

High-Frequency Macro Forecasts: Fourth Quarter 2002

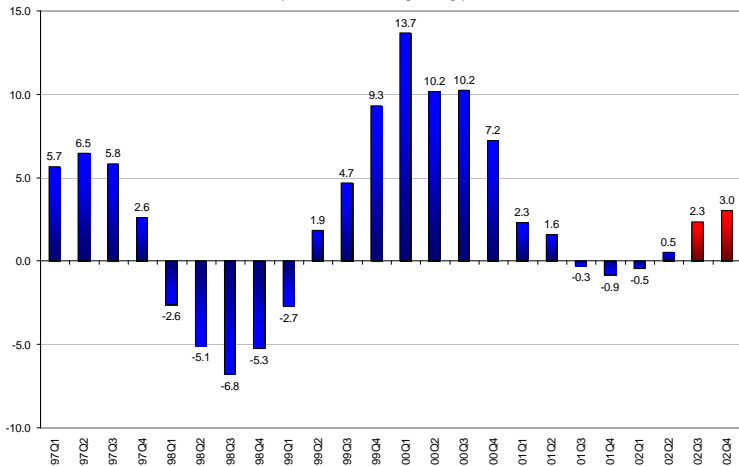
September 30, 2002

<http://www.hku.hk/apec/cqm/02Q4/>

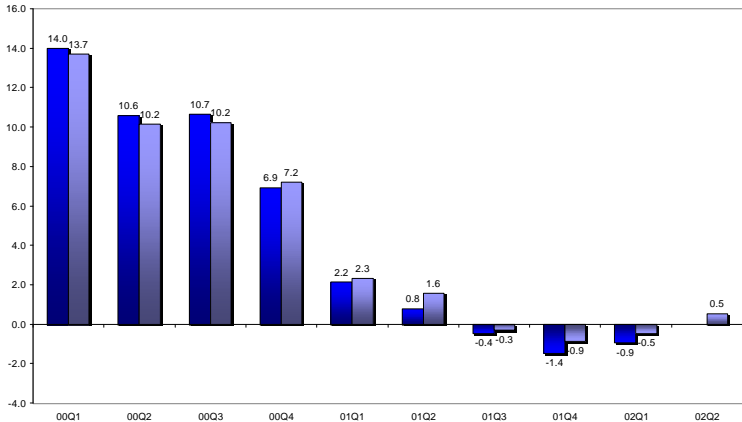
Slowly on the Mend

- Real GDP in 2000 prices did increase by 0.5% in the 2nd quarter, rebounding from the -0.5% contraction in the first quarter.
- The robust performance in the external trade sector, as well as the booming tourist trade, will carry the growth momentum forward.
- Real GDP is forecasted to increase by 2.3% and 3.0% in the third and fourth quarters of 2002 on a year-on-year basis respectively.
- For the year as a whole, real GDP is projected to grow by 1.4% in the current year. As compared with the lacklustre output growth of 0.6% last year, the performance this year will be better, but is still below our potential.

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



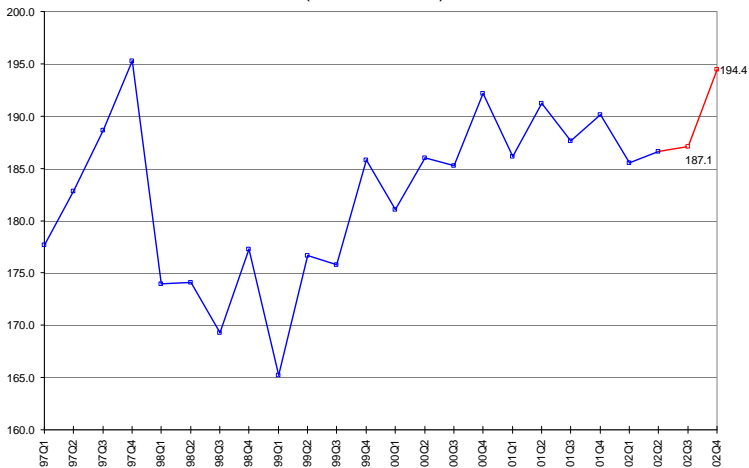
Real GDP : 1990 vs 2000 Prices
(Year-on-Year Percentage Change)



Consumption Spending

- Private consumption spending dropped by 2.4% in the second quarter of 2002.
- Clouded by weak performances in the stock and property markets, consumption is projected to continue to fall by 0.3% in the third quarter year-on-year.
- As the economic recovery becomes more apparent, consumption spending will start to pick up. It is projected to increase at an annual rate of 2.3% in the fourth quarter.

Private Consumption Expenditure (Billion of 2000 HK Dollar)



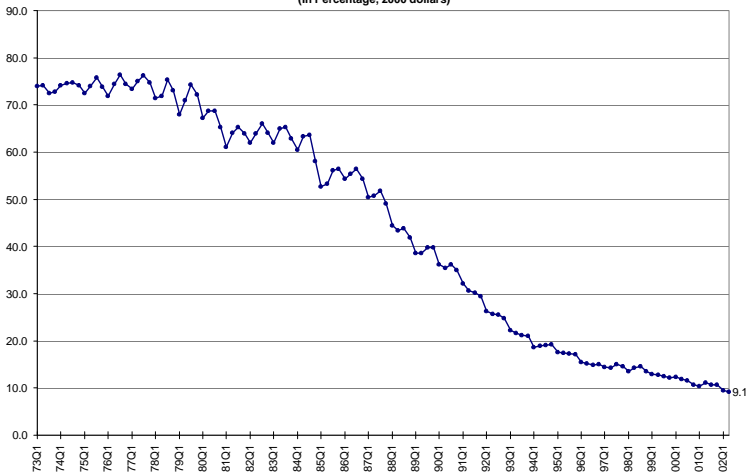
External Trade

- Domestic exports continued to fall by 13.6% in the second quarter of 2002.
- In July, the decline in total domestic exports was 9.1%, with domestic exports to the Mainland China and United Kingdom declined by 20.8% and 2.7% respectively on a year-on-year basis, while domestic exports to the US increased by 3.5%.
- The drop in domestic exports is predicted to decelerate to -10.6% in the third quarter and to -8.5% in the fourth quarter of 2002.

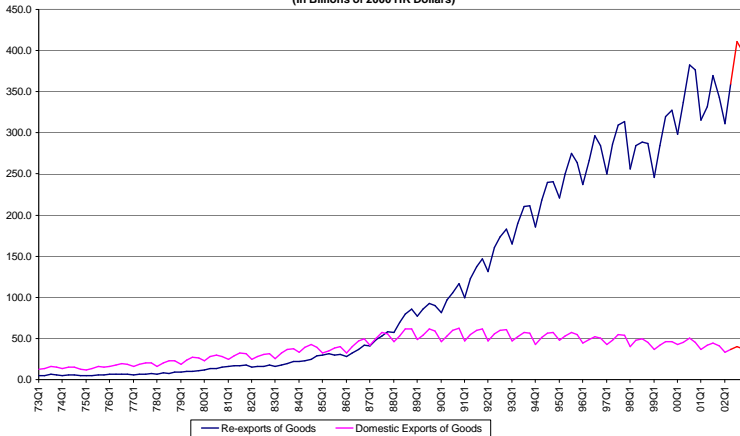
- The global economy is expected to continue to grow at a slow pace. Re-exports to the United States grew by 9.7% in April, while re-exports to the mainland of China rose by 15.7%, both on a year-on-year basis.
- Re-exports of goods is expected to grow by 11.4% and 16.5% in the third and fourth quarters of 2002.
- The number of visitors from the Mainland China and South East Asia rose by 41.3% and 16.2% in July compared to a year ago. The visitors from these 2 regions accounted for 96% of the total growth.
- The exports of services are projected to grow by 7.6% and 7.1% in the third and fourth quarters of 2002 respectively.

- Imports of goods increased by 6% in 02Q2 mainly to support the growth in re-exports.
- Retained imports only increased by 0.8% in the second quarter in 2002, reversing the downward trend in the preceding 3 quarters.
- The imports of goods are estimated to increase by 7.8% and 13.5% in the third and fourth quarters of 2002 respectively.
- The trade balance, as measured by the net exports of goods and services, was estimated to be 4.5% of GDP in the second quarter. Due to the robust growth in the reexports of goods and the exports of services, the trade balance is forecasted to rise sharply to around 10% of GDP in the second half of 2002.

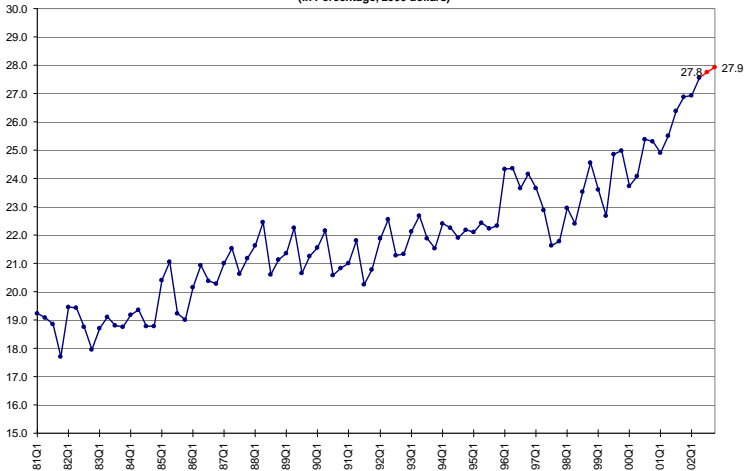
Domestic Exports to Total Exports
(In Percentage, 2000 dollars)



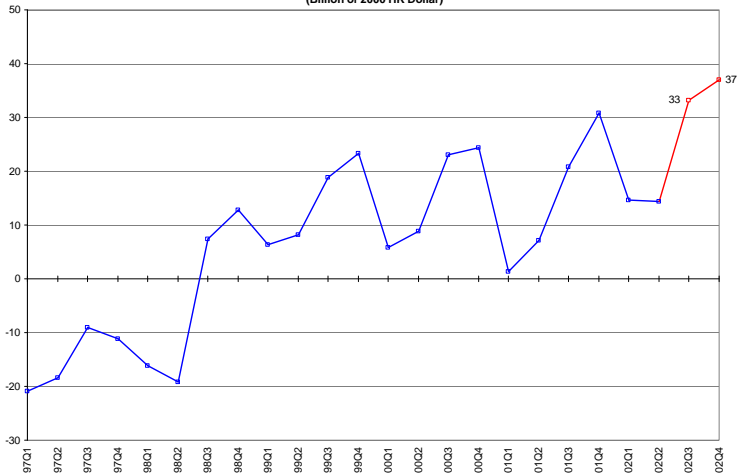
Re-Exports vs Domestic Exports (In Billions of 2000 HK Dollars)



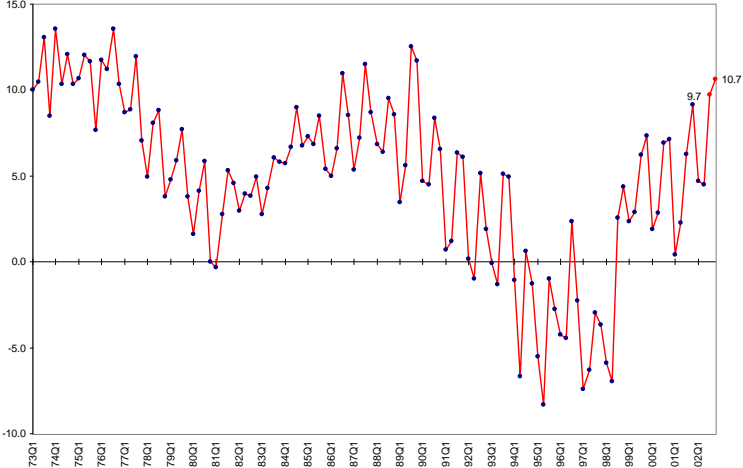
Export of Services to GDP (In Percentage, 2000 dollars)



Net Export of Goods and Services (Billion of 2000 HK Dollar)



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

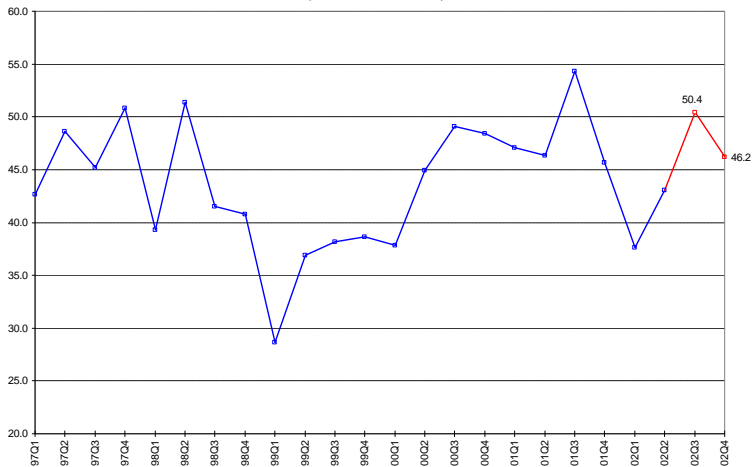


Investment

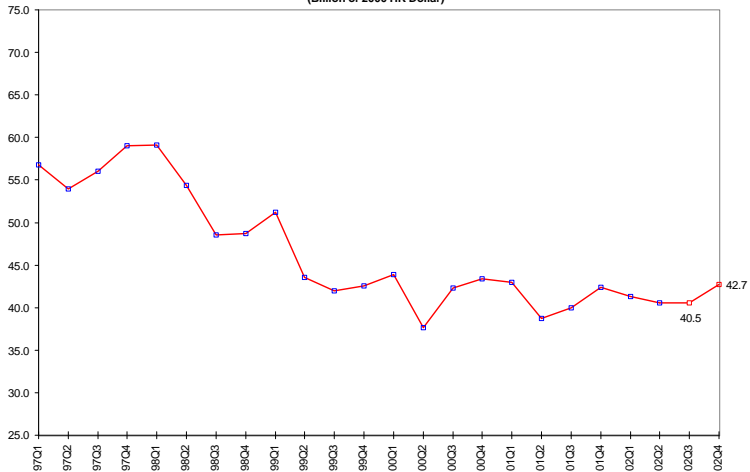
- The investment spending on Machinery, Equipment and Computer Software shrank by 7.0% in the second quarter of 2002 on an annual basis, thus decelerated from the 20.1% plunge in the first quarter.
- It is forecasted to contract by 7.2% in the third quarter and reverts to grow at 1.3% and the fourth quarter.

- Investment in land and construction showed a sharp turnaround of 4.7% growth in the second quarter of 2002 after 3 consecutive quartersly decline.
- This growth was mainly accounted for by major public projects like the Disneyland and Science Park. Thus, the investment in construction by the public sector increased by 1.9% in the second quarter 2002, improving from the 17.5% decline in the first quarter of 2002.
- Construction related investment is predicted to grow by 1.4% in the third quarter and by 0.8% in the fourth quarter of 2002 on a year-on-year basis.

Investment in Machinery, Equipment & Computer Software (Billion of 2000 HK Dollar)



Investment in Land and Construction (Billion of 2000 HK Dollar)



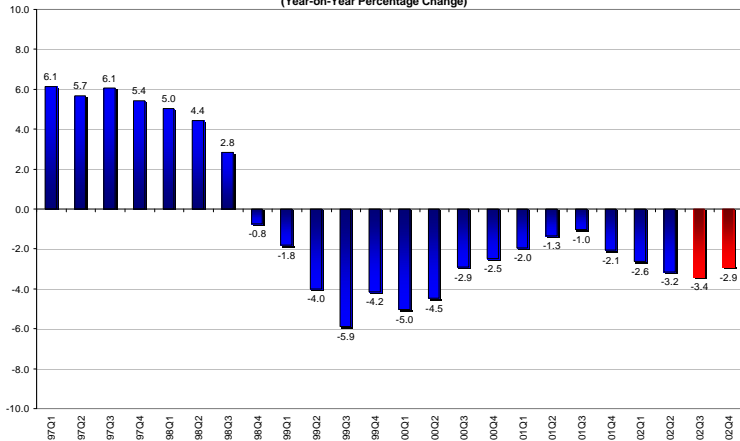
Consumer Prices

- Deflationary expectations are now strongly entrenched in the Hong Kong society.
- In August, the composite CPI declined by 3.2%. The housing and durable goods components fell by 6.1% and 4.9%, while the price index for clothing and footwear increased by 1.8%.
- Deflation rate is forecasted to be 3.3% in the third quarter of 2002 and 2.8% in the fourth quarter of 2002.

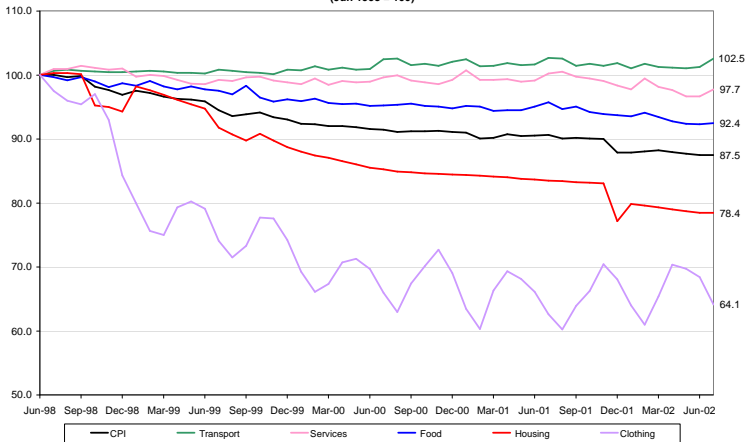
- Note that around 1.5 percentage point of the measured deflation rate is due to administrative measures, like rate rebates and fee waivers. These one-off measures will only lower the price level, but not the underlying deflationary pressure. Stripped away these one-off measures, the core deflationary rate would be lower to be around 2%.

- The prolonged drop in the consumer price level is unprecedented in the postwar history of Hong Kong. Since September 1998 when consumer prices started to fall, the consumer price level has fallen cumulatively by 12%, bringing the average consumer prices back to their 1995 level. All major components of the CPI except transport and miscellaneous goods have declined in prices. The housing component alone has been responsible for more than half of the deflation during this period. Three other components, namely, food, clothing and durable goods accounted for around 40% of the decline in the price level.

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



Composite Consumer Price Index (Jun 1998 = 100)

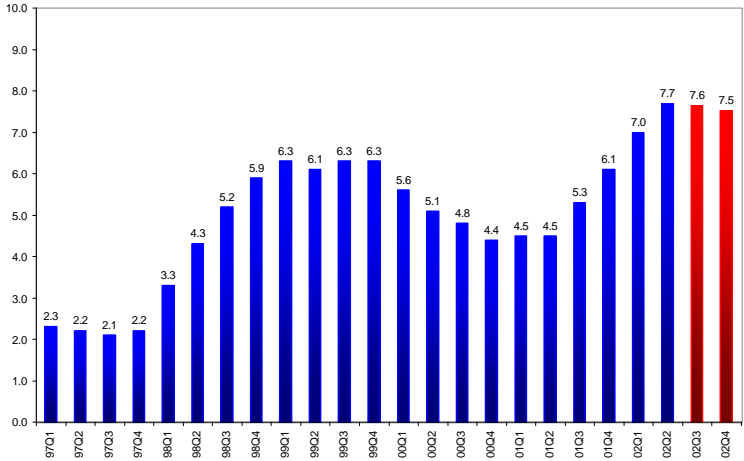


Employment

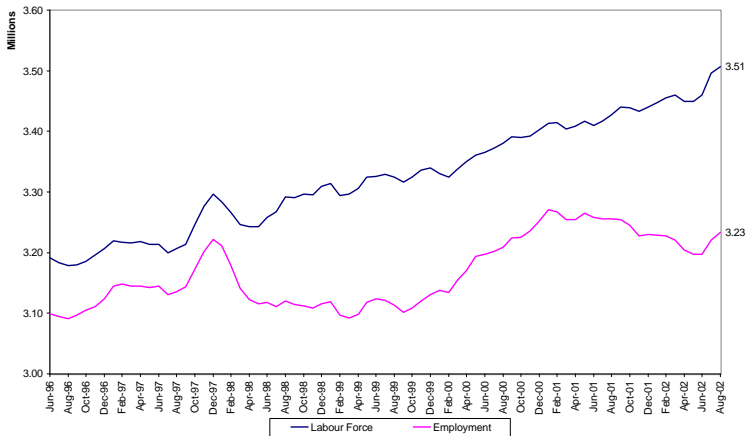
- The provisional seasonally adjusted unemployment rate in June to August is 7.6%, slightly improving from the high level of 7.8% in May to July.
- The continuous increase in the unemployment rate since 01Q2 was thus arrested.
- However, the median duration of unemployment increased from 87 days in first quarter to 89 days in the second quarter of 2002.
- Unemployment is still concentrated in the construction sector, with unemployment rate at 16.9% in 02Q2.
- The unemployment rate of young workers, those between 15 and 19 years old, was at a very high level of 32.3% in the 02Q2.

- The unemployment situation is expected to improve. The unemployment rate is forecasted to be 7.6% in the third quarter of 2002 and 7.5% in the fourth quarter of 2002.

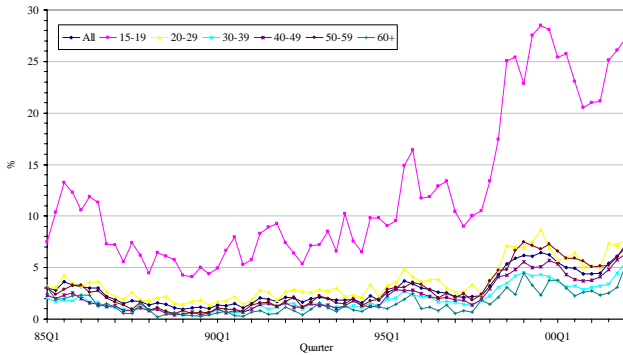
Unemployment Rate (Seasonally Adjusted)



**Labour Force vs Employment
(Persons)**



Unemployment Rates by Age Groups



Concluding Remark

- The economic malaise facing Hong Kong was triggered by the Asian Financial Crisis.
- Since October 1997, property prices have fallen by more than 60 percent.
- Compounded by the global correction in stock prices after the bursting of the tech bubble, the balance sheets of the private sector have been badly hit.
- The seemingly non-stop sequence of negative shocks have severely damaged confidence.
- Nevertheless, our external trade sector which is the autonomous engine of growth of the economy, has remained healthy.

- The trade account started to turn positive in 98Q3, and since then has improved steadily.
- It is 4.5% of GDP in the 2nd quarter and is projected to improve to 10% in the 3rd and 4th quarter.
- Such strong performance in the external sector is inconsistent with any substantial loss of competitiveness of the economy.
- The projected robust performance of the external sector is conditional on a slowly growing global economy. Economic growth could be arrested by a sustained sharp rise in the price of oil. Whether this would happen depends on how the geopolitical conflicts in the Middle East would play out in the next couple of months. Economic outlook remains cloudy.

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/>.