its land sales targets, continue.

Hong Kong notched another budget surplus in FY2013/14, once again defying government forecasts for a modest deficit of HKD4.9bn. Nevertheless, the government has seen fit to tighten the purse strings in both capital and operating expenditure terms in order to shore up the long-term sustainability of its fiscal accounts. Given the government's proactive efforts to maintain a solid fiscal trajectory, we believe that Hong Kong will run a small surplus averaging 0.4% of GDP over the next 10 years.

Hong Kong's democratic reform process, the cornerstone of which is meant to entail the introduction of universal suffrage by 2017, remains an issue of considerable contention between pro-Beijing and pro-autonomy interests. On balance, we believe that the Hong Kong government will not be capable of enacting any substantial reforms that are not tacitly approved by Beijing. While this will likely have little effect on Hong Kong's investment or economic outlook, it could nevertheless undermine the city-state's social

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Hong Kong's democratic reform process, the cornerstone of which is meant to entail the introduction of universal suffrage by 2017, remains an issue of considerable contention between pro-Beijing and pro-autonomy interests. On balance, we believe that the Hong Kong government will not be capable of enacting any substantial reforms that are not tacitly approved by Beijing. While this will likely have little effect on Hong Kong's investment or economic outlook, it could nevertheless undermine the city-state's social stability, and we will be closely monitoring the process as such.

Table: Political Overview

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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The Hong Kong economy scarcely beat our expectations for 2.8% growth in 2013, notching a 2.9% full-year expansion on the back of 3.0% year-on-year growth in Q413. Nevertheless, we remain decidedly below consensus (3.7%) with our 2014 real GDP forecast of 3.0%, with expectations for the ongoing slowdown in China as well as the nascent correction in the Hong Kong property market to take a toll on broader economic

activity.

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Hong Kong notched another budget surplus in FY2013/14, once again defying government forecasts for a modest deficit of HKD4.9bn. Nevertheless, the government has seen fit to tighten the purse strings in both capital and operating expenditure terms in order to shore up the long-term sustainability of its fiscal accounts. Given the government's proactive efforts to maintain a solid fiscal trajectory, we believe that Hong Kong will run a small surplus averaging 0.4% of GDP over the next 10 years.

Table: FISCAL POLICY

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Inflation To Remain Elevated Even As Property Cools

Headline inflation cooled somewhat considerably in February, printing at 3.9% year-on-year versus 4.6% previously. Still, this is not a trend that we expect to continue, particularly as rental price growth is unlikely to retreat substantially even in the face of a mounting real estate correction. On the whole, we believe that inflation will remain relatively stable over the course of 2014, and are therefore maintaining our forecast for the category to average 4.0%.

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Increasing Downside Risk To Exports As China Slows

Hong Kong's exports took a 29.9% month-on-month tumble in February in sympathy with a considerable retrenchment in Chinese exports. We consider the ongoing slowdown in the mainland's economy to be a downside risk to our 8.2% export growth forecast for Hong Kong in 2014, but are happy to retain our 3.0% real GDP growth forecast.

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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

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