



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

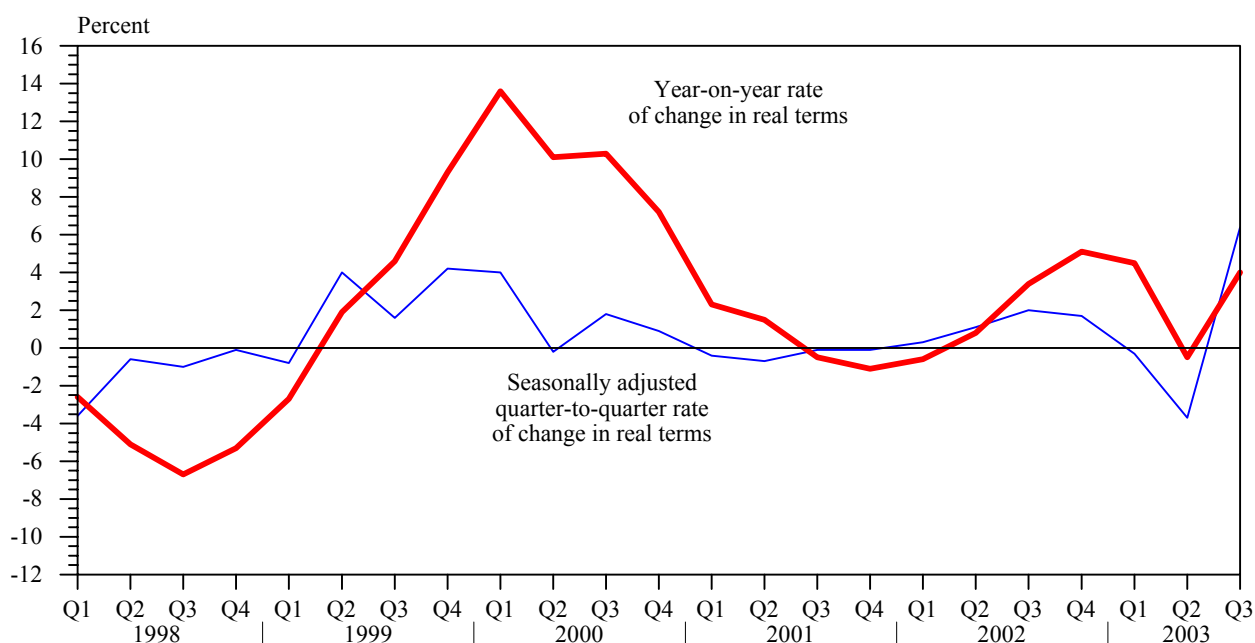
The Government has just released the Third Quarter Economic Report 2003. The Economic Report, together with the press release containing the updated economic forecasts for the whole year of 2003, have been furnished to LegCo Members.

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 briefly describes the latest updated economic forecasts by the Government for 2003 as a whole, before discussing broadly the economic outlook for 2004.

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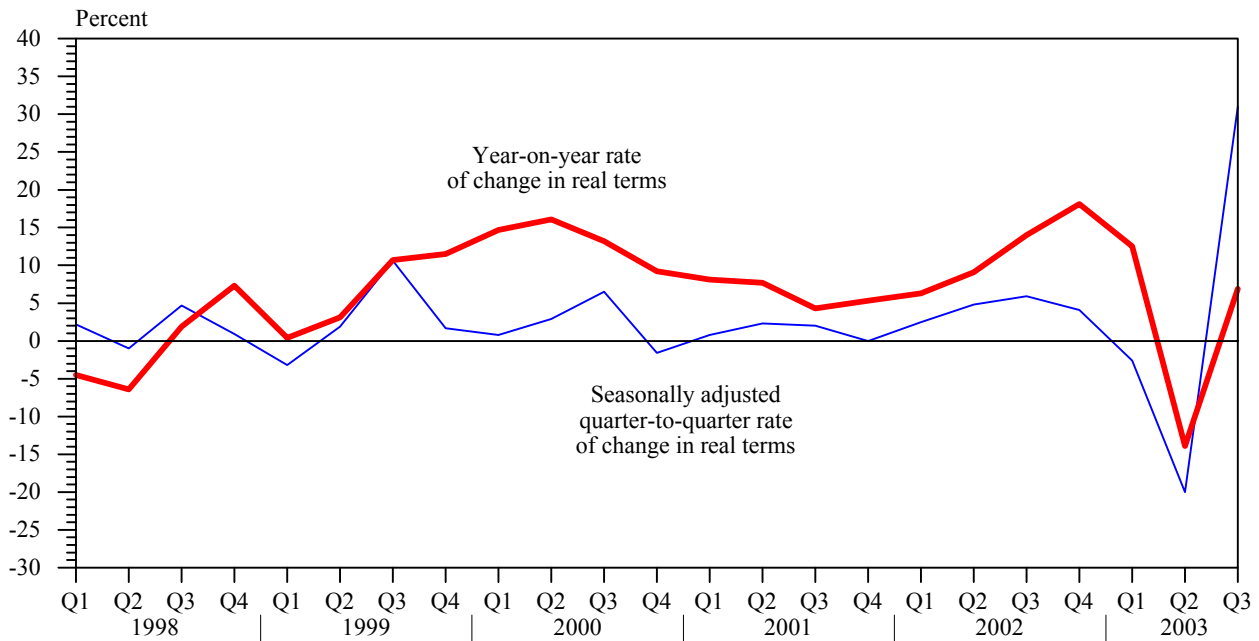
(I) Economic performance in the third quarter of 2003

Chart 1 : Gross Domestic Product



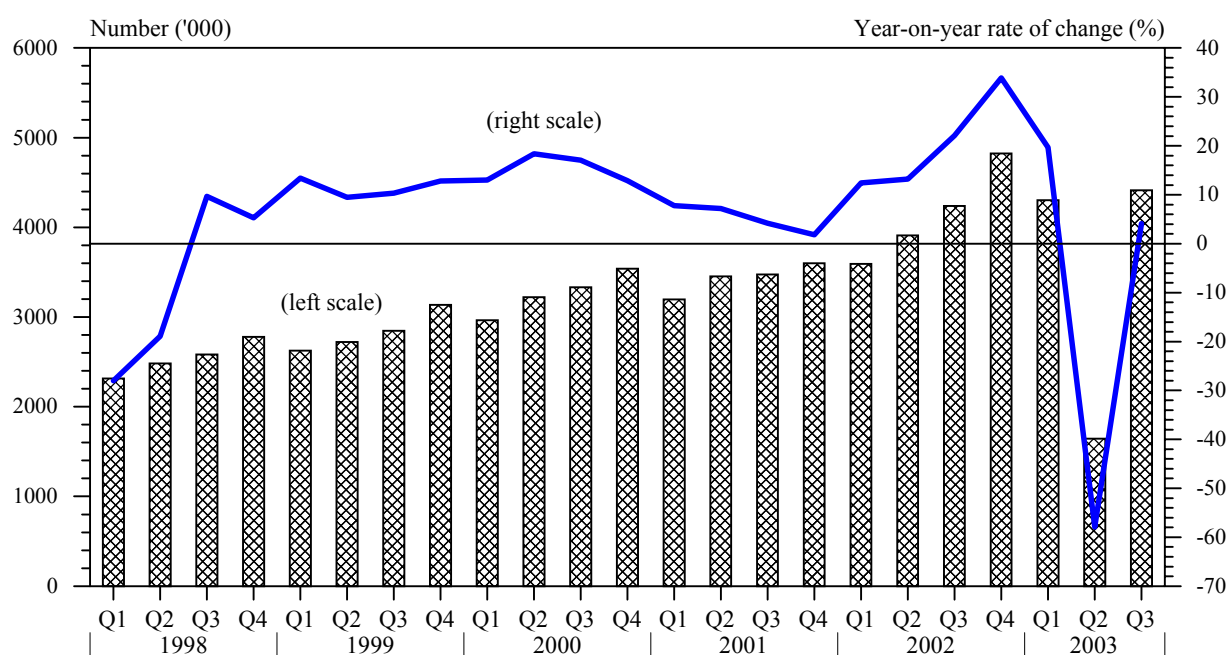
- The Hong Kong economy rebounded distinctly in the third quarter of 2003, after the setback caused by SARS in the second quarter.
- On a year-on-year comparison, the Gross Domestic Product (GDP) rose by 4.0% in real terms in the third quarter of 2003, in contrast to the 0.5% decline in the second quarter. The economic upturn in the third quarter was rather broad-based, with particularly strong rebound in inbound tourism. Exports of goods continued to register marked increase, while overall domestic demand also improved.
- On a seasonally adjusted quarter-to-quarter comparison, the turnaround in GDP was even more pronounced, with a 6.4% leap in real terms in the third quarter of 2003, after a 3.7% dip in the second quarter.

Chart 2 : Exports of services



- Tourist receipts rose back in the third quarter of 2003, as inbound tourism staged a distinct rebound, particularly upon the upsurge in incoming visitors from the mainland of China following the launch of the “individual visit” scheme since late July. Exports of transportation services likewise improved in the third quarter, along with a pick-up in receipts from passenger transportation. Together with a further appreciable growth in offshore trade, exports of services turned up to a 6.9% increase in real terms in the third quarter of 2003 over a year earlier, distinctly better than the 13.9% plunge in the second quarter.

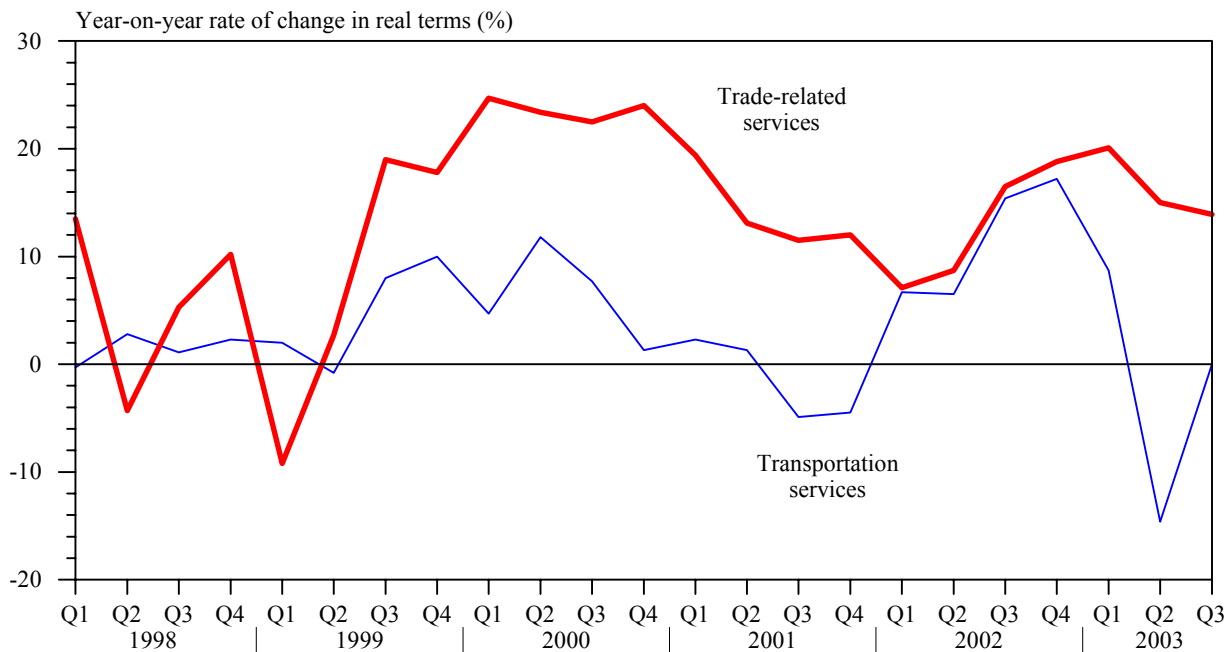
Chart 3 : Visitor arrivals



- On a year-on-year comparison, the number of incoming visitors reverted to growth, up by 4% in the third quarter of 2003, after a 58% plunge in the second quarter caused by the SARS impact. The increase in October was 7%.

- As the SARS situation was brought under control, the number of incoming visitors from the mainland of China recovered swiftly to give an 11% growth in June over a year earlier, and accelerated further to a 23% surge in July. Upon the launch of the “individual visit” scheme, the number of Mainland visitors soared by 43%, 28% and 31% respectively in August, September and October. Also, the declines in the number of incoming visitors from Japan and Europe continued to taper in recent months. But the improvement in visitor arrivals from other countries within the East Asian region and from the United States was slower and less steady.

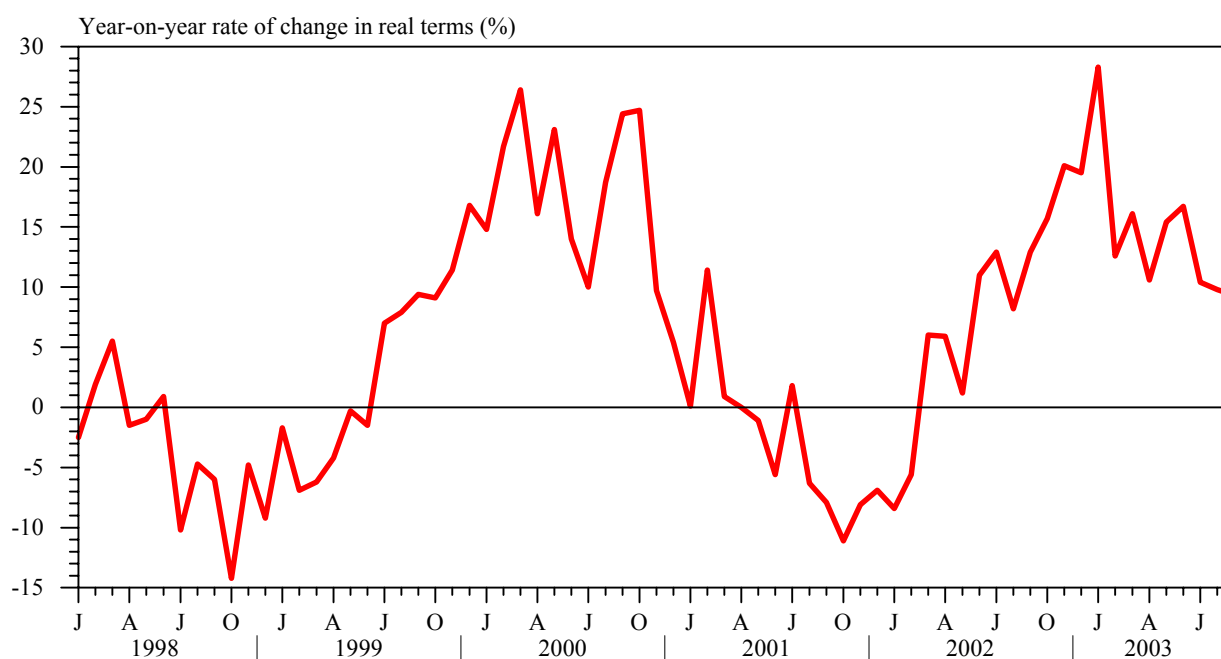
Chart 4 : Exports of trade-related services and transportation services



- Exports of transportation services, having plummeted by 14.6% in real terms in the second quarter of 2003 over a year earlier, bottomed out to zero change in the third quarter. Underlying this were the sustained growth in merchandise trade and the gradual recovery in air transport from the SARS impact.

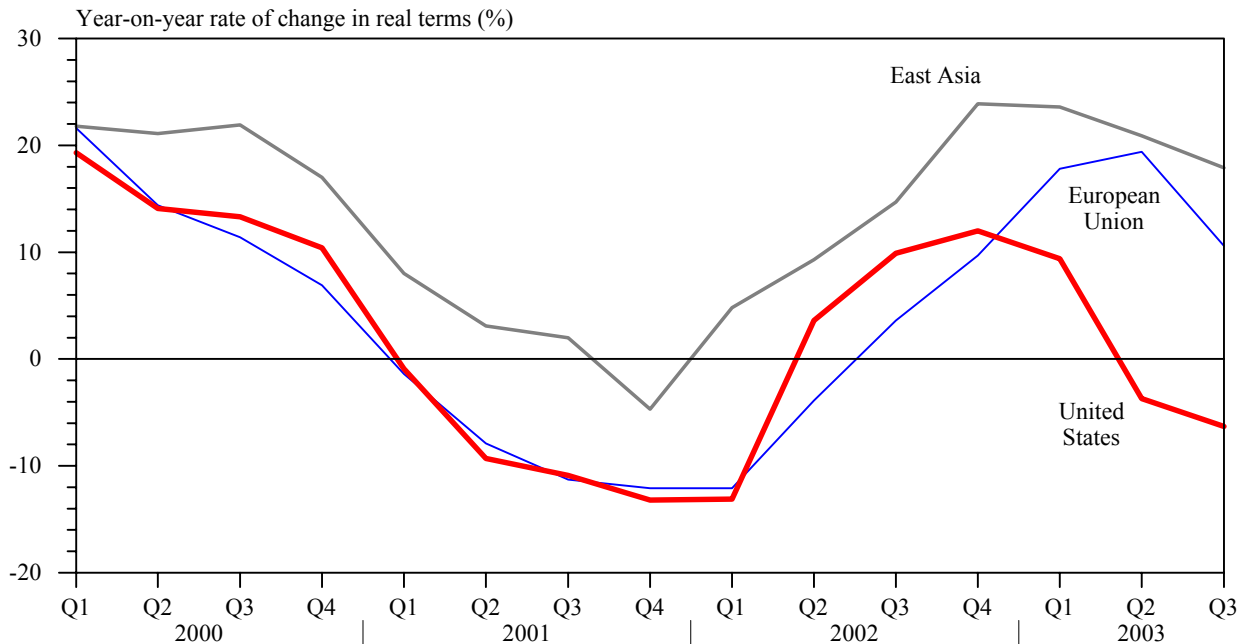
- Benefiting from sustained strong growth in the Mainland's exports, and also reflecting an on-going shift in Hong Kong's export trade pattern towards offshore trade, exports of trade-related services (comprising mainly offshore trade) continued to put up a robust performance. In the third quarter of 2003, exports of trade-related services rose by 13.9% in real terms over a year earlier.

Chart 5 : Total exports of goods



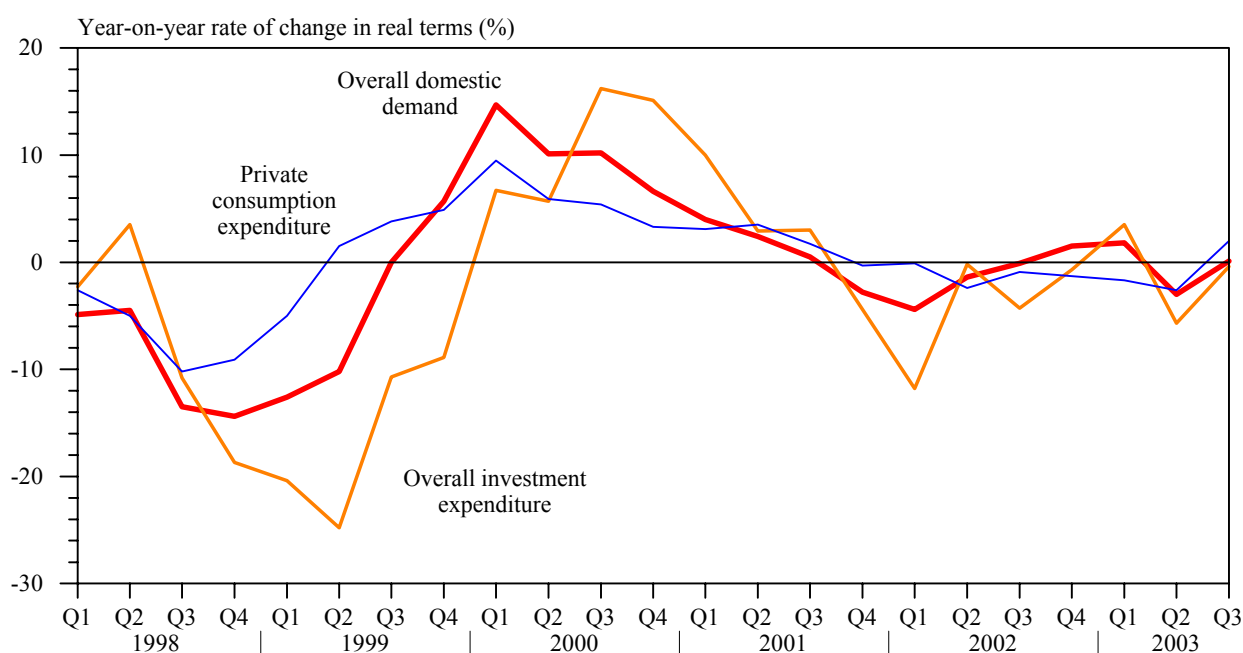
- On visible trade, total exports of goods remained strong in the third quarter of 2003, even though the growth pace had moderated somewhat due to a higher base of comparison in the same quarter last year.
- On a year-on-year comparison, total exports of goods rose by 9.8% in real terms in the third quarter of 2003, after a 14.3% increase in the second quarter. On a seasonally adjusted quarter-to-quarter comparison, exports of goods were virtually unchanged in real terms in the third quarter of 2003, after rising for six consecutive quarters and up by 2.4% in the second quarter.

Chart 6 : Hong Kong's total exports of goods by major market



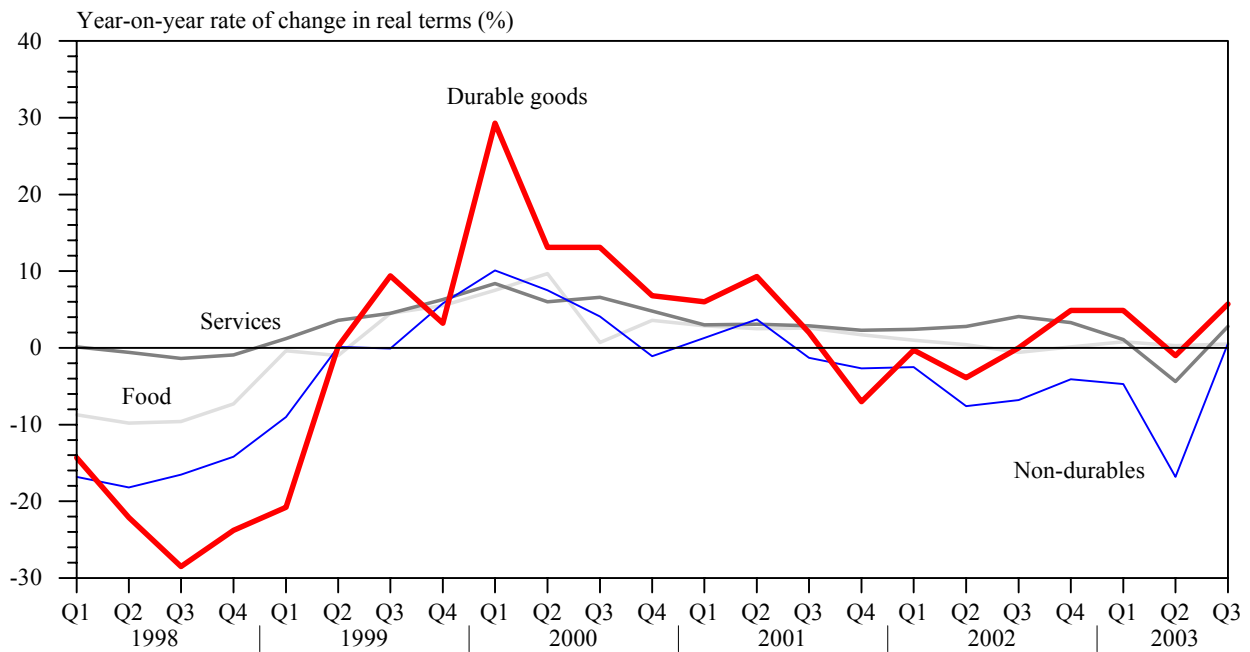
- Exports to the East Asian region remained the key driving force for growth in Hong Kong's total exports of goods. Hong Kong's exports to the East Asian region registered a marked increase of 17.9% in real terms in the third quarter of 2003 over a year earlier.
- Hong Kong's exports to the European Union continued to rise on the back of a strong euro, surging by 10.6% in real terms in the third quarter of 2003 over a year earlier.
- Yet Hong Kong's exports to the United States slackened further, declining by 6.3% in real terms in the third quarter of 2003 over a year earlier. Conceivably, this was caused by the deceleration in US import demand in that quarter, as well as the further structural shift from re-exports to offshore trade for shipment to the US market.

Chart 7 : Domestic demand



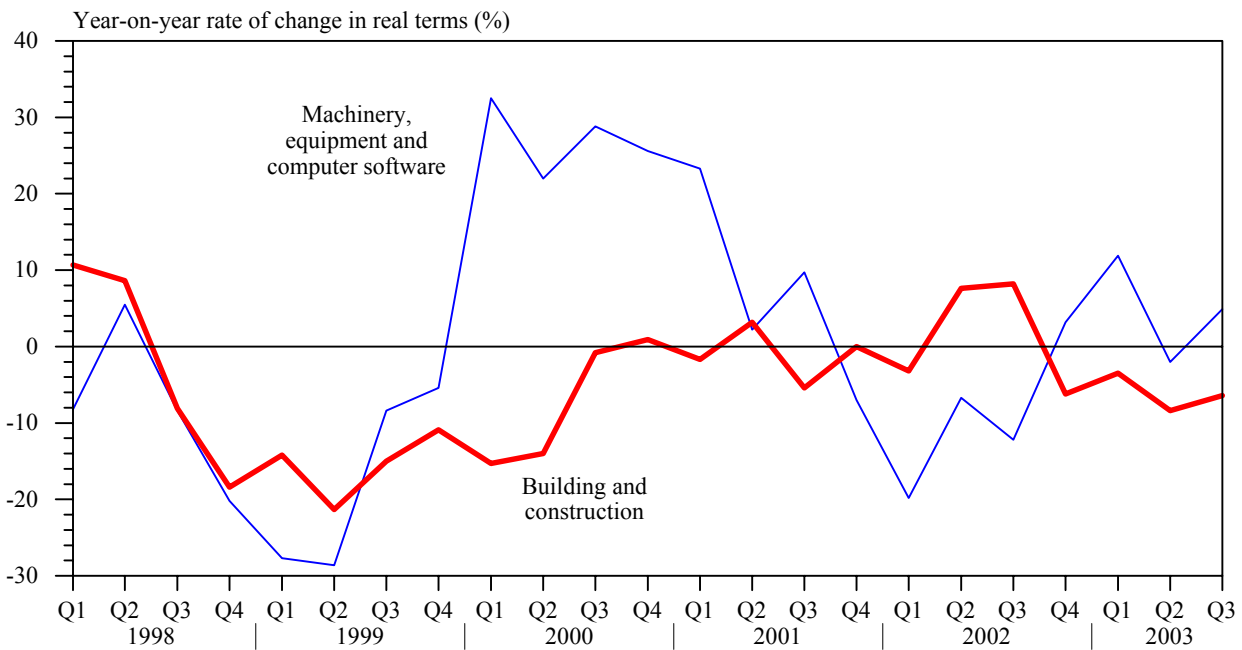
- As market sentiment turned for the better, overall domestic demand likewise generally improved in the third quarter of 2003.
- The improvement in private consumption expenditure was particularly notable, with a 2.0% increase in real terms in the third quarter of 2003 over a year earlier. This was the first increase since the third quarter of 2001, and was also in contrast to the 2.6% decline in the second quarter of 2003.
- Intake of machinery and equipment likewise rebounded visibly. Building and construction output remained slack, though with the rate of decline narrowed somewhat. Taken together, overall investment spending had a marginal decline of only 0.4% in real terms in the third quarter of 2003 over a year earlier, much improved from the 5.7% decrease in the second quarter.

Chart 8 : Private consumption expenditure by major component



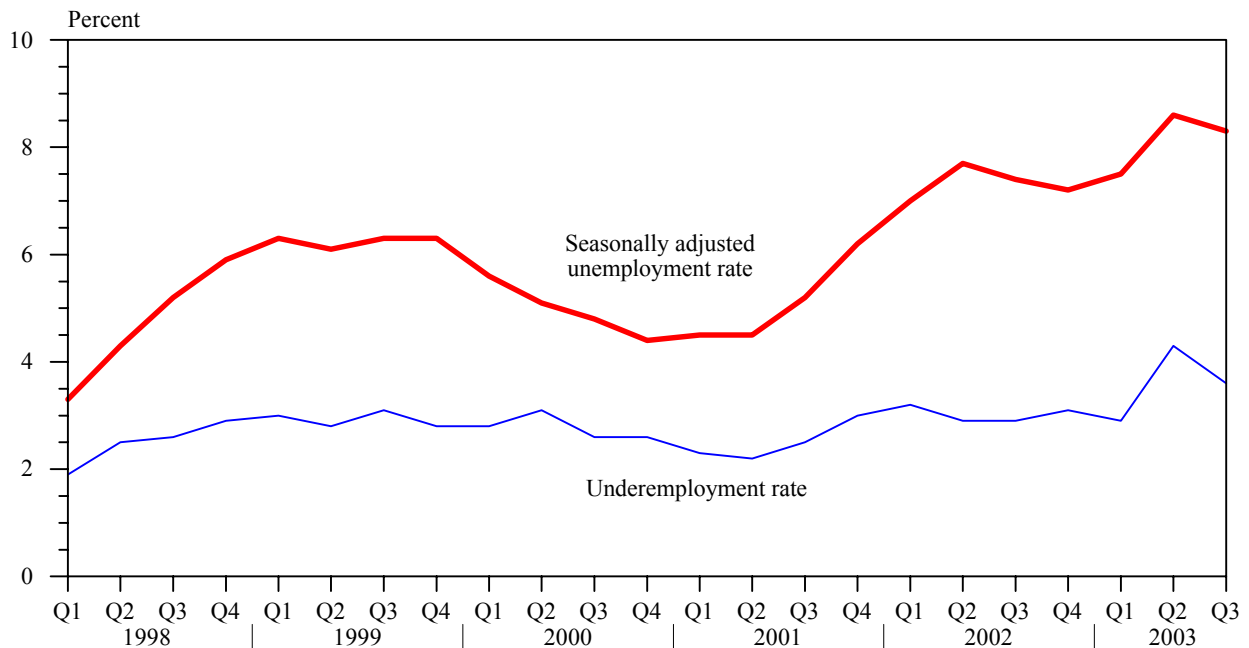
- Along with dissipation of the SARS impact, there was an almost across-the-board rebound in the major categories of local consumer spending. Compared with a year earlier, spending on both consumer goods and services rose back in the third quarter of 2003, while the decline in residents' spending abroad also narrowed distinctly.

Chart 9 : Investment expenditure by major component



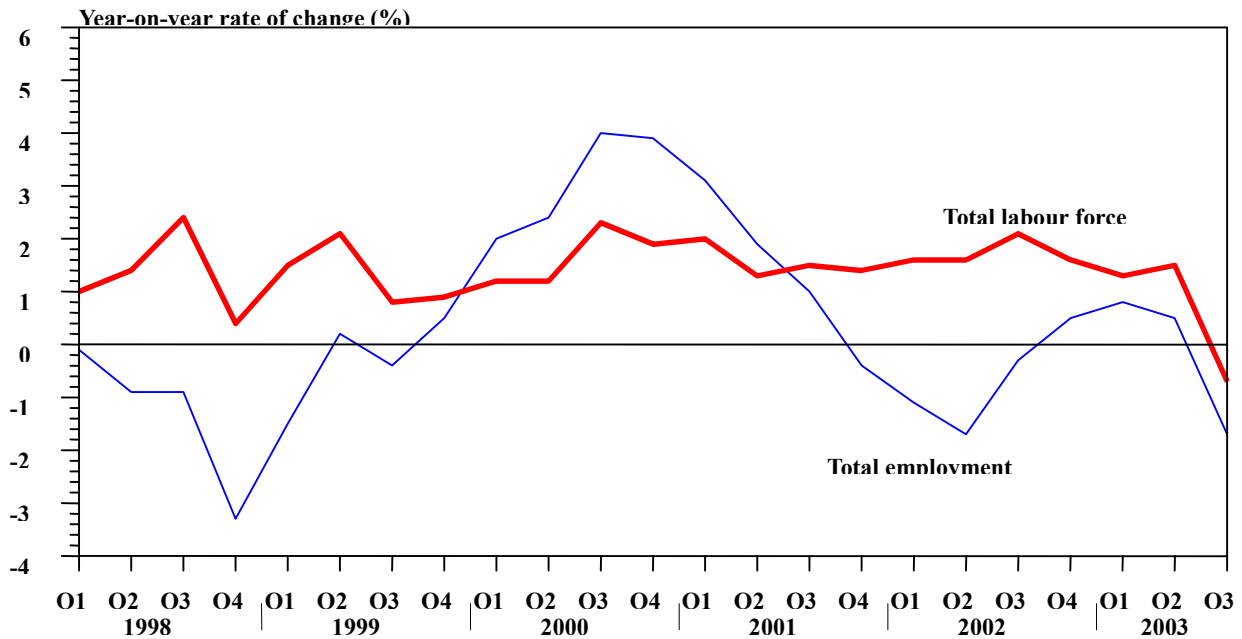
- With an improved business environment, and aided further by the delivery of some aircraft ordered earlier, expenditure on machinery, equipment and computer software rose back in the third quarter of 2003, by 4.9% in real terms over a year earlier.
- Public sector building and construction output rebounded distinctly in the third quarter. This was mainly driven by commencement of some large-scale projects in recent months, including the Hong Kong-Shenzhen Western Corridor and the Deep Bay Link. Moreover, work on the back-up area and infrastructure for Container Terminal 9 and on redevelopment of the Police Headquarters at Wanchai also had a marked increase. On the other hand, private sector building output continued to decline, amidst a dearth of new projects. Overall expenditure on building and construction still recorded a 6.4% fall in real terms in the third quarter of 2003 over a year earlier.

Chart 10 : Unemployment and underemployment rates



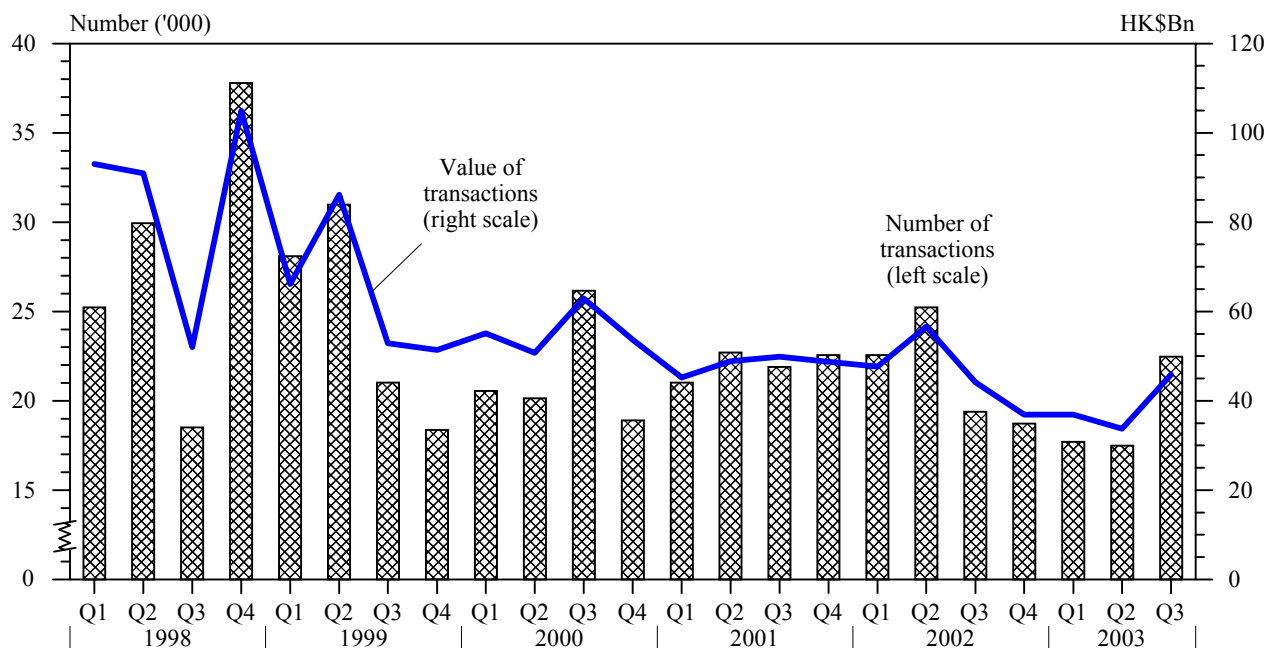
- Along with the progressive recovery in overall economic activity, the labour market showed a visible improvement recently. The seasonally adjusted unemployment rate fell to 8.0% in August - October 2003, from a high of 8.7% in May - July 2003. The underemployment rate likewise declined, from 4.2% to 3.5% between these two periods.
- Analysed by economic sector, comparing August - October 2003 with May - July 2003, the decrease in unemployment rate was rather broad-based, with particularly distinct declines in the sectors being hard hit earlier by SARS, including the retail trade, restaurants and hotels, transport, etc.
- Analysed by occupation category, the fall in unemployment rate in August - October 2003 over May - July 2003 was mainly concentrated in the middle and lower segments, including service workers and shop sales workers, elementary occupations, clerks, etc.

Chart 11 : Total labour force and total employment



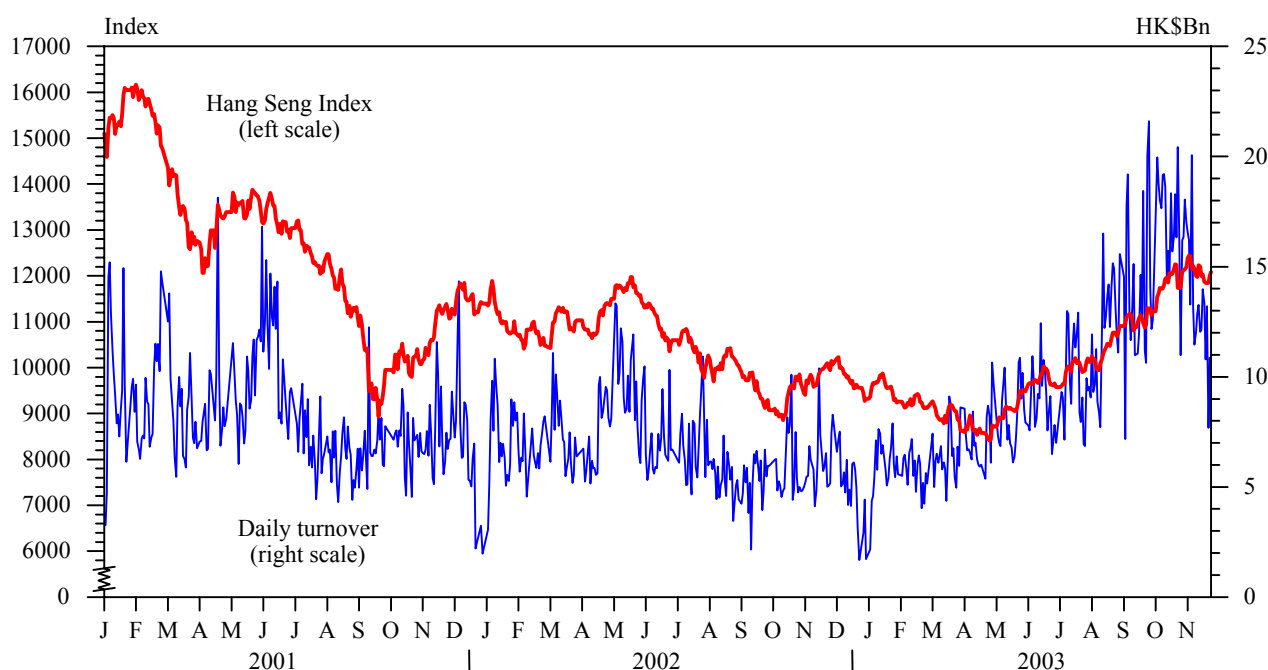
- Compared with a year earlier, total employment fell by 1.7% in August - October 2003, while total labour force declined by 0.9%.
- Compared with July - September 2003, total employment rose by 0.2% in August - October 2003, while total labour force dipped by 0.2%.
- Labour earnings and wages remained soft. Compared with the same month last year, the decline in labour wages enlarged to 2.5% in money terms in June 2003, from 1.5% in March. Labour earnings likewise recorded a 2.5% drop in money terms in the second quarter of 2003 when compared with the same quarter last year, further to a 2.0% decrease in the first quarter.

Chart 12 : Number and value of property transactions



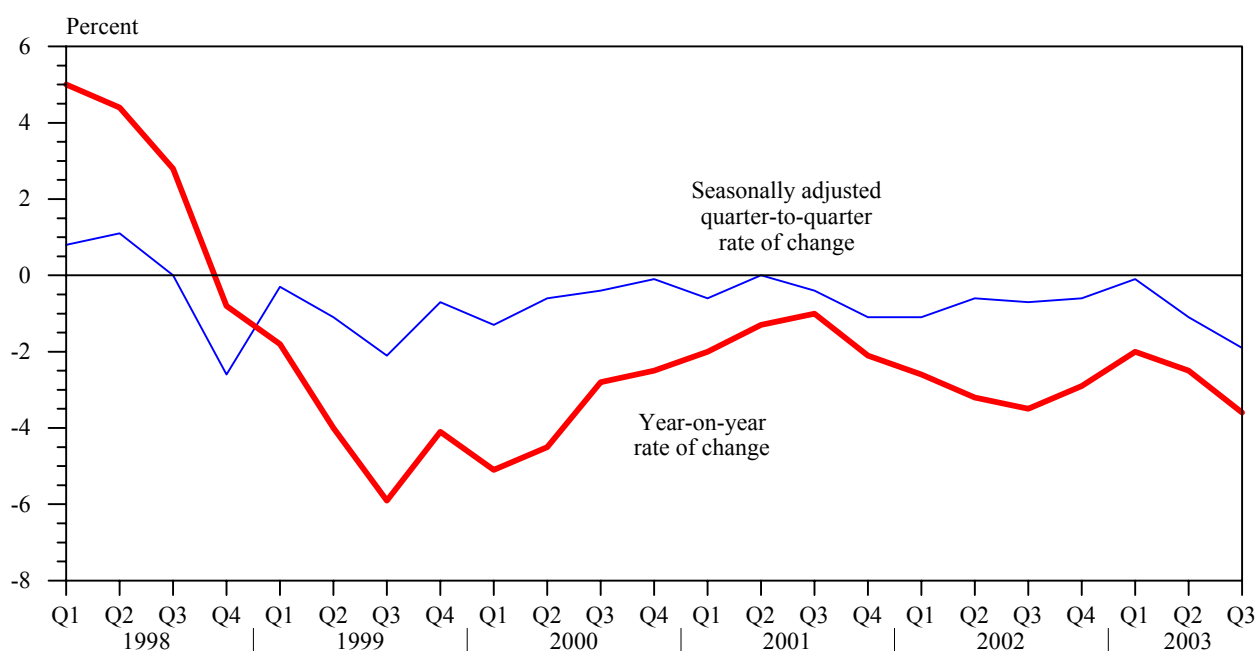
- With overall market sentiment improving, trading in the property market also turned more active in recent months.
- Property transactions rose back markedly by 29% in number in the third quarter of 2003 over the second quarter, the fastest quarterly increase since the third quarter of 2000. In terms of total value, property transactions also bounced up sharply, to a quarterly increase of 36% over the same period. In October 2003, property transactions surged by 63% in number and 131% in total value over September, which were the largest monthly figures recorded in the past 31 months and the past 53 months respectively.
- On residential property, trading activity in both the primary and secondary markets picked up. Flat prices rose by 2.9% in September 2003 over August, the first monthly increase in the past 16 months. Yet compared with the peak level in October 1997, flat prices were still down by 66% in September 2003.
- The market for office space was also activated lately. It was reported that, driven by a pick-up in demand, the average vacancy rate for Grade A office space continued to edge lower most recently.
- As to shopping space, as local consumption turned better and inbound tourism revived, there was a firmer demand for retail premises, particularly those in popular locations and better-managed developments.

Chart 13 : Hang Seng Index and Hong Kong's stock market turnover



- Bolstered by visibly better investment sentiment, continued fund inflow, and rally in the US stock market, the local stock market exhibited a strong uptrend in recent months.
- The Hang Seng Index reached a 27-month high on 4 November 2003, closing at 12 441. Market sentiment remained generally robust thereafter, with the Hang Seng Index closing 28 November at 12 317, up by 46% from the trough of 8 409 on 25 April this year and also up by 32% from 9 321 at the end of last year.
- The average daily turnover in the local stock market posted a three-year high in the third quarter of 2003, at \$12 billion, up by 48% over the second quarter of this year and also by 112% over the fourth quarter of last year.

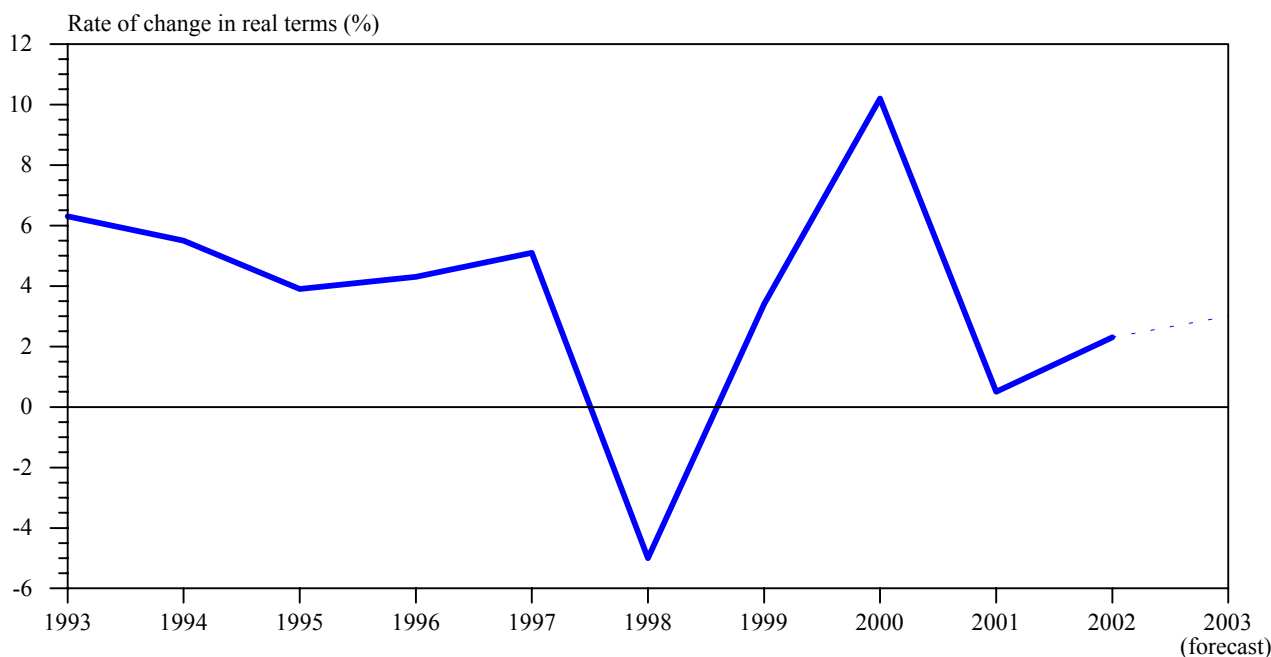
Chart 14 : Composite Consumer Price Index



- By now, overall consumer prices have stayed on a downtrend for five years.
- Compared with the same quarter last year, the decline in the Composite CPI enlarged from 2.5% in the second quarter of 2003 to 3.6% in the third quarter. Yet this was mainly due to the relief measures granted by the Government, including the rates concession and the waiver of water and sewage charges, which had a downward effect of around one percentage point on the Composite CPI. In addition, rentals and wages remained soft, also indirectly keeping overall consumer prices down.
- Nevertheless, the decline in consumer prices has tended to narrow in recent months, along with progressive upturn in local economic activity. Compared with the same month last year, the decline in the Composite CPI narrowed from 4.0% in July 2003 to 3.8% in August, and further to 3.2% and 2.7% in September and October.

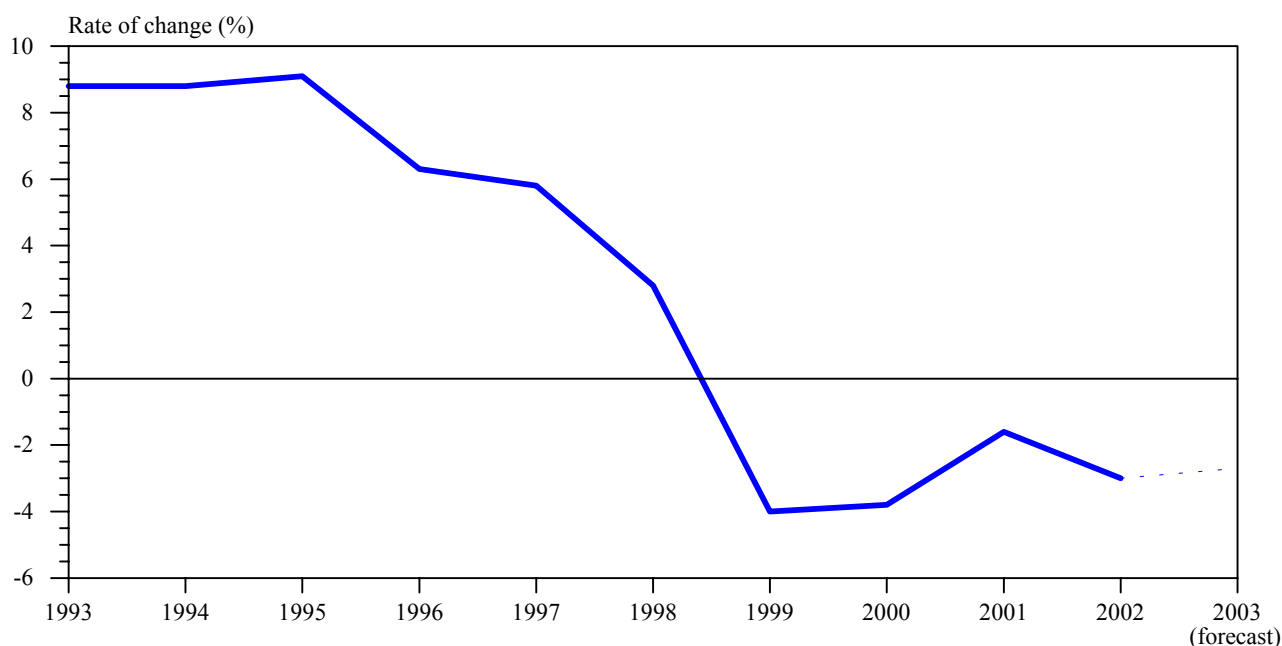
(II) *Economic situation in the rest of this year*

Chart 15 : Forecast of Gross Domestic Product for 2003



- For the rest of this year, Hong Kong's exports of goods should continue to benefit from the pick-up in demand in the East Asian region, in particular from the sustained robust demand in the mainland of China. Moreover, the weakness in the US dollar should be conducive to Hong Kong's export performance in the near term.
- At the same time, Hong Kong's exports of services can be expected to maintain robust growth, underpinned by sustained recovery in inbound tourism and continued surge in offshore trade.
- Domestic demand should also continue to turn better, on the back of generally improving labour market conditions and business environment.
- Overall, GDP is forecast for a solid growth at 3% in real terms for 2003 as a whole, one percentage point up from the forecast growth put out in the August round.

Chart 16 : Forecast of Composite Consumer Price Index for 2003



- In the light of the progressively tapering decline in overall consumer prices recently, the forecast rate of change in the Composite CPI for 2003 as a whole is now put at -2.7%, slightly narrowed by 0.3 of a percentage point from the forecast decline put out in the August round.

(III) Preliminary views on economic outlook for 2004

- The Government has yet to produce a forecast on Hong Kong's economic growth for 2004. This will be furnished in detail along with the Budget Speech in March 2004.
- The various economic indicators released recently all suggest that the economy is recovering steadily, and this trend should extend well into next year.
- Exports of goods and services are expected to remain the key driver for economic growth next year. The positive factors include :
 - Sustained improvement in the global and regional economies, together with continued robust growth in the mainland of China.
 - The recent further weakening in the US dollar, coupled with further down-drift in local business costs so far this year, should render support to the external competitiveness of Hong Kong's exports.
 - The signing of the Closer Economic Partnership Arrangement (CEPA) with the Mainland will accord Hong Kong with more business opportunities.
 - Inbound tourism should become even more vibrant, particularly with the continued surge in Mainland visitors upon extension of the "individual visit" scheme to residents in the entire Guangdong Province next year.
- Domestic demand also looks set for a further pick-up. Consumer spending should continue to recover steadily, as the employment situation goes better and as the asset markets have turned more active. Also, investment spending, particularly in machinery and equipment, should likewise improve, amidst a more sanguine business environment.
- As to the price trend, the continued pick-up in economic activity, coupled with the firming up in prices of retained imports upon a further weakening in the US dollar, should render push for a progressive narrowing in decline in local consumer prices. But the effect of structural factors, including mainly the downward pressure on local costs and prices arising from the cost differential between Hong Kong and the mainland of China, might require longer time to adjust.