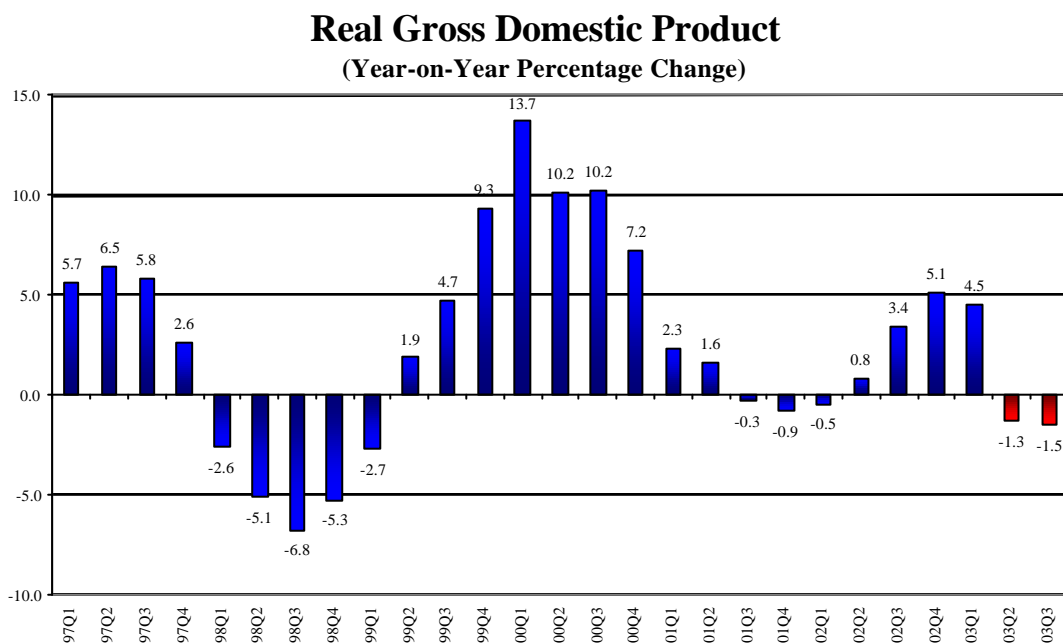


High Frequency Macroeconomic Forecasts Current Quarter Model: 2003Q3

APEC Study Center
The University of Hong Kong

July 10, 2003

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. According to the High Frequency Macroeconomic Forecast carried by the APEC Study Center of The University of Hong Kong, 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 1.5% year-on-year.

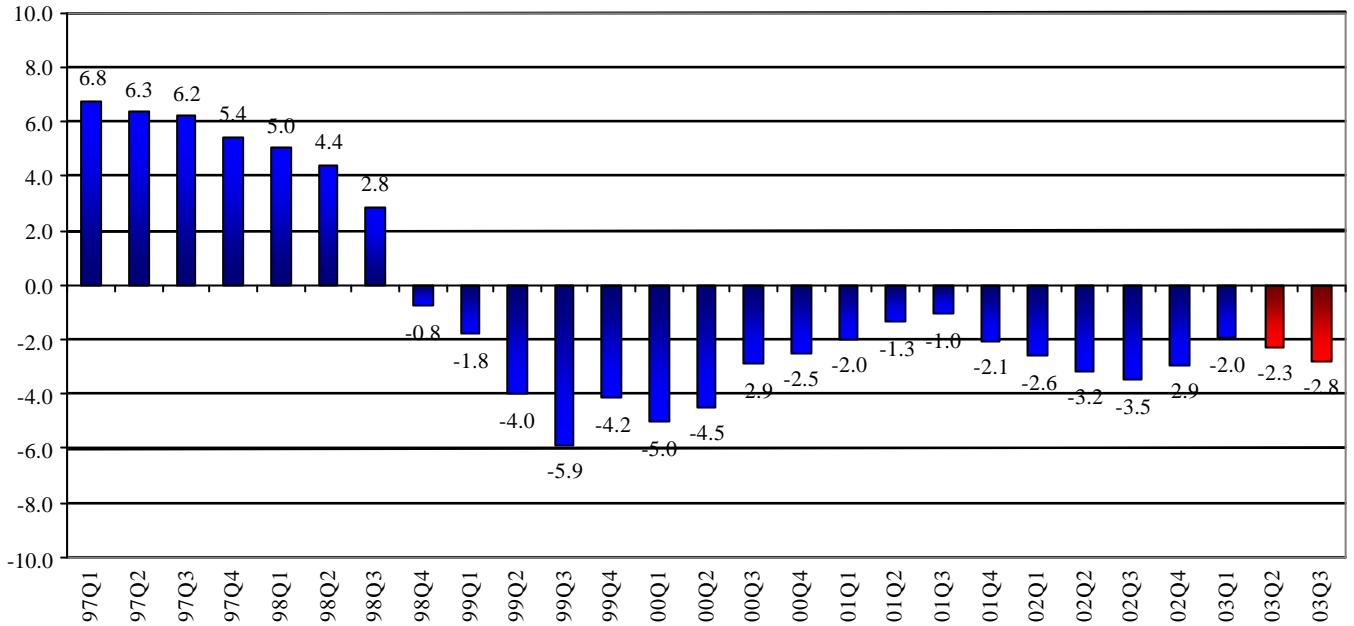
The forecast details are in Table 1 and Table 2, and the forecasts of selected monthly indicators are in Table 3.

Forecast Highlights

The highlights of our current forecasts are:

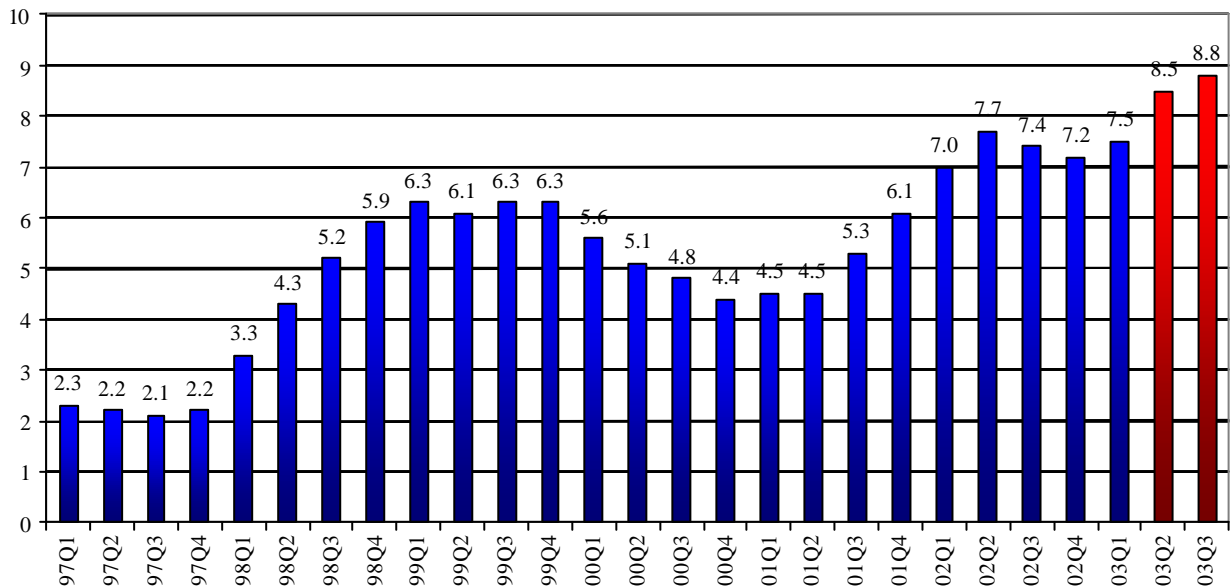
- High unemployment and uncertain outlook further dampened domestic demand. Private consumption spending dropped by 2.1% in the first quarter of 2003, and is expected to fall further by 2.9% in the second quarter and 2.7% in the third quarter of 2003, on a year-on-year basis.
- In April, the volume of 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 2003 at annual rate.
- 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 second quarter and the third quarter, respectively. The slowdown in growth in the second quarter is mainly due to the higher base of comparison, but it also reflects weaker external demand, particularly in Europe.
- 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 the Americas 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 on an annual basis.
- 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 on a year-on-year basis.
- 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 compared to an year ago.
- 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 2003 on a year-on-year basis.

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



- Sars has increased the deflationary pressure. 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 offsetting 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.

Unemployment Rate (Seasonally adjusted)



- 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 Remarks

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. As Hong Kong has been taken off from the WHO list of infected areas, the recovery will gather momentum. 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 a repeated SARS outbreak, full recovery 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/>.

High Frequency Macroeconomic Forecasts

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Table 1: Current Quarter Model Forecast
(Million of 2000 Dollar)

	2002					2003		
	Q1	Q2	Q3	Q4	Annual	Q1	Q2 (forecast)	Q3 (forecast)
Gross Domestic Product	309,548	317,857	342,983	353,262	1,323,650	323,544	313,747	337,840
Private Consumption Expenditure	186,032	187,462	185,745	187,072	746,311	182,084	182,117	180,755
Government Consumption Expenditure	33,884	31,130	33,087	32,378	130,479	34,266	32,375	34,410
Domestic Exports of Goods	32,346	35,925	40,524	35,581	144,376	28,470	30,881	34,318
Re-exports of Goods	310,846	358,972	419,633	418,118	1,507,569	380,121	414,402	462,177
Imports of Goods	364,074	422,910	476,286	469,200	1,732,470	432,701	463,425	500,913
Exports of Services	83,179	87,418	100,724	107,878	379,199	93,328	80,259	94,135
Imports of Services	49,093	46,097	51,927	48,766	195,883	47,126	42,960	47,986
Investment in Land & Construction	41,844	41,914	42,714	40,724	167,196	40,518	39,886	39,980
Investment in Machinery & Equipment	37,421	42,795	47,286	46,491	173,993	41,863	41,291	46,633
Changes in Inventories	-2,837	1,248	1,483	2,986	2,880	2,721	-1,081	-5,671

Date of Forecast: June 30, 2003

High Frequency Macroeconomic Forecasts

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

	2002					2003		
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3
						(forecast)	(forecast)	(forecast)
Gross Domestic Product	-0.6	0.8	3.4	5.1	2.2	4.5	-1.3	-1.5
Private Consumption Expenditure	-0.1	-2.2	-1.2	-1.8	-1.3	-2.1	-2.9	-2.7
Government Consumption Expenditure	2.3	3.0	3.5	0.8	2.5	1.1	4.0	4.0
Domestic Exports of Goods	-11.1	-13.6	-7.5	-12.9	-11.2	-12.0	-14.0	-15.3
Re-exports of Goods	-1.4	8.4	13.7	22.2	11.0	22.3	15.4	10.1
Imports of Goods	-4.0	6.0	10.8	18.2	7.9	18.8	9.6	5.2
Exports of Services	6.0	7.7	13.9	18.1	12.0	12.2	-8.2	-6.5
Imports of Services	-0.7	-3.8	2.0	3.4	0.7	-4.0	-6.8	-7.6
Investment in Land & Construction	-3.1	7.4	6.1	-4.8	1.3	-3.2	-4.8	-6.4
Investment in Machinery & Equipment	-19.8	-6.7	-12.2	3.2	-8.6	11.9	-3.5	-1.4
GDP Deflator Growth Rate	-2.3	-2.2	-3.1	-4.1	-3.1	-4.7	-4.0	-2.2
CPI (Composite) Inflation Rate	-2.6	-3.2	-3.5	-2.9	-3.0	-2.0	-2.3	-2.8
Unemployment Rate	7.0	7.7	7.4	7.2	7.3	7.5	8.5	8.8

Date of Forecast: June 30, 2003

High Frequency Macroeconomic Forecasts

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

	2002			2003								
	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP
Unit Value Trade Index (Domestic Exports)	-2.3	-0.9	-0.4	0.4	0.3	1.6	0.8	0.7	0.5	0.6	0.8	0.7
Unit Value Trade Index (Imports of Foodstuffs)	-4.7	-4.0	-3.7	-2.7	-2.9	-3.6	-2.2	-1.7	-2.1	-2.4	-1.4	-1.2
Unit Value Trade Index (Imports of Consumer Goods)	-3.1	-3.1	-2.8	-1.7	-0.2	1.0	1.4	1.8	1.4	1.5	1.5	1.6
Unit Value Trade Index (Imports of Raw Materials & Semi-Manufactures)	-2.2	-1.6	-1.0	-0.1	0.2	1.5	1.3	1.2	1.5	1.6	2.1	1.9
Unit Value Trade Index (Imports of Fuels)	15.3	17.4	47.5	37.5	43.4	33.5	12.2	13.1	16.4	16.6	15.0	4.8
Unit Value Trade Index (Imports of Capital Goods)	-4.2	-3.8	-2.9	-2.4	-2.2	-3.5	-3.7	-3.5	-3.5	-3.3	-3.5	-3.4
Real Retained Imports of Foodstuffs	-2.1	22.7	26.1	-14.0	1.3	10.0	-5.2	4.3	6.3	6.6	2.6	8.2
Real Retained Imports of Consumer Goods	18.3	-0.2	5.0	76.4	16.4	-11.1	-0.7	1.4	5.9	-10.7	-12.1	-9.5
Real Retained Imports of Raw Materials & Semi-Manufactures	6.6	21.7	24.8	72.0	26.9	23.6	10.9	6.2	3.2	-0.2	0.5	0.3
Real Retained Imports of Fuels	14.8	5.7	5.6	7.9	34.0	2.3	-17.8	18.3	2.1	22.4	0.6	19.7
Real Retained Imports of Capital Goods	17.6	-9.1	-13.8	94.5	23.6	-5.8	-24.7	11.2	-5.7	-2.7	5.1	2.6
Total Motor Vehicles Newly Registered	-29.0	-28.4	-15.9	-8.8	-20.2	-34.9	-51.2	-36.5	-30.6	-32.5	-41.6	-30.4
Private Cars Newly Registered	-16.6	-19.7	-3.2	-6.4	-21.9	-31.0	-51.6	-39.9	-34.3	-33.1	-41.2	-33.9
Volume Index of Retail Sales	-1.1	-1.4	-0.7	11.8	-11.2	-3.7	-12.2	-8.2	-7.5	-6.9	-7.3	-6.1
Money Supply (Definition 2)	-1.8	-0.3	0.5	0.3	2.1	1.9	1.8	2.0	2.8	5.2	6.3	7.5
Loans and Advances	-6.0	-6.0	-5.0	-4.8	-4.2	-4.5	-5.0	-5.0	-5.5	-5.2	-4.8	-4.4
Electricity Consumption	-1.9	-2.2	6.0	-0.2	6.0	5.0	-9.5	-2.2	2.2	-0.4	2.9	4.9
Gas Consumption	0.3	0.0	2.9	2.0	2.3	6.4	-1.1	-2.5	1.3	2.3	0.9	1.6
Visitors Arrivals	37.2	37.5	27.8	31.0	26.2	3.3	-64.8	-67.9	-61.6	-60.1	-57.7	-56.2
Hong Kong Resident Departures	8.7	5.1	0.0	10.7	-5.3	-14.1	-29.2	-23.8	-26.3	-26.6	-25.6	-22.8
Land Considerations	14.5	-29.2	-5.4	-33.4	-13.3	-15.6	-31.7	-32.5	-32.7	-28.4	-9.5	-22.5
Effective Exchange Rate Index	-1.2	-2.1	-2.6	-4.1	-4.3	-3.9	-3.6	-3.8	-2.4	-1.3	-1.7	-2.0

Date of Forecast: June 30, 2003