

## Terrorist attack in the United States and anticipated US retaliation

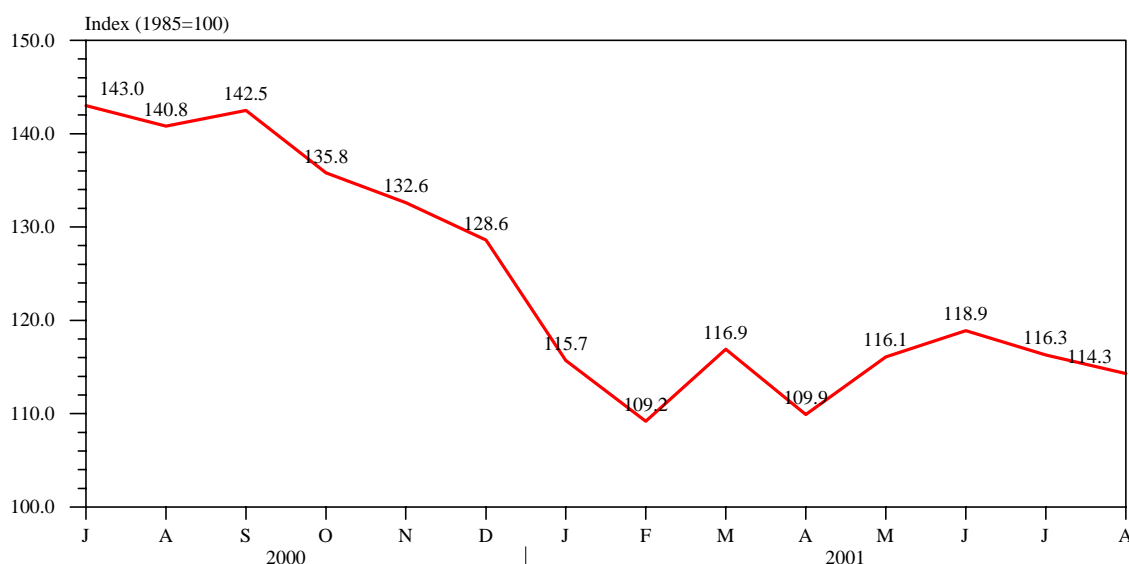
### Monitoring of impact on the US economy, the global markets and the Hong Kong economy (data updated to 21 September 2001)

#### A. Impact on the US economy

The impact on the US economy hinges on how severely and for how long US consumer sentiment and business confidence will be depressed after the terrorist attack, and further with the anticipated US retaliation. The overhang of alarm and distress at the incident itself and at the possibility of further attacks is currently heavy within the US community. So far this year, private consumption has been providing the main impetus to growth in the US economy. If consumer spending falters owing to households generally holding back from their festive shopping in the fourth quarter, this could lead the already slackened US economy into recession. Worse still, if business investment tumbles more, the setback could be even more pronounced.

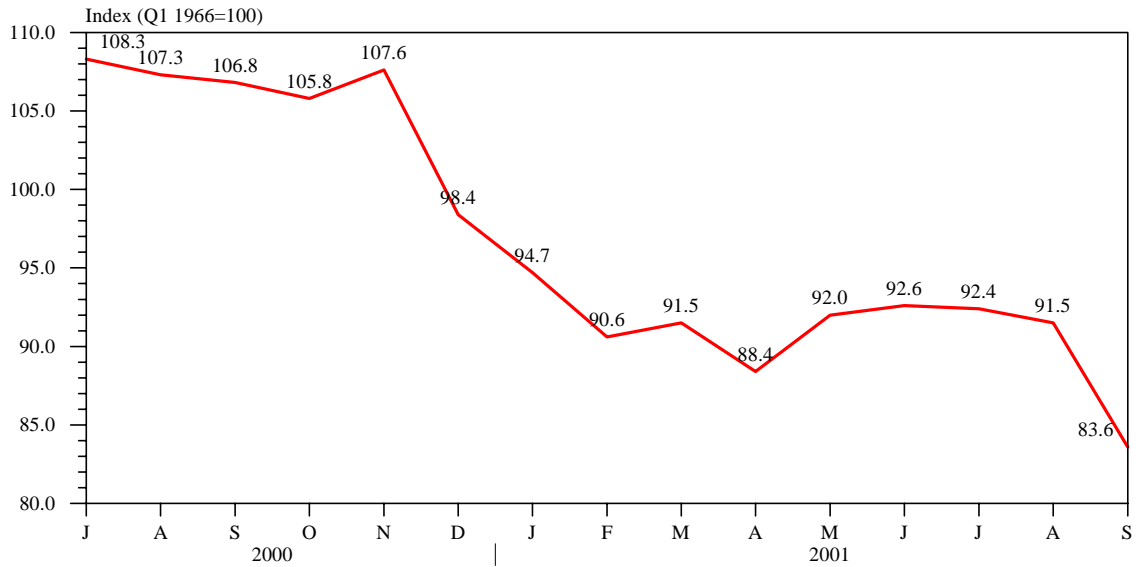
##### (a) *Consumer spending*

#### Consumer Confidence Indicator



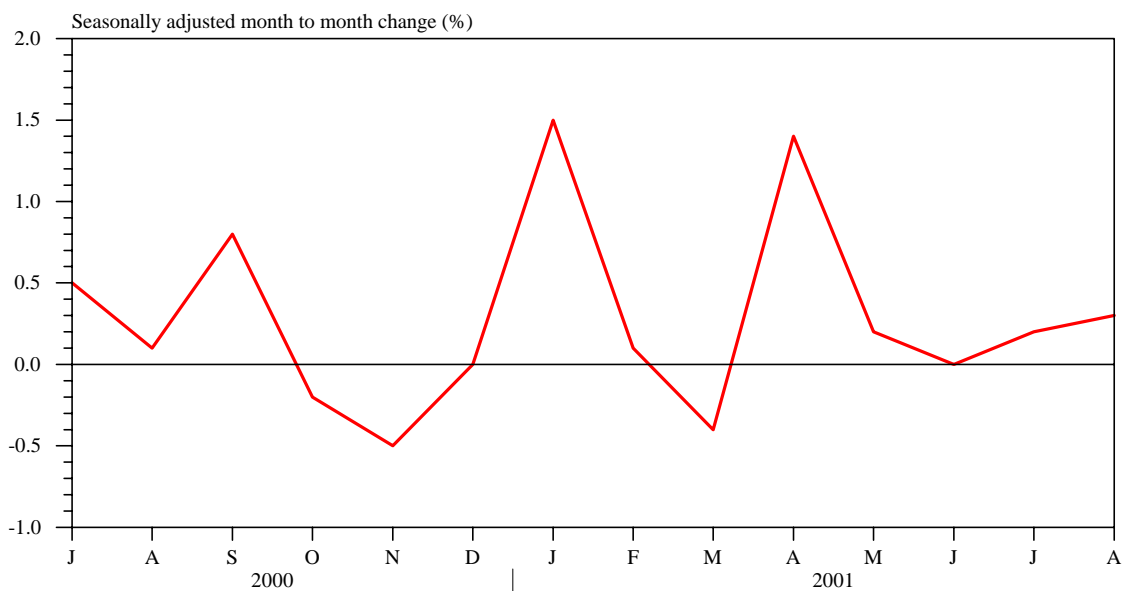
The Consumer Confidence Indicator has been on a general downtrend in the latter part of 2000 and early 2001. Having picked up somewhat in March, May and June, the indicator receded again in July and August as overall economic conditions deteriorated.

### Michigan Consumer Sentiment Index

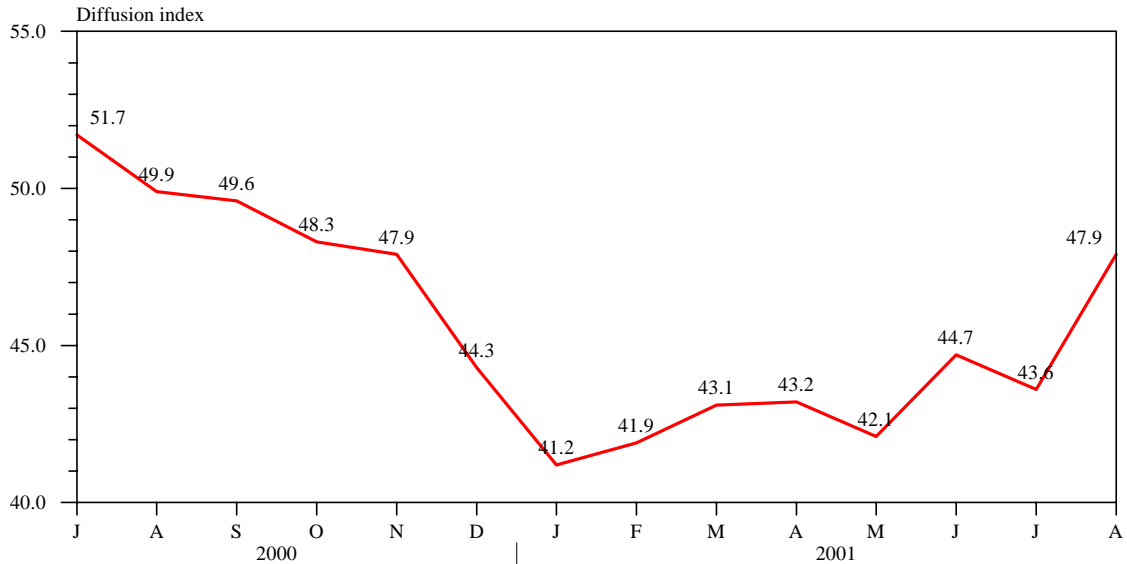


The Michigan Consumer Sentiment Index has also been falling since the latter part of 2000. Preliminary reading of the Index for September 2001 just before the attack showed that it fell to the lowest level since November 1993, amidst the worsened labour market situation.

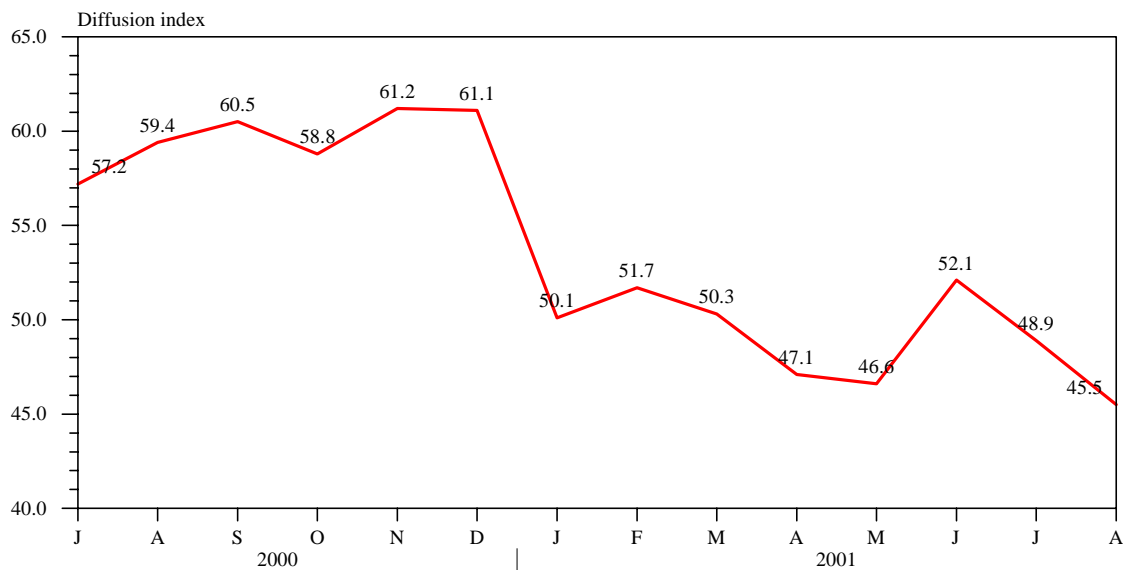
### Value of retail sales



Growth in the value of retail sales turned more sluggish in the more recent months.

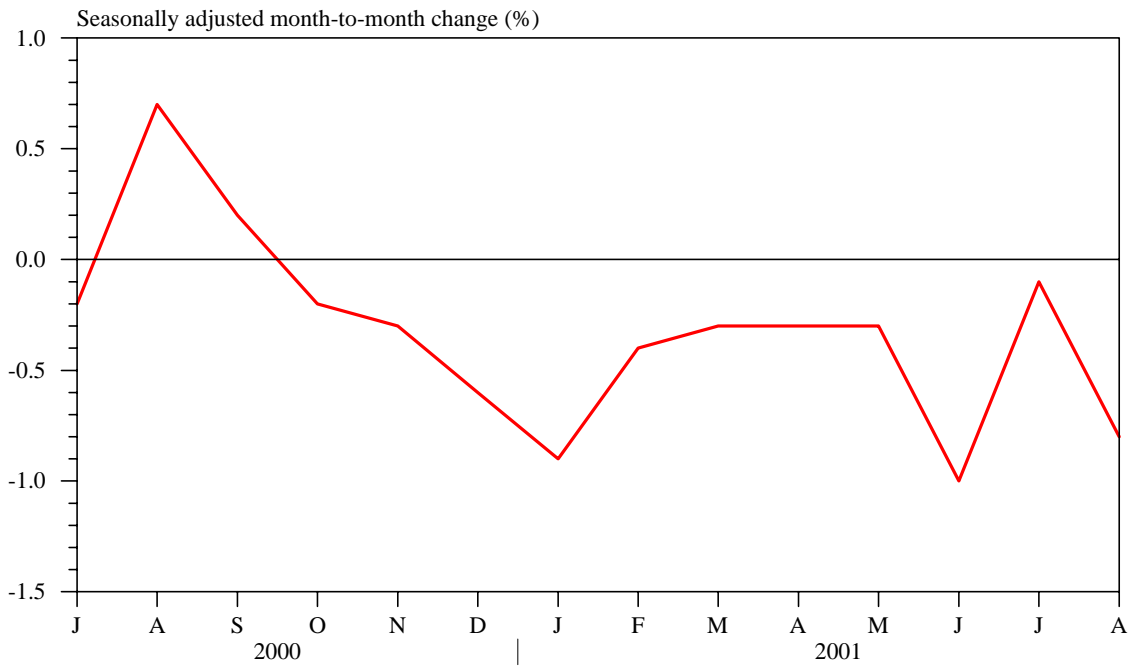
(b) *Production and orders***Purchasing Management Index - Manufacturing**

Though the index was still below 50, the more distinct pick-up in August might suggest that the manufacturing sector's downward drag on the economy had tended to lessen lately.

**Purchasing Management Index - Services**

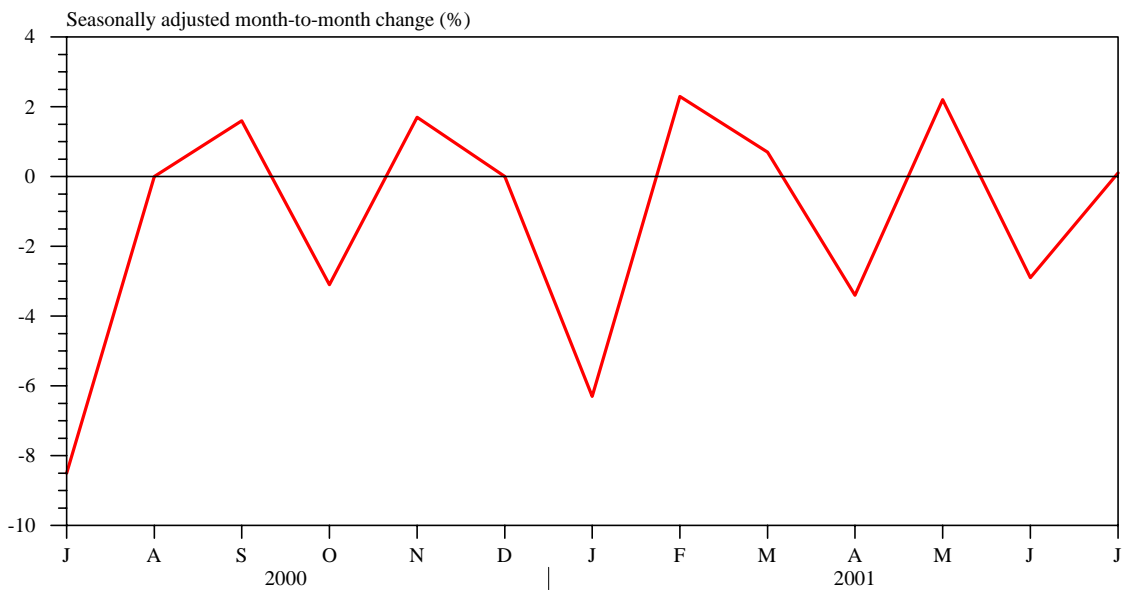
Yet business activity in the services sector contracted further in August.

### Volume of industrial production

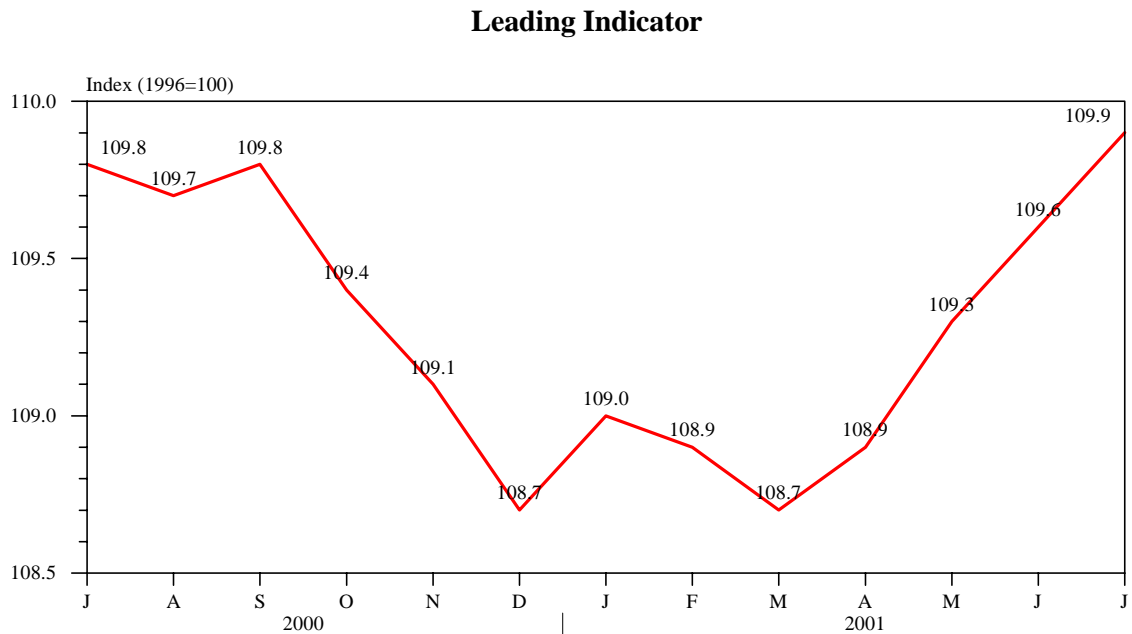


Industrial production fell for 11 consecutive months in August, the longest down-cycle since 1960.

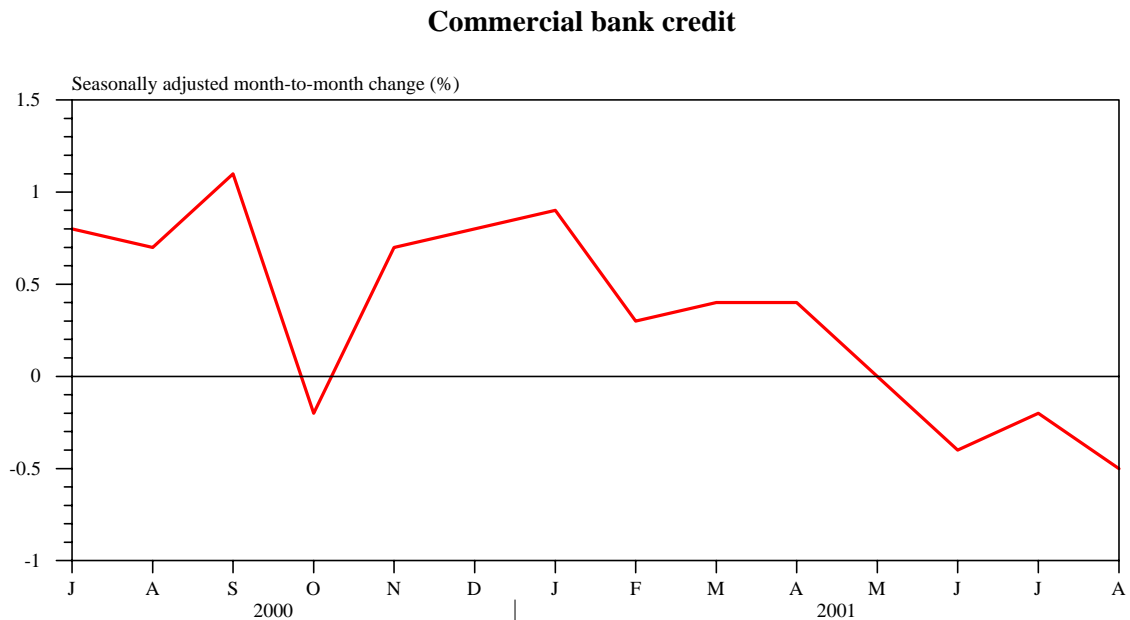
### Factory orders



New factory orders continued to be weak.

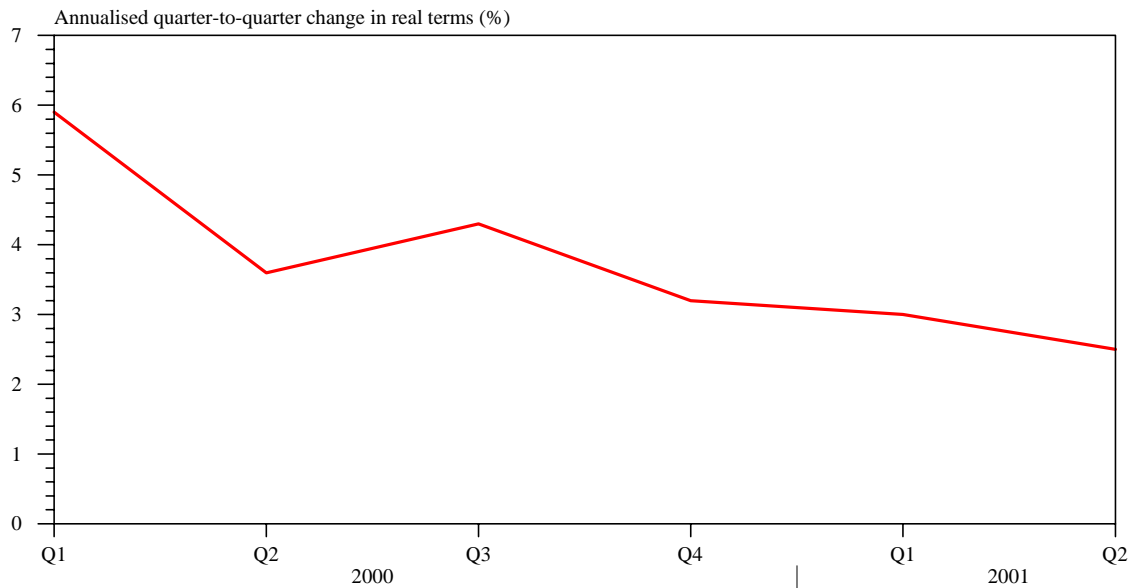
(c) *Overall economy*

Before the attack, the Leading Indicator for near-term economic activity edged higher for four consecutive months in July.



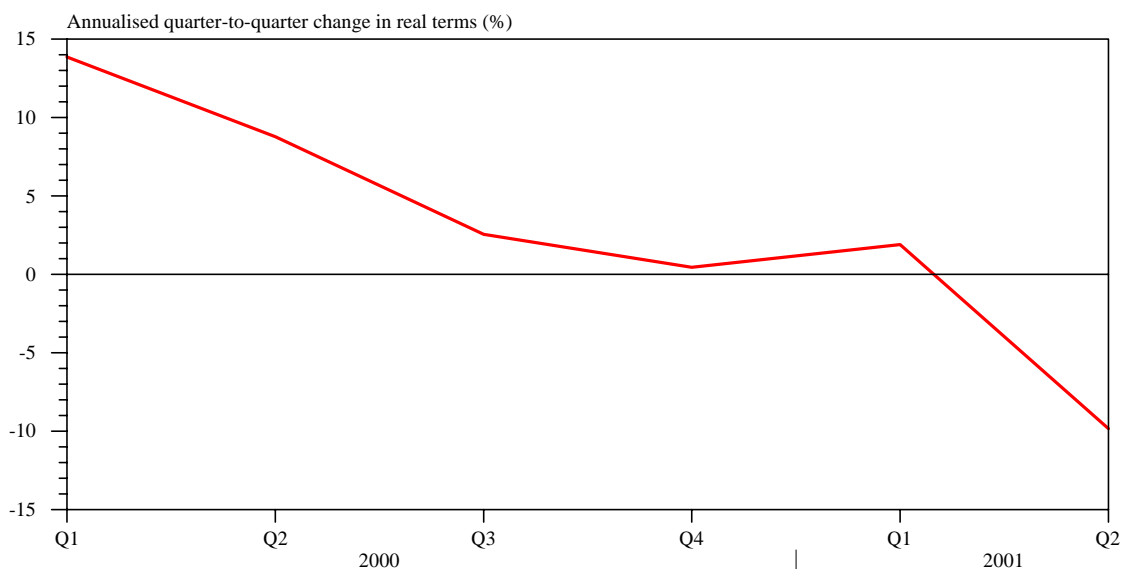
Along with the economic downturn, the demand for bank credit has weakened towards the middle of 2001.

### Personal consumption expenditure



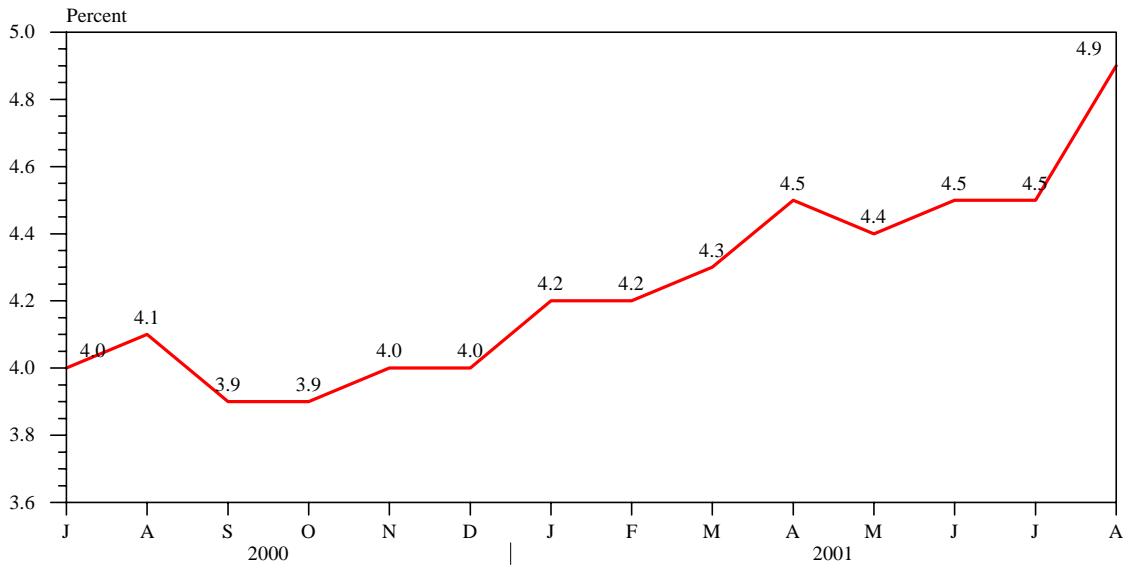
Private consumption expenditure held up relatively better up to Q2 2001. It is however expected to weaken consequential to the more distinct rise in the unemployment rate, and lately the blow to consumer sentiment brought about by the terrorist attack.

### Private domestic fixed investment



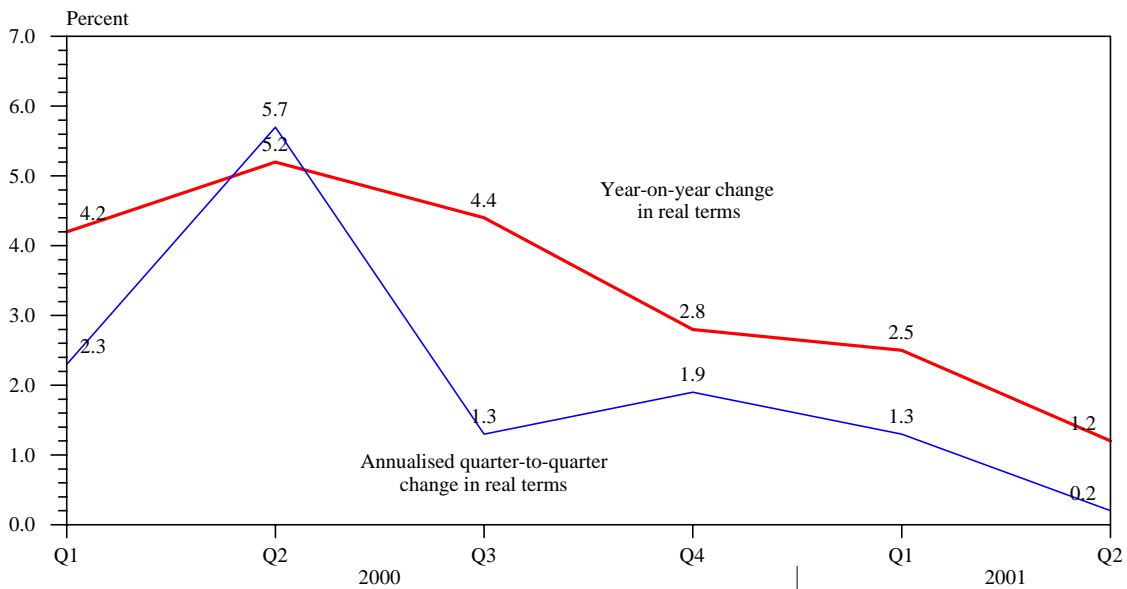
The plunge in private sector investment in Q2 2001 was the sharpest since Q1 1991, directly causing US GDP growth to slacken markedly. A further plunge is to be expected as business confidence is shaken by the grave uncertainty in the aftermath of the terrorist attack.

### Unemployment rate

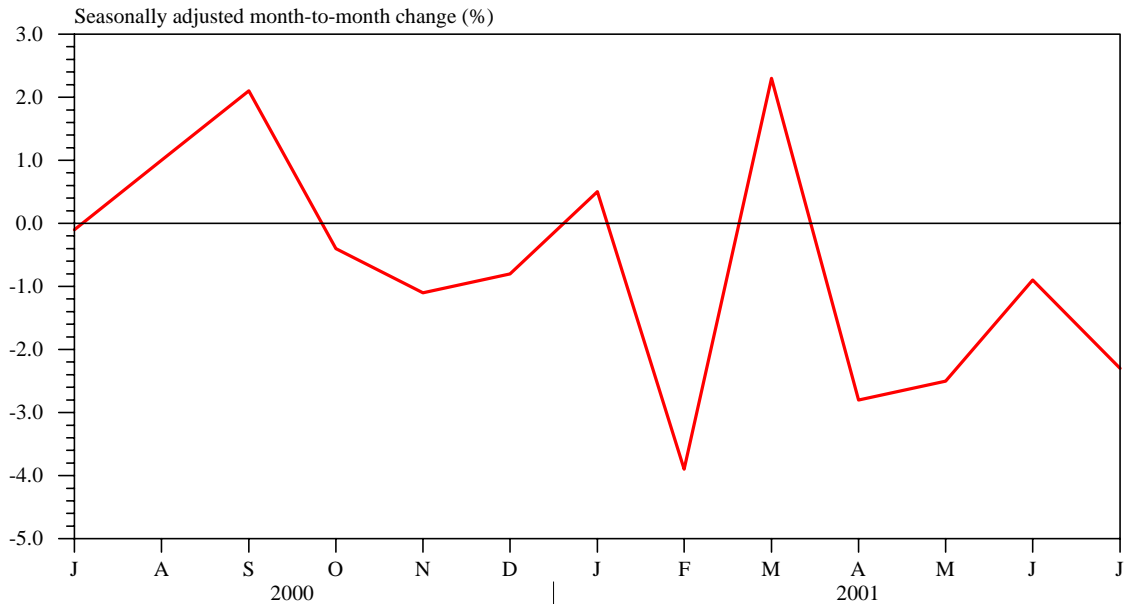


The unemployment rate rose to a four-year high of 4.9% in August, with the latest rise being particularly steep.

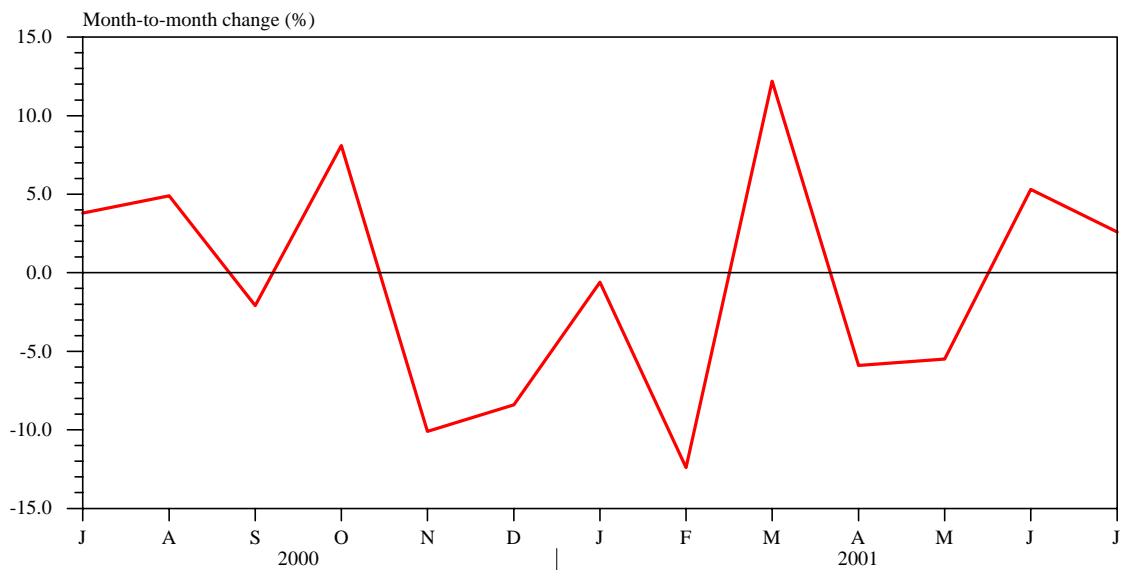
### Gross Domestic Product



US real GDP growth on an annualised quarter-to-quarter comparison fell below the 2% level for four consecutive quarters, to a meagre 0.2% in Q2 2001. There is a clear likelihood that US real GDP growth in the near term will be brought down to negative territory.

(d) *Imports***Total imports of goods**

Along with the setback in domestic demand, US imports went down visibly in recent months.

**Imports of goods from Asia**

The downswing in the global electronic product cycle curtailed US import demand from Asia. Yet in recent months, US import demand for ordinary consumer goods had fared not so worse.



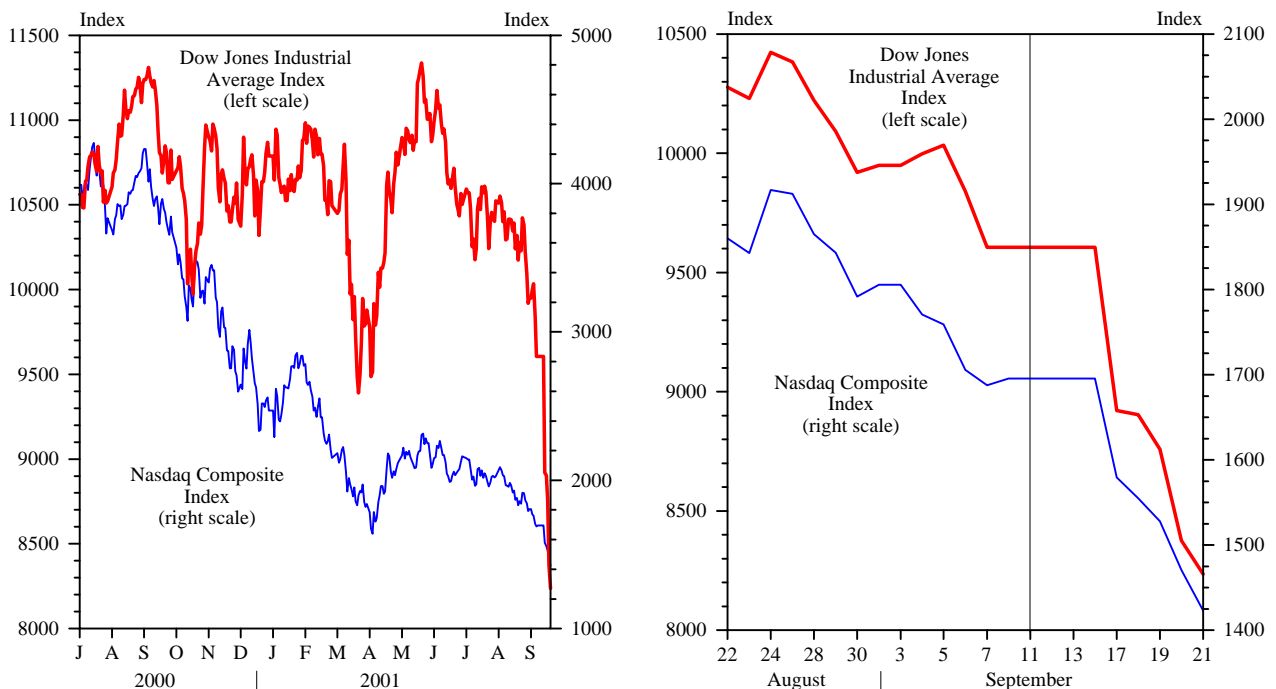
## B. Impact on the global markets

The attack has caused widespread repercussions in the global financial markets as well as the international oil market. While interest rates have come down reflecting conscious monetary easing, there is a keen concern about the volatilities in share prices and exchange rates, along with a close watch on the levels at which they may tend to settle. The movement in international oil prices towards the winter season is also of significance.

### (a) *Share prices*

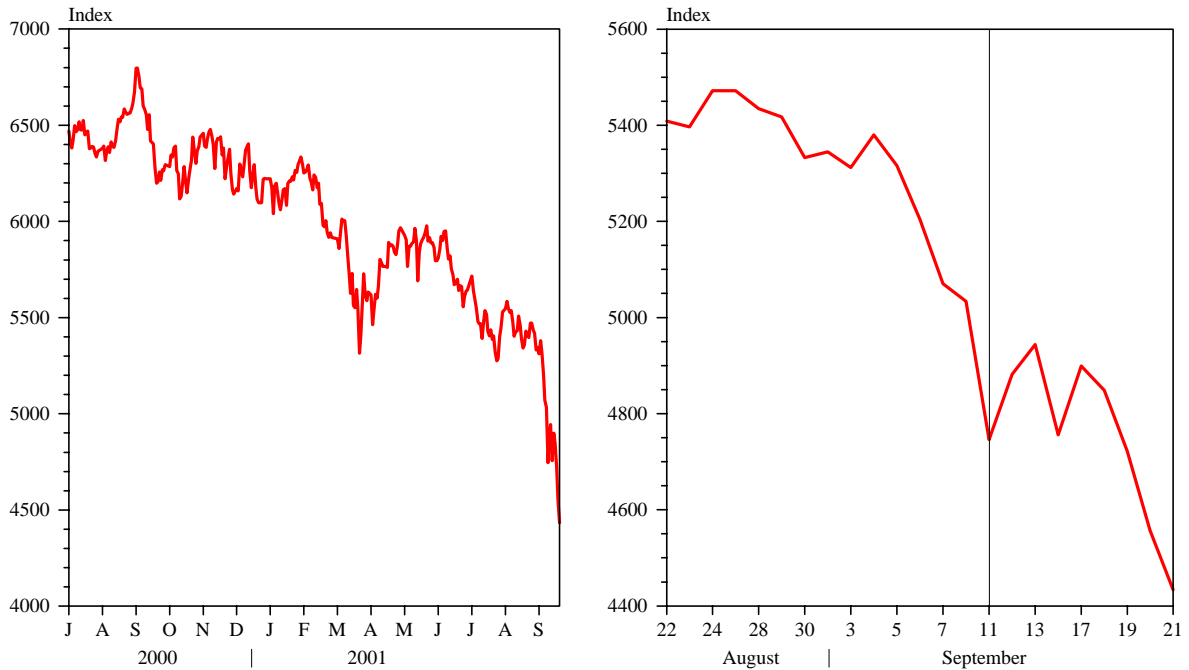
Financial market jitters are bound to hit economic sentiment. Moreover, the plunge in share prices is expected to inflict some negative wealth effect which will tend to dampen domestic demand further. After the attack, the spill-over from the US stock market onto the Japanese stock market has so far been less pronounced than onto the European and the other Asian stock markets. As very often there are overshoots and gyrations upon an initial shock, more time is needed to observe how share prices in the various markets are going to stabilise.

### US Dow Jones and Nasdaq Indices



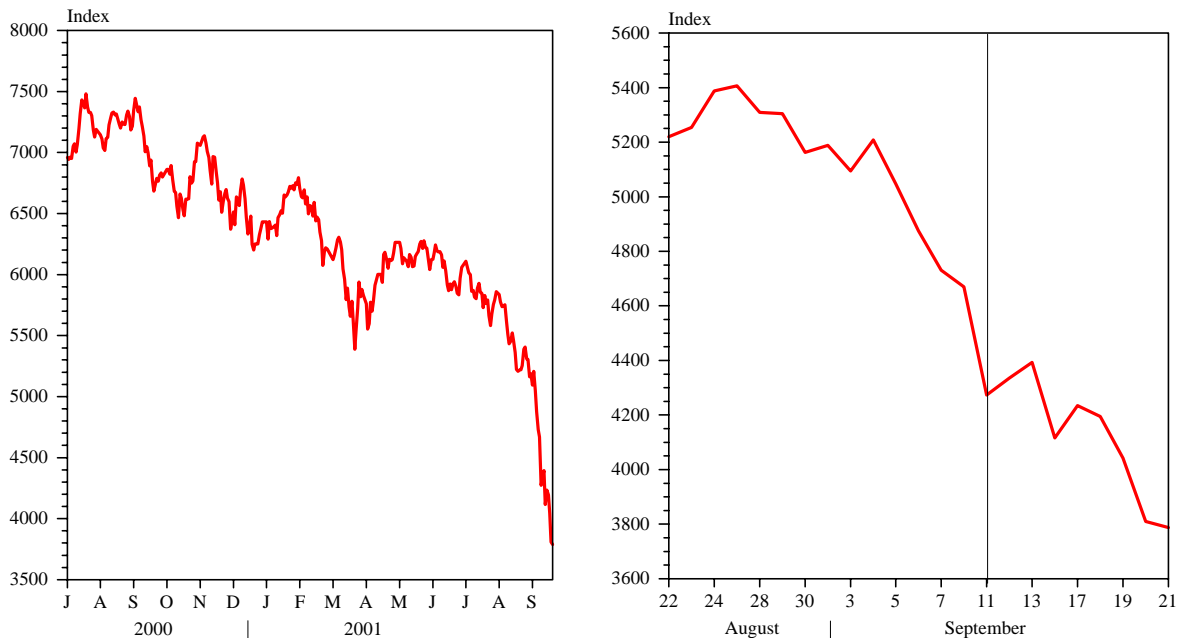
The US stock market fell for five straight days in the first week of resumed trading after the terrorist attack. By 21 September, the Dow Jones Industrial Average Index and the Nasdaq Composite Index plummeted by 14% and 16% respectively compared with the pre-attack closing on 10 September.

### UK FTSE 100 Index



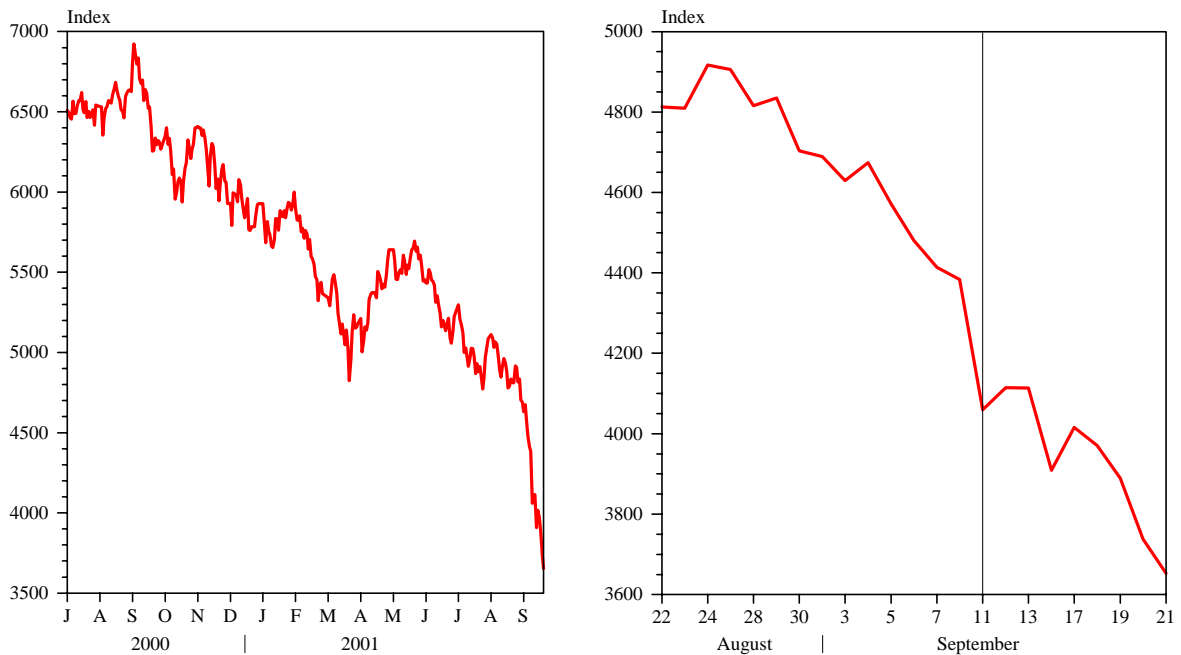
Compared with the pre-attack closing on 10 September, share prices in UK were on average down by 12% by 21 September.

### German DAX Index



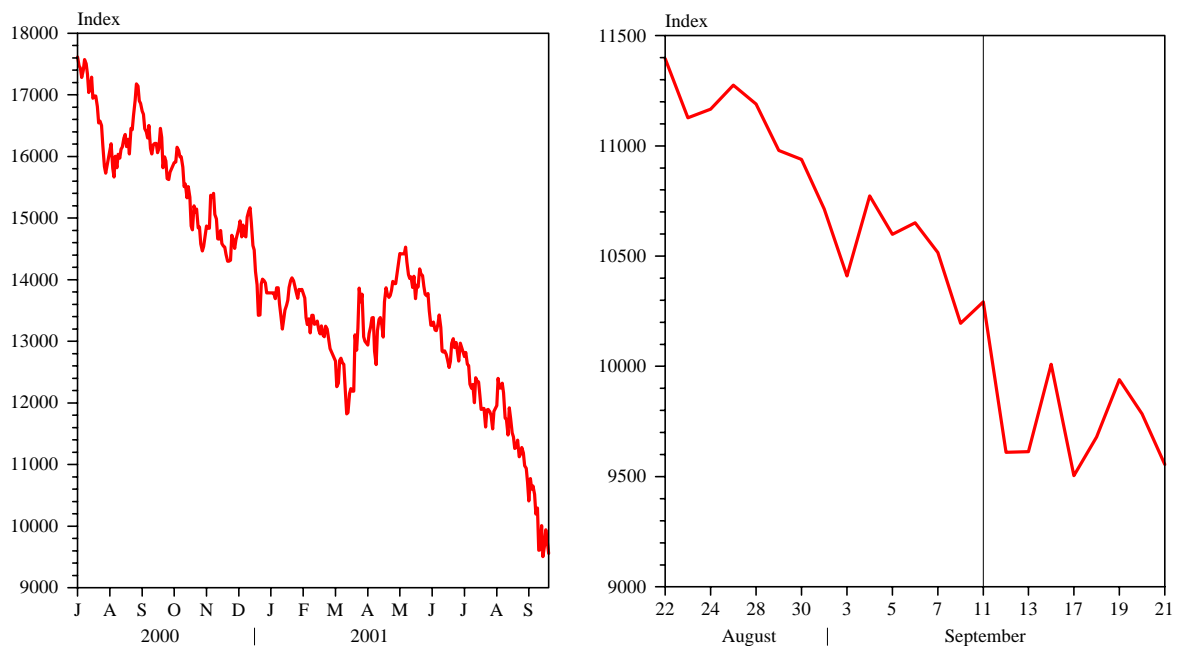
Compared with the pre-attack closing on 10 September, share prices in Germany plunged by an average of 19% by 21 September.

### French CAC 40 Index



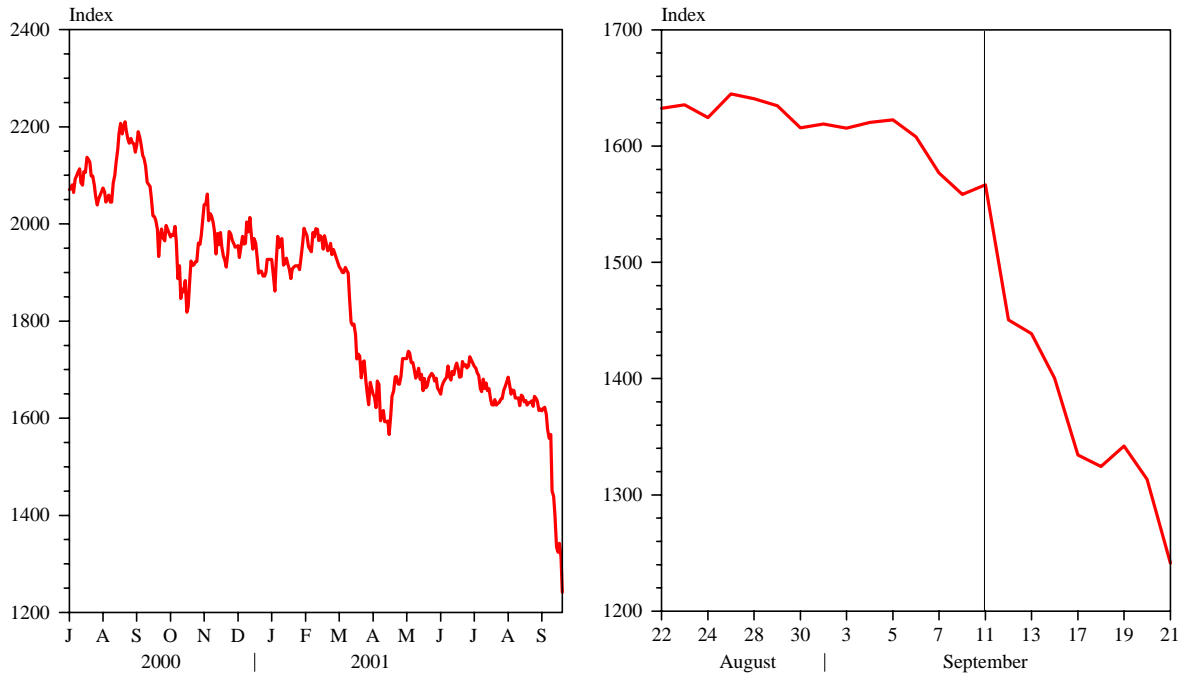
Compared with the pre-attack closing on 10 September, share prices in France went down by an average of 17% by 21 September.

### Tokyo Nikkei 225 Index



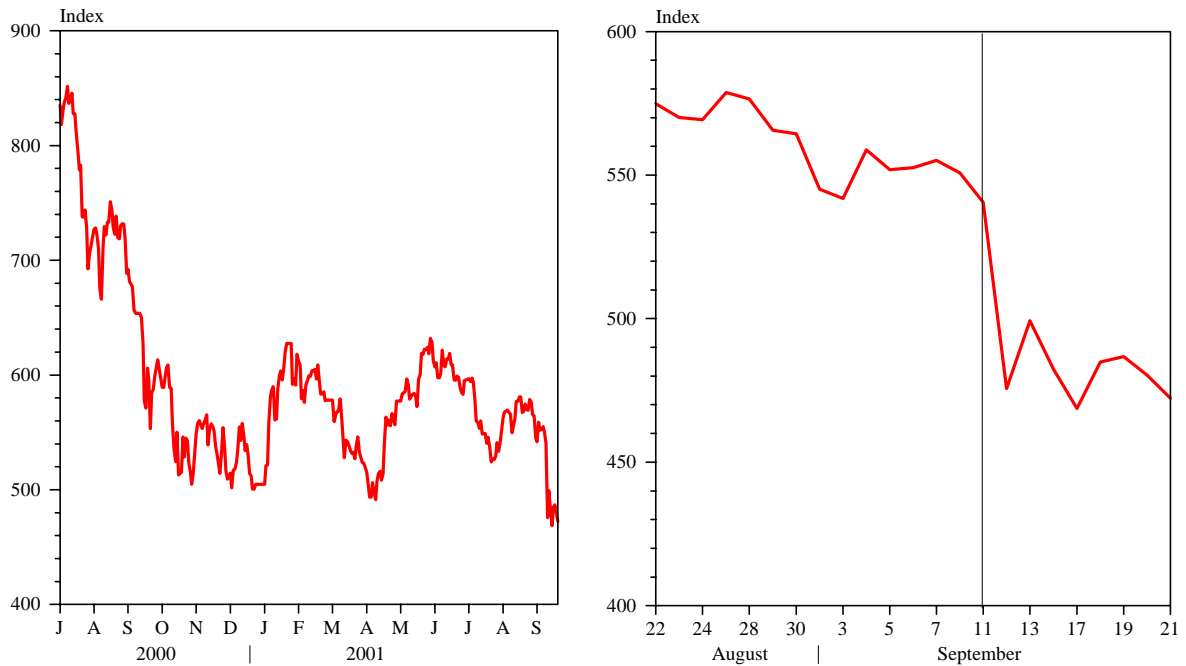
Amongst the major stock markets worldwide, the Tokyo stock market seems to have been affected the least after the terrorist attack. Compared with the pre-attack closing on 11 September, the Nikkei 225 Index was down by 7% by 21 September.

### Singapore Straits Times Index



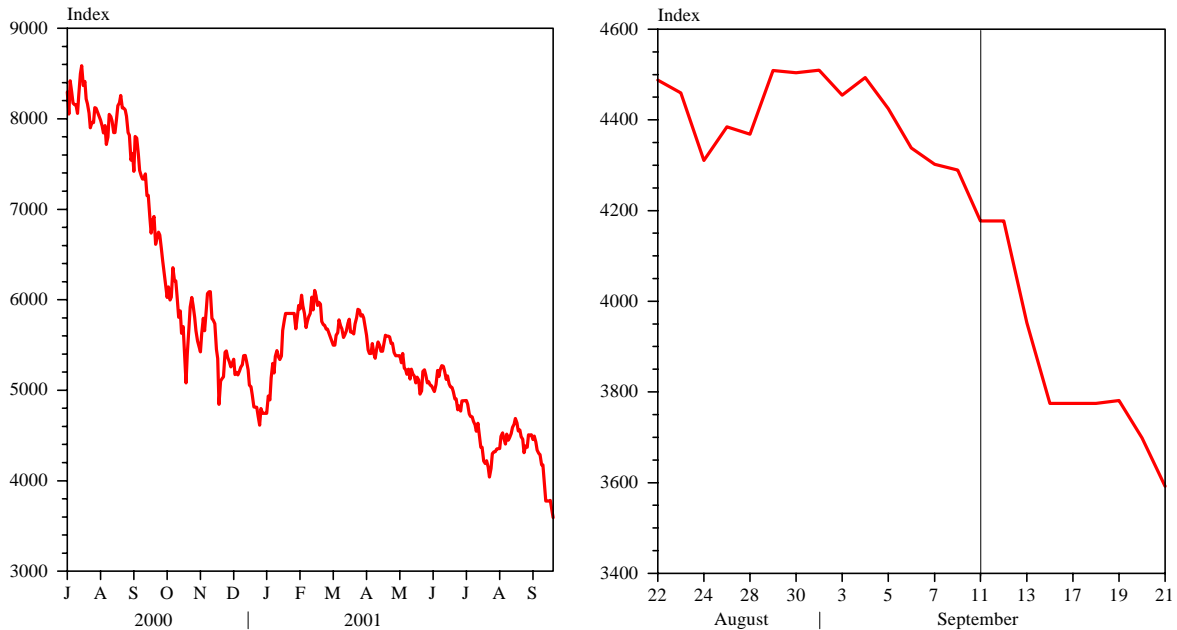
Share prices in Singapore on average plummeted by 21% by 21 September, compared with the pre-attack closing on 11 September.

### Korea Composite Index



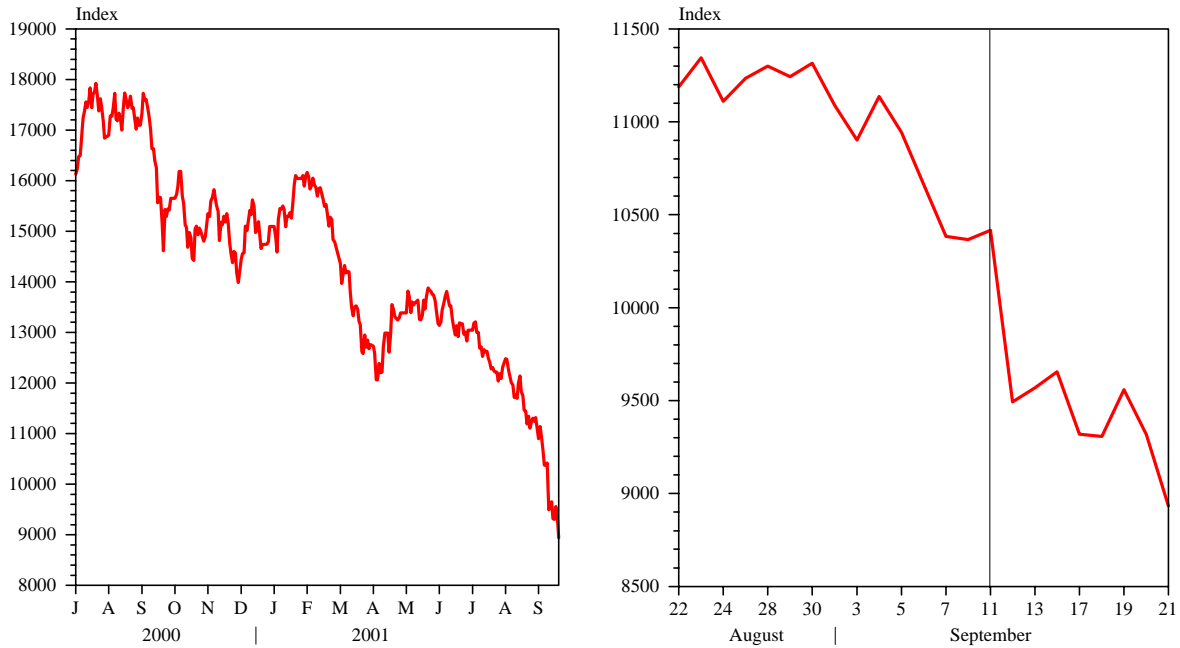
Share prices in South Korea fell by an average of 13% by 21 September, compared with the pre-attack closing on 11 September.

### Taiwan SE Weighted Price Index



Share prices in Taiwan were down by an average of 14% by 21 September, compared with the pre-attack closing on 11 September. The Taiwan stock market was suspended due to typhoon on 17 and 18 September.

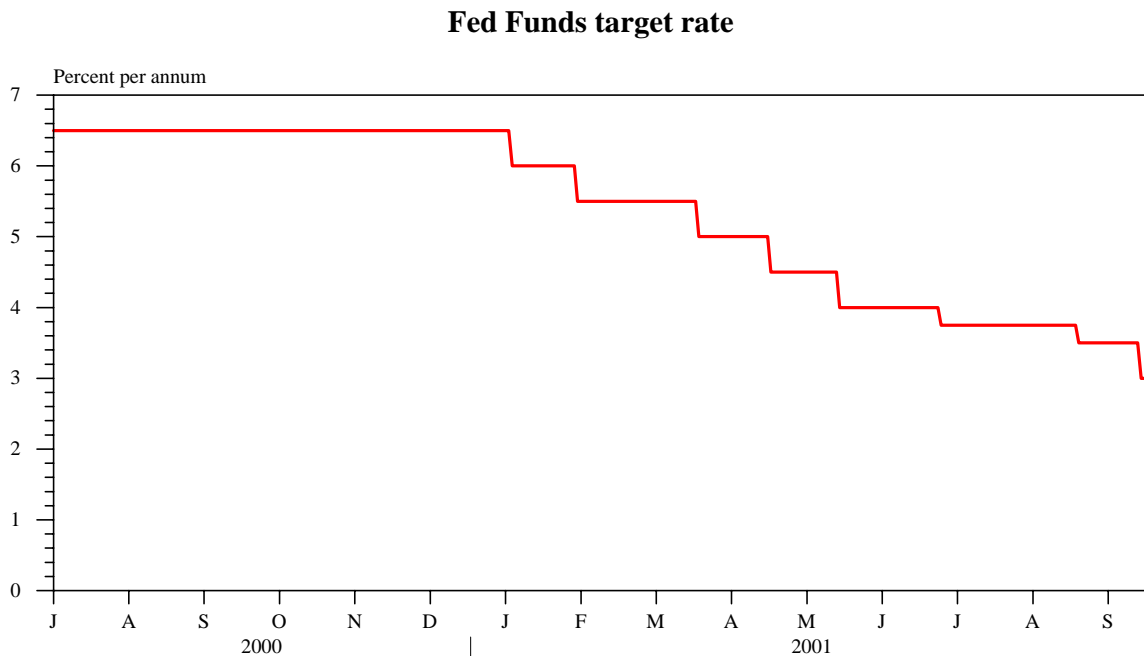
### Hong Kong Hang Seng Index



In Hong Kong, the Hang Seng Index came down by 14% by 21 September, compared with the pre-attack closing on 11 September. Yet the Hang Seng Index rebounded somewhat at opening on 24 September.

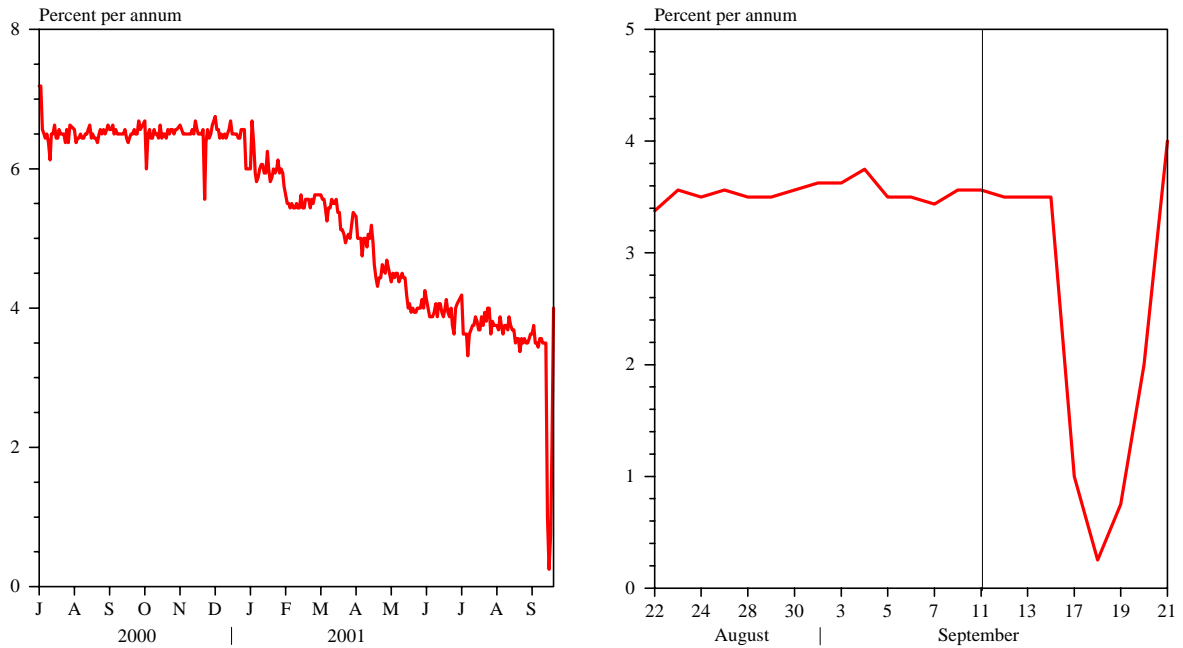
(b) *Interest rates*

US interest rates are on a further easing trend shortly after the terrorist attack. The spread between the short-term and long-term interest rates has widened further. European interest rates also ease. The major central banks are in a concerted effort to relax monetary conditions and to provide ample short-term liquidity to meet credit needs. The US Federal Reserve and the European Central Bank lowered their key benchmark interest rates by 50 basis points just before the US stock market re-opened on 17 September. The Bank of England cut its key lending rate by 25 basis points on 18 September. The Bank of Japan also cut its official discount rate by 15 basis points on 18 September, to only 0.1%.



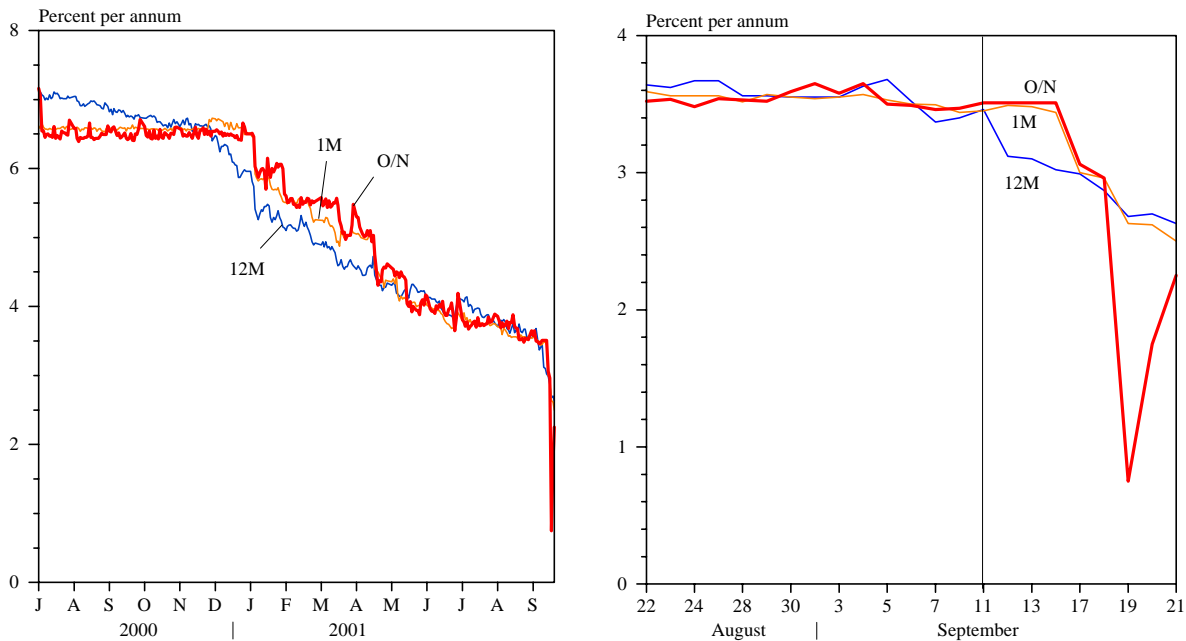
The cut in the Fed Funds target rate by 50 basis points to 3% on 17 September was the eighth Fed interest rate cut so far in 2001, cumulating to 350 basis points, and was the third one made outside the scheduled FOMC meetings. Further interest rate cut is widely expected at the next FOMC meeting on 2 October, or perhaps even before then.

### Fed Funds rate



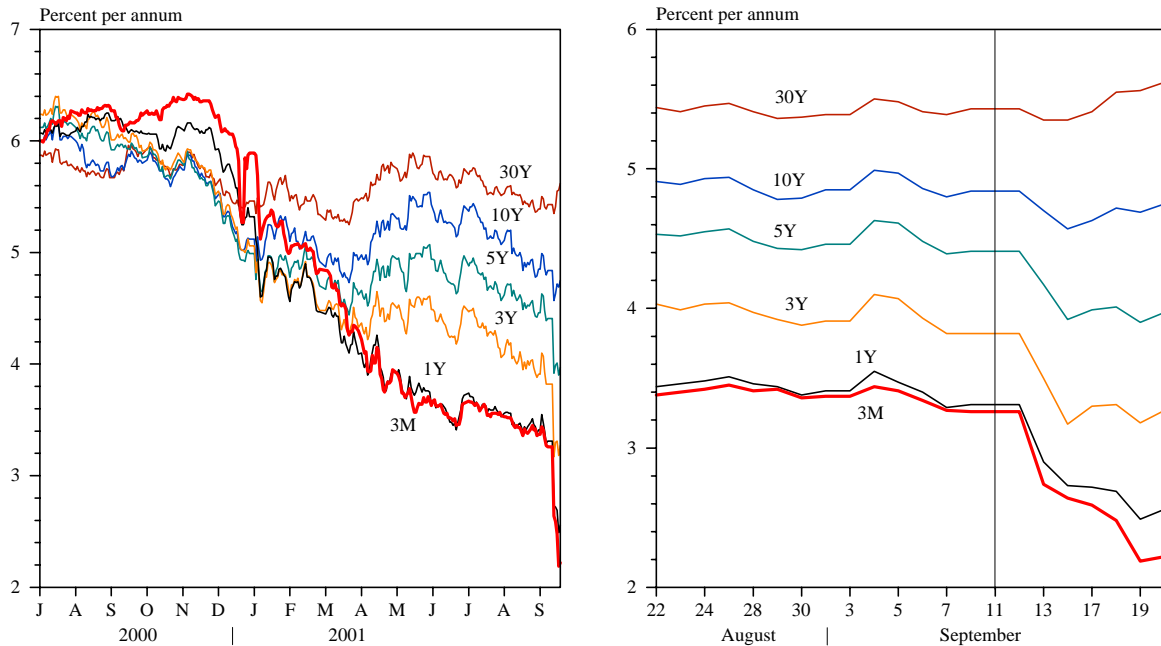
The US Fed Funds rate eased sharply to 0.25% on 18 September, but shot up to 4% on 21 September, one percentage point above the target level, amidst further jitters probably in the light of the imminent US military retaliation.

### Euro-dollar deposit rate



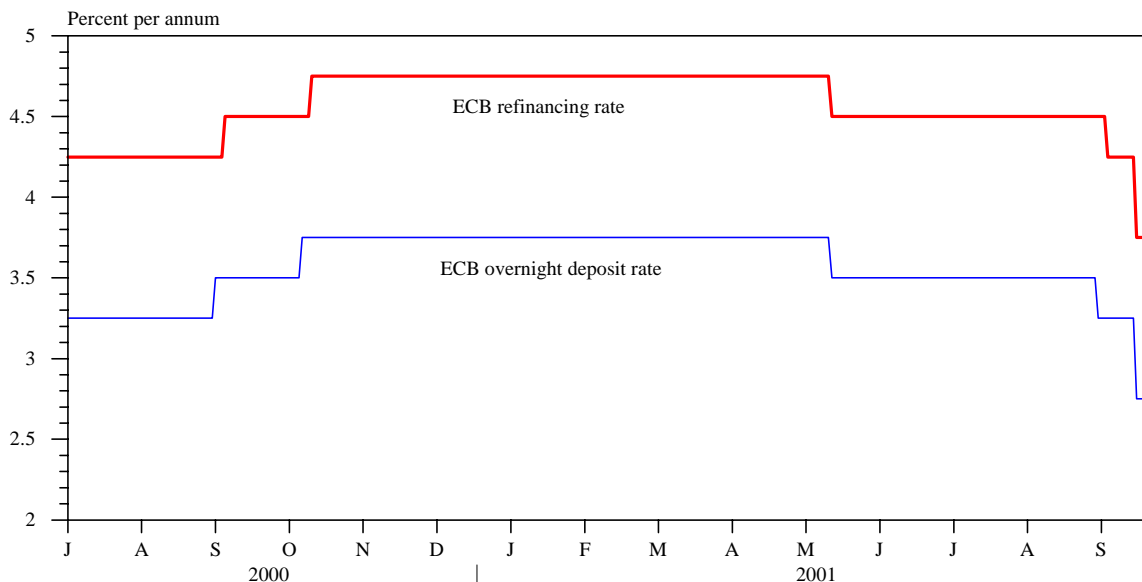
US dollar interest rates eased distinctly, except for the overnight rate which bounced back considerably after an initial dip.

## US Treasuries yields



Reflecting increased short-term liquidity, the short to medium term interest rates have fallen more distinctly than the long term rates, as the pattern of yield in US Treasuries indicates.

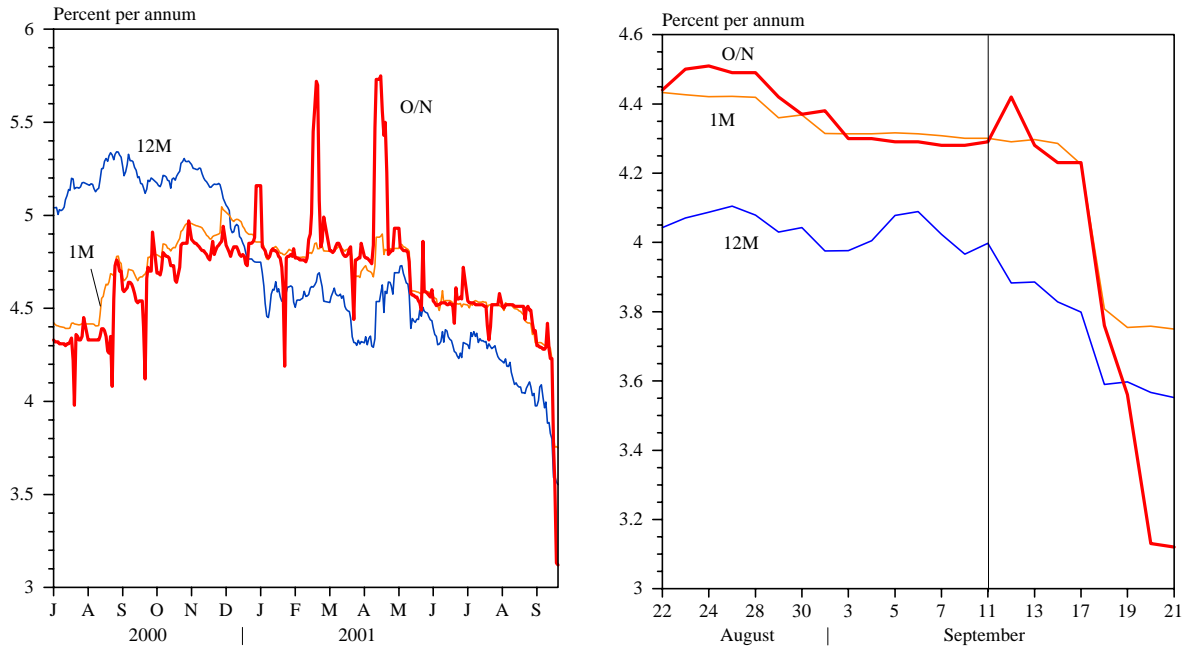
## ECB refinancing and deposit rates



ECB cut its benchmark interest rates only twice by a total of 50 basis points so far in the year, before the terrorist attack. It kept the interest rates unchanged at its first regular monetary policy meeting shortly after the attack. Then, it matched the Fed interest rate cut with a 50 basis points cut just before the US stock market re-opened on 17 September.

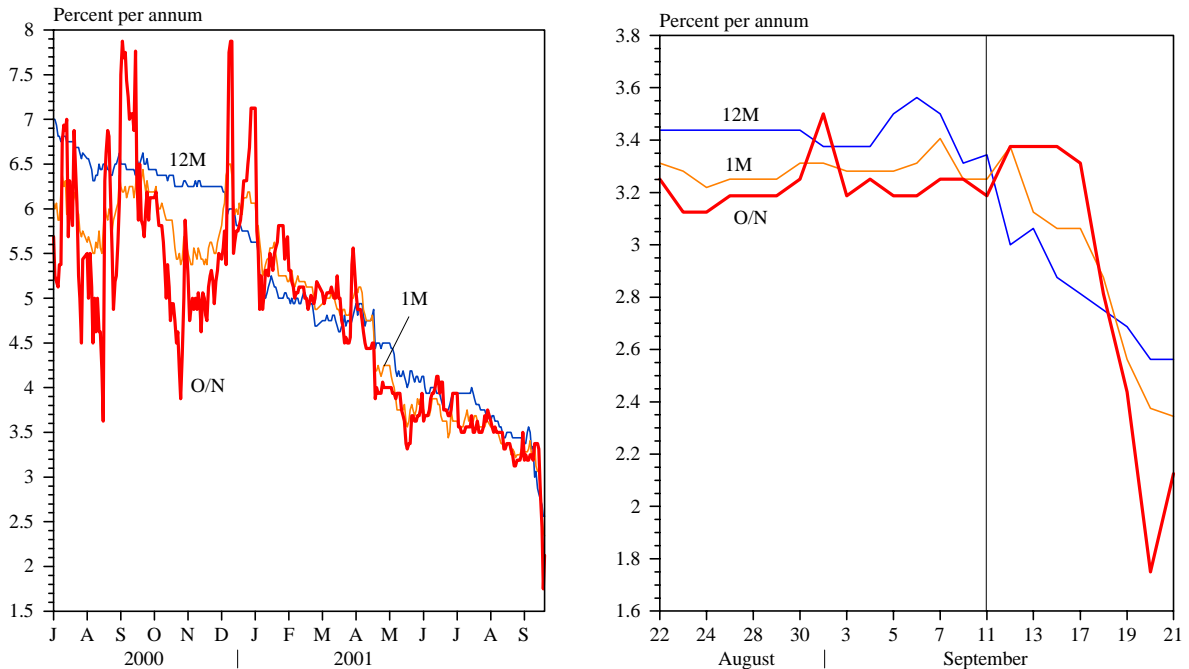


### EURIBOR



Interest rates in the euro inter-bank market also fell sharply.

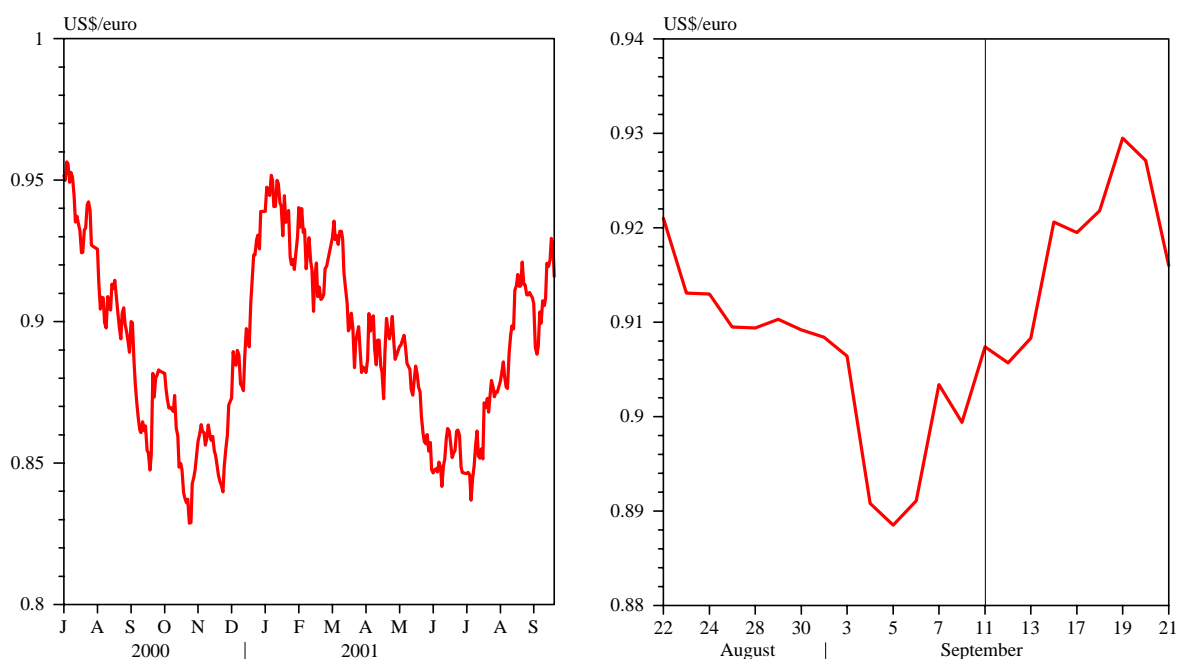
### HIBOR



In line with the movements in US dollar interest rates, Hong Kong dollar interest rates fell to new lows. Yet influenced by its US dollar counterpart, the Hong Kong dollar overnight interest rate bounced back somewhat.

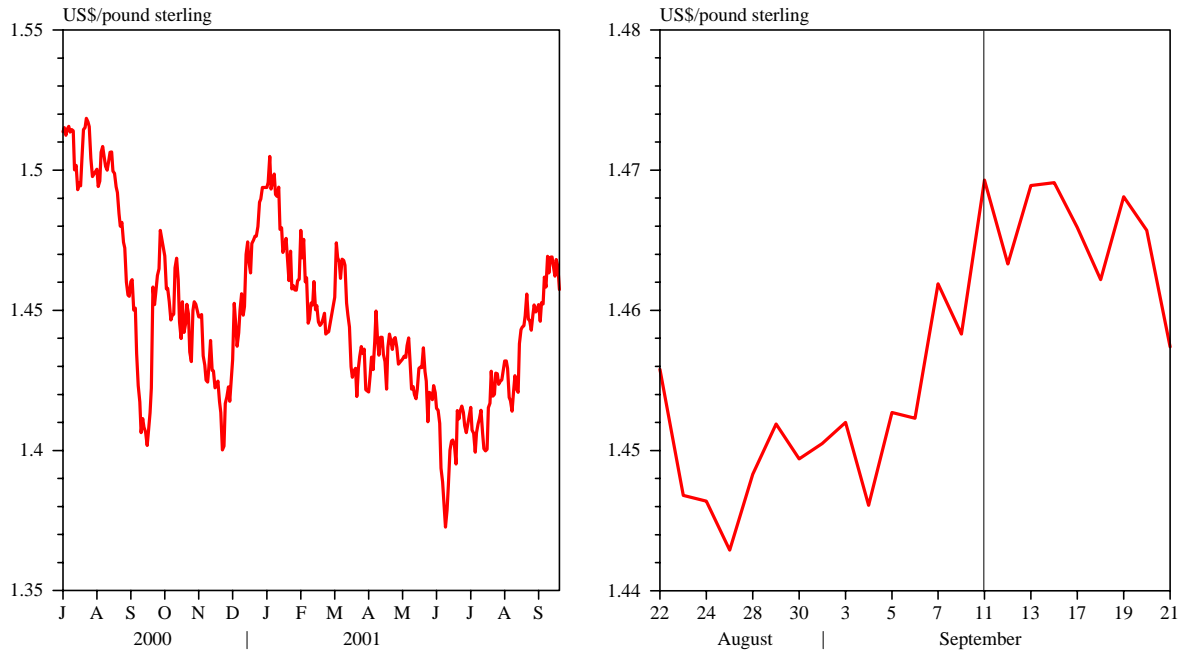
(c) *Exchange rates*

Market anxiety upon the terrorist attack have dampened the strength of the US dollar, yet with some resurrection lately. At US\$0.92/euro and 116.6 yen/US\$ on 21 September, the exchange rates were still around 2% below the pre-attack levels. In Asia, the Singapore dollar and New Taiwan dollar have risen marginally against the US dollar, while the Korean won has fallen marginally against the US dollar. Major fund flows across the money and forex markets will prompt re-alignment of currency values, which could sometimes be quite abrupt in the short term. The exchange rate situation in the time ahead will hinge on the level of international confidence in the US dollar upon the outbreak of US military retaliation action.

**US\$/euro**

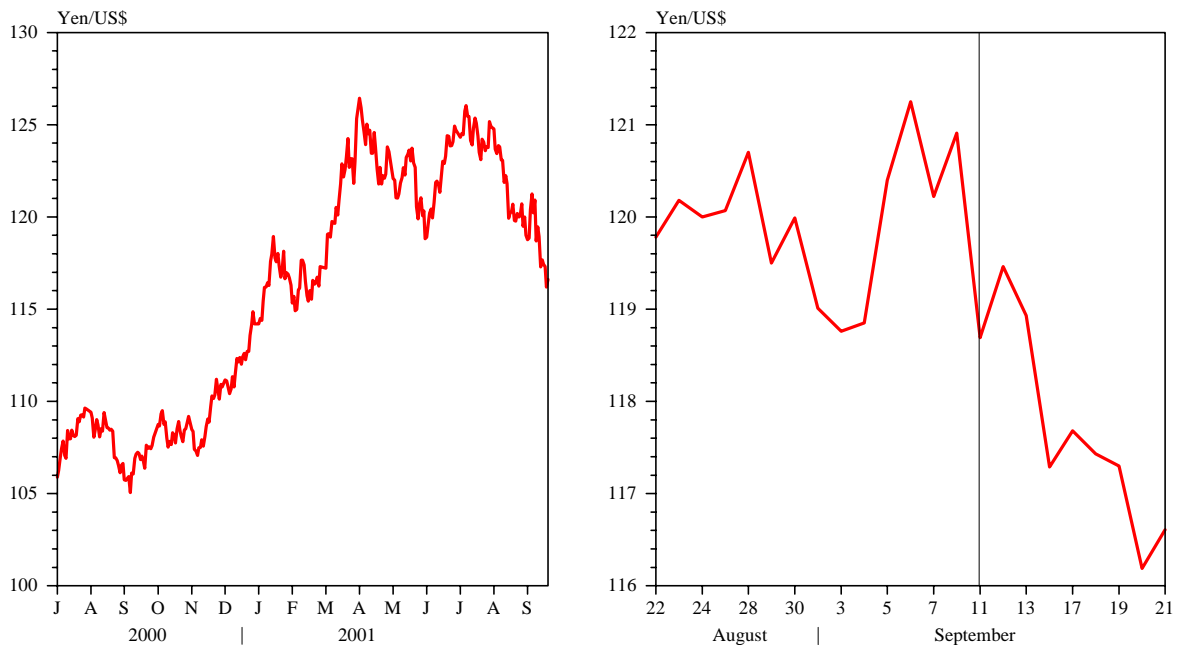
The euro rose to a high of US\$0.93/euro on 19 September, before easing back to slightly below US\$0.92/euro on 21 September, 1.8% higher than the level of US\$0.90/euro on 10 September.

### US\$/pound sterling



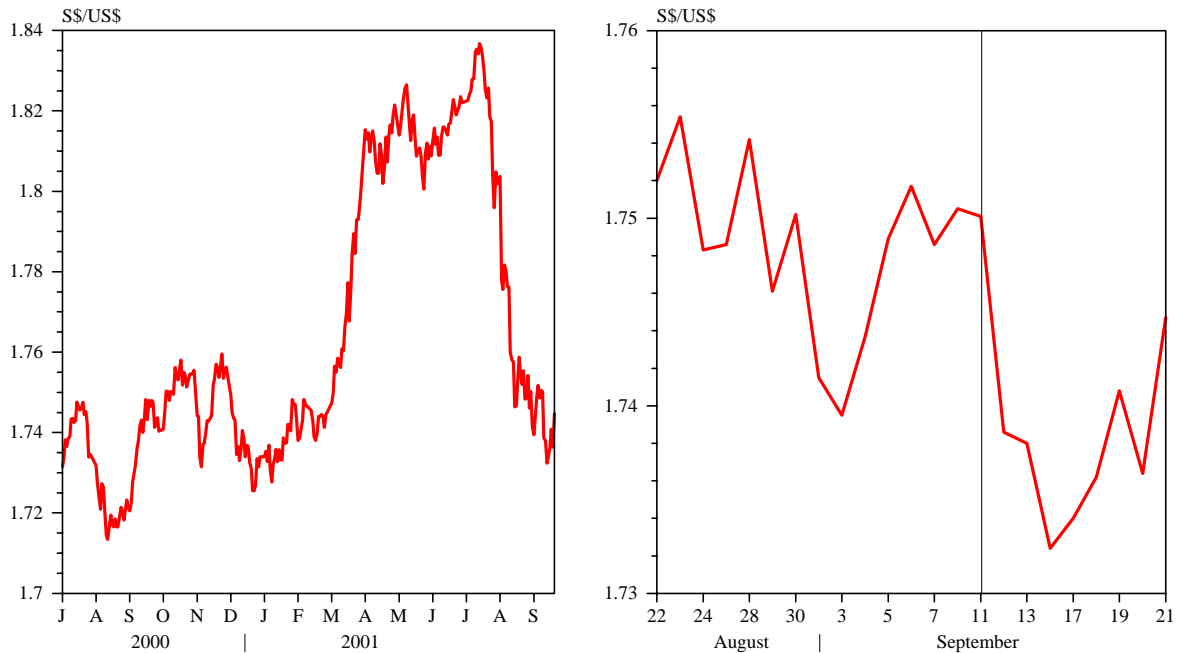
Having risen briefly to US\$1.47/£ shortly after the attack, the pound sterling fell back to US\$1.46/£ on 21 September, similar to the level on 10 September.

### Yen/US\$



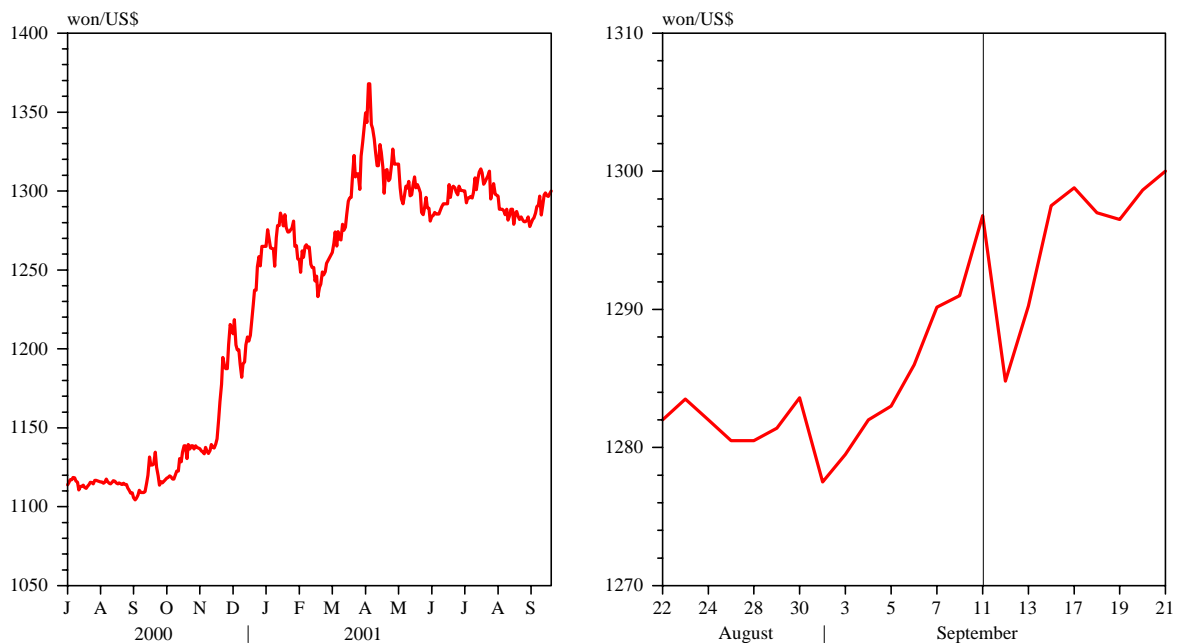
Notwithstanding successive interventions by the Bank of Japan, the yen rose by 1.8% from 118.7 per US dollar on 11 September to 116.6 on 21 September.

### Singapore\$/US\$



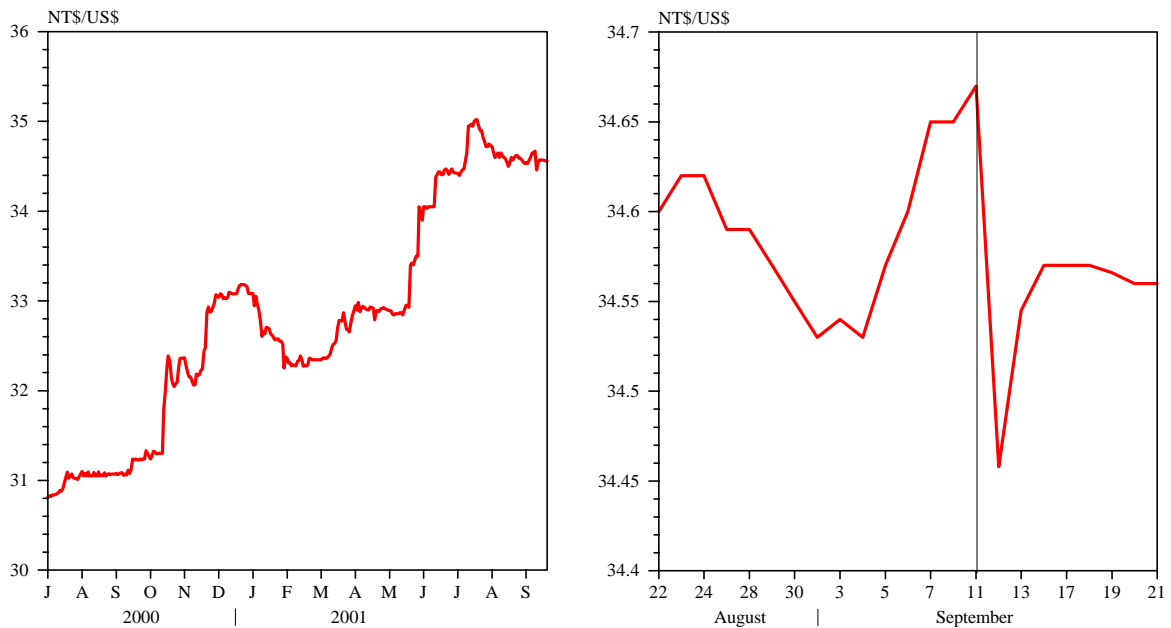
The Singapore dollar rose from 1.75 per US dollar on 11 September to 1.73 on 14 September, before easing back to slightly below 1.75 on 21 September. This represented a 0.3% gain from the pre-attack level.

### Korean won/US\$



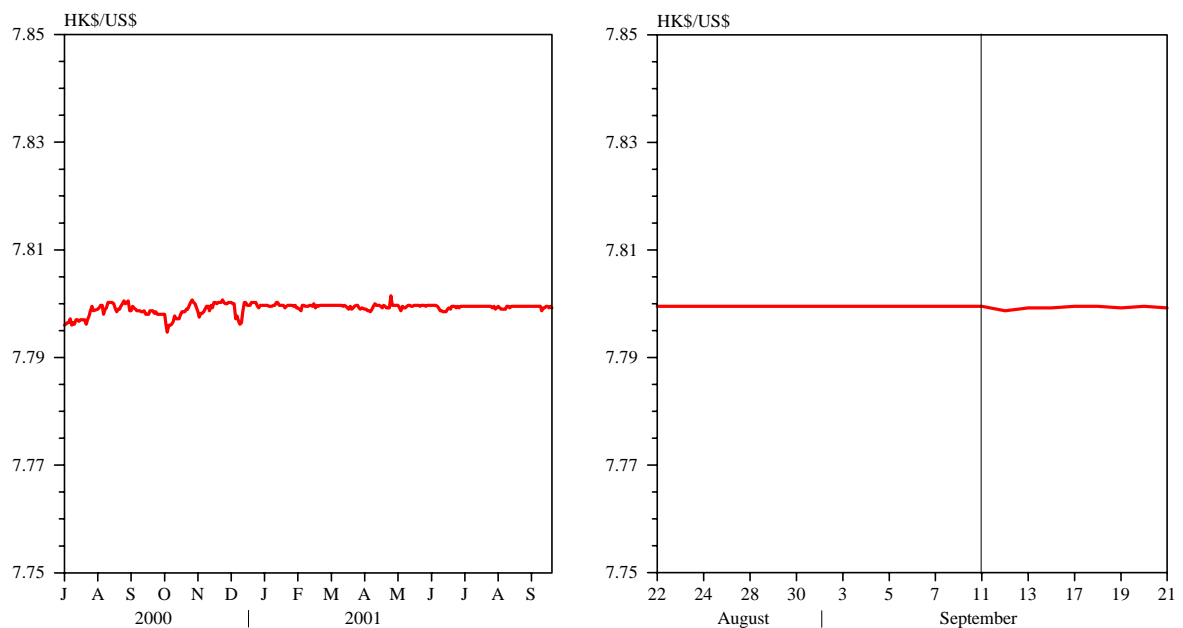
The Korean won rose from 1,297 per US dollar on 11 September to 1,285 on 12 September, before falling back to 1,300 on 21 September. This represented a 0.2% loss from the pre-attack level.

### New Taiwan Dollar/US\$



The New Taiwan dollar rose from 34.7 per US dollar on 11 September to 34.5 on 12 September, before easing back to 34.6 on 21 September. This represented a 0.3% gain from the pre-attack level.

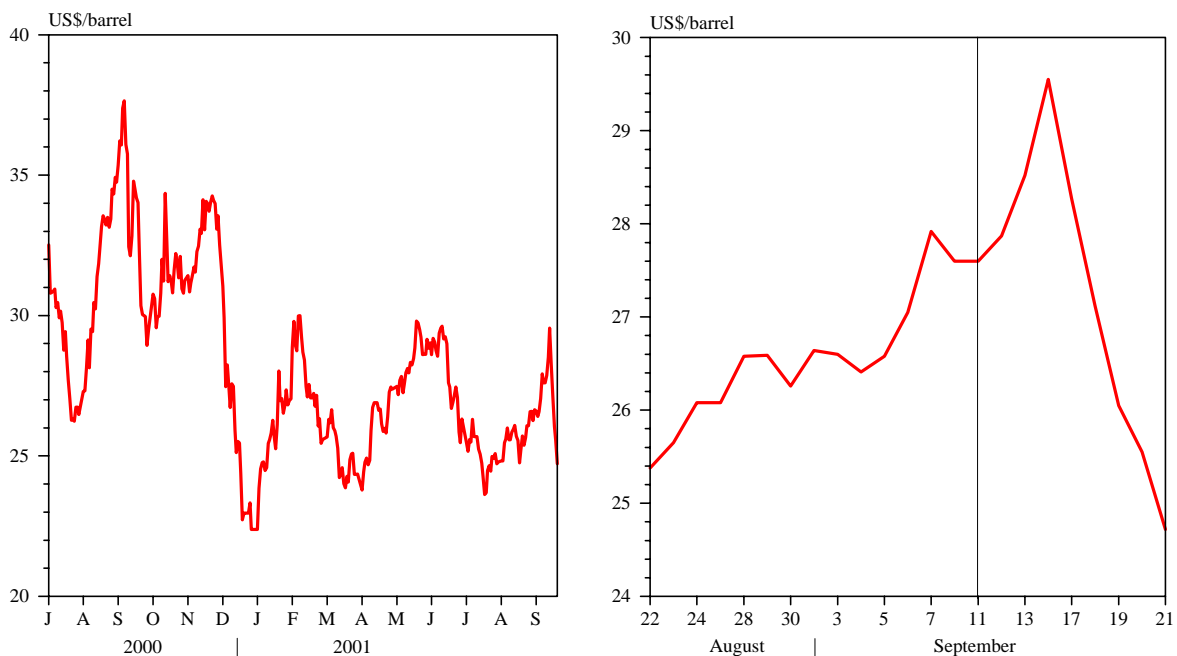
### Hong Kong Dollar/US\$



Despite considerable volatility in the global financial markets, the exchange value of the Hong Kong dollar against the US dollar has been holding remarkably stable under the linked exchange rate system.

(d) *International oil prices*

While oil prices have eased back lately, there is a risk that they may shoot up again with the winter season approaching. Much will depend on whether the current production and inventory levels are sufficient to meet the seasonal upsurge in oil demand. Also, notwithstanding OPEC's reassurance of oil supply immediately after the terrorist attack, US military retaliation action might arouse reaction from some of the oil producing countries in the Middle East. A curb in their supply could tilt the balance in the international oil market and lift oil prices again.

**Price of Brent**

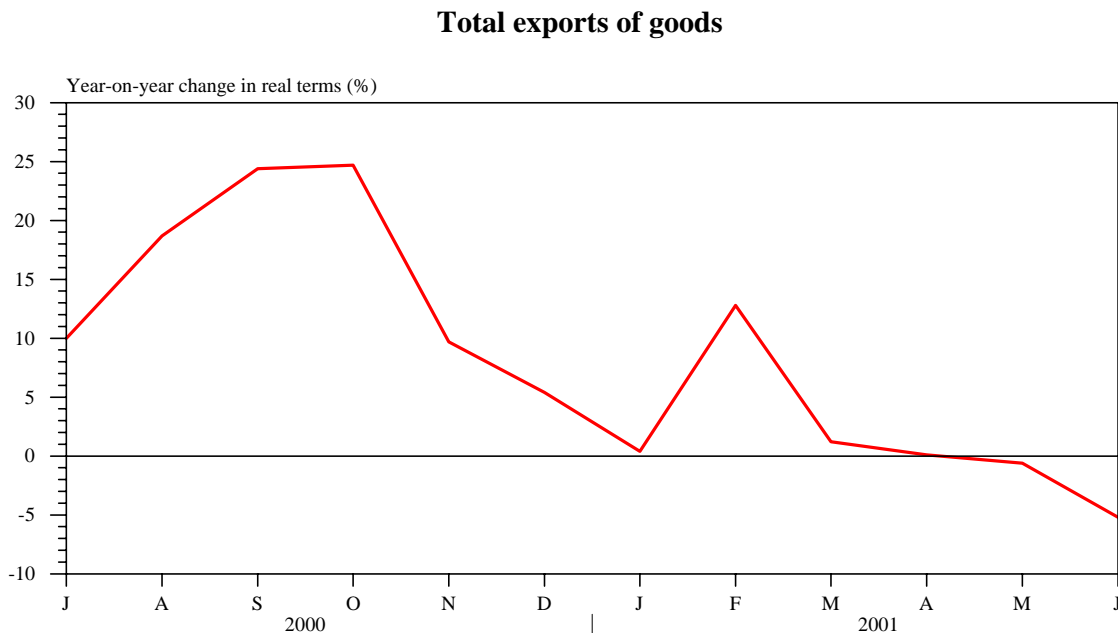
International crude oil prices have eased back to below the pre-attack level by 18 September, and have come down further.

### C. Impact on the Hong Kong economy

Apart from the direct impact on the Hong Kong economy that is already being anticipated on the export front, how the US economy will evolve in the coming weeks and months after the terrorist attack is instrumental, as it is the leading economy setting the tempo of the global economy. A further downturn in the US economy from its already slack state is bound to hit the Hong Kong economy even more.

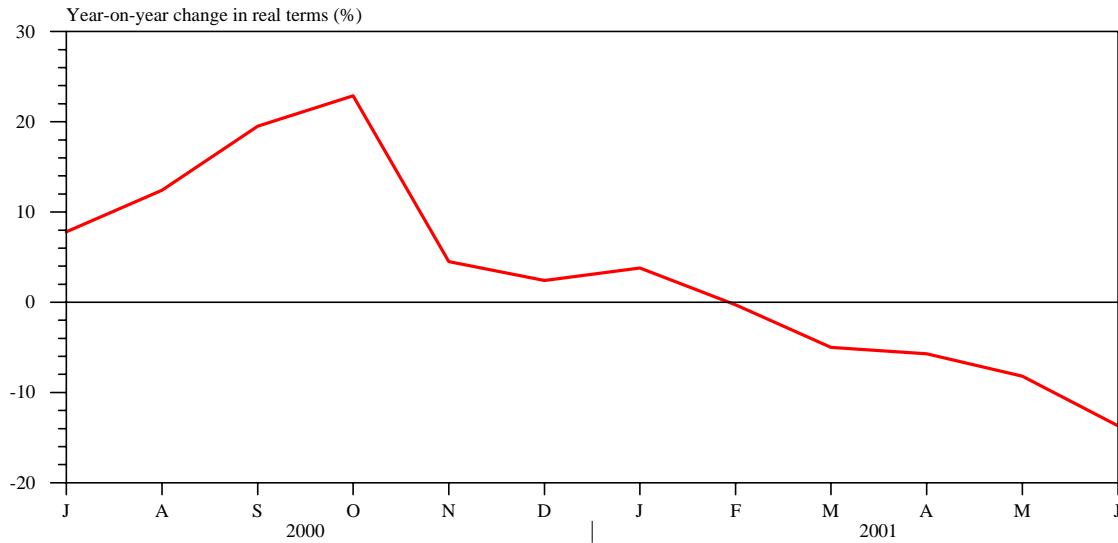
Moreover, in anticipation of the US Administration launching a large-scale military retaliation offensive, and with the risk of counter-retaliation attacks by the terrorist, there will be a large overhang of uncertainty on the global financial markets. The ensuing adverse effects on the global economy, and henceforth on the Hong Kong economy, could be profound and more protracted.

#### (a) *Exports of goods*



Hong Kong's total exports of goods were led to a decline in mid-2001, amidst the global economic slow-down. The latest performance continued to be sluggish, with the impact of the terrorist attack likely to aggravate the fall in the near term.

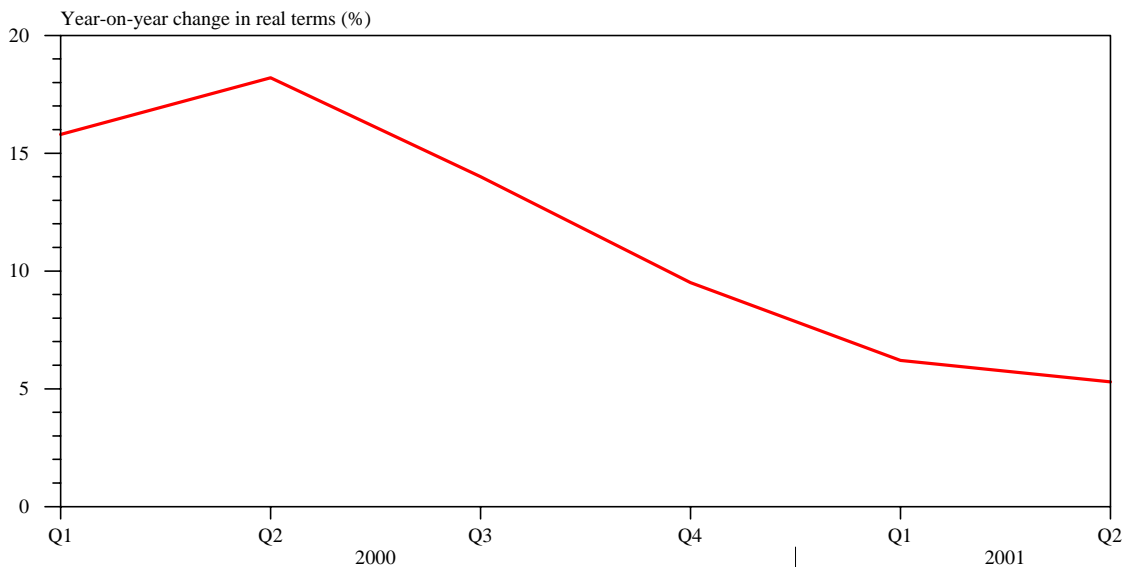
### Exports of goods to US



The US absorbs more than one-fifth of Hong Kong's total exports of goods. Exports of goods to the US already slackened to a decline in H1 2001. The key concern now is how severely Hong Kong's main lines of exports, including garment, toys, gifts, festive items etc, which typically go for mass consumption in the US market during the fourth quarter, will be hit.

### (b) *Exports of services*

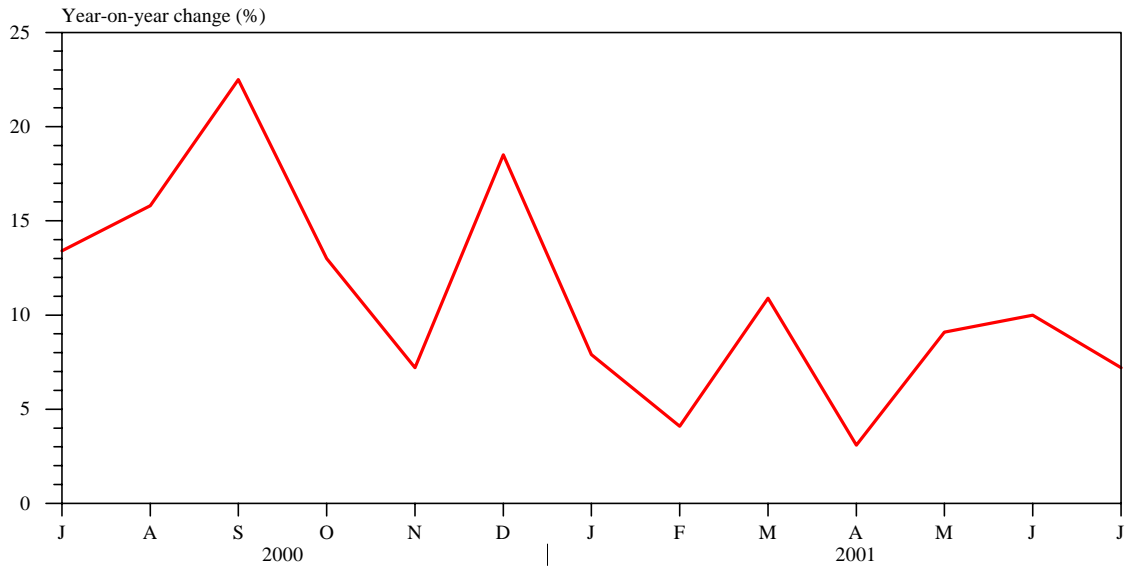
#### Exports of services



Exports of services, though also moderated in growth, held up relatively better up to Q2 2001, on the back of further notable growth in offshore trade and inbound tourism receipts. Yet the impact of the terrorist attack is likely to retard performance further.

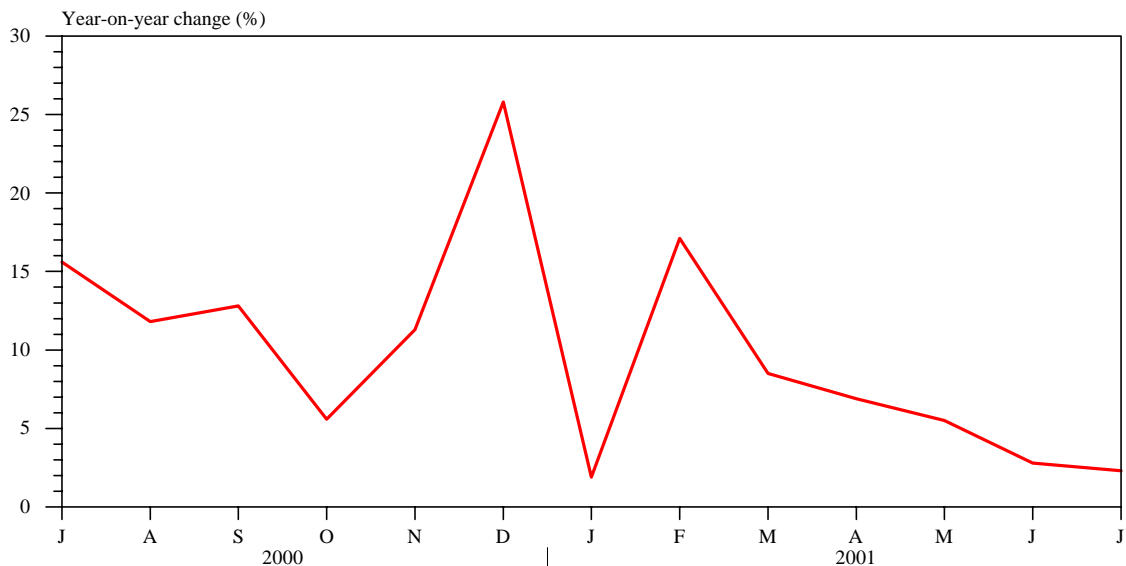


### Total visitor arrivals

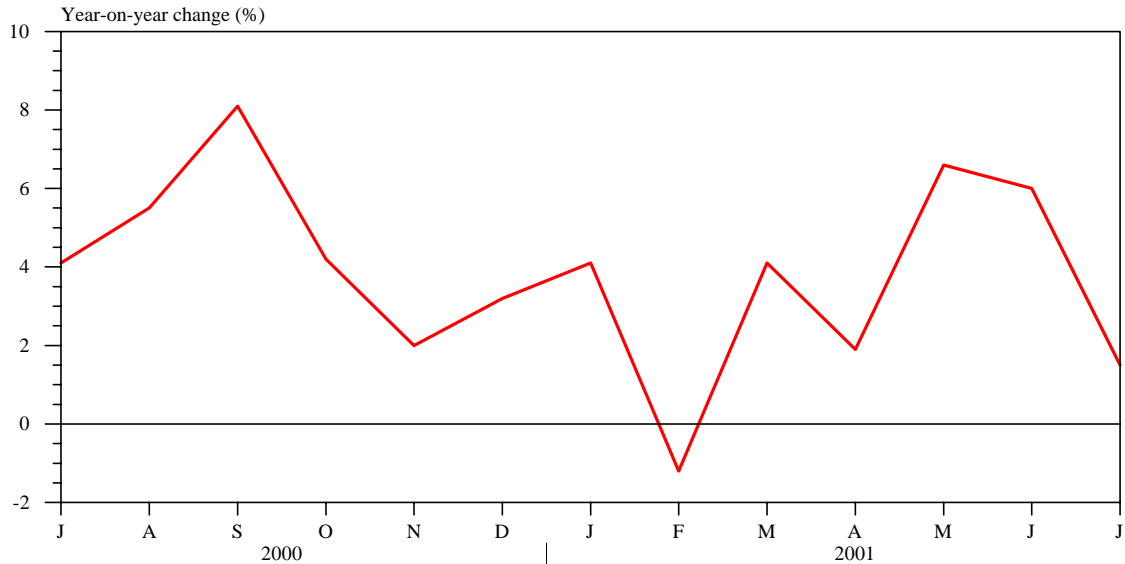


Bolstered mostly by visitors from the Mainland, total visitor arrivals recorded further solid growth in the first seven months of 2001.

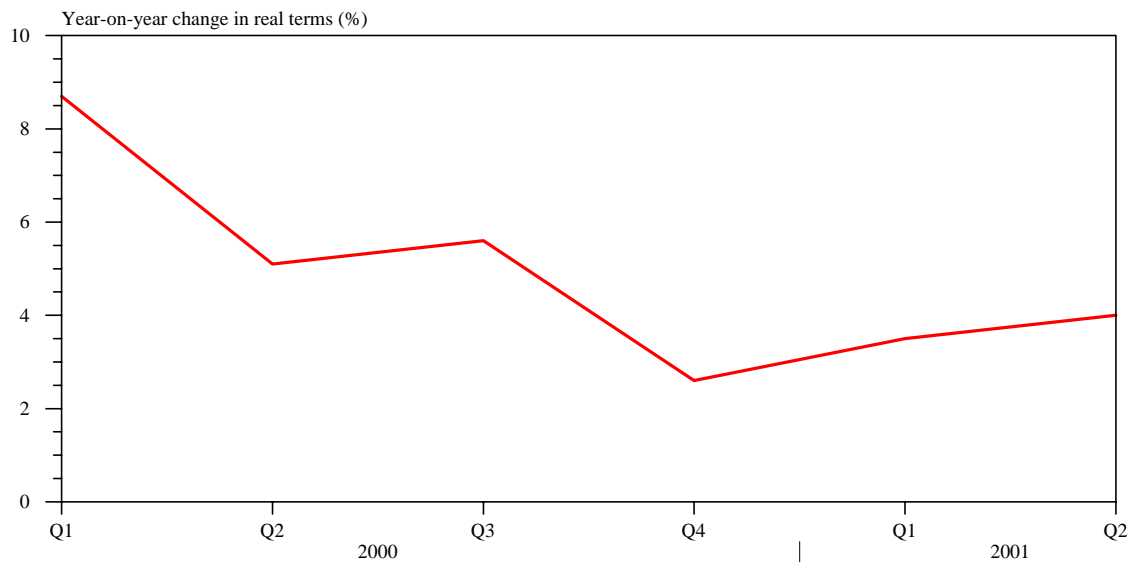
### Visitor arrivals from US



US is the 4th largest source of visitor arrivals and tourist earnings for Hong Kong, accounting for 7% and 8% of the respective totals in 2000. Visitor arrivals from US have already been decelerating in recent times. This is expected to be further down in the coming months.

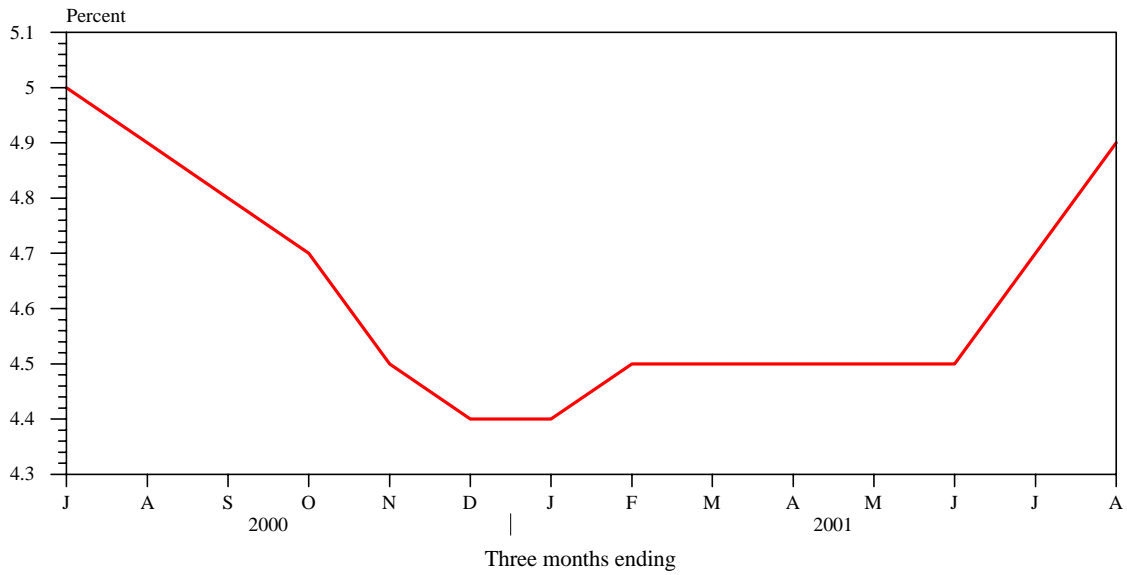
(c) *Overall economy***Volume of retail sales**

Retail sales showed signs of weakening lately.

**Private consumption expenditure**

Private consumption expenditure picked up in growth in Q1 and Q2 2001, upon increased household income and probably also helped by lower interest rates. Yet it seems likely to moderate in Q3 and Q4, as the unemployment rate is set to rise, and the more so as the impact of the terrorist attack filters through.

### Seasonally adjusted unemployment rate



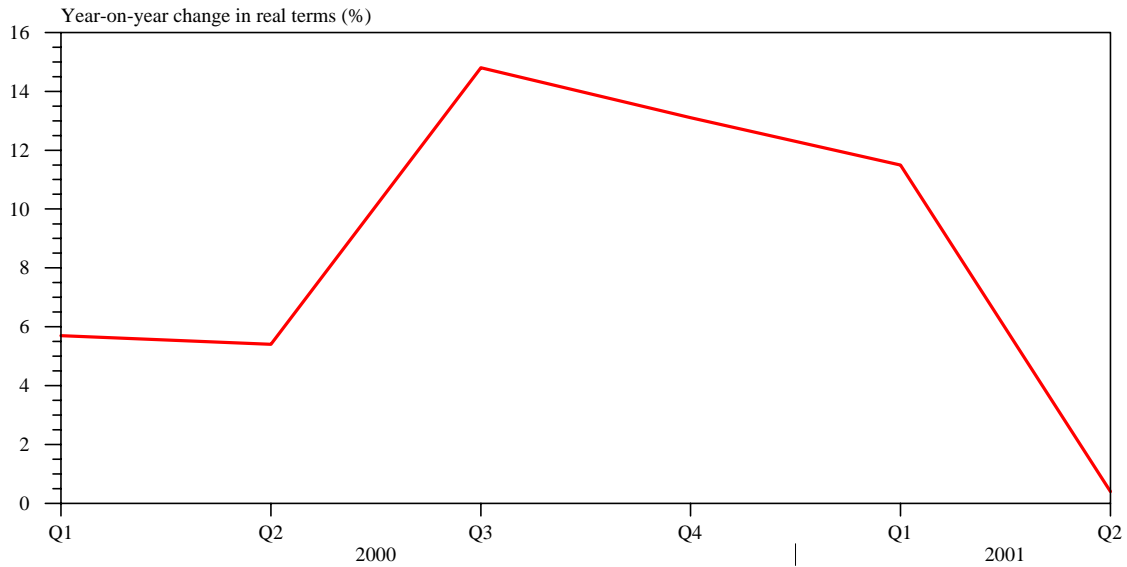
Along with the slow-down in overall economic activity, the seasonally adjusted unemployment rate rose to 4.9% in the three months ending August 2001.

### Residential property prices



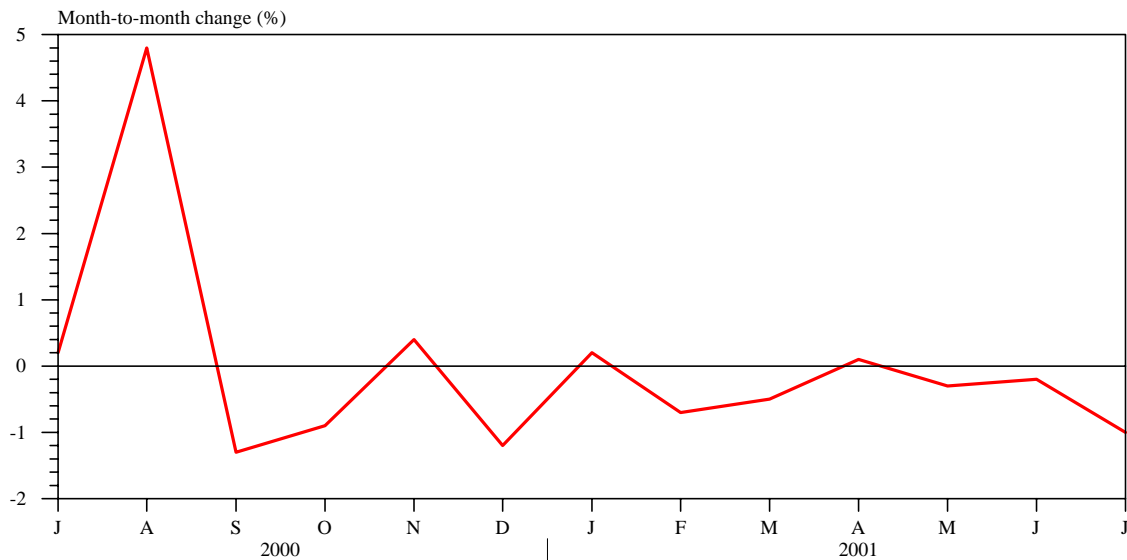
Affected by weak buying interest and an ample supply of new flats in the market, flat prices remained generally on a downtrend.

### Gross domestic fixed capital formation



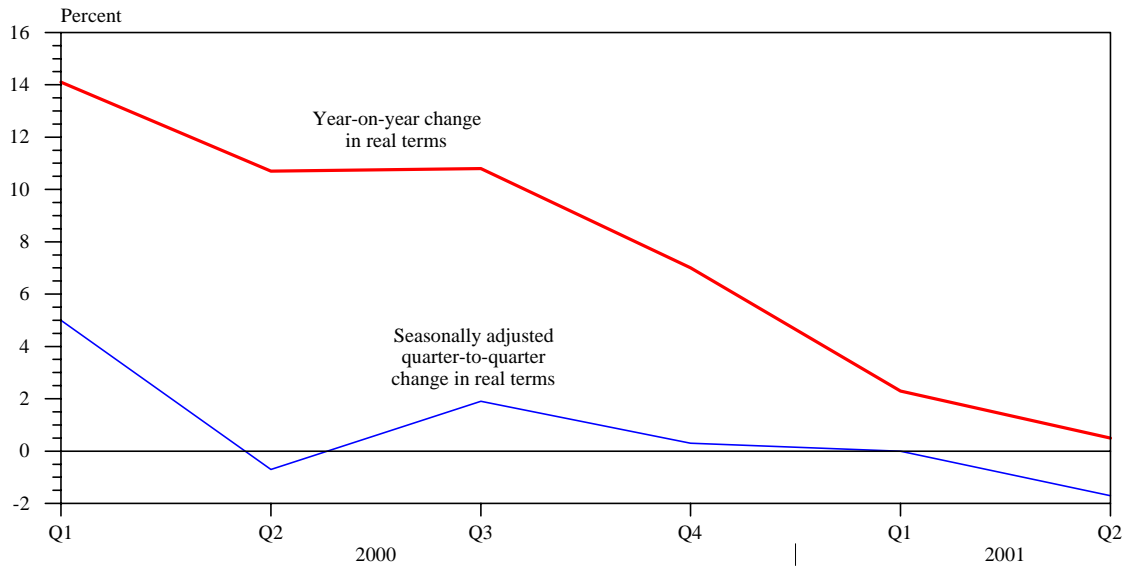
Overall investment spending eased back sharply in Q2 2001, with the uncertain business outlook tending to deter such expenditure. Again, it is likely to face continued setback as the impact of the terrorist attack filters through.

### Loans and advance for use in Hong Kong



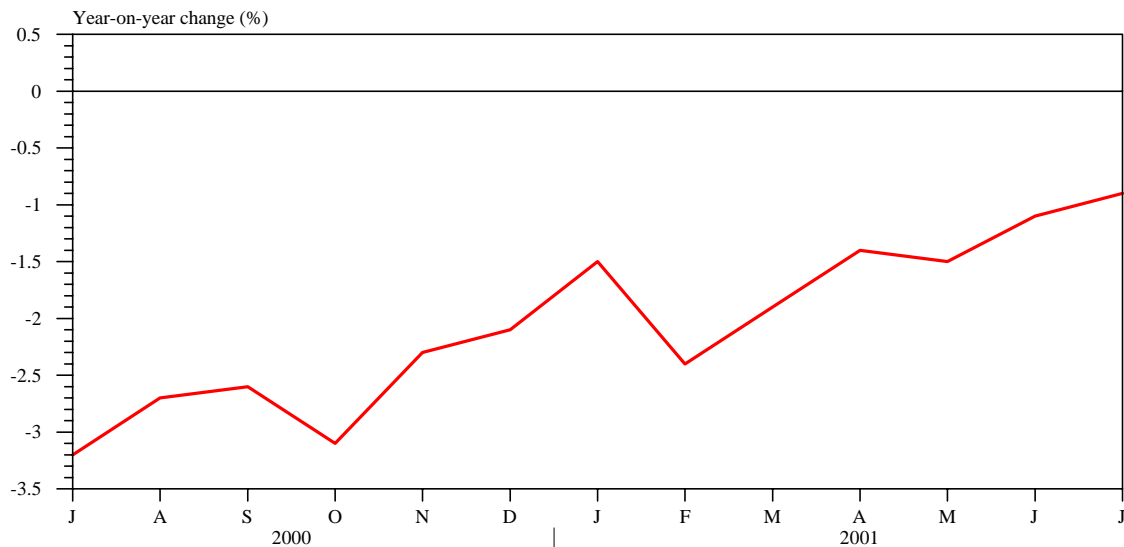
Along with the slow-down in overall economic activity in recent months, the demand for domestic loans and advances turned even more sluggish.

### Gross Domestic Product



On a year-on-year comparison, GDP growth moderated further, to only 0.5% in real terms in Q2 2001, after a 2.3% rise in Q1. On a seasonally adjusted quarter-to-quarter comparison, there was a 1.7% decline in real terms in Q2 2001, following virtually nil change in Q1. The more imminent outlook in the present circumstances is for GDP to weaken further.

### Composite Consumer Price Index



The year-on-year decline in the Composite CPI has continued to narrow. Yet the negative inflation may now become more protracted in the light of the latest developments, with possibly renewed downward pressure on domestic costs and prices.

24 September 2001