

Press Release

(embargoed until 4:15 p.m. on 29 August 2003)

Economic Situation in the Second Quarter of 2003 and Updated GDP and Price Forecasts for 2003

The Government released today (Friday) the Half-yearly Economic Report 2003, together with the preliminary figure on Gross Domestic Product for the second quarter of 2003.

The Government Economist, Mr K Y Tang, described the economic situation in the second quarter of 2003 and provided updated GDP and price forecasts for the year, taking into account the more recent upturn after the Severe Acute Respiratory Syndrome (SARS) was brought under control.

MAIN POINTS

- * The spread of SARS in Hong Kong since mid-March had dealt a heavy blow to the economy, causing GDP in the second quarter of 2003 to slacken to a 0.5% decline in real terms over a year earlier, from a solid growth of 4.5% in the first quarter. On a seasonally adjusted quarter-to-quarter comparison, GDP fell visibly, by 3.7% in real terms in the second quarter of 2003, following a 0.3% decline in the first quarter.
- * The blow to inbound tourism and the travel-related sectors was most severe, particularly in April and May. Even with some relative improvement in June, exports of services for the second quarter of 2003 as a whole still plummeted by 14.7% in real terms over a year earlier, markedly down from the 12.6% increase in the first quarter. While offshore trade continued to grow apace, it rendered only a partial offset.
- * Local consumer spending likewise went distinctly lower in April, yet turned up steadily in May and June as the SARS threat receded. For the second quarter of 2003 as a whole, private consumption expenditure fell by 2.2% in real terms over a year earlier, only slightly down from the 2.0% decline in the first quarter. The setback was concentrated in residents' spending abroad, as local people avoided visits to the SARS-affected places.
- * Investment spending slackened considerably, to a 5.3% decline in real terms in the second quarter of 2003 over a year earlier, in contrast to a 3.5% increase in the first quarter. Building and construction output had an enlarged decline amidst a weak property market, while machinery and equipment intake also moderated markedly as business conditions faltered.
- * Yet total exports of goods were relatively unaffected by SARS, sustaining double-digit growth all through the second quarter. After a 19.1% surge in real

terms in the first quarter of 2003 over a year earlier, there was a further leap by 14.3% in the second quarter. The robust external trade thus rendered a useful cushion to the economy against the setback in the domestic sector.

- * As the fuller impact of SARS on the labour market set in, the seasonally adjusted unemployment rate rose markedly, from 7.5% in the first quarter of 2003 to 8.6% in the second quarter (and further to a new high of 8.7% in the three months ending July). The underemployment rate likewise rose, from 2.9% to 4.3% between these two quarters (but edged down to 4.2% in the three months ending July).
- * Overall economic activity has begun to bottom out towards the end of May, and has been turning progressively better in June, July and August. The improvement is most visible in inbound tourism and the travel-related sectors, as visitor arrivals, being bolstered in particular by the swift return of Mainland visitors, are recovering fast from the earlier trough. Local consumer sentiment is also seen to be progressively improving, with strong promotion by the affected trades and relaunch by the Government helping to activate consumers' inclination to spend.
- * The Hong Kong economy should continue to pick up in the rest of the year. In the external sector, exports of services are expected to be vibrant. Inbound tourism looks set for a sharp upturn, particularly with the added boost from the launch of the "individual visit" scheme for Mainland visitors to Hong Kong. Offshore trade is likely to remain brisk, supported by strong trade flows in the mainland of China and a generally improved global economic environment. Exports of goods are also expected to advance further, albeit with the growth rate probably not as high as in the earlier months as the base of comparison shifts higher for the latter part of the year. A continued robust external sector performance should in turn bring about beneficial spill-overs to the local economy.
- * In the domestic sector, with sentiment reviving after SARS, consumer spending seems likely to recover further in the second half of the year. On the other hand, investment spending may remain slack until demand picks up more to underpin the overall business conditions.
- * With the GDP outturn in the second quarter being not as low as earlier thought, and having regard to the current pace of upturn, the forecast growth rate in real terms of GDP for 2003 is revised to 2%, half of a percentage point up from the 1.5% growth forecast in the May update.
- * There could be more upside potential if the growth momentum in exports of goods and offshore trade remains just as strong through the latter part of the year, and if inbound tourism surges even more. On the other hand, the recent

resurgence of geo-political tension and terrorist attacks in some places again casts shadow on the global scene.

- * On the price front, local costs and prices are expected to remain generally subdued in the coming months. Local retailers and service providers are likely to continue to exercise restraint on prices while overall demand in the economy is yet to return fully to normal. Wages and rentals are likely to come down further, as the slack conditions in the labour market and the property market have been exacerbated by the impact of SARS. Some of the relief measures being rendered by the Government carry a downward effect on the CPI. These together will outweigh the effect of higher prices of retained imports brought about by the earlier weakening in the US dollar and the rise in world commodity prices.
- * The forecast rate of change in the Composite CPI for 2003 is thus revised down by half of a percentage point to -3%, from -2.5% in the May round. Taking into account also the likely continuing decline in the terms of trade, the forecast rate of change in the GDP deflator is likewise revised down by half of a percentage point to -4%, from -3.5% in the May round.

DETAIL

GDP

According to the preliminary figure on *Gross Domestic Product (GDP)* released today by the Census and Statistics Department, GDP fell only modestly in the second quarter of 2003, by 0.5% in real terms over a year earlier, though distinctly down from the solid growth of 4.5% in the first quarter (latter figure unchanged from the estimate put out earlier). On a seasonally adjusted quarter-to-quarter comparison, GDP fell more visibly, by 3.7% in real terms in the second quarter of 2003, following a 0.3% decline in the first quarter (latter figure also unchanged from the estimate put out earlier) (*Chart*).

2. The latest figures on GDP and its major expenditure components up to the second quarter of 2003, including the year-on-year changes in the original series and the quarter-to-quarter changes in the seasonally adjusted series, are presented in *Tables 1 and 2*. Developments in different segments of the economy in the second quarter of 2003 are described below.

External trade

3. According to the merchandise trade statistics, *total exports of goods* (comprising re-exports and domestic exports) registered double-digit growth for the fourth quarter in a row, at 14.3% in real terms in the second quarter of 2003 over a year earlier. Together with a 19.1% leap in the first quarter, total exports of goods surged by 16.5% in real terms in the first half of 2003 over a year earlier, up further from a 14.7% rise in the second half of 2002. On a seasonally adjusted quarter-to-quarter comparison, total exports of goods increased further, by 2.4% in real terms in the second quarter of 2003, after a 3.2% leap in the first quarter.

4. The region remained the key driver of Hong Kong's export growth in the first half of 2003. Total exports of goods to *East Asia* as a whole surged by 20.9% in real terms in the second quarter of 2003 over a year earlier. Together with a 23.6% rise in the first quarter, total exports of goods to the region leaped by 22.2% in real terms for the first half of 2003 as a whole over a year earlier. This was further up from the already robust growth of 19.2% in the second half of 2002. Total exports of goods to *North America* however slackened markedly, to a 3.3% decline in real terms in the second quarter of 2003 over a year earlier, from a 9.1% rise in the first quarter. Apparently, the earlier war tension in Iraq had led to some cut-back in export orders particularly from the United States. For the first half of 2003 as a whole, total exports of goods to this area eased distinctly to a 2.2% increase in real terms over a year earlier, from a robust growth of 10.8% in the second half of 2002. Yet total exports of goods to the *European Union* continued to soar, by 19.4% in real terms in the second quarter of 2003 over a year earlier. Together with a 17.8% surge in the first quarter, there was a strong rise of 18.6% for the first half of 2003 as a whole, representing a further significant pick-up from the

6.6% rise in the second half of 2002. This could have much to do with the relative strength of the euro, which enhanced considerably the price attractiveness of Hong Kong's exports in the EU market.

5. *Imports of goods* likewise rose further, by 10.6% in real terms in the second quarter of 2003 over a year earlier, after an 18.7% leap in the first quarter. *Retained imports* were however slack throughout the second quarter, as import intake for local use was cut back sharply upon the spread of SARS in Hong Kong during the period. There was a 1.9% decline in real terms in the second quarter of 2003 over a year earlier, sharply down from the 11.5% increase in the first quarter. For the first half of 2003 as a whole, imports of goods had significant growth at 14.3% in real terms over a year earlier, while retained imports still rose by 4.3%. These compared with the respective increases by 14.3% and 7.5% in the second half of 2002. On a seasonally adjusted quarter-to-quarter comparison, imports of goods and retained imports both fell back distinctly, by 1.1% and 9.6% respectively in real terms in the second quarter of 2003, following increases by 3.6% and 2.9% in the first quarter.

6. On invisible trade, *exports of services* plummeted by 14.7% in real terms in the second quarter of 2003 over a year earlier, in stark contrast to a 12.6% rise in the first quarter. This abrupt fall-off was caused entirely by the shock impact of SARS, with inbound tourism and exports of transportation services both considerably down in the second quarter. Continued robust growth in offshore trade rendered only a partial offset. For the first half of 2003 as a whole, exports of services fell by 1.4% in real terms over a year earlier, sharply reversing the 16.1% surge in the second half of 2002. On a seasonally adjusted quarter-to-quarter comparison, exports of services were markedly down by 21.1% in real terms in the second quarter of 2003, having fallen by 3.4% in the first quarter.

7. *Imports of services* plunged even more, by 19.6% in real terms in the second quarter of 2003 over a year earlier, distinctly enlarged from the 3.9% decrease in the first quarter. Outbound travel and related spending, which accounted for over half of imports of services, had been severely deterred by the SARS situation elsewhere in the region as well as by the arrival restrictions and post-arrival quarantine imposed in some of the destinations on people travelling from Hong Kong. For the first half of 2003 as a whole, imports of services slumped by 11.5% in real terms over a year earlier, as against a 2.7% rise in the second half of 2002. On a seasonally adjusted quarter-to-quarter comparison, imports of services fell significantly, by 17.7% in real terms in the second quarter of 2003, enlarged from the 6.9% decrease in the first quarter.

8. On the trade balance, the *visible trade deficit* reckoned on a GDP basis narrowed to \$9.8 billion or 2.3% of the value of imports of goods in the second quarter of 2003, from \$16.4 billion or 4.2% in the same quarter in 2002. Taking exports and imports of services together, the *invisible trade surplus* reckoned on a GDP basis declined to \$31.5 billion or 84.6% of the value of imports of services in the second quarter of 2003, from \$37.8 billion or 83.0% in the same quarter in 2002. With the reduction in the invisible trade surplus offset by the reduction in the visible trade deficit, the *combined surplus* reckoned on a GDP basis was broadly unchanged in the second quarter of 2003, at \$21.7 billion or 4.6% of the total value of imports of goods and services, as against \$21.4 billion or 4.9% in the same quarter in 2002. For the first half of 2003 as a whole, the combined surplus still rose, to \$46.3 billion or 5.1% of the total value of imports of goods and services, from \$40.1 billion or 4.9% in the same period in 2002.

Domestic demand

9. Local consumer spending receded abruptly upon the spread of SARS in mid-March, as local people shunned the more crowded shopping areas to avoid being contracted. Yet local consumer sentiment began to improve in May, as the SARS situation was progressively being brought under control. It improved further in June, upon intensive promotion by the affected trades complemented with relaunch by the Government. For the second quarter of 2003 as a whole, *private consumption expenditure (PCE)* fell by 2.2% in real terms over a year earlier, only slightly down from the 2.0% decline in the first quarter. The setback was concentrated in residents' spending abroad, as local people avoided visits to the SARS-affected places. On a seasonally adjusted quarter-to-quarter comparison, PCE dropped by 0.7% in real terms in the second quarter of 2003, appreciably larger than the 0.2% fall in the first quarter.

10. *Government consumption expenditure (GCE)* reckoned on a national accounts basis registered a further modest increase, by 0.6% in real terms in the second quarter of 2003 over a year earlier, after a 1.3% rise in the first quarter. On a seasonally adjusted quarter-to-quarter comparison, GCE decreased by 0.1% in real terms in the second quarter of 2003, after a 0.1% rise in the first quarter.

11. Overall investment spending, as represented by *gross domestic fixed capital formation (GDFCF)*, fell back by 5.3% in real terms in the second quarter of 2003 over a year earlier, following a 3.5% rise in the first quarter. *Expenditure on building and construction* had an enlarged decline, by 7.2% in real terms in the second quarter of 2003 over a year earlier, further down from a 3.5% fall in the first quarter. Private sector building activity continued to be held back by the subdued property market. Concurrently, private sector civil engineering works shrank markedly, upon near completion of the first berth of Container Terminal 9 and a dearth of new projects. Public sector expenditure on building and construction recorded a further modest decline, as work on the KCR West Rail was nearing completion while work on the Ma On Shan Rail and the Tsim Sha Tsui Extension

had subsided from their peaks. Meanwhile, *expenditure on machinery, equipment and computer software* slackened into decline, falling by 2.4% in real terms in the second quarter of 2003 over a year earlier, having risen markedly by 11.9% in the first quarter. Conceivably, the dimmer business outlook at that time upon the spread of SARS had curbed investment intentions.

12. *Inventories* continued to rise in the second quarter of 2003. However, the stock accumulation by and large was likely to be involuntary, as both domestic demand and inbound tourism faltered abruptly upon the outbreak of SARS.

The property market

13. The sales market for *residential property* remained sluggish during most of the first half of 2003. After a relatively more active start early in the year, acquisition interest was curtailed further during mid-March to early June, amidst the impact from the spread of SARS in Hong Kong. Apart from dwindled demand under the poor sentiment, the ample supply of new flats in the mass market continued to pose a drag. Faced with such an austere situation, developers either withheld sales or else staged more intensive promotion, by offering larger price discounts and more sweeteners to prospective flat buyers. Then, with the impact of SARS fading away since early June, there were signs of improvement in sentiment, lifting demand mostly in the primary market. Meanwhile, the luxurious end of the market turned slightly more active during the first half of this year. As to the rental market for residential property, performance likewise remained lacklustre in overall terms, given the still subdued user demand and increased supply of flats for lease.

14. On *commercial property*, both the sales and rental markets for *office space* remained weak in the first half of 2003, upon further consolidation and downsizing in the corporate sector amidst an uncertain business outlook, especially under the impact of SARS. The market for Grade A office space, particularly that in the central business district, continued to be pulled down by abundant supply with the completion of some new projects, as well as by reduced demand with the relocation of more companies to the secondary districts for saving costs. The sales and rental markets for *shopping space* also remained bleak in the first half of 2003, especially during mid-March to early June when both inbound tourism and local consumption were hit by the spread of SARS in Hong Kong. Landlords of such premises were under a widespread plea to grant temporary rental concessions to help ease the difficulties facing tenant operators. On *industrial property*, the sales and rental markets remained stagnant in overall terms in the first half of 2003, on the back of a continued downtrend in local manufacturing activity.

The labour market

15. The labour market, which was already slack in the first quarter of 2003, weakened visibly further in the second quarter. Total employment contracted between the two quarters, as the outbreak of SARS curtailed business activity and

dampened labour demand. Coupled with a pick-up in labour supply, this led to a distinct further loosening in the overall manpower resource balance. The *seasonally adjusted unemployment rate* went up sharply, to 8.6% in the second quarter of 2003 (and further to a new high of 8.7% in May – July), from 7.5% in the first quarter. The surge in unemployment, whilst occurring almost across-the-board, was particularly pronounced in the tourism and consumption-related sectors. The *underemployment rate* had an even steeper rise, to 4.3% in the second quarter of 2003 (yet easing back to 4.2% in May – July), from 2.9% in the first quarter, as many employees were temporarily suspended from work or asked to take no-pay leave after the SARS outbreak.

16. On a quarter-to-quarter comparison, *total employment* as enumerated from households was reduced by 0.7% in the second quarter of 2003, further to a 0.4% fall in the first quarter. Yet *total labour force* expanded by 0.5% in the second quarter, reversing the 0.1% drop in the first quarter. This growth differential aggravated the labour demand and supply imbalance, thereby leading to a leap in unemployment rate in the more recent periods. On a year-on-year comparison, employment growth, though still positive in the second quarter of 2003, was distinctly slower than labour force growth, at 0.5% as against 1.5%. A roughly similar picture was observed in the first quarter, yet with a smaller difference between the two growth rates, at 0.8% as against 1.3%.

17. Overall labour income in money terms continued on a downtrend. Specifically, overall *labour earnings* were 2.0% lower in money terms in the first quarter of 2003 than a year earlier, exceeding the 1.2% fall in the fourth quarter of 2002. After adjusting for the decrease in the Composite CPI, labour earnings were static in real terms in the first quarter of 2003 as compared to a year earlier, as against a 1.8% rise in the fourth quarter of 2002.

Prices

18. Overall consumer prices continued to decline in the second quarter of 2003. By June 2003, the downtrend had lasted for 56 months. There was an accentuated decrease in May and June, mainly reflecting the impact of SARS on domestic demand and hence on consumer prices. In face of an austere business situation under the SARS impact, local retailers and service providers generally offered larger price discounts and other attractions in a move to induce sales. There was a one-off rebate of electricity charges from a power company in June. Also, new fare concessions were granted by some public transport operators. These, coupled with lower labour wages and continued softening in property rentals, more than offset the effect of the recent pick-up in prices of retained imports brought about by a weaker US dollar and higher world commodity prices.

19. The *Composite CPI* went down by 2.5% in the second quarter of 2003 from a year earlier (and further by 4.0% in July), larger than the 2.0% fall in the first quarter. Clothing and footwear, durable goods, transport, private housing and

miscellaneous services were the categories with accentuated price declines. For the first half of 2003 as a whole, the Composite CPI fell by 2.2% over a year earlier, which was smaller than the 3.2% decrease in the second half of 2002. Yet this was entirely due to dissipation of the downward effect of the special relief measures implemented by the Government in the earlier periods, including the rates concession in 2002 and the waiver of water and sewage charges over the twelve months ending March 2003. After adjusting for these special factors as well as for the difference in base of comparison caused by the waiver of public housing rentals in December 2001, the decline in the Composite CPI actually widened, by around 0.7 of a percentage point between the two half-yearly periods.

20. The *GDP deflator*, as a broad measure of overall price change in the economy, declined by 5.5% in the second quarter of 2003 from a year earlier, larger than the 4.6% drop in the first quarter. This was mainly due to enlarged declines in the terms of trade in goods and services, in the price deflator for private consumption expenditure, and in the price deflator for government consumption expenditure. On a seasonally adjusted quarter-to-quarter comparison, the GDP deflator went down further by 1.7% in the second quarter of 2003, following a 1.4% decrease in the first quarter.

The financial sector

21. The spot *exchange rate of the Hong Kong dollar* against the US dollar moved within a narrow range of 7.798 to 7.800 during the first half of 2003. The premium of the twelve-month forward rate over the spot rate held steady for most of the period. There was a brief upsurge to 355 pips (each pip equivalent to HK\$0.0001) in late April, amidst worries about the impact of SARS on the economy. But as SARS was progressively brought under control, the premium narrowed back to 120 pips at end-June 2003, even less than 169 pips at end-2002.

22. Under the linked exchange rate system, the movements in the exchange rates of the Hong Kong dollar against other major currencies follow closely those of the US dollar. During the first half of 2003, the US dollar depreciated against most of the other major currencies. This was triggered by uncertainties surrounding the US-led war on Iraq and concern over the pace of recovery in the US economy. In particular, the dollar - euro rate surged by 14.2%, from a monthly average of 1.022 in December 2002 to that of 1.167 in June 2003. Also, the dollar - pound sterling rate rose by 4.5% from a monthly average of 1.589 in December 2002 to that of 1.661 in June 2003, and the yen - dollar rate fell by 2.8% from a monthly average of 121.8 in December 2002 to that of 118.3 in June 2003. Likewise, the US dollar eased against many of the East Asian currencies. Taking these currency movements together, the trade-weighted *Nominal Effective Exchange Rate Index of the Hong Kong dollar* declined by 2.0%, from a monthly average of 102.7 in December 2002 to that of 100.6 in June 2003. After adjusting for changes in the respective consumer price indices, the trade-weighted *Real Effective Exchange Rate Index of*

the Hong Kong dollar had a larger decrease, by 3.5% from 93.3 to 90.0 over the same period.

23. Affected by movements in the Hong Kong dollar forward rate premium over the spot rate, local inter-bank *interest rates* moved up briefly in April, and then fell back in the ensuing two months. At end-June 2003, the three-month HIBOR closed at 1.0%, down from 1.4% at end-2002. Over the same period, the spread of the three-month HIBOR over the corresponding Euro-dollar deposit rate reversed from a premium of 9 basis points to a discount of 6 basis points. Following the movement in the US Fed Funds target rate, the Base Rate under the Discount Window operated by the Hong Kong Monetary Authority was reduced by 25 basis points to 2.5% in late June. Yet the best lending rate and savings deposit rate offered by the major commercial banks were kept at 5.00% and 0.03% respectively throughout the first half of 2003. Meanwhile, the spread of the best lending rate over the three-month time deposit rate widened modestly, from an average of 4.78 percentage points in the second half of 2002 to that of 4.91 percentage points in the first half of 2003.

24. *Hong Kong dollar deposits* rose back by 2.1% during the second quarter of 2003, following a 1.2% drop during the first quarter. *Hong Kong dollar loans* were reduced further by 0.8% during the second quarter, after a 0.4% decline during the first quarter. As Hong Kong dollar loans continued to decline while Hong Kong dollar deposits resumed increase during the first half of 2003, the Hong Kong dollar loan-to-deposit ratio fell, from 88.5% at end-2002 to 86.7% at end-June 2003.

25. The local *stock market* staged a distinct rebound during the second quarter of 2003. After falling to a 4½-year low of 8 409 on 25 April, the Hang Seng Index showed a significant upturn in the ensuing two months. This was aided by rallies in the major stock markets overseas upon the end of the US-led war on Iraq. Also, market sentiment was buoyed by SARS being progressively brought under control in Hong Kong, leading to withdrawal by the World Health Organisation (WHO) of its travel advisory against non-essential travel to Hong Kong on 23 May. The Hang Seng Index surged to a six-month high of 10 030 on 17 June. Removal of Hong Kong from the list of SARS-affected areas by WHO on 23 June, coupled with expectation for signing of the Closer Economic Partnership Arrangement (CEPA) by the end of June, rendered additional support to the share prices. Yet towards the end of the month, profit taking amidst renewed concern about the US economic outlook reduced some of the earlier price gains. The Hang Seng Index stood at 9 577 at end-June 2003, 10.9% above the level at end-March and 2.7% above the level at end-2002. (The Hang Seng Index rose further to a high of 10 764 on 25 August. It closed at 10 760 on 28 August.) Trading turned more active, with the average daily turnover rising to \$8.1 billion in the second quarter of 2003, from \$6.1 billion in the first quarter. For the first half of 2003 as a whole, the average daily turnover at \$7.1 billion was 22% higher than in the second half of 2002.

Updated GDP and price forecasts for 2003

26. The global economy is seen to be turning better in recent times. In the US economy, outlook is lifted by a better-than-expected GDP outturn in the second quarter of 2003 and by release of generally more upbeat economic data. The EU economy has also tended to improve in overall terms. The Japanese economy has likewise picked up in the second quarter, bolstered by higher business spending and net exports. The SARS-affected East Asian economies in general have shown signs of stabilisation lately. With firmer global demand underpinning their exports and with their domestic demand improving after SARS, their economic growth can be expected to accelerate again in the months ahead.

27. In the Hong Kong economy, the improvement after June is most visible in inbound tourism and the travel-related sectors, as visitor arrivals, being bolstered in particular by the swift return of Mainland visitors, are recovering fast from the earlier trough. By July, the number of incoming visitors was only around 6% lower than a year earlier. By August, the total number of incoming visitors should have been largely restored. With the launch of the "individual visit" scheme for Mainland visitors from several cities since late July, the pick-up in inbound tourism can be expected to accentuate in the months ahead. Locally, consumer sentiment is also seen to be progressively improving, with strong promotion by the affected trades and relaunch by the Government helping to activate consumers' inclination to spend.

28. Following regular practice, the GDP and price forecasts for 2003 have been reviewed by individual components. The updated forecasts are presented in **Table 3**.

29. On visible trade, the forecast growth rate in real terms of *total exports of goods* in 2003 is revised up again, from 5.5% in the May round to 9.2% in the current update. This is mainly on account of the much better-than-expected outturn for exports in the second quarter and also an improved global and regional economic outlook lately. Yet at the same time, it has allowed for a possible deceleration in export growth in the latter part of the year as the base of comparison shifts progressively higher. Within total exports, the forecast increase in real terms in *re-exports* is raised to 11.5% from 7.5%. But the forecast decline in real terms in *domestic exports* is maintained at 15%, having regard to the continuing structural shift from domestic exports to re-exports.

30. With upward revisions in the forecasts for both re-exports and retained imports, *imports of goods* are now expected to increase by 7.1% in real terms in 2003, up from the 2.9% rise put out earlier.

31. On invisible trade, the forecast rate of change in real terms in *exports of services* in 2003 is revised upward to 2%, from -2% in the earlier forecast. This is mainly on account of the strong pace of upturn in inbound tourism, including the

further boost from the “individual visit” scheme for Mainland visitors. Moreover, with an improved global and regional economic outlook, offshore trade is likely to continue to grow apace.

32. With outbound tourism recovering faster than earlier expected, and also with some further relative improvement envisaged for services intake on other fronts, the forecast rate of change in real terms in *imports of services* in 2003 is revised up, to -7% from -13.5%.

33. In the domestic sector, with the SARS impact receded, consumer spending seems likely to recover further in the second half of the year. Yet the higher unemployment and reduced income carried over from the earlier impact may hold back the pace of revival somewhat. Also, the setback in the first half of the year will weigh down the annual performance. *Private consumption expenditure* in 2003 is thus forecast for still a decline, by 1.5% in real terms, albeit already lifted from the forecast decrease of 3% put out earlier.

34. Having regard to the actual outturn in the second quarter and the expected spending for the rest of the year, the forecast increase in real terms in *government consumption expenditure* in 2003 is lowered slightly to 3.5%, from 4% in the May round.

35. The forecast rate of change in real terms in overall investment spending in the economy in 2003, as represented by *gross domestic fixed capital formation*, is broadly unchanged at -5.4%, as against -5.5% put out earlier.

36. Within this, the forecast rate of change in real terms in *expenditure on machinery, equipment and computer software* in 2003 is maintained at -3.6%. Looking ahead to the latter part of the year, machinery and equipment intake may stay slack as the overall business conditions have yet to return fully to normal.

37. The forecast rate of change in real terms in *expenditure on building and construction* in 2003, at -7.1%, is also not much different from that of -7.4% in the earlier forecast. Private sector building activity is likely to remain on the fall in the near term, in view of subdued demand against an ample supply of new premises in the property market. Public sector building and construction activity is also likely to remain sluggish, with work on the priority railway projects tapering down and with public housing production shrinking even further.

38. Having risen for five consecutive quarters, *inventories* are likely to be kept more steady in the rest of 2003.

39. Overall, the forecast growth rate in real terms of *GDP* for 2003 is now put at 2%, half of a percentage point up from that of 1.5% in the May round. This is in recognition of the GDP outturn in the second quarter being not as low as earlier thought, and the current upturn proceeding at a generally robust pace.

40. There could be more upside potential if the growth momentum in exports of goods and offshore trade remains just as strong through the latter part of the year, and if inbound tourism surges even more. On the other hand, the recent resurgence of geo-political tension and terrorist attacks in some places again casts shadow on the global scene.

41. For comparison, the forecasts on Hong Kong's GDP made by a selection of international organisations and local analysts are depicted in **Table 4**. The latest forecast growth rates in real terms of GDP for 2003 from the private sector analysts range from 0.5% to 2.5%, averaging at 1.4%. This is below the latest official growth forecast of 2%. The difference is reckoned to be mainly related to the less severe GDP outturn in the second quarter.

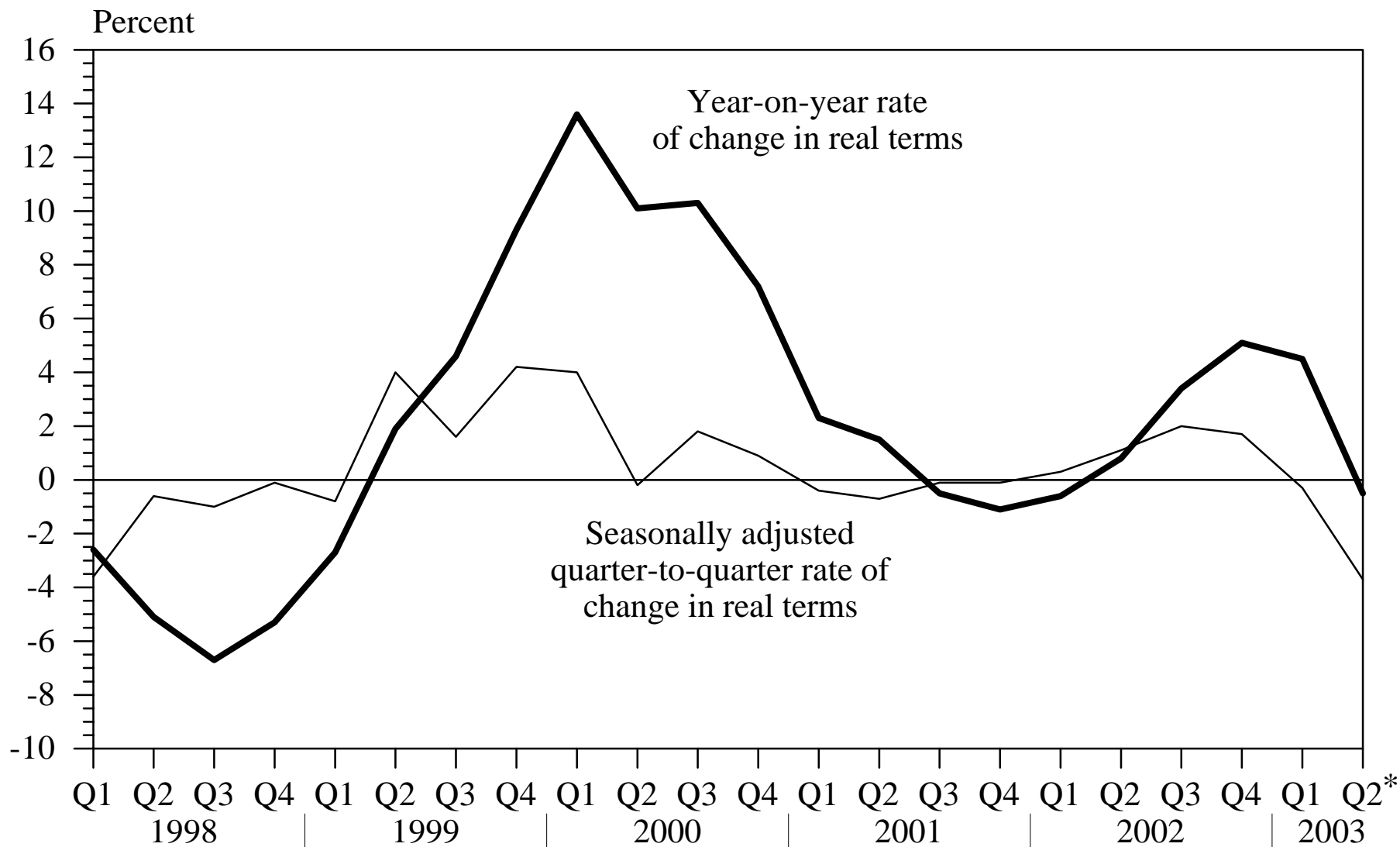
42. On the price front, local costs and prices are expected to remain generally subdued in the coming months. Local retailers and service providers are likely to continue to exercise restraint on prices while overall demand in the economy is yet to return fully to normal. Wages and rentals are likely to come down further, as the slack conditions in the labour market and the property market have been exacerbated by the impact of SARS. Some of the relief measures being rendered by the Government carry a downward effect on the CPI. These together will outweigh the effect of higher prices of retained imports brought about by the earlier weakening in the US dollar and the rise in world commodity prices.

43. The forecast rate of change in the *Composite CPI* for 2003 is thus revised down by half of a percentage point to -3%, from -2.5% in the May round. Taking into account also the likely continuing decline in the terms of trade, the forecast rate of change in the *GDP deflator* is likewise revised down by half of a percentage point to -4%, from -3.5% in the May round.

(The Half-yearly Economic Report 2003 can now be purchased on-line at http://www.statisticalbookstore.gov.hk/desc_eng.htm, or by calling the Publications Sales Section of the Information Services Department (ISD) at 2537 1910. Both the hard and soft copies of the report are available for sale at \$88 a copy, yet with a postage charge for the hard copy.)

(The GDP figures up to the second quarter of 2003 are published in the Report of the Gross Domestic Product, Second Quarter 2003, which can also be purchased on-line at http://www.statisticalbookstore.gov.hk/desc_eng.htm, or by calling the Publications Sales Section of ISD. Both the hard and soft copies of the report are available for sale at \$30 per copy, yet with a postage charge for the hard copy.)

Hong Kong's Gross Domestic Product



Note : (*) Preliminary figures.

Table 1

**Gross Domestic Product and its main expenditure components
and the main price indicators
(year-on-year rate of change (%))**

	<u>2001</u> [#]	<u>2002</u> [#]	<u>Q1</u> [#]	<u>2002</u>			<u>2003</u>	
				<u>Q2</u> [#]	<u>Q3</u> [#]	<u>Q4</u> [#]	<u>Q1</u> [#]	<u>Q2</u> ⁺
<i>Change in real terms of GDP and its main expenditure components (%)</i>								
Private consumption expenditure	1.6	-1.3	-0.1	-2.2	-1.2	-1.8	-2.0	-2.2
Government consumption expenditure	6.1	2.4	2.3	3.0	3.5	0.8	1.3	0.6
Gross domestic fixed capital formation	2.7	-4.3	-11.8	-0.2	-4.3	-0.7	3.5	-5.3
<i>of which :</i>								
Building and construction	-1.1	1.2	-3.2	7.6	8.2	-6.2	-3.5	-7.2
Machinery, equipment and computer software	6.2	-9.1	-19.8	-6.7	-12.2	3.2	11.9	-2.4
Total exports of goods	-3.3	8.7	-2.4	5.9	11.5	18.4	19.1	14.3
Re-exports	-2.4	11.0	-1.4	8.4	13.7	22.2	22.3	17.0
Domestic exports	-10.2	-11.2	-11.1	-13.6	-7.5	-12.9	-12.0	-12.6
Imports of goods ^(a)	-1.9	7.9	-4.0	6.0	10.8	18.2	18.8	10.9
Exports of services	6.9	11.7	6.0	7.7	13.9	18.1	12.6	-14.7
Imports of services	2.0	0.2	-0.7	-3.8	2.0	3.4	-3.9	-19.6
Gross Domestic Product	0.5	2.3	-0.6	0.8	3.4	5.1	4.5	-0.5
<i>Change in the main price indicators (%)</i>								
GDP deflator	-1.9	-3.0	-2.3	-2.2	-3.1	-4.1	-4.6	-5.5
Composite Consumer Price Index ^(b)	-1.6	-3.0	-2.6	-3.2	-3.5	-2.9	-2.0	-2.5
Consumer Price Index (A) ^(b)	-1.7	-3.2	-2.8	-3.6	-4.1	-2.4	-1.8	-1.8
<u>Change in nominal GDP (%)</u>	-1.4	-0.8	-3.0	-1.4	0.2	0.8	-0.2	-6.0
<u>GDP at current market prices (\$ billion)</u>	1,270	1,260	298	306	325	331	298	288
<u>GDP at constant (2000) market prices (\$ billion)</u>	1,294	1,324	310	318	343	353	324	316
<u>Changes in inventories at constant (2000) market prices (\$ billion)</u>	-5	3	-3	1	1	3	3	2

Notes : (#) Revised figures.

(+) Preliminary figures.

(a) Here imports of goods are valued on f.o.b. basis, instead of on c.i.f. basis as is the on-going practice for the merchandise trade statistics.

(b) Final figures.

Table 2

**Gross Domestic Product and its main expenditure components
and the main price indicators
(seasonally adjusted quarter-to-quarter rate of change (%))**

	<u>2002</u>				<u>2003</u>	
	<u>Q1</u> [#]	<u>Q2</u> [#]	<u>Q3</u> [#]	<u>Q4</u> [#]	<u>Q1</u> [#]	<u>Q2</u> ⁺
<i>Change in real terms of GDP and its main expenditure components (%)</i>						
Private consumption expenditure	0.5	-0.7	-0.3	-0.9	-0.2	-0.7
Government consumption expenditure	0.4	-0.2	2.3	-1.2	0.1	-0.1
Gross domestic fixed capital formation	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Total exports of goods	4.6	5.7	4.1	3.9	3.1	2.4
Re-exports	5.8	6.6	4.6	4.7	3.9	2.7
Domestic exports	-5.5	-2.0	-0.6	-4.3	-6.3	-1.8
Imports of goods ^(a)	4.6	5.9	4.6	3.0	3.7	-0.9
Exports of services	1.9	4.3	6.1	5.1	-3.4	-21.1
Imports of services	0.4	-1.6	3.8	1.1	-6.9	-17.7
Gross Domestic Product^(b)	0.3	1.1	2.0	1.7	-0.3	-3.7
<i>Change in the main price indicators (%)</i>						
GDP deflator	-0.7	-0.8	-0.9	-1.6	-1.4	-1.7
Composite Consumer Price Index^(c)	-1.1	-0.6	-0.7	-0.6	-0.1	-1.1
Consumer Price Index (A) ^(c)	-0.6	-0.6	-0.7	-0.6	*	-0.5

Notes : (#) Revised figures.

(+) Preliminary figures.

(*) Change of less than 0.05%.

N.A. Not applicable, as no clear seasonal pattern is found in gross domestic fixed capital formation, due to the presence of considerable short-term fluctuations.

(a) Here imports of goods are valued on f.o.b. basis, instead of on c.i.f. basis as is the on-going practice for the merchandise trade statistics.

(b) As gross domestic fixed capital formation does not exhibit a clear seasonal pattern, the seasonally adjusted series of GDP is compiled separately at the overall level.

(c) Final figures.

Table 3**Forecast growth rates of the Gross Domestic Product
and its main expenditure components and forecast rates of change
in the main price indicators for 2003**

	Forecast for 2003 as released <u>on 30.5.2003</u> (%)	August update of the forecast for 2003 released <u>on 29.8.2003</u> (%)
<i>Growth rate in real terms of:</i>		
Private Consumption Expenditure	-3	-1.5
Government Consumption Expenditure	4	3.5
Gross Domestic Fixed Capital Formation	-5.5	-5.4
<i>of which:</i>		
Building and construction	-7.4	-7.1
Machinery, equipment and computer software	-3.6	-3.6
Total Exports of Goods	5.5	9.2
Re-exports	7.5	11.5
Domestic exports	-15	-15
Imports of Goods	2.9	7.1
Exports of Services	-2	2
Imports of Services	-13.5	-7
Gross Domestic Product (GDP)	1.5	2
<i>Rate of change in:</i>		
GDP Deflator	-3.5	-4
Composite Consumer Price Index	-2.5	-3
<i>Rate of change in Nominal GDP</i>	-2	-2

Table 4

2003 GDP and price forecasts for Hong Kong put out by selected international organisations and private sector analysts

	Date of release	GDP (growth	Private consumption expenditure rate	Gross domestic fixed capital formation in real	Total exports of goods terms	Exports of services (%)	Rate of change in consumer prices (%)	Reference source
International organisations:								
IMF	Sep 2002	3.4	--	--	--	--	-0.5	World Economic Outlook, Sep 2002.
	Feb 2003	3	--	--	--	--	--	Asian Wall Street Journal, 26 Feb 2003.
	Apr 2003	3	--	--	--	--	-1.6	World Economic Outlook, Apr 2003.
	May 2003	2.2	1	1.2	--	--	-2	IMF Country Report No. 03/143, May 2003.
ADB	Sep 2002	3.5	--	--	--	--	0.5	Asian Development Outlook, 2002 Update, Sep 2002.
	Dec 2002	2.8	--	--	--	--	--	Media Briefing Note, Dec 2002.
	Apr 2003	2	--	--	--	--	-1.5	Asian Development Outlook 2003.
	May 2003	-1.4 to 0.8	--	--	--	--	--	News Release, No. 065/03, 9 May 2003.
World Bank	Apr 2002	4.3	--	--	--	--	--	East Asia Update, Apr 2002.
	Nov 2002	2.7	--	--	--	--	--	East Asia Update, Nov 2002.
	Apr 2003	2	--	--	--	--	--	East Asia Update, Apr 2003.
Private sector analysts:								
<i>(a) Major local banks</i>								
Hongkong Bank	Oct 2002	1.6	-0.9	-0.8	--	--	-0.8	Asian Economic Insight, 24 Oct 2002.
	Mar 2003	1.6	-0.9	-0.8	--	--	-1.5	Asian Economics, Q2 2003.
	Apr 2003	0.5	-3	-0.6	--	--	-2	Asian Economic Insight, 25 Apr 2003.
Standard Chartered Bank	Oct 2002	3.5	--	--	--	--	-0.5	Hong Kong Snapshot, 22 Oct 2002.
	Apr 2003	0.5	--	--	--	--	-2	Asian Economic Focus, May 2003.
Hang Seng Bank	Dec 2002	2.3	-0.5	-1.7	6.8	8.7	-1	Hang Seng Economic Monthly, Nov/Dec 2002.
	May 2003	0.8	-2.5	-4.1	9.4	3.2	-2	Hang Seng Economic Monthly, May 2003.

Table 4 (cont'd)

	Date of release	GDP (growth	Private consumption expenditure rate	Gross domestic fixed capital formation		Total exports of goods terms	Exports of services (%)	Rate of change in consumer prices (%)	Reference source
				in	real				
Bank of China (HK)	Dec 2002	2.8	0.5	-0.3		7.8	12.5	-2	BOC Economic Review Monthly, Vol. 1 No.12, 2002.
	Apr 2003	0 to 1.5	-3 to -5	-1.2 to -2		3.7 to 4.7	3 to 4.5	-2.3 to -2.5	BOC Economic Review Monthly, Vol. 1 No. 4 2003.
	Aug 2003	1.8	--	--		--	--	-2.5	Economic and Strategy Planning Department, Aug 2003.
Bank of East Asia	Nov 2002	3	--	--		--	--	-1.5	Economic Research Department, Nov 2002.
	Dec 2002	2	--	--		--	--	-1.5	Economic Research Department, Dec 2002.
	Jan 2003	2	0.5	1		5.9	9.3	--	Economic Analysis, Jan 2003.
	Apr 2003	1.6	--	--		--	--	--	Sing Pao, 14 Apr 2003.
	May 2003	1.6	-1.2	-1		7.1	7	-2.5	Economic Research Department, 28 May 2003.
<i>(b) Investment banks</i>									
JP Morgan Chase	Dec 2002	3.7	--	--		--	--	--	Hong Kong Economic Journal, 12 Dec 2002.
	Apr 2003	1.6	--	--		--	--	--	Hong Kong Economic Times, 12 Apr 2003.
	May 2003	1	--	--		--	--	--	Hong Kong Economic Journal, 21 May 2003.
	Jun 2003	1.6	--	--		--	--	--	The Standard, 3 Jun 2003.
Goldman Sachs Asia	Dec 2002	3	--	--		--	--	-1.2	Hong Kong Economic Journal, 13 Dec 2002.
	Apr 2003	1.7	--	--		--	--	--	Hong Kong Economic Journal, 3 Apr 2003.
Morgan Stanley Asia	Feb 2003	2.7	--	--		--	--	--	Apple Daily, 26 Feb 2003.
	Apr 2003	2.1	0.5	2.2		--	--	-1.2	Hong Kong Economics, 1 Apr 2003.
	Jun 2003	1.8	-2	1.3		--	--	-2.2	Hong Kong Economics, 2 Jun 2003.

Table 4 (cont'd)

	Date of release	GDP	Private consumption expenditure		Gross domestic fixed capital formation		Total exports of goods	Exports of services	Rate of change in consumer prices	Reference source
			(growth	rate	in	real				
Merrill Lynch	Feb 2003	3.9	--	--	--	--	--	--	-1.4	The Asian Equity Economist, 14 Feb 2003.
	Mar 2003	4.6	--	--	--	--	--	--	-1.4	Economics, 5 Mar 2003.
	Apr 2003	4	--	--	--	--	--	--	--	Hong Kong Economic Journal, 3 Apr 2003.
	Apr 2003	3.1	--	--	--	--	--	--	--	Hong Kong Economic Times, 15 Apr 2003.
	May 2003	3.1	--	--	--	--	--	--	-1.9	The Asian Equity Economist, 13 May 2003.
	Jun 2003	2.5	--	--	--	--	--	--	--	The Standard, 3 Jun 2003.
	Aug 2003	2.5	--	--	--	--	--	--	-1.9	The Asian Equity Economist, 11 Aug 2003.
Credit Suisse First Boston	Feb 2003	2.6	2		3.2	--	--	--	-1.7	Asian Daily, 19 Feb 2003.
	Apr 2003	2	--	--	--	--	--	--	--	Emerging Markets Economics Daily Non-Japan Asia, 7 Apr 2003.
	Apr 2003	1.8	--	--	--	--	--	--	-2.7	Emerging Markets Economics Research, 29 Apr 2003.
	Jun 2003	1.8	--	--	--	--	--	--	-2.6	Emerging Markets Economics Research, 23 Jun 2003.
<i>(c) Others</i>										
Economist Intelligence Unit	Mar 2003	2.7	0.2		3.5	--	--	--	-1.5	Country Forecast, Mar 2003.
	Apr 2003	0.3	-1		-8	--	--	--	-2.5	Country Forecast, Apr 2003.
	May 2003	0.3	-2		0	--	--	--	-3.5	Country Forecast, May 2003.
	Jun 2003	0.9	-5.3		0	--	--	--	-3.5	Country Forecast, Jun 2003.
	Jul 2003	1.1	-4.2		0	--	--	--	-2.8	Country Forecast, Jul 2003.
	Aug 2003	1.1	-4.5		0	--	--	--	-2.4	Country Forecast, Aug 2003.
Hong Kong General Chamber of Commerce	Nov 2002	2.1	--	--	--	--	--	--	-1.5	Hong Kong Business Summit, 27 Nov 2002.
	Apr 2003	1.5	--	--	--	--	--	--	-2	Chief Economist, HKGCC, 24 Apr 2003.

Observation :

The latest known GDP forecasts in real terms for 2003 from the private sector analysts listed above range from 0.5% to 2.5%, averaging at 1.4%. This is below the now updated official GDP growth forecast of 2%. Yet the difference is reckoned to be mainly related to the less severe GDP outturn in the second quarter of 2003.