



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

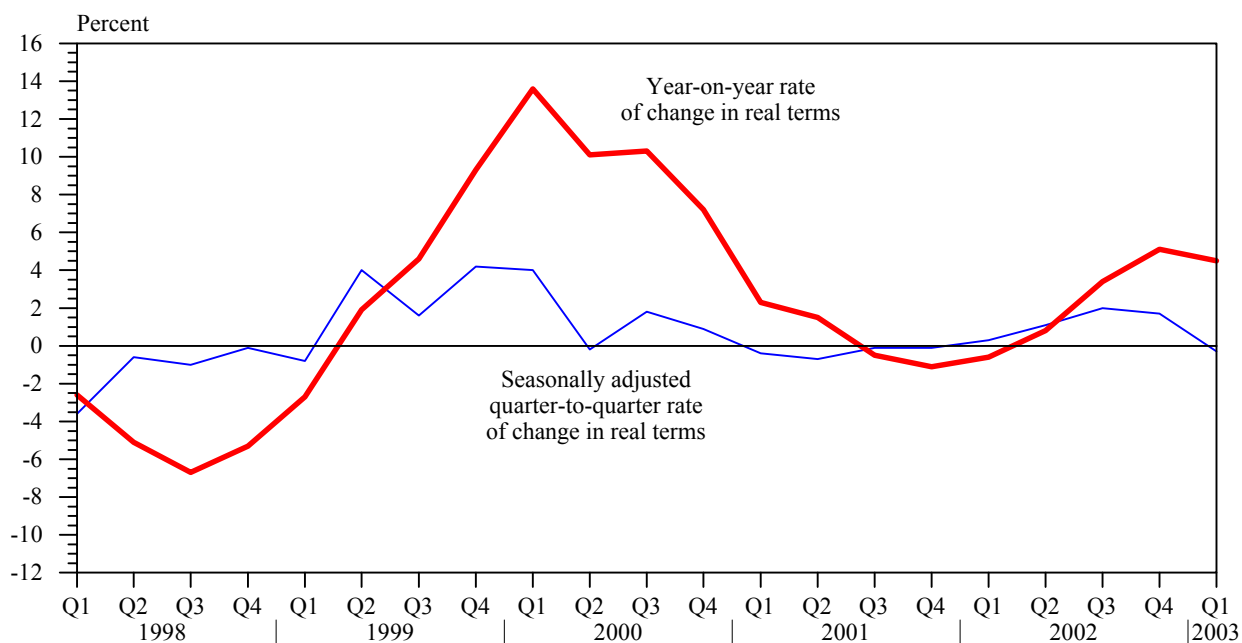
Today the Government released the First Quarter Economic Report 2003. The Economic Report, together with the press release containing the updated economic forecasts for the whole year of 2003, have been furnished to LegCo Members.

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 assesses the impact of the spread of Severe Acute Respiratory Syndrome (SARS) on the Hong Kong economy in overall terms, before describing briefly the latest updated economic forecasts by the Government for 2003 as a whole.

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Financial Services and the Treasury Bureau
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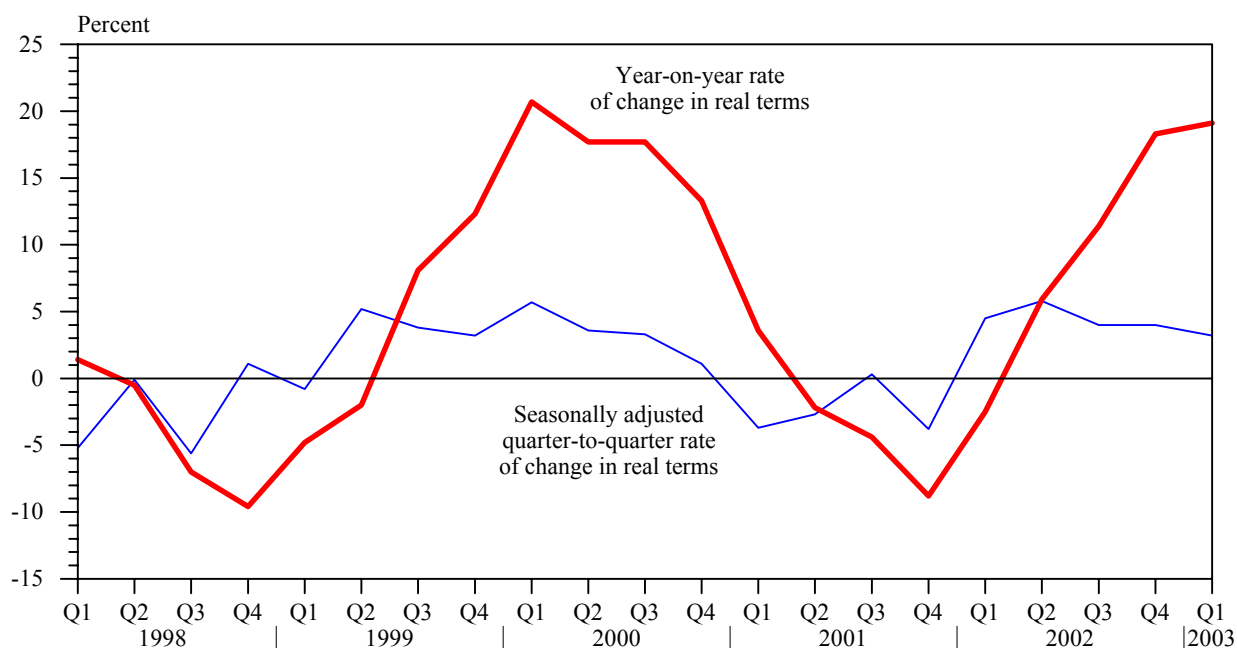
(I) Economic Performance in the First Quarter of 2003

Chart 1 : Gross Domestic Product



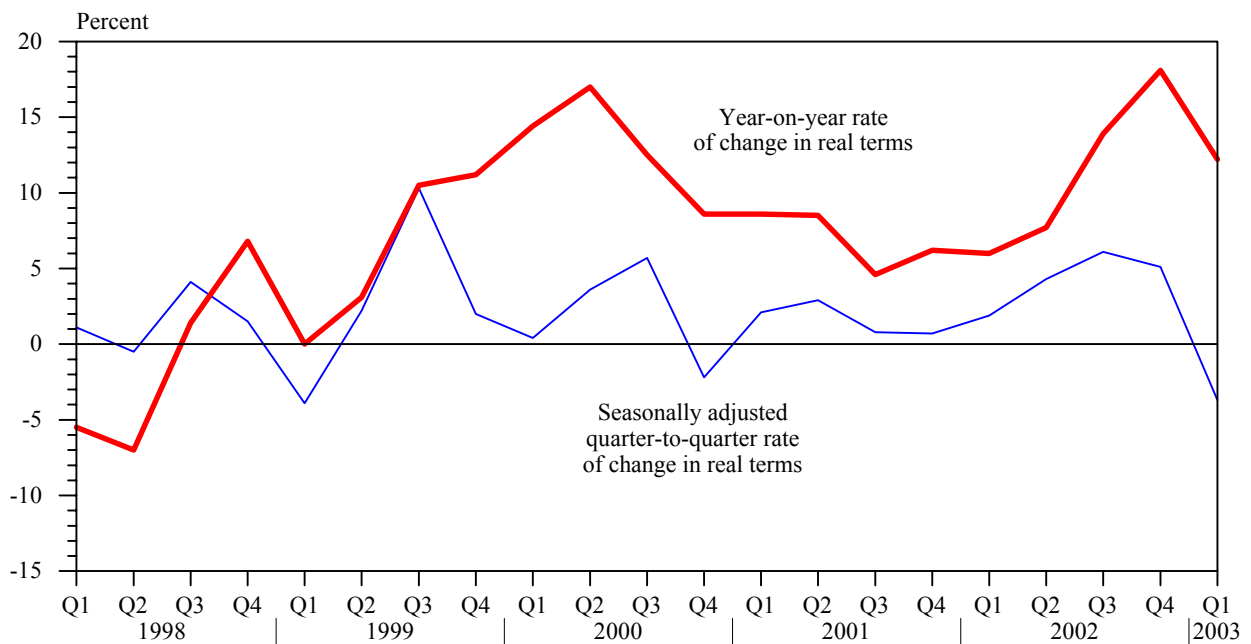
- After the distinct pick-up in the latter part of 2002, the Hong Kong economy maintained strong growth momentum at the beginning of 2003.
- On a year-on-year comparison, the Gross Domestic Product (GDP) still attained solid growth at 4.5% in real terms in the first quarter of 2003, albeit somewhat slower than the 5.1% growth in the fourth quarter of 2002. The external sector remained the key driver of economic growth, while domestic demand also showed signs of improvement in overall terms in the first two months of this year.
- On a seasonally adjusted quarter-to-quarter comparison, GDP fell back by 0.3% in the first quarter of 2003, after a 1.7% increase in the fourth quarter of 2002.

Chart 2 : Total exports of goods



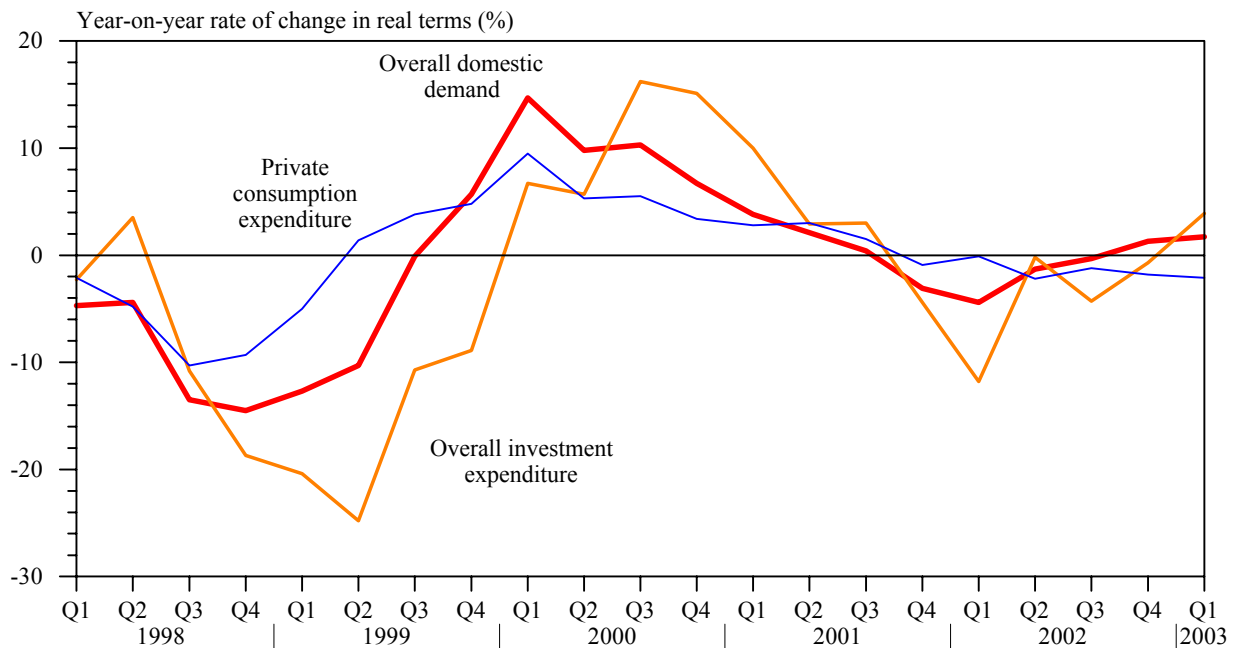
- On visible trade, total exports of goods continued to grow strongly in the first quarter of 2003, registering the third consecutive quarter of double-digit year-on-year growth in a row.
- Total exports of goods surged by 19.1% in real terms in the first quarter of 2003 over a year earlier, better than the 18.3% growth in the fourth quarter of 2002.
- Analysed by market, exports of goods to East Asia continued to provide the key impetus to export growth in the first quarter of 2003. Exports to the mainland of China and Taiwan were particularly robust. Exports to Japan also picked up distinctly in growth. Exports to the United States remained strong in the first quarter, as its import intake continued to improve steadily. Enhanced price competitiveness of Hong Kong's exports on the back of a weaker US dollar should have also helped. Concurrently, exports to the European Union accentuated distinctly further, supported by steadier import demand there and a stronger euro.

Chart 3 : Exports of services



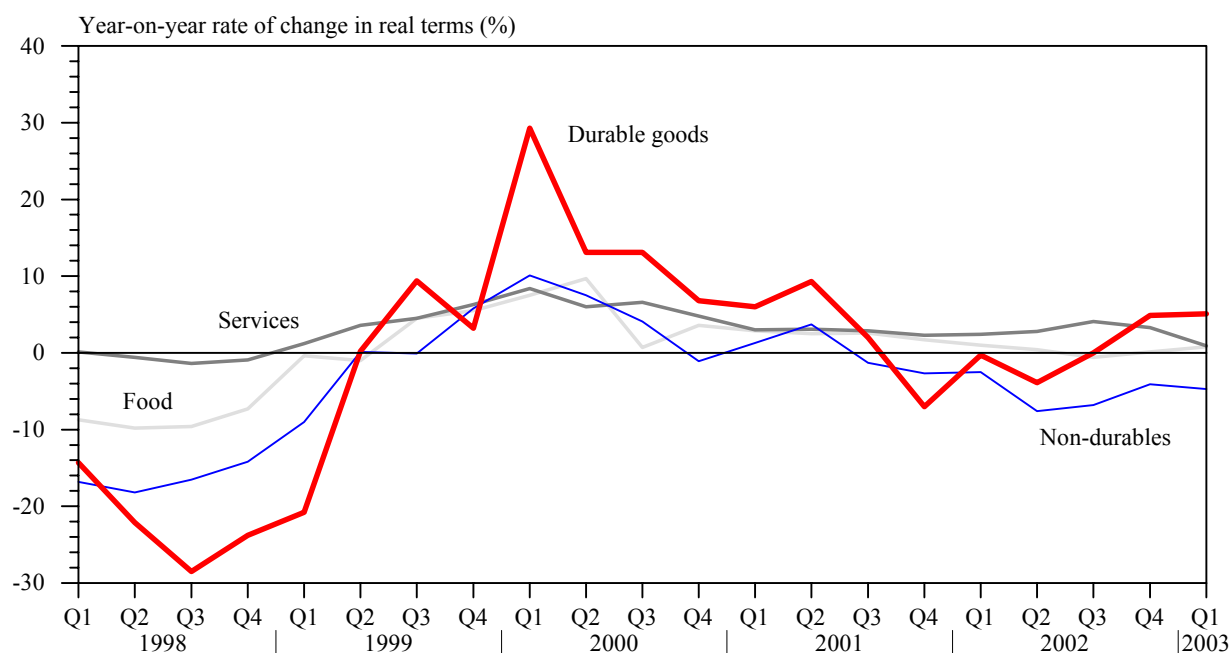
- On invisible trade, inbound tourism receipts performed well in most of the first quarter of 2003. Along with a distinct surge in both exports of transportation services and offshore trade, exports of services still attained 12.2% growth in real terms in the first quarter of 2003 over a year earlier, though moderated from an 18.1% growth in the fourth quarter of 2002.
- This mostly reflected a sharp plunge in visitor arrivals in the latter part of March amidst the spread of SARS towards the end of the quarter.

Chart 4 : Domestic demand



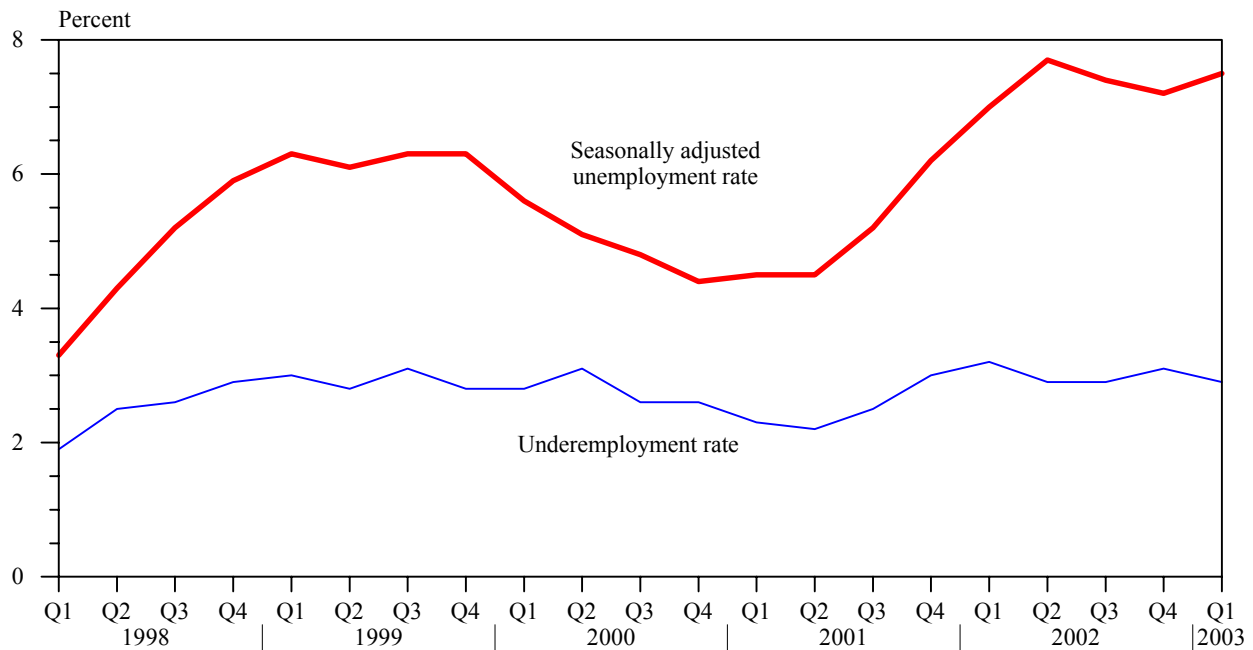
- Domestic demand showed signs of improvement in overall terms at the beginning of this year, but receded abruptly towards the end of the first quarter under the shock impact of SARS.
- Private consumption expenditure fell by 2.1% in real terms in the first quarter of 2003 over a year earlier, slightly enlarged from a 1.8% decline in the fourth quarter of 2002.
- As to overall investment spending, expenditure on building and construction remained subdued. But expenditure on machinery, equipment and computer software picked up further. Overall investment spending had a modest growth of 3.9% in real terms in the first quarter of 2003 over a year earlier. This came after a 0.7% fall in the fourth quarter of 2002.

Chart 5 : Private consumption expenditure by major component



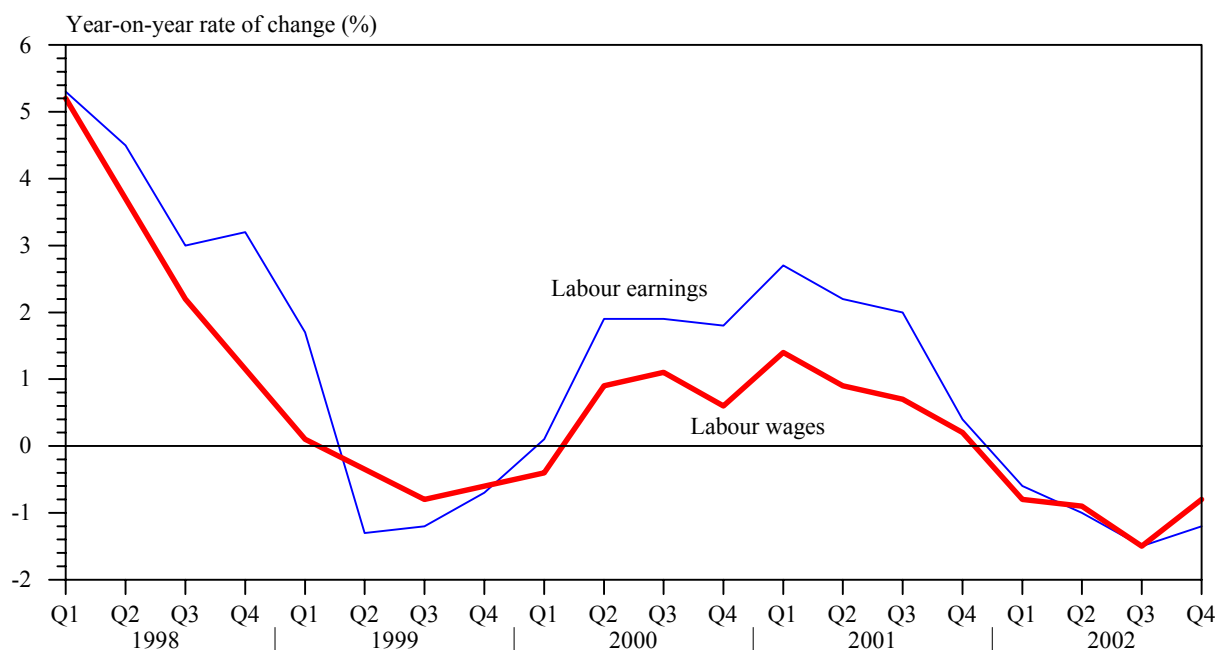
- Under the shock impact of SARS, there were across-the-board fall-off in major categories of consumer spending in the latter part of March. For the first quarter as a whole, spending on non-durable goods showed an enlarged decline. Spending on consumer services likewise moderated visibly. Spending by Hong Kong residents travelling abroad, which was already weak, plunged more sharply. While spending on durable goods still had growth, this merely reflected purchases in the earlier part of the quarter.

Chart 6 : Unemployment and underemployment rates



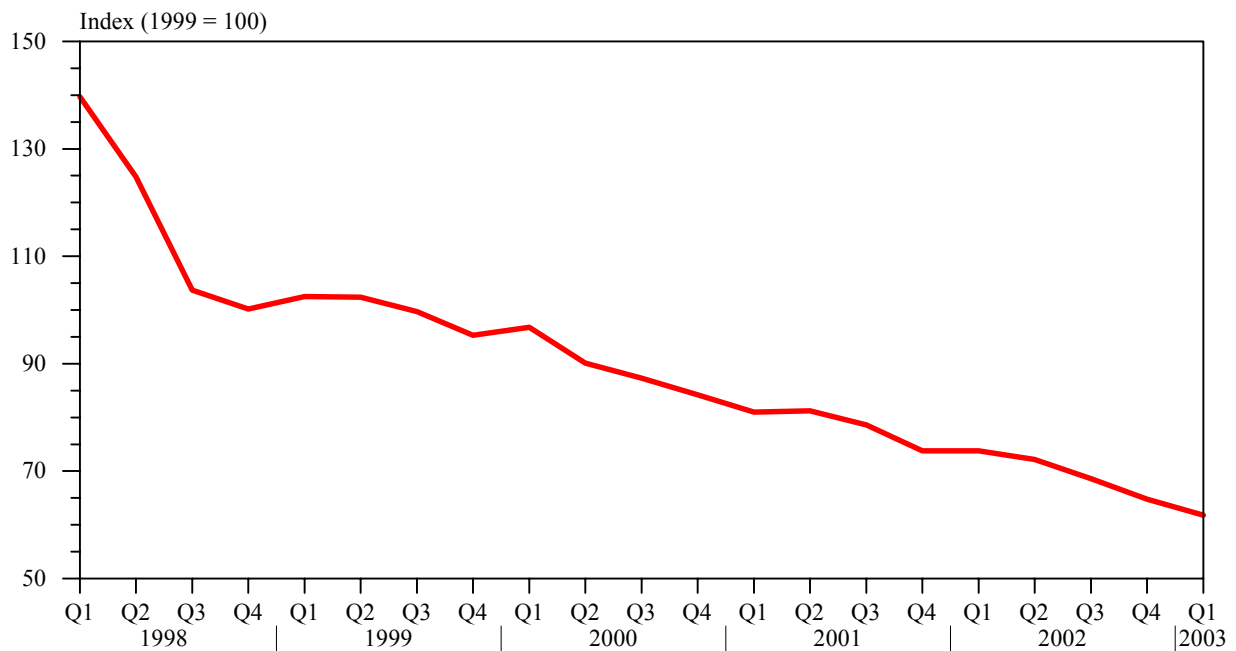
- The labour market remained slack in the first quarter of 2003, and deteriorated further upon the spread of SARS towards the end of the quarter. The seasonally adjusted unemployment rate turned up to 7.8% in February - April 2003, from 7.1% in September - November 2002. The underemployment rate also edged higher to 3.2% in February - April 2003.
- Analysed by economic sector, comparing February - April 2003 with November 2002 - January 2003, the rise in unemployment rate was seen in many major economic sectors, with the increase particularly distinct in construction, manufacturing, restaurants and hotels, and the wholesale/retail trades.
- Analysed by occupation category, the rise in unemployment rate in February - April 2003 over November 2002 - January 2003 was mainly concentrated in those occupation categories such as craft and related workers, plant and machine operators and assemblers, and associate professionals.

Chart 7 : Labour wages and earnings



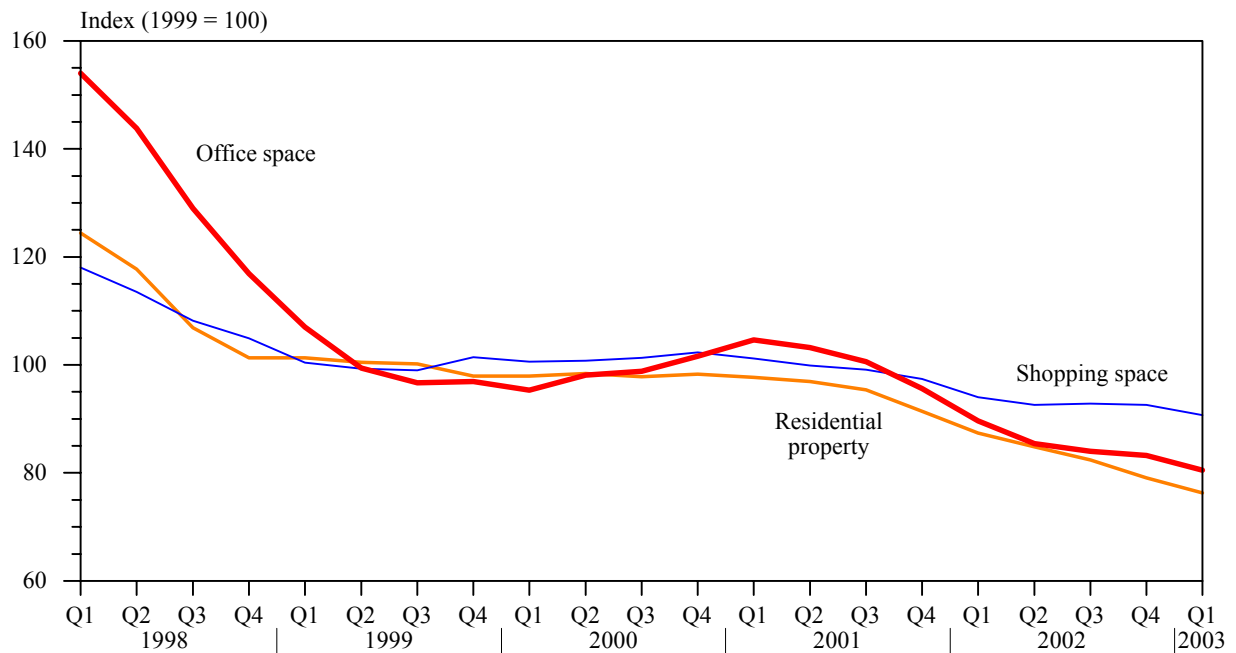
- As the labour market slackened further, nominal labour income remained on a moderating trend.
- Compared with a year earlier, labour wages fell further by 0.8% in money terms in December 2002, after a 1.5% decline in September. Labour earnings fell by 1.2% in money terms in the fourth quarter of 2002 over a year earlier, further to a 1.5% decline in the third quarter.

Chart 8 : Residential property price



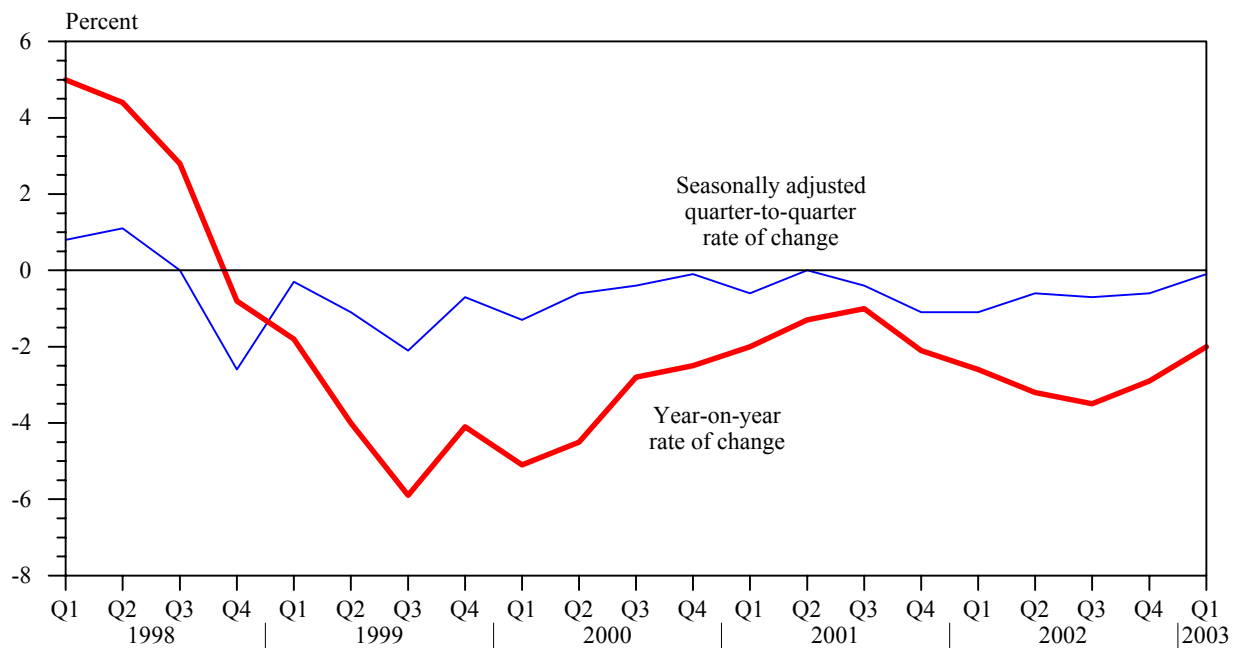
- The sales market for residential property remained generally slack in the first quarter of 2003.
- Acquisition interest was curtailed further after mid-March, first in the light of the uncertainties stemming from the war on Iraq, and then upon the impact of the spread of SARS in Hong Kong. Also, the ample supply of new flats in the mass market continued to affect the demand/supply balance in the residential property market.
- On a quarter-to-quarter comparison, flat prices fell further, on average by 5% in the first quarter of 2003.

Chart 9 : The rentals of residential property, office space and shopping space



- Rentals stayed soft, and the spread of SARS had aggravated the already sluggish situation further.
- Market conditions became more subdued after mid-March, as inbound tourism, local consumer spending and hence the overall economy were severely hit, causing leasing activities to quieten down even more.
- In the first quarter of 2003, rentals for residential property, office space and shopping space on average fell by 12.7%, 10.2% and 3.5% respectively over a year earlier.

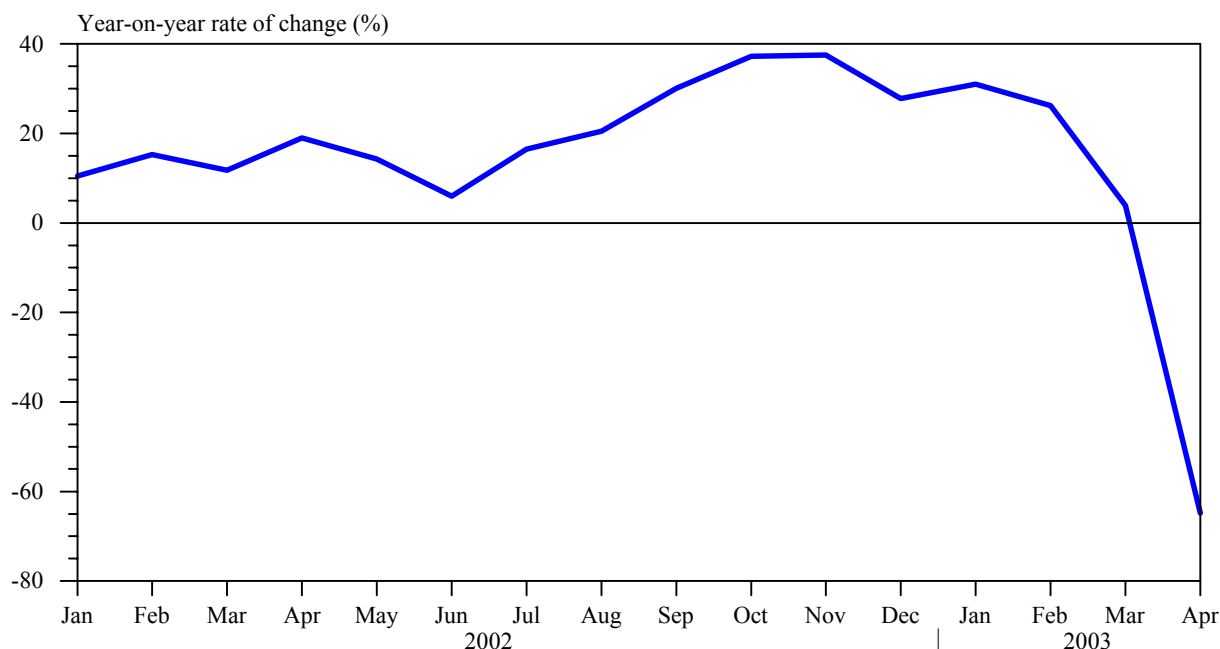
Chart 10 : Composite Consumer Price Index



- The Composite CPI fell by 1.8% in April 2003 over a year earlier, and by an average of 1.9% in the first four months of this year.
- Price competition in the local market turned even keener under the adverse impact of SARS, resulting in larger price discounts. Local operating costs are coming down along with a further moderation in both rentals and labour income, thereby adding to the decline in local in Chinese, only local prices.

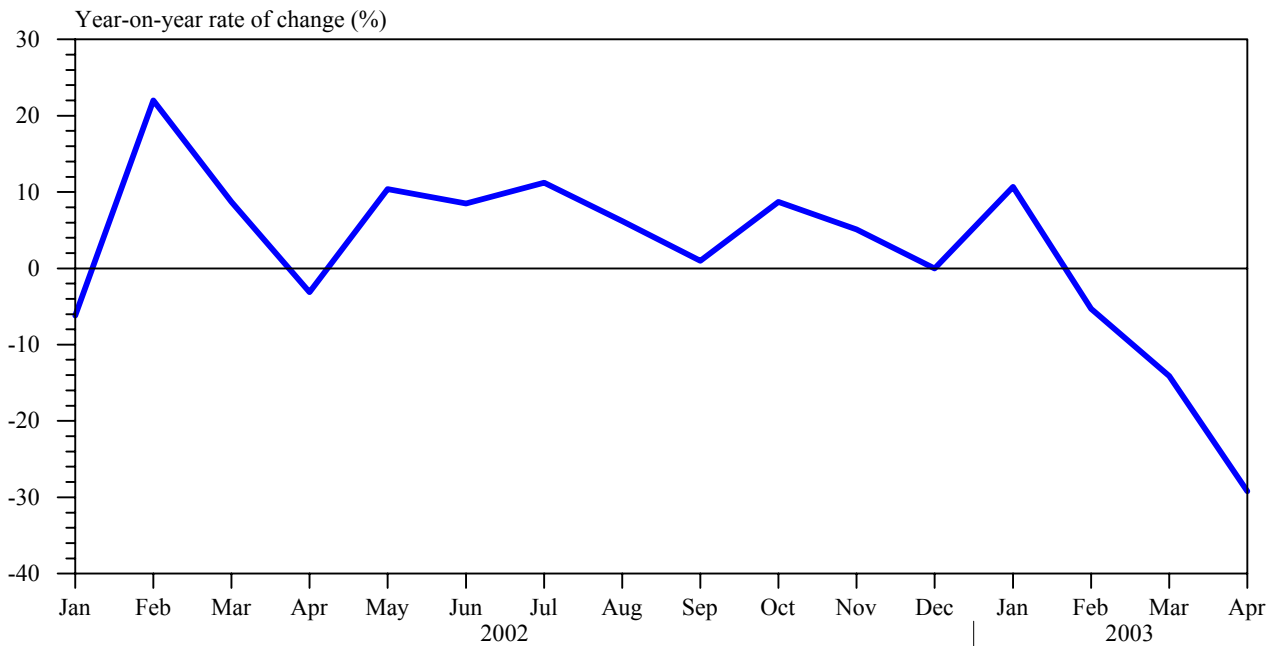
(II) Impact of the spread of SARS on the Hong Kong Economy

Chart 11 : Visitor arrivals



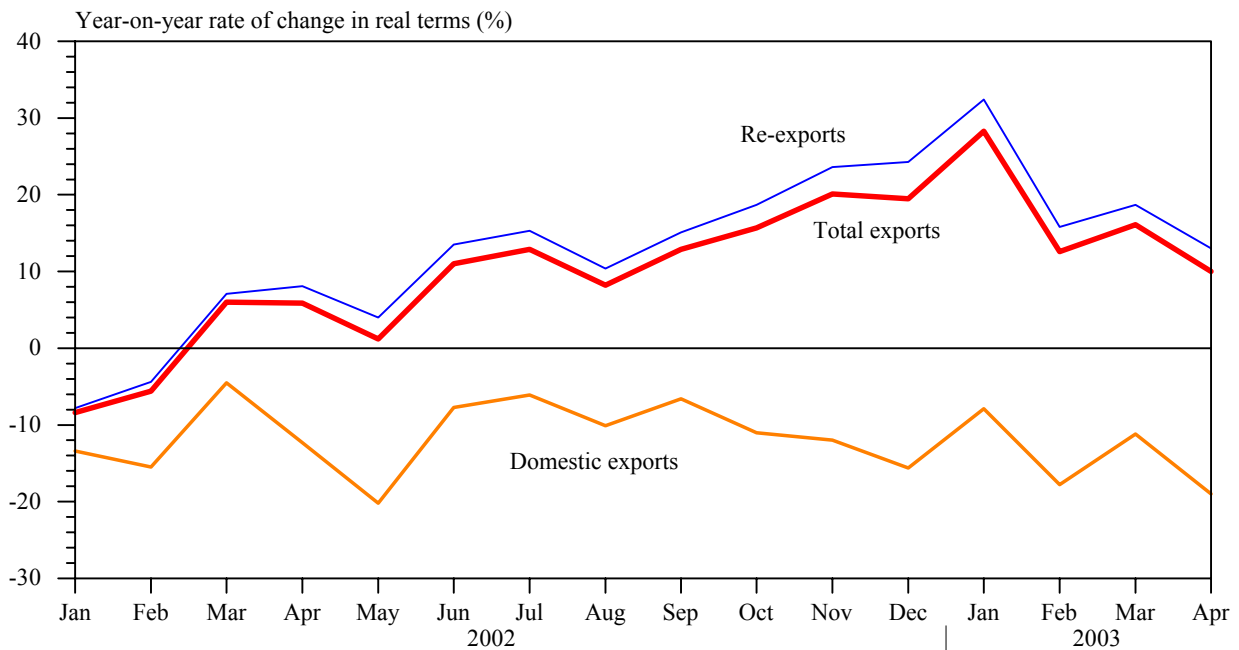
- SARS has extensively hit the local economy on many fronts, with the blow to inbound tourism particularly severe.
- Inbound tourism remained robust in the first two months of this year, with visitor arrivals surging by 29% over a year earlier. Nevertheless, the number of incoming visitors came down abruptly upon the spread of SARS since mid-March, by 10% in the second half of March over a year earlier, thereby yielding an increase of only 4% for March as a whole. This was followed by a 65% plunge in April.
- The hotel occupancy rate has recently been running at only around 20%, far below that of over 80% under normal situation in the same period.

Chart 12 : Resident departures



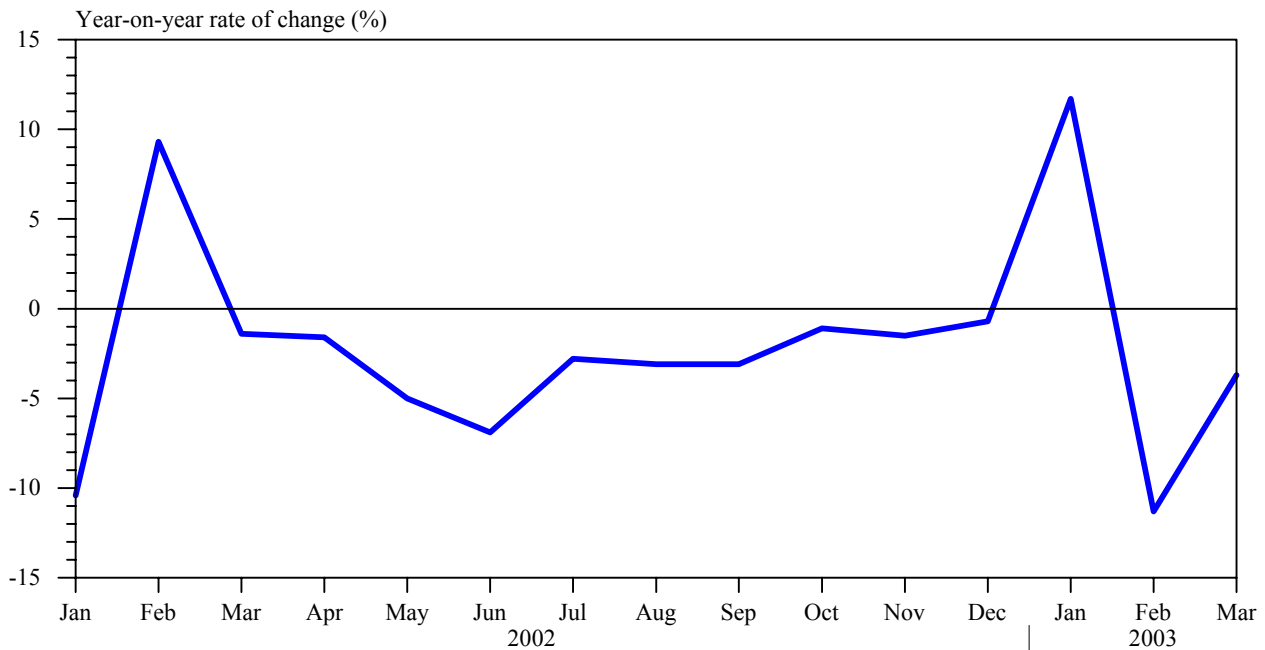
- Outbound tourism has likewise been drastically curbed as local people seek to avoid going to the affected places and also in face of arrival restrictions and post-arrival quarantine imposed by some neighbouring places on Hong Kong people.
- On a year-on-year comparison, the number of Hong Kong residents travelling abroad plummeted by 14% in March, in contrast to a 3% increase in January and February combined. The decline enlarged further in April, to 29%.

Chart 13 : Exports of goods



- As to merchandise trade, total exports of goods still attained around 10% increase in real terms in April over a year earlier, though moderated considerably from the 19% increase in the first quarter. Under the impact of SARS, the region's near-term economic outlook has turned dimmer and commercial activities related to business travel for negotiating business and placing orders have also been affected. These could lead to some diversion of orders and in turn further retard the growth in exports of goods later in the year.

Chart 14 : Retail sales volume



- Locally, the spread of SARS has severely dented consumption sentiment, derailing the nascent recovery in domestic demand.
- On a year-on-year comparison, the volume of retail sales in the local market, having risen by 0.7% in the first two months of this year combined, fell back by 3.7% in March. The decline in April is envisaged to be more pronounced.
- Local consumption sentiment appears to be stabilising lately. Together with the lifting of WHO's travel advisory against Hong Kong on 23 May, the impact of SARS on consumer sentiment can be expected to recede progressively in the period ahead.
- Reduced outbound travel should render some support to consumption in the local market. The Government's package of relief measures totaling \$11.8 billion as announced on 23 April should also help provide some cushion to the economy.
- Overall, the impact of SARS is reckoned to drag down GDP in 2003 by around 1.6 percentage points, after netting out the cushioning effect of the Government's relief measures.

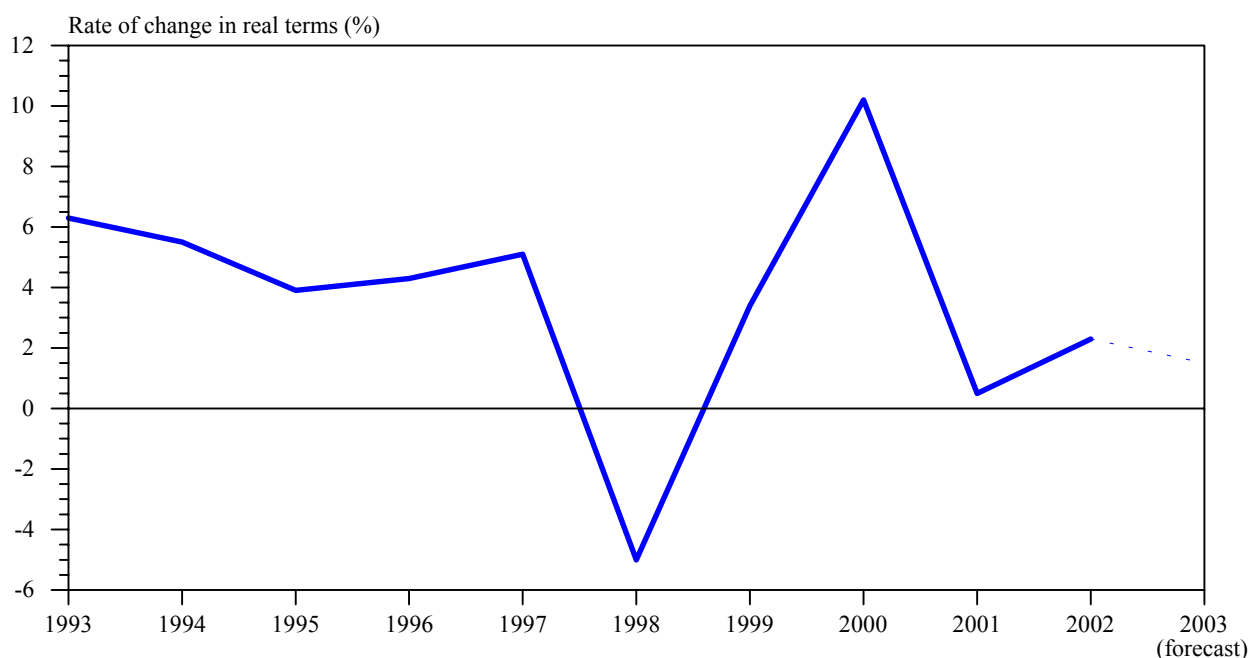
(III) Economic Outlook for 2003

Updated economic forecasts for the whole year of 2003

| | <u>Earlier forecasts</u> (%) | <u>Latest forecasts</u> (%) | <u>Extent of Revision</u> (% points) |
|--|---------------------------------|--------------------------------|---|
| <i>Growth rate in real terms of:</i> | | | |
| <i>Domestic Demand</i> | | | |
| Private Consumption Expenditure | 0 | -3 | -3 |
| Government Consumption Expenditure | 2.5 | 4 | 1.5 |
| Gross Domestic Fixed Capital Formation | 0.9 | -5.5 | -6.4 |
| <i>External Trade</i> | | | |
| Total Exports of Goods | 6.6 | 5.5 | -1.1 |
| Imports of Goods | 6.3 | 2.9 | -3.4 |
| Exports of Services | 8 | -2 | -10 |
| Imports of Services | 1.5 | -13.5 | -15 |
| Gross Domestic Product (GDP) | 3 | 1.5 | -1.5 |
| <i>Rate of change in:</i> | | | |
| GDP Deflator | -2 | -3.5 | -1.5 |
| Composite Consumer Price Index | -1.5 | -2.5 | -1 |

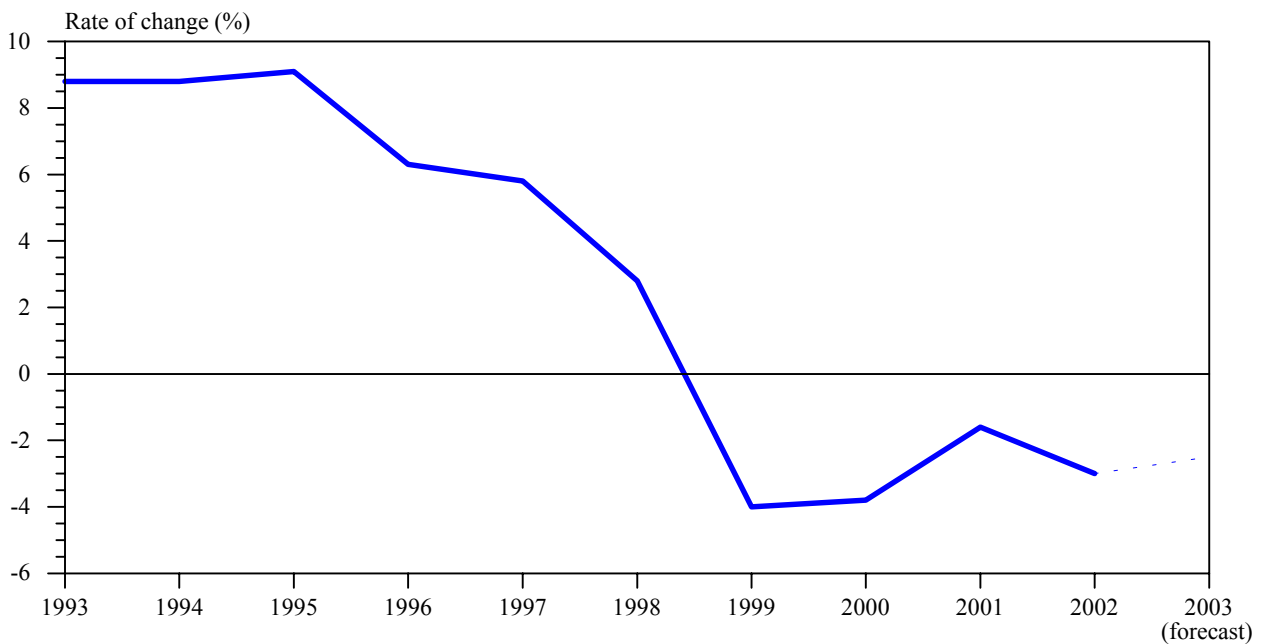
- In light of the envisaged moderation in exports of goods in the latter part of this year, the forecast growth rate in real terms of total exports of goods in 2003 is trimmed down to 5.5%, from the earlier forecast of a 6.6% growth.
- The short-term outlook for exports of services remains bleak, as inbound tourism may take time to recover and transportation services will also be curbed by the subdued airline business. Moreover, moderation in trade flows will also hit cargo freight services. Taken together, the forecast rate of change in real terms in exports of services in 2003 is slashed markedly down to -2%, from 8% put out earlier.
- Domestic demand has turned even weaker under the adverse impact of SARS. Private consumption expenditure is expected to plummet in the second quarter, and then recover from the trough in the ensuing period. However, with the unemployment hike, income loss and greater deflation, consumption may still be weak for some time. The forecast rate of change in real terms in private consumption expenditure in 2003 is scaled down to -3%, from nil change as put out earlier. Also, overall investment spending will remain weak amidst the prevailing subdued business environment.

Chart 15 : Forecast of Gross Domestic Product for 2003



- Overall, the forecast growth rate in real terms of GDP for 2003 is now put at 1.5%, down by 1.5 percentage points from the forecast put out earlier.
- The short-term economic outlook is still subject to much uncertainties:
 - With regard to exports, the geopolitical concerns have undoubtedly eased somewhat upon the end of the war on Iraq. But the situation in the US economy, including its subdued labour market, lacklustre investment and enlarged fiscal deficit, continues to attract concern. This, coupled with the similarly subdued situation in the European and the Japanese economies, would affect Hong Kong's export performance.
 - As to Hong Kong's exports to East Asia, it hinges on whether SARS has distinctly weakened import demand in the mainland of China, Taiwan and Southeast Asia.
 - With regard to inbound tourism, the SARS threat elsewhere in the region will continue to hold back visitor flows in the meantime. The slack in inbound tourism may persist for some time.
 - In the domestic economy, the unemployment hike, income loss and greater deflation emanating from the adverse impact of SARS are likely to keep down domestic demand, thereby retarding the pace of recovery.

Chart 16 : Forecast of Composite Consumer Price Index for 2003



- Local prices are expected to decline further as price competition in the local market has turned even keener as business conditions falter and business operating costs are also edging down further. Amongst the Government's relief measures announced in the latter part of April, those with downward effect on the CPI are reckoned to lower the Composite CPI by around 0.3 of a percentage point for 2003 as a whole. Thus, even though import prices may pick up upon further weakening in the US dollar, the forecast rate of change in the Composite CPI for 2003 is still revised down by one percentage point from the forecast put out earlier, to -2.5%.
