Ravaged by Sars

- Sars acted as an unexpected exogenous shock to the economy.

- The impact effects were on local consumption and the export of services related to tourism and air travel.

- The drop in demand has rippled through the whole economy affecting other sectors, putting further downward pressure on the price level and worsening the unemployment problem.

- Ravaged by Sars, the 4.5% output growth in the first quarter cannot be sustained.

- The Hong Kong economy has started to contract in the second quarter, and will continue to do so in the third quarter.
Real GDP is estimated to decrease by 1.3% in the second quarter of 2003 on a year-on-year basis, a sharp drop from the 4.5% growth in the first quarter.

In the third quarter, real GDP is forecasted to shrink by by 1.5% year-on-year.
Consumption Spending

- High unemployment and uncertain outlook further dampened domestic demand.

- Private consumption spending dropped by 2.1% in the first quarter of 2003, and is expected to fall further by 2.9% in the second quarter and 2.7% in the third quarter of 2003, on a year-on-year basis.

- In April, the volume of retail sales shrank by 12.2% compared to a year ago. It is expected to remain subdued in the current quarter.
Domestic exports continued to contract, dropping by 12.0% in the first quarter of 2003. In April, the fall in total domestic exports was 16.9%, with domestic exports to the Mainland China and United States declined by 24.7% and 19.0% respectively on a year-on-year basis. A further decline in domestic exports is expected. The domestic exports is expected to plunge by 14.0% in the second quarter and 15.3% in the third quarter of 2002.
Re-exports recorded third consecutive quarter of double-digit growth at 22.3% in the first quarter of 2003. So far Sars has not caused any major disruption in external trade. Re-exports are forecasted to grow by 15.4% and 10.1% in the third quarter and the fourth quarter, respectively. The slowdown in growth in the third quarter is mainly due to the higher base of comparison, but it also reflects weaker external demand, particularly in Europe.
The imports of goods grew along with the re-exports at 18.8% in the first quarter of 2003. The import of manufactured goods, machinery & transport equipment maintained double digit growth at 14.3% and 11.7% respectively in April. The total imports grew by 8.4 and 9.4% in April and May respectively in nominal terms. The imports of goods in real terms is estimated to increase by 9.6% and 5.2% in the second and third quarters of 2003 respectively.
• The export of services grew at 12.2% in the first quarter of 2003. The Sars outbreak hit the travel industry badly. The number of visitor arrivals dropped sharply by 64.8% in April and by 67.9% in May. Visitor arrivals from China decreased by 42.7% and dropped by over 80% from America and Europe in April. The exports of services is projected to fall by 8.2% and 6.5% in the second and third quarters of 2003 respectively.
Hotel Room Occupancy Rate
(Percentage)

Jan-98
Mar-98
May-98
Jul-98
Sep-98
Nov-98
Jan-99
Mar-99
May-99
Jul-99
Sep-99
Nov-99
Jan-00
Mar-00
May-00
Jul-00
Sep-00
Nov-00
Jan-01
Mar-01
May-01
Jul-01
Sep-01
Nov-01
Jan-02
Mar-02
May-02
Jul-02
Sep-02
Nov-02
Jan-03
Mar-03
May-03
Investment

- Investment in Machinery and Equipment picked up and grew by 11.9% in the first quarter of 2003 on an annual basis. The growth was mainly due to the increase in private investment. For the coming quarters, the uncertain outlook will dampen investment spending. It is forecasted to contract by 3.5% and 1.4% in the second and the third quarter of 2003.

- Investment in land and construction dropped by 3.2% in the first quarter of 2003. The slowdown is expected to persist. It is forecasted to decline by 4.8% in the second quarter and by 6.4% in the third quarter of 2002 on a year-on-year basis.
**Consumer Prices**

- Sars has increased the deflationary pressure.
- Poor consumer sentiment and the sharp fall in the number of tourists visiting Hong Kong will put downward pressure on consumer prices.
- In May, the composite CPI declined by 2.5%, with prices of durable goods falling by 7.8% and clothing & footwear by 7.7%, thus offseting the 10.7% increase in the prices of electricity, gas and water.
- The deflation rate is forecasted to be 2.3% in the second quarter of 2002 and 2.8% in the second quarter of 2002.
**Employment**

- The provisional seasonally adjusted unemployment rate in March to May climbed to a high level of 8.3%.

- Although the median duration of unemployment decreased from 90 days in the fourth quarter of 2002 to 82 days in the first quarter of 2003, the unemployment situation is expected to worsen.

- The weak economy will not be able to create enough jobs to keep the unemployment rate from rising.

- The unemployment rate is forecasted to be 8.5% in the second quarter of 2003 and 8.8% in the third quarter of 2003.
Concluding Remark

- Sars has derailed the economic recovery in Hong Kong. Instead of continuing with the output growth of 4.5% in the first quarter, the economy is projected to start contracting in the second quarter due the severe negative shock to private spending in the domestic economy.

- When the Sars outbreak appeared to be under control in mid-May, the economy started to recover.

- The recovery has gathered momentum, after WHO took Hong Kong off the list of infected areas. But the bounce back will not be immediate.

- The economy is projected to continue to shrink in the current quarter.
Conditional on stable external environment and barring another outbreak, full recovery from the Sars epidemic can be expected by the end of this year.
About Our Model

Our forecasting system was developed in collaboration with Professor Lawrence Klein of the University of Pennsylvania, and is partially funded by the Better Hong Kong Foundation. Researchers at the APEC Study Center of The University of Hong Kong are solely responsible for the accuracy and interpretation of the forecasts. The Hong Kong Center for Economic Research provides administrative support for the project. Our quarterly forecasts can be accessed at http://www.hku.hk/apec/cqm/.