Euler Hermes Economic Research

Country Report

Hong Kong

Coping with China's slowdown

General Information

GDP	USD290.9bn (World ranking 38, World Bank 2014)
Population	7.2mn (World ranking 99, World Bank 2014)
Form of state	Limited Democracy
Head of government	Leung Chun-ying
Next elections	2016, legislative

Strengths

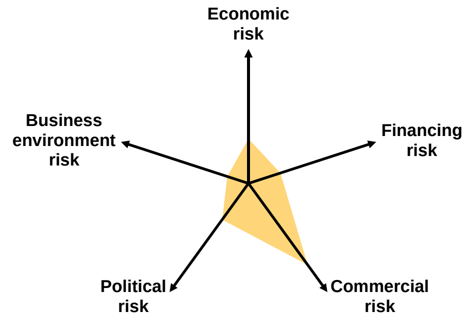
- Being a gateway to China and close ties help Hong Kong capitalize on competitive advantage in finance and services
- Good record of strong dynamic growth
- Strong external liquidity and public debt position
- Sound banking system and proven monetary policy framework
- Very strong business environment

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 property sector price fluctuations

Country Rating

A2



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

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

By product (% of total)

Exports		Rank		Imports
Electrical machinery and apparatus	27%	1	27%	Electrical machinery and apparatus
Telecom. and sound recording apparatus	18%	2	15%	Telecom. and sound recording apparatus
Office and data processing machines	10%	3	9%	Gold, non-monetary (excluding gold ores and concentrates)
Gold	10%	4	8%	Office and data processing machines
Miscellaneous manufactured articles	5%	5	6%	Miscellaneous manufactured articles.

Source: UNCTAD

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Economic Overview

More slow growth in 2016

GDP growth slowed to +2.4% in 2015 (from +2.6%) due lower exports and investment. Insolvencies increased by +13% in 2015. In 2016, EH expects GDP growth to slow further (+2%), insolvencies to continue to rise (+15%). Downward pressures will stem from weak exports and low private investment. China's imbalanced rebalancing will continue to weigh negatively on the economic activity through lower exports, weak retail sales (as tourist arrivals recede) and volatile financial sentiment.

Improving demand growth in large advanced economies will provide limited cushion due to its nature (more domestic oriented) and pace (very moderate). Domestic conditions will remain unconducive for private investment growth with tightened monetary policy, lower new orders and volatile financial sentiment. Government support will likely step up with further expenditures in infrastructures and salaries tax cuts. Lower inflation, more favourable fiscal environment and firm labour market will help keeping private consumption in positive territory.

Monetary policy to remain tight

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, Hong Kong monetary policy was tightened in line with the previous Fed hike. Assuming a gradual tightening of the FED, this trend is set to continue going forward. This will translate into tougher credit conditions for the private sector but also lower inflationary pressure. The latter has already eased with lower commodity prices and lower property prices. We expect further reduction over 2016 (+2.5% from +3.0% in 2015).

Healthy public finances and sound external position should act as buffers

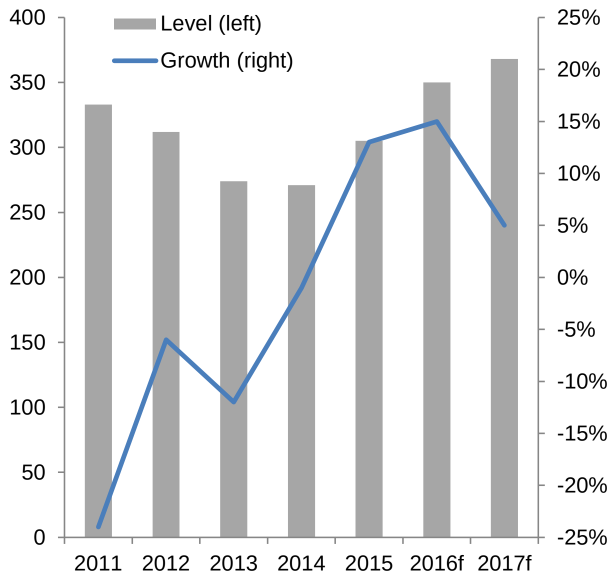
Hong Kong has built significant buffers overs the past years. Fiscal reserves stand at 35% GDP. Public debt is low and fiscal balance is in surplus. The government's plan in its 2016 budget is clearly pro-growth, planning further expenditures to support innovative companies (start-up, high-tech oriented companies), infrastructure development and households consumption (tax cuts). Furthermore, the external position is comfortable as Hong Kong continues to record large current account surplus, maintain large level of reserves. External debt is large but should not be a matter of concern in the short-run as the country has a large net creditor position: net external financial assets represent 316% of GDP.

Key economic forecasts

	2014	2015f	2016f	2017f
GDP growth (% change)	2.6	2.4	2.0	2.1
Inflation (%, average)	4.4	3.0	2.5	2.9
Fiscal balance (% of GDP)	3.2	1.5	0.7	0.1
Public debt (% of GDP)*	0.07	0.06	0.06	0.06
Current account (% of GDP)	1.7	2.8	2.5	2.9
External debt (% of GDP)	447	421	430	435

Sources: HKMA, IHS, IMF, Euler Hermes

Insolvencies



Sources: IHS, Euler Hermes

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