

Regional Update: Business Conditions in Hong Kong

Our associate has lived in Hong Kong for the past two decades and runs his own consulting firm. He has worked in the interconnect industry for more than 25 years, closely watching technologies and business conditions as they evolve in Europe and Asia.

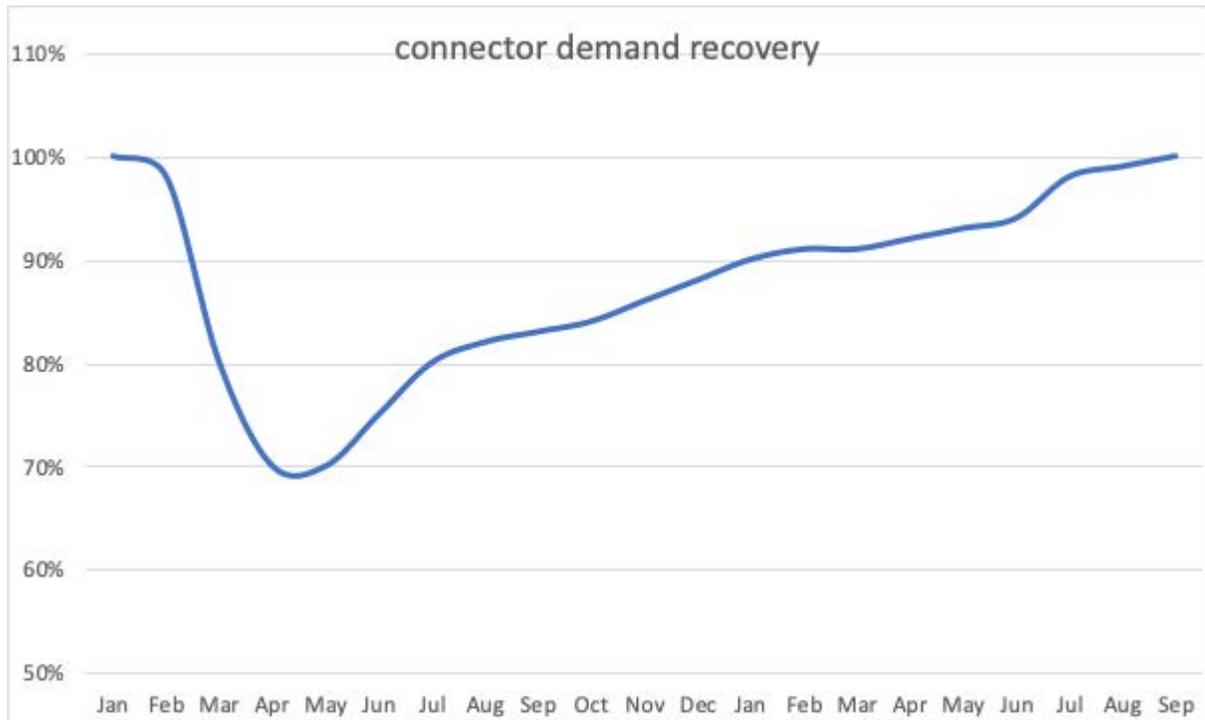
In line with my expectations, Hong Kong has found its way back to relative normalcy following the initial outbreak of the COVID-19 pandemic, and by June 2020 the country is reporting only a few new infections per day. Full contact tracing via digital means is in place, which allows authorities to identify those exposed and require quarantine and follow-up testing. As a result, we all feel very safe and have returned to normal business routines. A few weeks ago, we discontinued working from home and our staff is now together in an office environment. This is true of most of Hong Kong. We are rapidly returning to normal.

Return to normalcy is a slower process in the rest of the world. The awareness of the pandemic grew more slowly in Europe, the US, and the rest of the world than it did in China. China gained experience from the SARS pandemic in 2003. Lessons learned from that experience convinced China to not take chances and the country implemented far reaching and tough measures very quickly. Europe and the US were observers at the beginning of the year, and those regions did not anticipate how quickly the virus would reach their shores. Consequently, their measures were implemented late and perhaps not as broadly as they might have been. A good example is the debate about masks and whether wearing masks is helpful or not. Six months later, citizens are now advised to wear masks. In Hong Kong, people have been wearing masks since January.

The control of the virus differs greatly between continents and the countries within each continent. Countries that have successfully pushed back the virus most likely will not allow their borders to open, as this might jeopardize their success. We believe this will mean travel will remain restricted for the foreseeable future; our estimation is for at least another 12 months. Restricting travel will have significant negative consequences on businesses and the economy. One example of how business is impacted by travel restrictions is that customers that have purchased complex machines from overseas cannot get them installed or commissioned, because the related personnel cannot travel.

From a Hong Kong perspective, we believe we will not get back to full connector demand until the 4th quarter of 2021. (See following graph.) The economy has bottomed out in May and we now see the beginning of a recovery. We believe the recovery will accelerate in the coming months, and reach 2019 demand levels in the summer and fall of 2021. This assumes that we will have a working vaccine within this time period.

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For China, the recovery started in April. The companies with whom we work expect a 15-20% lower overall business in 2020 over 2019. Beyond this, China will experience some long-term effects. Governments and industries around the globe want to reduce their dependency on China. Almost everybody we talk to has plans to move part of their production from China to other low-cost labor countries, such as other countries in Asia, South American, Central America, India, or Eastern Europe. Companies have not changed their interest in China's market, but the scale and approach of how to participate in the domestic market has changed.

All of this will impact the connector industry, on various levels. Over the last 30 years, Chinese manufacturers and their sub-suppliers have reached remarkable levels of qualification and efficiency, combined with extremely competitive pricing. This will make it difficult for many companies to move manufacturing operations to new regions. It will be even more difficult if a substantial degree of manual labor is involved in production.

Tariffs are another factor that companies must contend with in many regions. The trade war has focused most notably on China. However, we see Chinese manufacturers proactively setting up subsidiaries in countries throughout Southeast Asia, Eastern Europe, and Mexico to escape those tariffs.

A short comment must be made on the political developments in Hong Kong. It is important to understand that there was no choice for Great Britain to hold on to the colony. Fifty percent of the Hong Kong territory was leased from China, and that lease expired in 1997. UK Prime Minister Margaret Thatcher visited China in 1984 to begin the negotiations for the handover of Hong Kong to China. The Hong Kong people were not really part of this discussion. Hong Kong was never a democracy during its time as a colony. Today, Hong Kong citizens demand to have a word, but it is too late. In 1984, it was decided that 50 years after the handover of Hong Kong, it would become an integral part of China; now the process of assimilation has started. This comes as a surprise to a younger generation of Hong Kong people, but the process is unstoppable.

The Chinese government does not think in terms of years, but in decades and in centuries. For this government, it is important that Hong Kong's request for democracy does not find acceptance in mainland China, so the state-controlled media does everything possible to conjure visions of terrorism and foreign-influenced criminals among those protesting the takeover. The vast majority of Hong Kong people support the protest movement peacefully. Only a small group of young students turn to violence. Some people claim that the violence is instigated by the authority to hurt the reputation of the democracy movement.

For us foreigners working in Hong Kong, there is no danger and we are not affected by the unrest. The full integration of Hong Kong into China is scheduled for 2047. By then, we probably will have left the country. We have already moved our investments out of Hong Kong.

It is an interesting phenomenon that the elite Hong Kong citizens promote and advertise the progress of China, and they actively engage in shaping the future of Hong Kong. At the same time, most of these people have a private exit plan. It is almost as if they anticipate that something bad will happen in the future, and that it will be better for them to have left the country by then. Either directly or indirectly, these people own property overseas. Canada, the US, and Australia are their preferred destinations.

The largest portion of wealth in Hong Kong is bound to the country's real estate, so most people cannot move assets abroad. Those who can do so will move their investments overseas. Large corporations have moved their headquarters to the UK. Now that it has become clearer what the future of Hong Kong will look like, the exit of wealth and intelligence will accelerate.

Please check back in Q4 2020 for our next China/Hong Kong update.