Global Research
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GBA – Survey anniversary reflects improving mood

- **Our gauge of GBA activity and sentiment confirms a strong Q2, likely extending to Q3**
- **Respondents also indicate better cash positions; strong demand has allowed them to pass on higher costs**
- **Manufacturing and tech companies outperform; Shenzhen extends its lead over Guangzhou for now**

Carry on recovering

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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) conducted in collaboration with the Hong Kong Trade Development Council (HKTDC), shows business confidence has improved further in Q2-2021, boding well for a strong start to H2-2021. The GBAI's 'current performance' index for business activity has extended its uninterrupted uptrend since the GBAI's launch a year ago, to 58.7 in Q2-2021 from 53.0 in Q1. Sub-indices for production/sales, new orders and profits showed the strongest improvements, the latter thanks to respondents' ability to raise prices to maintain margins. The more forward-looking 'expectations' index eased q/q (to 59.3 from 62.7); however, this is from a very high Q1 level and was bound to normalise with a continued recovery. If anything, having the expectations index and all key components staying above the 50 neutral mark suggests that the region should handle rising inflation and policy tapering risks well in H2.

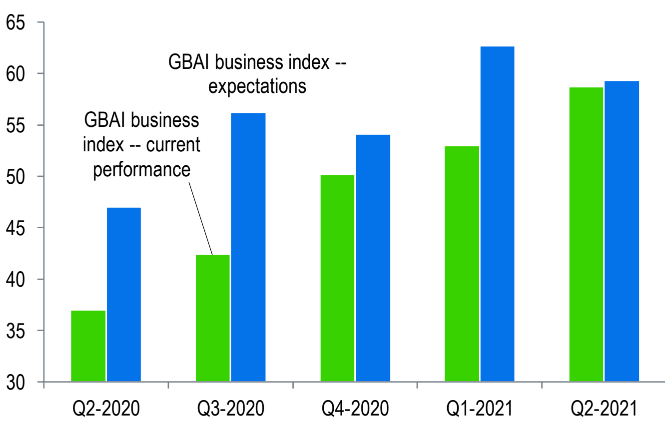
Respondents see credit conditions improving, as stronger business performance generates better cash flow. By industry, we see many similar drivers behind another strong quarter of performance for manufacturing and technology respondents. By city, Shenzhen has managed to outperform Guangzhou this time, possibly due to the former's higher innovation and finance content, and the latter's recent resurgence in COVID cases. On thematic questions, all 11 GBA cities are expected to see an increase in respondent presence in the next three years – a good sign for intra-regional integration – with the top three drivers being talent, infrastructure and population size. Just over half of our respondents said they are experiencing higher operating costs, most exposed being the manufacturers. Around two-thirds of respondents have yet to see a rise in pressure to implement environmental protection measures.

Figure 1: GBAI business index and its sub-components

	Current performance			Expectations		
	Q2-2021	Q1-2021	Q4-2020	Q2-2021	Q1-2021	Q4-2020
Business index	58.7	53.0	50.2	59.3	62.7	54.1
1. Production/sales	60.4	44.8	47.9	64.5	66.0	54.8
2. New orders	63.6	50.9	50.4	67.5	66.2	53.5
3. Capacity utilisation	52.8	47.8	46.3	57.3	62.2	53.0
4. Raw material inventory	60.8	57.1	50.5	51.8	60.0	50.0
5. Prices of finished goods/services	66.3	63.8	54.4	61.5	63.6	58.7
6. Fixed asset investment	55.2	55.3	50.5	54.6	60.9	52.6
7. Financing scale	54.8	56.7	52.2	55.3	60.1	54.1
8. Profit	55.8	47.3	49.4	61.5	62.7	55.8

Source: HKTDC, Standard Chartered Research

Figure 2: Headline GBAI prints stay well above 50 in Q2



Source: HKTDC, Standard Chartered Research

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Detailed findings of the GBAI survey for Q2-2021

Our latest GBAI was conducted between late April and early June, a period when accelerated vaccine rollouts further fuelled the global recovery, adding to an already strong domestic recovery. This was accompanied by an evident rise in inflation, including in the US and China. We expect the latest survey results to help answer key questions, including the sustainability and broadness of the current recovery, and how much of such recovery optimism will be marred by rising costs squeezing profit margins – all through the lens of GBA companies.

The GBA is expected to build on very strong Q2 momentum in Q3

- **Current performance index shows accelerated growth:** The GBAI current performance index for business activity extended its uninterrupted uptrend since its launch a year ago, rising to 58.7 in Q2 from 53.0 in Q1 (Figure 1). This not only indicates sustained strong post-COVID recovery momentum, but also a continued acceleration by moving further away from the 50 neutral mark. Six of eight GBAI sub-indices rose q/q for a second straight quarter, led by 'production/sales' (+15.6pts), 'new orders' (+12.7pts) and 'profit' (+8.5pts). 'Prices of finished goods and services' (+2.5pts) continued to see the highest print (66.3) among key components; the remaining sat comfortably above 50, consistent with an expansion in activity.

  All this confirms that the demand recovery story has strengthened of late, so much so that our respondents in general have been able to pass on at least part of the higher costs to their buyers; hence, the evident upward pressure on prices of finished goods and services, leading to an improvement in their profits. They have also been stocking up raw material inventory (+3.7pts), a likely reflection of lingering supply shortage and rising commodity prices.

- **Respondents expect strong recovery to extend to Q3:** The GBAI expectations index for business activity eased to 59.3 from a record 62.7 in Q1. Seven of eight sub-indices fell q/q, with 'new orders' the only exception (+1.3pts to 67.5, the highest of all components, confirming expectations of a strong pipeline as the global recovery expands). The drop in the expectations gauge is unsurprising, given it is a measure of optimism relative to prior levels, which were already very high. This is also in line with our view of growth likely easing in H2 from a strong H1 amid looming inflation and policy tapering headwinds (e.g. a likely easing of nationwide total social financing growth to 10-11% y/y this year from 13-14% in 2020); the fact that all eight sub-indices stayed well above 50 indicates continued expansionary momentum in the GBA.

Improving business performance helps boost cash positions

Figure 3: Businesses have been able to handle rebounding financing costs

Five sub-components of our GBAI's credit indices – current vs expectations

	Current performance			Expectations		
	Q2-2021	Q1-2021	Q4-2020	**Q2-2021**	Q1-2021	Q4-2020
Credit Index	**51.6**	49.8	49.6	**53.0**	53.7	50.8
1. Bank financing cost *	**47.5**	48.4	49.8	**47.8**	46.5	48.3
2. Non-bank financing cost *	**48.0**	48.3	50.9	**48.2**	47.7	49.8
3. Banks' attitude towards lending	**51.1**	53.7	50.3	**52.8**	57.4	50.4
4. Surplus cash	**56.3**	50.5	50.0	**58.1**	60.4	53.1
5. Receivables turnover	**55.2**	48.0	47.3	**58.1**	56.7	52.5

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

- **Respondents see net improvement in financial conditions**: For the first time since the GBAI's launch a year ago, the current performance index for credit rose above 50 in Q2 (Figure 3). This is despite a worsening drag from a further deterioration (i.e. more expensive) in both the bank and non-bank financing cost sub-indices, and also less willingness for banks to lend. However, this is more than offset by easing cash-flow stress (as reflected in the q/q jumps in surplus cash and receivables turnover sub-indices, by +5.8pts and +7.2pts, respectively). Our expectations index for credit, which stayed above the 53 handle, suggests that such trends will likely persist in Q3. All this echoes the tapering concerns mentioned earlier, while supporting the case for policy makers to stick with the stabilising leverage agenda for longer, given that businesses now have macro tailwinds to weather less cheap financing.

Technology and manufacturing respondents enjoy similar drivers underpinning their strong performance

- **Consistently positive messages from manufacturers:** By industry, the current performance and expectations sub-indices for 'manufacturing and trading' might not have seen the biggest q/q jump in the headline print (that would be 'professional services'), and neither was it the highest scoring sector (that goes to 'innovation and technology'). But manufacturers have been building on an already impressive Q1, after being the clear outperformers prior, while 'professional services' has caught up, after having been the underperformers prior; technology respondents are also rebounding from a small Q1 setback, possibly due to prior worries over tighter regulatory scrutiny (Figure 4). In contrast, retailers' gains appear more modest after a solid start to the year, possibly held back by the recent disruption from a resurgence of COVID cases.

  Looking closer at the manufacturing and technology respondents, we see many similar drivers for their strong index performance. For example, based on their respective expectations sub-indicators, they are clear leaders in 'production/sales', 'new orders', 'profits' and 'finished goods/services prices'. They also expect the strongest pressure from rising financing costs among sectors, only to be offset by their outperformance in 'receivables turnover', underpinning their overall positive outlook on financial conditions (Figure 5).

Figure 4: GBAI's industry business sub-indices

Business activity	Current performance			Expectations		
	Q2-2021	Q1-2021	Q4-2020	**Q2-2021**	Q1-2021	Q4-2020
Manufacturing and trading	**59.7**	54.0	51.6	**59.8**	63.9	55.4
Retail and wholesale	**52.4**	50.3	42.8	**55.1**	59.2	47.8
Financial services	**52.3**	46.4	40.8	**58.2**	58.7	48.7
Professional services	**58.3**	39.1	40.2	**60.3**	44.7	43.4
Innovation and technology	**60.3**	46.8	50.7	**60.4**	58.7	52.4

Source: HKTDC, Standard Chartered Research

Figure 5: GBAI's industry credit sub-indices

Credit	Current performance			Expectations		
	Q2-2021	Q1-2021	Q4-2020	**Q2-2021**	Q1-2021	Q4-2020
Manufacturing and trading	**51.9**	50.1	49.9	**53.2**	53.6	50.6
Retail and wholesale	**50.8**	49.4	49.4	**52.2**	55.4	52.8
Financial services	**53.1**	50.2	45.9	**52.2**	54.2	50.6
Professional services	**46.7**	46.4	44.8	**51.6**	48.8	46.9
Innovation and technology	**51.9**	41.0	51.7	**52.2**	52.8	52.2

Source: HKTDC, Standard Chartered Research

This complements findings from *a separate annual GBA survey* that we recently conducted, where we asked our 220+ manufacturing clients operating in the region how they see their 2021 business outlook. Results point to a broad-based recovery across orders, sales, hiring, wages and capex in 2021, with larger companies likely to keep outperforming smaller ones. On the other hand, this annual survey also showed weak appetite for investing in key innovations beyond the usual capex; that said, our latest GBAI sub-indices for 'innovation and technology' showed the sector still leading all industries, which should help ease some of this concern, suggesting that China's innovation drive remains alive and kicking.

Shenzhen enjoying a likely transitory lead over Guangzhou

- **Shenzhen and Guangzhou diverge:** Traditionally, respondents can be generalised into three main city groups based on their similar index performances, possibly due to their similar economic structure and drivers: the core mainland cities (Shenzhen and Guangzhou), the non-core mainland cities (including Foshan, Dongguan) plus Macau, and Hong Kong. Over the past year, we have seen the first two groups alternate as the quarter's outperformer, while Hong Kong has persistently underperformed. This time is no exception, with the non-core cities regaining top spots across most sub-indices; Foshan is particularly strong following a disappointing Q1, reflecting some catch-up play. Foshan and Dongguan's improvements could also be reflections of the global recovery story, as they are heavily integrated with and a core part of the GBA export sector's extensive supply chain.

  Catching our eye this time is the divergence between Shenzhen and Guangzhou (Figure 6). The current performance sub-index for Shenzhen stood at 63.1 in Q2, second only to Foshan's 65.9; in contrast, Guangzhou's was 8.3pts lower at 54.7, beating only Hong Kong's 45.1. The difference between the two cities is particular large for many current performance sub-components, especially

Figure 6: GBAI's city business sub-indices

Business activity	Current performance			Expectations		
	Q2-2021	Q1-2021	Q4-2020	**Q2-2021**	Q1-2021	Q4-2020
Hong Kong	**45.1**	37.3	34.9	**50.8**	50.7	38.3
Guangzhou	**54.7**	55.6	48.7	**57.9**	66.0	51.1
Shenzhen	**63.1**	58.4	51.8	**60.0**	65.9	56.9
Foshan	**65.9**	49.2	59.3	**65.6**	60.8	60.2
Dongguan	**60.7**	52.6	56.4	**65.2**	64.1	59.6
Macao and other cities	**62.7**	55.1	55.8	**62.4**	64.5	61.1

Source: HKTDC, Standard Chartered Research

Figure 7: GBAI's city credit sub-indices

Credit	Current performance			Expectations		
	Q2-2021	Q1-2021	Q4-2020	**Q2-2021**	Q1-2021	Q4-2020
Hong Kong	**45.1**	46.1	44.7	**50.5**	51.1	46.2
Guangzhou	**52.6**	49.7	48.2	**53.5**	55.1	48.1
Shenzhen	**53.0**	51.0	50.5	**52.6**	53.4	50.6
Foshan	**53.9**	51.3	53.5	**56.7**	55.2	53.6
Dongguan	**51.6**	47.8	51.2	**56.2**	54.4	53.0
Macao and other cities	**53.2**	50.9	52.1	**53.2**	54.8	57.7

Source: HKTDC, Standard Chartered Research

'production/sales' (14.1pts), 'new orders' (14.8pts) and 'raw material inventories' (20.8pts); while this could in part be a reflection of the bigger disruptions from a resurgence in COVID cases Guangzhou has faced since late May, it does not explain Guangzhou's weak 'new export orders' reading (49.2 versus Shenzhen's 65.4). Another explanation could be Shenzhen's higher technology (and maybe financial services and professional services) content giving the city an edge this time. We note that the gap between Shenzhen and Guangzhou narrows materially for the expectations indices, meaning the factors that affected Guangzhou in Q2 are likely to be short-lived, according to our respondents.

Hong Kong is finally turning the corner as well

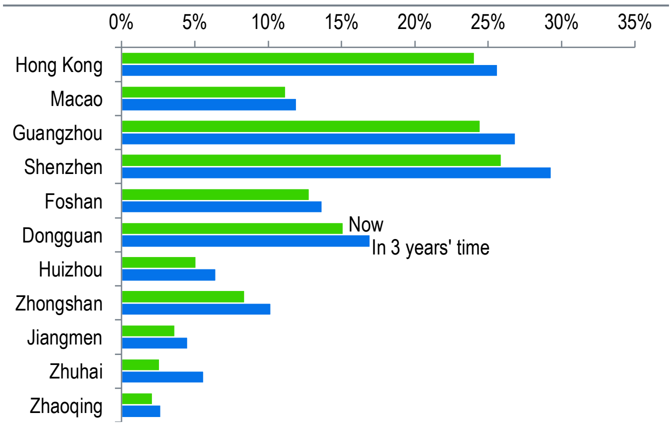
Meanwhile, Hong Kong is quietly improving, despite remaining a laggard. Its current performance index for business activity finally broke above 40 for the first time in Q2, while the corresponding expectations index stayed above 50, albeit only marginally. Our prior scores for Hong Kong suggested a bottoming out economy, best reflected in the fall in local unemployment (on a seasonally adjusted, 3mma basis) for three straight months as of May, mainly driven by the unwinding of social distancing measures. We believe a continued global recovery, together with an acceleration in the vaccination pace extending recent stretches of zero daily local untraceable COVID cases, would mean more catching up to come.

Key takeaways from our thematic questions

Our thematic questions this time focused on (1) our respondents' plans for business expansion in the next three years, including which cities they will be operating in by then and why; (2) how they are coping with higher operating costs; and (3) how the need to step up environmental protection efforts are impacting/will impact their profits and business plans. We list our key findings below.

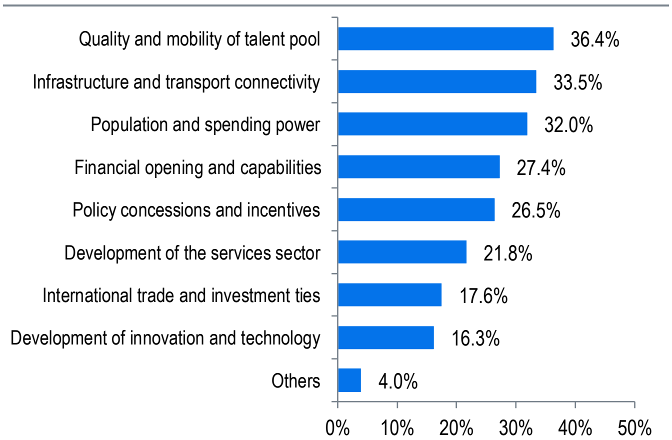
- **Expansion plans:** Our first question was which GBA cities our respondents are currently operating in, and where they plan to have a presence in three years' time (Figure 8). For bigger cities that have their own sub-index (i.e. Shenzhen, Guangzhou Hong Kong, Foshan and Dongguan), they all see the proportion of respondents already having a presence there exceeding their allotted survey sample size (see Figure 17 in the Appendix). All 11 GBA cities see an increase

Figure 8: Which cities does your company operate in now? And where does your company plan to have business presence in three years' time? *(% of respondents)*



Source: HKTDC, Standard Chartered Research

Figure 9: What are your main considerations for choosing to operate in these GBA cities?
% of respondents



Source: HKTDC, Standard Chartered Research

in respondent presence in the next three years, with Shenzhen and Dongguan leading the core and bigger cities, and Zhuhai way ahead of the remaining ones, which are bound to see proportionally bigger improvements due to their lower starting points. By industry, it is unsurprising that respondents' presence in 'innovation and technology', 'financial services' and 'professional services' – be it now or in three years' time – is mostly concentrated in Shenzhen, Guangzhou and Hong Kong, with Dongguan also rather popular for technology companies, Macau for retail and wholesale, and Zhuhai an up-and-coming destination for professional services. Manufacturers, in contrast, are most diverse in location.

High-quality talent topped the list of qualities respondents look for in choosing to operate in a GBA city

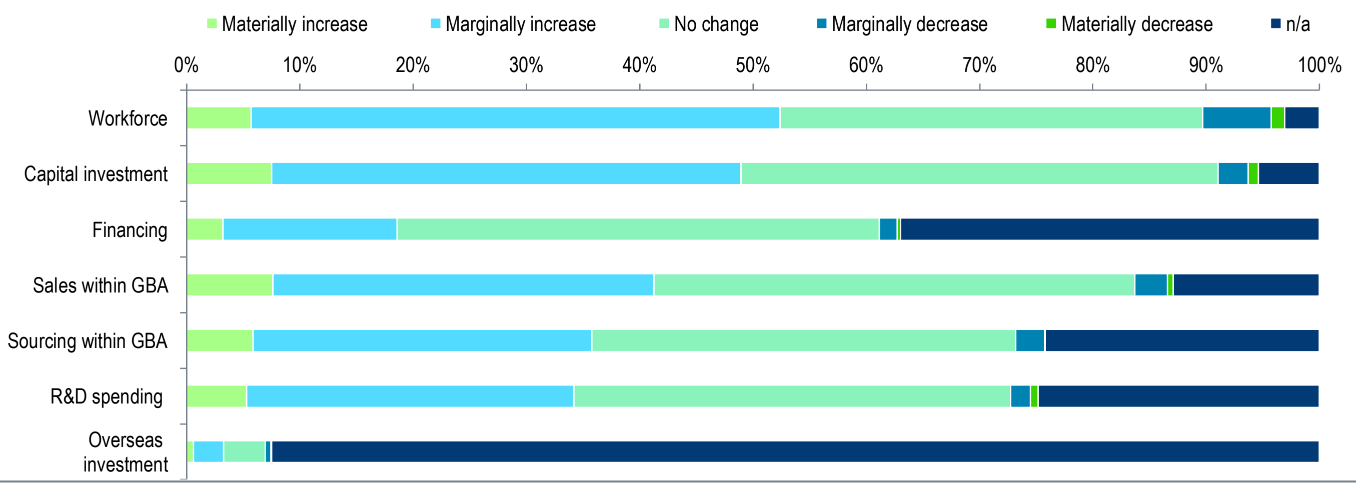
When asked what their main considerations are for operating in these cities, the top three answers were (1) quality and mobility of talent pool; (2) infrastructure and transport connectivity; and (3) population and spending power (Figure 9). Labour quality and talent availability have been a long-time priority, based on our prior surveys; this time too, it was the only answer ranked top three across all five of our industry categories. In particular, almost half (48%) of our technology respondents ranked talent availability first, making it a key long-term driver for the GBA's long-term innovation aspiration. It was unsurprising that infrastructure topped the list for manufacturers, and population size for retailers and professional services providers. Interestingly, financial opening and capabilities only ranked second for 'financial services' (39.5%), with the first place going to 'policy concessions and incentives' (43.4%).

In term of our respondents' plans for their company's operations in GBA over the next one to three years, excluding those answering 'not applicable', 54% said they would (be it marginally or materially) increase their workforce size; 52% for capital investment; 47% for sales within the GBA; 47% for sourcing with the GBA; 46% for R&D spending; 44% for overseas investment; and 30% for financing – all significantly more than those reporting decreases (Figure 10). Small sample sizes notwithstanding, 'financial services' relative to other sectors appeared slightly more eager to invest overseas, and unlike manufacturers who prefer ASEAN markets, the US, the UK and Singapore are their top choices.

Manufacturers appear most exposed to higher operating costs

- **Coping with higher costs:** Just over half of our respondents (51.3%) said they are experiencing higher operating costs (Figure 11). The impact across sectors,

Figure 10: What are your plans for your company's operations in GBA over the next 1-3 years?
% of respondents

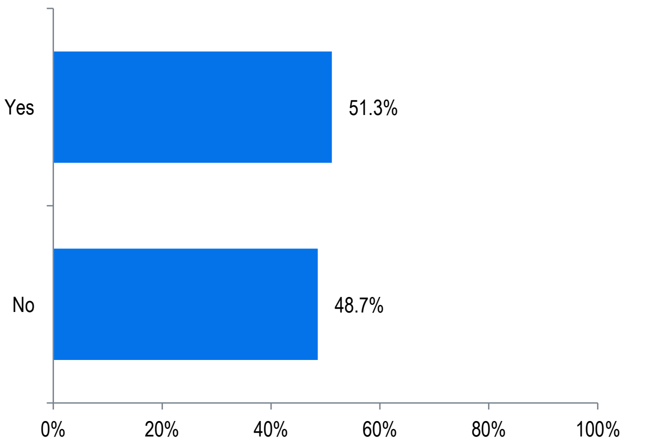


Source: HKTDC, Standard Chartered Research

however, is far from even, with manufacturers clearly the most impacted recently by global reflation drivers, including rising commodity prices and transportation costs, plus lingering supply-side bottlenecks; and by extension, a larger proportion of respondents from the more export-oriented GBA cities like Foshan, Dongguan and Huizhou also reported higher costs.

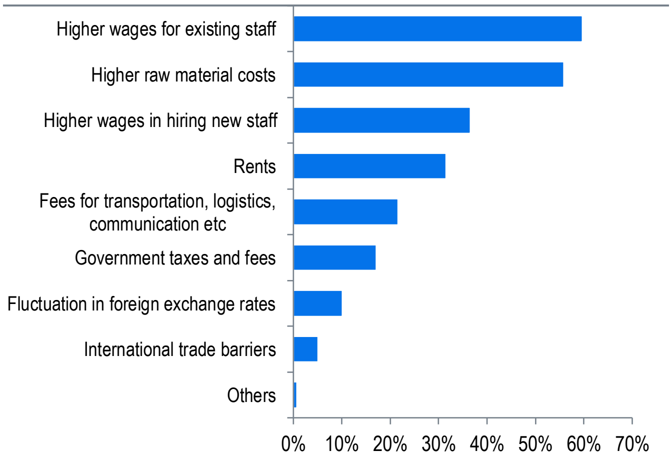
Focusing just on those reporting higher costs, beyond higher raw material costs –- which disproportionately affect manufacturers more – higher wages for existing staff was also a popular answer across all industry groups (accounting for almost 60% of all respondents), more so than the other usual suspects like transportation and rentals (Figure 12). And in response to such pressures, the top three actions are to (1) achieve savings on other expenses; (2) increase sales to offset smaller margins; and (3) pass on higher costs (partly or wholly) to buyers (Figure 13). Retailers are particularly keen to boost volumes to compensate for lost margins, while a relatively larger share of 'professional services' (49%) and 'innovation and technology' (47%) respondents can/plan to pass on higher costs. 21% of all respondents currently experiencing higher costs think it is very difficult to pass them on, with another 60% saying it is quite difficult (Figure 14).

Figure 11: Is your company experiencing higher operation costs? *(% of respondents)*



Source: HKTDC, Standard Chartered Research

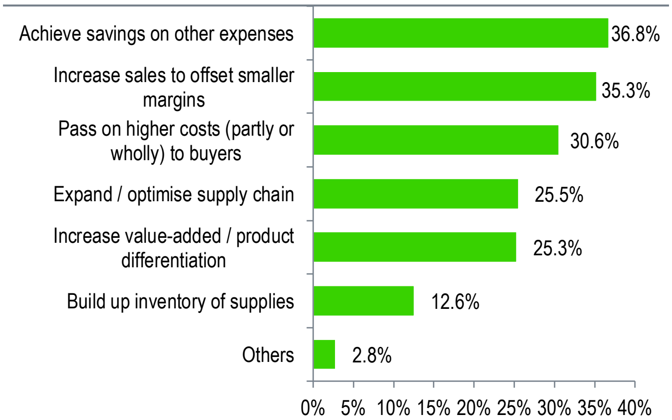
Figure 12: What are the major sources of higher operation costs? *(% of respondents experiencing higher costs)*



Source: HKTDC, Standard Chartered Research

Figure 13: How are you handling / how do you plan to handle rising input costs?

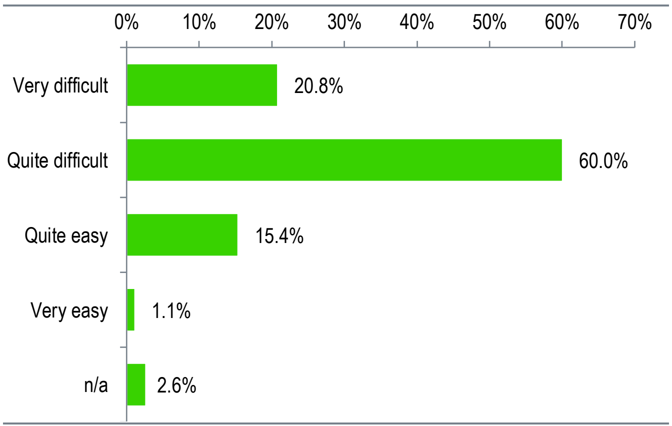
% of respondents experiencing higher costs



Source: HKTDC, Standard Chartered Research

Figure 14: How easy is it for you to pass on higher costs to your customers?

% of respondents experiencing higher costs



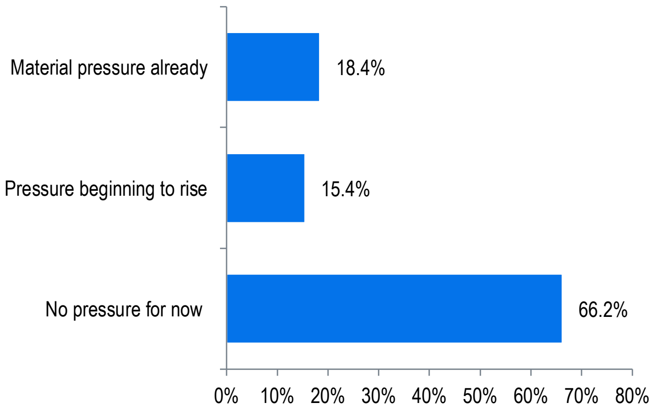
Source: HKTDC, Standard Chartered Research

Policy push for environmental protection comes with challenges and opportunities

- **Decarbonisation and other pollution reduction:** Finally, we asked our respondents whether they feel the pressure to engage in environmental protection in their operations (Figure 15). This could be decarbonisation, other means to reduce pollution, or simply complying with policies that are expected to become more stringent over time. Only 18% said there is material pressure already, with another 15% seeing pressure beginning to rise. The remaining accounts for two-thirds of our respondents, who see no pressure for now; we believe this group of respondents (and by extension the majority of GBA companies that they represent) will see pressure to take action on environmental protection rising evidently very soon, especially on reducing carbon emissions.

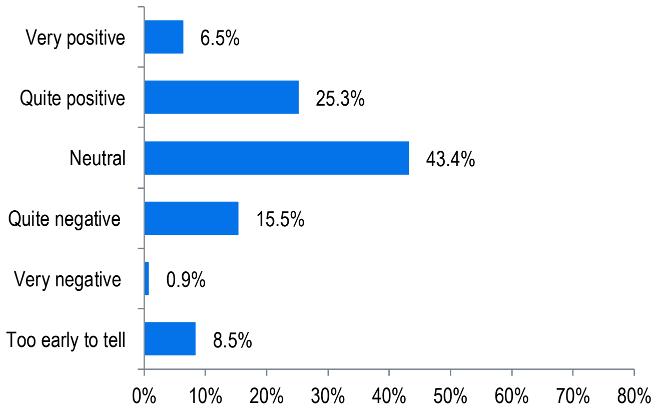
  China has pledged to achieve peak emissions by 2030 and carbon neutrality by 2060. *This is an extremely challenging goal, in our view*, given the country's energy-intensive growth model and coal-dominant energy mix, and its short window to achieve net zero. All this means that China needs to go through major economic transformation to reach such lofty goals, and the GBA will be asked to lead the way, much like many other China aspirations. The good news is that not all changes are negative to businesses, and could also bring new opportunities: a total 32% of respondents see the need to comply with environmental protection requirements having a positive impact on their profits and long-term business plans, twice the size of those seeing negative impacts (16%; Figure 16).

Figure 15: Do you feel the pressure to be required to engage in environmental protection* in your operations? *% of respondents*



* E.g, requirement to decarbonise, reduce pollution, and adopt environmental protection measures; Source: HKTDC, Standard Chartered Research

Figure 16: How would you see such environmental protection requirements impacting your company's profit and long-term business plan? *(% 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 Q2-2021), and the other looking at 'expectations' (Q3-2021). 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 2).

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 17: GBAI

Number of respondents

By city

	Targeted respondents
Hong Kong	200
Guangzhou	200
Shenzhen	200
Foshan	100
Dongguan	100
Huizhou Zhongshan Jiangmen Zhuhai Zhaoqing Macau	200
Total	**1,000**

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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