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ECONOTE No. 96 The PRC and Hong Kong: Uneven recovery, the role of GBA and of president-elect Biden 12/11/2020

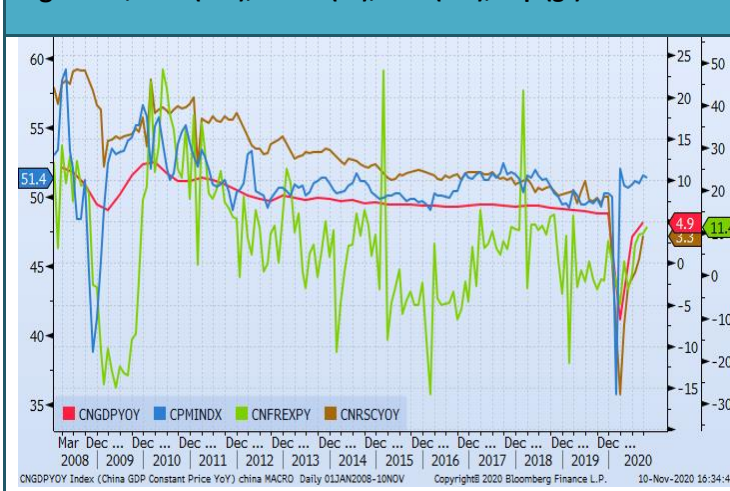
Summary	Investment Conclusions
American elections offer a fertile ground for “What happens next” type of reports. Well, this one is NOT one of them! Ecognosis has railed against the “Americanocentricity” of reports on, and from Asia. The US election was very important for the US, but local developments in the PRC and Hong Kong were even more important for their economies. Hence we place the role of the new US president in the context rather than in the center of this analysis. The Greater Bay Area (GBA) and Hong Kong’s lingering doubts as to its role is juxtaposed to PRC’s recovery pace and the likelihood that president-elect Biden will have a limited role to play, at least for now, in these trends and developments.	There is widespread conviction that Biden will not ease up on the US-China trade conflict or on political pressures. In any case US-China trade performed better despite the US tariffs. China’s recovery metrics are impressive while Hong Kong is a long way off a clear bottoming. Sections of the HK property sector, especially the residential, continue to believe that nothing has changed while the service and tourism sector slips even further into deep recession. The stock markets in both economies appear stable, but the role of the private sector in China received a blow by the Ant IPO cancellation.

The macro metrics to the fore

As Fig. 1 shows China’s key metrics of GDP, retail sales, and exports are all registering positive YoY while PMI is now over 50.0. The reasons for all these are well-known. The CV19 impact was dealt with draconian initial lockdowns which limited the spread and thus avoided further infections and more lockdowns. The PRC continues to register infections and provincial cities were recently partially isolated as cases flared. But to the extent that the figures published reflect the actual situation, the efforts of the authorities have proved successful, so far, in limiting the damage to the economy. The fact that China was not an exports-dependent economy, despite widespread belief to the contrary, meant that the reliance on domestic demand and the limited CV19 disruption kept GDP shrinkage in check. The announced outline 5 year plan, as all PRC plans, is not a quantitative exercise but a broad developmental guide as to the future direction of the economy. The “dual circulation” concept, which was given impetus by the CV19, signals more reliance on domestic rather than external demand, something which has been true, in any case, in the last few years. The story for Hong Kong is pessimistic (Fig. 2). The economy has been decelerating since 1Q.18 and the latest GDP growth for 3Q.20 is still negative albeit giving a sign of bottoming. We believe that this is possibly premature as tourism, and its dependent sectors of restaurants, retail trade and hotels, will not recover till free travel is restored between Hong Kong and the Mainland and the rest of the world.

Unemployment will very likely accelerate once the impact of the Employment Support Scheme fades. Restaurant takings in 3Q.20 were down 35.3 YoY, while unemployment in the related sectors climbed to 11.7%, both record levels since 2003-4. It is always forgotten that HK has no unemployment benefits or Social Security safety nets such as those in the EU, and even in the US. The property sector, bar residential, continues to be hit hard. The Xmas and CNY season will, therefore, likely be very poor.

Fig 1. PRC, GDP (red), Retail (br), PMI (blu), Exp (gr) 2008-20



Source: Bloomberg.

Demystifying the Greater Bay Area (GBA)

The obsessive preoccupation in Hong Kong about its role in the GBA, and especially vs Shenzhen, needs reappraising. Consider the following. **First**, the concept of the GBA has been around for several years now, well before its formalisation in 18/2/2019. The 62pp “founding document” contains no quantitative plans or figures but only directive and exhortations as to the integration between the HK+Macau+9 cities of the area. (See Box). **Second**, HK has been active in fostering the integration of the 11 cities with multibillion HKD projects such as the HK-Zhuhai-Macao bridge and the Guangzhou-Shenzhen-HK express rail link. **Third**, the role of the central and regional governments is of crucial importance in terms of the implementation of the broad directives and in the provision of infrastructure. The GBA is not “a centre for attracting FDI” but an instrument of restructuring China’s economy towards high technology as well as making use of the HK’s financial markets particularly for IPOs. **Fourth**. The role of

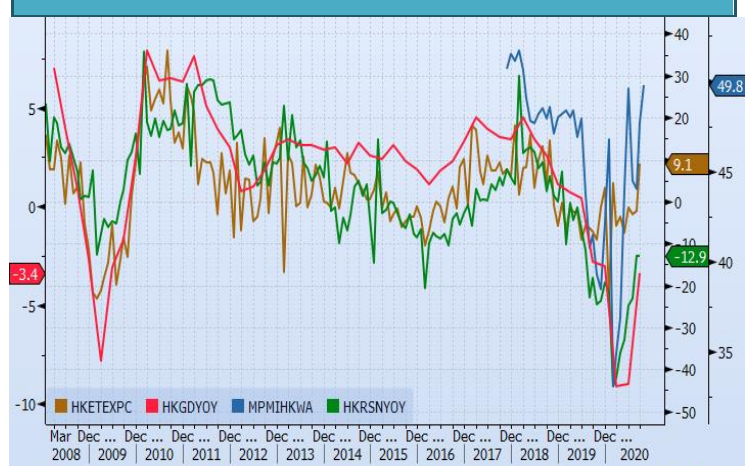
BOX: The Greater Bay Area



Source: Wikipedia

private enterprises, both local and foreign, in GBA will remain very important. Shenzhen is the headquarters of major Chinese private enterprises such as Huawei, Tencent, ZTE, DJI and BGI. Up to 2019, more than 69,000 HK private enterprises had invested in, or moved to GBA involving USD 342 bl of funding. The HKSEX has held repeatedly the global top IPO position and most of the funds raised were for Chinese companies. The recent case of the Ant IPO serves as warning, however, that private enterprises are not immune from the control of the communist party. **In sum**, the GBA initiative is an on-going process and not a recently proposed scheme relying mostly on state and local governments initiative and direction but not forming part of a quantitative plan with actual targets, timelines and deadlines.

Fig.2: HK GDP (red),Exp (BR), PMI (BLU),Retail (GR), 2008-20



Source: Bloomberg.

Conclusions

The traditional role of the PRC offering HK a “cushion” relied primarily on tourism flows which have now all but disappeared. These flows are unlikely to recover until the next Spring/ Summer season, by which time it may well be too late for a lot of restaurants and retailers in HK. Integration with the GBA is by no means a “new development” and it is not a short term solution. The publicity campaign and reassurances that HK will not lose out to Shenzhen do not guarantee that, in relative terms, HK may find the balance tipping. Invitations to the younger HK generation to immigrate and work in the GBA, where housing is significant cheaper, might be unduly optimistic given the recent scars of the political instability. Should, as memories fade and attitudes change, this happens, and HK is par excellence an immigrant/emigrant society, then this would be bullish for employment and bearish for the residential property market in HK. **The role of the president elect Biden** is unlikely to change any of these conclusions. **First**, the consensus is that the new administration will not be in a hurry to change the US-China trade policies but may well tone down their aggressiveness. So any trade-related impact on PRC’s deriving from US tariffs will stay unchanged. **Second** the decision removing HK’s “preferred status” with US trade will remain, but its quantitative impact is still hard to determine and likely to be very small. **Third**, the technology war (Huawei, etc) will not end now, but refusing access to Chinese firms to Wall Street may benefit Hong Kong. As for the positives, we have the reintegration of the US to the Paris 15 pact and the WHO, all resonating well with the PRC.

Andrew Freris (writing completed 11/11/2020)