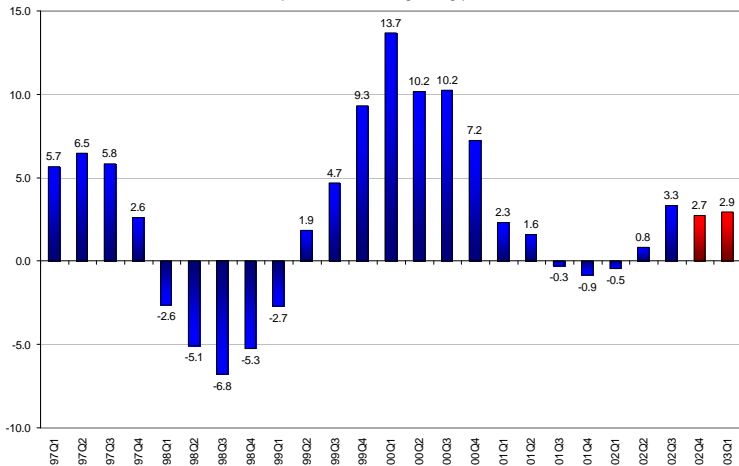


High-Frequency Macro Forecasts: First Quarter 2003

January 13, 2003

<http://www.hku.hk/apec/cqm/03Q1/>

Real Gross Domestic Product (Year-on-Year Percentage Change)



Still Slowly on the Mend

- The HK economy contracted by three consecutive quarters from the third quarter of 2001 to the first quarter of 2002 and started to grow by 0.8% and 3.3%, on a year-on-year basis, in the second and third quarter, respectively.
- Led by strong growth in external trade and massive inflow of visitors from the Mainland, the recovery continued into the fourth quarter, and is expected to maintain its course in the first quarter of this year.
- Real GDP is forecasted to increase by 2.7% in the fourth quarter of 2002 and 2.9% in the first quarter of 2003.
- For the whole of last year, real GDP is estimated to grow by 1.7%, while the implicit GDP deflator fell by 2.7%, implying that nominal GDP fell by 1% last year.

Consumption Spending

- Given the strong export performance, coupled with the abnormally low consumption level in the last quarter of 2001, consumption spending is projected to grow by 1% on an annual basis in the fourth quarter of 2002.
- In the first quarter of 2003, the consumption growth rate is forecasted to be lower at 0.6%.

External Trade

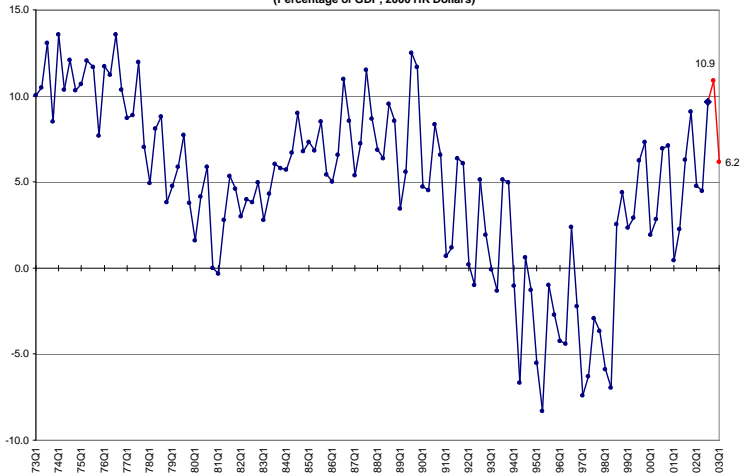
- Followed by the by 7.6% fall in the third quarter of 2002, domestic exports are forecasted to shrink by 10.4% in 2002Q4 and 10.9% in 2003Q1 on a year-on-year basis.
- Re-exports surged by an annual rate of 13.6% in the third quarter of 2002, and the growth accelerated in the last quarter of 2002. Re-exports is estimated to grow by 20% in real terms in the fourth quarter of 2002, and is forecasted to grow more slowly at 15% in the first quarter of 2003.

- The number of visitor arrivals maintained high growth throughout last year, with double-digit growth in each month except June, and is expected to top 16.5 million for the year as a whole. The number of visitors from the Mainland jumped by an annual rate of 71.8% in November 2002, accounting for 44.4% of the total number of visitors.
- Coupled with the strong growth of exports of goods, exports of service is forecasted to grow by 13.1% in the fourth quarter of 2002 and 5.8% in the first quarter of 2003.

- Imports of goods increased by 10.8% in the third quarter mainly to support the growth in re-exports, but was also buoyed on by the 5.2% increase in retained imports destined for the local domestic market.
- The import of goods is projected to increase by 17.2% in the fourth quarter of 2002 and 11.6% in the first quarter of 2003.
- In the third quarter of 2002, service imports reverted to a positive growth of 1.0% after falling for 4 consecutive quarters, mainly due to a pick-up in outbound tourism. Resident departures increased by 5.6% in November. Service imports are estimated to maintain modest growth of 3.6% in the fourth quarter of 2002 and 2.5% in the third quarter of 2003.

- The trade balance, as measured by the net exports of goods and services, was 9.6% of GDP in the third quarter of 2002. Due to strong growth in the exports of goods and services, the trade balance is forecasted to rise further to 10.9% of GDP in the fourth quarter of 2002, and moderate to 6.2% in the first quarter of 2003.

External Trade Balance of Goods and Services
(Percentage of GDP, 2000 HK Dollars)



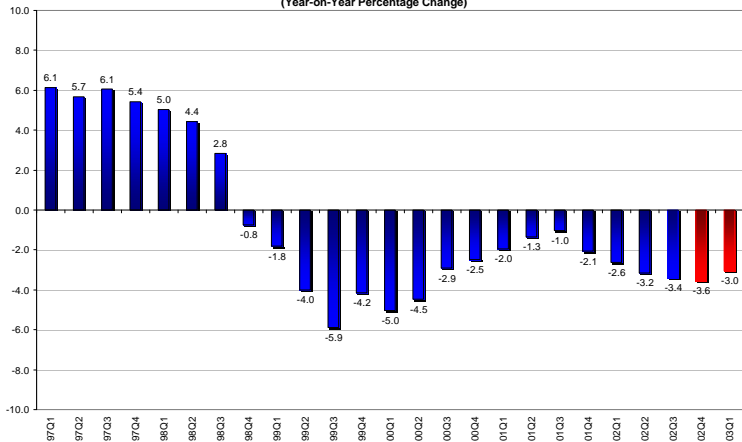
Investment

- Investment spending on equipment and software is projected to fall by 4.9% in the fourth quarter of 2002, but to increase by 3.0% in the first quarter of 2003.
- Investment in land and construction registered a sharp turnaround in the second quarter of 2002 by growing at an annual rate of 7.2%. The growth continued into the third quarter at a rate of 5.9%.
- Land and construction related investment is predicted to grow by 3.8% in 2002Q4 and 3.3% in 2003Q1 on a year-on-year basis.

Consumer Prices

- The consumer price level fell for a consecutive 49 months, with the the composite CPI declining by 3.6% year-on-year in November 2002.
- Deflation is expected to continue. The composite CPI is forecasted to fall by 3.6% in 2002Q4 and 3.1% in 2003Q1.
- Note that around 1 percentage point of the measured deflation rate is due to administrative measures. Stripped away these one-off measures, the core deflationary rate would be lower to be around 2.5%.

Composite Consumer Price Index (Year-on-Year Percentage Change)

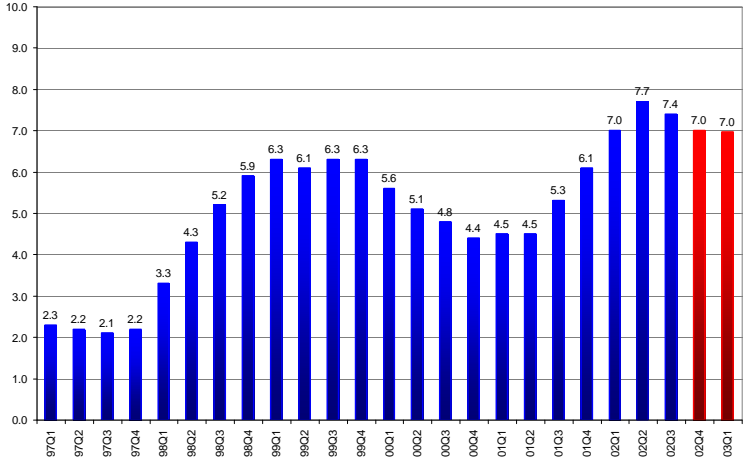


Employment

- The economic recovery is reflected by steady improvement in the labour market since August 2002.
- The unemployment rate fell to 7.1% in September-November, 2002 from the high level of 7.8% in May-July, 2002.
- The number of jobs also started to grow.
- In September-November 2002, 3.27 million people were employed which is a historical high level, an increase of 1.3% compared with the same period in the previous year.
- The median duration of unemployment was also shortened from 89 days in 2002Q2 to 82 days in 2002Q3.

- The improvement in the employment situation is expected to continue though at a slow pace.
- The unemployment rate is forecasted to be static at 7.0% in both the fourth quarter of 2002 and the first quarter of 2003.

Unemployment Rate (Seasonally Adjusted)



Concluding Remark

- The economic recovery in Hong Kong since the second quarter of 2002 has been led by strong growth in the external trade sector, as well as the huge number of visitors from the Mainland.
- Even though output was growing, the economy was still not out of the wood because prices kept on falling.
- Deflation expectation weakens private domestic spending, and is now so entrenched that it would tend to feed on itself. Shifting expectations are of crucial importance.

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/>.