

# GBA – Survey confirms setback; rebound expected

- Our GBA index fell for a fourth straight quarter, dipping further below 50, reflecting a tough April and May
- A confluence of headwinds hurt both manufacturers and retailers; expectations still point to a recovery
- Respondents most worried about COVID, global inflation; they discussed how to deal with rising costs

## Gauging COVID and inflation impact

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 that the current performance of ‘business confidence’ weakened for a fourth straight quarter in Q2, falling further to 43.3 after marginally breaching below the 50 neutral mark in Q1. This is also the worst print since Q3-2020 – not surprising given the latest survey was conducted in April and May, when the GBA’s businesses were facing strong external and domestic headwinds. In particular, April saw peak COVID disruption to production, sales and logistics across many GBA cities, even though they were spared from Shanghai-style lockdowns. Nonetheless, respondents still expect some form of a recovery in the coming quarter, although any recovery is likely to be moderate, at best, given the drop in the headline expectations index (to 52.5 from 55.5 prior, weakest in two years).

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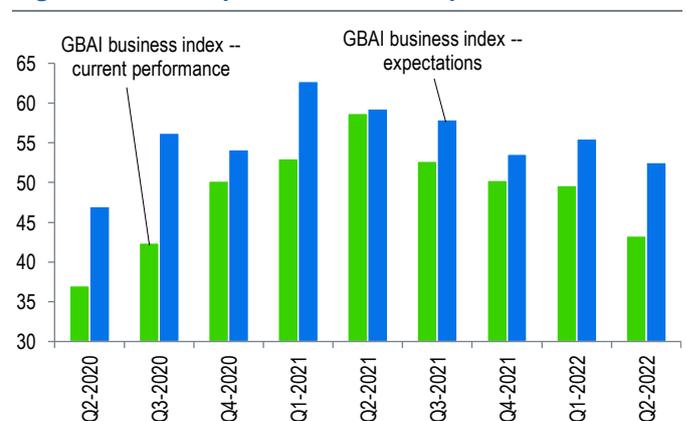
A further breakdown of responses shows that not all sectors suffered equally from the still-present set of domestic and external headwinds. ‘Manufacturing and trading’ and ‘retail and wholesale’ bore the brunt, while ‘innovation and technology’ outperformed possibly due to easing regulatory concerns. By city, all sub-indices endured the regional setback, including Hong Kong, which has seen its fifth COVID wave normalise since the start of Q2. Our credit indices reflected expectations of lower bank financing costs going forward, though overall credit conditions remain tight for now, especially due to the hit to cash flow positions. For thematic questions, we asked respondents about their top challenges, deep diving into their views on changes in various price factors and the business impact, and how they plan to deal with them.

**Figure 1: GBAI business index and its sub-components**

	Current performance			Expectations		
	Q2-2022	Q1-2022	Q4-2021	Q2-2022	Q1-2022	Q4-2021
<b>Business index</b>	<b>43.3</b>	<b>49.6</b>	<b>50.3</b>	<b>52.5</b>	<b>55.5</b>	<b>53.6</b>
1. Production/sales	40.4	48.1	49.8	55.1	55.9	56.1
2. New orders	42.2	47.9	50.7	56.3	55.8	56.1
3. Capacity utilisation	43.4	45.5	47.2	51.5	54.5	51.0
4. Raw material inventory	40.7	50.4	45.7	46.9	53.1	47.4
5. Prices of finished goods/services	54.8	61.4	61.9	57.8	61.7	61.4
6. Fixed asset investment	46.3	48.3	49.6	53.6	52.9	52.3
7. Financing scale	39.7	49.6	49.8	46.2	55.0	52.5
8. Profit	38.8	45.8	47.5	52.8	55.4	51.9

Source: HKTDC, Standard Chartered Research

**Figure 2: ‘Current performance’ vs ‘expectations’ indices**



Source: HKTDC, Standard Chartered Research

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## Detailed findings of the GBAI survey for Q2-2022

When describing *the Q1-2022 GBAI setback in our last report*, we highlighted that GBA businesses faced a confluence of headwinds, and that many of these were still playing out. We had warned that any expectations of a swift sentiment rebound needed to be tempered. Our cautious view was borne out by the latest Q2-2022 survey results, which reflected a worsening in both the current performance and expectations indices from the previous quarter. While several external challenges (the Russia-Ukraine conflict, high commodity prices and global inflation, monetary policy tightening by major central banks) likely contributed to this quarter-on-quarter setback, stringent COVID-related measures in China also caused short-term physical disruptions to production and sales, and dragged down spending and investment appetite. Despite this, most expectations sub-indices remained in expansionary territory, and not all industries were impacted equally by the headwinds. Our credit indices suggest higher expectations of lower bank financing costs and improving cash flows.

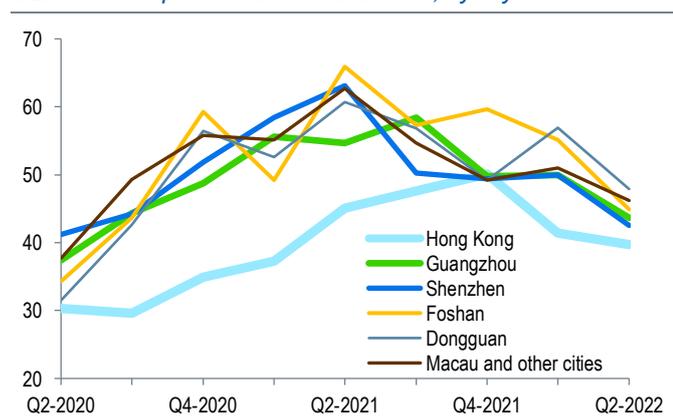
*Peak COVID disruptions weighed heavily on sentiment during this survey*

- **Current performance index worsened further in Q2:** The GBAI current performance index for business activity plunged to a seven-quarter low of 43.3 in Q2 from 49.6 in Q1 (Figure 1). This marks a fourth straight quarterly drop and the second straight sub-50 print since Q3-2020 – not surprising given the latest survey was conducted in April and May, when the GBA was facing strong external and domestic headwinds. The 12.8% q/q drop was also the largest since the initial COVID outbreak and the launch of GBAI in Q2-2020.

In particular, April represented peak COVID disruptions in Shanghai. Moreover, while outbreaks in other China GBA cities were better contained, there was a widespread impact on real activity (especially in services, but also production) and sentiment; *the subsequent recovery in May was subdued at best*. This explained the broad-based drop across all eight index components, ranging from the typical demand gauges in production (-13% q/q) and orders (-16%) to sub-40 prints in profits (-15%) and financing scale (-20%).

External demand in April and May also weakened due to the lingering drag from the Russia-Ukraine conflict and increasingly from elevated global inflation eroding household spending power. The current performance of our new export orders sub-index fell to 41.3 in Q2 from 47.1 in Q1. Narrowing pressure on profit margins was also likely a function of persistently high costs, especially of raw materials, which saw their inventory being drawn down (-19% q/q).

**Figure 3: China cities converging towards Hong Kong**  
GBAI 'current performance' sub-indices, by city



Source: HKTDC, Standard Chartered Research

**Figure 4: Bank financing costs expected to reduce**  
Sub-components of our GBAI credit indices

	Current performance			Expectations		
	Q2-2022	Q1-2022	Q4-2021	Q2-2022	Q1-2022	Q4-2021
<b>Credit Index</b>	<b>46.7</b>	<b>49.1</b>	<b>47.8</b>	<b>51.7</b>	<b>51.8</b>	<b>51.0</b>
1. Bank financing cost *	47.6	49.4	49.2	50.9	48.4	49.1
2. Non-bank financing cost *	46.7	50.1	49.2	48.5	48.8	49.1
3. Banks' attitude towards lending	46.2	50.2	47.1	51.0	51.3	49.9
4. Surplus cash	39.3	47.0	47.3	53.3	55.9	53.8
5. Receivables turnover	42.1	48.6	46.4	53.3	54.6	53.1

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



## On the Ground

*Expectation indices stayed mostly above 50, suggesting a recovery ahead, though likely a modest one*

- **Expectation indices suggest a modest recovery ahead:** The GBAI expectations index for business activity eased to 52.5 in Q2 from 55.5 prior. Business activity posted the weakest print since Q2-2020 (47.0), but the expectations component remained above current performance and above the 50 neutral mark, indicating a general perception among respondents that businesses would start to improve, albeit modestly, after a challenging first two months in Q2. We expect continued improvement in the growth momentum in June on Shanghai's reopening and increased policy support more generally across regions. The government has stepped up efforts to revive the economy since late May, aiming to prevent GDP growth from slipping into negative territory in Q2 and to stem further increases in unemployment.

Six of our eight main expectations sub-components fell q/q, but only two dropped by double digits q/q to below the 50 neutral mark: raw material inventory (-12% q/q) and financing scale (-16%). While a combination of elevated commodity prices, lingering supply chain disruptions and demand uncertainty likely limited respondents' short-term plans to build inventory for now, their equally low appetite for financing in the coming quarter could be more reflective of weakening long-term confidence. However, such concerns have yet to spread to fixed asset investment (FAI; +1% q/q).

Bringing the domestic COVID situation under control bodes well for the services sector, including retail and catering. The question is how much of a lift this might provide to the housing sector, given the persistent constraints of falling affordability, rising household debt and concerns over further housing price declines. We also expect infrastructure investment growth to accelerate to 10-15% in the coming months from c.7% y/y in May on normalising economic conditions and increased government support. President Xi recently called for infrastructure modernisation largely to drive growth in 2022 following the COVID shock, but also in anticipation of slowing global growth as higher inflation and tighter monetary conditions start to bite.

*Financing costs may drop further while companies wait for cash flow positions to start improving*

- **Financial conditions improving as policy focus shifts:** The current performance index for credit fell to 46.7 in Q2 from 49.1 prior (Figure 4). All five current credit sub-components contributed to this drop, but especially those reflective of respondents' cash flow positions, as the weak macroeconomic backdrop hurt their surplus cash (-16% q/q) and receivables turnover (-13%). Weak cash flows also reflect pressure on profit margins, as mentioned previously. There was some concern that all the talk of more monetary policy support for the economy has yet to translate into improvements at the company level; for example, bank financing costs (-4% q/q to 46.7), non-bank financing costs (-7% to 46.7) and banks' attitude towards lending (-8% to 46.2) all disappointed.

By contrast, the expectations index for credit held up well at 51.7 in Q2, almost matching the 51.8 print in Q1. Notably, the expectations index for bank financing costs rose 5.2% q/q to 50.9, the first above-50 print since our index was inaugurated in Q2-2020. This, together with a second straight quarter of elevated expectations prints for 'banks' attitude towards lending', indicates that respondents continue to expect some forthcoming credit relief. That said, the still-weak expectations print for 'non-bank financing cost' is a timely reminder that there is no cheap liquidity flooding the economy, but rather there will be a



## On the Ground

highly targeted approach to policy easing going forward. Respondents also see their own cash positions improving after a Q2 setback – expectations for surplus cash and receivables turnover stayed above 50 despite falling q/q.

*Clear divergence between sector outperformers and underperformers this time*

- **Industries disrupted by COVID and more:** The current performance component of 'retail and wholesale' and 'financial services' clearly underperformed this quarter, both dropping 22% q/q and posting below-40 prints (the only two below 40). The setback to retailers and wholesalers was not a surprise, considering the survey was conducted during peak COVID concerns and given that the stringent measures had prevented shops from opening and people from leaving their homes. Less clear, however, was the pessimism among financial services providers; this likely reflected a combination of still-soft housing market activity, accelerated outflows from onshore equity and bond markets amid CNY weakness, and the general policy push for more and cheaper lending, possibly at the expense of banks' profitability, while credit quality worsened. Furthermore, some 'manufacturing and trading' respondents felt they were worse off in the past quarter, partly for similar reasons (such as COVID disruptions to production) and also owing to high input costs squeezing margins, and fears of global demand softening on rising global inflation and monetary tightening.

All this is in stark contrast with the improvements in the current performance of 'professional services' (+22% q/q) and 'innovation and technology' (+7%). The former's jump likely reflects a normalisation after professional services providers saw an uncharacteristic plunge in sentiment in Q1. More telling is the rise in confidence among our technology respondents, who possibly benefited from receding regulatory headwinds as the authorities turned their policy focus more to the quantity versus quality of growth. Expectations towards these two sectors also improved (almost back to neutral for professional services, and a seven-quarterly high of 61.3 for innovation and technology), suggesting that they could be turning the corner for good.

**Figure 5: GBAI business sub-indices by sector**

Business activity	Current performance			Expectations		
	Q2-2022	Q1-2022	Q4-2021	Q2-2022	Q1-2022	Q4-2021
Manufacturing and trading	<b>44.1</b>	50.3	50.3	<b>52.9</b>	55.8	53.8
Retail and wholesale	<b>37.7</b>	48.0	49.2	<b>51.1</b>	55.2	50.9
Financial services	<b>39.4</b>	50.6	54.2	<b>42.4</b>	58.4	59.6
Professional services	<b>45.0</b>	37.0	46.9	<b>49.9</b>	45.3	52.2
Innovation and technology	<b>50.3</b>	47.1	59.6	<b>61.3</b>	58.1	58.0

Source: HKTDC, Standard Chartered Research

**Figure 6: GBAI credit sub-indices by sector**

Credit	Current performance			Expectations		
	Q2-2022	Q1-2022	Q4-2021	Q2-2022	Q1-2022	Q4-2021
Manufacturing and trading	<b>47.1</b>	49.3	47.5	<b>52.2</b>	52.5	50.6
Retail and wholesale	<b>44.3</b>	47.8	49.2	<b>49.2</b>	48.3	52.0
Financial services	<b>42.9</b>	51.8	49.1	<b>46.5</b>	51.2	50.8
Professional services	<b>44.5</b>	43.6	49.7	<b>47.8</b>	46.5	58.9
Innovation and technology	<b>49.6</b>	50.9	52.0	<b>53.0</b>	54.7	52.6

Source: HKTDC, Standard Chartered Research



## On the Ground

Manufacturing and retail respondents also expected improvements in the coming quarter, with the expectations sub-indices posting 52.9 and 51.1, respectively. While these forward-looking readings are down q/q, they remain above 50, unlike still-weak expectations for 'financial services' at 42.4 (down from an industry-leading 58.4 in the previous quarter).

- **All cities suffered during COVID resurgence:** All city sub-indices for current business performance fell q/q, led by drops of 18% for Foshan and 16% for Dongguan. However, these declines were from high Q1 levels; in fact, they continued to beat core cities on actual current scores, as the core cities have more services-sector businesses and have been more vulnerable to local COVID disruptions. Although they did not undergo Shanghai-style lockdowns, Shenzhen (42.5) and Guangzhou (43.7) faced disruptions from stringent testing routines, shop closures, suspended production and interrupted logistics, which kept sentiment weak during the survey period.

More surprising was a further weakening in Hong Kong's current performance of business activity in Q2, to 39.7 from 41.4 prior, while other macro indicators have been pointing to a rebound since April. After contracting by a deep 4.0% y/y in Q1, Hong Kong's economy was on the mend after the unwinding of stringent social-distancing measures and travel bans imposed during the fifth COVID wave. The resulting release of pent-up demand, coupled with the boost from the government's fresh round of electronic consumption voucher scheme, helped fuel a 11.7% y/y rise in retail sales by value in April (a stark turnaround from a 7.6% fall in Q1), and the latest fall in jobless rate to 5.1% (3mma) in May from 5.4% prior. Weaker prints among China's cities likely weighed on Hong Kong's sentiment despite its own domestic recovery and still-decent export performance; the survey sample was dominated by small-and-medium sized companies which may also have contributed to the weak survey result.

Figure 7: GBAI business sub-indices by city

Business activity	Current performance			Expectations		
	Q2-2022	Q1-2022	Q4-2021	Q2-2022	Q1-2022	Q4-2021
Hong Kong	39.7	41.4	50.1	43.3	47.5	52.7
Guangzhou	43.7	50.0	49.8	52.1	58.6	52.3
Shenzhen	42.5	50.0	49.4	54.6	56.5	53.4
Foshan	44.9	55.1	59.6	51.0	56.2	57.6
Dongguan	47.9	56.9	49.2	55.0	57.4	55.0
Macau and other cities	46.2	51.0	49.2	57.2	56.5	53.3

Source: HKTDC, Standard Chartered Research

Figure 8: GBAI credit sub-indices by city

Credit	Current performance			Expectations		
	Q2-2022	Q1-2022	Q4-2021	Q2-2022	Q1-2022	Q4-2021
Hong Kong	42.1	45.1	46.9	45.5	47.8	50.2
Guangzhou	45.7	49.0	49.3	49.4	53.5	50.9
Shenzhen	47.9	49.4	47.6	54.7	52.7	50.0
Foshan	44.7	52.7	53.1	49.0	51.5	55.5
Dongguan	47.9	51.5	47.1	51.4	53.0	53.2
Macau and other cities	49.7	49.6	45.8	53.7	51.1	51.7

Source: HKTDC, Standard Chartered Research



## On the Ground

Expectations towards Hong Kong remain the most cautious, at 43.3 (down from 47.5 prior), while those for all other GBA cities stayed above 50, albeit falling q/q across the board. Guangzhou (-11.1%) and Foshan (-9.2%) fell the most to 52.1 and 51.0, respectively. The previously mentioned sector divergence seems to have had little impact on performance differentiation by city.

### Gauging challenges, especially from inflation

### Key takeaways from our thematic questions

Our thematic questions this time focused on how our GBA respondents see the confluence of macro, financial and policy headwinds impacting their business. We asked them to measure how this year's COVID disruptions stacked up against last year's, how they see the inflation trend this year, and how they plan to tackle the resulting cost challenges. All this helped add context and depth to the largely weak headline indices and sub-indices this quarter.

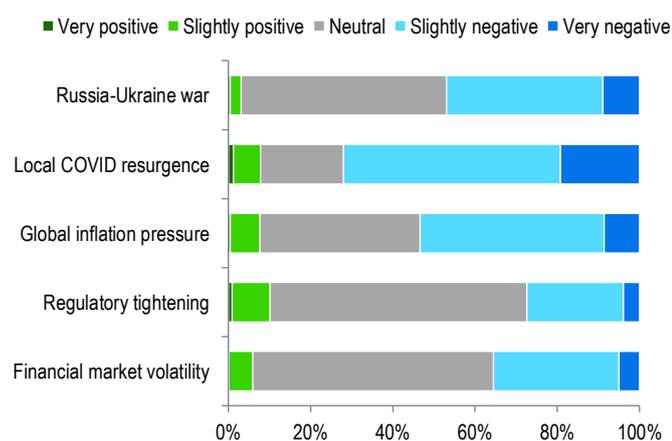
- COVID and inflation topped the list of challenges:** We asked respondents to describe the impact of various recent key developments on their business (Figure 9). A majority 72% saw 'slightly negative' or 'very negative' impact from local COVID disruptions, followed by 53% from global inflation pressure, and 47% from the Russia-Ukraine war. These were prominent challenges compared with financial market volatility (36%) and regulatory tightening (27%).

By city, Guangzhou and Foshan had the highest share of negative responses for COVID resurgence (77% and 76%, respectively), while five of the other nine GBA cities were also above 70%. On global inflation pressure, Hong Kong and Foshan (both c.62%) had the most negative responses. Hong Kong is likely more exposed to tightening global liquidity, and Foshan, whose economy is more manufacturing- and export-centric, may be more vulnerable to rising raw material and transport costs. On the Ukraine crisis, Shenzhen respondents were most pessimistic (60% reporting a slight or very negative impact), versus 42% for Hong Kong and 37% for Guangzhou.

- This year's COVID impact versus 2021:** Given the well-anticipated vulnerability of our respondents towards local COVID resurgence, we asked the follow-up question of how they see this year's COVID-related impact on their business compared with 2021 (Figure 10). The results were pretty even, with those reporting less severe impact (23.6%) almost matching those saying the impact

Figure 9: How would you describe the impact of the following developments on your business?

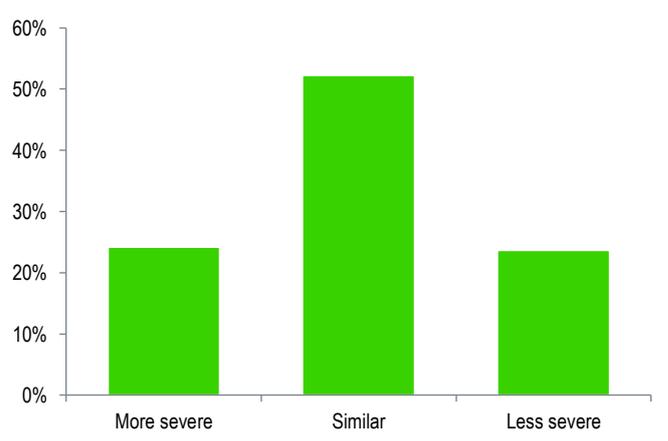
% of respondents



Source: HKTDC, Standard Chartered Research

Figure 10: How do you see this year's COVID-related impact on your business compared with 2021?

% of respondents



Source: HKTDC, Standard Chartered Research



## On the Ground

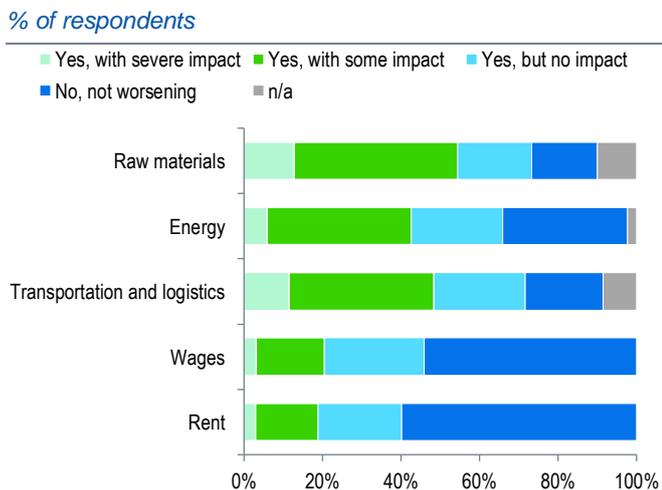
was more severe (24.1%). On the face of it, these results were at odds with the macroeconomic backdrop, which seemed to have slowed more due to COVID lockdowns this year. However, this is explained by a further breakdown which shows a higher percentage of 'manufacturing and trading' and 'retail and wholesale' respondents reporting a 'more severe' impact than those reporting 'less severe', which was offset by opposite outcomes among the other three sector sub-indices.

*Raw materials were the top cost driver for many*

- Identifying the biggest inflation pressures:** Of the five types of price pressures faced by our respondents, 73% reported a rise in raw material costs YTD, closely followed by transport and logistics (72%) and energy (66%). GBA respondents also appear most impacted by higher raw material prices, with 54% reporting at least some degree of impact on their business; again, transport and logistics (48%) and energy (43%) rounded up the top three spots (Figure 11). Looking ahead, 61% respondents expect raw material prices to rise further for the remainder of the year (Figure 12), followed by costs of transport and logistics (57%), energy (57%), wages (25%) and rent (24%). All this echoes the general market perception that broad-based inflation pressure is here to stay for longer as long as global monetary conditions stay loose and geopolitical and supply chain uncertainties linger – probably until these are superseded by concerns over global recession risk.
- Understanding respondents' cost structure:** We asked respondents to share the breakdown of their cost base (Figure 13). On a mean basis, raw materials account for 29% of their total costs, followed by wages (20%), and rent (15%). While rising transport and energy costs YTD have had a material impact on many GBA businesses, the share of these costs in respondents' cost base is at a relatively low 9% and 8%, respectively.

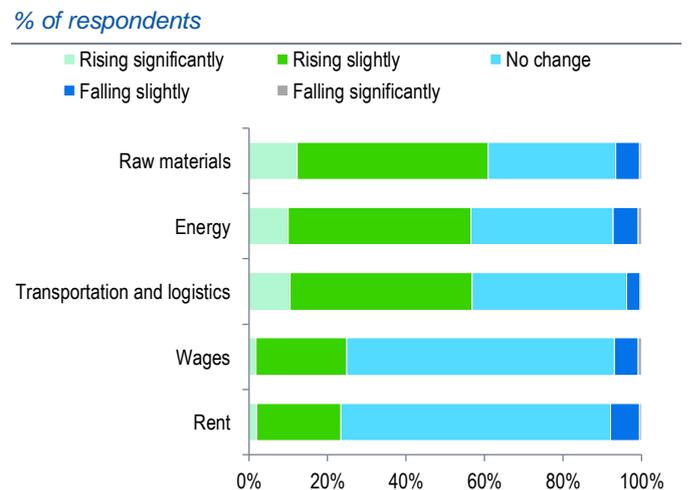
Unsurprisingly, cost structures vary across industries; manufacturers, retailers and technology companies reported the highest shares of raw materials (39%, 31% and 29%, respectively), while services-oriented industries are more exposed to wage inflation (c.31% for both financial services and professional services). This is further reflected in the breakdown by city, where more production-centric cities in China have a higher proportion of raw material in their cost base, while Hong Kong and Macau have a higher wage cost component.

**Figure 11: Have the following areas of inflation worsened YTD? If so, how have they impacted your business?**



Source: HKTDC, Standard Chartered Research

**Figure 12: How do you see the following areas of inflation changing for the remainder of the year?**



Source: HKTDC, Standard Chartered Research

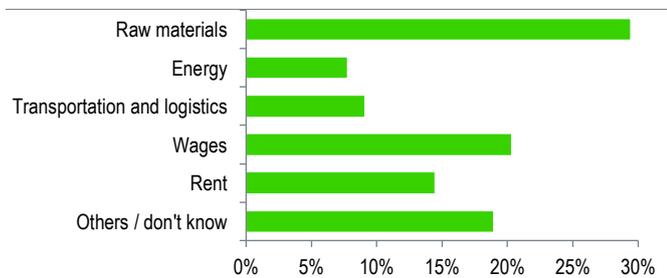
## On the Ground

**A substantial 41% of respondents said they were unable to pass on higher costs to their buyers**

- Passing on higher costs to buyers:** We previously saw that GBA businesses have not been very successful in passing on higher costs to buyers, judging by their weak profit performance and expectations, as well as their weak surplus cash positions. We directly asked them about cost pass-through; only 7.3% said they were able to pass on at least 50% of the cost increase to buyers, and another 37% said they were able to pass on less than 50%. This leaves a material share of 41% reporting an inability to pass on higher costs, and only 15% saying they did not need to pass on costs. By industry, technology and retail respondents reported a higher share, with at least some pass-through rates of 62% and 52% respectively, versus only 24% for financial services (Figure 14).
- Ways to deal with inflation:** We asked respondents how they dealt with rising inflation, if they were not able to pass on higher costs to buyers (Figure 15). 'Diversifying products/services' got the most votes (42%), followed by 'cutting costs in other areas' (40%) and 'streamlining/automation' (35%). More than 30% of votes went to 'exploring suppliers/providers' and 'upgrading products/services'. We believe improving energy efficiency, relocating production and more hedging could gain more importance over time in fighting inflation. On a positive note, 'reduction of scale', of either headcount or inventory, was the least chosen answer for now.
- Effectiveness of policy support:** Our final thematic question focused on gauging the effectiveness of policy support in easing inflation pressure: 7% reported receiving significant help, and 62% received marginal help (Figure 16).

**Figure 13: What share of your total cost base do the following costs account for?**

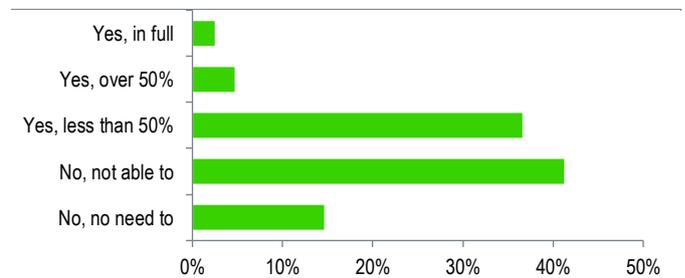
Mean, %



Source: HKTDC, Standard Chartered Research

**Figure 14: Have you been able to pass the higher costs above onto your buyers? If so, to what extent?**

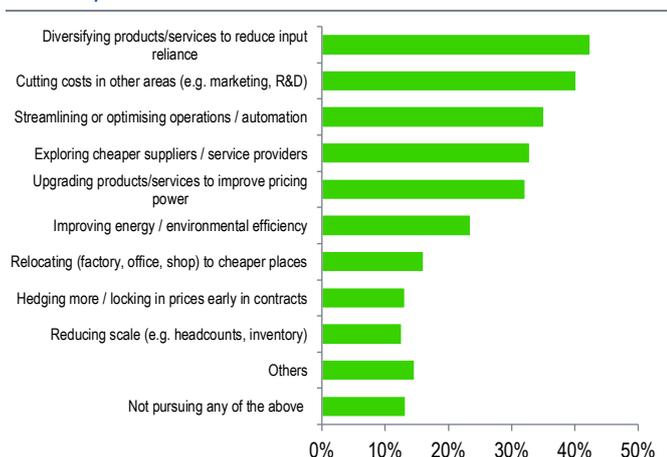
% of respondents



Source: HKTDC, Standard Chartered Research

**Figure 15: What other ways are you pursuing to deal with inflation challenges?**

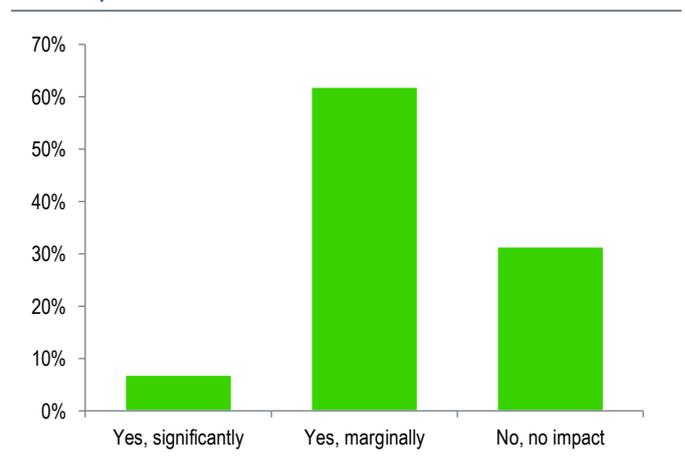
% of respondents



Source: HKTDC, Standard Chartered Research

**Figure 16: Do you see policy measures (such as tax and fee cuts) helping to ease cost pressures?**

% 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 Q2-2022), and the other looking at 'expectations' (Q3-2022). 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 17: 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		<b>Total</b>	<b>1,000</b>
Zhongshan			
Jiangmen	200		
Zhuhai			
Zhaoqing			
Macau			
<b>Total</b>	<b>1,000</b>		

Source: HKTDC, Standard Chartered Research



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