Global Research
11 October 2021

GBA – Benign survey results, but headwinds loom

- **Our gauge of GBA sentiment softened in Q3 due to COVID resurgence, but hints at a swift Q4 rebound**
- **Expectations need to be tempered due to power outage and Evergrande spillover, in our view**
- **Our thematic questions shed light on real estate, labour and wages, and the ESG investment outlook**

Curb your enthusiasm

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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 region's business confidence weakened in Q3-2021. The GBAI's 'current performance' index for business activity saw its first q/q drop since its Q2-2020 launch, to 52.7 in Q3-2021 from 58.7 in Q2-2021. It is clear from official data that China's broader economy has gone through a soft patch for much of the past quarter due to the COVID-19 resurgence; the latest GBAI confirms that the region, while not fully insulated, has slowed only modestly, with six of the eight GBAI components still above the 50 neutral mark (Figure 1). Respondents also expect the Q3 growth setback to be transitory – the GBAI 'expectations' index eased only marginally to 57.9 from 59.3 (Figure 2); that said, given the timing of the survey, this forward-looking measure does not fully capture the Evergrande fallout (which continues to play out), or production disruptions due to rolling power outages.

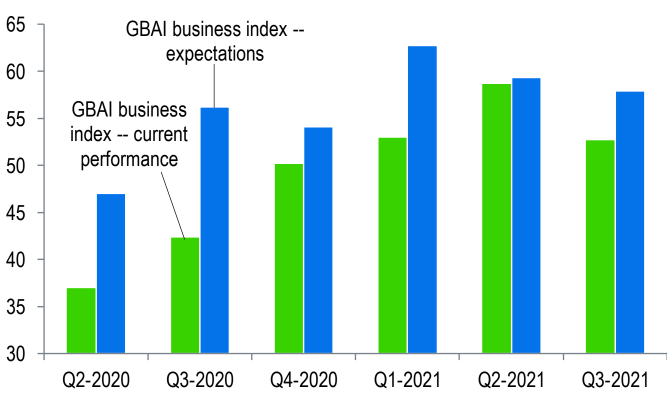
A further breakdown showed that service-oriented sectors continued to underperform. This also helps to explain the sizeable drop in the Shenzhen sub-index (-12.9pts for current performance), which has high services-sector content. Credit conditions stayed largely neutral in Q3, with weaker cash flow offset by easing financing costs; however, the benign credit 'expectations' index reading may not reflect potential contagion from the Evergrande incident. Respondents were broadly neutral on the GBA real-estate market, but the risk factors they identified appear increasingly relevant as the sector faces growing short-term headwinds. We also asked respondents for their views on the labour market and their ESG investment plans.

Figure 1: GBAI business index and its sub-components

	Current performance			Expectations		
	Q3-2021	Q2-2021	Q1-2021	Q3-2021	Q2-2021	Q1-2021
Business index	52.7	58.7	53.0	57.9	59.3	62.7
1. Production/sales	54.3	60.4	44.8	61.8	64.5	66.0
2. New orders	56.1	63.6	50.9	64.6	67.5	66.2
3. Capacity utilisation	46.9	52.8	47.8	56.1	57.3	62.2
4. Raw material inventory	52.6	60.8	57.1	54.6	51.8	60.0
5. Prices of finished goods/services	62.0	66.3	63.8	59.5	61.5	63.6
6. Fixed asset investment	50.5	55.2	55.3	52.1	54.6	60.9
7. Financing scale	48.6	54.8	56.7	52.9	55.3	60.1
8. Profit	50.8	55.8	47.3	61.3	61.5	62.7

Source: HKTDC, Standard Chartered Research

Figure 2: Q3 headline GBAI softened but stayed above 50



Source: HKTDC, Standard Chartered Research

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Detailed findings of the GBAI survey for Q3-2021

Our latest GBAI survey was conducted between late July and mid-September, a period when the COVID resurgence caused disruptions, especially in the services sector. While daily new cases have since been largely brought under control, new challenges – the escalation of the Evergrande fallout and production disruptions due to rolling power outages – will only be fully captured in our next survey. This calls for caution as we interpret the more forward-looking indices and responses from the latest survey.

Q3 was just a speed bump for the GBA; Q4 could be the real challenge

- **Current performance index shows only a modest setback:** The GBAI current performance index for business activity fell for the first time since its Q2-2020 introduction, to 52.7 in Q3-2021 from 58.7 prior. This is not surprising, as July and August nationwide data – ranging from the non-manufacturing and new export order PMIs to retail sales and residential floor space sold – *reflect widespread disruptions related to the Delta variant*. While all eight index components contributed to the index's q/q decline, six stayed above 50, indicating only a modest speed bump rather than a sustained slowdown. Weak capacity utilisation (46.9), for example, is less worrying in the context of the still-high print (56.1) for new orders, albeit down from 63.6 in Q2 (Figure 1). Respondents' still-strong ability to raise final prices (62.0 versus 66.3 prior) helped to maintain profit margins (50.8 versus 55.8), another sign of solid demand.

- **Upbeat expectations meet intensifying headwinds:** The GBAI expectations index for business activity fell only 1.4pts q/q to 57.9, confirming still-upbeat expectations for Q4 (Figure 2). 'New orders' had the highest reading, at 64.6 (67.5 prior), followed by 'production' (61.8 versus 64.5) and profits (61.3 versus 61.5); the resilience of production echoes our confidence in companies' ability to continue passing on higher costs to end buyers. This also gives businesses a larger buffer to weather further production disruptions, even if power shortages persist in Q4. We believe the government will try to encourage more coal production short-term, and allow more coal imports, to limit downside risks to economic growth, making the economic impact largely transitory.

  Gauging the impact of the Evergrande fallout may be less straightforward; much will depend on how defaults and subsequent restructurings are managed to limit contagion to the broader financial sector and real economy. The risk is a further softening of the real-estate sector (we discuss this in more detail in *Key takeaways from our thematic questions* below), cautious consumer and investor sentiment for longer, and more expensive and difficult funding access for some

It may be overly optimistic to expect a swift rebound in the cash position in Q4

Figure 3: Businesses have been able to handle rebounding financing costs
Five sub-components of our GBAI credit indices – current vs expectations

	Current performance			Expectations		
	Q3-2021	Q2-2021	Q1-2021	**Q3-2021**	Q2-2021	Q1-2021
Credit Index	**50.8**	51.6	49.8	**51.9**	53.0	53.7
1. Bank financing cost *	**51.7**	47.5	48.4	**48.4**	47.8	46.5
2. Non-bank financing cost *	**50.7**	48.0	48.3	**49.2**	48.2	47.7
3. Banks' attitude towards lending	**51.8**	51.1	53.7	**49.2**	52.8	57.4
4. Surplus cash	**48.8**	56.3	50.5	**58.2**	58.1	60.4
5. Receivables turnover	**51.3**	55.2	48.0	**54.7**	58.1	56.7

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

borrowers. Against this backdrop, 'fixed asset investment' and 'financing scale' could continue to be the weaker components within the GBAI.

Difficult to gauge Evergrande's contagion on overall financial conditions at this stage

- **Financial conditions stayed neutral in Q3**: The current performance index for credit stayed above 50 for a second straight quarter, though it fell 0.8pt from Q2 (Figure 3). This was helped by improvements (i.e. declines) in the bank and non-bank financing cost sub-indices after an evident worsening in H1-2021; this is consistent with the general market perception that *monetary policy has become less tight since mid-year*, as reflected in the reserve requirement ratio (RRR) cut in July. Easing financing costs helped to offset weaker cash positions, especially the 7.5pt drop in the 'surplus cash' current performance sub-index to 48.8 amid a business slowdown.

  Our expectations index for credit stayed elevated at 51.9 in Q3, despite declining from 53.0 in Q2; respondents see cash flow improving again, even though they do not expect much lower funding costs or easier borrowing. Financing conditions could vary more evidently among GBA businesses in Q4 and early 2022: funding access and costs could worsen for some as part of the Evergrande spillover, while others could see weaker cash flow due to power-related disruptions (for manufacturers) or slower trade receivables turnover (for property companies).

Power shortages mean a more cautious manufacturing outlook than our expectations index suggests

- **Manufacturers were holding up well prior to the power outage:** While all five of our 'current performance' industry sub-indices fell q/q, manufacturing (53.4) and IT (55.3) continued to outperform (Figure 4). IT had the highest prints of any sector for six of the eight index components, indicating that the recent increase in regulatory uncertainty has had little impact. The current performance index for 'manufacturing and trading' saw strong contributions from production/sales (56.0) and new orders (57.4), suggesting limited disruptions from the global rise in Delta-variant cases (although the 'new export orders' reading fell below 50). Apart from a dip in capacity utilisation to 47.5, manufacturers overall scored

Figure 4: GBAI business sub-indices by sector

Business activity	Current performance			Expectations		
	Q3-2021	Q2-2021	Q1-2021	**Q3-2021**	Q2-2021	Q1-2021
Manufacturing and trading	**53.4**	59.7	54.0	**58.3**	59.8	63.9
Retail and wholesale	**50.0**	52.4	50.3	**56.2**	55.1	59.2
Financial services	**51.8**	52.3	46.4	**56.3**	58.2	58.7
Professional services	**41.3**	58.3	39.1	**50.2**	60.3	44.7
Innovation and technology	**55.3**	60.3	46.8	**61.2**	60.4	58.7

Source: HKTDC, Standard Chartered Research

Figure 5: GBAI credit sub-indices by sector

Credit	Current performance			Expectations		
	Q3-2021	Q2-2021	Q1-2021	**Q3-2021**	Q2-2021	Q1-2021
Manufacturing and trading	**51.0**	51.9	50.1	**51.9**	53.2	53.6
Retail and wholesale	**50.5**	50.8	49.4	**51.9**	52.2	55.4
Financial services	**50.1**	53.1	50.2	**49.3**	52.2	54.2
Professional services	**49.3**	46.7	46.4	**52.6**	51.6	48.8
Innovation and technology	**50.1**	51.9	41.0	**53.9**	52.2	52.8

Source: HKTDC, Standard Chartered Research

higher than retailers (50.0), whose weak 'production/sales' component (45.4) reflected the impact of the local COVID resurgence. 'Professional services' performed even worse than retailers this time, but this was partly a normalisation after a surge in Q2.

Looking ahead, respondents in all sectors expected better times in Q4, judging from the resilience of their 'expectations' indices (Figure 4). Since our survey, however, disruptions from power shortages have clouded the outlook for the region's manufacturing production – China's official manufacturing PMI fell further to 49.6 in September from 50.1 in August, the first dip below 50 since last year's COVID outbreak. High energy-consuming industries dragged down the overall index this time.

Shenzhen is losing its top spot for now

- **Shenzhen briefly cooled down in Q3.** In *last quarter's GBAI survey update*, we noted that the city sub-indices tended to take turns in the top spot. Q3 was no exception – Shenzhen gave up its lead (and then some) after beating Guangzhou by a wide margin in Q2. The setbacks for both core cities were related to the fact that they were disproportionately affected by the COVID resurgence due to their greater services-sector focus. The 'expectations' measures show upbeat sentiment for the Q4 outlook across our city sub-indices (Figure 6). With daily COVID cases now back under control, more export-oriented, non-core mainland cities are likely to be more vulnerable to production disruptions due to power shortage. In the meantime, we expect Hong Kong to keep catching up given its success in avoiding material Delta-related disruptions so far, which is allowing its domestic economy to recover.

  We will watch whether Hong Kong can narrow the gap with Shenzhen over time under the Qianhai cooperation zone aimed at accelerating integration and collaboration between the two cities (the new development plan for the zone was

Figure 6: GBAI business sub-indices by city

Business activity	Current performance			Expectations		
	Q3-2021	Q2-2021	Q1-2021	**Q3-2021**	Q2-2021	Q1-2021
Hong Kong	**47.6**	45.1	37.3	**56.4**	50.8	50.7
Guangzhou	**58.4**	54.7	55.6	**60.6**	57.9	66.0
Shenzhen	**50.2**	63.1	58.4	**58.0**	60.0	65.9
Foshan	**57.3**	65.9	49.2	**59.5**	65.6	60.8
Dongguan	**56.8**	60.7	52.6	**55.5**	65.2	64.1
Macao and other cities	**54.7**	62.7	55.1	**56.8**	62.4	64.5

Source: HKTDC, Standard Chartered Research

Figure 7: GBAI credit sub-indices by city

Credit	Current performance			Expectations		
	Q3-2021	Q2-2021	Q1-2021	**Q3-2021**	Q2-2021	Q1-2021
Hong Kong	**49.7**	45.1	46.1	**51.9**	50.5	51.1
Guangzhou	**53.3**	52.6	49.7	**52.0**	53.5	55.1
Shenzhen	**51.1**	53.0	51.0	**52.2**	52.6	53.4
Foshan	**51.4**	53.9	51.3	**54.1**	56.7	55.2
Dongguan	**50.6**	51.6	47.8	**52.5**	56.2	54.4
Macao and other cities	**48.4**	53.2	50.9	**49.8**	53.2	54.8

Source: HKTDC, Standard Chartered Research

recently announced). The Qianhai plan expands the zone's size to eight times the original size, providing a broader economic base for cross-border technology innovation, financial opening and services trade expansion (be it household wealth, advance manufacturing, or transportation infrastructure) to build on over time. Similarly, the new Hengqin plan should accelerate Macau's industry diversification and integration with Zhuhai and other GBA cities, mainly through Macau's more direct participation in Hengqin's policy-making and execution.

Key takeaways from our thematic questions

Our thematic questions this time focused on (1) our respondents' views on the real-estate market in the cities they currently operate in, and the main risk factors to such views; (2) challenges in the local labour market in terms of talent and wages; and (3) our respondents' plans on ESG-related investment in the coming year. We list our key findings below.

Risk factors point to downside risk for the real-estate sector in Q4

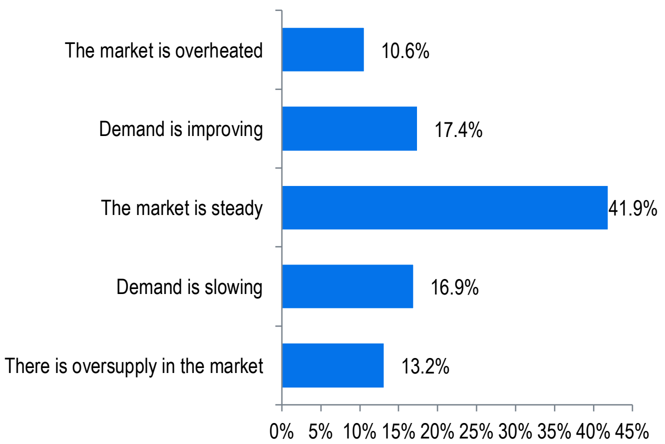
- **Real-estate sector:** We asked respondents to describe the current real-estate market (not just for residential properties, but also offices, shops, factories, etc.) in the GBA cities they operate in (Figure 8). Respondents were broadly neutral on the GBA real-estate market, with almost 42% saying the market is steady, and the share of respondents seeing slowing demand (16.9%) almost the same as those seeing improvement (17.4%). There was also good representation on both extreme ends, with 10.6% seeing overheating and 13.2% oversupply.

  The responses reflect the authorities' repeated calls for housing being "for living in and not speculation" (meaning emphasis on ensuring housing price stability). However, with the Evergrande situation continuing to unfold, downside risks for the real-estate market appear to be increasing, with apartment sales slowing and residential prices falling further. The top three risk factors that respondents identified – rising financing costs (37.4%), weakening demand (35.7%), and tightening regulations (34.4%) – also appear to be playing out amid growing short-term headwinds for the sector (Figure 9).

  The immediate fallout from the Evergrande incident is that access to and the cost of credit have worsened, not just for property developers but also their trade

Figure 8: How would you describe the current real-estate market* in the GBA city(ies) you operate in?

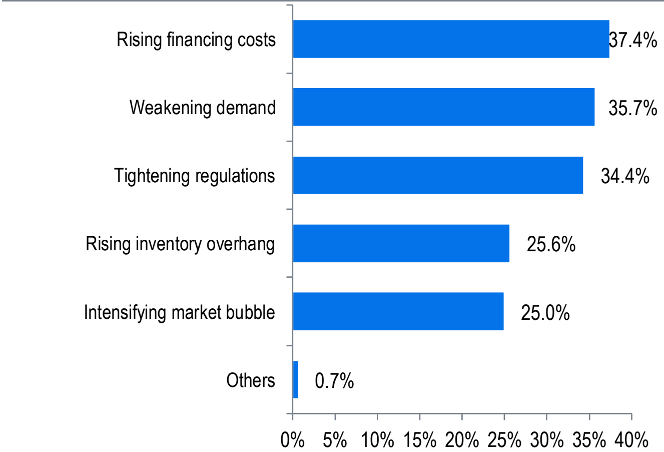
% of respondents



* The real estate market refers to the purchase and leasing market for residential properties, offices, shops, factories etc. Source: HKTDC, Standard Chartered Research

Figure 9: What is the biggest risk to the real estate market in the city(ies) your company operates in?

% of respondents experiencing higher costs



Source: HKTDC, Standard Chartered Research

suppliers, as lenders turn more cautious due to the fear of contagion and hence more defaults. Demand for real estate is also likely to weaken more evidently the longer the Evergrande situation continues. And finally, the low likelihood of an outright government bailout sends out a strong signal that managing the sector's leverage and tackling moral hazards remain crucial to the primary objective of maintaining a healthy housing market.

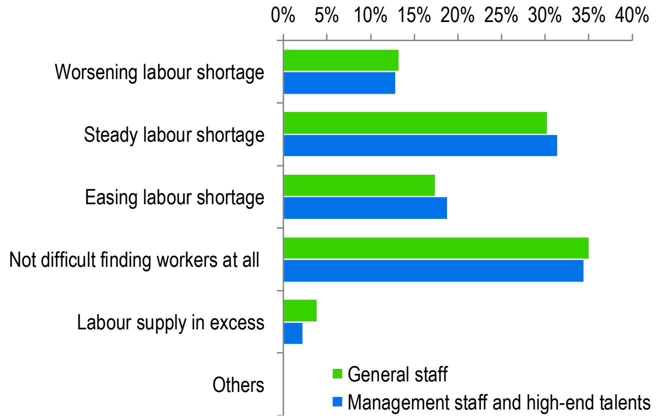
Wage pressure and labour shortage, while challenging, may not be the most pressing concerns for now

- **Workers and wages:** *In our last report,* we asked respondents about their major sources of higher operation costs, and almost 60% of respondents chose 'higher wages for existing staff', more than 'higher raw material costs' (which disproportionally affects manufacturers more); 'higher wages in hiring new staff' was in third place. This, together with the challenge of securing talent in the region, prompted us to ask some labour-specific follow-up questions this time. The first was on current labour-market conditions in the GBA cities they operate in; only 13.3% respondents see the shortage of general staff worsening, while another 30.3% sees a steady labour market (with shortage nonetheless). That leaves more than half of all respondents expecting either easing or no shortage in general workers (Figure 10). Interestingly, the response pattern was similar for management staff and high-end talent.

  The results on the question of wage pressure were similar; only 19.2% see intensifying pressure to increase staff salaries, versus almost 50% saying there was little pressure to do so (Figure 11). This suggests that wages and talent, while important business considerations on an ongoing basis, may not be at the top of GBA companies' minds as they deal with other more prominent headwinds. 43.3% of respondents said they are not worried about the impact of wages on overall costs, versus 47.6% who said they are quite worried, and a mere 9.1% expressing more concern.

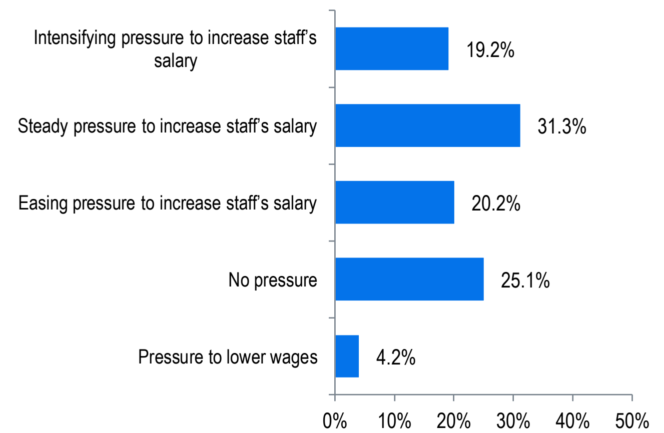
  By industry, manufacturing and technology respondents saw the smallest proportion of their respondents (albeit over 50%) reporting easing or no labour shortage at all staff levels. In terms of wages, manufacturers and those in professional services saw the highest proportion of respondents reporting worsening pressure to raise salaries, at 22% and 24%, respectively. Larger companies by annual turnover tend to report higher wage pressure and labour

Figure 10: How would you describe current labour-market conditions in the GBA city(ies) your company operates in? *(% of respondents, by employee type)*



Source: HKTDC, Standard Chartered Research

Figure 11: How would you describe your company's level of wage hike pressure?
% of respondents



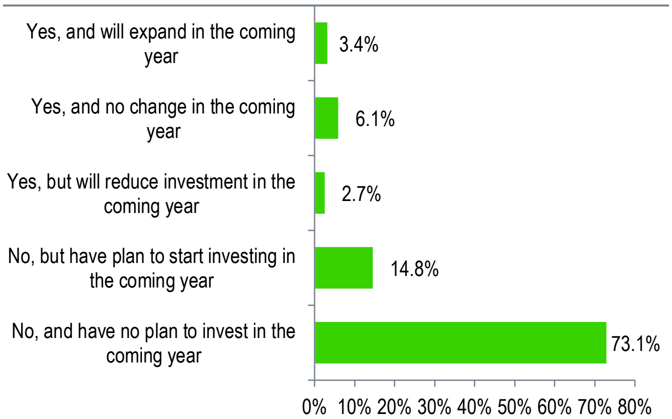
Source: HKTDC, Standard Chartered Research

shortage, but are also less worried about the related negative cost implications compared with smaller companies.

- **ESG investment:** Another topic that deserves recurring feedback is ESG. In our last report, we noted that two-thirds of our respondents saw no pressure to engage in environmental protection in their operations. This time around, we specifically asked respondents' about their ESG investment plans and found that almost three quarters of them currently do not have such investment and do not plan to invest in the coming year (Figure 12). When asked about the challenges faced in achieving their ESG goals, 35% cited the lack of funding or financial support, while the second and third ranked answers were both related to the need for more information or policy clarity (Figure 13).

Figure 12: Do you have ESG-related investment, and how do you expect such plans to change in the coming year?

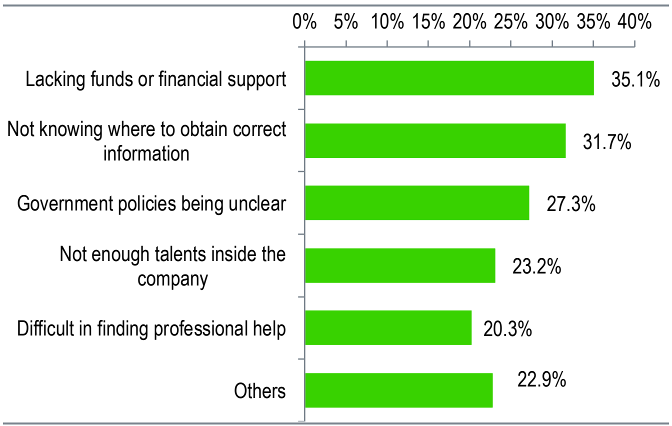
% of respondents



Source: HKTDC, Standard Chartered Research

Figure 13: What are the challenges for achieving your company's ESG goals?

% of respondents



Source: HKTDC, Standard Chartered Research

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

Appendix: How the GBAI works

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 Q3-2021), and the other looking at 'expectations' (Q4-2021). 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 3).

Sample distribution: The sub-indices above are weighted according to the sample sizes and GDP of these industries in the respective cities. Figure 11 shows the distribution of survey responses, which are based on the cities' industrial sectors and number of enterprises. The five designated industrial sectors are (1) manufacturing and trading, (2) retail and wholesale, (3) financial services, (4) professional services, and (5) innovation and technology. By GBA city, Hong Kong, Guangzhou and Shenzhen have the largest samples, of 200 each.

Figure 14: GBAI

Number of respondents

<table>
<tr><th colspan="2">By city</th></tr>
<tr><th></th><th>Targeted respondents</th></tr>
<tr><td>Hong Kong</td><td>200</td></tr>
<tr><td>Guangzhou</td><td>200</td></tr>
<tr><td>Shenzhen</td><td>200</td></tr>
<tr><td>Foshan</td><td>100</td></tr>
<tr><td>Dongguan</td><td>100</td></tr>
<tr><td>Huizhou</td><td rowspan="7">200</td></tr>
<tr><td>Zhongshan</td></tr>
<tr><td>Jiangmen</td></tr>
<tr><td>Zhuhai</td></tr>
<tr><td>Zhaoqing</td></tr>
<tr><td>Macau</td></tr>
<tr><td>Total</td><td>1,000</td></tr>
</table>

By industry	
	Targeted respondents
Manufacturing and trading	500
Retail and wholesale	200
Financial services	125
Professional services	125
Innovation and technology	50
Total	**1,000**

Source: HKTDC, Standard Chartered Research

Disclosures appendix

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