

High Frequency Macroeconomic Forecasts

Current Quarter Model: 2001Q1

APEC Study Center
The University of Hong Kong

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The real economy in Hong Kong as a whole has fully recovered. Real GDP is estimated to grow at the annual rate of 11% in 2000, according to the High Frequency Macroeconomic Forecast carried by the APEC Study Centre of The University of Hong Kong. The level of real output in 2000 is expected to surpass the historical high level attained in 1997 by more than 8%.

After three consecutive quarters of double-digit growth at 14.2%, 10.9% and 10.4% in the first, second and third quarter of last year, real GDP growth in the last quarter is predicted to be 8.8%. After the full recovery in 2000, the Hong Kong economy will revert to its normal growth path. Real GDP is forecasted to grow at 5.1% in the first quarter of this year.

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

Component	00Q1	00Q2	00Q3	00Q4
Private Consumption	5.3	3.1	3.1	3.8
Government Consumption	0.3	0.2	0.2	0.2
Merchandise Trade	-4.6	-3.1	-1.8	0.0
Service Trade	4.3	4.3	3.1	2.4
Investment in Land and Construction	-2.5	-1.7	-0.6	-0.2
Investment in Machinery and Equipment	4.0	3.2	4.2	4.4
Inventory Investment	7.3	4.9	2.2	-1.7
GDP	14.2	10.9	10.4	8.8

The major contribution to output growth in the third and fourth quarters of last year was investment in machinery and equipment which accounted for 4.2

percentage points of the 10.4% growth in the third quarter, and 4.4 percentage points of the forecasted growth of 8.8% in the fourth quarter. This pattern of high investment in machinery and equipment bodes well for the future growth, as such investment is known to raise labour productivity.

Another encouraging signal is provided by inventory investment. Inventories were built up in the first three quarters of last year, but are estimated to be run down in the fourth quarter, thus improving the cash flow of the business sector.

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

Forecast Highlights

The highlights of our current forecasts are:

- Private consumption spending grew by 5.6% in the third quarter. The growth continued to be moderate. The rate is forecasted to be 6.8% in the fourth quarter, and is expected to reduce to 3.2% in the first quarter of 2001. The weakening in consumption spending reflects the slowdown in economic growth.
- Consumption growth has been slower than income growth throughout last year, implying that the gross saving rate was increasing. This trend is expected to continue, but the gap between the two will narrow. Households continue to save to rebuild their financial portfolios. With continued growth in the economy, private consumption spending is expected to pick up later in 2001.
- The growth in retail sales remained sluggish. The volume of retail sales only grew by 2.9% in October 2000 compared to a year ago.
- The robust growth in external trade is expected to continue. Rather than concentrated in a few markets, re-export trade to all major markets had double-digit growth in the third quarter of last year – 21.3% for Mainland China and 14.5% for United States. This trend will continue for a while. Re-export is predicted to grow by 22.0% in the fourth quarter and by 17.7% in the first quarter of 2001. Domestic export of goods is expected to grow at a high rate of 9.9% in the fourth quarter and at a more moderate rate of 4.8% in first quarter of 2001.
- The number of visitor arrivals continued to have double-digit growth of 13.0% in October last year. As external trade is predicted to be vigorous,

export of services is expected to grow by 9.0% in the fourth quarter and by 6.6% in first quarter of 2001.

- In tandem with the growth in re-export and domestic spending, especially on investment goods, the import of goods is estimated to grow by 20.2% and 14.0% in the fourth quarter of 2000 and the first quarter of 2001 respectively.
- The strong growth of investment spending in machinery and equipment, beginning in the first quarter last year, is expected to continue. The rate is predicted at 30.0% in the fourth quarter. It is expected to grow by 17.7% in the first quarter of 2001.
- The recovery of the property market has been uneven last year, but the outlook is positive. Investment on land and construction has shrunk by 8.7% in 2000. The rate of decline has moderated in the fourth quarter and is expected to level off. The drop is estimated to be 2.0% and 2.6% in fourth quarter of 2000 and first quarter of 2001 respectively.
- We are in the process of climbing out of deflation. The drop in the price level has become smaller in recent months. Prices are basically stable except for the clothing and footwear, and housing sectors. In November, these two components of the Composite CPI drop by 4.5% and 6.0% respectively. But the drop in the housing component does not mean residential rents are falling. Compared with the levels in 1999, rents had been quite stable throughout last year. The drop in the CPI housing component is due to the lower rents of new leases, and thus basically reflect the large drop in rents in 1998. Excluding housing, the deflation rate would only be 0.2%, instead of the 2.7% in November. The deflation rate is estimated to be 2.2% in the fourth quarter of 2000. And it is forecasted to be 0.7% in the first quarter of 2001.
- The employment situation continues to improve, though slowly. The unemployment rate is projected to be at 4.6% in both the fourth quarter of 2000 and the first quarter of 2001. Unemployment is still concentrated in the construction sector with unemployment rate at 9.8%. Between the third quarter of 1999 and the third quarter of 2000, while the number of unemployed persons went down from 184,000 to 144,300, the number of vacancy increased from 25,000 to 35,000. During the same period, the labour force increased slightly from 3.34 million to 3.40 million; and the number of employed persons increased from 3.12 million to 3.23 million. The increase in employment was thus faster than the increase in the labour force in this period.

- Another positive sign on the employment front is the continued shortening of unemployment duration. For example, the number of workers unemployed for more than 6 months went from 52,400 in 00Q1 down to 34,400 in 00Q3. The number unemployed between 3 and 6 months dropped from 38,800 in 00Q1 to 24,500 in 00Q3. There is no evidence to support the worsening of long-term unemployment.
- The jury is still out on the issue of whether much of the unemployment is structural rather than cyclical in nature. However, given that unemployment is concentrated in the construction sector which has yet to be fully recovered, it is a good bet that much of the unemployment is really cyclical in nature. Provided that CSSA maintains its tight eligibility criteria for unemployment benefits, worrying about structural unemployment may be premature. The adaptability of our workers cannot be overstated.

Concluding Remarks

After the full recovery of the economy in 2000, with real GDP growing at an estimated rate of 11%, real output is expected to overtake its historical high level recorded in 1997 by more than 8%. However, much of the growth is due to deflation. Nominal GDP is expected to grow by only 3.6% last year. Consequently, output in nominal terms is still expected to be 4% off its historical high attained in 1997. Analyzed by components, the external sector has been the star performer. Export of goods and services continued to have high growth. The external sector was thus the engine of growth in 2000. In contrast, domestic final demand had been lacklustre. Although the investment in machinery and equipment grew substantially in 2000, it was still off by 6% compared to 1997. Investment in land and construction continued its slump in 2000 and was off by 28% compared to 1997. Consumption spending was down by 0.6% in 2000 compared to the 1997 level. The unemployment rate in 1997 was only 2% and was around 5% in 2000. After three years of recovery, the external sector has completely regained the lost ground, but there is still some catching up to do for the domestic sector.

Looking ahead, the external sector is expected to continue as the engine of growth in 2001. China's imminent accession to the WTO will generate more trade and investment which will on balance benefit Hong Kong's economy. The worry is the possible slowdown of the U.S. economy. This is the crucial factor to watch out for.

About Our Model

Our forecasting system was developed in collaboration with Professor Lawrence Klein of the Wharton School 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. Our quarterly forecasts can be accessed at **<http://www.hku.hk/apec/cqm/>**.

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Table 1: Current Quarter Model Forecast
(Million of 1990 Dollar)

	2000					2001
	Q1	Q2	Q3	Q4 (forecast)	Annual (forecast)	Q1 (forecast)
Gross Domestic Product	209270	213571	234801	240417	898059	220029
Private Consumption Expenditure	120880	121744	124888	130364	497876	124804
Government Consumption Expenditure	17459	15657	16170	16742	66028	17895
Domestic Exports of Goods	43191	46184	50498	51011	190884	45252
Re-exports of Goods	309157	350328	394432	414312	1468229	363987
Imports of Goods	370029	414015	454008	472312	1710364	421838
Exports of Services	59200	62236	69204	70906	261546	63079
Imports of Services	35277	34928	38470	35607	144282	36997
Investment in Land & Construction	26746	23929	25809	25950	102434	26040
Investment in Machinery & Equipment	32045	37637	41260	41913	152855	37723
Changes in Inventories	5898	4799	5018	-2863	12852	82

Date of Forecast: Dec 22, 2000

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Table 2: Current Quarter Model Forecast
Year-on-Year Growth Rate (%)

	2000					2001
	Q1	Q2	Q3	Q4 (forecast)	Annual (forecast)	Q1 (forecast)
Gross Domestic Product	14.2	10.9	10.4	8.8	10.9	5.1
Private Consumption Expenditure	8.7	5.1	5.6	6.8	6.5	3.2
Government Consumption Expenditure	3.7	2.7	2.5	2.5	2.8	2.5
Domestic Exports of Goods	16.2	8.3	8.2	9.9	10.4	4.8
Re-exports of Goods	21.4	19.1	19.0	22.0	20.4	17.7
Imports of Goods	22.9	18.8	18.4	20.2	19.9	14.0
Exports of Services	15.3	18.3	12.6	9.0	13.5	6.6
Imports of Services	-0.2	3.8	3.2	1.3	2.0	4.9
Investment in Land & Construction	-14.9	-12.0	-4.6	-2.0	-8.7	-2.6
Investment in Machinery & Equipment	29.8	19.5	27.8	30.0	26.6	17.7
GDP Deflator Growth Rate	-6.9	-7.5	-6.7	-5.7	-6.7	-1.7
CPI (Composite) Inflation Rate	-5.1	-4.5	-2.8	-2.2	-3.6	-0.7
Unemployment Rate	5.6	5.0	4.8	4.6	5.0	4.6

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Table 3: Selected Monthly Indicators
Year-on-Year Growth Rate (%)

	2000									2001		
	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	JAN	FEB	MAR
Unit Value Trade Index (Domestic Exports)	-1.3	-1.9	-0.9	-0.5	0.2	-0.1	-0.2	0.0	-0.3	0.1	0.0	0.5
Unit Value Trade Index (Imports of Foodstuffs)	-6.4	-4.9	-4.9	-4.4	-2.9	-2.6	-2.3	-1.9	-1.7	-0.2	0.0	0.7
Unit Value Trade Index (Imports of Consumer Goods)	-1.7	-1.9	-1.4	-1.9	-1.6	-1.4	-1.1	-0.5	-0.8	1.2	0.5	1.9
Unit Value Trade Index (Imports of Raw Materials & Semi-Manufactures)	2.0	2.1	2.4	2.6	2.4	2.8	2.2	1.8	1.2	1.7	1.9	1.7
Unit Value Trade Index (Imports of Capital Goods)	72.0	61.8	72.1	82.4	61.3	62.6	62.2	61.5	58.6	58.7	51.5	38.4
Real Retained Imports of Foodstuffs	7.9	28.6	43.7	-10.1	4.1	8.1	3.1	11.7	0.5	6.3	2.6	2.6
Real Retained Imports of Consumer Goods	32.1	70.8	1.6	20.5	46.0	30.7	-30.9	22.2	-10.2	-32.7	-6.0	-19.5
Real Retained Imports of Raw Materials & Semi-Manufactures	17.0	25.6	9.9	16.9	22.2	19.7	25.9	21.1	23.2	23.2	23.2	23.2
Real Retained Imports of Fuel	-21.7	-10.0	-49.9	-48.9	-7.2	-20.6	-21.2	13.4	-10.6	-4.2	-3.7	28.6
Real Retained Imports of Capital Goods	16.0	70.8	7.6	15.2	65.5	28.5	67.4	53.5	32.6	33.4	34.9	8.7
Total Motor Vehicles Newly Registered	10.0	31.0	22.1	23.1	19.4	-0.7	9.6	0.9	7.1	-5.5	13.5	-11.8
Private Cars Newly Registered	4.4	35.2	17.8	23.9	11.0	-12.4	0.7	-2.7	3.6	-1.1	27.3	-13.4
Money Supply (Definition 2)	6.9	7.3	9.9	8.3	10.8	8.7	8.6	8.8	8.7	10.9	12.4	13.2
Loans and Advances	-12.2	-11.2	-10.4	-11.7	-8.5	-10.8	-10.8	-10.5	-10.9	-8.8	-8.3	-8.2
Electricity Consumption	-8.2	14.7	9.7	5.5	2.9	10.0	9.0	11.2	6.5	9.4	4.7	5.6
Gas Consumption	5.3	4.4	5.5	3.6	5.3	5.5	6.0	5.1	4.7	3.0	2.8	2.4
Visitors Arrivals	20.5	18.1	16.3	13.4	15.8	22.5	13.0	12.0	19.8	13.6	12.1	13.4
Hong Kong Resident Departures	16.2	12.7	9.8	11.9	15.1	18.0	6.0	12.3	14.5	29.7	-1.8	12.2
Land Considerations	-14.7	-31.4	-31.4	-17.7	18.7	13.1	-17.2	-5.7	12.6	-14.5	-1.1	3.4
Effective Exchange Rate Index	-1.5	-0.5	-1.3	-0.9	0.7	1.9	3.2	3.4	3.8	3.9	2.9	2.9
Hang Seng Index of Shares Prices	28.5	14.8	21.0	26.2	31.1	21.9	18.4	4.4	-7.1	-4.2	-9.7	-13.8

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