

## Adapting to China's New Normal

### General Information



|                           |  |
|---------------------------|--|
| <b>GDP</b>                | USD290.9bn (World ranking 38, World Bank 2014) |
| <b>Population</b>         | 7.2mn (World ranking 99, World Bank 2014)      |
| <b>Form of state</b>      | Limited Democracy                              |
| <b>Head of government</b> | LEUNG Chun-ying (nonpartisan)                  |
| <b>Next elections</b>     | 2016, legislative                              |



### Strengths

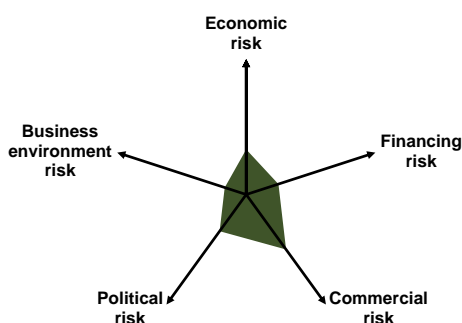
- Being a gateway to China and close ties help Hong Kong capitalize on competitive advantage in finance and services
- Good record of strong dynamic growth
- Strong external liquidity and public debt position
- Sound banking system and proven monetary policy framework
- Very strong business environment

### Weaknesses

- Long-term competition from Mainland cities
- Sensitive to political developments in mainland China
- As a small, very open and financially integrated economy, Hong Kong is highly sensitive to global economic and financial shocks
- Exposed to possible property sector price bubble

### Country Rating

**A1**



Source: Euler Hermes

### Trade Structure

By destination/origin (% of total, 2014)

| Exports       |     | Rank |     | Imports       |  |
|---------------|-----|------|-----|---------------|--|
| China         | 57% | 1    | 45% | China         |  |
| United States | 8%  | 2    | 7%  | Taiwan        |  |
| Japan         | 3%  | 3    | 7%  | Japan         |  |
| India         | 3%  | 4    | 6%  | United States |  |
| Taiwan        | 2%  | 5    | 6%  | Singapore     |  |

By product (% of total, 2014)

| Exports               |     | Rank |     | Imports               |  |
|-----------------------|-----|------|-----|-----------------------|--|
| Electrical machinery  | 24% | 1    | 24% | Electrical machinery  |  |
| Telecommunication     | 16% | 2    | 14% | Telecommunication     |  |
| Office machines       | 11% | 3    | 10% | Office machines       |  |
| Gold                  | 10% | 4    | 9%  | Gold                  |  |
| Manufactured articles | 6%  | 5    | 6%  | Manufactured articles |  |

Sources: ITC, Chelem

## Economic Overview

### GDP growth to slowdown in 2015

GDP growth will decelerate to +2.1% in 2015, rebound slightly in 2016 (+2.5%). In that context, growth in insolvency will likely accelerate to +22% in 2015 (from +7% in 2014) before slowing to +15% in 2016. Political environment has eased since end of 2014, and economic disruptions have stopped. This has allowed a strong pick-up in activity in H1. While, the performance of exported goods weakens due to lower growth in external demand, domestic demand strengthened. In Q2, GDP growth was up to 2.8%y/y, (from 2.4% in Q1) driven by strong consumer spending (6% y/y), and solid investment growth (5% y/y). Property markets have picked up above long term level suggesting policy actions to contain overheating risk. The outlook for H2 is more challenging. Output growth is expected to decelerate reflecting: (i) moderate growth in demand from advanced economies, low growth in China Mainland; (ii) weak sentiment after Asian market turbulence; and tighter monetary policy. In the short term, fiscal support (large infrastructure projects) and robust households fundamentals (improving wages and sound labour market) will help to keep growth in an adequate range. In the long term, market integration with China will be key for enabling further growth in both services exports and domestic market activities through tourism; and further exports of financial services.

### Monetary policy to tighten gradually to keep growth in stable range

Monetary policy is determined by the currency board that pegs the HKD exchange rate to the USD, therefore, interest rates mirror those of the U.S. In that respect, monetary policy is set to tighten in line with the upcoming Fed hike. The pace will likely be gradual to allow a progressive adjustment of the property market. Inflationary pressures have already eased in line with lower commodity prices and we expect further reduction over 2015 (+3.2% from +4.3 in 2014) in and 2016 (+2.5). Credit conditions will tighten but remain adequate for solid growth with still large financing flows coming into the economy. The city has a strong strategic position as a financial hub and hence benefit from solid financing flows from both China-mainland and foreign investors.

### Healthy public finances and sound external position

Hong Kong presents strong public finances with a fiscal balance in surplus in 2014 and a public debt relatively low. The government's plan in its 2015 budget is to continue investing in business and services with a special emphasis on start-ups and art and entertainment related companies. As an international hub Hong Kong continues to record large current account surplus though it is undermined by weak growth in external demand. The main contributors to this surplus are services while the goods balance is negative. The government's external debt is low and import cover is adequate.

#### DISCLAIMER

These assessments are, as always, subject to the disclaimer provided below.

This material is published by Euler Hermes SA, a Company of Allianz, for information purposes only and should not be regarded as providing any specific advice. Recipients should make their own independent evaluation of this information and no action should be taken, solely relying on it. This material should not be reproduced or disclosed without our consent. It is not intended for distribution in any jurisdiction in which this would be prohibited. Whilst this information is believed to be reliable, it has not been independently verified by Euler Hermes and Euler Hermes makes no representation or warranty (express or implied) of any kind, as regards the accuracy or completeness of this information, nor does it accept any responsibility or liability for any loss or damage arising in any way from any use made of or reliance placed on, this information. Unless otherwise stated, any views, forecasts, or estimates are solely those of the Euler Hermes Economics Department, as of this date and are subject to change without notice. Euler Hermes SA is authorised and regulated by the Financial Markets Authority of France.

© Copyright 2015 Euler Hermes. All rights reserved.

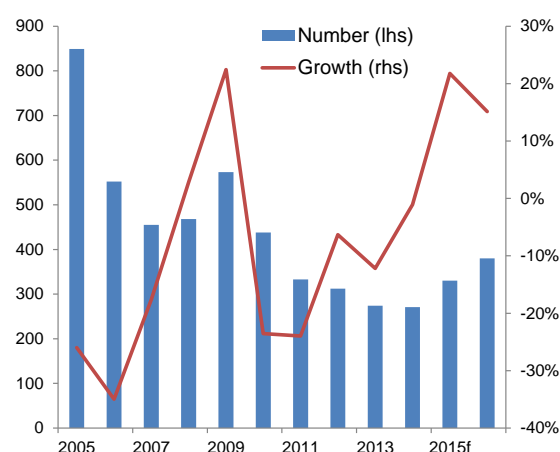
### Key economic forecasts

|                              | 2013  | 2014  | 2015f | 2016f |
|------------------------------|-------|-------|-------|-------|
| GDP growth (% change)        | 3.1   | 2.5   | 2.1   | 2.5   |
| Inflation (% , year average) | 4.3   | 4.4   | 3.2   | 2.5   |
| Fiscal balance (% of GDP)    | 0.6   | 2.8   | 1.5   | 0.8   |
| Public debt (% of GDP)*      | 7.0   | 6.9   | 6.4   | 6.2   |
| Current account (% of GDP)   | 1.5   | 1.8   | 2.1   | 2.5   |
| External debt (% of GDP)     | 421.5 | 443.9 | 440.0 | 435.0 |

\*General government debt, IMF/WEO definition

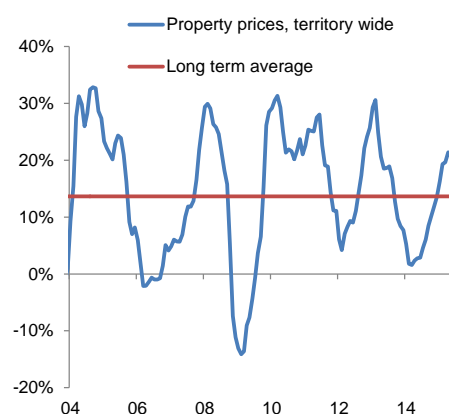
Sources: National sources, IMF, IHS, Euler Hermes

### Insolvencies



Sources: National sources, IHS, Euler Hermes

### Property prices (y/y)



Sources: National sources, IHS, Euler Hermes