The Hong Kong economy expanded at a markedly slower rate in the first quarter, hurt by a slump in merchandise exports amid a difficult external environment. Private consumption growth remains healthy but the export-based economy will be vulnerable to further slowing in the eurozone, United States and mainland China economies. Keeping the US dollar peg minimises currency risk but makes Hong Kong vulnerable to commodity price shocks. The housing and equity markets are over-inflated with the potential for substantial corrections.

The key indicators¹ are highlighted below:
• GDP increased 0.4% year-on-year in Q1-2012, well down on the 3.0% observed seen in Q4-2011
• merchandise exports gains of 5.2% in May were offset by a 4.8% decline in June; imports also dropped by 2.9%, following an increase of 4.6% in May
• the trade deficit widened to HKD43 billion in April of 2012, with exports being worth HKD266 billion
• fixed investment climbed by 12.2% in Q1-2012, the highest rate seen in almost two years due to an increase in public infrastructure works
• household spending increased by 5.6% in Q1, slowing slightly from a 6.6% gain in Q4-2011.

¹ source: International Monetary Fund, The Economist and Experian.

The business perspective

The Grant Thornton International Business Report (IBR) surveys more than 12,000 businesses in 40 economies around the world. This report focuses on businesses in Hong Kong and their expectations for the next 12 months, as illustrated in figure 1.

The IBR survey tells us that businesses in Hong Kong are only cautiously optimistic about their economy over the next 12 months. Expectations for employment remain below 2011 levels whilst the availability of a skilled workforce and bureaucracy are both far less of a constraint than in 2011.
The outlook
Hong Kong is expected to face slower GDP growth over 2012 with the key export markets of Europe and the United States sluggish, before a trade surplus recovery from 2013. The economy is forecast to expand by 2.8% in 2012, accelerating to 3.9% per annum on average in the period 2012-16. Slower economic growth on the Mainland would also have a negative effect on local trade but domestic demand is expected to remain firm.

In short-term, the Hong Kong dollar’s peg to the US dollar means monetary conditions are expected to stay loose. In the longer term, Hong Kong is expected to have enviable growth potential with further integration into the Mainland supply chains and as a RMB off-shore hub. Financial market integration looks set to be faster than previously anticipated due to significant momentum behind capital account liberalisation on the Mainland. Huge street protests greeted the swearing in of Hong Kong’s new chief executive, Leung Chun-ying. Much will depend on how the new government sets out and implements policies, particularly the recently enacted competition law and greater provision of social housing.

Talk to us to find out how we can help you deal with the challenges your business is facing today.

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Figure 1: Key indicators for businesses

<table>
<thead>
<tr>
<th>Hong Kong compared with APAC</th>
<th>2010 HK</th>
<th>2011 HK</th>
<th>Q2-2012 HK</th>
<th>Q2-2012 APAC</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Outlook for the economy over the next 12 months</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net optimism over pessimism</td>
<td>64%</td>
<td>41%</td>
<td>8%</td>
<td>6%</td>
</tr>
<tr>
<td>Change in employment levels</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net hiring expectations</td>
<td>41%</td>
<td>39%</td>
<td>22%</td>
<td>29%</td>
</tr>
<tr>
<td>Constraints on expansion</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Availability of skilled workforce</td>
<td>27%</td>
<td>41%</td>
<td>24%</td>
<td>37%</td>
</tr>
</tbody>
</table>

Source: Grant Thornton IBR 2012
The results reveal that global business optimism rose marginally in Q2-2012 with net 23% of businesses optimistic for their economies over the next 12 months. Businesses sentiment for the next 12 months in mainland China is positive with net 33% of businesses optimistic, up from net 23% in the first quarter.

The sovereign debt crisis continues to weigh heavily on businesses confidence in Europe; business optimism across the eurozone stands at net -5%. However confidence in the BRIC economies remains strongly positive at 41% and confidence in the United States increased from 46% to 50%, the highest level recorded since 2005.

Optimism/pessimism
• business optimism for the year ahead increased in Q2-2012, climbing to net 8%
• business sentiment in the Asia Pacific region as a whole also climbed to stand at net 6%
• globally, business optimism climbed to net 23%, up from 19% in Q1.

Figure 2: Outlook for the economy over the next 12 months: Q4-2010 to Q2-2012

<table>
<thead>
<tr>
<th>Country</th>
<th>Q4-2010</th>
<th>Q1-2011</th>
<th>Q2-2011</th>
<th>Q3-2011</th>
<th>Q4-2011</th>
<th>Q1-2012</th>
<th>Q2-2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>57</td>
<td>67</td>
<td>46</td>
<td>42</td>
<td>10</td>
<td>-2</td>
<td>8</td>
</tr>
<tr>
<td>APAC</td>
<td>5</td>
<td>17</td>
<td>8</td>
<td>-7</td>
<td>-9</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>Global</td>
<td>23</td>
<td>34</td>
<td>31</td>
<td>3</td>
<td>0</td>
<td>19</td>
<td>23</td>
</tr>
</tbody>
</table>

Source: Grant Thornton IBR 2012

2 The balance is the proportion of companies reporting they are optimistic less those reporting they are pessimistic.
3 The BRIC economies are Brazil, Russia, India and China
**Employment**

- net 22% of businesses in Hong Kong expect to hire workers over the next 12 months, slightly up on Q1, but well below levels observed this time last year (44%)
- actual employment growth reported by businesses in Hong Kong in Q1 (30%) was higher than expected the previous quarter (20%).

**Revenue expectations**

- the proportion of businesses expecting to see revenues rise in the year ahead climbed to net 26% in Q2-2012, up from 22% in Q1
- expectations are in line with Q1 for businesses in the Asia Pacific region and globally, with net 59% in APAC and net 52% globally expecting to increase revenues over the next 12 months.
Profitability expectations

- the proportion of businesses expecting to increase profits in Hong Kong dropped sharply over the past 12 months
- just 8% of businesses now expect to see profits rise over the next 12 months, compared with 54% in Q2-2011
- net 40% of businesses in the Asia Pacific region expect to see profits rise over the next 12 months, slightly above the global average (38%).

Constraints

- a lack of skilled workers is cited as being the greatest constraint on business expansion for businesses in Hong Kong (24%), lower than for businesses in the APAC region (37%)
- regulations and red tape is cited by just 12% of businesses in Hong Kong as being a major constraint, again, far lower than the APAC average (33%).
Accessing finance
- the majority of businesses in Hong Kong are happy with the level of support provided by lenders; 87% of class lenders as supportive or very supportive towards their business, compared with 81% of APAC businesses
- moving forward, 14% of businesses expect finance to become more accessible in Hong Kong, whilst 12% expect it to become less accessible.

Currencies
- the majority of businesses in Hong Kong use the HKD (92%) in their business, followed by the USD (36%) and RMB (34%)
- businesses have the most confidence in the RMB (80%) whilst the least confidence in the Euro (2%)
- stability is identified as being the most important factor in determining confidence in a currency (78%), followed by liquidity (72%).
The Grant Thornton International Business Report (IBR) is a quarterly survey of 3,000 senior executives in businesses all over the world. Launched in 1992 in nine European countries the report now surveys more than 12,000 business leaders in 40 economies on an annual basis providing insights on the economic and commercial issues affecting the global economy.

In Hong Kong, 200 businesses were surveyed over the past 12 months across all industry sectors. These businesses ranged from medium to large in size with total employment of between 100 to 499 employees. Q2-2012 data are drawn from interviews conducted in May/June 2012.

To find out more about IBR and to obtain copies of reports and summaries please visit: [www.internationalbusinessreport.com](http://www.internationalbusinessreport.com).