2019

Open a business in Hong-Kong

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Preview

I - Current situation

Government: Devolved executive-led system within a socialist republic

Chief of State: Carrie Lam

Official languages: Chinese - English

Country Population: 7.560 million

HDI: 0,933 (very high – 7th)

The next elections

President: March 2023

Chief Executive: 2022

Legislative Council: September 2020

Elections to the District Council: November 2019

Hong Kong is a “special administrative region” of China with a population of 7 million. Retroced to Beijing by the United Kingdom in 1997, it is a strong financial and commercial center. Hong Kong has a special administrative regime that has enabled it to retain its currency, political system, international sports teams and immigration laws. An autonomy that it should retain until 2047, according to the terms of the joint Sino-British declaration. The principle of “one country, two systems” allows for the coexistence of socialism and capitalism under “one country,” which is mainland China.

Mainland Chinese authorities have no right to arrest people in Hong Kong. Like other countries, they must apply for an international arrest warrant.

Immigration and passport control is also separate from China. The China-Hong Kong border is treated as an international border by both sides. The import and export of goods between Hong Kong and China are also restricted, although rules and regulations have been relaxed. Investment between both countries now flows relatively freely.

Since the beginning of July 2019, Honk Kong has been facing its most serious political crisis in decades. It was born out of the rejection of a bill by the local pro-Beijing executive to allow extraditions to China. Democracy activists organize almost daily rallies that have often escalated into violent clashes between police and demonstrators.

II – Global environment

A. Political risk

Risks arise from further escalating U.S.-China trade tensions, possible disorderly tightening of global financial conditions, slower-than-expected growth in Mainland China, and a sharp housing market correction. These shocks are likely correlated and could materialize together, which would amplify their effects. At the same time, the development of the Greater Bay Area creates opportunities for Hong Kong over the medium term, given its unique position as the gateway to Mainland China and as a global financial center with renowned professional services. Efforts to raise labor force participation of women and older workers should continue. The authorities' plan to abolish the arrangement for "offsetting" severance payment and long service payment with Mandatory Provident Fund benefits is welcome, and should proceed as planned. Plans to develop the bond market and further promote innovation and technology are steps in the right direction. Further expansion of the Hong Kong SAR's role as a leading financial center and as the gateway to Mainland China should also help.

We now have the biggest pro-democracy rebellion on chinese soil since the 1989 tiananmen square demonstrations. Donald Trump uses the events of HK as a negotiating power on China. It threatens China on the agreements in progress in case of non-respect of human rights on people. China also threatens US of consequences if they come to support democracy in HK and urges Trump to respect the country's sovereignty.

<u>*What about International Relations?*</u>

UK has a positive long-term relationship with The Hong Kong Government.

Around 3.5 million people in Hong Kong are either British passport-holders or entitled to apply. The majority are British Natives. This form of British nationality accords visa-free access to the UK for visits, but not the right of abode in the UK. Hong Kong is a major business partner for UK. It is important as a very significant market and as the principal gateway into, and increasingly, out of mainland China. It is:

· the UK's second largest market for goods in Asia-Pacific (after mainland China), and 10th largest worldwide in 2018

· the 10th fastest-growing market for UK exports of goods and services between 2010 and 2018

· £11.1bn of goods and services were exported to Hong Kong in 2018, and £9.5bn imported.

· the destination for 5% of the UK's outward FDI stock in 2017, or £66.1bn

· the test-bed for the internationalization of China's currency, the renminbi (RMB)

Cooperation through both London & Hong Kong Financial Services has helped establish London's status as an offshore hub for RMB trading.

The "Shanghai-Hong Kong Stock Connect pilot" was launched on 17 November 2014 and allows international investors to invest in mainland China's A-share market and Chinese investors to invest in Hong Kong. After repeated delays due to market volatility, the Shenzhen-Hong Kong Stock Connect was launched in December 2016. The operation of this scheme mirrors its Shanghai-Hong Kong counterpart with its tech stocks offering investors a higher yield alternative to Shanghai's "blue chip" stocks with typical annual returns potentially as high as 25%.

In addition to the Stock Connect, a 'China-Hong Kong Bond Connect' was launched on 3 July 2017, allowing international investors to gain access to the mainland bond market via Hong Kong accounts.

Hong Kong is a strong advocate for free trade and open markets in fora such as the World Trade Organization (WTO), where it takes part separately from China. In other multilateral fora, such as the G20, Hong Kong participates as part of the Chinese delegation.

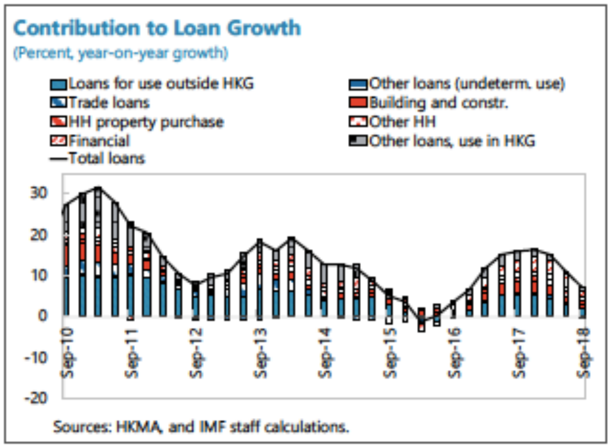
B. Commercial risk

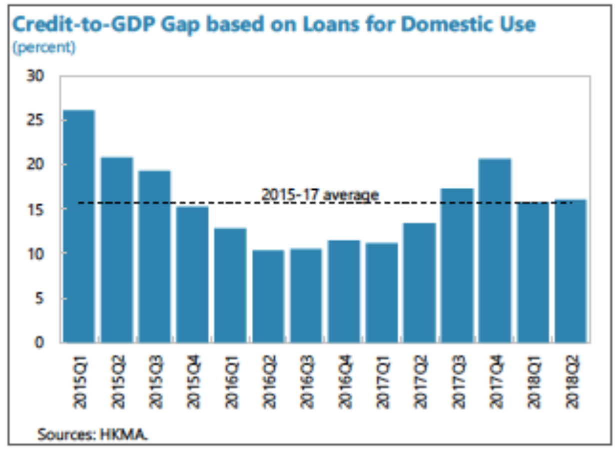
Hong Kong's economy is considered a model of capitalism because of its commitment to free trade, with foreign trade accounting for 375.1% of the country's GDP (World Bank). The main products exported are integrated circuits, gold, radiotelephone transmission tools, electrical equipment for fixed telephony and meat. The main imported products are integrated circuits and telephones (WTO).

Hong Kong's exports are to China, India, India, Japan, Thailand and the United States, while its imports come from China, Singapore and Japan (UNCTAD). Hong Kong is one of the nine largest exporters in the world and the seven largest importers. The greatest threat to Hong Kong's trade is the tensions and tariffs between the United States and China.

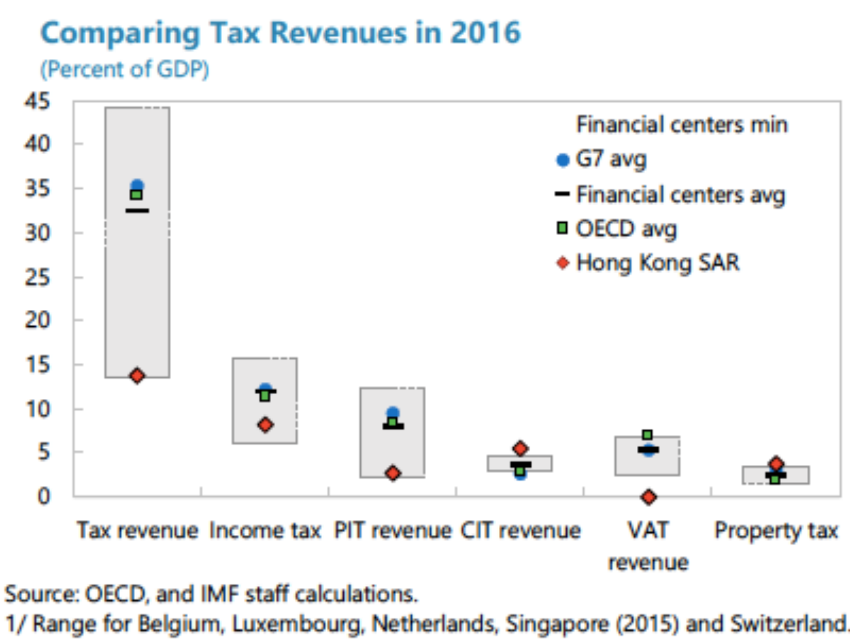
In 2017, the total value of exported goods and services reached 188% of GDP, while imports of goods and services amounted to 187.1% of GDP. The trade balance, including services, was in surplus in 2017, at USD 3.092 billion (World Bank). Foreign trade has continued to enjoy sustained growth in recent years, supported by the expansion of the Chinese economy. Hong Kong does not apply customs duties in general on imported products, but only on four goods, whether imported or produced locally: spirits, tobacco, hydrocarbon oil and methanol. Hong Kong has no quota or anti-dumping law.

C. Fiscal situation





According to the IMF, prudent fiscal management and the strong real estate market allowed Hong Kong SAR to accumulate fiscal reserves of 41.4 percent of GDP. Budgetary debt remains negligible at 0.1 percent of GDP, 4.6 percent if considering the wider General Government, and are more than offset by the official assets. Staff and the authorities project fiscal surpluses in the coming 5 years, and staff estimates that fiscal reserves will increase to HK$1.5 trillion (41 percent GDP) by 2023.



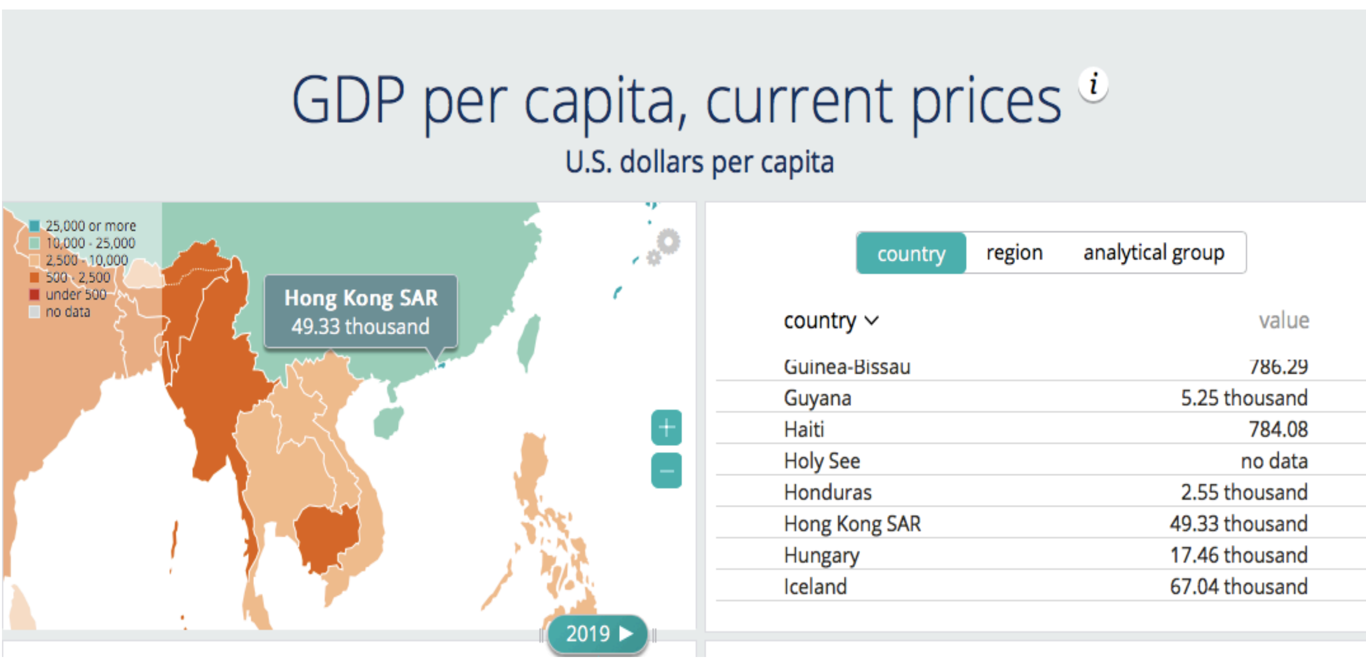
III - Economic overview

A. Economic overview

The booming economy, coupled with conservative fiscal management, helped deliver another large fiscal surplus in FY2017/18, which the authorities partially redistributed through a mix of retroactive tax cuts and additional spending. We expect a slowdown of the economic growth in 2019 as result of the trade war between US and China, global recovery and ongoing tensions in Hong-Kong. Over the medium-term, Hong Kong is expected to grow close to its potential growth of around 3 percent supported by sustainable growth in Mainland China as rebalancing and financial sector reforms progress.

	2015	2016	2017	2018	*2019*	*2020*	*2021*	*2022*	*2023*
Real GDP (% change)	2.4	2.2	3.8	3.5	2.9	3.0	3.1	3.1	3.1
Unemployment rate	3.3	3.4	3.1	2.6	2.6	2.6	2.6	2.6	2.6
Real wages (% change)	0.5	1.2	2.3	1.6	1.0	1.2	1.3	1.3	1.3
Inflation	3.6	1.7	2.9	3.1	2.0	2.0	1.7	1.9	1.9

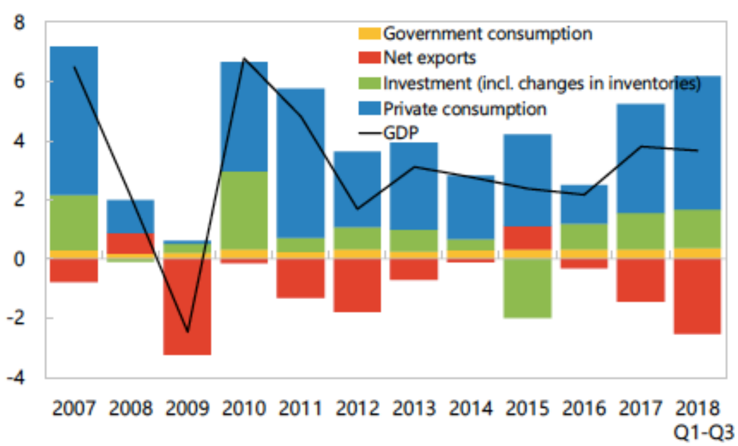
Source: IMF, Hong-Kong SAR: Selected Economic and Financial Indicators



Source: IMF

Economic indicators seem to be in a rather gloomy situation for Hong Kong. For example, the city's GDP growth rose from 1.2% in the last quarter of 2018 to 0.5% in the second quarter of 2019, according to the government. In addition, its trade balance has turned into a deficit (-6% in the second quarter of 2019), and tourism has significantly decreased since the beginning of the demonstrations (-40% according to the Tourism Board in August following the occupation of the airport for 6 days). In September, the US rating agency Fitch downgraded Hong Kong's sovereign debt rating by one notch. Fitch explained it as follows: "Current events have (...) had a lasting impact on the international perception of the quality and effectiveness of Hong Kong's governance system and rule of law. They questioned the stability and dynamism of its economic environment. Some Hong Kong companies have also bought advertising space in local newspapers to encourage more restraint and pacifism. This may discourage companies from setting up in the territory.

Contribution to Real GDP Growth by Major Expenditure Components
(percent)



Source: IMF staff

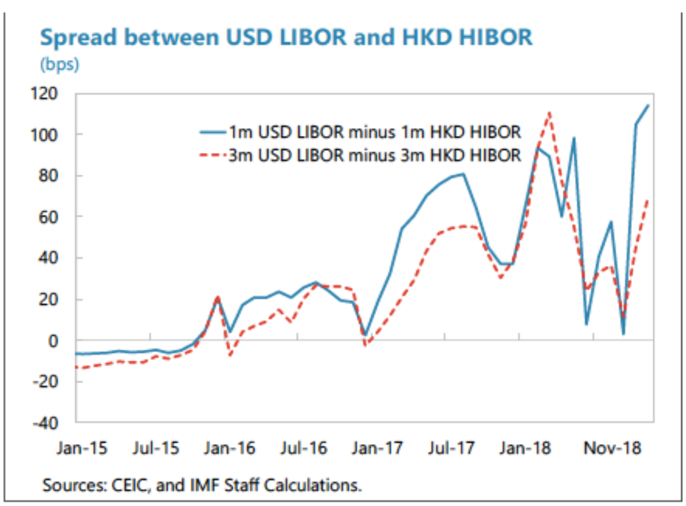
B. Currency

HKD is the eighth most widely used currency in the world. Since 1983, the Hong Kong dollar has been pegged to the US dollar through a currency board. This method of linking has allowed local authorities to maintain a very high degree of flexibility in the exchange rates of this currency.

Compared to the United States, Hong Kong banks have been slow to raise interest rates since the Fed started raising rates at the end of 2015. This has created a spread between US and Hong Kong short-term interest rates and created arbitrage opportunities, leading to capital outflows from Hong Kong and draining interbank liquidity. As a result, the overall balance decreased, but not the foreign exchange reserves.

Even today, HKD's anchoring still enjoys strong political support, which differentiates it from other monetary anchors that have failed for lack of political support. First, Beijing wants to keep the HKD anchored at least until the renminbi becomes a global currency in the future. Secondly, anchoring has been a guarantee of stability for Hong Kong, which is in line with Beijing's interest in maintaining Hong Kong's stability. Hong Kong's real importance to China still lies in its role as a credible financial and legal center, a center that China cannot easily build from scratch despite its rapid growth over the past four decades.

Third, the majority of Hong Kong's local interests, to which local government is also accountable, do not want to see indexation disappear. All companies benefit from zero exchange rate risk as part of the HKD indexation, which allows them to match HKD commitments with USD revenues. Thus, hedging using tools such as forward or options is very easy to set up with the HKD.



IV- Legal risk

Intellectual Property (IP) rights are territorial, that means they only give protection in jurisdictions where they are granted or registered. Specific advice should be given from qualified professionals either in the UK or overseas.

Hong Kong has a separate IP system to mainland China. The Hong Kong IP legal framework is comprehensive and generally considered to be one of the most effective in Asia. Hong Kong is ranked 9th in the world for IP protection in the World Economic Forum's Global Competitiveness Report 2017.

Hong Kong is a signatory to several international conventions on IP. Its legislative and administrative regime for IP rights is generally compliant with the World Trade Organization agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS).

The European Union has published a guide to protecting IP in Hong Kong for Small and Medium Companies.

The Hong Kong government is very serious about **organised crime** and has in place severe measures to counter it, including large fines and long sentences for drug and firearms trafficking, money laundering and human and goods trafficking. The Hong Kong Police has specific responsibility for investigating triad-related offences and has dedicated units to take proactive action against triads. While you should be vigilant against triad-related activity, there is no evidence to suggest this is a growing problem.

Hong Kong is often seen as an attractive option for money laundering, due to the nature of its financial structure. The money laundering regulations are enforced by the financial investigation bureaus of both the Hong Kong Police Force and Hong Kong Customs and Excise Department. For example: throughout 2015/2016, Hong Kong residents were the victims of large-scale telephone scams resulting in significant personal losses. Hong Kong police launched an awareness campaign and have taken enforcement actions about it; however, this fraud remains a risk and the value of losses continues to grow.

Conclusion

As the world's tenth largest trading power and third largest financial center, Hong Kong is often cited as a prime example of a liberal economy. Its GDP increased by 3.8% in 2018, but estimates for 2019 range from 2.9% to 3.8% and projections for 2020 are estimated at 3% (IMF). Nomura economists forecast GDP growth of 2.3% in 2019. This deceleration is linked to the slowdown in the Chinese economy, the world trade wars, the decline in FDI, and the tightening of credit conditions if the Fed's policy forces the Hong Kong

Monetary Authority (HKMA) to follow its rates. However, Hong Kong benefits from tourism revenues and low inflation (Coface).

The Hong Kong government ended the 2018 financial year with a budget surplus of 1.5%, but the IMF forecasts budget balances close to zero for 2019 and 2020. Hong Kong continues to enjoy strong public finances with almost no public debt and no trend change is expected in the near future. Inflation reached 2.3% in 2018 and is expected to remain at this level (2.1% in 2019 and 2.2% in 2020). The expansion of credit and the tightening of housing supply have led to a rapid rise in Hong Kong house prices in recent years. The poorest segments of the population are increasingly unable to afford adequate housing. The number of Chinese tourists (75% of total visitors) is also expected to decrease in 2019 due to the slowdown in economic growth in mainland China and the depreciation of the RMB against the HKD.

The unemployment rate remained stable at 2.6% in 2018, and is expected to remain at this level in 2019 and 2020. Challenges facing the country include the management of pro-Chinese and anti-Chinese sentiments, growing income inequality and lack of economic innovation.

Risk Assessment Matrix

Source of risk	*Likelihood*	*Impact*	*Policy Advice*
External			
1. **Rising protectionism and retreat from multilateralism.** Escalating trade tensions could lead to lower global growth both directly, through a negative impact on global trade, and by indirectly through confidence and financial markets. Trade flowing through Hong Kong SAR would fall, and its financial markets follow international financial markets down.	*High*	*High*	Counter the adverse impact on growth through a temporary fiscal stimulus centered on vulnerable households. Continue to actively monitor financial stability.
2. **Sharp tightening of global financial conditions** could cause higher debt service and refinancing risks, stress on leveraged households and firms, and capital account pressures. Tighter financial conditions could be triggered by a sharper than expected increase in U.S. interest rates (prompted by higher than expected inflation) or the materialization of other risks.	*High*	*High*	Provide targeted fiscal support as needed. Continue to adopt policies to ease housing supply constraints by ensuring an adequate supply of land and public housing.
3. **Weaker than expected global growth, especially in Mainland China.** Over the medium term, insufficient progress in deleveraging and rebalancing could reduce growth, with additional stimulus postponing the slowdown. Should a sharp adjustment occur, this would entail weak domestic demand, and reduce global growth.	*Low/Medium*	*High*	Counter the adverse impact on growth through a temporary fiscal stimulus centered on vulnerable households. Safeguard financial stability through macro-prudential measures and liquidity provision. Work closely with Mainland counterparts to facilitate an orderly resolution of distressed assets and address any weaknesses in bank balance sheets.
Domestic			
Disorderly correction of house prices: Higher global market volatility and financing costs resulting from faster-than-expected Fed tightening leads to an abrupt downturn in property prices. Falling collateral values and negative wealth effect trigger adverse feedback loop between economic activity, bank lending, household indebtedness, and housing market.	*Medium*	*High*	Adjust macro-prudential measures and provide targeted fiscal support if needed. Safeguard financial stability and stand ready to provide liquidity through existing facilities.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term (ST)" and "medium term (MT)" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Source: IMF

Annex 1: BOP

Table 2. Hong Kong SAR: Balance of Payments, 2015-23

	2015	2016	2017	2018	2019	Proj. 2020	2021	2022	2023
	(In billions of U.S. dollars)								
Current account	10.3	12.7	14.8	12.2	13.3	13.9	14.7	15.7	17.1
Goods balance	-22.9	-16.7	-24.0	-29.2	-31.5	-35.3	-39.2	-44.6	-48.9
Services balance	30.3	24.1	27.1	30.5	34.0	38.8	44.1	50.9	56.4
Income balance	2.9	5.4	11.6	10.9	10.8	10.5	9.8	9.4	9.5
Primary income balance	5.7	8.1	14.2	13.6	13.8	13.7	13.3	13.3	13.9
Secondary income balance	-2.9	-2.7	-2.6	-2.7	-3.0	-3.2	-3.5	-3.9	-4.3
Transfer balance									
Capital and financial account 1/	-16.6	-13.0	-19.9	-12.1	-13.2	-13.9	-14.7	-15.6	-17.0
Capital account	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-16.6	-13.0	-19.8	-12.1	-13.2	-13.8	-14.7	-15.6	-17.0
Net direct investment	102.5	57.7	21.5	23.1	23.1	23.5	23.6	24.1	21.9
Assets	-78.5	-75.5	-100.9	-109.1	-120.0	-132.4	-144.7	-158.5	-176.5
Liabilities	181.0	133.2	122.4	132.2	143.1	155.9	168.3	182.6	198.3
Portfolio investment	-125.2	-60.5	39.1	13.8	12.9	11.9	10.5	8.8	6.7
Assets	-85.3	-68.3	3.0	-16.7	-19.4	-22.6	-26.1	-30.2	-34.8
Liabilities	-39.9	7.8	36.2	35.1	34.0	32.9	31.8	30.7	29.6
Financial derivatives	12.8	4.7	5.1	5.5	6.1	6.7	7.3	8.0	8.9
Assets	72.8	95.1	81.6	88.3	97.1	107.1	117.1	128.2	142.7
Liabilities	-60.0	-90.4	-76.5	-78.0	-79.5	-81.0	-82.5	-84.0	-85.5
Other investment	29.7	-13.7	-53.4	-37.0	-38.3	-41.0	-43.4	-46.2	-49.1
Assets	36.8	-41.5	-187.7	-178.3	-184.6	-197.4	-209.0	-222.4	-236.5
Liabilities	-7.0	27.8	134.4	141.2	146.2	156.4	165.6	176.2	187.4
Reserve assets (net change)	-36.4	-1.1	-32.1	-17.5	-17.0	-14.9	-12.6	-10.3	-5.3
Net errors and omissions	6.3	0.3	5.1	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum item:									
Nominal GDP	309.4	320.9	341.5	362.3	384.8	411.1	435.6	463.8	494.3
	(In percent of GDP)								
Current account	3.3	4.0	4.3	3.4	3.5	3.4	3.4	3.4	3.5
Goods balance	-7.4	-5.2	-7.0	-8.1	-8.2	-8.6	-9.0	-9.6	-9.9
Services balance	9.8	7.5	7.9	8.4	8.8	9.4	10.1	11.0	11.4
Income balance	0.9	1.7	3.4	3.0	2.8	2.5	2.3	2.0	1.9
Capital and financial account	-5.4	-4.1	-5.8	-3.3	-3.4	-3.4	-3.4	-3.4	-3.4
Capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-5.4	-4.0	-5.8	-3.3	-3.4	-3.4	-3.4	-3.4	-3.4
Net direct investment	33.1	18.0	6.3	6.4	6.0	5.7	5.4	5.2	4.4
Portfolio investment	-40.5	-18.9	11.5	3.8	3.4	2.9	2.4	1.9	1.4
Financial derivatives	4.1	1.5	1.5	1.5	1.6	1.6	1.7	1.7	1.8
Other investment	9.6	-4.3	-15.6	-10.2	-10.0	-10.0	-10.0	-10.0	-9.9
Reserve assets (net change)	-11.8	-0.4	-9.4	-4.8	-4.4	-3.6	-2.9	-2.2	-1.1
Net errors and omissions	2.0	0.1	1.5	0.0	0.0	0.0	0.0	0.0	0.0

Sources: CEIC and HKSAR Census and Statistics Department.

1/ Sign convention as per BPM5: Negative = net lending (net outflow); Positive = net borrowing (net inflow).