HONG KONG

SEPTEMBER 2023

COUNTRY REPORT

HONG KONG
ISSN: 1054-5581

PUBLISHED BY THE PRS GROUP, INC.

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China
Sheung Shui
New Territories
Tuen Mun
HONG KONG
Tsuen Wan
Kowloon
Lantau Island
Hong Kong
Aberdeen
Hong Kong island
South China Sea

KEY TAKEAWAYS

MOST LIKELY REGIMES & THEIR PROBABILITIES	
18-MONTH	Limited Autonomy 60%
FIVE-YEAR	Limited Autonomy 50%

FORECASTS OF RISK TO INTERNATIONAL BUSINESS				
	TURMOIL	**FINANCIAL TRANSFER**	**DIRECT INVESTMENT**	**EXPORT MARKET**
18-MONTH	Moderate	A	A-	A
FIVE-YEAR	Moderate	A-	B+	A-

( ) Indicates change in rating
* Indicates forecast of a new regime

KEY ECONOMIC FORECASTS			
	REAL GDP GROWTH (%)	**INFLATION (%)**	**CURRENT ACCOUNT ($bn)**
2018-2022(AVG)	-0.5	1.8	28.08
2023(F)	3.8	1.8	27.60
2024-2028(F)	2.9	2.5	21.90

BARRIERS TO RESTORING CONFIDENCE

The prosecution of dozens of democracy activists on charges of subversion and changes to the electoral rules that significantly diminish the influence of popularly elected representatives have sapped the vigor of the political reform movement that spearheaded disruptive mass protests in 2019-2020, but the restoration of internal order has come at the cost of lasting (and quite possibly permanent) damage to Hong Kong's reputation among foreign investors.

In 2020−2022, the population of the SAR decreased by more than 187,000, a decline of 2.5% in three years. Over the same period, dozens of foreign companies relocated their regional headquarters out of Hong Kong, and the number of new visas issued for foreign workers in the financial services industry in 2022 was only about one-half of the figure for 2019.

The partial reversal of the population decline over the last 12 months is partly attributable to the easing of health restrictions and highlights the success of various talent and labor recruitment schemes introduced by the SAR in the last 18 months. However, the number of high-net-worth residents of Hong Kong has decreased at a much a steeper rate (30% since 2012) than the overall population decline, a trend that will not be reversed by the enticements on offer from the government, nor are the middle-class families that sold property and moved overseas likely to ponder a return in the current political climate.

As a complement to its talent recruitment efforts, the government is attempting to overcome the damage to Hong Kong's reputation among investors by pitching the SAR as a destination of choice for crypto companies in the burgeoning digital assets industry. However, there are indications that the enthusiasm surrounding the initiative might be more apparent than real.

In fairness, it is very early days yet for the digital assets push. But given Beijing's evident skepticism about cryptocurrency (which is banned in mainland China), it is debatable how much benefit of the doubt Chief Executive John Lee and his colleagues will be granted before the Communist leadership clamps down on the effort, a threat that may explain why there has not been a rush to secure licenses.

In any case, the investment climate will remain under the pall created by US sanctions targeting four members of the SAR government (including Lee) over their role in the anti-democracy crackdown, and evidence of emerging challenges for the mainland economy that could spell political trouble for President Xi Jinping points to a heightened risk of escalating international tensions that would have negative implications for the security of foreign businesses operating in Hong Kong.

Lee is feeling pressure from Beijing to revive an export-led economy that registered an annual real contraction in three of the last four years, including a 3.5% decline in 2022. The 2023/2024 budget contains various schemes (including one-off tax relief and consumption vouchers) that will help to stimulate household consumption and business investment, and the growth rate in the second half of the year will benefit from a favorable base effect.

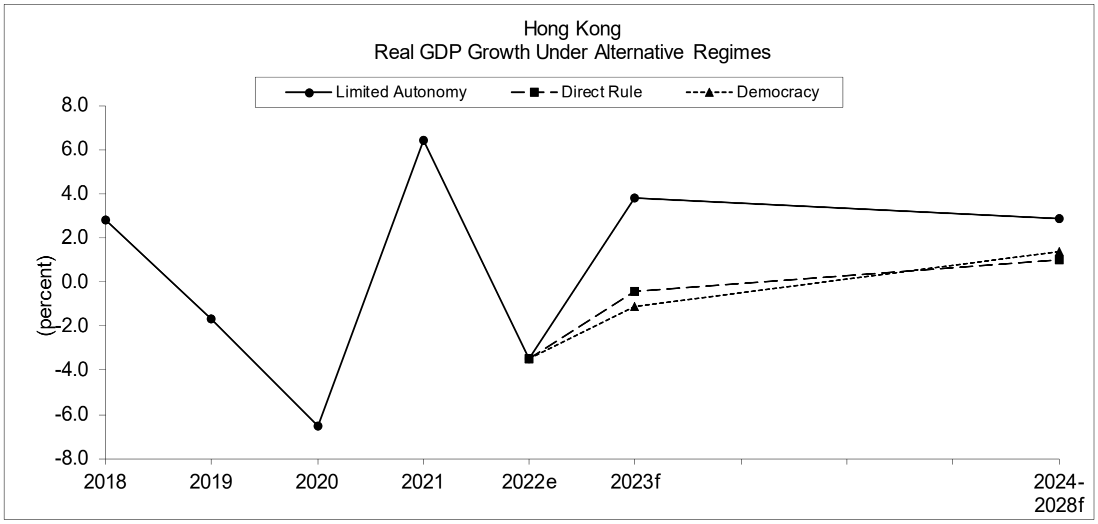
However, mainland indicators suggest that the local economy will not receive a boost from that quarter in the near term. With tourism numbers still running well below the pre-pandemic level and the purchasing managers' index continuing to point to contractionary conditions in the manufacturing sector, it is likely that average growth for the year will undershoot the government's revised target of 4%-5%.

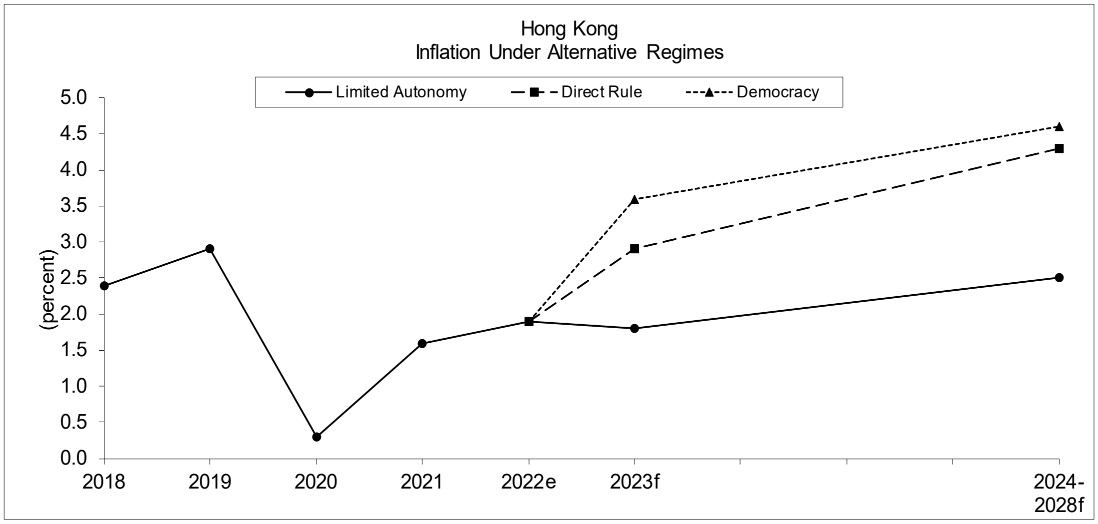
ECONOMIC FORECASTS FOR THE THREE ALTERNATIVE REGIMES									
	Limited Autonomy			Direct Rule			Democracy		
	GROWTH (%)	INFLATION (%)	CACC ($bn)	GROWTH (%)	INFLATION (%)	CACC ($bn)	GROWTH (%)	INFLATION (%)	CACC ($bn)
2023	3.8	1.8	27.60	-0.4	2.9	12.70	-1.1	3.6	9.40
2024-2028	2.9	2.5	21.90	1.0	4.3	-5.70	1.4	4.6	3.90

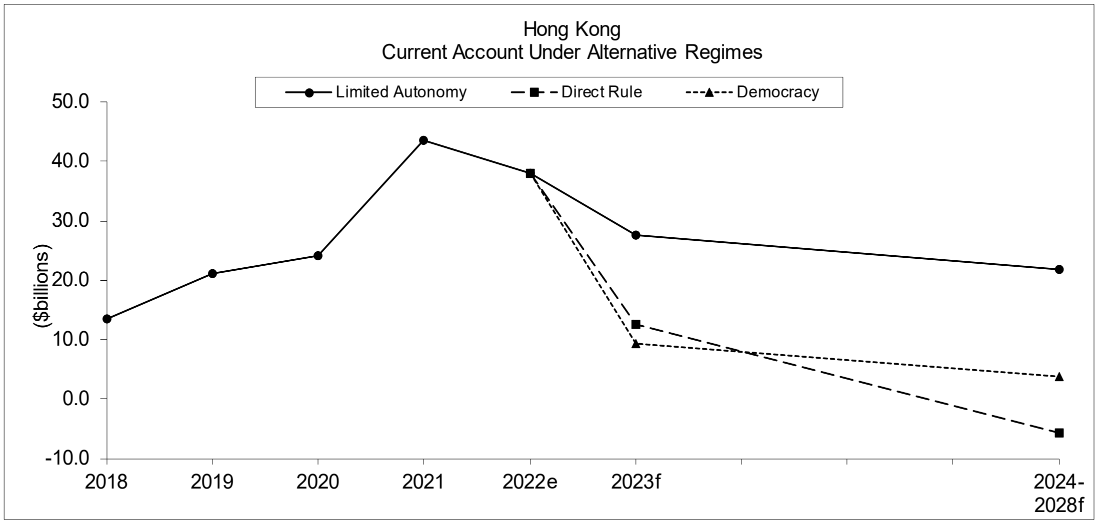
REGIME, BUSINESS & INVESTMENT FORECASTS

SUMMARY OF 18-MONTH FORECAST				
REGIMES & PROBABILITIES		Limited Autonomy 60%	Direct Rule 35%	Democracy 5%
RISK FACTORS	**CURRENT**			
Turmoil	Low	SLIGHTLY MORE	MUCH MORE	MORE
Investment				
Equity	Low	Same	SLIGHTLY MORE	Same
Operations	Moderate	SLIGHTLY MORE	MORE	SLIGHTLY MORE
Taxation	Low	Same	SLIGHTLY MORE	Same
Repatriation	Low	Same	MORE	Same
Exchange	Low	Same	MORE	Same
Trade				
Tariffs	Low	Same	SLIGHTLY MORE	Same
Other Barriers	Low	SLIGHTLY MORE	MORE	Same
Payment Delays	Low	Same	SLIGHTLY MORE	Same
Economic Policy				
Expansion	Moderate	SLIGHTLY LESS	SLIGHTLY MORE	SLIGHTLY MORE
Labor Costs	Low	SLIGHTLY MORE	SLIGHTLY MORE	SLIGHTLY MORE
Foreign Debt	Low	Same	SLIGHTLY MORE	Same
SUMMARY OF FIVE-YEAR FORECAST				
REGIMES & PROBABILITIES		Limited Autonomy 50%	Direct Rule 45%	Democracy 5%
RISK FACTORS	**BASE**			
Turmoil	Low	Same	MUCH MORE	MORE
Restrictions				
Investment	Low	Same	MORE	Same
Trade	Low	Same	SLIGHTLY MORE	Same
Economic Problems				
Domestic	Moderate	SLIGHTLY LESS	MORE	SLIGHTLY MORE
International	Low	Same	MORE	SLIGHTLY MORE

* When present, indicates forecast of a new regime


Hong Kong
Real GDP Growth Under Alternative Regimes
Limited Autonomy
Direct Rule
Democracy
(percent)
8.0
6.0
4.0
2.0
0.0
-2.0
-4.0
-6.0
-8.0
2018
2019
2020
2021
2022e
2023f
2024-2028f


Hong Kong
Inflation Under Alternative Regimes
Limited Autonomy
Direct Rule
Democracy
(percent)
5.0
4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
2018
2019
2020
2021
2022e
2023f
2024-2028f


Hong Kong
Current Account Under Alternative Regimes
Limited Autonomy
Direct Rule
Democracy
($billions)
50.0
40.0
30.0
20.0
10.0
0.0
-10.0
2018
2019
2020
2021
2022e
2023f
2024-2028f

Hong Kong
Econometric Data

	2013-2017 Average	2018-2022 Average	2013	2014	2015	2016	2017
Domestic Economic Indicators							
GDP (Nominal, $bn)	307.73	359.70	275.62	291.46	309.38	320.87	341.33
Per Capita GDP ($)	42058	48363	38227	40201	42323	43478	46063
Real GDP Growth Rate (%)	2.9	-0.5	3.1	2.8	2.4	2.2	3.8
Inflation Rate (%)	3.1	1.8	4.3	4.4	3.0	2.4	1.5
Capital Investment ($bn)	69.42	64.62	66.46	68.47	69.30	68.95	73.92
Capital Investment/GDP (%)	22.6	17.9	24.1	23.5	22.4	21.5	21.7
Budget Revenues ($bn)	65.34	78.67	57.88	60.62	57.54	72.52	78.16
Budget Revenues/GDP (%)	21.2	21.9	21.0	20.8	18.6	22.6	22.9
Budget Expenditures ($bn)	55.87	88.66	55.12	50.42	55.69	58.72	59.39
Budget Expenditures/GDP (%)	18.2	24.7	20.0	17.3	18.0	18.3	17.4
Budget Balance ($bn)	9.48	-9.99	2.76	10.20	1.85	13.80	18.77
Budget Balance/GDP (%)	3.0	-2.9	1.0	3.5	0.6	4.3	5.5
Money Supply (M1, $bn)	253.34	369.40	194.78	220.37	254.28	285.23	312.05
Change in Real Wages (%)	1.5	0.1	-1.5	1.0	2.0	3.7	2.2
Unemployment Rate (%)	3.3	4.2	3.4	3.3	3.3	3.4	3.1
International Economic Indicators							
Foreign Direct Investment ($bn)	129.34	106.16	76.84	129.84	181.06	133.23	125.72
Forex Reserves ($bn)	360.02	439.66	311.06	328.38	358.66	386.15	415.86
Gross Reserves (ex gold, $bn)	363.17	455.48	311.13	328.44	358.70	386.22	431.38
Gold Reserves ($bn)	0.08	0.11	0.08	0.08	0.07	0.08	0.09
Gross reserves (inc gold, $bn)	363.25	455.60	311.21	328.52	358.77	386.30	431.47
Total Foreign Debt ($bn)	1337.09	1743.75	1160.21	1301.23	1300.10	1355.57	1568.34
Total Foreign Debt/GDP (%)	433.9	484.8	421.0	446.5	420.2	422.5	459.5
Debt Service ($bn)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Debt Service/XGS (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current Account ($bn)	9.37	28.08	4.19	4.06	10.26	12.71	15.64
Current Account/GDP (%)	3.0	7.8	1.5	1.4	3.3	4.0	4.6
Current Account/XGS (%)	1.2	3.1	0.5	0.5	1.3	1.7	1.9
Exports ($bn)	512.84	588.13	506.13	514.16	501.71	501.53	540.65
Imports ($bn)	537.39	599.24	534.05	546.52	524.58	518.24	563.57
Trade Balance ($bn)	-24.56	-11.11	-27.92	-32.36	-22.87	-16.71	-22.92
Exports of Services ($bn)	103.74	96.47	104.76	106.92	104.35	98.54	104.12
Income, credit ($bn)	165.09	212.12	152.58	161.82	164.40	164.07	182.58
Transfers, credit ($bn)	1.27	1.92	1.04	1.14	1.24	1.35	1.58
Exports G&S ($bn)	782.93	898.64	764.51	784.04	771.70	765.49	828.93
Liabilities ($bn)	8.59	8.57	7.53	7.64	8.37	10.99	8.44
Net Reserves ($bn)	354.66	448.31	303.68	320.88	350.40	375.31	423.03
Liquidity (months import cover)	7.9	9.0	6.8	7.0	8.0	8.7	9.0
Currency Exchange Rate	7.763	7.807	7.757	7.754	7.752	7.762	7.792
Currency Change (%)	-0.1	-0.1	0.0	0.0	0.0	-0.1	-0.4
Social Indicators							
Population (million)	7.31	7.44	7.21	7.25	7.31	7.38	7.41
Population Growth (%)	0.8	-0.2	1.4	0.6	0.8	1.0	0.4
Infant Deaths/1000	2	2	2	2	2	2	2
Persons under Age 15 (%)	11	12	11	11	11	11	11
Urban Population (%)	100	100	100	100	100	100	100
Urban Growth (%)	0.8	-0.2	1.4	0.6	0.8	1.0	0.4
Literacy % pop.	96	96	96	96	96	96	96
Agricultural Work Force (%)	0	0	0	0	0	0	0
Industry-Commerce Work Force (%)	11	11	11	11	11	11	11
Services Work Force (%)	89	89	89	89	89	89	89
Unionized Work Force (%)	22	22	22	22	22	22	22
Energy - total consumption (10^{15} Btu)	1.27	1.17	1.21	1.17	1.28	1.33	1.38
Energy - consumption/head (10^{9} Btu)	0.18	0.43	0.17	0.16	0.18	0.18	0.19

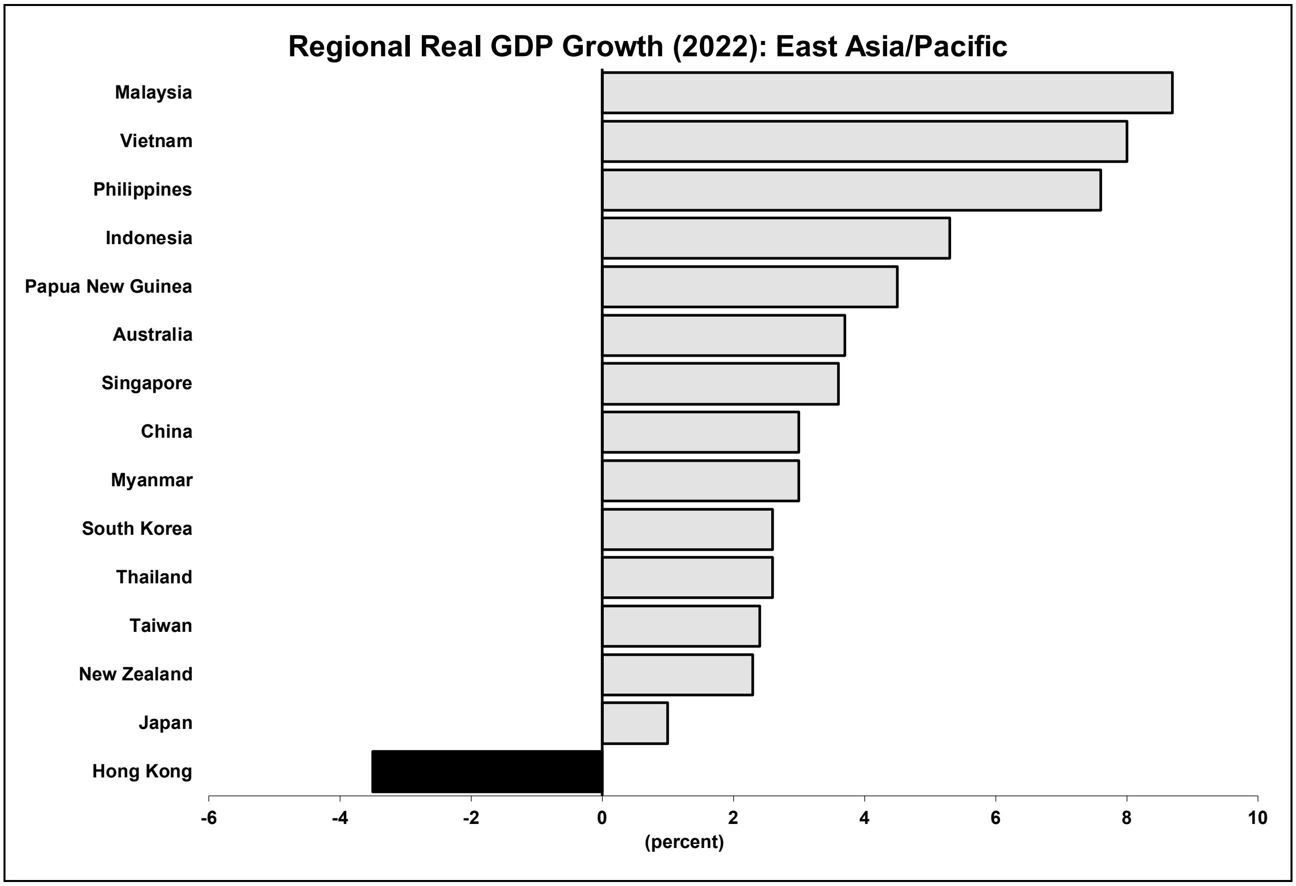
Note: budget fiscal year beginning April 1

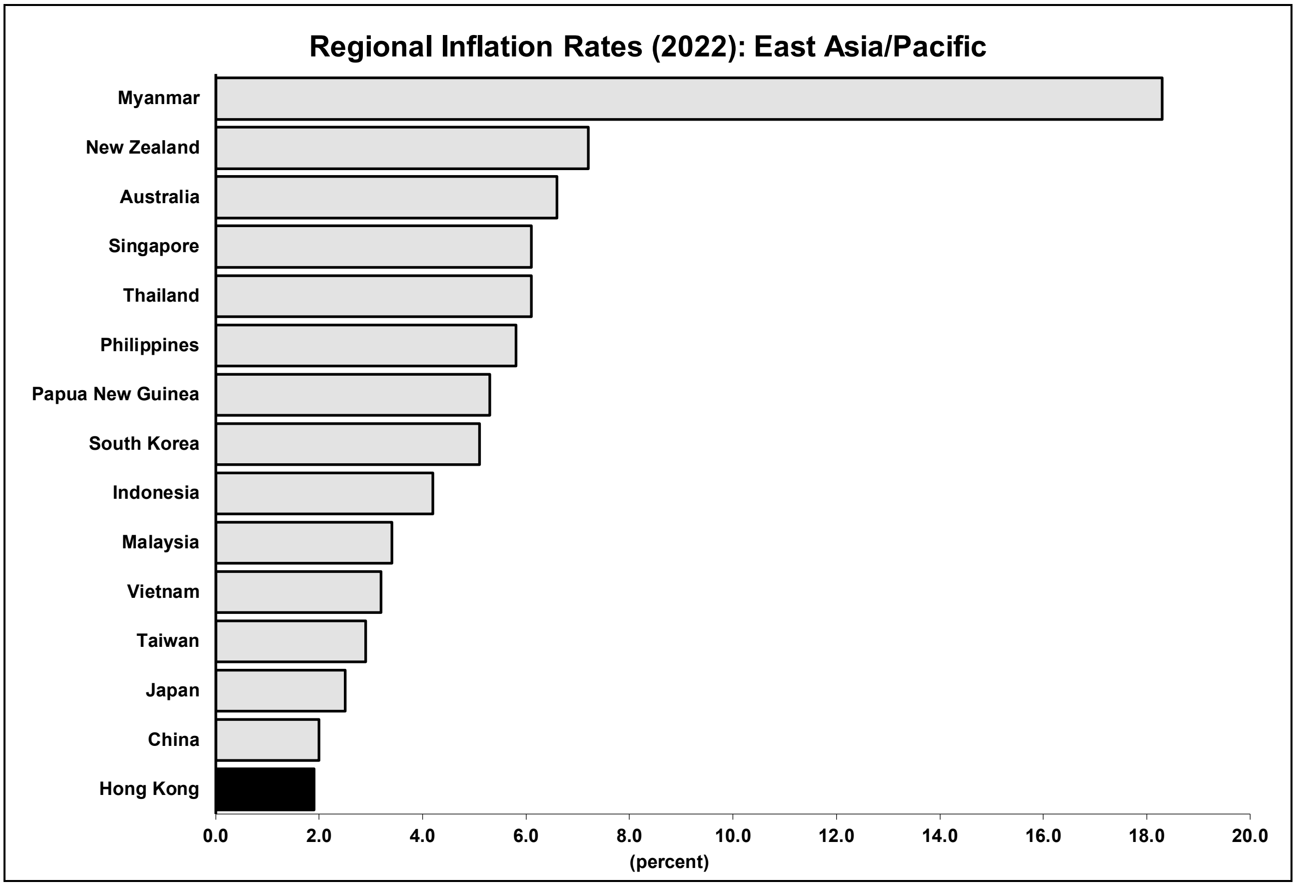
Hong Kong
Econometric Data

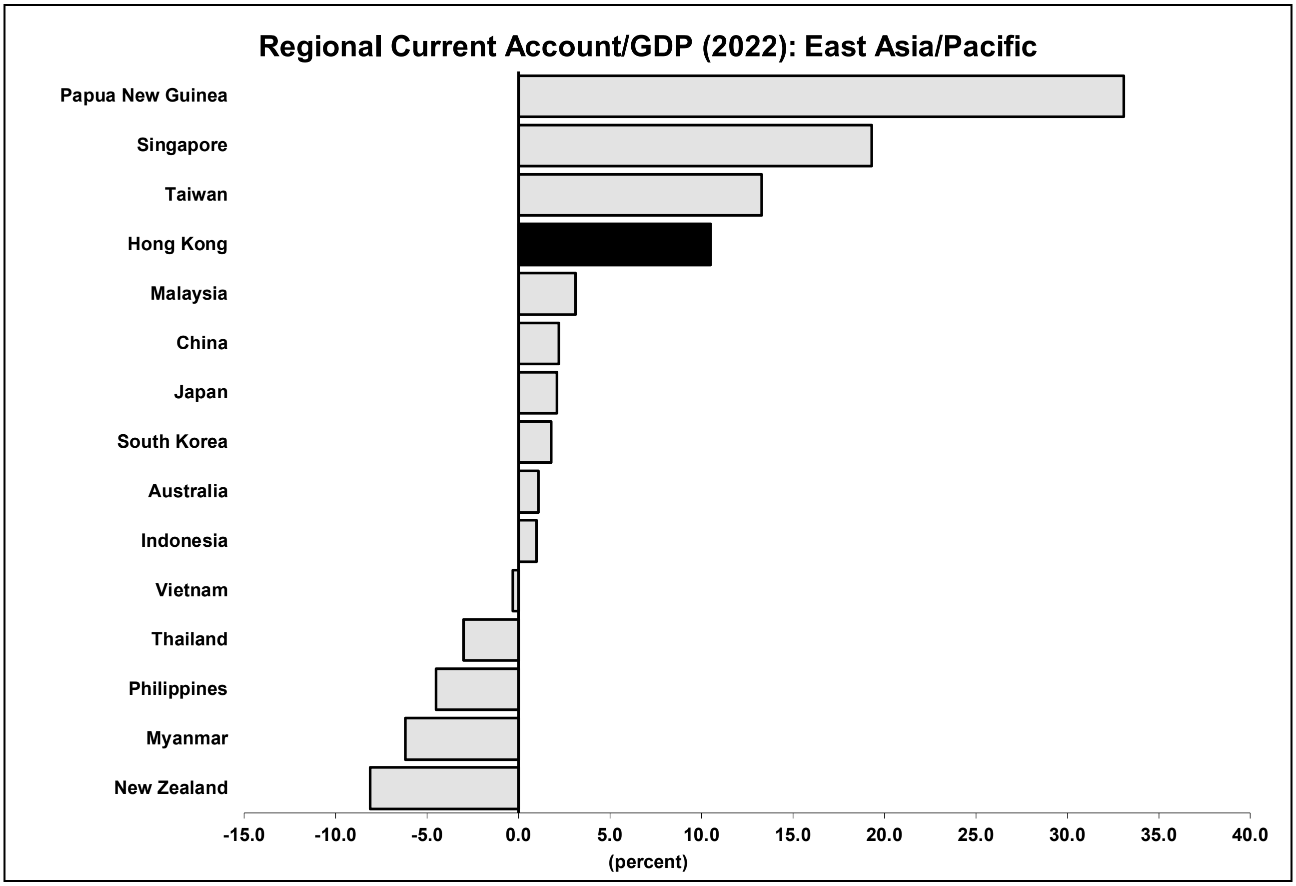
	2013-2017 Average	2018-2022 Average	2018	2019	2020	2021	2022
Domestic Economic Indicators							
GDP (Nominal, $bn)	307.73	359.70	361.75	363.02	344.94	368.94	359.86
Per Capita GDP ($)	42058	48363	48298	48274	46425	49857	48961
Real GDP Growth Rate (%)	2.9	-0.5	2.8	-1.7	-6.5	6.4	-3.5
Inflation Rate (%)	3.1	1.8	2.4	2.9	0.3	1.6	1.9
Capital Investment ($bn)	69.42	64.62	78.14	66.43	58.75	62.14	57.65
Capital Investment/GDP (%)	22.6	17.9	21.6	18.3	17.0	16.8	16.0
Budget Revenues ($bn)	65.34	78.67	76.52	75.40	72.74	89.23	79.45
Budget Revenues/GDP (%)	21.2	21.9	21.2	20.8	21.1	24.2	22.1
Budget Expenditures ($bn)	55.87	88.66	67.85	77.56	105.20	89.20	103.50
Budget Expenditures/GDP (%)	18.2	24.7	18.8	21.4	30.5	24.2	28.8
Budget Balance ($bn)	9.48	-9.99	8.67	-2.16	-32.46	0.03	-24.05
Budget Balance/GDP (%)	3.0	-2.9	2.4	-0.6	-9.4	0.0	-6.7
Money Supply (M1, $bn)	253.34	369.40	308.96	309.93	425.40	449.10	353.60
Change in Real Wages (%)	1.5	0.1	1.4	-0.1	-0.3	-0.5	-0.2
Unemployment Rate (%)	3.3	4.2	2.8	2.9	5.8	5.2	4.3
International Economic Indicators							
Foreign Direct Investment ($bn)	129.34	106.16	97.02	58.27	117.45	137.16	120.92
Forex Reserves ($bn)	360.02	439.66	415.06	425.14	475.27	478.69	404.14
Gross Reserves (ex gold, $bn)	363.17	455.48	424.58	440.53	491.65	496.75	423.91
Gold Reserves ($bn)	0.08	0.11	0.09	0.10	0.13	0.12	0.12
Gross reserves (inc gold, $bn)	363.25	455.60	424.67	440.63	491.78	496.87	424.03
Total Foreign Debt ($bn)	1337.09	1743.75	1691.45	1628.22	1701.20	1885.02	1812.85
Total Foreign Debt/GDP (%)	433.9	484.8	467.6	448.5	493.2	510.9	503.8
Debt Service ($bn)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Debt Service/XGS (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Current Account ($bn)	9.37	28.08	13.52	21.22	24.09	43.67	37.91
Current Account/GDP (%)	3.0	7.8	3.7	5.9	7.0	11.8	10.5
Current Account/XGS (%)	1.2	3.1	1.5	2.5	2.8	4.5	4.1
Exports ($bn)	512.84	588.13	568.17	542.95	541.23	673.61	614.70
Imports ($bn)	537.39	599.24	600.45	558.33	546.56	670.44	620.43
Trade Balance ($bn)	-24.56	-11.11	-32.28	-15.38	-5.33	3.17	-5.73
Exports of Services ($bn)	103.74	96.47	113.15	101.94	105.19	79.13	82.92
Income, credit ($bn)	165.09	212.12	208.03	213.58	199.12	215.48	224.41
Transfers, credit ($bn)	1.27	1.92	1.63	1.70	1.92	1.94	2.42
Exports G&S ($bn)	782.93	898.64	890.98	860.17	847.46	970.16	924.45
Liabilities ($bn)	8.59	8.57	6.60	13.92	7.30	5.67	9.34
Net Reserves ($bn)	354.66	448.31	418.07	426.71	484.48	491.20	421.07
Liquidity (months import cover)	7.9	9.0	8.4	9.2	10.6	8.8	8.1
Currency Exchange Rate	7.763	7.807	7.838	7.837	7.757	7.773	7.831
Currency Change (%)	-0.1	-0.1	-0.6	0.0	1.0	-0.2	-0.7
Social Indicators							
Population (million)	7.31	7.44	7.49	7.52	7.43	7.40	7.35
Population Growth (%)	0.8	-0.2	1.1	0.4	-1.2	-0.4	-0.7
Infant Deaths/1000	2	2	2	2	2	2	2
Persons under Age 15 (%)	11	12	12	12	12	12	12
Urban Population (%)	100	100	100	100	100	100	100
Urban Growth (%)	0.8	-0.2	1.1	0.4	-1.2	-0.4	-1.0
Literacy % pop.	96	96	96	96	96	96	96
Agricultural Work Force (%)	0	0	0	0	0	0	0
Industry-Commerce Work Force (%)	11	11	11	11	11	11	11
Services Work Force (%)	89	89	89	89	89	89	89
Unionized Work Force (%)	22	22	22	22	22	22	22
Energy - total consumption (10^{15} Btu)	1.27	1.17	1.41	1.40	0.19	1.43	1.42
Energy - consumption/head (10^{9} Btu)	0.18	0.43	0.19	0.19	1.41	0.19	0.19

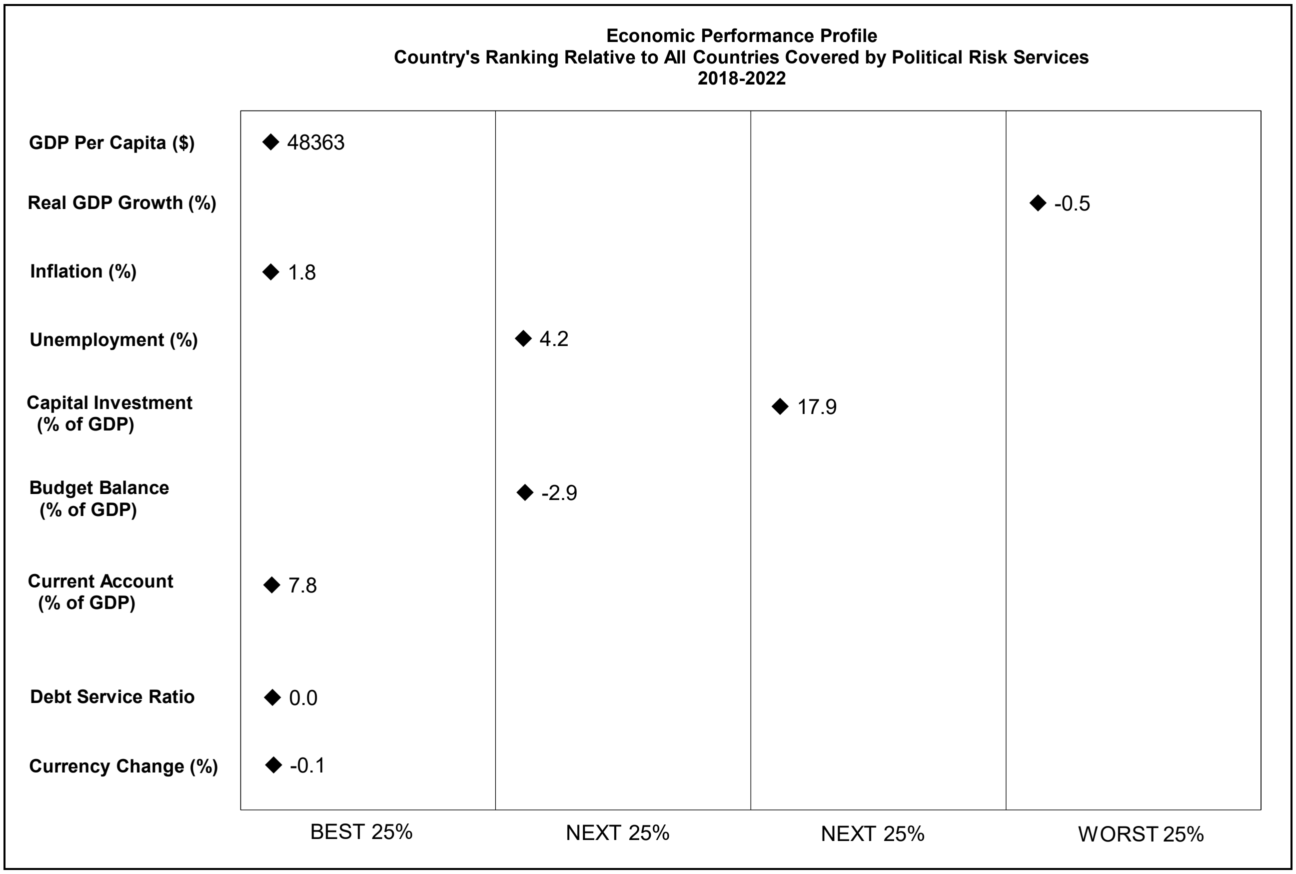
Note: budget fiscal year beginning April 1

INTRA-REGIONAL COMPARISONS






Regional Current Account/GDP (2022): East Asia/Pacific
Papua New Guinea
Singapore
Taiwan
Hong Kong
Malaysia
China
Japan
South Korea
Australia
Indonesia
Vietnam
Thailand
Philippines
Myanmar
New Zealand
-15.0
-10.0
-5.0
0.0
5.0
10.0
15.0
20.0
25.0
30.0
35.0
40.0
(percent)


Economic Performance Profile
Country's Ranking Relative to All Countries Covered by Political Risk Services
2018-2022
GDP Per Capita ($)
48363
Real GDP Growth (%)
-0.5
Inflation (%)
1.8
Unemployment (%)
4.2
Capital Investment (% of GDP)
17.9
Budget Balance (% of GDP)
-2.9
Current Account (% of GDP)
7.8
Debt Service Ratio
0.0
Currency Change (%)
-0.1
BEST 25%
NEXT 25%
NEXT 25%
WORST 25%

GEOPOLITICAL & ECONOMIC ANALYSIS

POLITICAL CRACKDOWN CARRIES A COST

A government crackdown on democracy undertaken on orders from Beijing has continued under the leadership of John Lee, who replaced Carrie Lam as chief executive of the Special Administrative Region (SAR) last year. The prosecution of dozens of democracy activists on charges of subversion and changes to the electoral rules that significantly diminish the influence of popularly elected representatives within the Legislative Council (LegCo) have sapped the vigor of the political reform movement that spearheaded disruptive mass protests in 2019-2020, but the restoration of internal order has come at the cost of lasting (and quite possibly permanent) damage to the SAR's reputation among foreign investors.

The application of the rule of law within Hong Kong is chief among the "special" factors that differentiate the SAR from the mainland under China's "one country, two systems" model, and has been vital to the city's attractiveness as a global financial center, trade hub, and magnet for international investment. The chilling effect of Beijing's steady encroachment on Hong Kong's autonomy is evident in the demographic data.

In 2020–2022, the population of the SAR decreased by more than 187,000, a decline of 2.5% in three years. Over the same period, dozens of foreign companies relocated their regional headquarters out of Hong Kong, and the number of new visas issued for foreign workers in the financial services industry in 2022 was only about one-half of the figure for 2019.

The prolonged imposition of draconian health restrictions to prevent the spread of COVID-19 undoubtedly was a key contributing factor to the population exodus. Indeed, the trend has partially reversed following the lifting of the SAR's restrictions in the second half of 2022 and the mainland government's abandonment of its "zero COVID" strategy late last year. Data for the 12-month period to June 2023 showed the population increasing to close to 7.5 million, compared to 7.53 million in 2019.

The increase highlights the success of various talent and labor recruitment schemes introduced in the last 18 months, which include the provision of preferential access to work visas and tax breaks on property purchases. However, it remains to be seen to what extent the recent influx reflects the entry of mainland Chinese for whom relocation to Hong Kong is just a stopover on their way to another destination that is further removed from Beijing's control.

Other factors point to persistent demographic challenges for the SAR government. A poll conducted by Chinese University of Hong Kong in 2021 showed that close to 60% of the 800 respondents aged 15-30 wanted to move elsewhere; it is doubtful such sentiments derived primarily from exasperation with health restrictions. It is also worth noting that the number of high-net-worth residents of Hong Kong has decreased at a much a steeper rate (30% since 2012) than the overall population decline, a trend that will not be reversed by the enticements on offer from the government, nor are the middle-class families that sold property and moved overseas likely to ponder a return in the current political climate.

CRYPTO PUSH OFF TO A ROCKY START

As a complement to its talent recruitment efforts, the government is attempting to overcome the damage to Hong Kong's reputation among investors by pitching the SAR as a destination of choice for crypto companies in the burgeoning digital assets industry. In late February, the SAR's Securities and Futures Commission (SFC) published draft rules for virtual asset trading platforms (VATP) and began accepting applications for crypto exchange licenses in June.

The government has also created a task force dedicated to promoting the initiative, and there are early signs of interest. In late March, Kaiko, a crypto data provider, announced its intention to move its Asia headquarters from Singapore to Hong Kong, and an inaugural Hong Kong Web3 Festival held in April was highlighted by a keynote speech by Binance CEO Changpeng Zhao.

However, there are indications that the enthusiasm surrounding the push might be more apparent than real. Earlier this month, the JPEX crypto exchange closed its Hong Kong operations amid arrests of top personnel on fraud charges. The revelation that JPEX had lied about applying for a VATP license prompted the SFC to disclose which companies had submitted applications. The list consisted of five firms, and does not include HBX (formerly Huboi), whose purported eagerness to participate has been hyped by advocates of the crypto strategy as proof of its soundness.

In fairness, it is very early days yet for the digital assets push. But given Beijing's evident skepticism about cryptocurrency (which is banned in mainland China), it is debatable how much benefit of the doubt Chief Executive Lee and his colleagues will be granted before the Communist leadership clamps down on the effort, a threat that may explain why there has not been a rush to secure licenses.

TROUBLES ON THE MAINLAND A CAUSE FOR CONCERN

In any case, the investment climate will remain under the pall created by US sanctions targeting four members of the SAR government (including Lee) over their role in an anti-democracy crackdown that violated the terms of the 1997 handover, which included upholding the democratic freedoms enumerated in the International Covenant on Civil and Political Rights (ICCPR). Lee's dismissive response to the sanctions suggests that Hong Kong's internal stability and security are a higher priority than the SAR's international reputation, which undoubtedly is consistent with the signals he has received from Beijing.

Beijing's adoption of a less aggressive diplomatic posture immediately following Xi Jinping's confirmation to a precedent-setting third term as Communist Party leader last year fueled speculation of a possible easing of tensions between China and the west that presumably would have positive implications for perceptions of Hong Kong's attractiveness to investors. However, in March, then-Foreign Minister Qin Gang downplayed the potential for a detente, citing various provocations by the Biden administration—including punitive tariffs and sanctions against Chinese tech firms, Washington's leading role in the push to weaken China's control of the global supply chain, and defense support for Taiwan—as evidence that the US does not seek improved relations except on its terms.

Indeed, evidence of mounting economic problems in China that could spell political trouble for Xi at home point to a growing risk of escalating international tensions that would have negative implications for the investment climate in Hong Kong. The more sanguine assessments of the likely impact of the steady stream of bad economic news on China's foreign policy suggest that Xi will be too focused on keeping a lid on discontent at home to consider any major military operations elsewhere. But the danger that a regime on the defensive might feel compelled to lash out cannot be dismissed out of hand.

China has many reasons to avoid a resort to force against Taiwan, which would likely bring damaging sanctions, the possibility of direct military conflict with the US, and huge negative repercussions for the international supply chain and the global economy. However, it is debatable whether the deterrent effect of any of those considerations would be as powerful under conditions of economic deterioration and political tumult in China, and such a scenario, although still unlikely, would pose grave risks for foreign businesses operating in the SAR.

REBOUND LOSING MOMENTUM

Lee is feeling pressure from Beijing to revive an export-led economy that registered an annual real contraction in three of the last four years, including a 3.5% decline in 2022, when a surge in global prices for energy and food triggered by the outbreak of war in Europe contributed to the highest inflation in decades worldwide, prompting aggressive monetary tightening that weakened external demand for Hong Kong's exports, which registered a year-on-year decrease of 8.7%. The poor performance was partly attributable to population decline, which contributed to a loss of productivity and talent that exacerbated the negative effects of the global shocks generated by the war in Europe.

The fall in population also had a negative impact on housing prices, which decreased by 15% in 2022, and are on track to drop by another 5%-8% this year, despite the uptick in population since the start of the year, reflecting the dampening effect of a combination of high interest rates, an oversupply of new units, and reduced demand from mainland buyers. Although the easing of prices could be beneficial from the standpoint of attracting foreign residents who might otherwise be deterred by high housing costs, the decline in equity has negative implications for the borrowing capacity of homeowners.

Inflation averaged less than 2% in 2022, held in check by Hong Kong's insulation from soaring global energy prices (with most of its coal and gas supply imported from the mainland) and the heavy weighting of housing costs (which fell sharply last year) in the consumer price index. Nevertheless, maintaining the local currency's peg to the US dollar required the Hong Kong Monetary Authority (HKMA) to follow the policy lead of the Fed, which initiated an aggressive tightening cycle in March 2022.

The base rate was hiked seven times last year, and four more increases in 2023 have pushed the rate up to 5.75%, the highest level in 15 years. Monetary tightening has dampened domestic demand, undermining the beneficial economic impact of the loosening of pandemic-related restrictions on public movement since mid-2022.

The government had been counting on faster mainland growth to compensate for weak demand in Europe and elsewhere in Asia. However, hopes that Beijing's abandonment of the "zero COVID" strategy would unleash a flood of pent-up demand have been disappointed, and a modest revival of economic activity on the mainland early in the year has more recently shown signs of fizzling out.

GDP contracted by 1.3% (quarter-on-quarter) in the April-June period, and year-on-year real growth slowed to 1.5% (from 2.9% in the first quarter), as subdued government spending reinforced the loss of momentum from weaker household consumption and private fixed investment. The 2023/2024 budget contains various schemes (including one-off tax relief and consumption vouchers) that will help to stimulate household consumption and business investment, and the growth rate in the second half of the year will benefit from a favorable base effect.

However, mainland indicators suggest that the local economy will not receive a boost from that quarter in the near term. With tourism numbers still running well below the pre-pandemic level and the purchasing managers' index continuing to point to contractionary conditions in the manufacturing sector, it is likely that average growth for the year will undershoot the government's revised target of 4%-5%.

The government posted a budget deficit equivalent to 6.7% of GDP in the fiscal year that ended in March 2023. Overall spending in 2023/2024 will be restrained, but the revenue losses implied by tax givebacks and a reduced stamp duty will keep the fiscal balance firmly in negative territory in the near term.

The government's financial position is not particularly worrisome, but a second consecutive sizeable deficit will shrink fiscal reserves to less than $100 billion by next year, a reduction of more than 50% compared to the pre-pandemic figure. Bolstering the reserves cushion will require a level of restraint that does not square with the Department of Finance's forecast of average real GDP growth of 3.5% over the medium term.

INTERNATIONAL COUNTRY RISK GUIDE (ICRG) RATINGS

PRS' Country Reports and Economic Forecasts (CREF) and the International Country Risk Guide (ICRG) have been independently back-tested for accuracy and relevance for over 40 years.

In a landmark 2014 study published in the International Journal of Business Studies* – using data on political risk clams and a unique textual-based database of risk realizations – both CREF and ICRG forecasts were found to have "predictive power for both political risk insurance claims as well as political risk events measured by news coverage."

It is therefore instructive to present the scores from Table 1 of the ICRG for a complimentary look at the composite risk scores – calculated by using a combination of the overall political, financial, and economic risk metrics – for the 141+ countries covered each month. Please contact custserv@prsgroup.com for more information.

TABLE 1
COUNTRY RISK, RANKED BY COMPOSITE RISK RATING
SEPTEMBER 2023 VERSUS OCTOBER 2022

RANK IN 09/23	COUNTRY	COMPOSITE RISK RATING 09/23	COMPOSITE RISK RATING 10/22	09/23 VERSUS 10/22	RANK IN 10/22
Very Low Risk					
1	Norway	86.8	86.3	0.5	2
2	Switzerland	86.0	87.0	-1.0	1
3	Luxembourg	85.8	85.5	0.3	4
4	Denmark	84.8	83.8	1.0	6
5	Taiwan	84.5	83.8	0.8	6
6	Singapore	84.3	85.8	-1.5	3
7	Ireland	83.8	81.8	2.0	9
8	Saudi Arabia	82.5	85.5	-3.0	4
9	Brunei	81.5	79.5	2.0	15
10	Canada	80.8	81.3	-0.5	10
10	Iceland	80.8	80.0	0.8	14
10	Qatar	80.8	78.8	2.0	17

* C Harvey, et al., "Political Risk Spreads," Journal of International Business Studies, (2014), 471-493.

TABLE 1 COUNTRY RISK, RANKED BY COMPOSITE RISK RATING SEPTEMBER 2023 VERSUS OCTOBER 2022					
RANK IN 09/23	COUNTRY	COMPOSITE RISK RATING 09/23	COMPOSITE RISK RATING 10/22	09/23 VERSUS 10/22	RANK IN 10/22
13	Japan	80.5	75.8	4.8	25
13	Netherlands	80.5	79.3	1.3	16
13	United Arab Emirates	80.5	82.3	-1.8	8
16	Korea, Republic	80.3	77.0	3.3	23
17	Kuwait	80.0	80.8	-0.8	11
17	Sweden	80.0	80.3	-0.3	13
	Low Risk				
19	Australia	79.5	80.8	-1.3	11
19	Botswana	79.5	76.3	3.3	24
21	Germany	79.3	78.3	1.0	18
22	Finland	78.8	78.0	0.8	20
23	Hong Kong	78.0	73.8	4.3	36
24	New Zealand	77.8	74.8	3.0	32
25	Portugal	77.0	75.0	2.0	31
25	Trinidad & Tobago	77.0	77.5	-0.5	22
27	Austria	76.5	78.0	-1.5	20
27	Oman	76.5	78.3	-1.8	18
29	Czech Republic	76.0	75.5	0.5	28
30	Kazakhstan	75.5	75.5	0.0	28
31	Guyana	75.3	75.8	-0.5	25
32	Malaysia	75.0	73.0	2.0	40
33	Uzbekistan	74.8	72	2.5	43
34	Bahamas	74.5	70.8	3.8	55
34	Belgium	74.5	74.0	0.5	35
34	Italy	74.5	72.8	1.8	41
37	Israel	74.3	74.8	-0.5	32
38	Slovenia	74.0	72.3	1.8	43
38	United Kingdom	74.0	75.8	-1.8	25

TABLE 1 COUNTRY RISK, RANKED BY COMPOSITE RISK RATING SEPTEMBER 2023 VERSUS OCTOBER 2022					
RANK IN 09/23	COUNTRY	COMPOSITE RISK RATING 09/23	COMPOSITE RISK RATING 10/22	09/23 VERSUS 10/22	RANK IN 10/22
40	Azerbaijan	73.8	73.3	0.5	38
40	Croatia	73.8	73.3	0.5	38
40	Libya	73.8	70.5	3.3	59
40	Malta	73.8	74.3	-0.5	34
40	Panama	73.8	73.5	0.3	37
40	Uruguay	73.8	75.5	-1.8	28
46	Costa Rica	73.0	72.0	1.0	45
47	Latvia	72.8	71.0	1.8	52
48	France	72.5	71.8	0.8	48
48	Jamaica	72.5	72.0	0.5	45
50	Chile	72.0	70.5	1.5	59
50	Dominican Republic	72.0	72.5	-0.5	42
50	Spain	72.0	72.0	0.0	45
53	Philippines	71.8	70.0	1.8	61
54	Bulgaria	71.5	70.0	1.5	61
54	Vietnam	71.5	70.8	0.8	55
56	Poland	71.3	70.8	0.5	55
57	Brazil	71.0	69.0	2.0	70
58	Hungary	70.8	71.3	-0.5	50
59	Thailand	70.5	64.3	6.3	91
60	Guatemala	70.3	71.0	-0.8	52
60	India	70.3	69.5	0.8	64
60	United States	70.3	71.5	-1.3	49
63	Cyprus	70.0	69.5	0.5	64
63	Gabon	70.0	66.0	4.0	85
	Moderate Risk				
65	China, Peoples' Rep.	69.8	69.5	0.3	64
65	Lithuania	69.8	69.8	0.0	63

TABLE 1 COUNTRY RISK, RANKED BY COMPOSITE RISK RATING SEPTEMBER 2023 VERSUS OCTOBER 2022					
RANK IN 09/23	COUNTRY	COMPOSITE RISK RATING 09/23	COMPOSITE RISK RATING 10/22	09/23 VERSUS 10/22	RANK IN 10/22
67	Greece	69.5	67.3	2.3	78
68	Bahrain	69.3	68.8	0.5	71
68	Estonia	69.3	70.8	-1.5	55
68	Indonesia	69.3	68.3	1.0	73
68	Papua New Guinea	69.3	69.3	0.0	67
72	Namibia	69.0	71.0	-2.0	52
73	Iraq	68.8	71.3	-2.5	50
74	Congo, Republic	68.5	63.8	4.8	96
74	Mexico	68.5	68.8	-0.3	71
74	Peru	68.5	68.0	0.5	75
77	Algeria	67.8	69.3	-1.5	67
78	Slovakia	67.5	68.3	-0.8	73
79	Romania	67.3	66.3	1.0	84
79	South Africa	67.3	66.8	0.5	81
81	Honduras	67.0	66.8	0.3	81
82	Gambia	66.8	65.8	1.0	88
82	Russia	66.8	66.0	0.8	85
84	El Salvador	66.5	63.5	3.0	98
84	Mongolia	66.5	65.5	1.0	89
84	Serbia	66.5	66.8	-0.3	81
87	Morocco	66.3	64.3	2.0	91
88	Ecuador	66.0	67.5	-1.5	76
88	Tanzania	66.0	64.8	1.3	90
90	Guinea-Bissau	65.3	62.5	2.8	103
90	Jordan	65.3	64.0	1.3	95
92	Paraguay	65.3	64.3	1.0	91
93	Albania	64.8	67.5	-2.8	76
94	Bolivia	64.5	66.0	-1.5	85

TABLE 1 COUNTRY RISK, RANKED BY COMPOSITE RISK RATING SEPTEMBER 2023 VERSUS OCTOBER 2022					
RANK IN 09/23	COUNTRY	COMPOSITE RISK RATING 09/23	COMPOSITE RISK RATING 10/22	09/23 VERSUS 10/22	RANK IN 10/22
95	Nicaragua	63.8	62.8	1.0	100
96	Bangladesh	63.5	62.5	1.0	103
96	Cote d'Ivoire	63.5	61.0	2.5	107
96	Togo	63.5	62.8	0.8	100
99	Colombia	63.3	63.8	-0.5	96
100	Iran	63.0	67.0	-4.0	79
101	Madagascar	62.8	62.8	0.0	100
102	Angola	62.3	67.0	-4.8	79
103	Zambia	62.0	63.0	-1.0	99
104	Belarus	61.8	56.5	5.3	126
104	Cuba	61.8	69.3	-7.5	67
104	Ghana	61.8	59.0	2.8	114
107	Cameroon	61.5	59.8	1.8	110
108	Moldova	61.3	58.8	2.5	116
108	Ukraine	61.3	56.3	5.0	127
110	Armenia	61.0	60.5	0.5	108
111	Guinea	60.0	57.3	2.8	124
111	Mozambique	60.0	53.5	6.5	132
111	Uganda	60.0	59.3	0.8	112
High Risk					
114	Tunisia	59.8	61.3	-1.5	106
115	Burkina Faso	59.0	58.3	0.8	118
116	Suriname	58.8	59.0	-0.3	114
117	Senegal	58.5	58.0	0.5	122
118	Ethiopia	58.0	58.0	0.0	122
119	Mali	57.8	58.3	-0.5	118
120	Zimbabwe	57.5	61.5	-4.0	105
121	Congo, Dem. Republic	57.0	60.3	-3.3	109

TABLE 1 COUNTRY RISK, RANKED BY COMPOSITE RISK RATING SEPTEMBER 2023 VERSUS OCTOBER 2022					
RANK IN 09/23	COUNTRY	COMPOSITE RISK RATING 09/23	COMPOSITE RISK RATING 10/22	09/23 VERSUS 10/22	RANK IN 10/22
121	Kenya	57.0	58.3	-1.3	118
121	Myanmar	57.0	55.8	1.3	128
124	Haiti	56.5	54.8	1.8	130
125	Argentina	56.3	64.3	-8.0	91
125	Sierra Leone	56.3	53.8	2.5	131
127	Egypt	56.0	59.3	-3.3	112
128	Yemen, Republic	55.8	48.3	7.5	138
129	Nigeria	55.5	59.8	-4.3	110
130	Turkey	55.3	55.8	-0.5	128
131	Liberia	55.0	58.3	-3.3	118
131	Venezuela	55.0	58.5	-3.5	117
133	Sri Lanka	54.5	48.5	6.0	137
134	Malawi	52.8	51.0	1.8	135
135	Somalia	51.8	52.0	-0.3	133
Very High Risk					
136	Korea, D.P.R.	49.3	51.0	-1.8	135
136	Pakistan	49.3	52.0	-2.8	133
138	Niger	46.8	56.8	-10.0	125
139	Syria	45.0	43.8	1.3	139
140	Sudan	44.8	43.0	1.8	140
141	Lebanon	35.0	41.5	-6.5	141