

GBA – When survey meets a confluence of headwinds

- Our GBA index weakened again in Q1, dipping below 50, but the headline expectations index rebounded
- Services sectors underperformed, and Hong Kong was a drag; new headwinds yet to be fully reflected
- Our thematic questions showed respondents are optimistic towards the RCEP’s impact on their business

Take expectations rebound with a pinch of salt

Our GBA Business Confidence Index (GBAI), based on quarterly surveys of over 1,000 companies operating in the Guangdong-Hong Kong-Macau Greater Bay Area (GBA) and conducted in collaboration with the Hong Kong Trade Development Council (HKTDC), shows business confidence weakened for a third straight quarter in Q1, but is expected to improve in the coming quarter. The GBAI’s ‘current performance’ index for business activity fell to 49.6 – the first time back below the 50 neutral mark since Q3-2020 – from 50.3 in Q4-2021. This partly reflected headwinds from H2-2021, when the mainland housing market slowed, COVID disruptions lingered and regulations on tech companies were tightened. Policy easing likely helped limit the headline drop this time, as our credit indices did see better bank appetite to lend; but that alone was not enough to offset Hong Kong’s sizeable drag, as the city battled (and is still battling) its worst COVID wave so far.

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A further breakdown showed that the ‘current performance’ indices for the services sectors underperformed those for manufacturing and trading; that in turn explains the more modest readings for Shenzhen and Guangzhou compared with, say, Dongguan and Foshan. In comparison, the latest rebound in the more forward-looking ‘expectations’ indices – with the headline rising to 55.5 in Q1 from 53.6 prior – appears much more broad-based; however, note that these numbers have yet to fully reflect newer headwinds such as the COVID resurgence and escalation in the Russia-Ukraine conflict, both of which only started being captured towards the tail end of our survey period. For thematic questions, we asked respondents to share their views on the Regional Comprehensive Economic Partnership (RCEP), including the different ways it can impact business performance, as well as long-term strategies.

Figure 1: Sentiment weakened further in Q1
 GBAI business index and its sub-components

	Current performance			Expectations		
	Q1-2022	Q4-2021	Q3-2021	Q1-2022	Q4-2021	Q3-2021
Business index	49.6	50.3	52.7	55.5	53.6	57.9
1. Production/sales	48.1	49.8	54.3	55.9	56.1	61.8
2. New orders	47.9	50.7	56.1	55.8	56.1	64.6
3. Capacity utilisation	45.5	47.2	46.9	54.5	51.0	56.1
4. Raw material inventory	50.4	45.7	52.6	53.1	47.4	54.6
5. Prices of finished goods/services	61.4	61.9	62.0	61.7	61.4	59.5
6. Fixed asset investment	48.3	49.6	50.5	52.9	52.3	52.1
7. Financing scale	49.6	49.8	48.6	55.0	52.5	52.9
8. Profit	45.8	47.5	50.8	55.4	51.9	61.3

Source: HKTDC, Standard Chartered Research

Figure 2: The gap between ‘current performance’ and ‘expectations’ re-widened in Q1



Source: HKTDC, Standard Chartered Research

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Detailed findings of the GBAI survey for Q1-2022

Our latest survey was conducted from January to early March, a period when GBA businesses faced a confluence of headwinds. These included headwinds carried over from last year, such as a weak real-estate market, high input costs for manufacturers, and a tightening regulatory environment for the tech sector. And then there were also newer challenges – like the sharp surge in COVID cases leading to disruptive lockdowns and the escalation in the Russia-Ukraine conflict exacerbating cost pressures, worsening supply-side disruptions, and potentially weighing on export demand – many of which are still playing out. Our GBAI survey therefore provides a timely on-the-ground look at how businesses in the region fared against this challenging backdrop, and more importantly how they think things will pan out in the coming quarter. Our credit indices are once again a useful gauge of the effectiveness of monetary policy easing so far in supporting activity.

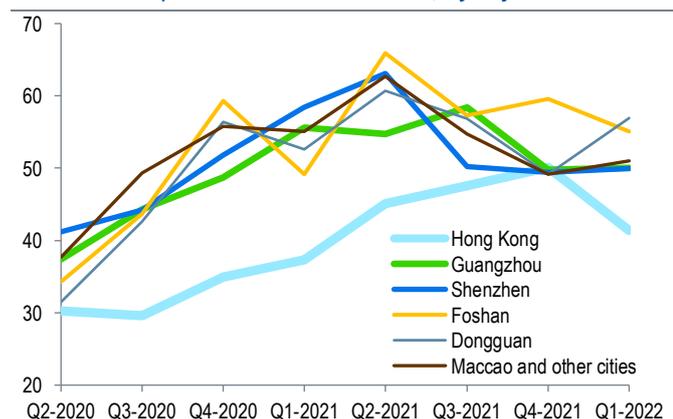
Still falling current performance index echoes the need for more pro-growth policies

- **Current performance index dipped below 50 in Q1:** The GBAI current performance index for business activity fell for a third straight quarter to 49.6 in Q1 from 50.3 prior. This is the first sub-50 print since Q3-2020, supporting the authorities' growing calls for stepping up and front-loading policy easing to stabilise the economy. This shift to a more pro-growth policy mix started with the reserve requirement ratio (RRR) cut late last year, followed by outright interest rate cuts in early January; the government then set an ambitious 2022 growth target of 5.5% – one we believe can only be reached with further expansionary fiscal and credit policies – at this year's 'Two Sessions'.

Expectations did not fully reflect the risk of further COVID lockdowns and escalation in Russia-Ukraine conflict

No doubt the current performance index could have risen q/q if not for Hong Kong's underperformance – the city spent much of Q1 knee-deep in fighting its worst COVID outbreak, causing an 8.7pts drop in the city's sub-index (Figure 3). But Hong Kong alone cannot completely explain away other signs of setback, with seven of our eight main components falling q/q (the exception being 'raw material inventory', which likely rose due to rising commodity prices and lingering supply disruptions, rather than in anticipation of a demand surge). The inability of other GBA cities to provide a greater offset to Hong Kong's drag reflects lingering headwinds carried over from H2-2021, including a weaker housing market and regulatory tightening on the tech sector, in our view. And then there were also the more recent escalations in the Russia-Ukraine conflict and local COVID outbreak, although they only happened towards the tail end of our survey period.

Figure 3: Just when Hong Kong managed to catch up
GBAI 'current performance' sub-indices, by city



Source: HKTDC, Standard Chartered Research

Figure 4: Can do with more monetary easing
Sub-components of our GBAI credit indices

	Current performance			Expectations		
	Q1-2022	Q4-2021	Q3-2021	Q4-2021	Q3-2021	Q3-2021
Credit Index	49.1	47.8	50.8	51.8	51.0	51.9
1. Bank financing cost *	49.4	49.2	51.7	48.4	49.1	48.4
2. Non-bank financing cost *	50.1	49.2	50.7	48.8	49.1	49.2
3. Banks' attitude towards lending	50.2	47.1	51.8	51.3	49.9	49.2
4. Surplus cash	47.0	47.3	48.8	55.9	53.8	58.2
5. Receivables turnover	48.6	46.4	51.3	54.6	53.1	54.7

* Index above 50 indicates lower cost; Source: HKTDC, Standard Chartered Research



On the Ground

- **Expectations need to be tempered:** The GBAI expectations index for business activity rose 1.9pts q/q to 55.5; this was the first increase in a year, resulting in a widening gap over the current performance index, possibly reflecting anticipation of further policy efforts to stabilise growth. This is also in line with robust nationwide growth during the first two months of 2022, *beating market expectations by a wide margin* across key gauges including industrial production, retail sales and fixed-asset investment (although services growth did moderate over the same period, likely due to slowing housing sales). All eight of our expectations sub-indices stayed comfortably over 50; six of those eight improved q/q, the exceptions being 'production / sales' and 'new orders' (down by a very modest 0.2pts and 0.3pts, respectively). While this is positive, one also needs to consider the potential impact of the Russia-Ukraine conflict and sharp resurgence in new COVID cases – we already got a glimpse of their negative impact from the weak official PMI numbers in March.

Our calculation shows that only 0.4% of China's GDP is driven by demand from Russia. The impact of higher commodity prices due to major disruptions to Russia's supply, however, is likely to be more evident, and prompted us to recently raise our 2022 PPI inflation forecast to 6% from 3.5% on surging Brent oil prices. This in turn may exacerbate the already high input cost pressures for GBA companies, especially manufacturers; the 3.5pts q/q jump in 'expected profits' therefore looks a tad too optimistic, in our view. The combination of higher prices of imported crude oil and weaker demand from the West (which are *more economically dependent on Russia in the case of Europe* and *prone to real income squeeze in the case of the US*) could also weigh on China's trade surplus. Weaker external demand calls for a more cautious take on 'expected new export orders', which rebounded to 55.0 in Q1 from 47.7 prior.

Closer to home, the GBA has not been spared by the surge in COVID cases since late February, which culminated in a week-long stringent lockdown in both Shenzhen and Dongguan in mid-March, causing not only shops to close and families to stay homebound, but also factories to shut down. Quick policy response has helped new COVID cases come down since, allowing economic activity to normalise. Yet with some other cities/provinces outside of the GBA still struggling to keep daily infections down, GBA businesses still see the need for caution, on concerns that more lockdowns and factory shutdowns could be on the horizon.

Borrowing costs can come down further

- **Financial conditions improving as policy focus shifts:** The current performance index for credit rose to 49.1 in Q1 from 47.8 prior (Figure 4). Four out of five current credit sub-components contributed to this improvement, led by a clear rebound in banks' attitude towards lending (+3.1pts versus -4.7pts prior) back above 50, while borrowing costs also marginally improved (both the bank and non-bank sub-indices rose, with the latter also returning above 50). All this suggests that the evident loosening in monetary policy since December has fed through to banks' behaviour. That said, with the economy still facing slowdown pressure, be it from lingering housing market weakness or new COVID disruptions, companies saw weak cash positions in general, as both 'current surplus cash' and 'receivables turnover' stayed evidently below the 50 mark.



On the Ground

Our expectations index for credit also rose in Q1, by 0.8pts to 51.8, bringing it almost back to Q3-2021's 51.9. The improvement was possible despite respondents expecting little easing in bank (-0.7pts) and non-bank (-0.3pts) borrowing costs, in part thanks to an offset from a likely further improvement in banks' appetite to lend (+1.4pts). While we agree with the authorities' reassurance to not flood the economy with cheap liquidity, we see the need for more monetary policy support to the economy; our forecast therefore has at least another round of a 50bps RRR cut and a 10bps cut in the medium-term lending facility (MLF) rate in the near term. But what really drove the expectations index for credit this time was the anticipated improvement in respondents' own cash positions – which could be prone to disappointment if the aforementioned macro headwinds are to stay strong for longer.

Manufacturers have shown great resilience so far, but are unlikely to be insulated from further headwinds on the horizon

- **Manufacturing has been holding up well so far:** 'Manufacturing and trading' respondents reported largely the same current performance index as the prior quarter; this was already enough to make them the outperformers in Q1, as all other industry sub-indices for current performance fell q/q (Figure 5). 'Innovation and technology' – a regular outperformer in our prior surveys – dropped the most this time, by 12.5pts to 47.1 from 59.6 in Q4-2021, possibly reflecting headwinds from recent regulatory tightening. Besting only the 37.0 print for 'professional services', this puts IT respondents lower than 'retail and wholesale', which has faced intermittent COVID disruptions even before the recent sharp surge in daily new cases. The -9.9pts q/q and -3.6pts drop in 'professional services' and 'financial services', respectively, could potentially reflect a weaker housing market on the mainland side, as well as the COVID situation in Hong Kong pushing the city into a likely Q1 contraction. But even so, financial respondents remained the most optimistic with a 50.6 print.

Resilient external demand likely supported the solid manufacturing performance in Q1, but with the Ukraine situation likely leading to global demand destruction (be it directly from military conflict and supply chain disruptions, or indirectly via

Figure 5: GBAI business sub-indices by sector

Business activity	Current performance			Expectations		
	Q1-2022	Q4-2021	Q3-2021	Q1-2022	Q4-2021	Q3-2021
Manufacturing and trading	50.3	50.3	53.4	55.8	53.8	58.3
Retail and wholesale	48.0	49.2	50.0	55.2	50.9	56.2
Financial services	50.6	54.2	51.8	58.4	59.6	56.3
Professional services	37.0	46.9	41.3	45.3	52.2	50.2
Innovation and technology	47.1	59.6	55.3	58.1	58.0	61.2

Source: HKTDCC, Standard Chartered Research

Figure 6: GBAI credit sub-indices by sector

Credit	Current performance			Expectations		
	Q1-2022	Q4-2021	Q3-2021	Q1-2022	Q4-2021	Q3-2021
Manufacturing and trading	49.3	47.5	51.0	52.5	50.6	51.9
Retail and wholesale	47.8	49.2	50.5	48.3	52.0	51.9
Financial services	51.8	49.1	50.1	51.2	50.8	49.3
Professional services	43.6	49.7	49.3	46.5	58.9	52.6
Innovation and technology	50.9	52.0	50.1	54.7	52.6	53.9

Source: HKTDCC, Standard Chartered Research



On the Ground

higher commodity prices and inflation eroding real income), the 2.0pts q/q increase in manufacturers' expectations index to 55.8 (and with all its sub-components standing above 50) looks optimistic, in our view. Lingered worries over stringent COVID containment measures disrupting production could also weigh on manufacturers as much as on domestically oriented sectors like 'retail and wholesale'; *our proprietary China SME Index* – a gauge for nationwide SME business sentiment – showed that the 'accommodation and catering' sector was a clear underperformer (alongside 'real estate') in March, likely due to the COVID resurgence. In contrast, despite a disappointing drop in its GBAI current performance index, 'innovation and technology' managed to maintain a high expectations index at 58.1 (second only to 'financial services'), reflecting little lasting negative effect from the recent regulatory headwinds.

Slow recovery from a likely sharp Q1 contraction in Hong Kong means a persistent drag on headline GBAI

- **Hong Kong the main drag:** It was no surprise that both Hong Kong's current performance and expectations indices fell materially in Q1, by 8.7pts and 5.2pts, respectively. The city was battling its worst COVID outbreak throughout the survey period, likely weighing heavily on Q1 growth. While this epidemic wave likely peaked in early March, daily new cases have stayed elevated since; low vaccination rates among the elderly also continue to contribute to a high mortality rate. All this explains the authorities' cautious approach to relaxing social distancing rules, which will be done in three phases over a three-month period starting in late April. Any recovery in business sentiment in the coming quarters is therefore likely to be modest, in our view. The key to lifting Hong Kong's recovery ceiling lies in the city's ability to materially open up its borders by exiting its 'dynamic zero-COVID' strategy in an orderly manner; we believe the recent lifting of flight bans and quick ramp-up in medical capacity to deal with new cases are small steps in the right direction.

Figure 7: GBAI business sub-indices by city

Business activity	Current performance			Expectations		
	Q1-2022	Q4-2021	Q3-2021	Q1-2022	Q4-2021	Q3-2021
Hong Kong	41.4	50.1	47.6	47.5	52.7	56.4
Guangzhou	50.0	49.8	58.4	56.5	52.3	60.6
Shenzhen	50.0	49.4	50.2	58.6	53.4	58.0
Foshan	55.1	59.6	57.3	56.2	57.6	59.5
Dongguan	56.9	49.2	56.8	57.4	55.0	55.5
Macao and other cities	51.0	49.2	54.7	56.5	53.3	56.8

Source: HKTDC, Standard Chartered Research

Figure 8: GBAI credit sub-indices by city

Credit	Current performance			Expectations		
	Q1-2022	Q4-2021	Q3-2021	Q1-2022	Q4-2021	Q3-2021
Hong Kong	45.1	46.9	49.7	47.8	50.2	51.9
Guangzhou	49.4	49.3	53.3	52.7	50.9	52.0
Shenzhen	49.0	47.6	51.1	53.5	50.0	52.2
Foshan	52.7	53.1	51.4	51.5	55.5	54.1
Dongguan	51.5	47.1	50.6	53.0	53.2	52.5
Macao and other cities	49.6	45.8	48.4	51.1	51.7	49.8

Source: HKTDC, Standard Chartered Research

While the drag from Hong Kong clearly mattered, the city's underperformance alone could not fully explain away the broad-based weakness across the services sector sub-indices. Both Shenzhen and Guangzhou's current performance indices merely recovered back to the 50 mark, while Dongguan (+7.7pts to 56.9) and Foshan (-4.5pts but still standing at 55.1) outperformed, suggesting weak services activity in the mainland as well (Figure 7). Shenzhen, in particular, appeared to have been weighed down by its higher IT content, while the broader real-estate slowdown and stringent COVID containment measures have also likely had a disproportionately larger impact on the more services-oriented core GBA cities. But by the look of the strong expectations indices across core and non-core mainland GBA cities, respondents generally expect GBA's services sector challenges to be short-lived. Shenzhen's success with its week-long lockdown in mid-March was a good start, but much still depends on how well COVID will be contained in other parts of China too.

Key takeaways from our thematic questions

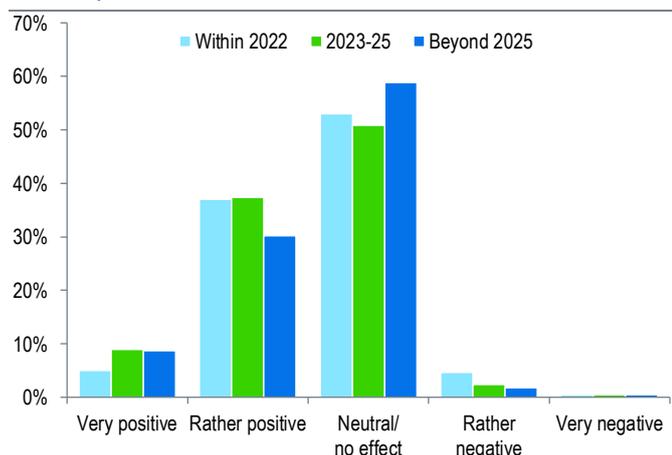
RCEP is expected to bring the most benefits over 2023-25

Our thematic questions this time focused on how the Regional Comprehensive Economic Partnership (RCEP) agreement, which took effect on 1 January 2022, will impact our diverse group of GBA respondents. On paper, the prospect of removing 90% of the tariffs and facilitating freer movement of factors of production among the FTA's member states appear to be the perfect antidote to the many more economic, social and geopolitical uncertainties/challenges that GBA businesses are bound to face over the coming decade. The sheer size and diversity of the combined RCEP economies have the potential to reshape regional supply chains and boost their collective consumption and investment. In this survey, we tried to find out whether our respondents share our optimism, in what ways RCEP will help or change their business, and their plans to harness such potential.

- A multi-year window of opportunity:** We wanted to understand how the implementation of the RCEP would affect our GBA respondents' business revenue and investment plans. Understanding that the creation of freer regional trade is a process, we asked them to identify the RCEP's impact across three timeframes – within 2022, between 2023 and 2025, and beyond 2025. The results are very encouraging, with a substantial 42.0% respondents seeing (a

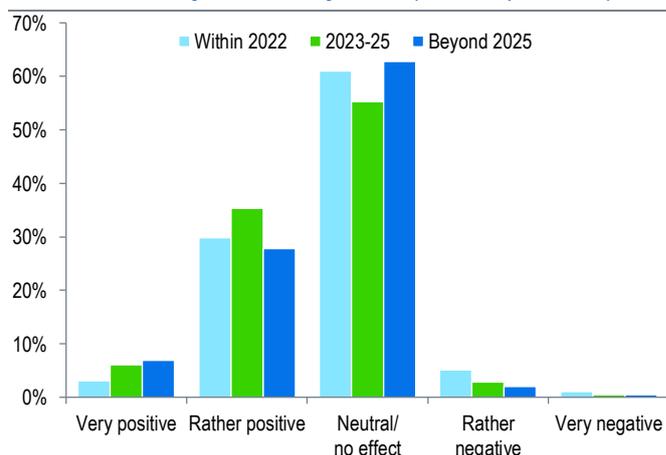
Figure 9: How do you see RCEP impacting your business revenue this year and beyond?

% of respondents



Source: HKTDC, Standard Chartered Research

Figure 10: How will the implementation of RCEP impact your company's investment decisions in the RCEP economies this year and beyond? (% of respondents)



Source: HKTDC, Standard Chartered Research



On the Ground

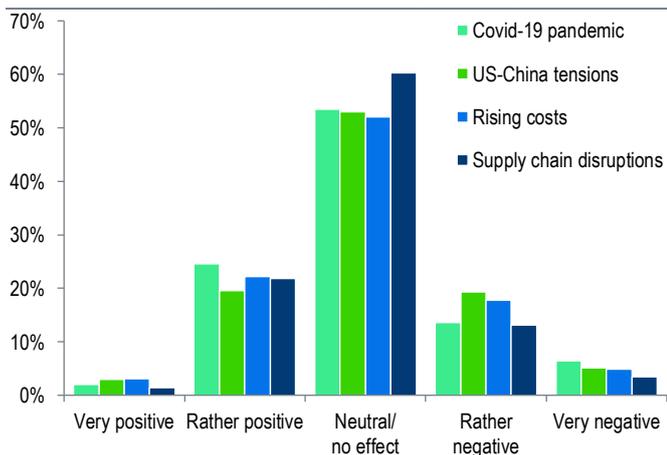
very or somewhat) positive impact on their business revenue, and 32.9% for investment, in 2022 (Figures 9 and 10). These numbers further improved to 46.4% and 41.4%, respectively, for 2023-25, reflecting the perceived structural gains that come with time. Beyond 2025, however, some of the positive responses started to revert to neutral, as early movers would have already reaped much of RCEP's benefits by then.

A further breakdown showed that bigger companies have higher shares of positive responses, possibly reflecting the need for scale and capital to maximise the benefits from more cross-border trade, optimising supply chains, diversifying markets and making more investment. By industry, financial services appeared most optimistic on the RCEP's impact on revenue this year, followed by professional services; beyond 2022, however, innovation and technology saw the biggest jump to take the top spot for 2023-25, while retail and wholesale saw the least drop-off in positive responses beyond 2025. In terms of lifting investment, IT and manufacturing respondents appeared most optimistic in 2022, before being surpassed by retailers and wholesalers, as well as those in financial services. In any case, these results showed that the RCEP is not just about benefiting manufacturing and trading, but also the various services sectors that facilitate cross-border trade and gaining access to new markets.

RCEP brings about many different benefits to GBA businesses

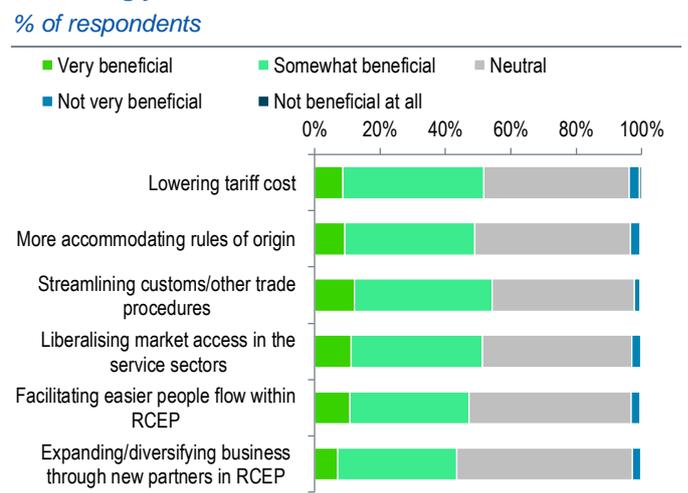
- RCEP as a boost and as a relief:** We asked respondents how different aspects of the RCEP benefit their business (Figure 12). The RCEP being a free-trade agreement first and foremost, it is unsurprising to see 'streamlining customs and other trade procedures' and 'lowering tariff cost' getting the most positive votes, at 54.2% and 51.8%, respectively. More encouragingly, 51.3% also associated their business outlook positively to the RCEP's ability to grant new market access to services sectors among the member states. Other options including more relaxed rules of origin (49.0%), easier people flow within RCEP (47.3%) and greater access to new business partners in other member states (43.5%) all had 40%+ positive votes, suggesting strong awareness of the RCEP's wide-ranging benefits among our economically diversified group of GBA respondents. Figure 13 shows the breakdown of positive responses across industry categories.

Figure 11: How do you think the implementation of RCEP can help alleviate the stress on your company's business from the following events? (% of respondents)



Source: HKTDC, Standard Chartered Research

Figure 12: How do you see the following aspects of RCEP benefitting your business?



Source: HKTDC, Standard Chartered Research



On the Ground

We also asked respondents how they think the implementation of RCEP can help alleviate some of the more immediate stresses on the business (Figure 11). Here we saw less one-sided positive results compared with the previous questions. The new trade pact's ability to reduce the impact from 'supply chain disruptions' and 'COVID-19 pandemic' got the most net-positive results, at +6.8ppts and +6.7ppts, respectively. 'Rising costs' also got a net positive of 2.7ppts, while 'US-China tensions' was a net negative 1.9ppts. We, however, believe that these challenges – be it COVID disruptions, geopolitical tensions, or worsening costs – all lead back to the need for production and market diversification, which in turn will continue to be a key driving force for much closer intra-Asia trade and investment integration, and the RCEP's role in accelerating this transformation will likely be appreciated over time.

RCEP will bring changes to GBA respondents' trade and supply chain models

- RCEP as a catalyst for operational changes:** Speaking of transformation, over the next one to three years, 46.1% of respondents expect the RCEP to change their trade and supply chain models by (either significantly or slightly) increasing their sourcing of goods / services from RCEP economies; 44.7% also said they would export more goods and services to RCEP member states, and 29.0% starting more production and/or investment there. These are obviously materially more than the RCEP's impact on respondents' trade and supply chain models with non-RCEP economies (Figure 14).

We also asked our respondents how they see the scale of their business activity in/with RCEP member countries change in the coming one to three years (Figure 15). Mainland China led the way with 53.6% of respondents saying an increase in scale, followed by ASEAN's 26.4%, and Japan's 24.9%. Mainland China had the most positive responses from their 'manufacturing and trading', 'professional services' and 'innovation and technology' respondents, while the more developed RCEP economies (Japan, South Korea, Australia and New Zealand) were the opposite, doing better among their 'financial services' and 'retail and wholesale' respondents. ASEAN, in contrast, had the least diverse range of responses among industry groups.

Figure 13: The share of respondents seeing various aspects of RCEP benefitting their business

% of respondents with positive response (top three answers picked for each industry category in bold)

	Manufacturing and trading	Retail and wholesale	Financial services	Professional services	Innovation and technology
Lowering tariff cost	52.8%	48.0%	41.7%	59.5%	64.0%
More accommodating rules of origin	42.2%	54.5%	59.1%	49.2%	68.0%
Streamlining customs and other trade procedures	50.0%	58.0%	57.5%	54.0%	74.0%
Liberalising market access in the service sectors	47.6%	50.0%	55.9%	57.1%	68.0%
More convenient people flow within RCEP	45.0%	52.0%	48.0%	47.6%	48.0%
Expanding/diversifying business through financing business partners in RCEP	42.6%	42.0%	40.9%	48.4%	52.0%

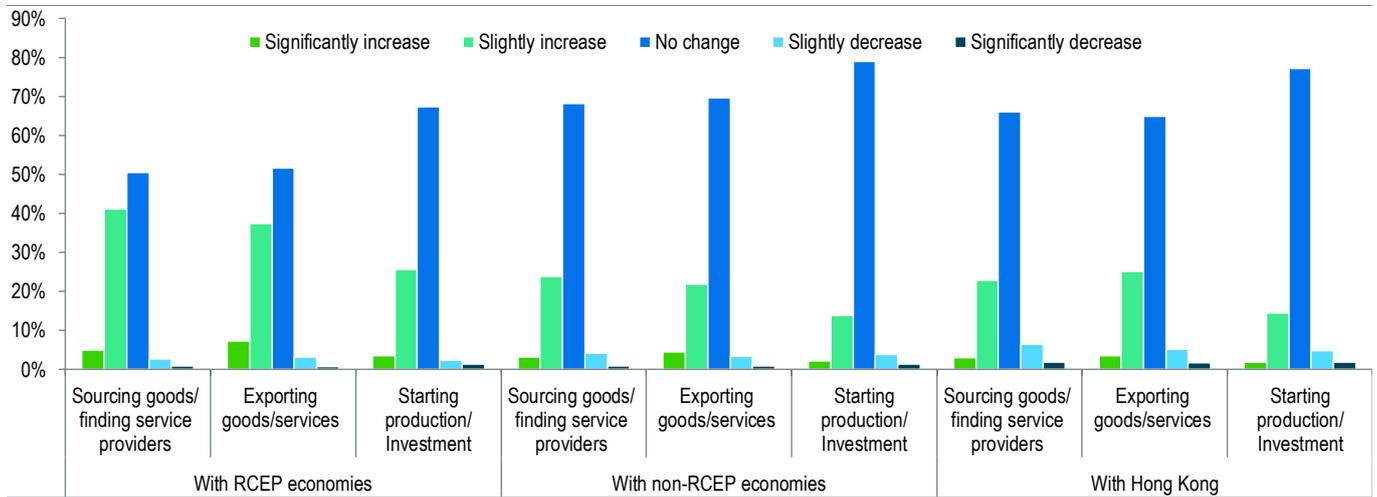
Source: HKTDC, Standard Chartered Research



On the Ground

Figure 14: How do you expect RCEP to change your trade and supply chain models in RCEP economies, non-RCEP economies, and in Hong Kong in the coming 1 to 3 years?

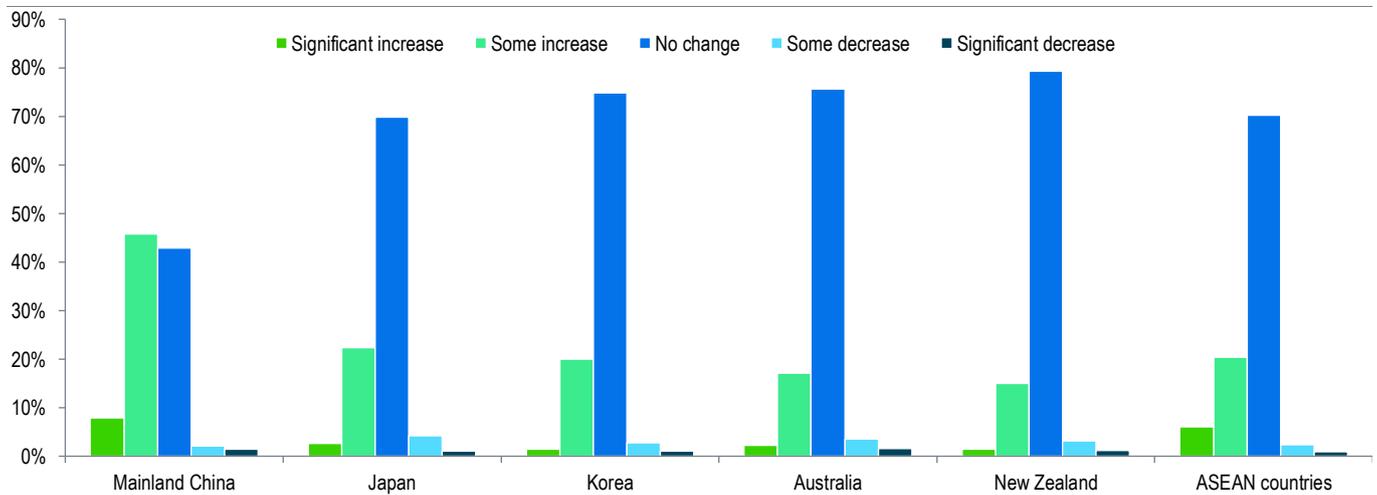
% of respondents



Source: HKTDC, Standard Chartered Research

Figure 15: How would you expect the scale of business activity of your company in/with these RCEP member countries change in the coming years?

% of respondents



Source: HKTDC, Standard Chartered Research



On the Ground

Appendix: How the GBAI works

The GBAI is a diffusion index based on responses from no less than 1,000 enterprises across 11 GBA cities and key industry sectors

The GBAI is compiled based on a quarterly survey conducted by the HKTDC in collaboration with Standard Chartered. Every quarter, no less than 1,000 enterprises in key business sectors across the GBA provide valuable feedback on a range of subjects, including their current business situation and credit conditions, and their outlooks on these subjects for the coming quarter. The GBAI also asks respondents thematic questions that help us understand what drives their business decisions and plans, and how this might shape the GBA's future.

Index calculation: The GBAI comprises two main business indices, one gauging 'current performance' (in this case Q1-2022), and the other looking at 'expectations' (Q2-2022). Each index is calculated as an average of eight sub-indices that reflect different aspects of business activity, as outlined in Figure 1. Respondents indicate the corresponding changes, actual or expected, in three ways: up, same or down; a diffusion index is then calculated using the following formula:

$$\text{Up}\% \times 100 + \text{Same}\% \times 50 + \text{Down}\% \times 0$$

An index reading above 50.0 means that respondents are generally optimistic about the business environment in the coming quarter, while a reading below 50.0 indicates predominantly pessimistic sentiment. A reading of 50 is neutral.

The two credit indices are calculated in the same way, but with five of their own sub-components that focus on measuring the costs and ease of obtaining credit, and respondents' willingness and/or eagerness to do so (Figure 4).

Figure 16: GBAI

Number of respondents

By city		By industry	
	Targeted respondents		Targeted respondents
Hong Kong	200	Manufacturing and trading	500
Guangzhou	200	Retail and wholesale	200
Shenzhen	200	Financial services	125
Foshan	100	Professional services	125
Dongguan	100	Innovation and technology	50
Huizhou		Total	1,000
Zhongshan			
Jiangmen	200		
Zhuhai			
Zhaoqing			
Macau			
Total	1,000		

Source: HKTDC, Standard Chartered Research



Disclosures appendix

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