

## Dynamism maintained

### General Information



<b>GDP</b>	USD248,6bn (World ranking 37, World Bank 2011)
<b>Population</b>	7.07 million (World ranking 99, World Bank 2011)
<b>Form of state</b>	Limited Democracy
<b>Head of government</b>	LEUNG Chun-Ying (nonpartisan)
<b>Next elections</b>	2017, legislative



### Strengths

- Gateway to China and close ties help Hong Kong to capitalise 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 framework
- Very strong business environment
- The one country, two systems approach of Mainland China

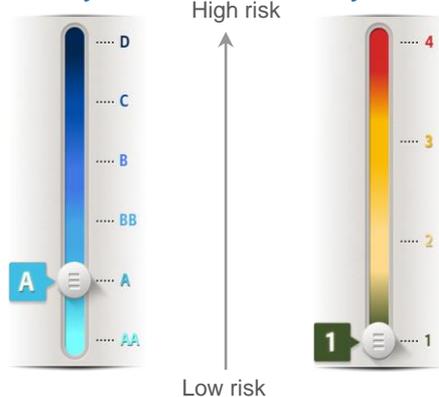
### Weaknesses

- 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

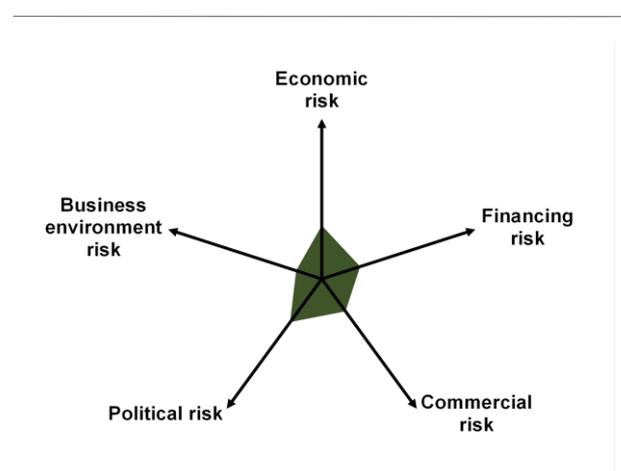
### Country Rating

**A1**

#### Country Grade Country Risk Level

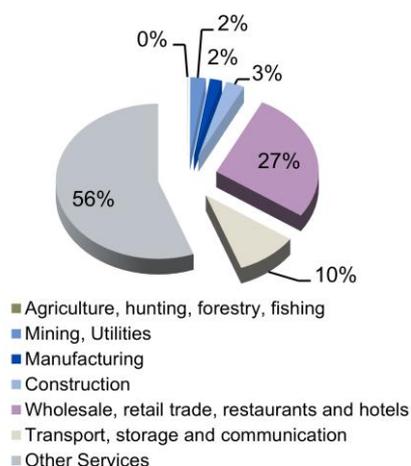


### Risk Dimensions



## Economic Structure

### GDP breakdown (% of total, 2010)



Sources: Chelem, UnctadStat, IHS Global Insight, Euler Hermes

### Trade structure (% of total, 2010)

By destination / origin

Exports	Rank	Imports
China	33% 1	32% China
United Kingdom	15% 2	13% Singapore
Switzerland	6% 3	9% Japan
Singapore	6% 4	5% United States
South Korea	5% 5	5% Taiwan

By product

Exports	Rank	Imports
Non-Monetary Gold	40% 1	17% Electronic Components
Plastic Articles	8% 2	9% Jewellery, Works Of Art
Jewellery, Works Of Art	7% 3	8% Computer Equipment
Telecommunications Equipment	6% 4	7% Electrical Apparatus
Electronic Components	3% 5	7% Telecommunications Equipment

## Economic Forecast

	2009	2010	2011	2012	2013f	2014f
GDP growth (% change)	-2.5	6.8	4.9	1.4	2.8	3.5
Inflation (% end-year)	1.5	2.9	5.7	3.7	3.5	3.3
Fiscal balance (% of GDP)	1.5	4.4	4.0	0.5	1.5	2.3
Public debt (% of GDP)	32.4	33.8	33.1	31.3	31.0	30.0
Current account (% of GDP)	9.5	6.6	4.8	1.1	0.4	0.3
External debt (% of GDP)	230.6	269.3	275.4	395.0	390.0	385.0

Source: IHS Global Insight, National sources, Euler Hermes

## Economic Growth

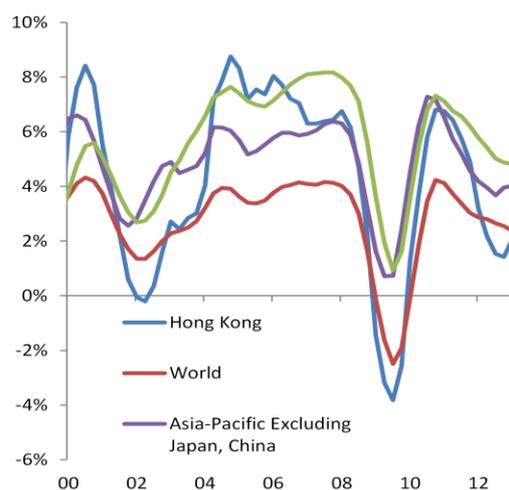
### Open and dynamic, but sensitive to global shocks

Hong Kong is a high income, open economy, with exports of goods and services around 200% of GDP. The economy is also highly dependent on Mainland China. Manufacturing accounts for just over 2% of GDP, while services account for 92%. This reflects Hong Kong's development as a service provider, particularly to companies doing business with Mainland China. This structure, along with a globally integrated financial system, however, though a crucial factor in sustained growth, also makes the economy highly sensitive to external shocks. Annual average growth of real per capita GDP was a relatively strong 3.9% in the past ten years.

### Short term prospects are for slower growth

In 2012 growth of GDP slowed to +1.5%. Q4 saw some recovery as GDP increased by +2.8% y/y and +1.4% q/q. The improvement continued in Q1 as GDP increased again by +2.8% y/y, though q/q growth fell back to +0.2% and the overall pace remains lacklustre. Domestic demand is the main driver and should continue to provide some impetus, though this could be dampened if the US fed to begin to reverse QE early. The property sector also remains a downside threat. Nonetheless, overall growth in full year 2013 is likely to be +2.8% followed by +3.5% in 2014.

### GDP growth (y/y, 4 qtrs cumulated %)



Sources: IHS Global Insight, Euler Hermes

## Economic Policies

Economic policy is pro-business and monetary and fiscal policies are prudent, with strong continuity exhibited under successive Chief Executives, operating within the Basic Law which establishes the principles of rule under Mainland China's "one country, two systems" approach.

### Monetary policy linked to US

Monetary policy is determined by the currency board that pegs the Hong Kong dollar exchange rate to the USD. Accordingly, interest rates track those of the US and monetary policy has been expansionary for some time. The currency board was established in 1983 and having survived all the various emerging market crises since then should continue to prove durable (though it is not enshrined in the Basic Law). Foreign exchange reserves are just under 200% of the monetary base.

Inflation, which eased through 2012, helped by easing food prices, was 4%/y in April 2013 and should ease to 3.5% at year-end. Domestic credit and private sector bank lending slowed in 2012.

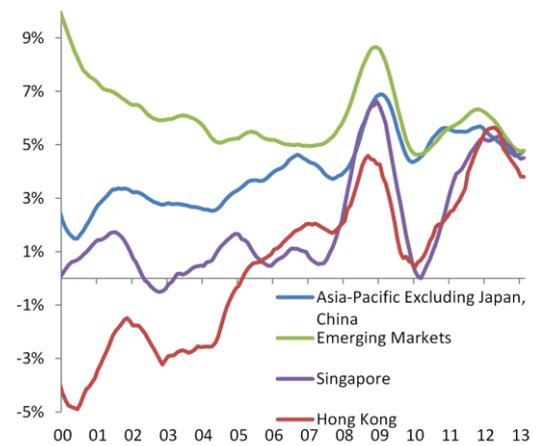
The banking system is well capitalised and non-performing loans are low. The financial system has strong linkages to the global system and increasingly to China making it vulnerable to external shocks. Banks' claims exceed liabilities in BIS data, however. Ultra-loose policy has fuelled a property sector boom, but the banks have proved resilient in the past to property downturns.

### Fiscal surpluses

The fiscal balance is consistently in surplus, though as fiscal policy is the only means of influencing domestic demand, the authorities use counter-cyclical policies and in 2012 the general government surplus fell to 0.2% of GDP from 4% in 10 and 2011 (IMF data) as the government took various measures to stimulate the economy. With somewhat stronger economic activity in 2013, the surplus is expected to increase modestly.

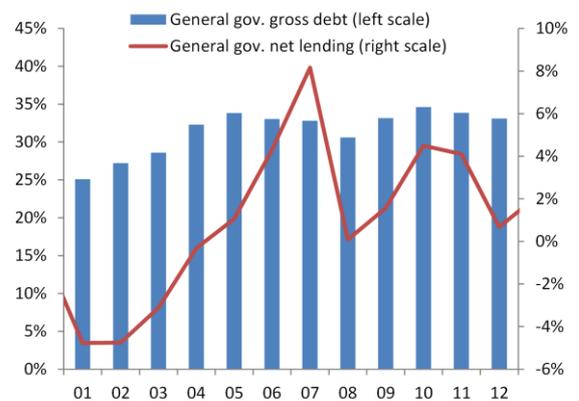
The authorities also maintain large fiscal reserves and general government debt as a proportion of GDP is low.

Inflation rate (%)



Sources: IHS Global Insight, Euler Hermes

Fiscal balance and debt (% of GDP)



Sources: IHS Global Insight, Euler Hermes

## External sector

### Current account surplus

The current account balance is typically in surplus as net earnings from services and income more than offset the trade deficit. Moreover, as a large proportion of goods exports are re-exports and the majority of imports are not for domestic end-use consumption there is a significant self-correcting element to the trade balance.

In 2012 the current account surplus fell to +1.1% of GDP. Both export and import growth slowed but the former more rapidly, as Eurozone demand weakened, and as result the trade deficit widened. China demand also weakened and services export growth slowed.

The current account surplus may fall further in 2013 but should recover to just over 2% of GDP in 2014, as the global economy gains momentum.

FDI flows are strong in both directions and net flows oscillate between small surpluses and small deficits.

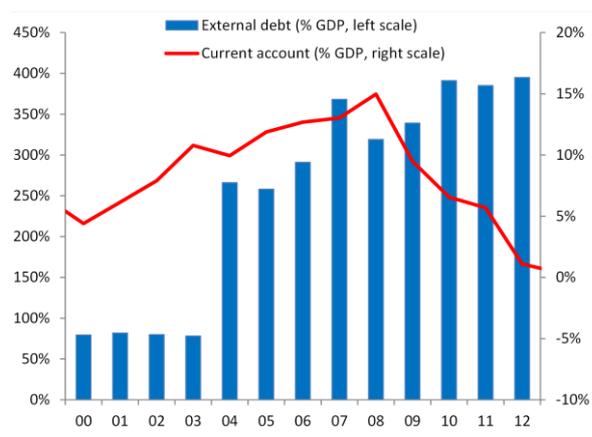
External debt as a proportion of GDP is relatively high, but this comprises total external liabilities, the bulk of which is the banking system. Public sector debt is very low. Moreover, as noted earlier, claims on BIS banks exceed liabilities.

### FX reserves continue to rise

FX reserves have risen steadily and are more than 200% of monetary base, comfortably underpinning the currency board system. Broad money liabilities are also moderate relative to FX reserves.

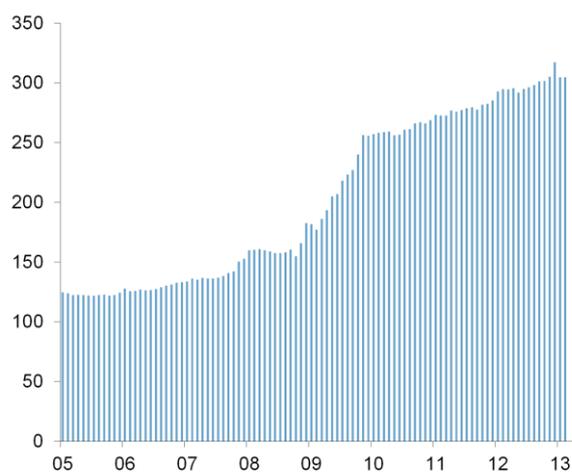
Overall the external balance is sound.

Current account and external debt (% of GDP)



Sources: IHS Global Insight, Euler Hermes

FX reserves (USDbn)



Sources: IHS Global Insight, Euler Herm

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