

High-Frequency Macro

Forecasts: 4th Quarter 2001

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Heading for Recession

- The US economy, even before the terrorist attacks, has already decelerated sharply.
- The attacks have disrupted normal economic activity and made the economic outlook much more uncertain.
- As a small open economy that is heavily dependent on trade, Hong Kong cannot escape from the global economic slowdown. Recession is a likely scenario.

- Real GDP is projected to shrink by 0.2% and 1.9% in the third quarter and the fourth quarter of 2001 respectively, on a year-on-year basis.
- The contraction in the second half of this year will wipe out the output growth recorded in the first half. For the year as a whole, real GDP growth is estimated to be around zero.

Consumption

- Private consumption spending grew by 4.0% in the second quarter.
- Despite falling consumer prices and successive reduction in interest rates, the downturn in the economy, coupled with the uncertain economic outlook, will drag down consumption spending.
- Private consumption is expected to decelerate in the fourth quarter.
- It is forecasted to be 2.1% in the third quarter and 1.0% in the fourth quarter, on a year-on-year basis.

External Trade

- With the global slump in demand, a decline in exports is expected in the second half of 2001.
- Among the major markets of re-exports, only the Mainland of China and Japan have recorded positive in growth in the second quarter.
- For the Mainland of China, the growth rate was just 5.5% in the second quarter of 2001, a sharp drop from the rate of 21.5% in 2000.
- For Japan, the growth rate was 8.3% in the second quarter of 2001, compared to the rate of 24.4% in 2000.

- And for the United States, the rate of decline was 10.1% in the second quarter of 2001.
- The re-exports of goods are predicted to decline by 3.8% in the third quarter and by 3.5% in the fourth quarter respectively.
- The domestic exports of goods continued to shrink with rate of 8.5% in the second quarter. The rate of decline is expected to be 11.8% in the third quarter and to 6.2% in the fourth quarter respectively.
- After a long period of double-digit growth, the number of visitor arrivals only grew by 7.2% in July.

- With the slowdown of visitor arrivals and the slackened external trade, export of services is expected to grow by 2.7% in the third quarter and by 2.8% in the fourth quarter respectively.
- Mirroring the slowdown in re-exports of goods and local demand, the imports of goods are estimated to decline by 6.1% and 3.3% in the third and the fourth quarter respectively.

Investment

- Investment spending on machinery and equipment grew only by 0.3% in the second quarter.
- It is predicted to decline in the second half of 2001.
- The rate of decline is predicted at 5.9% and 7.4% in the third quarter and in the fourth quarter of this year.

- Investment in land and construction stabilised after more than two years of decline – growing by 0.5% in the second quarter.
- With the uncertain economic outlook, investment in land and construction is expected to decline by 0.4% and 1.2% in the third and the fourth quarter respectively.

Deflation

- We are still facing deflation pressure.
- In August, the Composite CPI declined by 1.1%, with durable goods dropping the most by 7.5%.
- Clothing and footwear, and the housing sector dropped by 4.3% and 1.7% respectively.
- The deflation rate is forecasted to be 1.0% and 1.2% in the third quarter and the fourth quarter respectively.

Unemployment

- Unemployment is expected to worsen. The unemployment rate was steady at 4.6% in the second quarter.
- The rate is forecasted to be 4.9% and at 5.0% in the third and fourth quarter respectively.
- Unemployment is still concentrated in the construction sector, with rate at 9.9% in the second quarter, due to the continued slack in the property market.

- As external trade weakened, the unemployment rates in the manufacturing and the import/export trade sectors also increased in the second quarter on a quarter-on-quarter basis, and both stood at 5.2%.

Concluding Remarks

- Given the slowdown in the global economy which became apparent in the second quarter, and the uncertainties arising from the abominable terrorist attacks in the United States, the economic environment in Hong Kong will remain unfavourable in the short-term.

- The silver lining is the timely policies adopted to arrest the decline of the global economy. The Fed cut interest rates for the ninth time this year. After the 50bps drop, the federal fund rate is now 2.5%, the lowest since 1962. President Bush promised another stimulus package, suggesting new spending and tax cuts worth as much as \$75 billion.
- Given its resilience, and the massive fiscal stimulus, barring any unforeseen circumstances, the US economy is expected to rebound next year, and this will pull the Hong Kong economy out of its current temporary economic difficulties.

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. 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/>.