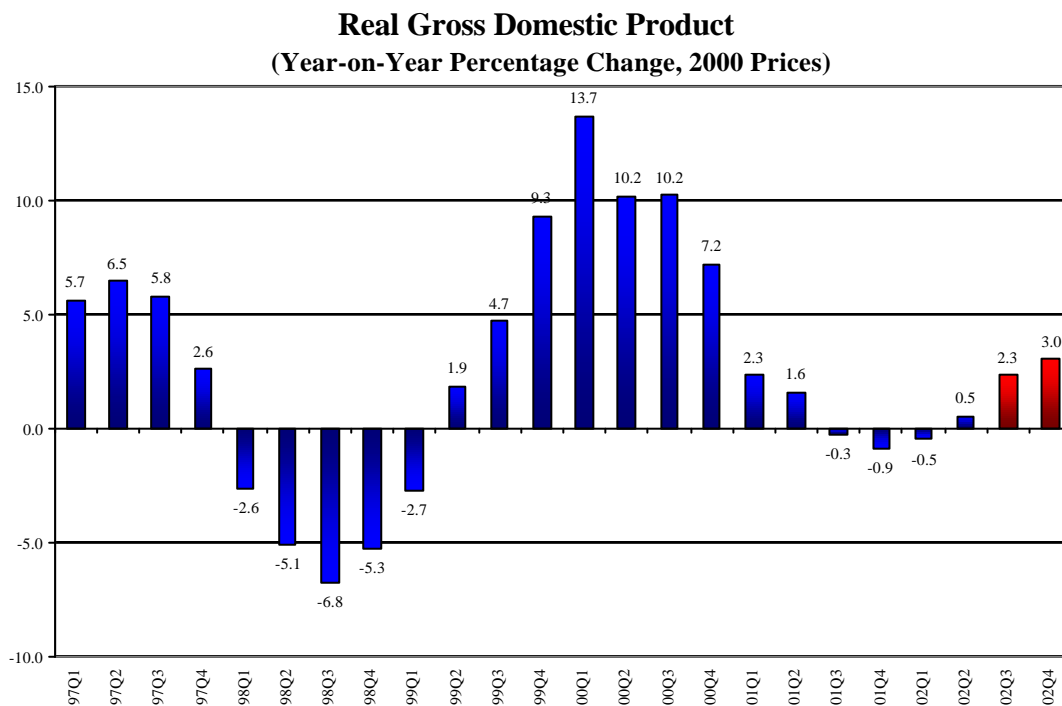


# High Frequency Macroeconomic Forecasts Current Quarter Model: 2002Q4

APEC Study Center  
The University of Hong Kong

September 30, 2002

## Slowly on the Mend



In our last public release on July 3, 2002, the Hong Kong economy was predicted to start growing again in 02Q2, after three consecutive quarters of contraction in real GDP on a year-on-year basis. Our prediction has been confirmed by official figures. 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 economic recovery is projected to continue, albeit at a slow pace. The robust performance in the external trade sector, as well as the booming tourist trade, will carry the growth momentum forward. The Hong Kong economy is slowly on the mend. According to the High Frequency Macroeconomic Forecast carried out at the APEC Study Center of The University of Hong Kong, 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 lackluster output growth of 0.6% last year, the performance this year will be better, but is still below our potential.

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

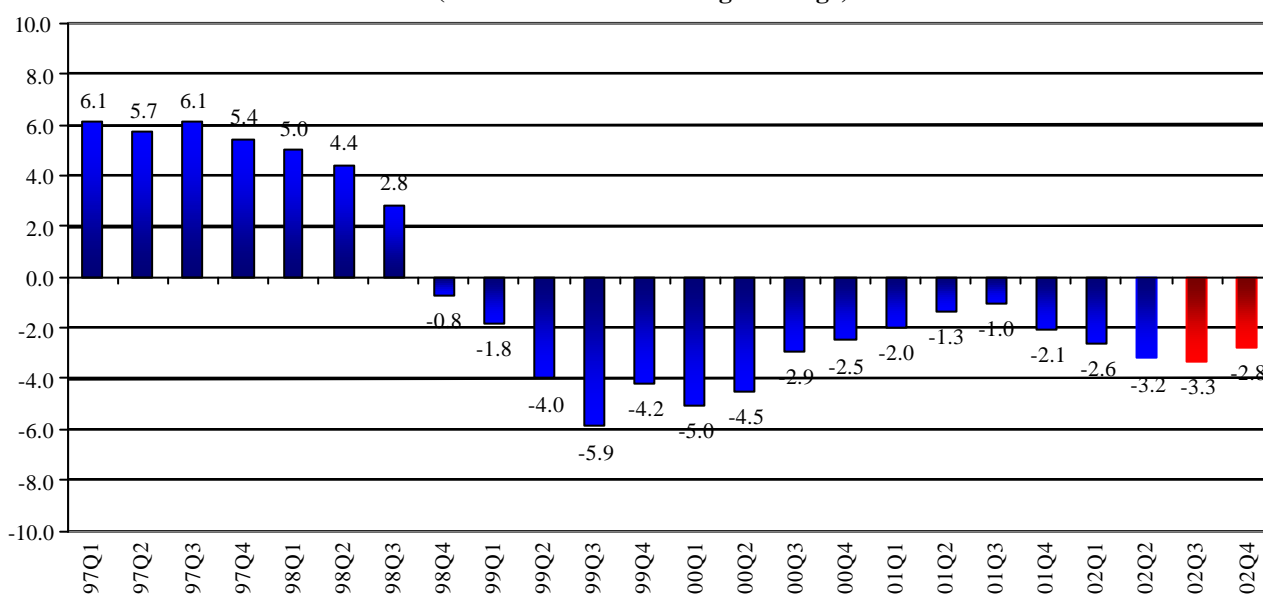
## Forecast Highlights

The highlights of our current forecasts are:

- Private consumption spending 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.
- In July, the volume of retail sales shrank by 2.8% compared to the same period last year, it is expected to stay flat in the second half of this year due to the subdued employment situation.
- 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 declining trend in domestic exports is expected to continue. 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 July, 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 visitor arrivals regained a double-digit growth at 16.5% year-on-year in July after a slower than average growth of 6% in June due to the World Cup Soccer event. 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. Telecommunication and Electrical Machinery and Electrical Parts grew the fastest in July. 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 re-exports 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.

- 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 quarterly 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.

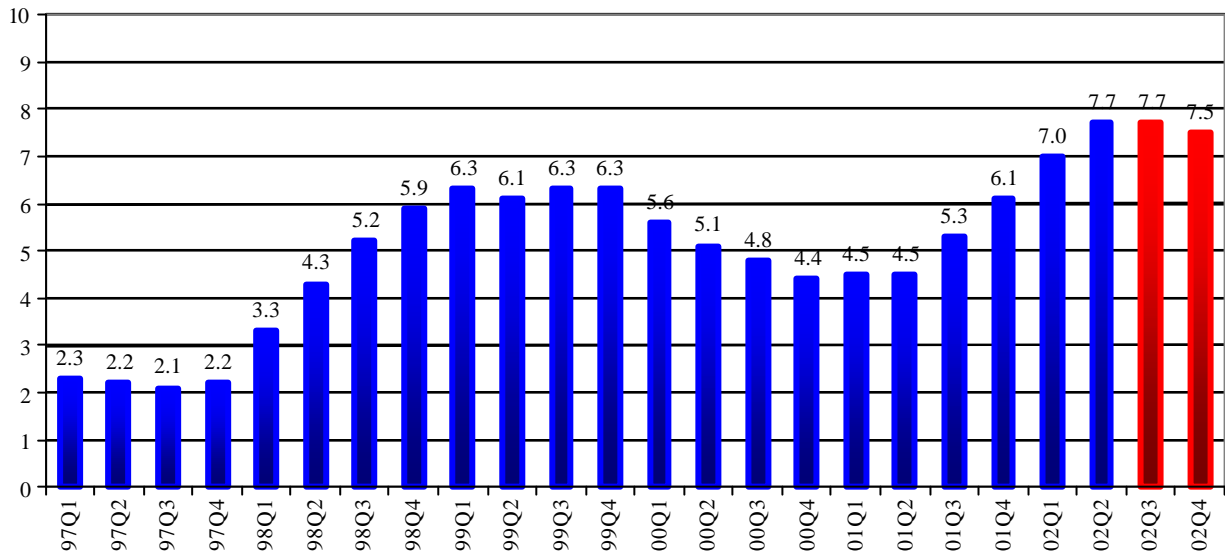
**Composite Consumer Price Index  
(Year-on-Year Percentage Change)**



- Deflationary expectations are now strongly entrenched in the Hong Kong society. In August, the composite CPI declined by 3.3%. The housing and durable goods components registered the sharpest decline at 6.4% and 5.4%, while the price index for clothing and footwear registered a steady growth of 2.1%.
- The 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 at 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.

**Unemployment Rate**  
(Seasonally adjusted)



- 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.

## **Concluding Remarks**

- The economic malaise facing Hong Kong was triggered by the Asian Financial Crisis. Since October 1997, property prices have fallen by around 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 has 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 will 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/>.

**High Frequency Macroeconomic Forecasts**  
**APEC Study Centre**  
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Table 1: Current Quarter Model Forecast  
(Million of 2000 Dollar)

	2001			2002				
	Q3	Q4	Annual	Q1	Q2	Q3 (forecast)	Q4 (forecast)	Annual (forecast)
Gross Domestic Product	332,268	336,922	1,296,511	310,256	317,316	340,036	347,140	1,314,749
Private Consumption Expenditure	187,584	190,087	754,979	185,542	186,613	187,106	194,449	753,710
Government Consumption Expenditure	31,987	32,085	127,357	33,765	31,090	33,266	33,368	131,490
Domestic Exports of Goods	43,794	40,808	162,554	32,348	35,922	39,151	37,335	144,756
Re-exports of Goods	368,807	342,364	1,357,626	310,702	359,065	410,657	398,684	1,479,108
Imports of Goods	429,710	397,029	1,605,267	364,074	422,910	463,395	450,726	1,701,106
Exports of Services	87,671	90,553	336,295	83,568	87,391	94,362	96,967	362,289
Imports of Services	49,735	45,920	191,217	47,921	45,153	47,650	45,287	186,011
Investment in Land & Construction	39,963	42,388	163,973	41,320	40,526	40,522	42,731	165,099
Investment in Machinery & Equipment	54,296	45,632	193,332	37,621	43,070	50,411	46,209	177,311
Changes in Inventories	-2,389	-4,046	-3,120	-2,615	1,703	-4,394	-6,590	-11,897

Date of Forecast: September 25, 2002

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

	2001			2002				
	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual
						(forecast)	(forecast)	(forecast)
Gross Domestic Product	-0.3	-0.9	0.6	-0.5	0.5	2.3	3.0	1.4
Private Consumption Expenditure	1.3	-1.1	1.4	-0.3	-2.4	-0.3	2.3	-0.2
Government Consumption Expenditure	7.3	7.0	6.0	2.2	2.7	4.0	4.0	3.2
Domestic Exports of Goods	-11.9	-8.3	-10.2	-11.1	-13.6	-10.6	-8.5	-10.9
Re-exports of Goods	-3.4	-8.9	-2.4	-1.4	8.4	11.3	16.5	8.9
Imports of Goods	-2.8	-8.7	-1.9	-4.0	6.0	7.8	13.5	6.0
Exports of Services	3.7	5.3	5.9	7.7	8.6	7.6	7.1	7.7
Imports of Services	-2.4	-2.8	-0.2	-1.3	-4.0	-4.2	-1.4	-2.7
Investment in Land & Construction	-5.4	-2.4	-1.9	-3.8	4.7	1.4	0.8	0.7
Investment in Machinery & Equipment	10.7	-5.8	7.3	-20.1	-7.0	-7.2	1.3	-8.3
GDP Deflator Growth Rate	-1.2	-0.8	-1.4	-2.1	-2.1	-0.2	0.3	-1.0
CPI (Composite) Inflation Rate	-1.0	-2.1	-1.6	-2.6	-3.2	-3.3	-2.8	-3.0
Unemployment Rate	5.3	6.1	5.1	7.0	7.7	7.6	7.5	7.5

Date of Forecast: September 25, 2002

# High Frequency Macroeconomic Forecasts

## APEC Study Centre

### The University of Hong Kong

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

	2002											
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Unit Value Trade Index (Domestic Exports)	-5.7	-5.5	-5.0	-3.9	-3.7	-3.2	-2.9	-2.7	-2.9	-2.4	-1.8	-1.3
Unit Value Trade Index (Imports of Foodstuffs)	-6.2	-4.7	-3.7	-5.1	-6.4	-4.5	-5.1	-3.9	-4.1	-3.6	-2.7	-1.7
Unit Value Trade Index (Imports of Consumer Goods)	-2.2	-3.3	-3.6	-3.7	-3.4	-2.8	-3.1	-3.4	-3.5	-3.4	-2.6	-2.6
Unit Value Trade Index (Imports of Raw Materials & Semi-Manufactures)	-7.7	-7.1	-6.3	-6.5	-5.9	-5.5	-4.5	-3.3	-2.6	-1.8	-1.0	-0.2
Unit Value Trade Index (Imports of Fuels)	-18.4	-17.6	-11.1	-5.6	-6.4	-7.6	-9.0	-6.4	-4.9	2.1	10.3	35.2
Unit Value Trade Index (Imports of Capital Goods)	-3.8	-4.0	-3.8	-4.1	-3.9	-4.3	-4.3	-4.1	-3.9	-3.6	-2.8	-2.2
Real Retained Imports of Foodstuffs	19.0	5.9	16.6	1.2	1.8	41.8	-7.8	-5.7	2.1	7.9	4.3	13.4
Real Retained Imports of Consumer Goods	159.6	-51.9	7.5	11.9	0.4	-13.9	-7.2	-4.5	-26.8	-28.7	-11.6	1.1
Real Retained Imports of Raw Materials & Semi-Manufactures	-4.7	-25.6	0.3	-12.7	8.4	18.1	14.2	43.3	23.0	22.8	24.9	17.4
Real Retained Imports of Fuels	-9.0	-13.3	0.4	11.9	-11.3	13.3	-13.4	29.9	9.3	8.5	26.1	2.1
Real Retained Imports of Capital Goods	-18.6	-50.1	-7.5	-19.1	-14.4	-7.7	-20.7	-18.5	-17.8	-4.1	-18.0	-5.5
Total Motor Vehicles Newly Registered	-16.0	-22.2	-40.0	-3.7	-31.1	-35.2	-24.8	-28.8	-12.4	-16.9	-6.2	0.8
Private Cars Newly Registered	-3.0	3.4	-34.5	8.4	-22.9	-20.3	-19.6	-24.8	-6.4	-7.1	-2.9	1.8
Volume Index of Retail Sales	-10.5	9.3	-1.5	-1.6	-5.0	-6.9	-2.8	-2.4	-2.3	0.3	-0.2	-0.7
Electricity Consumption	7.1	1.4	-1.6	21.7	4.5	3.4	8.7	4.5	7.3	5.9	4.7	7.4
Gas Consumption	0.2	2.5	0.4	0.8	0.1	-2.7	-1.9	-0.9	0.7	1.2	1.8	1.4
Money Supply (Definition 2)	-1.5	-2.8	-1.9	-1.8	-1.7	-1.8	-2.7	-3.2	-1.7	-0.4	1.6	3.8
Loans and Advances	-11.0	-11.1	-9.3	-8.7	-8.4	-7.3	-6.4	-6.4	-6.1	-5.4	-5.3	-4.8
Visitors Arrivals	10.5	15.3	11.8	19.0	14.3	6.0	16.5	13.2	17.8	22.5	18.6	13.8
Hong Kong Resident Departures	-6.2	22.0	8.7	-3.1	10.4	8.5	11.2	6.2	2.3	12.8	8.5	6.2
Land Considerations	7.6	-25.0	-29.5	-8.8	-10.0	-8.0	-15.7	-41.9	-29.3	-3.5	-18.9	1.7
Effective Exchange Rate Index	2.7	2.8	1.6	0.7	-0.4	-1.9	-3.3	-1.9	-1.6	-2.1	-2.4	-2.7
Hang Seng Index of Shares Prices	-28.3	-31.6	-18.0	-14.3	-14.0	-17.4	-16.9	-13.5	1.8	-1.2	-7.9	-12.9

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