

High-Frequency Macro Forecasts: 2nd Quarter 2001

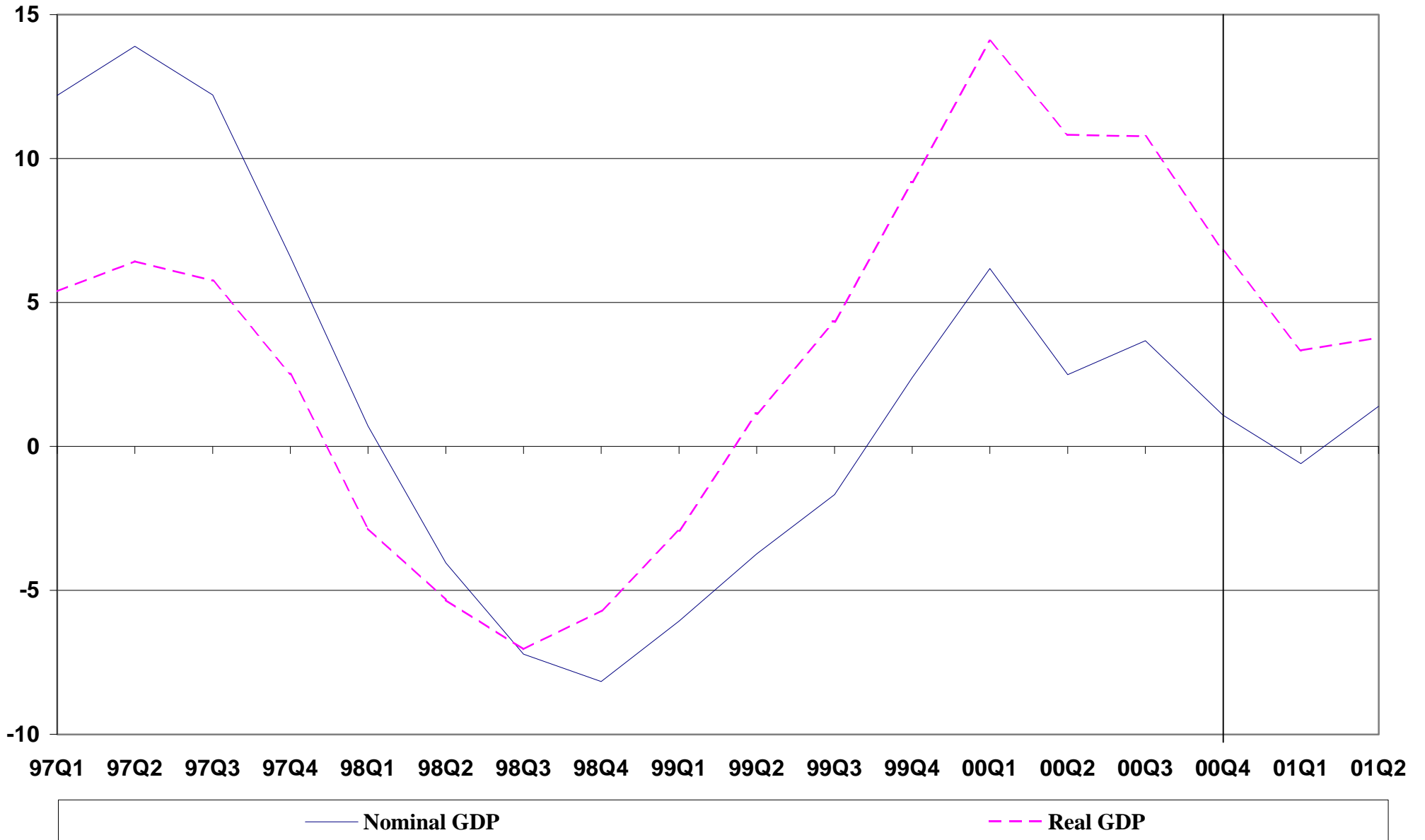
April 9, 2001

<http://www.hku.hk/apec/cqm/01Q2/>

Slower Growth Environment

- After growing at more than 10% last year, Hong Kong has to deal with a slower growth environment.
- Real GDP is forecasted to grow at 3.3% in the first quarter, down from our 5.1% estimate released on January 3.
- Real GDP is projected to grow at 3.8% in the second quarter of this year.
- After three consecutive quarters of double-digit growth at 14.2%, 10.8% and 10.8% in the first three quarters of last year, real GDP growth in the final quarter of 2000 is estimated to be 6.8%.
- The deceleration in the rate of output growth is due to the sharp slowdown of the U.S. economy which is estimated to grow by around 1% in the first quarter, after growing at 5% in 2000.

Nominal and Real GDP (Year-on-Year Growth Rate in Percentage)



Growth Decomposition

- A major contribution to output growth came from the investment in machinery and equipment which accounted for 3.4 percentage points of the 6.8% output growth in the fourth quarter. It continued to contribute a major part to output growth accounting for 1.5 percentage points of the 3.3% forecasted output growth in the first quarter and for 1.9 percentage points of the 3.8% in the second quarter.
- Investment in machinery and equipment is conducive to raising labour productivity.
- Another major contribution to output growth came from the trade in services. It accounted for 2.5 percentage points of the 6.8% growth in the fourth quarter of 2000. It is expected to account for 1.4 percentage points of the 3.3% forecasted growth in the first quarter and for 0.7 percentage in the second quarter

of 2001.

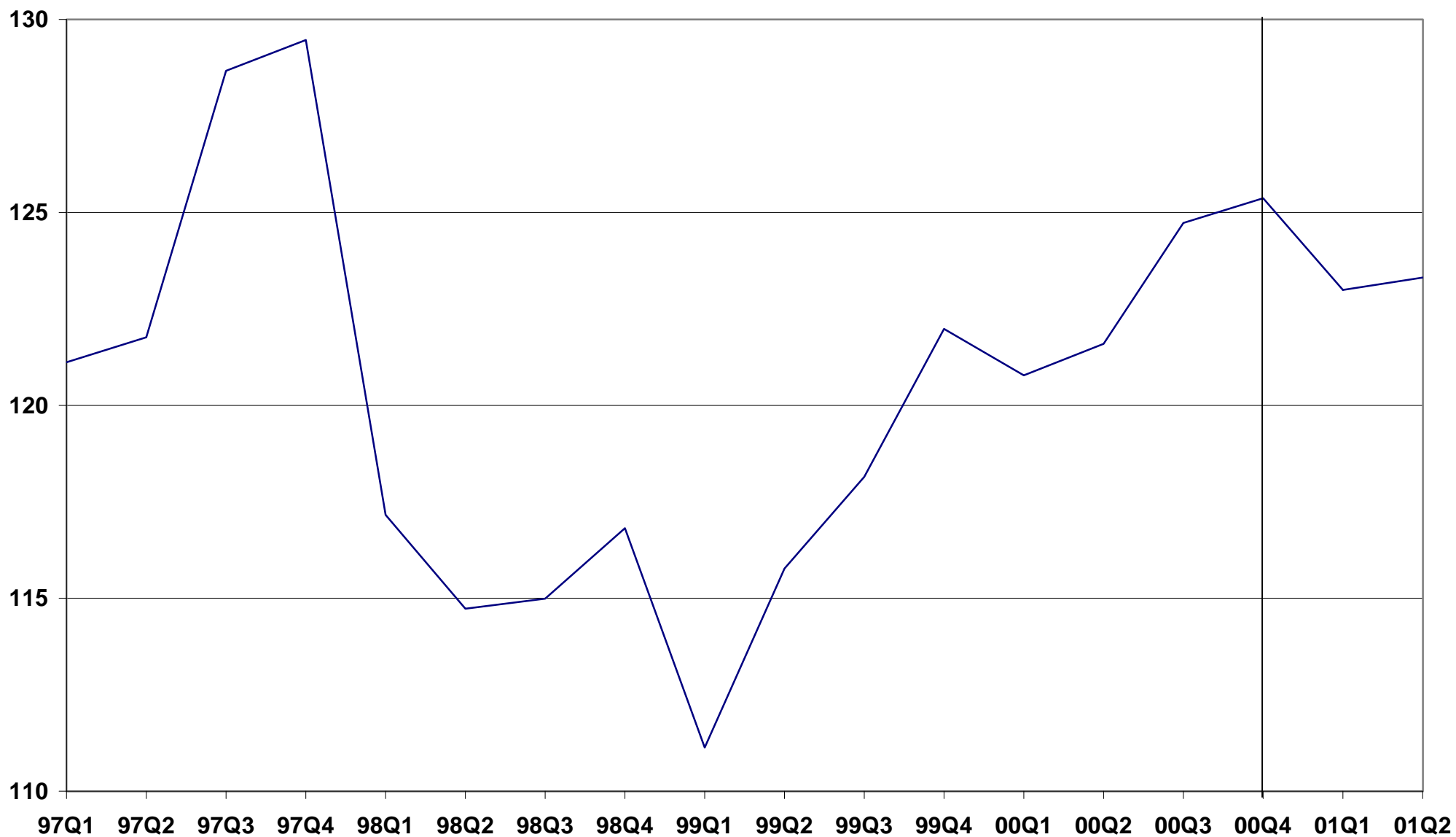
- As Mainland of China will enter the WTO in the near future, the importance of trade in services to output growth is expected to increase.
- Inventory investment is expected to be very important as a source of growth in the second quarter of 2001. It is expected to account for nearly all of the growth in real output in the second quarter. The piling up of unsold goods will dent the cash flow position of the business sector.

Consumption

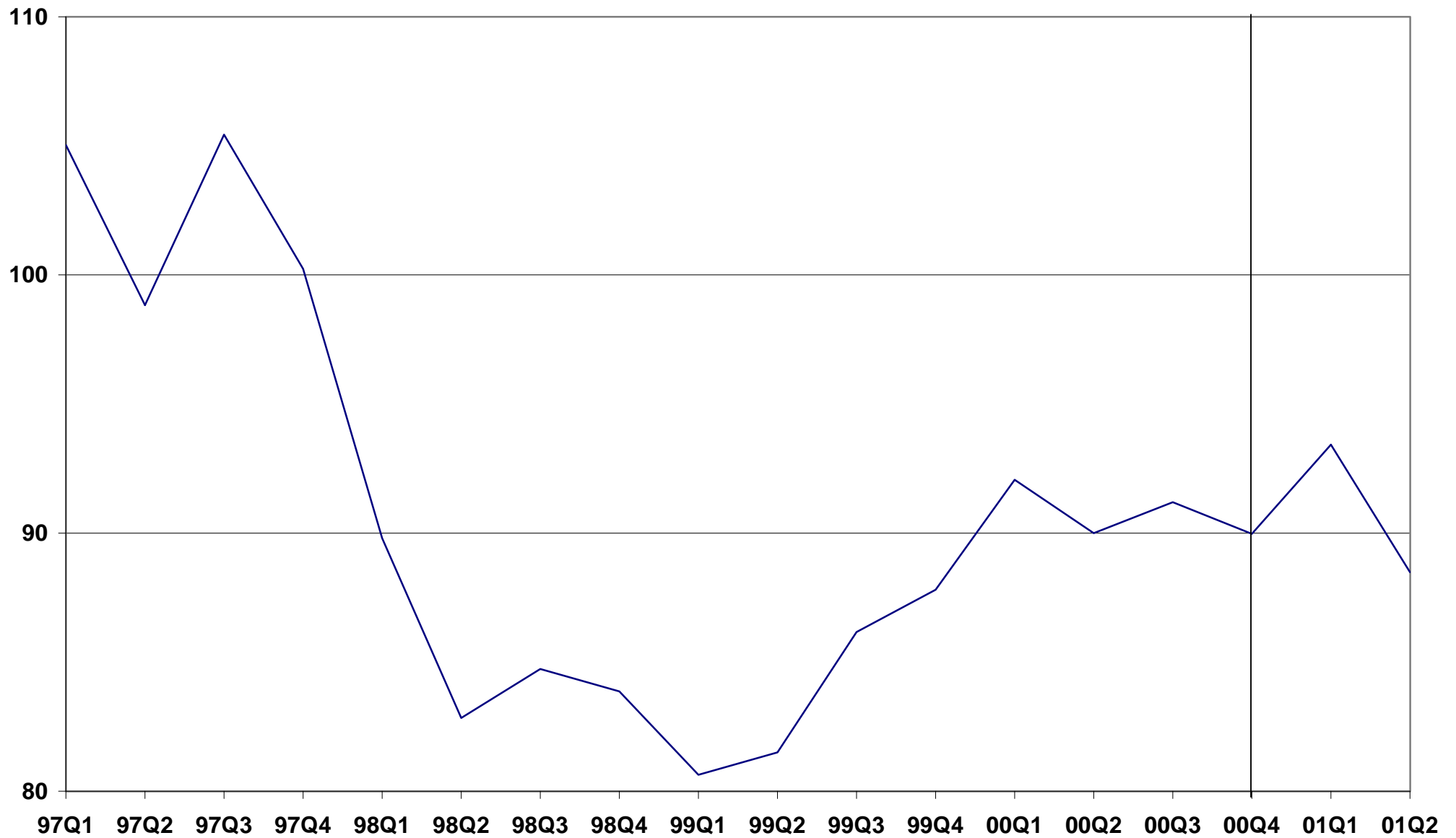
- Private consumption spending grew by 2.8% in the fourth quarter of 2000. As the economy slows down, consumption spending will remain weak. The rate is forecasted to be 1.8% in the first quarter, and is expected to be 1.4% in the second quarter of 2001.
- Consumption growth was slower than income growth throughout last year, implying that gross saving rate was increasing. The gross saving rate is 37.6% in 2000 which is the highest point since 1988. Households continue to save to rebuild their financial portfolios.
- Retail sales remain sluggish. Notwithstanding the Lunar New Year celebration, the volume of retail sales only grew by 2.5% in January 2001 compared to a year ago. Clothing, footwear and clothing accessories were still the major category with strong

growth in the volume. The year-on-year growth rate for this category was 12.4% in January, but with a 7.5% drop in prices.

Private Consumption Expenditure (Billion of 1990 HK Dollar)



Retail Sale Volume Index (Oct 94 - Sep 95 = 100)

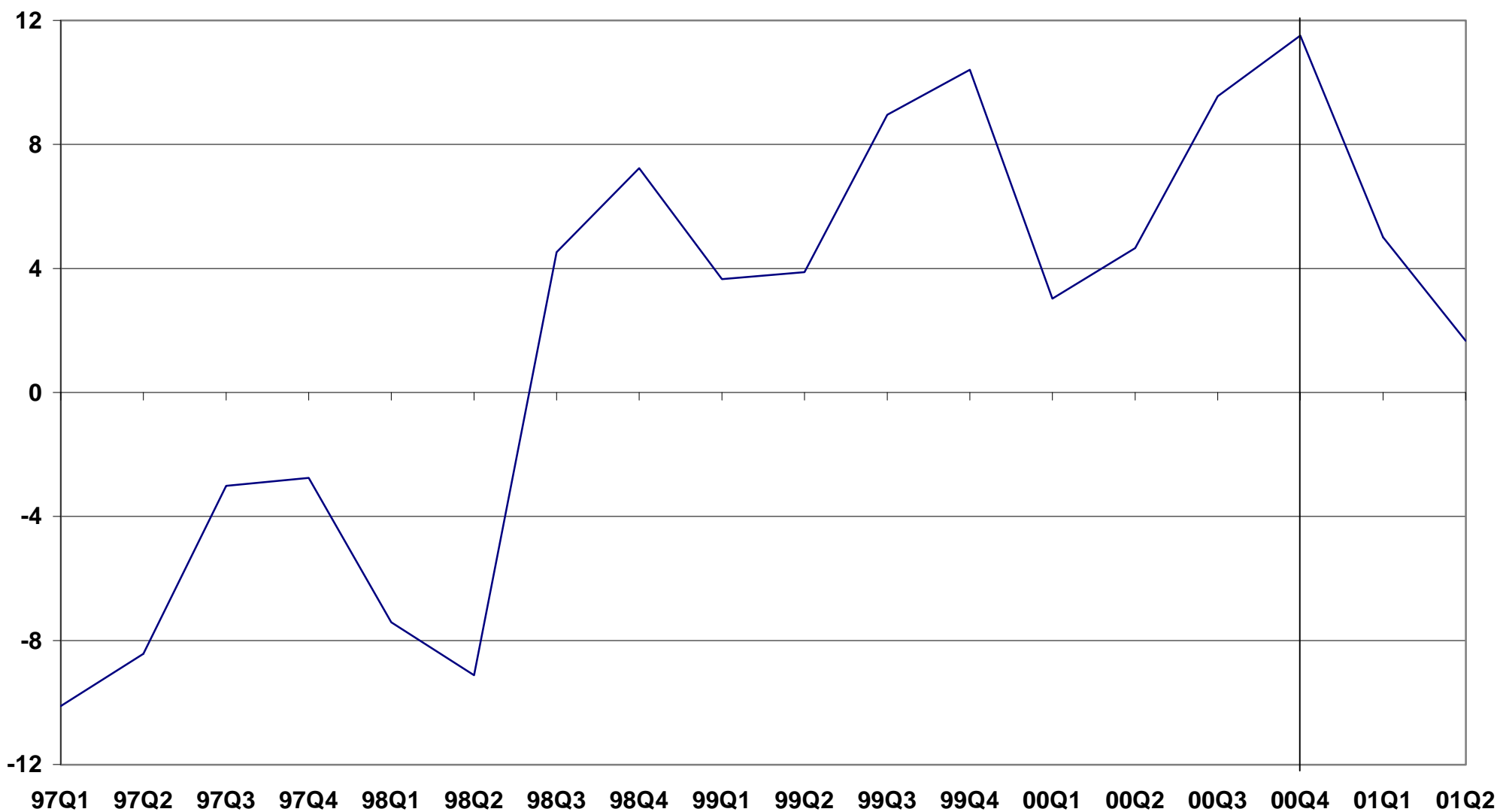


External Trade

- The growth in external trade is expected to slow in 2001. The effect of slowdown in the U.S. economy on external trade was first revealed in last November. The growth rate of re-exports dropped from 25.8% in October to 11.8% in November. Meanwhile, the growth rate of domestic exports moved from positive 15.8% to negative 5.4%.
- In the first two months of 2001, China's export growth rate has already slowed to 14.5%, about half of the 29% surge of 2000.
- Faced with weak global demand, re-export is predicted to grow by 9.1% in the first quarter and by 9.3% in the second quarter of 2001 respectively. Domestic export of goods is expected to be level off and grows by 0.1% in both the first and second quarter of 2001.

- After the double-digit growth in last year, the number of visitor arrivals is expected to be moderate this year. The growth rate was only 4.1% in February.
- Export of services is projected to slow down. It is expected to grow by 6.6% in the first quarter and by 3.6% in the second quarter of 2001 respectively.
- In tandem with the moderation in the growth of re-exports and domestic spending, the import of goods is estimated to grow by 7.1% and 9.7% in the first and the second quarter of 2001 respectively.

Total Trade Balance as a Ratio of GDP (in Percentage)



Investment

- Investment spending on machinery and equipment was very strong with growth rate at 24.6% for the whole of 2000. The spending spree will decelerate. The rate is predicted at to grow at 9.9% in the first quarter, and by 10.8% in the second quarter of 2001.
- The recovery of the property market has been uneven last year. Investment on land and construction has shrunk by 8.3% in 2000. The rate of decline has moderated since the third quarter of last year. The drop is estimated to be 1.1% and 0.1% in the first quarter and the second quarter of 2001 respectively.

Deflation

- We are still in the process of climbing out of deflation.
- Prices are basically stable except for the clothing and footwear, and housing sectors. In February, these two components of the Composite CPI dropped by 7.7% and 3.5% respectively.
- Excluding housing, the deflation rate would only be 1.5%, instead of the 2.1% in February.
- The deflation rate is forecasted to be 1.8% and 1.9% in the first quarter and the second quarter of 2001 respectively.

Employment

- The slowdown of the economy will not be conducive to improving the employment situation.
- The unemployment rate will be at a similar level as the fourth quarter of 2000. It is projected to be at 4.5% and 4.6% in the first quarter and the second quarter of 2001 respectively.
- Unemployment is still concentrated in the construction sector, with rate at 9.9% in the fourth quarter of 2000.
- The continued shortening of unemployment duration can be regarded as a positive sign on the employment front. For example, the number of workers unemployed for more than 6 months went from 68,100 in the fourth quarter of 1999 down to 35,400 in the fourth quarter of 2000. In the same period, the number unemployed between 3 and 6 months dropped from

40,600 to 27,900. There is no evidence to support the worsening of long-term unemployment.

Concluding Remarks

- The slowdown of the U.S. economy, coupled with still sluggish economic performance in Japan, will drag down the growth of the Hong Kong economy in the next couple of quarters.
- Lower interest rates will help to stimulate domestic spending in consumption and investment, as well as easing the financing burdens of debtors, but it will take 6 to 12 months before the positive effects beginning to have an impact on the real economy.
- In the absence of speedy WTO resolution, Permanent Normal Trade Relations (PNTR) has to be debated again in the U.S. Congress by June. If the tensions between China and the US were not resolved quickly, the PNTR renewal could be far from automatic. A negative surprise in June on the PNTR vote, though unlikely, is in the realm of possibility.

- We have to brace ourselves for a volatile and slower growth environment.

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/>.