

Hong Kong hit with a downgrade

Fitch has downgraded Hong Kong to AA from AA+ with a negative outlook. Though we agree that the governance has deteriorated recently, we believe the situation will change when there is an election of the next Legislative Council in September 2020



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Fitch downgrade cites worries about governance

Fitch has downgraded Hong Kong from AA+ to AA with a negative outlook, citing the international perception of weak governance and rule of law.

Fitch also claims that stronger integration with the mainland could lead to a narrower rating between Hong Kong and China (A+/Stable).

Other rating agencies have not changed Hong Kong's rating so far. S&P holds a AA+ rating while Moody's rating stands at Aa2, both with a stable outlook.

Where we agree with Fitch and where we don't

We agree with Fitch only partially.

The Hong Kong government has been slow to respond to the protests, which could give the impression that governance is weak. But we think perceptions about the rule of law should improve now that Hong Kong's Chief Executive, Carrie Lam, has officially withdrawn the

extradition bill.

Fitch noted that the outlook is negative because "a degree of public discontent is likely to persist". We think that the free expression of public discontent in Hong Kong could be seen as positive. But we agree that protests will continue until the government can successfully build a channel of dialogue, which seems difficult at the moment. We think protestors will express their views through the election of the Legislative Council in September 2020, which will help to rebuild the communication channels between the people and the government.

Impacts on the economy

The material impact of this downgrade should be small as Hong Kong is still rated investment grade. But we can't rule out the possibility that some investors will stay away from Hong Kong for a while, particularly in sectors directly affected by the protests, such as tourism, local spending and transportation. This, together with the impact from the trade war with the US, will keep Hong Kong in recession (i.e. negative quarter-on-quarter growth) for four straight quarters this year. We still expect *year-on-year* GDP growth to be 1.0% in 2019 and 1.4% in 2020.

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