

High Frequency Macroeconomic Forecasts

Current Quarter Model

APEC Study Center
The University of Hong Kong

July 3, 2000

The pace of economic recovery has gathered momentum since the fourth quarter of last year. According to government estimates, real GDP soared by 14.3% in the first quarter of 2000. This strong growth of the economy is expected to continue. Based on the High Frequency Macroeconomic Forecasting Model of the APEC Study Center of The University of Hong Kong, (which is developed in collaboration with Professor Lawrence Klein of the Wharton School of the University of Pennsylvania), real GDP growth in the second quarter of 2000 is estimated to be 11.8% on a year-on-year basis, and is forecasted to grow at 11.0% in the third quarter.

The sources of growth can be shown by the following decomposition:

Source of GDP Growth	2000Q1	2000Q2	2000Q3
Private Consumption	5.2	5.7	5.7
Government Consumption	0.4	0.2	0.2
Net Trade in Goods	-4.6	-3.7	3.7
Net Trade in Services	4.6	3.6	2.7
Fixed Investment	1.7	2.3	0.7
Changes in inventories	7.0	3.7	-2.0
Total GDP Growth	14.3	11.8	11.0

The double-digit strong growth of real GDP in the second quarter was fueled by strong domestic demand, with private consumption and investment each accounting for half of the output growth. External trade played a negligible role in the growth of output in the second quarter as strong growth in the exports of goods and services was matched by high growth in imports. The growth in the second quarter was not export-led.

In the third quarter, consumption and exports are expected to remain strong, with some moderation in the growth of imports. Consequently, real GDP growth in the third quarter will be led by private consumption and external trade.

The forecast details are in Table 1 and Table 2, and the forecasts of selected monthly indicators are in Table 3.

The highlights of our current forecasts are as follows:

- Private consumption spending is expected to grow by 9.3% in the second quarter and the growth will be sustained in the third quarter at 10.1%. Retail sales in April 2000 registered a 13.7% growth on a year-on-year basis. Clothing, consumer durables and goods bought at supermarkets grew by 29.2%, 22.4% and 17.5% respectively.
- External trade activities continue to be vigorous. Re-export trade is estimated to grow by 18.4% in the second quarter and 14.9% in the third quarter. Re-exports to Japan, the United States and the Mainland of China, the top three re-export countries, grew by 25.9%, 19.8% and 19.8% respectively in the first quarter. In terms of end-use category, the re-exports of raw materials and semi-manufactures, capital goods and consumer goods grew by 25.4%, 23.7% and 18.4% respectively in the same period.
- Domestic export of goods also grew strongly after ending a 22-month contraction on last November. It is expected to grow at 11.5% and 12.4% in the second and third quarter respectively. Domestic exports to the Mainland of China and the United States grew by 16.7% and 17.0% respectively in the first quarter. Spectacular growth came from Singapore and Germany with domestic export growth rates of 67.2% and 34.6% respectively. Clothing continues to be our most important domestic export, and grew by 17.7% in the first quarter. Footwear, radios, metal manufactures and domestic electrical appliances grew by 135.8%, 100.0%, 57.0% and 55.3% respectively in the same period.
- As predicted, tourism continues to have good performance. The number of visitor arrivals grew by 20.5% on a year-on-year basis in April. Export of services as a result of strong tourism and external trade is estimated to grow by 15.4% in the second quarter and is forecasted to grow by 10.9% in the third quarter.
- In tandem with the strong export and consumption growth, the import of goods is estimated to grow by 19.0% and 12.3% in the second and third quarter respectively. Capital goods, raw materials and semi-manufactures

and consumer goods showed strong growth in the first quarter. Their rates were 29.7%, 26.5% and 19.0% respectively. The import of services is expected to grow by 2.0% in the second quarter and 1.2% in the third quarter.

- Investment spending in machinery and equipment, especially in the category of office equipment, has improved drastically and grew by 25.2% in the first quarter of 2000. This strong growth would continue. The growth rates are estimated to be 20.1% and 13.9% in the second and third quarter respectively.
- For the investment on land and construction, the rate of decline is estimated to be 7.6% at the end of second quarter and 10.9% at the end of third quarter.
- Deflation is expected to level off. The deflation rate, as measured by year-on-year percentage change in the Composite CPI, is estimated to be 4.5% in the second quarter and forecasted to be 3.2% in the third quarter. The deflation rate in May is 4.5%. The drop in prices is mainly concentrated in clothing and footwear, housing and durable goods. The rates of decline are 10.0%, 9.8% and 4.8% respectively. Due to the large weight of housing in the Composite CPI index (0.2883), housing alone accounts for 3.1 percentage points of the 4.5% deflation rate. Excluding housing, the deflation rate would only be 2% in May.
- The unemployment rate is projected to be lower at 5.1% and 4.7% in the second and third quarter. The Hong Kong labour force was 3.53 million in the fourth quarter of last year and has a small increase to 3.54 million in the first quarter of this year. During the same period, the number of employed persons increased from 3.31 million to 3.34 million. The increase in employment was faster than the increase in the labour force in this period, breaking the trend in the past two years during which the labour force grew faster than employment. At the same time, the median duration of unemployment dropped from 97 days in the fourth quarter of last year to 90 days in the first quarter of this year. Also, the number of newly unemployed was stable at around 35,000 in the first quarter. All these indicate that the employment situation is slowly improving.

We will make one quarter ahead forecasts based on our Current Quarter Model on a regular basis. Our forecasts for the fourth quarter of 2000 will be released in the first week of October 2000.