

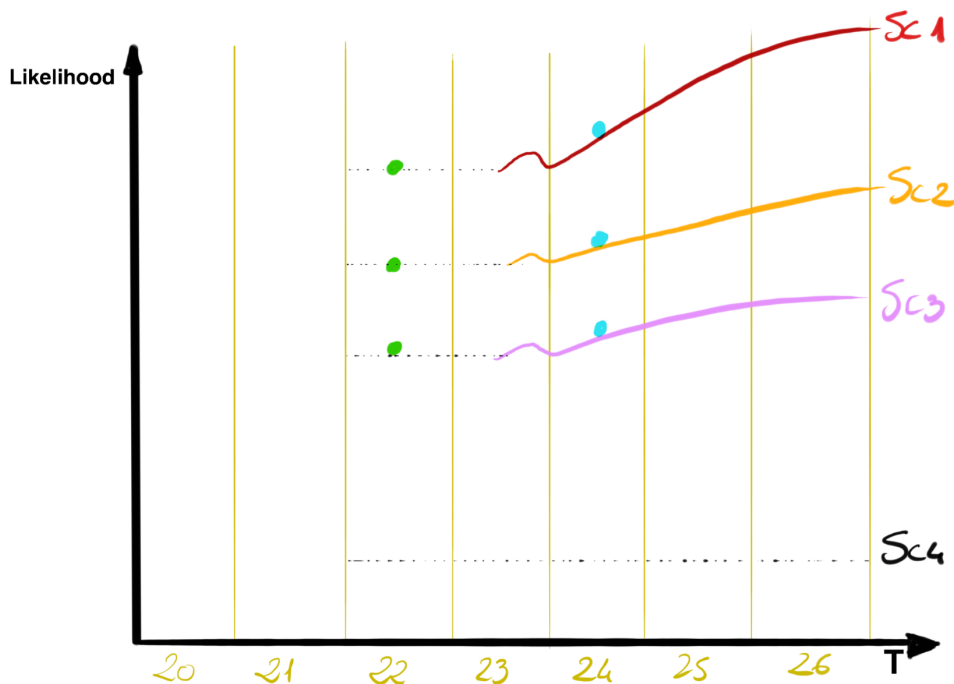
Forecast of different scenarios for a gradual relaxation of CoVid measures in Hong Kong

Strategic outlook for the international business community in Hong Kong, 2022-2025

With the start of the New Year of 2022, Hong Kong's international business community in Hong Kong is entering another year of uncertainty. In the last year, The European Chamber of Commerce in Hong Kong has conveyed the concerns of our members and the consequences of the so-called "Zero Covid" policy. We think that our duty and obligation to our members beyond listening, conveying, and lobbying is to help them to understand and to make appropriate plans going forward in the next few years. With that in mind we have set up a Think Tank with the purpose of collecting experts from diverse fields that can help us to understand better the scientific, political, and economic factors around CoVid, so that the international business community can be less reactive and have more long-term decision making in its strategic business and personal plans.

After a few sessions organized with different parties over the last months the Think Tank has consolidated all the insights and analysis into the following point of view that is based on four possible scenarios.

Scenarios and Timelines



Scenario 1 (increasingly highest likelihood):

Hong Kong to wait for Mainland China to launch and roll out booster doses with a new locally-developed mRNA vaccine. Hong Kong to start opening to the rest of the world in Summer 2023, but more likely in Spring 2024

The limited effectiveness of Sinovac and other locally developed vaccines is forcing the Mainland authorities to be extra careful and keep the country closed to avoid any major outbreaks. While adopting more efficient vaccines such as BioNTech/Fosun Pharma would be a way to accelerate the protection of the population, it seems that Mainland China is prioritizing the development and launch of their own mRNA vaccine somewhere during 2022. In our estimations, the full roll out the vaccine across the entire Chinese population could take up to a year.

If no new more complex variants of the virus evolve that would require additional re-engineering of the vaccines, we could expect that by Fall 2023 earliest, China would be able to gradually start opening to the rest of the world and relaxing the current measures. However, based on the experiences during the winter of 2021 and 2022, it is very likely that if a considerable fraction of the population remains unvaccinated with the mRNA vaccine, the authorities might want to avoid re-opening before the winter of 2023, since the risks for spreading the virus is higher in colder climates. This suggests that if the launch of the new mRNA vaccine or its roll out gets delayed, the start of re-opening in Spring-Summer 2024 is considered more likely.

Consequences of Scenario 1:

Human

While this scenario might achieve a high level of population immunity through repeated vaccination, by the time Hong Kong is ready to open and avoid the number of Covid fatalities that other countries have seen, there will be several consequences that are worth considering. Stress levels will continue to raise. Mental health cases will continue to grow, especially among the younger population. Disruption from stringent containment of local epidemics will disrupt society from time to time, and changing policies will add to further uncertainties for local businesses on repeated closures and community, e.g., in terms of switching to remote classes for children.

Society

With the measures introduced in early 2020, most foreigners in Hong Kong have been separated from their families for two years now. A prospect of remaining separated for another 2-2.5 years more is something that the vast majority will not take lightly, especially those in more senior positions who might have ageing parents outside of Hong Kong. We anticipate an exodus of foreigners, probably the largest that Hong Kong has ever seen, and one of the largest in absolute terms from any city in the region in the recent history. While there is always an expectation that this exodus will bring a replacement, such replacement is likely to come from the Chinese workforce.

The implications of this are worth understanding. Hong Kong has established itself as one of the few international business hubs in the world, and arguably the main one for China. By acting as a bridge between different markets around the world, such international business hubs create value both for the local society and for the economy at large. Today Hong Kong is losing some of the characteristics that make it an international business hub. By losing most of its international community, the city becomes less diverse, less appealing to international firms, and eventually will limit its potential to contribute to the China's economy.

Business

While most of the big multinational corporations have not yet showed signals of fully abandoning Hong Kong in 2021, we believe there is a risk of a cascade effect for many firms to leave in 2023 if not earlier. The current view of the international business firms in Hong Kong is that the shape of the organizations in Hong Kong is changing and evolving from Regional Headquarters to local sales representation offices. Given the travel restrictions, many top executives are missing out on their potential to add value to their organizations and thus on their persona career prospects.

With the top executive layer relocating to other cities in the region, it is being replaced by locals with less international experience. As a result, international headquarters of multinational firms start considering that Hong Kong is losing weight as a strategic outpost in APAC, and as one of the three global business hubs. Companies are taking different approaches to this phenomenon, from relocating the Chinese focus teams to Mainland China to relocating the Asia regional teams to Singapore or Seoul.

Beyond largest corporations we foresee a massive exodus of SMEs led by foreigners over the next couple of years. As most of the international talent leaves Hong Kong, this can likely have further spillovers of attracting and developing new talent who might start seeing limited career opportunities in the city, which would also hamper Hong Kong's potential to maintain world class universities.

The following industries and sectors associated to the international business community will suffer a significant recession during 2022 and 2023:

- Airlines
- Outbound and Inbound travel agencies
- International education institutions
- Chambers of commerce and other non-profit international organizations

According to the Census and Statistics Department, Hong Kong's Four Key Industries were Financial Services, Tourism, Trading and Logistics, and Professional Services, together constituting 55-60% of value added to the Hong Kong's GDP. Comparing to 2015, the loss of Tourism sector and the substantial reduction of Trading has already reduced Hong Kong's GDP by 4.7%.¹ As a result of further associated divestments, we expect to see a negative

¹ https://www.censtatd.gov.hk/en/data/stat_report/product/FA100099/att/B72112FA2021XXXXB0100.pdf

impact on the other key industries getting affected more permanently further limiting the growth of Hong Kong's GDP.

An additional negative factor of continued decoupling from the rest of the world on Hong Kong's economy will come from rising inflation that could start affecting most vulnerable population soon. Global supply chain disruptions are already affecting inflation expectations around the world and Hong Kong's further limitations on airline and cargo operations will add additional impact on rising food prices.

Scenario 2 (average likelihood):

Uncontrolled outbreaks in Mainland China that would make Hong Kong to seal the boundary with Mainland and start reopening with the rest of the world

While Mainland China has been very efficient in controlling the spread of the different variants after the original outbreak in Wuhan, recent worrying developments in Xi'An have suggested that a new major outbreak could take place in Mainland, especially if new variants with higher transmissibility might be harder to contain. In the hypothetical scenario that this would take place, we anticipate that Hong Kong and Mainland China would close the boundary.

Hong Kong would then be back to a position where it can decide whether to wait for Mainland China to resolve the outbreak and then re-open the boundary , or to decouple from the Zero Covid policy and start a journey towards co-existing with the virus by opening to the rest of the world. While today this does not seem like a very likely scenario, we think that the trigger, an uncontrolled outbreak in China, could happen any time.

The process and timeline from the event to a gradual relaxation of measures of Hong Kong towards opening with the rest of the world could at its best consist of 3 months of waiting for the outbreak to resolve, 3 months of negotiation with Mainland authorities to de-couple, 3 months to accelerating the vaccination of the un-vaccinated population in Hong Kong, and then finally opening with 3 months of more restrictive social distancing measures to prevent potential increase in numbers. So altogether the reopening might happen 12 months from the trigger event.

Consequences of Scenario 2:

In this scenario Hong Kong and Mainland China might decide to wait for Mainland China to control their outbreak and delay the potential opening, or reposition Hong Kong as a gateway of China to the rest of the world. With the current information at hand we find it more likely that Hong Kong will prefer to wait for Mainland China to control the outbreak and therefore the consequences would be a significant delay on any possible opening. This scenario then becomes very similar to scenario 4.

Scenario 3 (average likelihood):

Uncontrolled outbreak in Hong Kong when any additional restrictions become meaningless

As we have just seen in the last week, although Hong Kong has had an excellent track record of keeping the virus out of the community the city is not 100% secured to a virus coming from outside, either from overseas or from across the boundary with Mainland China.

An uncontrolled outbreak of Omicron could be devastating for Hong Kong since a large percentage of the risk groups, like the elderly, have low vaccination rates or are vaccinated with Sinovac which has been shown to have limited protection against the new variants such as Omicron.

An outbreak would force the government to enter into even more restrictive measures around social distancing than the city has seen so far, possibly even with severe lockdowns and complete boundary closures with Mainland China that might start limiting food supply.

As a result, Hong Kong will need to deal with the outbreak, but after eventually realizing that after outbreak's start, its complete control has been almost impossible in any place in the world, Hong Kong might potentially concluding that the only way forward is to co-exist with the virus. This scenario might consist of a number of different small outbreaks before we have a big one. From the outbreak to the potential opening of Hong Kong we can refer to the experience of similar situations in other countries and anticipate that if in the end Hong Kong would decide to open the whole process might take around 12 months.

Consequences of Scenario 3:

Human

We think that this scenario is the most dangerous one to Hong Kong as it might mean that there could be up to 10 to 20 thousand casualties amongst the elderly part of the population that currently has a low vaccination coverage.² Increasing the vaccination uptake in this group should be a priority. While recent policies of increasing vaccine bubbles and restricting access to unvaccinated residents to various venues is commendable, further toughening of the measures might be required to facilitate even faster vaccination uptake. The government could seriously consider following some European countries that have recently started mandating the vaccination for those that are fit for it.

Society

While most of the world has already experienced the severity of CoVid, Hong Kong has not gone through the different phases that most of the other societies have gone through. In this scenario we see many parallels with what has happened in the rest of the world. Elderly houses might become severely affected, families will not be able to mourn their relatives, and lockdowns and more severe measures that eventually might not work will put a lot of stress on the lives of all the residents of Hong Kong.

Business

² Just 20.5% of those aged 80 and above took at least one dose as of January 1, 2022.

We foresee a very dramatic impact on most of the sectors mainly because of the stringent public health measures used to attempt to control transmission, but primarily on those that were already impacted on the first waves and in 2019, in particular, hospitality services and retail, driving the economic growth down.

It is almost impossible to protect 100% a place like Hong Kong from incoming infections without risking to become completely isolated from the rest of the world. Full isolation would mean no passenger or cargo flights, ships or road transportation, with the massive human and economic impact that it would cause, among other reasons because the dependency of the import of goods.

Scenario 4 (Low likelihood):

China, including Hong Kong, does not open to the world for the foreseeable future.

A hopefully very unlikely scenario but not unthinkable is the one in which China does not manage to get the population protected because the continuous mutation of the virus outpaces the capability of the vaccines to protect them. As a result, China, that has already learned to live isolated from the world, decides to continue this way and continue focusing on their internal markets and policies. Hong Kong would be a collateral casualty in this scenario as it would linger between its dependency to Mainland China and the role as international city locked within China.

Consequences of Scenario 4:

Human

There will be increase of mental health issues across Hong Kong, as well as other social and economic impacts of remaining closed off from the world for a prolonged period of time.

Society

There will be massive exodus of foreigners but also of local talent. Hong Kong will lose its cultural diversity.

Economic

Hong Kong will isolate more and more gradually to the rest of the world, losing the international hub status but also impacting the financial hub status. Hong Kong will lose any regional competitive advantages to other financial hubs in the region as regional headquarters of international corporations will continue relocating their key roles.

Scenario Disruptor

Any of the above scenarios can be disrupted by new emerging mutations that would eventually delay all the timelines of opening Mainland China and Hong Kong.

Recommendations

We have been recommending to the Hong Kong Government a number of measures such as:

- Considering the potential increase of fatalities of scenario 3, bring in measures to accelerate the vaccination of the entire population as soon as possible, including starting public discussions of mandatory vaccinations for those who are fit;
- If scenario 2 happens we recommend Hong Kong to move forward and leave behind the Zero Covid policy and start a program to accelerate the vaccination of the entire population in preparation for opening Hong Kong to the rest of the world.
- Introduce measures to earn a bit of the hearts of the international business community alleviating the current pain the quarantine measures introduced in the lives of Hong Kong residents:
 - Since the 21 days quarantine has not been scientifically justifiable and a number of Hong Kong public health officials have argued against it, we recommend to revise the quarantine policies by reducing them to 7-14 days;
 - Improve the quality of accommodation at Penny's Bay such as providing bare minimum facilities like WIFI, exercise equipment, delivery services, and consider allowing for scheduled time outdoors.

Meanwhile, we offer our recommendations to the international business community:

- Consider several plans for best and worst scenarios to diversify the risks;
- Consider that HK is very likely to be semi-closed for international travel in the coming 12-36 months and that talent retention will continue to be a precious commodity in Hong Kong for the next two years if not longer;
- Engage in the longer-term planning of the APAC regional headquarter location in terms of the ability to cater for regional customers and other stakeholders when travel to HK will remain at best limited.