Newsletter Nr. 191 (EN)

The Budget of Hong Kong 2015/2016

March 2015

I. Introduction

On 25 February 2015 the Financial Secretary of Hong Kong, John Tsang, held his annual budget report to the 2015/2016 budget of Hong Kong.

It was eagerly awaited if Hong Kong was able to exceed the expectation of the predicted tax surplus of approx. HK$ 9 billion (approx. EUR 1.2 billion) which was forecasted in February 2014.

II. The Highlights

1. Economic Performance 2014/2015

The Financial Secretary forecasts that the revised estimate for government revenue for the financial year 2014/2015, from 01 April 2014 until 31 March 2015, will be HK$ 470.7 billion (approx. EUR 48 billion), 9.4 percent or HK$ 40.6 billion (approx. EUR 4 billion) higher than the original estimate. It reflects mainly the revenues from stamp duties, profits tax, salaries tax and land premium.

For 2014/2015, Tsang forecasts a surplus of HK$ 63.8 billion (approx. EUR 7 billion), and by 31 March 2015, the total fiscal reserves of Hong Kong are expected to reach HK$ 819.5 billion (approx. EUR 83 billion).

The economy of Hong Kong only grew 2.3 percent last year, the third consecutive year with a growth rate lower than the annual average of 3.9 percent over the past decade. The unemployment rate averaged at a low level of 3.2 percent for the year as a whole, sustaining a state of full employment. The headline inflation rate was 4.4 percent.

2. Outlook for 2015/2016

a) General Outlook

According to the Financial Secretary the year 2015 will be a challenging year. The US inflation outlook will be affected, making it more difficult to forecast the pace of interest rate rise, the rising deflation risks in Europe and Japan will add headwinds to the economic recovery and some oil exporting countries face huge pressures on finance and exchange rates due to geopolitical tensions and dropping oil prices.

Mainland China's economic growth is relatively stable but faces downward pressure this year, according to Tsang. Domestically, local consumption and local investment sentiment will be dampened by the increased uncertainties over the US interest rate hike and weaker spending power of inbound visitors.

In the face of internal and external challenges, the Financial Secretary forecasts a Gross Domestic Product (GDP) growth at 1 – 3 percent in 2015. The inflation is forecasted to fall at the level of 3.5 percent.

The total government revenue for 2015/2016 is estimated to be HK$ 477.6 billion (approx. EUR 49 billion).

The total government expenditure is estimated to reach HK$ 440.8 billion (approx. EUR 46 billion) in the next financial year, 11 percent more than last year. Almost 60 percent of the recurrent expenditure for the next financial year will be deployed for education, health and social welfare.

Taking all these into account, the Financial Secretary forecasts a surplus of HK$ 36.8 billion (approx. EUR 4 billion) in the Consolidated Account in the coming year 2015/2016. Fiscal reserves are estimated to be HK$ 856.3 billion (approx. EUR 88 billion) by the end of March 2016, representing 36.8 percent of GDP and equivalent to 23 months of government expenditure.

b) Concrete Relief Measures

A majority of Hong Kong citizens are expecting relief measures from the Government to allay their burdens, as in the past years. These demands were only partly fulfilled by the Financial Secretary. More particularly Tsang announced similar measures than in the past years. These are in detail:

- Reduce salaries tax, tax under personal assessment and reduced profits tax for 2014/2015 by 75 percent, subject to a ceiling of HK$ 20,000 (approx. EUR 2,300).

- Waive rates for the first two quarters of 2015/2016, subject to a ceiling of HK$ 2,500 (approx. EUR 280) per quarter for each rateable property.

- Provide an extra allowance to Comprehensive Social Security Assistance (CSSA) recipients, and an extra allowance to the recipients of Old Age Allowance, Old Age Living Allowance and Disability Allowance, equal to two months of the respective allowances.

- Pay one month's rent for lower income tenants living in the rental units of social housing.

c) New "iBonds"

As in the past years Hong Kong will also release new, so called "iBonds" which are retail inflation-indexed bonds issued by the Hong Kong Government. The rate for each interest payment will be determined by the year-on-year inflation rate of Hong Kong, which is announced according to the Hong Kong Composite Consumer Price Index, with the lower limit of 1% return.

These iBonds can be purchased by Hong Kong ID card holders and act as inflationary compensation. But the popularity of the iBonds has decreased in the last years because they only balance the average rate of inflation without any higher interests.

3. Further Measures

Besides the stated measures the Financial Secretary announced further measures to encourage and ensure the competitiveness of Hong Kong in the upcoming years:

- An increase of the basic and additional child allowances from HK$ 70,000 (approx. EUR 7,500) to HK$ 100,000 (approx. EUR 11,500) from 2015/2016 onwards.

- A special support for the aging population (encourage labour participation with strengthened child care services, improve retirement protection and enhance healthcare services with additional 2,800 hospital beds and the support of public-private partnership initiatives).

- A special support for Small and Medium-sized Enterprises (**"SME"**) in 2015/2016, including increases of the SME exports, marketing and development funds.

- A plurality of different measures and support for certain industry sections (e.g. tourism and transportation) which suffered from the 79 days of protests that occupied Hong Kong's Central district.

- Encouragement of sustainable development (e.g. require all ocean going vehicles to use low sulphur diesel, phase out 82,000 Euro-III or earlier diesel governmental vehicles by the end of 2019, extend the Cleaner Production Partnership Programme for five years, promotion for electronic cars, etc.).

4. Situation and Intensions

The Financial Secretary warns that at the current rate of spending, Hong Kong will run into a deficit in 10 years. He is asking all departments to reduce spending.

Tsang says that the skills mismatch in the labour market has become more evident in recent years and that a chronic manpower shortage and recruitment difficulties in individual sectors (e.g. construction) will hamper the sustainable and diversified economic development. More help for manpower training in several sectors has been announced.

Hong Kong will step up its efforts in combating cross-border tax evasion. Financial institutions are required to report to the Inland Revenue Department specified financial account information on a regular basis, so that Hong Kong can exchange such information with other jurisdictions by the end of 2018.

Tsang says he hopes the Mainland will further deepen liberalisation measures embarked on this year with Guangdong and Hong Kong and extend them nationwide, thereby achieving basic liberalisation of trade in services between the entire Mainland and Hong Kong by the end of this year.

III. Conclusion

The annual budget speech of Tsang has not contained any surprises. Hong Kong is still trying to reduce its expenditures but most of the measures remain unchanged. The 2015/2016 budget does not move away substantially from the line taken in recent years. Tsang propagandized a conservative finance policy to be prepared for the future challenges.

Those who are waiting for a substantial financial reform have been disappointed. In 2015/2016 Hong Kong will probably be able to outreach the surplus forecast again.

We believe that the information provided was helpful for you.
If you have any further questions, please do not hesitate to contact:

Lorenz & Partners (Hong Kong) Ltd.
Unit 2906, 29/F, Wing On Centre
111 Connaught Road Central

Tel: +852 252 814 33
www.lorenz-partners.com
E-Mail: hongkong@lorenz-partners.com