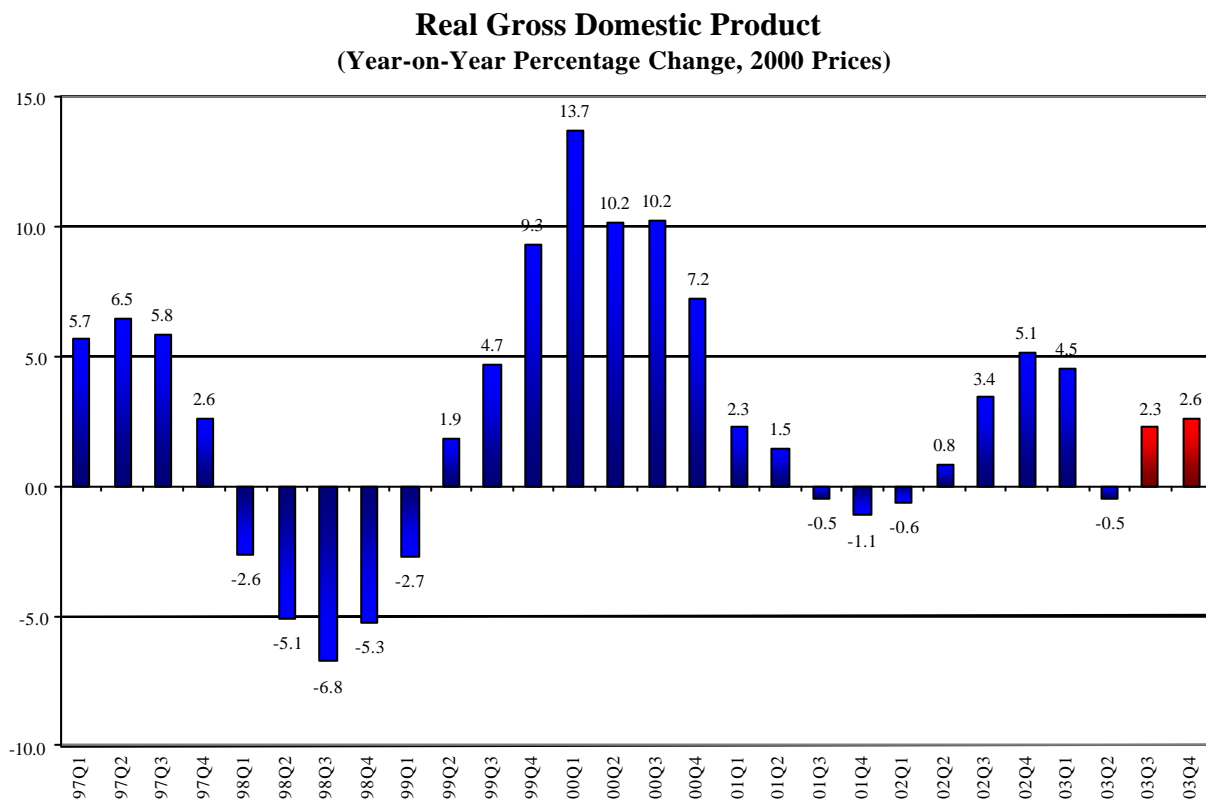


High Frequency Macroeconomic Forecasts Current Quarter Model: 2003Q4

APEC Study Center
The University of Hong Kong

October 13, 2003

Out of Recession



The economic environment has improved markedly since the World Health Organization declared Hong Kong to be Sars-free on June 23. The rapid rebound in visitor arrivals provided much needed relief to the tourism related sectors. The signing of the Closer Economic Partnership Arrangement (CEPA) served to provide a focus on future business opportunities. Capital inflows helped to lift the stock market and strengthen the local currency. Output growth in Hong Kong's major trading partners is expected to hold up in the second half of this year. There are more signs of a revival in Japan, and the strong euro makes Hong Kong's exports more competitive.

The sequence of positive developments served to bring Hong Kong out of its latest economic recession experienced in the first half of this year. The robust growth in the exports of goods and services, coupled with improving consumer sentiments laid the foundation for the economic recovery. 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% year-on-year in the third quarter of 2003, turning around from the -0.5% contraction in the second quarter of 2003. The growth momentum is expected to continue, with real GDP growing by 2.6% year-on-year in the fourth quarter of 2003. For the current year as a whole, real GDP is projected to grow by 2.2%. The forecast details are in Table 1 and Table 2, and the forecasts of selected monthly indicators are in Table 3.

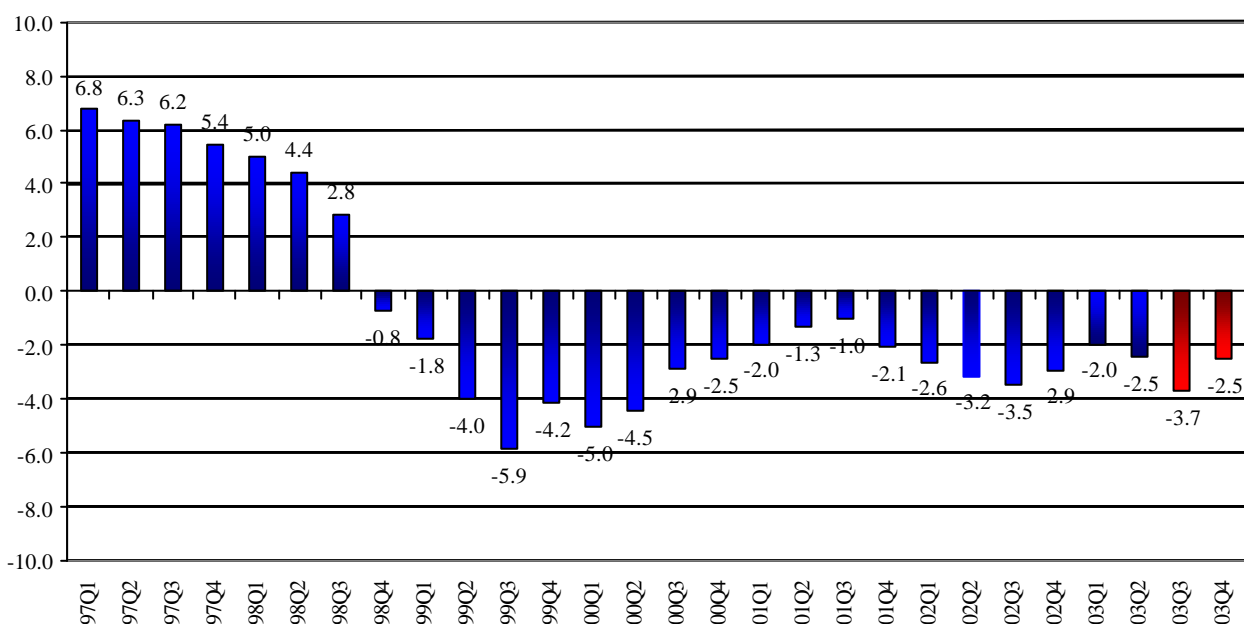
Forecast Highlights

The highlights of our current forecasts are:

- Battered by Sars, private consumption spending dropped by 2.2% in the second quarter of 2003. In the third quarter of 2003, despite an observable improvement in consumer sentiments, consumption spending was still weighed down by the high unemployment rate, and is projected to fall by 0.4% when compared with the same period last year. As the economy continues to recover, consumption spending will be stronger and is forecasted to increase at an annual rate of 1.3% in the fourth quarter of 2003.
- The volume of retail sales shrank by 0.3% year-on-year in July, but grew by a robust 2.9% in August due to improving consumer sentiments and the sharp increase in visitor arrivals, particularly from the Mainland. It is expected to improve steadily in the current quarter.
- Domestic exports dropped by 12.6% in the second quarter of 2003, continuing the fall started in the fourth quarter of 2000. The downward momentum will continue but the rate of decrease is expected to moderate. It is predicted to fall by 6.1% in the third quarter and by 3.1% in the fourth quarter of 2003.
- After growing by 19.4% year-on-year in the first half of this year, the growth in the re-exports of goods will decelerate to 11.6% and 10.7% in the third and fourth quarters of 2003, respectively.
- Reflecting the 57.9% drop in the number of visitor arrivals, export of services dropped sharply by 14.7% in the second quarter. The number of visitor arrivals rebounded sharply and grew by 9.6% year-on-year in August, mainly due to the huge influx of Mainland visitors, with the number of visitors from the Mainland jumped by 43.4% year-on-year. The export of services is projected to grow by 5.6% and 5.8% in the third and fourth quarters of 2003 respectively.
- The import of goods increased by 10.9% in the second quarter of 2003 mainly to support the growth in re-exports, as retained imports fell by 3.7%, reversing the upward trend in the preceding 4 quarters. Reflecting the projected growth in re-exports, the import of goods is estimated to increase by 7.1% and 7.3% in the third and fourth quarters of 2003 respectively.

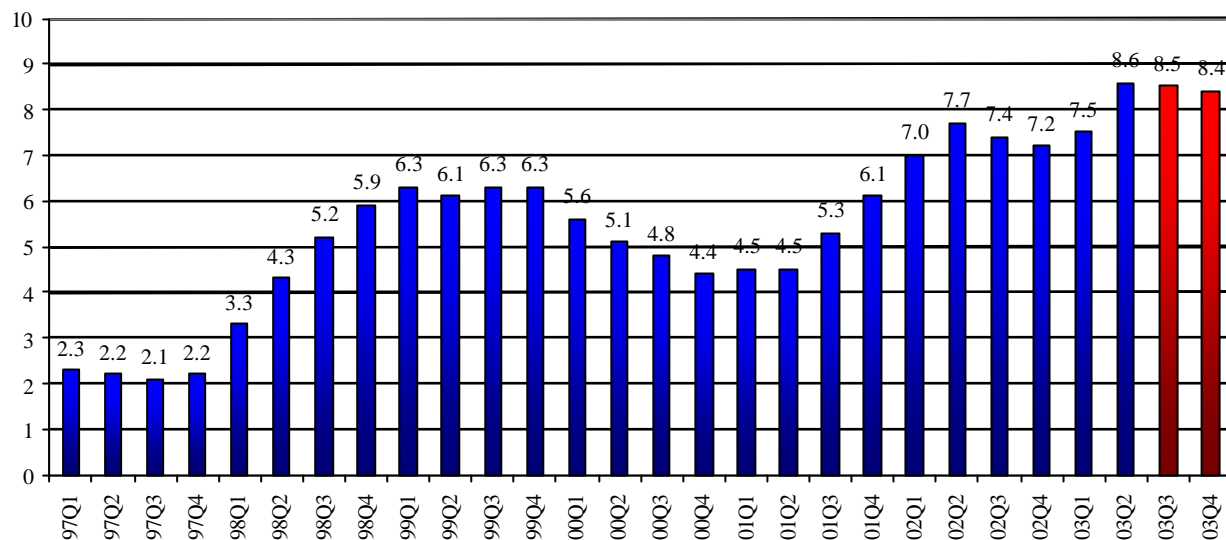
- The import of services dropped by 19.6% in the second quarter of 2003 due to Sars. The number of resident departures recorded the low level at 3.7 million persons in April 2003. The number picked up quickly after Sars was brought under control. In August, the number of resident departures grew by an annual rate of 2.3% to 6.0 million persons. The import of services is predicted to expand at the year-on-year growth of 4.7% in the third quarter and 8.8% in the fourth quarter of 2003.
- The trade balance, as measured by the net exports of goods and services, was estimated to 6.3% of GDP in the second quarter of 2003. Due to the stronger growth in the exports of goods and services, the overall trade balance is forecasted to rise sharply to around 15% of GDP in the second half of 2003.
- The investment spending on machinery, equipment and computer software shrank by 2.4% in the second quarter of 2003 on an annual basis, and is to contract by 1.9% in the third quarter, and 4.3% in the fourth quarter of 2003.
- Investment in land and construction fell by 8.3% decline in the second quarter of 2003 on an annual basis. With no major new project commencing in the second half of 2003, construction related investment will remain subdued, and is predicted to decline by 7.6% in the third quarter and by 6.7% in the fourth quarter of 2003 on a year-on-year basis.

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



- In August, the composite CPI declined by 3.7%, with 2.2 percentage points of the fall attributed to the housing component which fell by 7.9%. The rates concession for the third quarter of 2003 and the waiver of water and sewage charges worsened the measured deflation rate in August by 1.1 percentage points. The headline deflation rate is forecasted to be 3.7% in the third quarter of 2003. As the economy improves further, the fall in the consumer price level is expected to moderate and is projected to be 2.5% in the fourth quarter of 2003.

Unemployment Rate (Seasonally adjusted)



- The provisional seasonally adjusted unemployment rate in June to August is 8.5%, improving slightly from the high level of 8.6% in May to July. The median duration of unemployment stayed flat at 82 days in the second quarter of 2003. Unemployment is still concentrated in the construction sector, with unemployment rate at 19.3% in July 2003. The employment situation is expected to improve though slowly. The unemployment rate is forecasted to be 8.5% in the third quarter and 8.4% in the fourth quarter of 2003.

Concluding Remarks

Given the positive external environment, the economic recovery started in June is expected to continue. The current stance of economic policy with the primary focus on stimulating growth is conducive to the recovery process. But the short-term outlook is clouded by the likelihood of re-emergence of Sars in the coming months. The economy is resilient enough to withstand minor localized outbreaks, but another large-scale Sars epidemic could do serious damage to the economy. Hong Kong has to be prepared for the next test.

About Our Model

Our 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 at the APEC Study Center of The University of Hong Kong. The project was partially funded by the Better Hong Kong Foundation. It is now supported by a grant from the university, and the Hong Kong Center for Economic Research provides administrative support. Researchers at the APRC 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
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Table 1: Current Quarter Model Forecast
(Million of 2000 Dollar)

	2002			2003				
	Q3	Q4	Annual	Q1	Q2	Q3 (forecast)	Q4 (forecast)	Annual (forecast)
Gross Domestic Product	342,983	353,262	1,323,650	323,628	316,407	350,735	362,564	1,353,334
Private Consumption Expenditure	185,745	187,072	746,311	182,084	183,395	184,913	189,567	739,959
Government Consumption Expenditure	33,087	32,378	130,479	34,313	31,321	34,245	33,511	133,390
Domestic Exports of Goods	40,524	35,581	144,376	28,470	31,416	38,042	34,479	132,407
Re-exports of Goods	419,633	418,118	1,507,569	380,121	419,908	468,352	462,764	1,731,145
Imports of Goods	476,286	469,200	1,732,470	432,701	468,962	510,207	503,319	1,915,189
Exports of Services	100,724	107,878	379,199	93,636	74,575	106,381	114,083	388,675
Imports of Services	51,927	48,766	195,883	47,171	37,060	54,360	53,058	191,649
Investment in Land & Construction	42,714	40,724	164,409	40,147	38,419	39,447	37,984	155,997
Investment in Machinery & Equipment	47,286	46,491	173,993	41,863	41,764	46,379	44,487	174,493
Changes in Inventories	1,483	2,986	5,667	2,866	1,631	-2,457	2,066	4,106

Date of Forecast: October 6, 2003

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

	2002			2003				
	Q3	Q4	Annual	Q1	Q2	Q3	Q4	Annual
						(forecast)	(forecast)	(forecast)
Gross Domestic Product	3.4	5.1	2.3	4.5	-0.5	2.3	2.6	2.2
Private Consumption Expenditure	-1.2	-1.8	-1.3	-2.1	-2.2	-0.4	1.3	-0.9
Government Consumption Expenditure	3.5	0.8	2.4	1.3	0.6	3.5	3.5	2.2
Domestic Exports of Goods	-7.5	-12.9	-11.2	-12.0	-12.6	-6.1	-3.1	-8.3
Re-exports of Goods	13.7	22.2	11.0	22.3	17.0	11.6	10.7	14.8
Imports of Goods	10.8	18.2	7.9	18.8	10.9	7.1	7.3	10.5
Exports of Services	13.9	18.1	11.7	12.6	-14.7	5.6	5.8	2.5
Imports of Services	2.0	3.4	0.2	-3.9	-19.6	4.7	8.8	-2.2
Investment in Land & Construction	6.1	-4.8	7.0	-4.1	-8.3	-7.6	-6.7	-5.1
Investment in Machinery & Equipment	-12.2	3.2	-9.1	11.9	-2.4	-1.9	-4.3	0.3
GDP Deflator Growth Rate	-3.1	-4.1	-3.1	-4.6	-5.5	-3.4	-3.4	-4.2
CPI (Composite) Inflation Rate	-3.5	-2.9	-3.0	-2.0	-2.5	-3.7	-2.5	-2.7
Unemployment Rate	7.4	7.2	7.3	7.5	8.6	8.5	8.4	8.3
Date of Forecast: October 6, 2003								

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Table 3: Selected Monthly Indicators												
Year-on-Year Growth Rate (%)												
	2003											
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Unit Value Trade Index (Domestic Exports)	0.4	0.3	1.6	0.8	0.7	0.7	0.5	0.7	0.6	0.3	-0.4	-0.3
Unit Value Trade Index (Imports of Foodstuffs)	-2.7	-2.9	-3.6	-1.7	-1.0	-0.8	-0.9	0.4	0.7	1.4	1.7	2.5
Unit Value Trade Index (Imports of Consumer Goods)	-1.7	-0.2	1.0	1.5	0.9	0.7	0.7	0.8	0.9	1.0	1.6	1.3
Unit Value Trade Index (Imports of Raw Materials & Semi-Manufactures)	-0.1	0.2	1.5	1.0	0.6	0.2	0.4	0.7	0.4	0.2	0.5	0.5
Unit Value Trade Index (Imports of Fuels)	37.5	43.4	33.5	14.3	5.8	8.2	9.0	7.8	-1.3	-5.0	3.2	3.5
Unit Value Trade Index (Imports of Capital Goods)	-2.4	-2.2	-3.5	-3.5	-3.2	-4.2	-5.1	-5.4	-5.5	-5.4	-5.3	-5.6
Real Retained Imports of Foodstuffs	-14.1	-6.6	9.9	-5.5	-10.9	-6.1	-6.6	-5.9	-1.3	1.9	-9.0	-10.4
Real Retained Imports of Consumer Goods	76.4	23.3	-11.1	-0.8	-20.0	-11.2	1.2	-21.4	-14.9	5.6	-6.4	0.2
Real Retained Imports of Raw Materials & Semi-Manufactures	75.6	28.5	26.1	13.5	-9.2	11.0	-10.2	-3.0	-4.3	7.0	0.6	-0.1
Real Retained Imports of Fuels	8.2	34.5	2.7	-19.5	9.4	-24.9	-6.7	-8.9	8.4	-10.4	-5.1	-11.5
Real Retained Imports of Capital Goods	111.2	34.6	0.5	-18.7	14.6	-3.3	-2.4	4.7	-3.4	-16.0	4.2	4.0
Total Motor Vehicles Newly Registered	-8.8	-20.2	-34.9	-51.2	-48.7	-30.0	-35.5	-45.7	-34.4	-33.7	-27.8	-32.5
Private Cars Newly Registered	-6.4	-21.9	-31.0	-51.6	-45.4	-31.2	-33.1	-41.2	-33.9	-30.3	-25.2	-30.5
Electricity Consumption	-0.2	6.0	5.0	-9.5	-0.4	-1.9	-1.5	1.7	3.7	3.9	5.1	0.7
Gas Consumption	2.0	2.3	6.4	-1.1	-2.5	4.8	1.4	0.0	1.7	1.9	2.4	0.4
Volume Index of Retail Sales	11.8	-11.2	-3.7	-12.2	-7.5	-3.3	-0.3	2.9	1.8	3.4	2.5	2.5
Money Supply (Definition 2)	0.3	2.1	1.9	1.8	2.3	2.4	4.3	4.7	5.4	6.0	6.5	7.9
Loans and Advances	-4.8	-4.2	-4.5	-5.0	-4.4	-4.3	-4.8	-4.2	-3.8	-3.7	-3.5	-3.7
Visitors Arrivals	31.0	26.2	3.9	-64.8	-67.9	-38.2	-5.6	6.6	5.3	3.6	2.3	4.5
Hong Kong Resident Departures	10.7	-5.3	-14.1	-29.2	-23.8	-11.3	-4.2	2.3	3.0	-0.2	-1.0	4.2
Land Considerations	-33.4	-13.3	-15.6	-31.7	-32.5	-45.1	-22.5	11.9	-15.8	-26.6	-3.6	-8.9
Effective Exchange Rate Index	-4.1	-4.3	-3.9	-3.6	-3.8	-2.9	-1.5	-1.6	-2.2	-2.7	-2.1	-1.9

Date of Forecast: September 30, 2003