

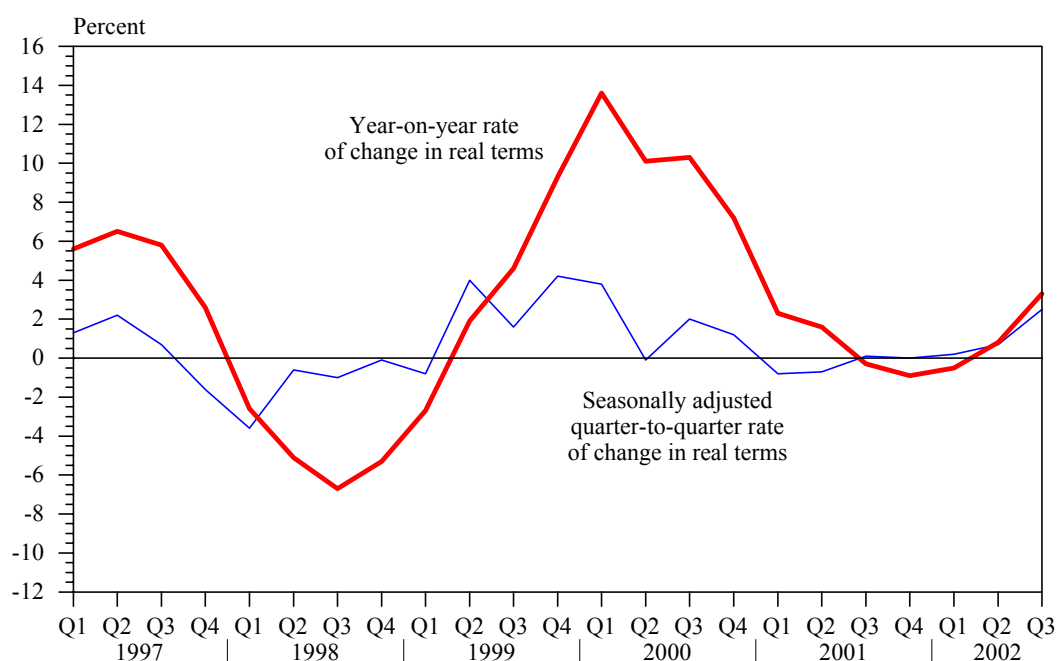


Hong Kong's recent economic situation and short-term outlook

The Government has just released the Third 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.

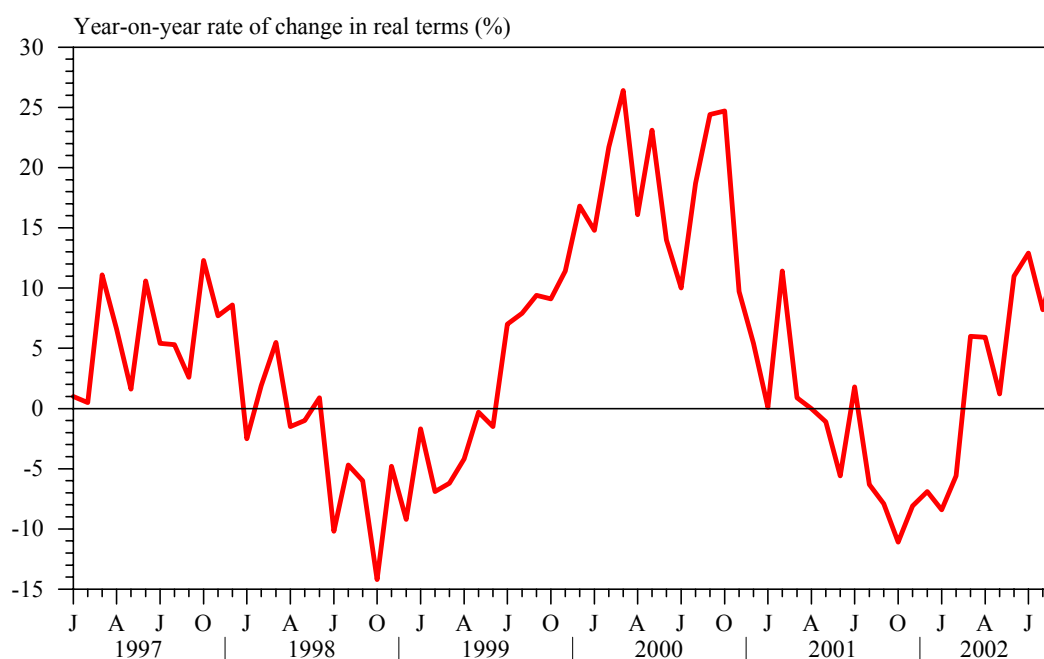
This paper first analyses Hong Kong's overall economic growth and the developments in regard to external trade, domestic demand, labour market, consumer prices, and so forth in the recent period. It then briefly describes the latest updated economic forecasts by the Government for 2002 as a whole, before discussing broadly the economic outlook for 2003 in preliminary terms.

Chart 1 : Gross Domestic Product



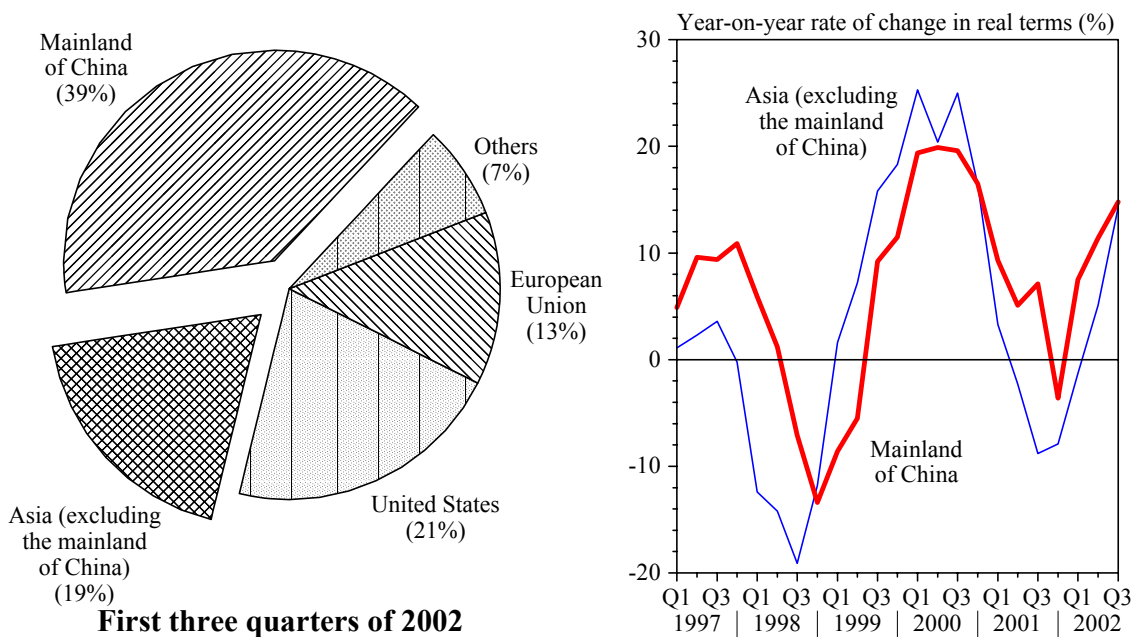
- The Hong Kong economy, after turning around to a modest growth in the second quarter, picked up visibly further in the third quarter of 2002.
- On a year-on-year comparison, the Gross Domestic Product (GDP) accelerated to a 3.3% growth in real terms in the third quarter of 2002, from a 0.8% growth in the second quarter. The growth impetus continued to come from the external sector. Domestic demand also recorded a much lesser decline in overall terms.
- On a seasonally adjusted quarter-to-quarter comparison, GDP rose for the third quarter in a row, by 2.5% in real terms in the third quarter of 2002, significantly better than the 0.7% rise in the second quarter.

Chart 2 : Total exports of goods



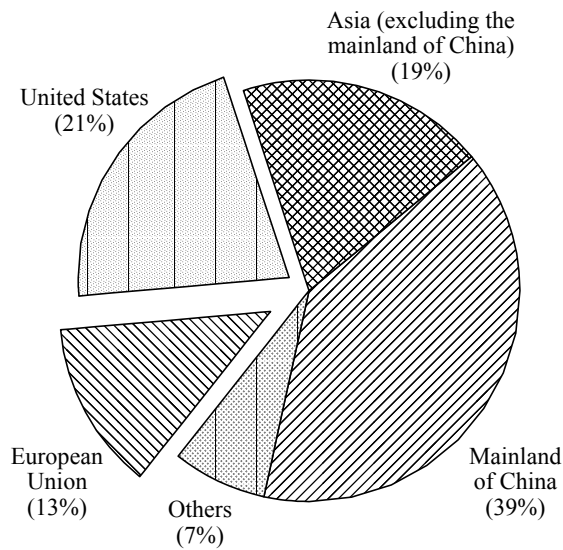
- On visible trade, total exports of goods accelerated distinctly further to a double-digit growth in the third quarter, the fastest year-on-year growth recorded since the fourth quarter of 2000.
- Total exports of goods picked up to a growth of 11.4% in real terms in the third quarter of 2002 over a year earlier, further improved from the 5.9% rise in the second quarter. On a seasonally adjusted quarter-to-quarter comparison, total exports of goods leaped for the third consecutive quarter, by 4.0% in real terms in the third quarter of 2002, after a 5.3% increase in the second quarter.

Chart 3 : Hong Kong's total exports of goods to Asia

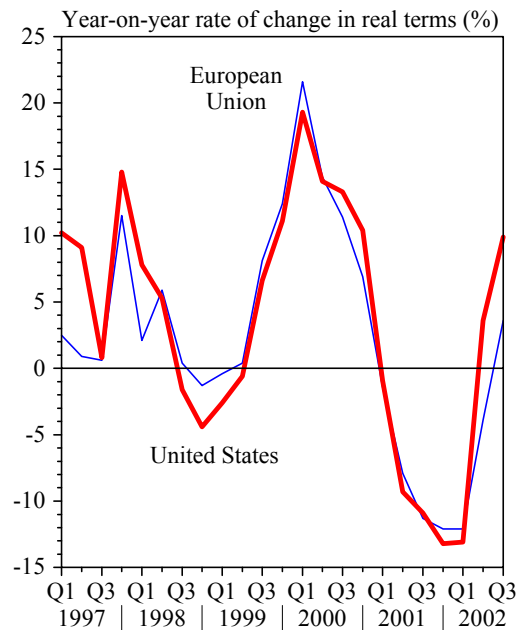


- Around three-fifths of Hong Kong's exports of goods go to Asia, within which around 70% are destined for the mainland of China.
- Total exports of goods to Asian markets soared even more in the third quarter of 2002, benefiting not only from the sustained robust import intake in the mainland of China, but also from a broad-based surge in import demand in the other East Asian economies.
- The Mainland economy continues to display robust growth, with its exports performing particularly well in the recent period. As a result, Hong Kong's exports of goods to the Mainland, including those for export processing by the manufacturing industry, leaped further, by 14.8% in real terms in the third quarter of 2002 over a year earlier.
- Hong Kong's exports to the other Asian markets also improved further, up 14.3% year-on-year in real terms in the third quarter of 2002. There was particularly remarkable growth in exports to the Republic of Korea, Malaysia, Thailand and the Philippines. Exports to Singapore also maintained significant growth. Exports to Japan and Taiwan, having been on a sustained decline over the past few quarters, reverted to positive growth by the third quarter.

Chart 4 : Hong Kong's total exports of goods to the United States and the European Union

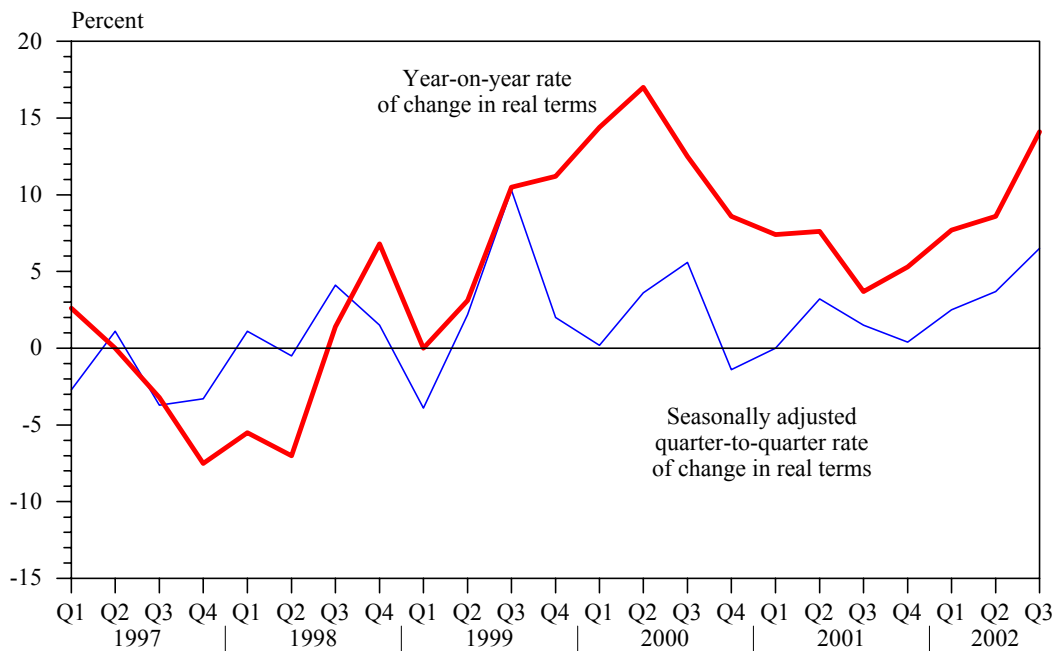


First three quarters of 2002



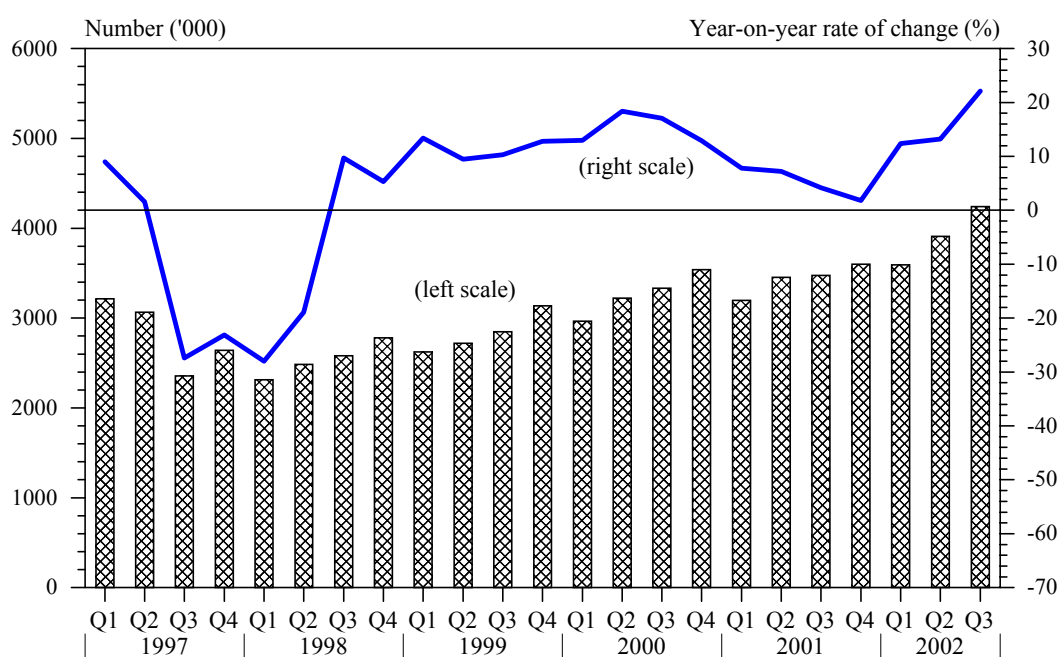
- Likewise, exports to the major conventional markets continued to improve.
- Along with increased import intake in the United States, and further helped by improved relative price competitiveness of Hong Kong's exports upon the earlier weakening in the US dollar, total exports of goods to this market accelerated to a growth of 9.9% in real terms in the third quarter of 2002 over a year earlier.
- The downtrend in total exports of goods to the European Union likewise seemed to have been arrested lately, helped in part by the earlier strengthening of the euro. Having fallen for six straight quarters, these exports rebounded to a modest growth of 3.6% in real terms in the third quarter of 2002 over a year earlier.

Chart 5 : Exports of services



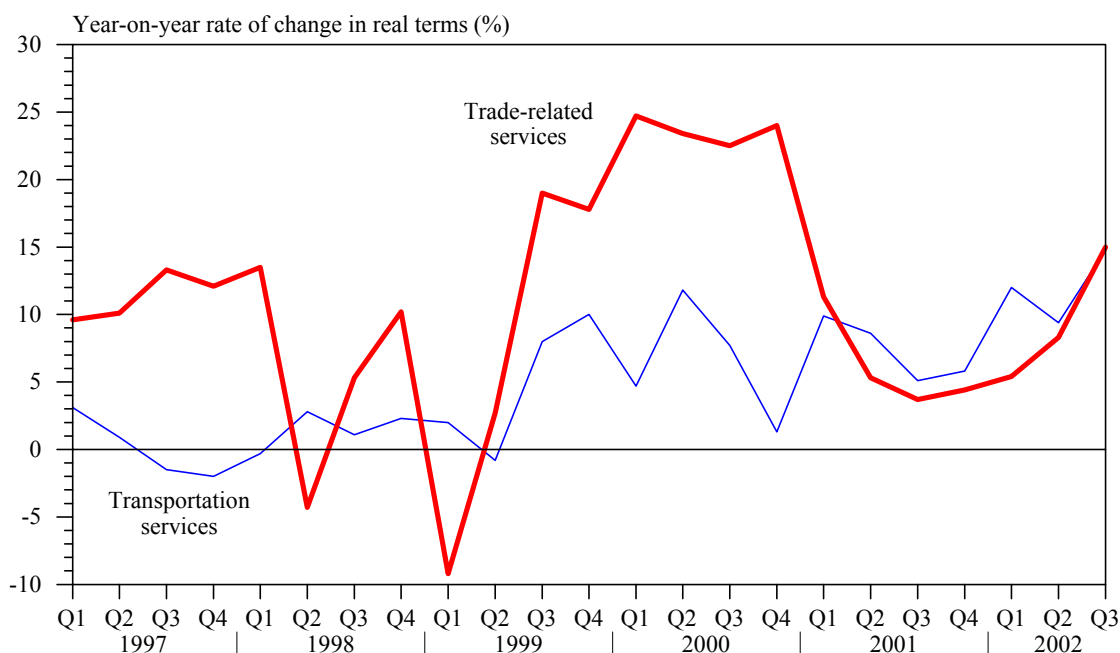
- On invisible trade, inbound tourism receipts picked up further to a marked growth in the third quarter of 2002. Along with a further surge in both exports of transportation services and offshore trade, exports of services accelerated to a growth of 14.1% in real terms in the third quarter of 2002 over a year earlier, further up from an already rather robust growth of 8.6% in the second quarter.

Chart 6 : Visitor arrivals



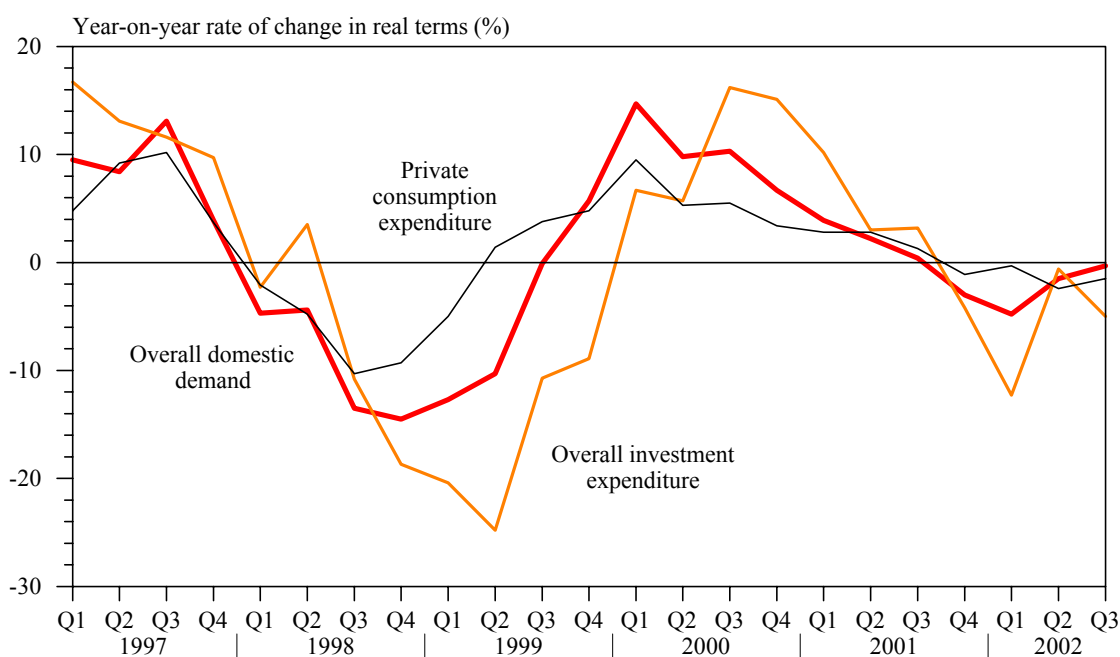
- Inbound tourism remained vibrant, with the number of incoming visitors recording double-digit growth all through the first three quarters of 2002. In the third quarter of 2002, the number of incoming visitors surged by 22.1% over a year earlier. Upon the removal of quota on “Hong Kong tours”, the number of Mainland visitors has been on a strong upsurge so far this year, attaining a distinct year-on-year growth of 55.1% in the third quarter. The number of incoming visitors from Europe and the United States also resumed moderate growth in the recent period.
- Exports of travel services had a marked growth of 24.6% in real terms in the third quarter of 2002 over a year earlier.

Chart 7 : Exports of trade-related services and transportation services



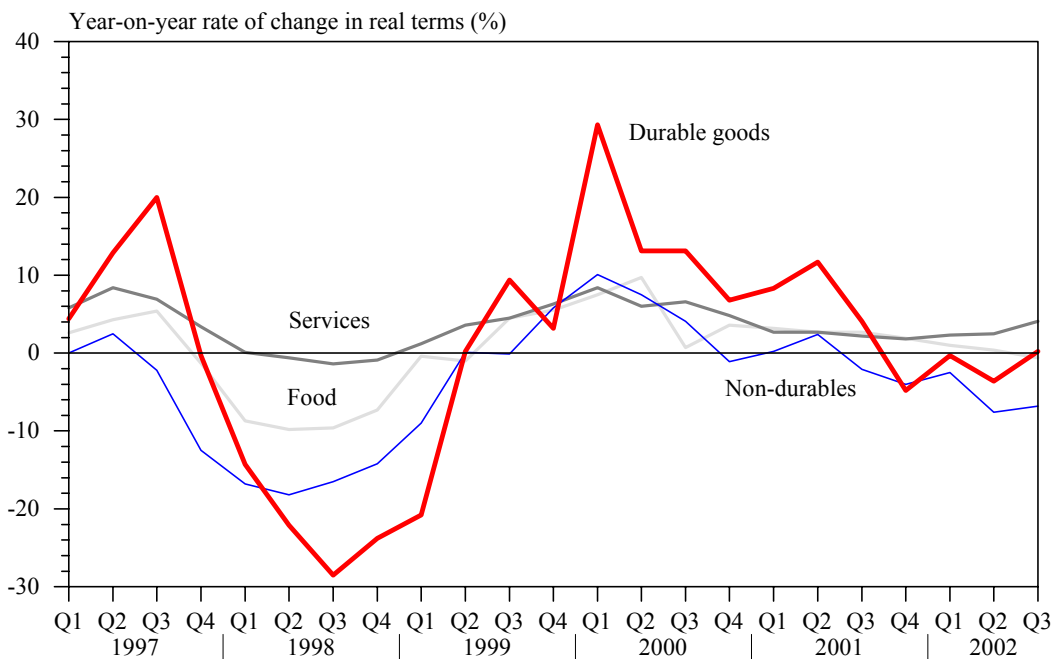
- Exports of transportation services leaped by 14.8% in real terms in the third quarter of 2002 over a year earlier, on the back of robust growth in merchandise trade.
- Benefiting from the distinct upsurge in the Mainland's merchandise exports, and also reflecting an ongoing shift more towards offshore trading activities within total exports, Hong Kong's exports of trade-related services (comprising mainly offshore trade) remained buoyant. These exports registered a remarkable growth of 15.0% in real terms in the third quarter of 2002 over a year earlier.

Chart 8 : Domestic demand



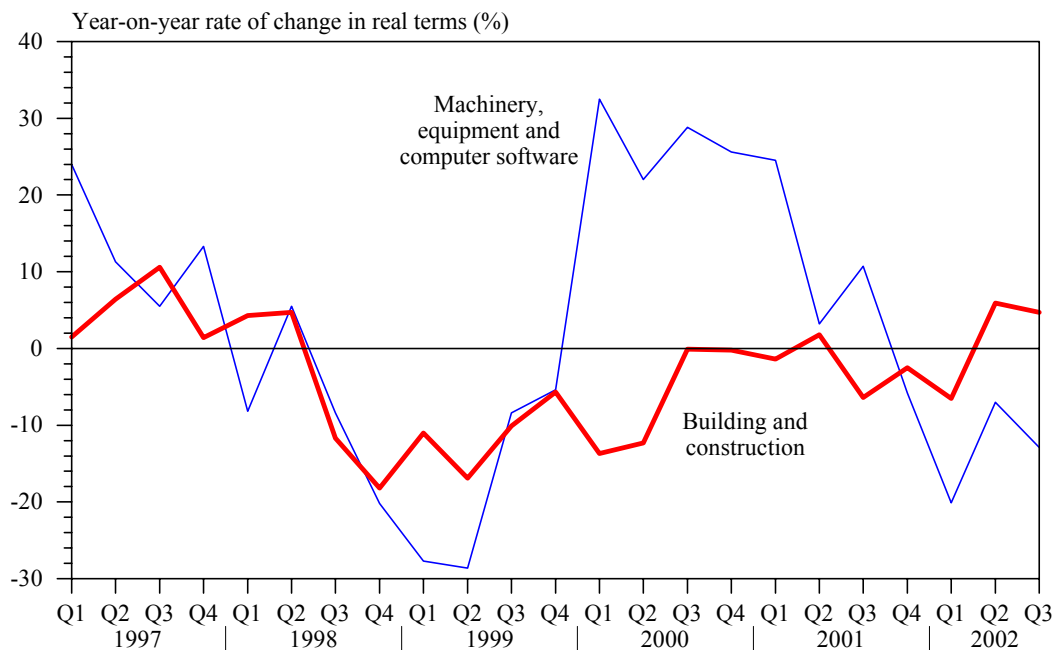
- Hong Kong's domestic demand remained slack in overall terms.
- Private consumption expenditure had yet to recover. It fell by 1.5% in real terms in the third quarter of 2002 over a year earlier, though narrowed somewhat from the 2.4% decline in the second quarter.
- Intake of machinery and equipment plummeted further, more than offsetting the pick-up in expenditure on buildings and construction. Taken together, investment spending still had a further decline of 5.0% in real terms in the third quarter of 2002 over a year earlier. This came after a 0.6% fall in the second quarter.

Chart 9 : Private consumption expenditure by major component



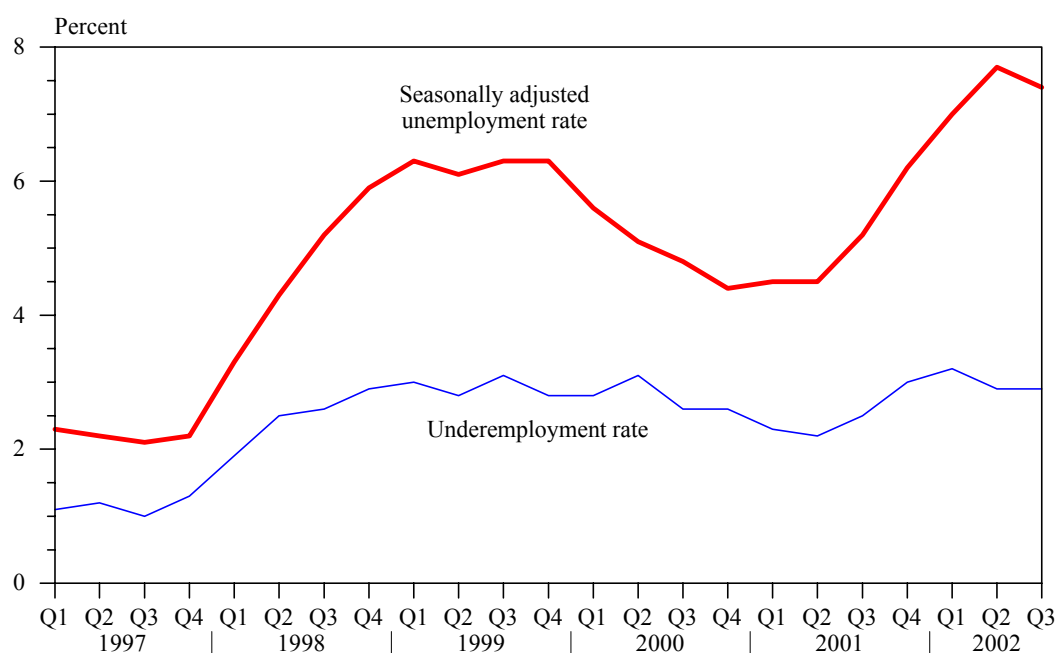
- Analysed by major category of consumer spending, spending on non-durable goods remained on a decline. But spending on durable goods, supported by a significant rebound in spending on motor cars, tended to bottom out. Expenditure on consumer services picked up further, while the decline in spending by Hong Kong residents travelling abroad also tapered.

Chart 10 : Investment expenditure by major component



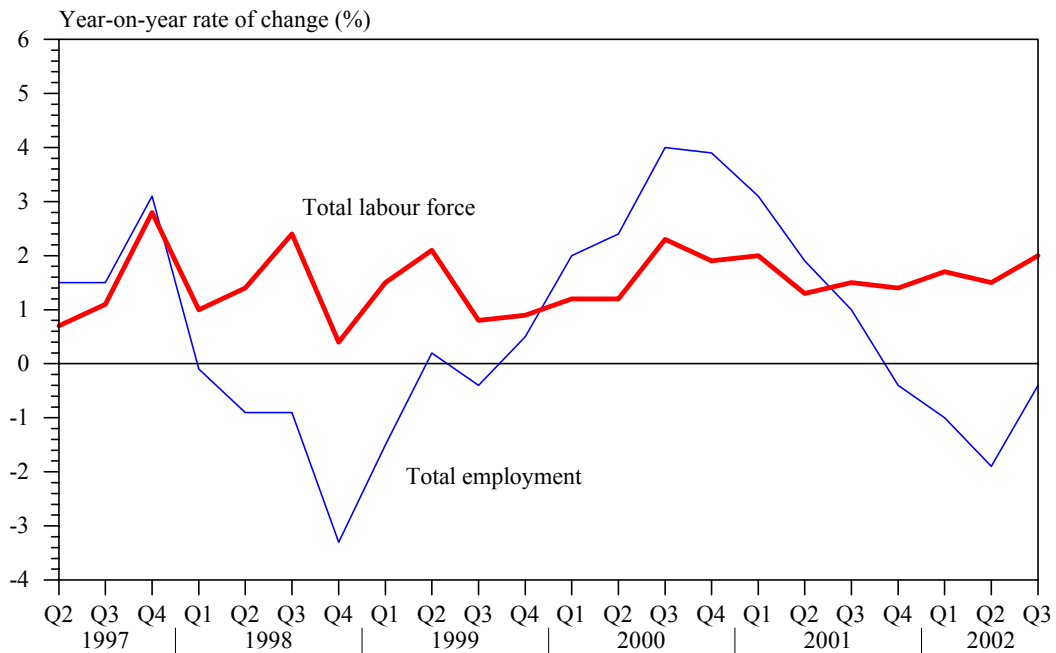
- Amidst a still uncertain business outlook, and an overhang of excess production capacity, expenditure on machinery, equipment and computer software dwindled further, by 12.9% in real terms in the third quarter of 2002 over a year earlier.
- Along with the continued cut-back in the Public Housing Programme, the completion of the Tseung Kwan O Extension, and also the winding down of works on the West Rail, public sector construction activity fell further. But with a further increase in private sector building activity, overall expenditure on buildings and construction still had a moderate growth of 4.7% in real terms in the third quarter of 2002 over a year earlier.

Chart 11 : Unemployment and underemployment rates



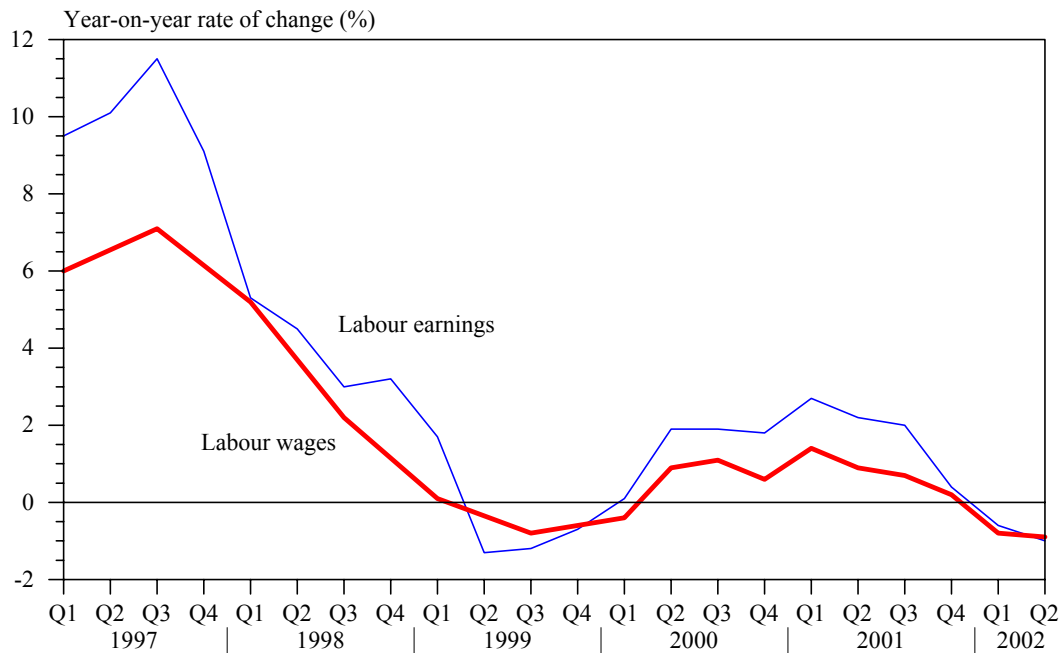
- The labour market showed some relative improvement lately. The seasonally adjusted unemployment rate came down from the peak of 7.8% in May - July 2002, to 7.2% in August - October 2002. The underemployment rate stood at 3.0% in August - October 2002. Total employment rose back slightly in the recent period. But labour earnings and wages stayed soft.
- Analysed by economic sector, comparing August – October 2002 with May - July 2002, the decline in unemployment rate was concentrated in construction and real estate, manufacturing, and the wholesale/retail trade.
- Analysed by occupation category, those occupation categories facing more distinct decline in unemployment rate in August - October 2002 over May - July 2002 included managers and administrators, professionals, service workers and shop sales workers, craft and related workers, and plant and machine operators and assemblers.

Chart 12 : Total labour force and total employment



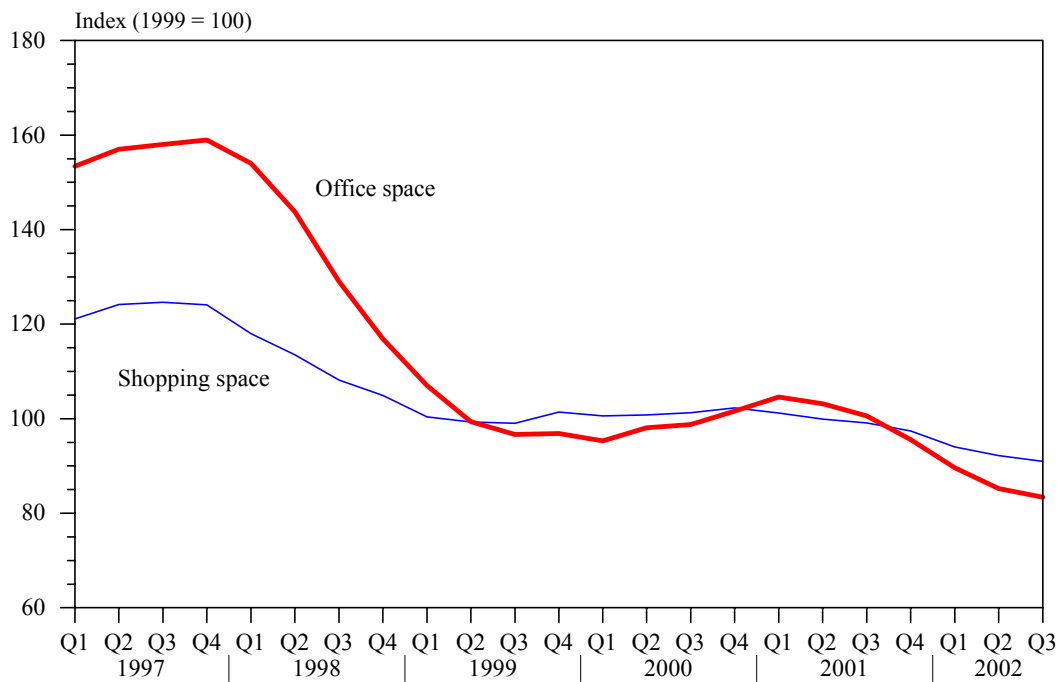
- Compared with the same period a year earlier, total employment turned up to a 0.2% growth in August - October 2002, while labour force rose further by 2.0%.
- Compared with May - July 2002, total employment rose by 1.2%, yet labour force by only 0.7% in August - October 2002. This signified that the overall labour demand and supply situation had improved somewhat lately.

Chart 13 : Labour wages and earnings



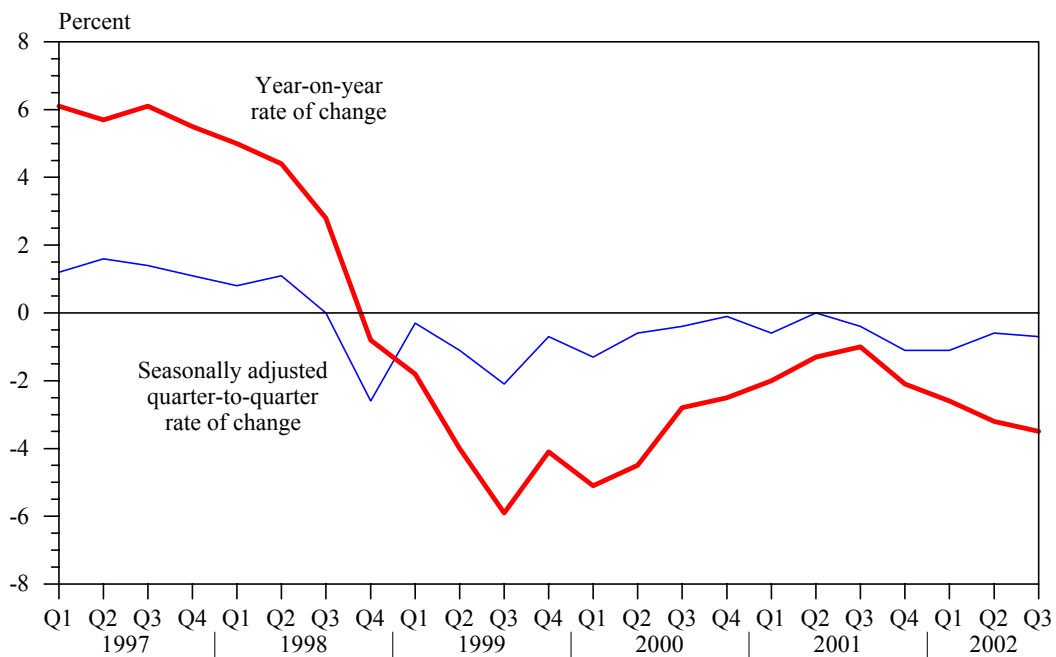
- Upon the earlier slackening in the labour market, labour income showed a renewed moderation.
- Compared with a year earlier, labour wages came down by 0.9% in money terms in June 2002, after a 0.8% decline in March. Labour earnings had a slightly larger decline, by 1.0% in money terms in the second quarter of 2002, having decreased by 0.6% in the first quarter.

Chart 14 : The rentals of office space and shopping space



- The fall in local operating costs in the recent period was not only seen in labour wages, but also in rentals. In the third quarter of 2002, rentals for office space and shopping space on average fell by 17.1% and 8.2% respectively over a year earlier.

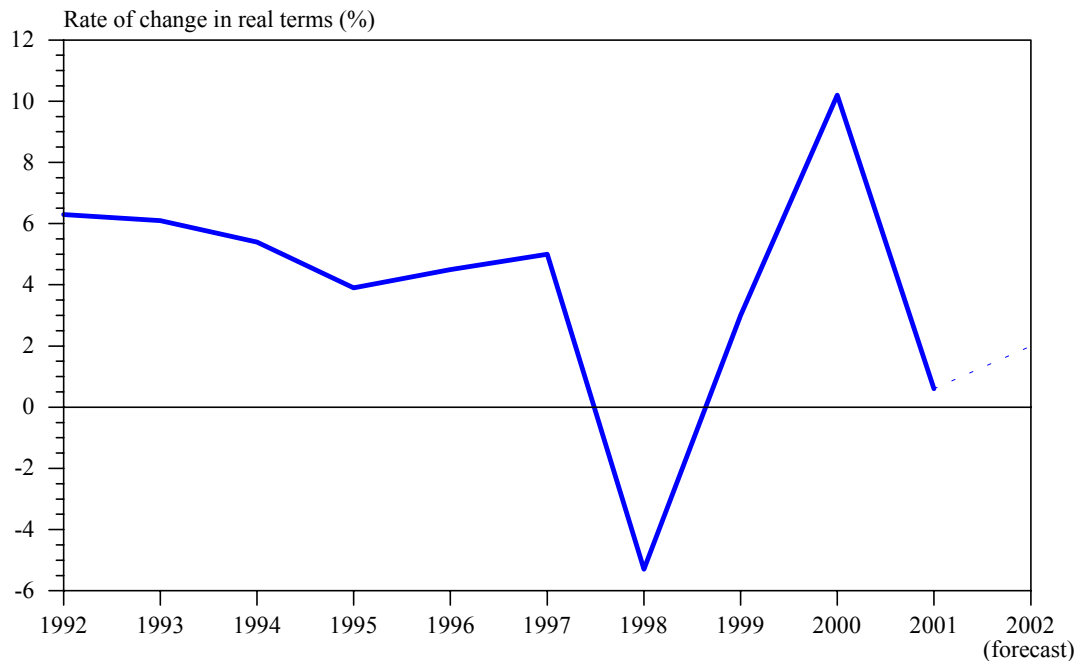
Chart 15 : Composite Consumer Price Index



- Local consumer prices remained on a general downtrend, essentially a reflection of subdued domestic demand. The easing in local operating costs, together with soft import prices, were both conducive to the decline in consumer prices.
- The Composite CPI fell by 3.6% in October 2002 over a year earlier, and by an average of 3.1% in the first ten months of 2002. By now, overall consumer prices had stayed on a downtrend for four years.

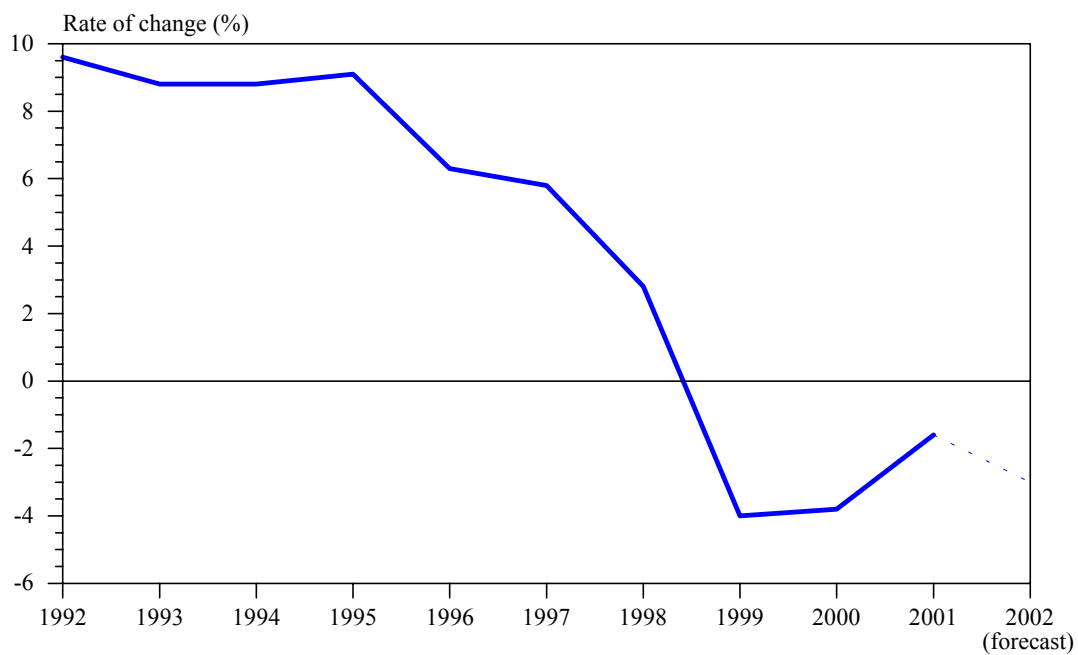
(II) Economic Outlook for 2002

Chart 16 : Forecast of Gross Domestic Product for 2002



- For the rest of this year, Hong Kong's performance of exports of both goods and services should continue to benefit from the pick-up in regional demand, in particular robust demand in the Mainland. Also, sustained demand in US consumer spending and the earlier weakening in the US dollar should render support to Hong Kong's exports in the near term.
- Nevertheless, with domestic demand yet to revive, for 2002 as a whole GDP growth is likely to be only modest, currently forecast at 2% in real terms. This is half a percentage point up from the forecast put out earlier.

Chart 17 : Forecast of Composite Consumer Price Index for 2002



- In face of the slack in both local costs and import prices leading to a sustained fall in consumer prices so far this year, the rate of change in the Composite CPI is currently forecast for a 3% decline for 2002 as a whole. This is 0.2 of a percentage point down from the earlier forecast.

- The Government has yet to produce a forecast on Hong Kong's economic growth for 2003. Private sector entities generally expect a further revival in the Hong Kong economy next year. Their recent growth forecasts average at around 3%.

- Much uncertainties still prevail on the external front :
 - A possible relapse in the US economy would inevitably have knock-on effects on the rest of the world, including on the European and East Asian economies. In this regard, the US Federal Reserve's latest interest rate cut by half a percentage point should help support the US economy.

 - Plausible military action led by the United States on Iraq, coupled with resurgence of terrorist activities in recent months, continues to overshadow the geopolitical perspective.

 - gyrations in the overseas financial markets in recent months also affect market sentiment.

- Locally, the labour market is still generally subdued, while both consumer and investment sentiment have yet to improve. Whether the growth momentum in exports can be sustained, and whether the better performance of exports can filter through sufficiently to resurrect local demand, will be of crucial significance to overall economic growth next year.

- As to the price trend, on account of the prevailing downward adjustment in local costs and the on-going restructuring of the local economy, the downtrend in local consumer prices would probably continue for some time. As far as the cyclical factors are concerned, prices can be expected to gradually rise back as and when recovery in the global economy and henceforth the local economy gather pace. But the effect of the structural factors, such as the downward pressure on local prices arising from the cost differentials between Hong Kong and the Mainland, might require even longer time for adjustment.