



Hong Kong's recent economic situation and short-term outlook

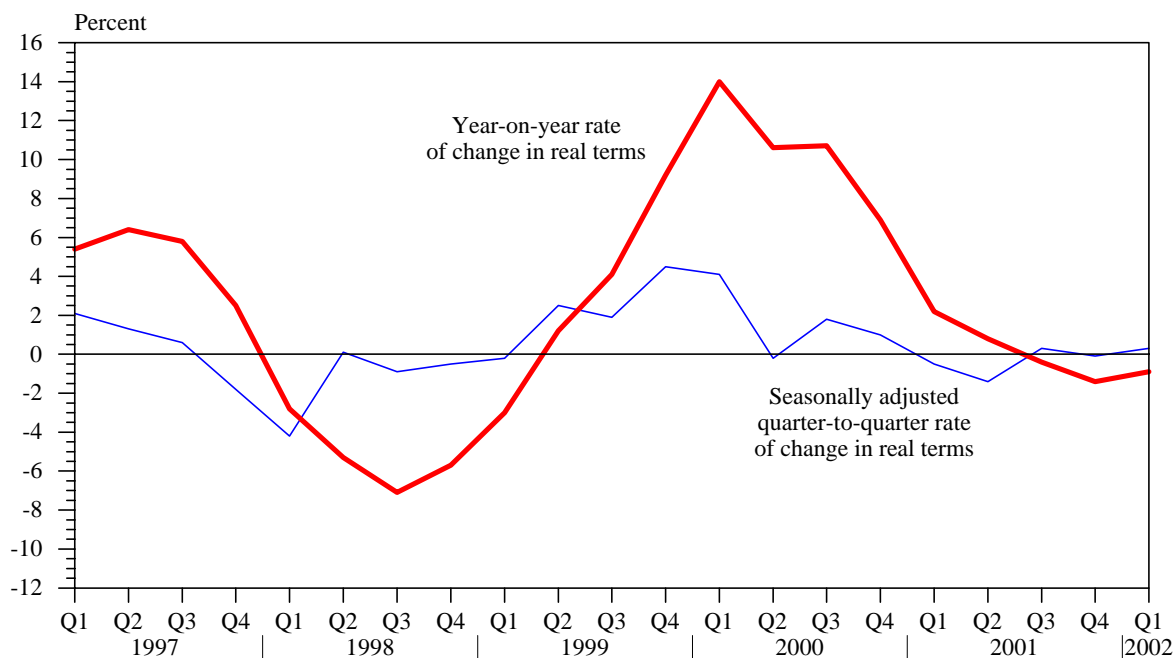
The Government has just released the First Quarter Economic Report 2002 at the end of last month. The Economic Report, together with the press release containing the updated economic forecasts for 2002 as a whole, have been furnished to LegCo Members.

This paper first analyses Hong Kong's overall economic growth and the developments in regard to external trade, domestic demand, labour market, consumer prices, and so forth in the recent period. It then briefly discusses the economic outlook for 2002.

10 June 2002

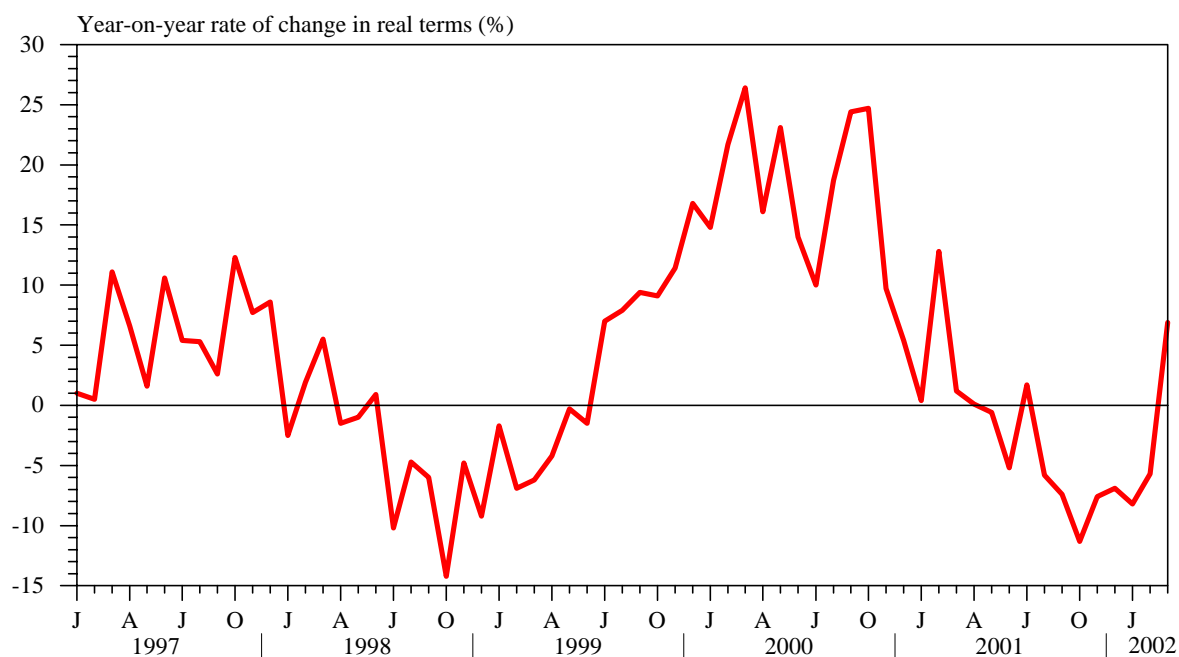
(I) *Recent economic situation*

Chart 1 : Gross Domestic Product



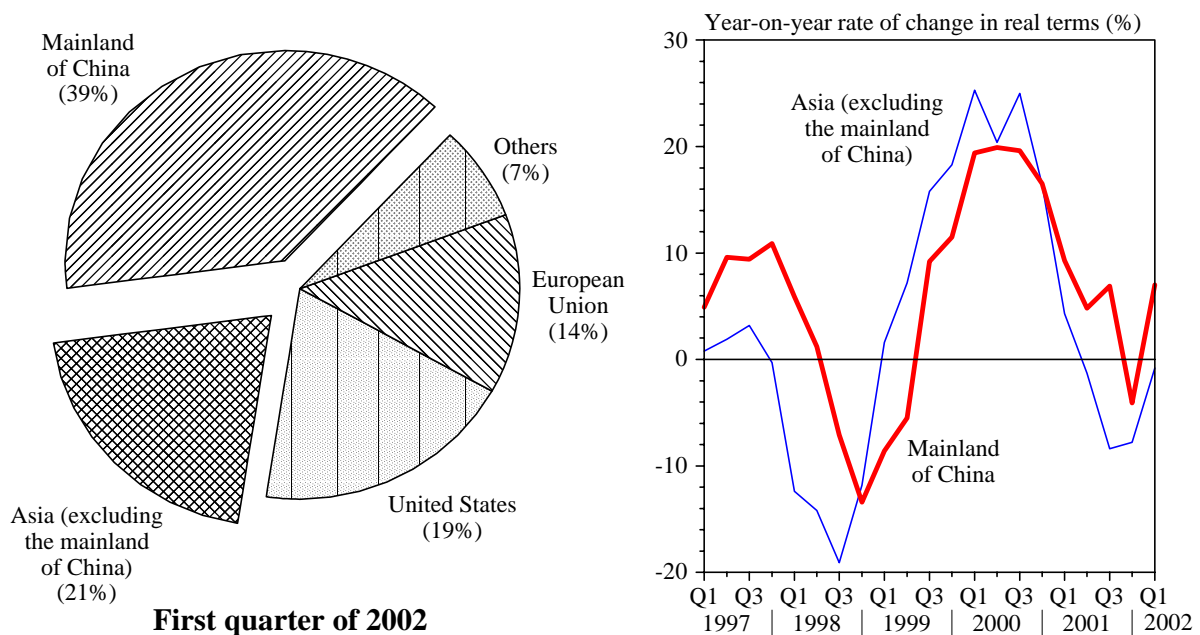
- After the severe downturn last year, overall economic activity was still modest in the first quarter of this year.
- Although export performance has been improving in recent months, domestic demand has slackened further, thereby dragging down the overall economic activity.
- On a year-on-year comparison, the Gross Domestic Product (GDP) registered negative growth for three consecutive quarters, down 0.9% in real terms in the first quarter of 2002, yet lesser than the 1.4% decline in the fourth quarter of last year.
- On a seasonally adjusted quarter-to-quarter comparison, GDP rose back slightly by 0.3% in real terms in the first quarter of 2002, indicating that the economic downturn has begun to turn around.

Chart 2 : Total exports of goods



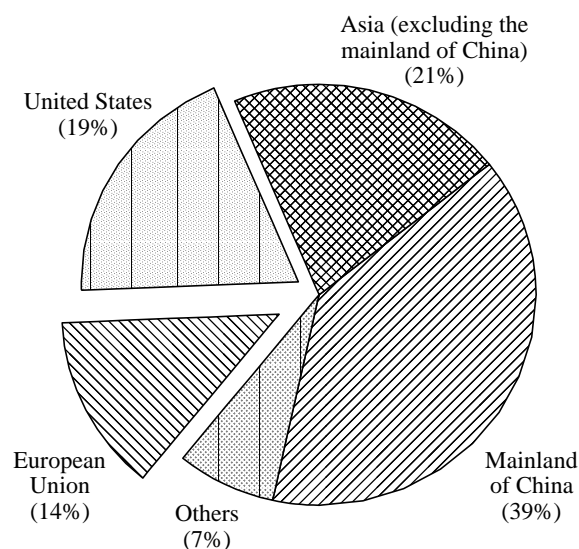
- Visible trade has shown signs of revival recently. Total exports of goods still had a marked decline in January this year. But as the external conditions steadily improved, they fell distinctly less in February, and then picked up to positive growth in both March and April. In the first quarter of 2002, total exports of goods still recorded a 2.1% decline in real terms over a year earlier, yet much narrowed from the 8.8% fall in the fourth quarter of last year.

Chart 3 : Total exports of goods to Asia

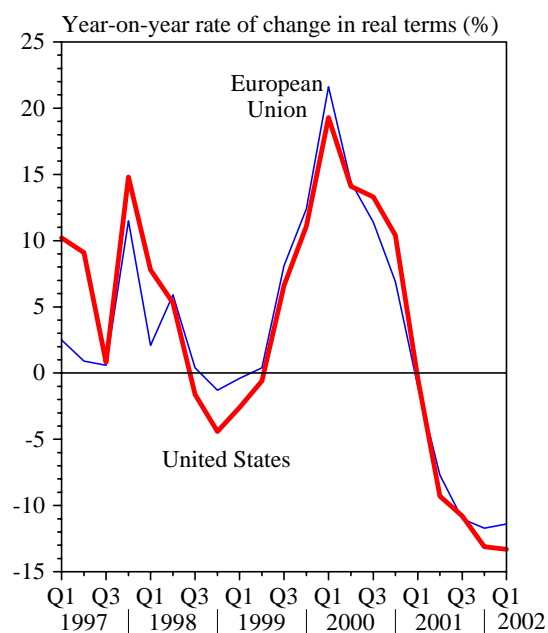


- Around three-fifths of Hong Kong's exports of goods go to Asia, within which two-thirds are destined for the mainland of China.
- The recent pick-up in exports of goods came mostly from the distinct improvement in exports to the mainland of China and to the other East Asian markets.
- The Mainland economy continues to hold up well with sustained robust growth, and its exports have also picked up lately. As a result, Hong Kong's exports of goods to the Mainland leaped by 7.0% in real terms in the first quarter of 2002 over a year earlier, markedly better than the 4.1% decline in the fourth quarter of last year.
- With the regional economic situation likewise stabilising somewhat, Hong Kong's exports to most of the other East Asian markets also improved by various extents, with particularly remarkable growth for the Singapore and Republic of Korea markets. Hong Kong's exports of goods to other Asia as a whole (after excluding the Mainland market) fell by a mere 0.8% in real terms in the first quarter of 2002 over a year earlier, again distinctly lesser than the 7.8% fall in the fourth quarter of last year.

Chart 4 : Total exports of goods to the United States and the European Union

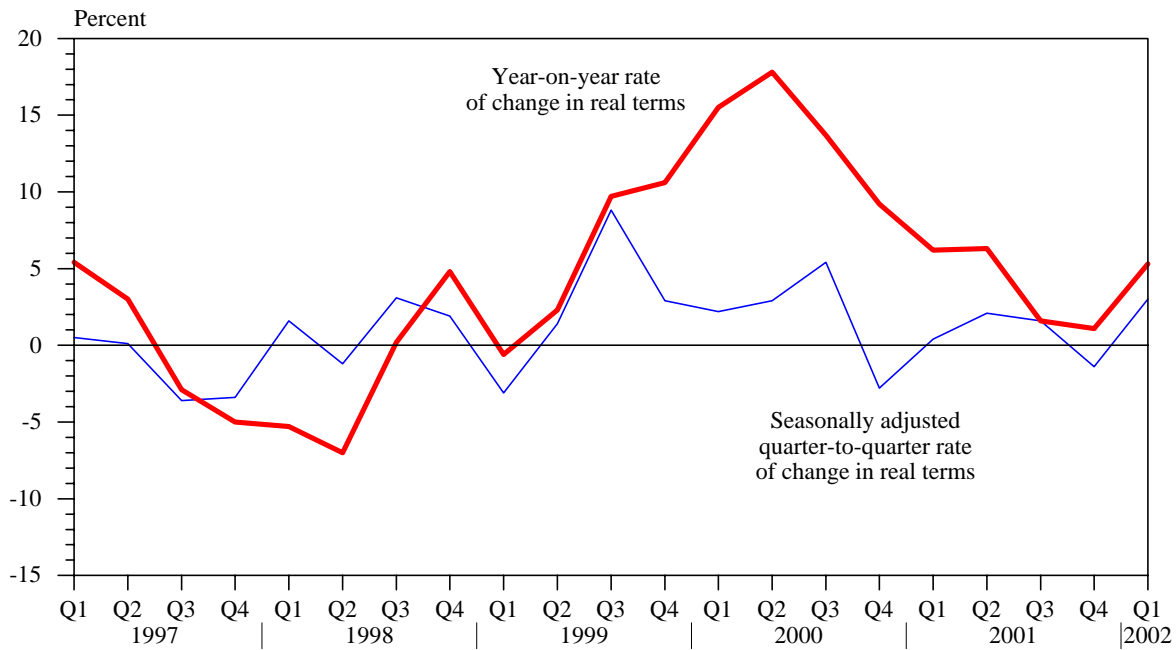


First quarter of 2002



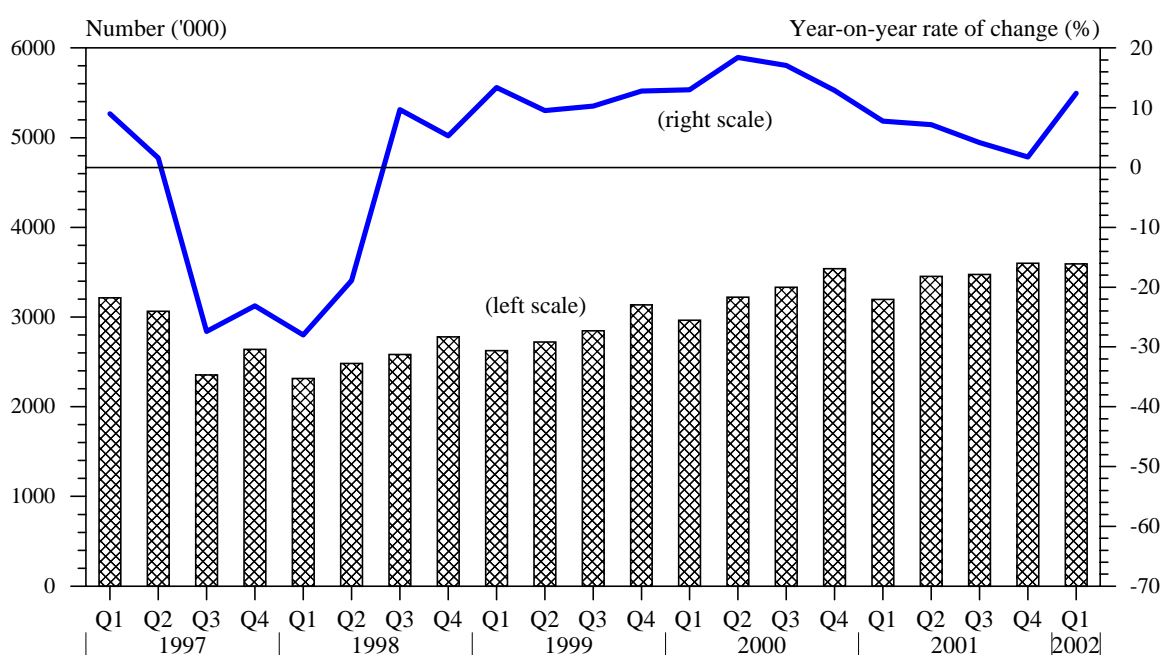
- However, Hong Kong's exports to the major conventional markets were still generally sluggish.
- While the US economy staged a strong rebound in the first quarter of this year, its import demand was still slack with a 12.3% plunge in the quarter over a year earlier. Hong Kong's exports of goods to the United States thus registered a marked decline of 13.3% in real terms in the first quarter of 2002 over a year earlier. Yet the situation has also improved most recently, with exports to the US rebounding to positive growth lately.
- Hong Kong's exports of goods to the European Union likewise fell markedly in the first quarter of 2002, by 11.4% in real terms over a year earlier. This was due to the lack of growth impetus in the EU economy. The earlier down-slide in the euro had also curbed import demand in the EU region.

Chart 5 : Exports of services



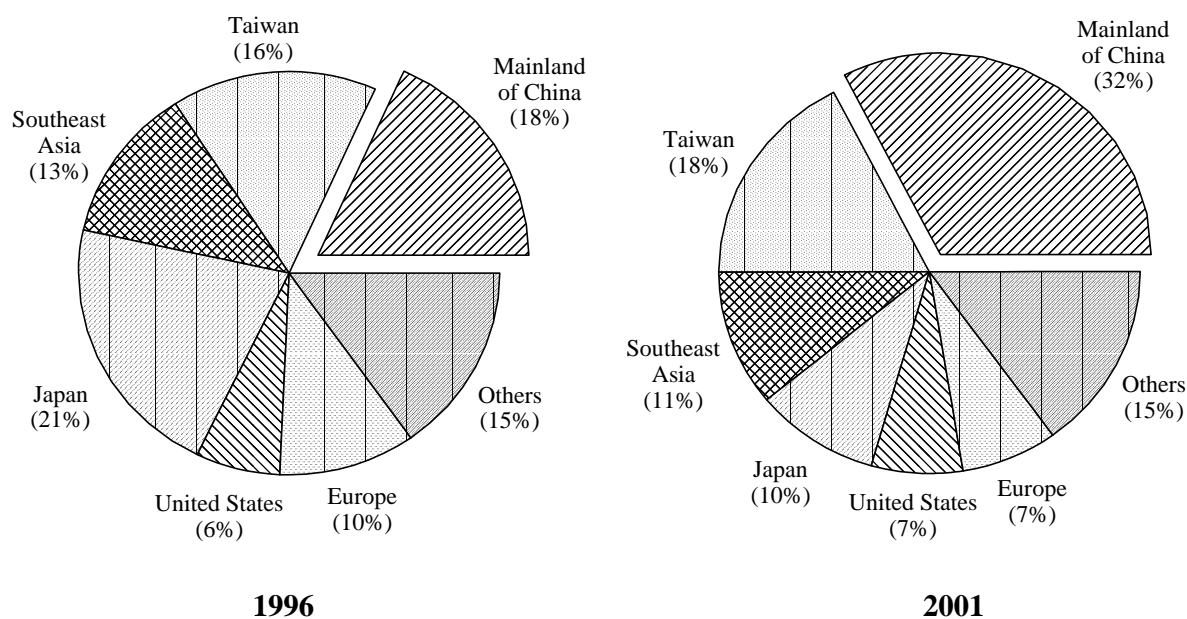
- On invisible trade, inbound tourism in overall terms has recovered swiftly from the impact of the 911 incident. Coupled with a sustained rise in offshore trade, exports of services accelerated to a 5.3% growth in real terms in the first quarter of 2002 over a year earlier, distinctly faster than the meagre rise of 1.1% in the fourth quarter of last year.

Chart 6 : Visitor arrivals



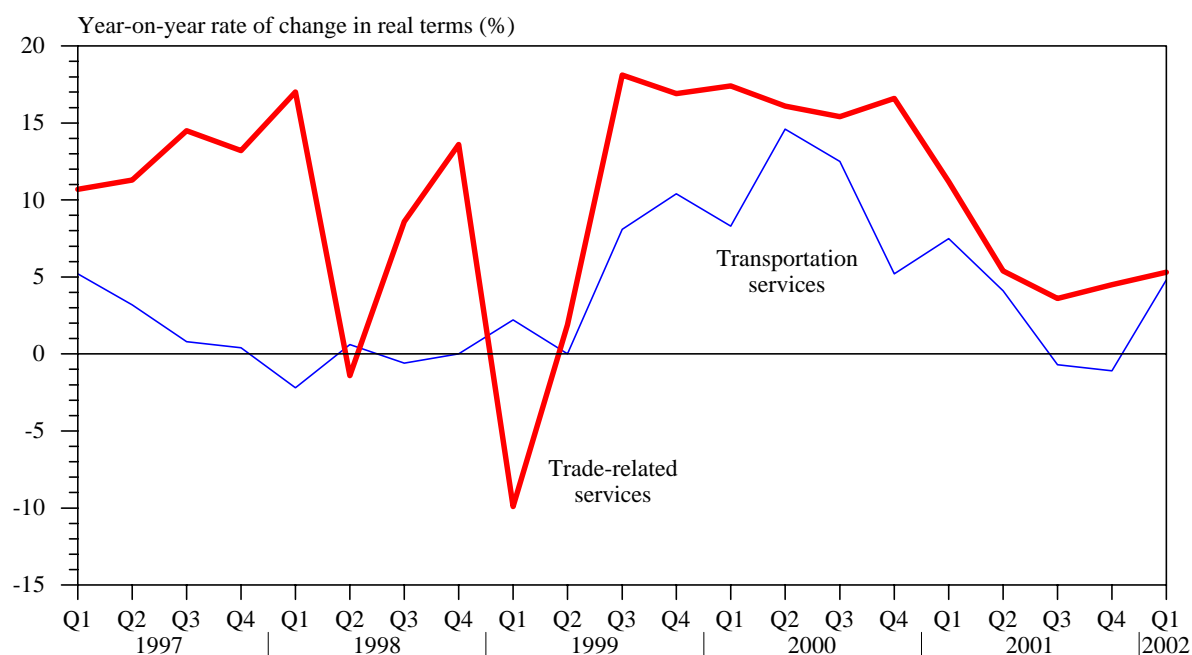
- Despite the global economic downturn, the number of incoming visitors still recorded a 5% growth last year. The number keeps growing even more entering into 2002. The number of incoming tourists picked up to a 12% growth in the first quarter of 2002 over a year earlier (with growth accelerating further to 19% in April). This was bolstered mainly by a 42% surge in Mainland visitors in the first quarter (soaring further by 65% in April), upon the removal of quota on “Hong Kong tours”. The number of incoming visitors from Europe and the United States also resumed growth in recent period.
- Exports of travel services leaped by 7.2% in real terms in the first quarter of 2002 over a year earlier, distinctly up from the marginal growth of 0.1% in the fourth quarter of 2001.

Chart 7 : Visitor arrivals by source



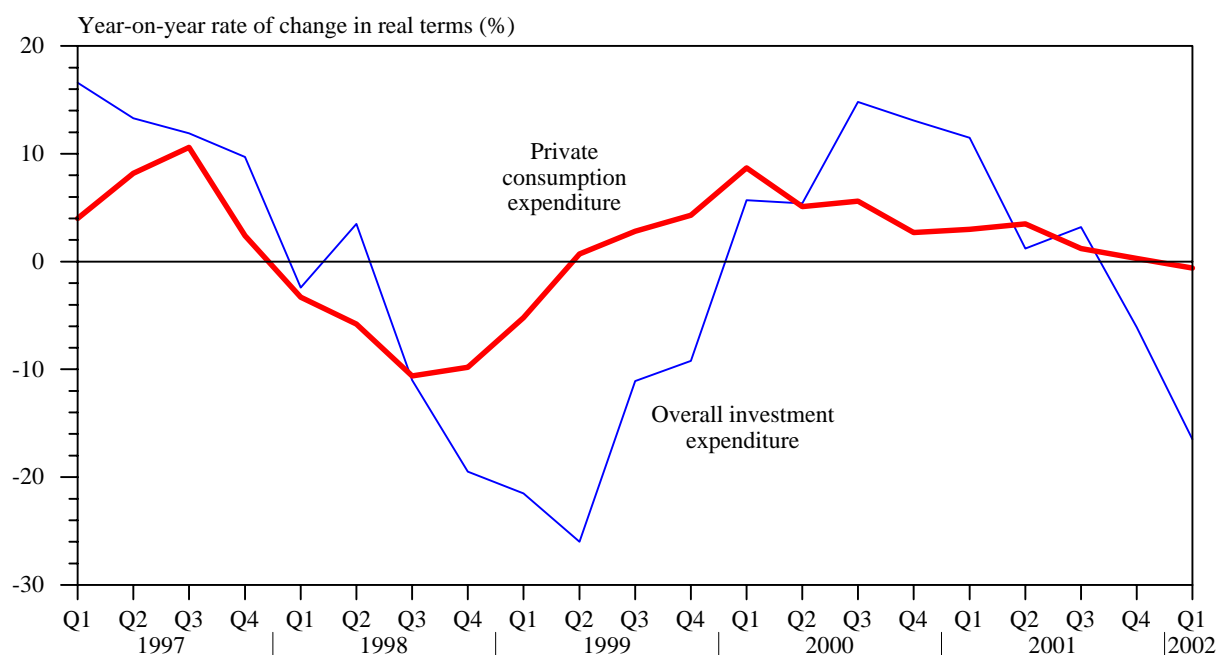
- Since 1994, the mainland of China has remained the largest source of Hong Kong's incoming tourists. Over the past ten years, visitor arrivals from the Mainland surged at an average annual growth of 18%, considerably faster than the average annual growth of 7% for the total visitor arrivals. The share of Mainland visitors in the total thus rose markedly, from 18% in 1996 to 32% in 2001, and further to 38% in the first four months of 2002. The number of Mainland visitors reached 4.45 million last year.
- Apart from the mainland of China, other Asian economies such as Japan, Taiwan and the Republic of Korea are also important sources of Hong Kong's incoming visitors. Currently, visitor arrivals from Asia including the mainland of China take up around 80% of the total. In the first four months of 2002, they rose by 18% over a year earlier.

Chart 8 : Exports of trade-related services and transportation services



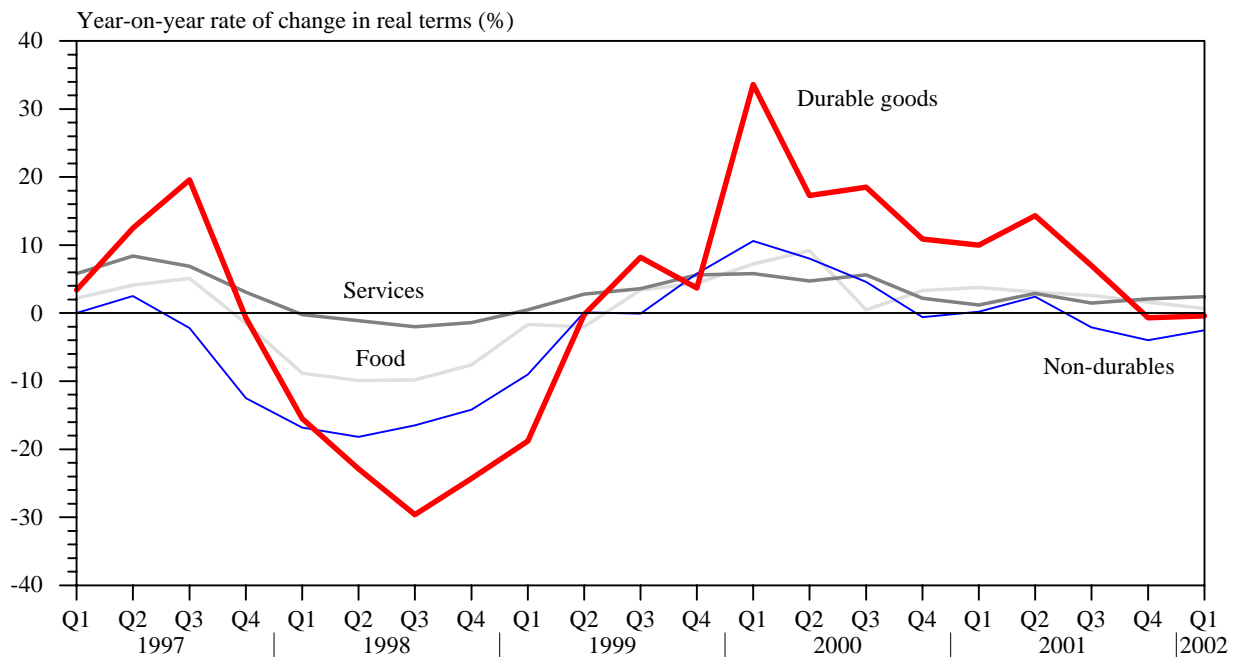
- As growth in merchandise trade in the mainland of China re-accelerated, Hong Kong's exports of trade-related services (comprising mainly offshore trade) picked up to a 5.3% increase in real terms in the first quarter of 2002 over a year earlier, after a 4.5% rise in the fourth quarter of 2001.
- Exports of transportation services rebounded markedly, up 4.8% in real terms in the first quarter of 2002 over a year earlier, reversing the decline at 1.1% in the fourth quarter of 2001.
- Exports of professional, business and other services likewise improved, rising by 4.1% in real terms in the first quarter of 2002 over a year earlier, following a meagre 0.5% rise in the fourth quarter of 2001.

Chart 9 : Domestic demand



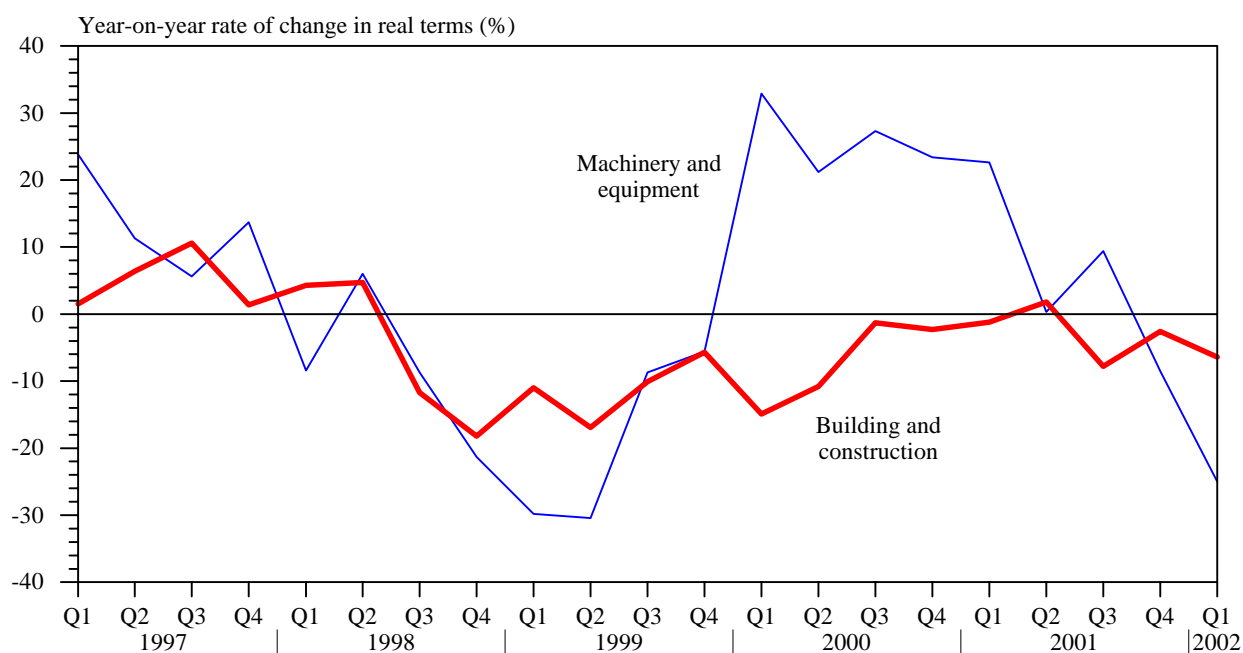
- Although external conditions are improving, Hong Kong's domestic sector is still in the midst of consolidation, as can be seen from the recent trend in domestic demand.
- Amidst rising unemployment and wage restraint, private consumption expenditure weakened further, falling by 0.6% in real terms in the first quarter of 2002 over a year earlier. This was the first decline since the first quarter of 1999.
- Upon the continued setback in the economy, overall investment spending has been falling abruptly since the fourth quarter of last year. In the first quarter of 2002, it plummeted further, by 16.5% in real terms over a year earlier.

Chart 10 : Private consumption expenditure by major component



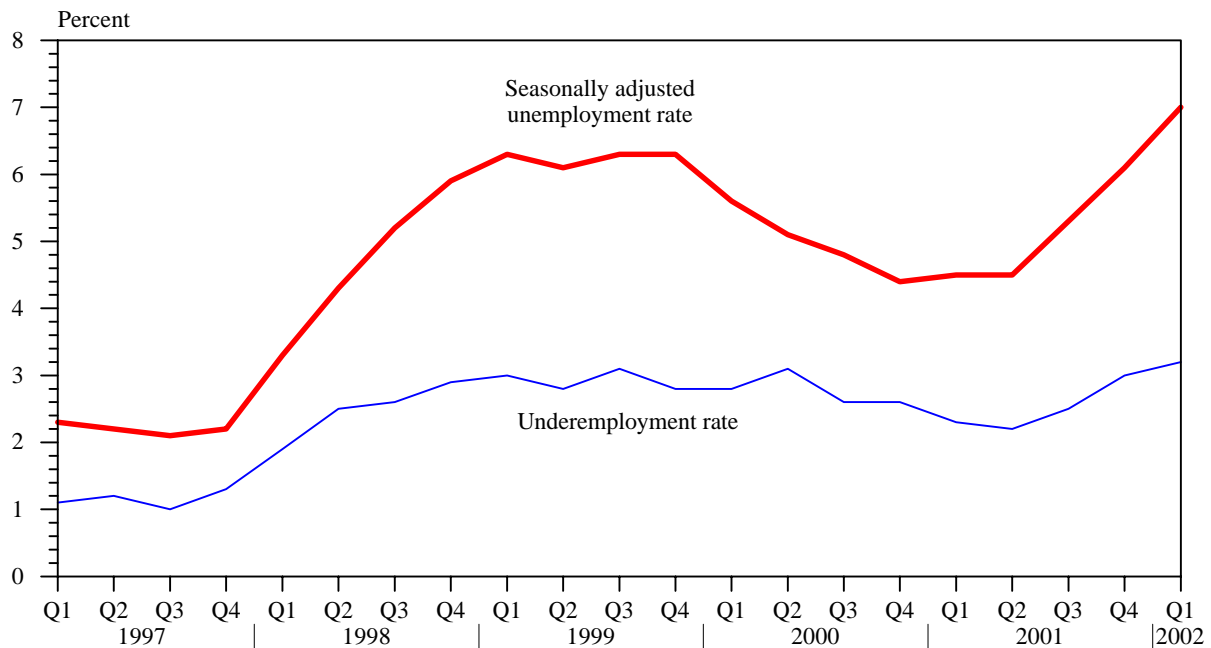
- Analysed by major category of consumer spending, expenditure on consumer services maintained steady growth in the first quarter of 2002 over a year earlier. Spending on foodstuffs also had a moderate increase. Spending on durable goods was flat, while spending on non-durable goods continued to fall. Meanwhile, spending of Hong Kong residents travelling abroad also fell.

Chart 11 : Investment expenditure by major component



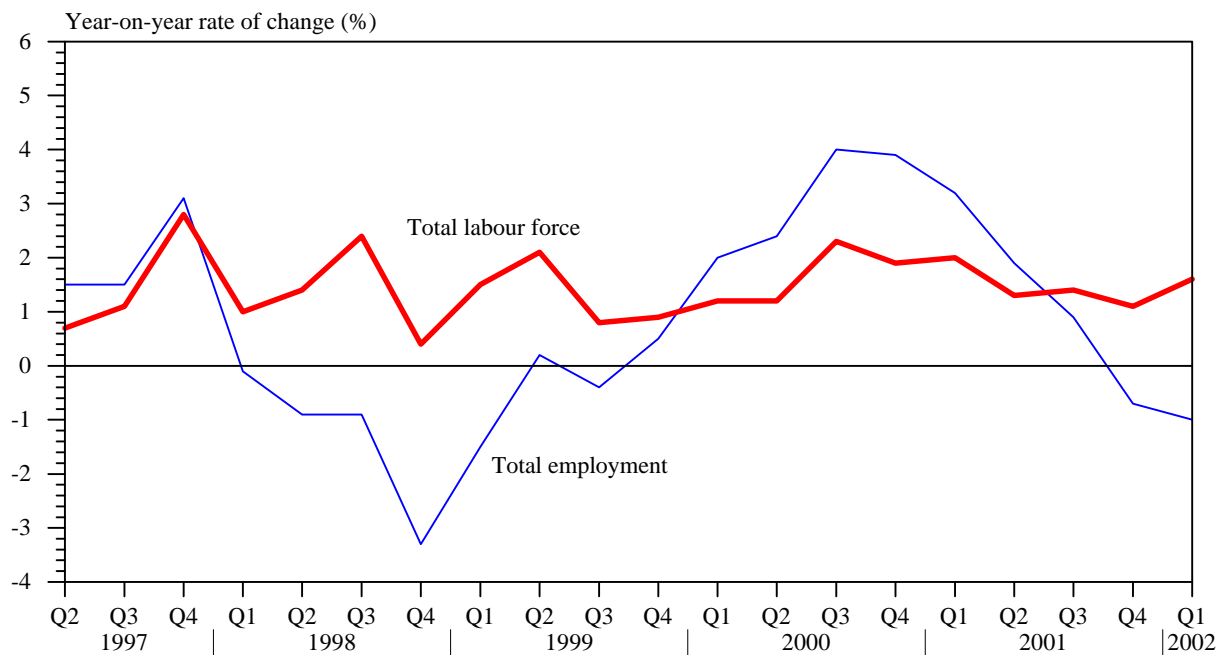
- Analysed by major type of investment spending, expenditure on machinery and equipment continued to be held back by an uncertain business outlook, weakened corporate profits, and adjustment to surplus capacity, with a 25.0% plunge in real terms in the first quarter of 2002 over a year earlier.
- Though with private sector building activity resurrecting somewhat, overall building and construction activity was still dampened by the substantial cut-back in the Public Housing Programme and the winding down of building output of two of the Priority Railway Projects, namely, the Tseung Kwan O Extension and West Rail. Expenditure on building and construction thus had a 6.4% decline in real terms in the first quarter of 2002 over a year earlier.

Chart 12 : Unemployment and underemployment rates



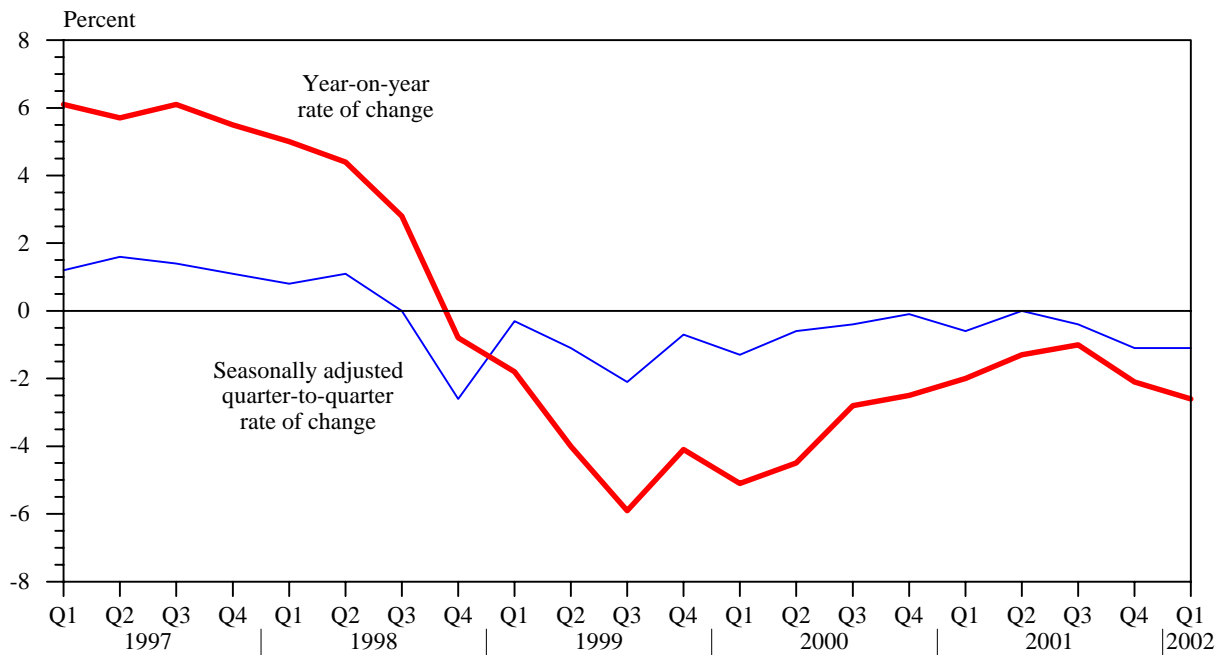
- The labour market continued to slacken in recent period. The seasonally adjusted unemployment rate surged to 7.0% in the first quarter of 2002, and further to 7.1% in the three months ending April. Yet the underemployment rate fell back somewhat, to 3.0% in the three months ending April this year, from 3.2% in the first quarter.
- Analysed by economic sector, comparing the first quarter of 2002 with the fourth quarter of 2001, the increase in unemployment rate was most significant in construction and real estate, due to a general fall-off in building and construction works and subdued activity in the property market. Also facing pronounced increase in unemployment rate were the wholesale/retail trade, restaurants, the import/export trade, manufacturing, communications and business services, largely attributable to moderation in both consumer spending and external trade.
- Analysed by occupation category, those occupation categories facing more distinct increase in unemployment rate in the first quarter of 2002 over the fourth quarter of 2001 included managers and administrators, associate professionals, craft and related workers, workers in elementary occupations, and service workers and shop sales workers.

Chart 13 : Total labour force and total employment



- Total employment has been falling since the fourth quarter of 2001, amidst more extensive corporate downsizing and lay-offs upon continued slackening in local labour demand consequential to the distinct economic setback last year. Vacancies in the major sectors were also sharply down.
- Since the third quarter of last year, growth in labour demand has been unable to match the growth in labour force. In the first quarter of 2002, total employment fell by 1.0%, while labour force still had a 1.6% increase, directly leading to a further rise in unemployment rate in that quarter.

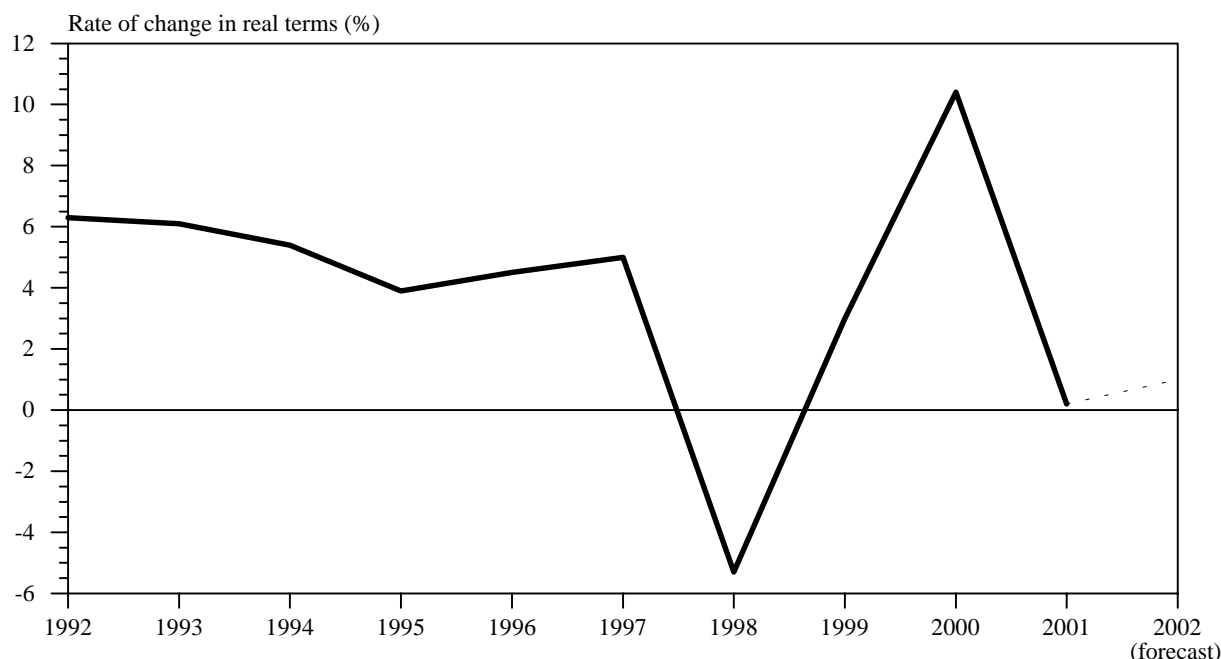
Chart 14 : Composite Consumer Price Index



- With renewed moderation in local prices and costs, and with import prices also falling further, the decline in the Composite CPI has widened again since the latter part of last year.
- So far this year, partly due to Government's relief measures taking effect, the decline in the Composite CPI enlarged to 2.7% in the first four months of 2002 over a year earlier.

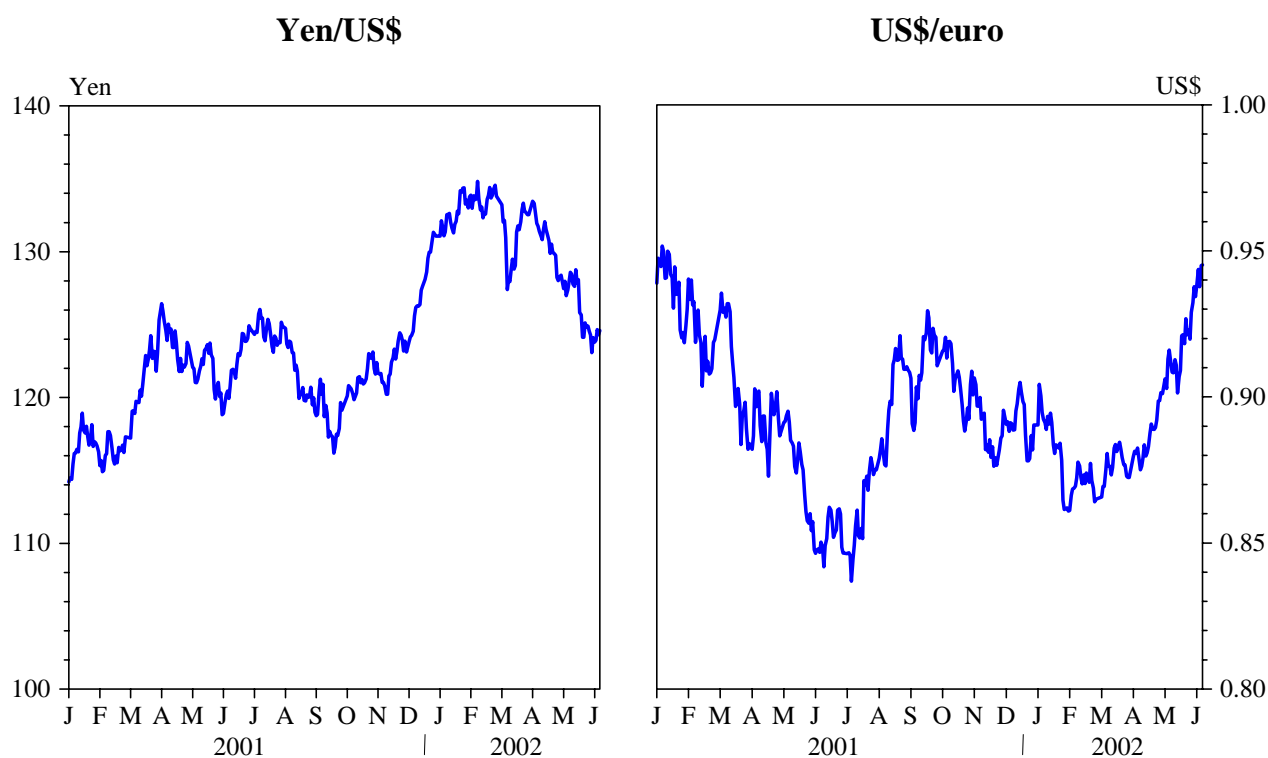
(II) *Economic outlook for 2002*

Chart 15 : Forecast of Gross Domestic Product for 2002



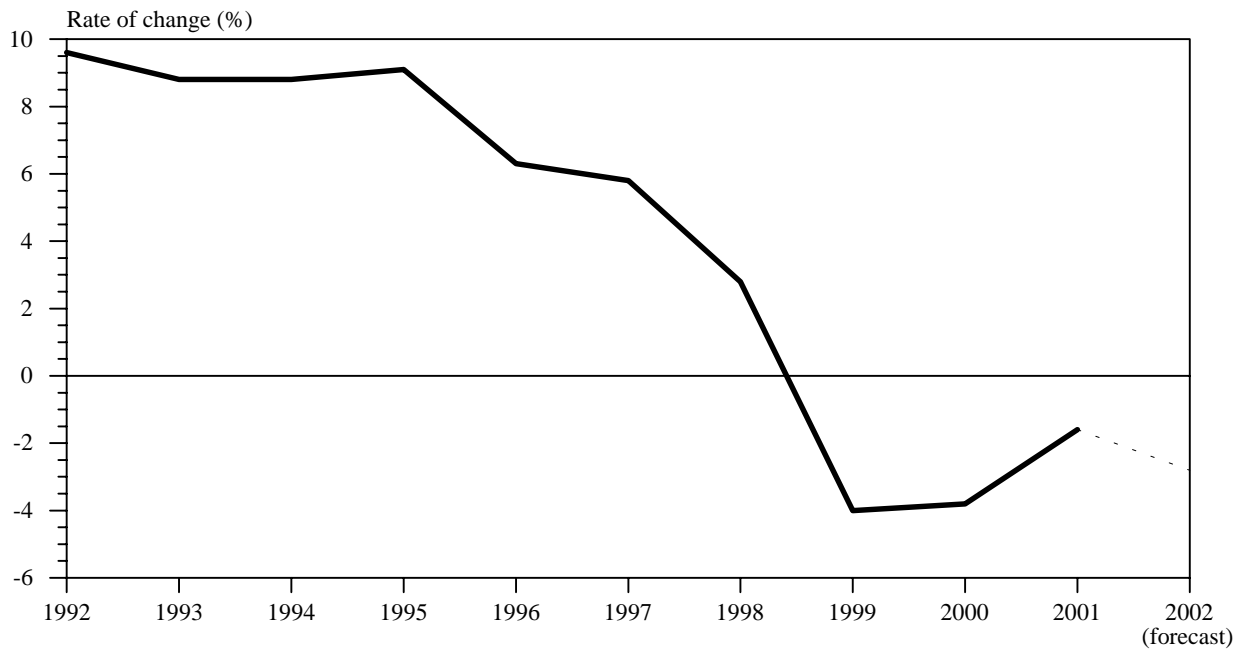
- While the US economy has turned for the better, the European and East Asian economies have also stabilised recently. However, Japan's economy may remain slack in the near term. Yet the Mainland economy continues to display a robust growth. On this positive turn in external environment, the Hong Kong economy can be expected to resume positive growth in the year.
- Externally, Hong Kong's exports of goods are poised to pick up further in the months ahead. Hong Kong's exports of services have continued to fare better than exports of goods over the past few quarters. It should remain so this year, partly on account of the on-going structural shift from re-export trade towards offshore trade. Moreover, the removal of quota of "Hong Kong tours" on Mainland visitors since the beginning of this year should add impetus to the further development of inbound tourism.
- Locally, consumer spending is likely to remain relatively modest in the months ahead, yet possibly resurrecting somewhat in the latter part of this year along with the economic recovery. However, investment spending may still be on a decline amidst a still rather uncertain business outlook, overhang of surplus capacity, and continuing adjustments to an ample supply in the property market.
- For 2002 as a whole, the forecast GDP growth rate in real terms is maintained at a modest 1.0%.

Chart 16 : Exchange rate of the US dollar



- Conceivably, the distinct weakening in the US dollar most recently should help the price competitiveness of Hong Kong's exports. But on the other hand, the recent fall-back in the US dollar had arisen out of market concern about certain pitfalls in the US economic recovery process, which is not so favourable to Hong Kong and the other export-dependent East Asian economies.
- Also, if adjustments in the US dollar exchange rate were too abrupt, thereby causing immense volatility in the directions of fund flows, the stability of international financial markets would be affected, in turn also hampering the recovery process in the global economy.
- Heightened tension in the political arena and concern about national security in certain regions lately, whilst not expected to affect Hong Kong in any direct way, would still overshadow the global economy.
- The surge in warnings about possible terrorist attacks in the United States lately has also aroused concern, and it remains uncertain as to whether and how this would impinge on the US economy.

Chart 17 : Forecast of Composite Consumer Price Index for 2002



- Consumer prices are likely to remain on a downtrend in the year, as local costs have tended to ease in recent period, and as import prices are also softening further. Furthermore, the relief measures as announced in the Budget would also bring down consumer prices to a certain extent.
- For 2002 as a whole, the forecast rate of change in the Composite CPI is also kept unchanged, at an average decline of 2.8%.