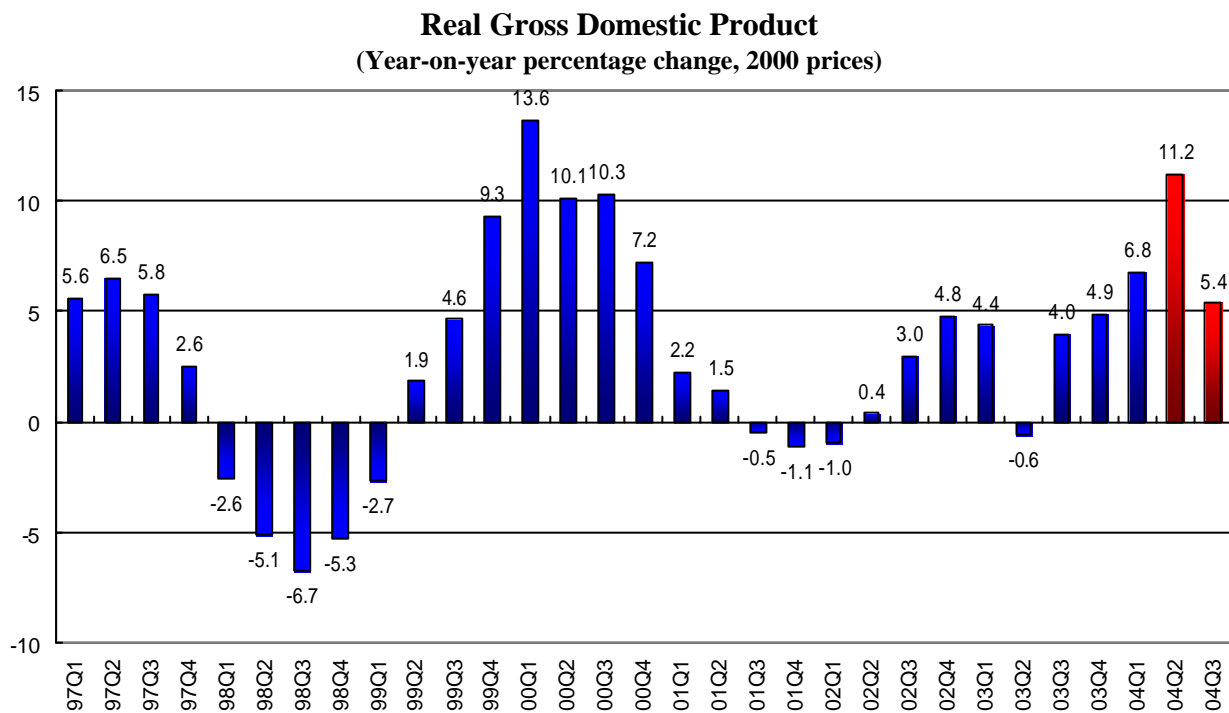


# High Frequency Macroeconomic Forecasts Current Quarter Model: 2004Q3

APEC Study Center  
The University of Hong Kong

July 8, 2004

## Sustained Economic Growth



Hong Kong's broadly based economic recovery, starting from the third quarter of last year, is expected to be sustainable. Despite higher oil prices and the recent quarter of a percentage point increase in the US federal funds rate, the global economy will continue to grow at a robust pace, thus providing continued support for Hong Kong's external demand. In particular, the Mainland economy has remained vibrant, with the moderation in investment growth offset by strong consumption spending. Hong Kong's private domestic demand has rebounded sharply from the SARS impact, and is expected to hold up given the positive economic outlook.

According to the High Frequency Macroeconomic Forecast conducted by the APEC Study Center of The University of Hong Kong, real GDP growth in the second quarter is forecast to be at double-digit, with output growing by 11.2% when compared with the low base in the second quarter of last year. This growth estimate is an upward revision of the 9.2% forecast released on April 7, 2004. In the third quarter, economic growth will continue, with real GDP projected to grow by 5.4% on a year-on-year basis. For the first half of this year, real GDP is forecast by grow by 8.9% when compared with the same period last year. The economy is estimated to grow by 7.7% in the first three quarters, and by 6.5% to 7.5% for the year as a whole.

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

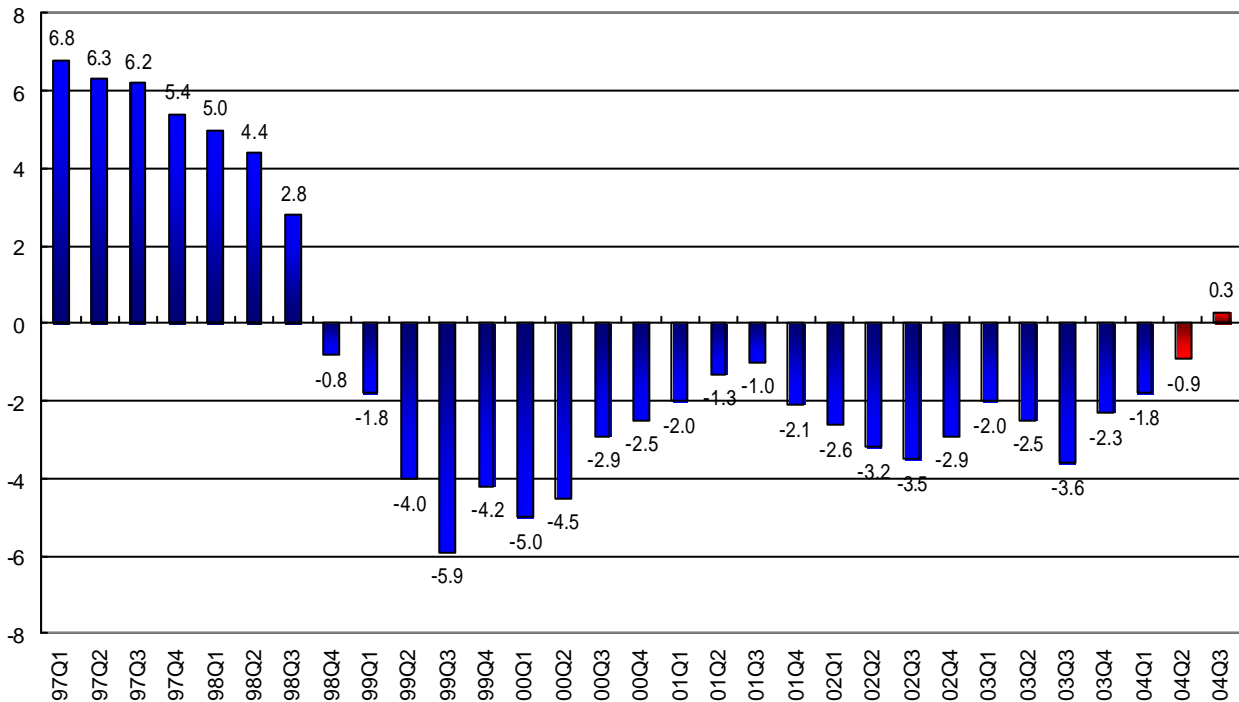
## Forecast Highlights

The highlights of our current forecasts are:

- Private consumption spending rose by 5.0% in the first quarter of 2004. Boosted by better consumer sentiment and the lower base of comparison due to the SARS epidemic last year, it is projected to grow by 7.3% in the second quarter and by 5.2% in the third quarter of 2004, both on a year-on-year basis.
- Comparing with the lower base last year, the volume of retail sales grew rapidly by 20.0% year-on-year in April 2004, rising for the ninth consecutive month. Buoyed by improving domestic demand and the influx of Mainland visitors, the volume of retail sales is forecast to grow in the second and third quarters of 2004 by 17.2% and 11.5% respectively, both on a year-on-year basis.
- Domestic exports registered an increase of 0.8% in the first quarter of 2004. It is estimated to expand by 5.1% in the second quarter of 2004 but revert back to a decrease of 5.4% in the third quarter of 2004, on a year-on-year basis. Although domestic exports is expected to fall in the second half of this year, the rate of decline will be significantly less than the ones experienced in previous years.
- Re-exports exhibited a strong growth of 16.1% in the first quarter of 2004 along with the improving global economy. The growth in re-exports is projected to be 17.5% in the second quarter of 2004, but moderate to 8.8% in the third quarter of 2004, both on a year-on-year basis.
- Given the rapid growth in the number of visitors from the Mainland, exports of services registered a double-digit growth of 13.7% in the first quarter of 2004. Comparing with the same period last year, the total number of visitor arrivals surged by 28.6% and 251.8%, with hotel occupancy rate kept at 94% and 86%, in March and April 2004 respectively. The export of services is estimated to grow sharply by 41.3% in the second quarter of 2004 due to the lower base of comparison. The growth momentum of visitor arrivals is expected to be maintained in the second half of this year, with the export of services expected to rise by 14.7% in the third quarter of 2004.
- Imports of goods expanded further by 16.3% in the first quarter of 2004. Retained imports pick up noticeably by 16.9% in the same period reflecting the economic revival from the SARS impact last year. In tandem with the strong demand of re-exports, the growth in the imports of goods is projected to be 18.6% in the second quarter. The growth is expected to moderate to 10.3% in the third quarter of 2004.
- Imports of services went up by 4.0% in the first quarter of 2004. The number of resident departures grew by 9.5% and 69.9% in March and April 2004 respectively. The growth is expected to continue in the summer months. Service imports is projected to pick up further by 27.6% in the second quarter of 2004 due to the lower base of comparison. The growth will be 7.2% in the third quarter 2004.

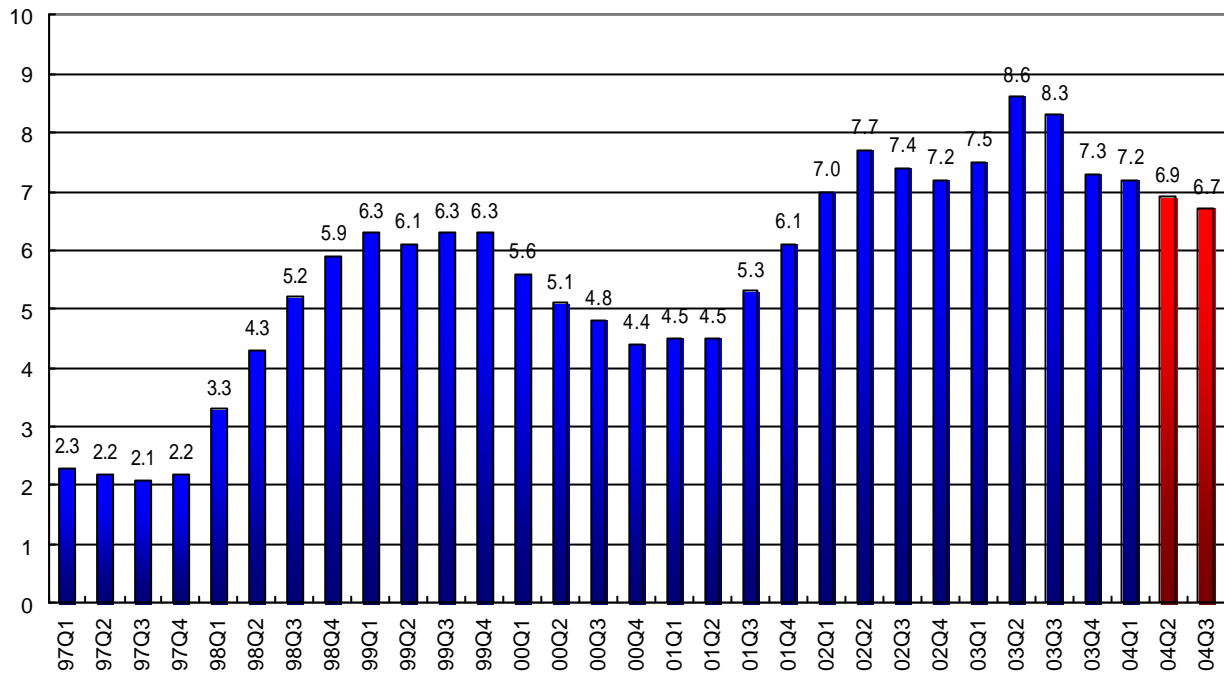
- The trade balance, as measured by the net exports of goods and services, is 5.0% of GDP in the first quarter of 2004. The net trade balance is estimated to be 6.7% of GDP in the second quarter of 2004 and to rise to 10.3% of GDP in the third quarter of 2004.
- Investment in land and construction declined by 5.2% in the first quarter of 2004. The fall is projected to moderate, with the investment in land and construction forecasted to drop by 0.5% in the second quarter and to turn to an increase of 1.5% in the third quarter of 2004.
- Investment spending in machinery, equipment and computer software rose by 15.9% in the first quarter of 2004. It is estimated to expand further by 16.3% in the second quarter of 2004 but moderate to 4.8% in the third quarter of 2004 on a year-on-year basis. The double-digit growth in the first half is mainly due to the lower base of comparison.

**Composite Consumer Price Index**  
(Year-on-year percentage change)



- Deflation, as measured by the year-on-year percentage change of the Composite Consumer Price Index, has become less of a problem. Rising import prices, coupled with improving domestic demand, have arrested the downward pressure on consumer prices. In May 2004, most components of the CPI were more expensive when compared with the same period last year, with housing and durable goods being the exception, but the fall in these two components decelerated to 6.8% and 1.4% respectively. The CPI is estimated to drop by 0.9% in the second quarter of 2004 and to rise by 0.3% in the third quarter of 2004.

## Unemployment Rate (Seasonally adjusted)



- The provisional seasonally adjusted unemployment rate dropped by a modest 0.1 percentage point from 7.1% in the three months ending April 2004 to 7.0% in the three months ending May 2004. The median duration of unemployment decreased from 109 days in the fourth quarter of 2003 to 103 days in the first quarter of 2004. The unemployment level is expected to fall slowly, with the unemployment rate forecasted to be 6.9% in the second quarter of 2004 and 6.7% in the third quarter of 2004.

### Concluding Remarks

The positive economic outlook is clouded by uncertainties. Global economic recovery could be side-tracked if oil prices shot up for a prolonged period in the next 6 months. Interest rates are also expected to increase further in the U.S. which would dampen its economic growth next year. On the domestic front, the sluggish adjustment in the labour market is a cause for concern. Despite four consecutive quarters of robust economic growth, the unemployment rate is still way above its natural rate. It appears that another year of sustained economic growth is required to bring the jobless number down to its equilibrium level.

## **About Hong Kong Macroeconomic Forecast Project**

The Hong Kong Macroeconomic Forecast is based on research conducted by the APEC Study Centre of the HKU's Faculty of Business and Economics. It aims to provide the community with timely information useful for tracking the short-term fluctuations of the economy. The current quarter macro forecasts have been released on a quarterly basis since 1999.

The high frequency forecasting system was originally developed in collaboration with Professor Lawrence Klein of the University of Pennsylvania in 1999-2000. Since then, the system has been maintained and further refined by the HKU APEC Study Centre.

The project is sponsored by the HKU Foundation for Educational Development and Research. The Steering Committee is chaired by Dr Chow Yei-Ching, Chairman & Managing Director of Chevalier International Holdings Ltd, with Mr Michael Leung, Executive Chairman of Onwel Group, as Deputy Chairman. Both Dr Chow and Mr Leung are members of the Board of Directors of the HKU Foundation.

The Hong Kong Centre for Economic Research at HKU provides administrative support to the project. Researchers at the APEC Study Center are solely responsible for the accuracy and interpretation of the forecasts. Our quarterly forecasts can be accessed at <http://www.hku.hk/apec/cqm/>

**High Frequency Macroeconomic Forecasts**  
**APEC Study Center**  
**The University of Hong Kong**

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

	2003					2004		
	Q1	Q2	Q3	Q4	Annual	Q1	Q2 (forecast)	Q3 (forecast)
Gross Domestic Product	321,955	314,636	355,174	369,271	1,361,036	343,729	349,794	374,196
Private Consumption Expenditure	185,872	185,525	192,930	199,837	764,164	195,250	199,018	203,014
Government Consumption Expenditure	34,229	31,325	33,292	34,210	133,056	35,980	31,795	33,791
Domestic Exports of Goods	28,470	31,416	38,419	35,505	133,810	28,685	33,033	36,347
Re-exports of Goods	380,121	419,908	467,819	485,101	1,752,949	441,279	493,333	509,219
Imports of Goods	432,701	468,962	515,205	542,735	1,959,603	503,287	556,302	568,318
Exports of Services	88,420	73,357	103,322	113,399	378,498	100,556	103,680	118,521
Imports of Services	48,126	39,430	53,547	52,383	193,486	50,062	50,305	57,389
Investment in Land & Construction	39,454	36,984	39,006	37,169	152,613	37,410	36,804	39,594
Investment in Machinery & Equip.	42,721	42,554	50,886	52,068	188,229	49,525	49,498	53,313
Changes in Inventories	3,495	1,959	-1,748	7,100	10,806	8,393	9,240	6,104

Date of Forecast: June 28, 2004.

**High Frequency Macroeconomic Forecasts**  
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Table 2: Current Quarter Model Forecast  
Year-on-Year Growth Rate (%)

	2003					2004		
	Q1	Q2	Q3	Q4	Annual	Q1	Q2 (forecast)	Q3 (forecast)
Gross Domestic Product	4.4	-0.6	4.0	4.9	3.2	6.8	11.2	5.4
Private Consumption Expenditure	-2.5	-3.6	1.5	3.6	-0.2	5.0	7.3	5.2
Government Consumption Expenditure	1.0	0.5	0.5	5.5	1.9	5.1	1.5	1.5
Domestic Exports of Goods	-12.0	-12.6	-5.2	-0.2	-7.3	0.8	5.1	-5.4
Re-exports of Goods	22.3	17.0	11.5	16.0	16.3	16.1	17.5	8.8
Imports of Goods	18.8	10.9	8.2	15.7	13.1	16.3	18.6	10.3
Exports of Services	12.6	-10.8	7.6	12.0	5.7	13.7	41.3	14.7
Imports of Services	-5.4	-16.8	-0.3	3.1	-4.6	4.0	27.6	7.2
Investment in Land & Construction	-3.8	-9.8	-6.5	-6.9	-6.7	-5.2	-0.5	1.5
Investment in Machinery, Equip.	12.8	-1.1	5.6	9.3	6.5	15.9	16.3	4.8
GDP Deflator Growth Rate	-4.4	-5.8	-6.1	-4.8	-5.4	-4.3	-3.3	-2.5
CPI (Composite) Inflation Rate	-2.0	-2.5	-3.6	-2.3	-2.6	-1.8	-0.9	0.3
Unemployment Rate	7.5	8.6	8.3	7.3	7.9	7.2	6.9	6.7
Date of Forecast: June 28, 2004.								

# High Frequency Macroeconomic Forecasts

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

	2003			2004								
	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP
Unit Value Trade Index (Domestic Exports)	-0.3	-1.4	-0.8	-0.8	-0.2	-0.8	0.3	0.6	0.5	0.7	0.8	1.4
Unit Value Trade Index (Imports of Foodstuffs)	1.1	2.3	3.7	3.6	3.7	4.4	3.5	3.4	2.7	2.5	2.3	2.2
Unit Value Trade Index (Imports of Consumer Goods)	0.4	0.9	1.3	0.6	0.6	0.1	-0.1	0.2	-0.1	-0.4	0.0	0.0
Unit Value Trade Index (Imports of Raw Materials & Semi-Manufactures)	0.9	2.0	2.8	3.0	3.6	3.8	4.7	5.4	6.3	6.6	6.4	6.4
Unit Value Trade Index (Imports of Fuels)	1.8	10.5	5.6	9.6	2.5	3.2	14.2	24.6	25.9	24.1	20.4	22.1
Unit Value Trade Index (Imports of Capital Goods)	-5.2	-4.9	-5.2	-4.8	-3.5	-2.2	-1.5	-1.9	-0.5	0.7	1.5	1.5
Real Retained Imports of Foodstuffs	10.1	20.4	11.3	3.4	6.9	7.7	13.4	23.9	20.7	21.9	8.6	13.9
Real Retained Imports of Consumer Goods	6.4	-8.0	9.9	-58.4	78.6	3.9	20.1	18.4	17.8	5.6	4.1	5.5
Real Retained Imports of Raw Materials & Semi-Manufactures	16.1	20.3	7.8	35.5	25.5	11.7	23.1	37.3	14.8	34.5	31.3	91.2
Real Retained Imports of Fuels	-10.5	13.0	-1.1	23.6	-15.3	24.9	47.9	20.5	45.1	44.9	24.1	14.3
Real Retained Imports of Capital Goods	-24.8	11.7	16.8	2.4	42.7	15.4	39.2	16.9	27.8	24.3	24.4	11.9
Total Motor Vehicles Newly Registered	-16.9	-21.2	-3.3	-28.5	-17.5	53.8	32.6	38.0	25.5	26.8	27.9	18.3
Private Cars Newly Registered	-17.8	-20.8	-7.8	-25.1	-21.2	65.0	54.9	45.0	34.4	34.4	32.3	27.6
Volume Index of Retail Sales	4.6	5.1	5.7	3.0	11.3	9.0	20.0	16.4	15.3	11.5	10.5	12.5
Visitors Arrivals	7.0	7.3	7.4	13.1	3.3	28.6	251.8	286.1	100.6	31.3	16.9	17.6
Hong Kong Resident Departures	0.5	0.9	3.1	2.0	-1.4	9.5	69.9	41.2	26.9	15.6	13.0	15.8
Money Supply (M2)	8.0	6.6	8.4	10.6	11.7	8.7	7.6	6.6	6.3	6.5	6.8	6.8
Loans and Advances	-0.7	-2.7	-2.0	0.9	3.0	-0.9	-0.1	-0.2	-1.2	0.5	0.9	0.1
Electricity Consumption	12.7	-0.2	9.4	3.6	3.0	1.8	4.5	0.9	6.5	1.6	0.7	1.5
Gas Consumption	-3.4	-0.4	2.5	1.2	2.8	3.7	2.0	0.9	-0.7	2.2	0.6	2.0
Effective Exchange Rate Index	-3.6	-3.2	-3.5	-3.13	-3.38	-3.2	-3.4	-1.5	-1.8	-1.7	-2.0	-1.6

Date of Forecast: June 28, 2004.