Overall situation

The Hong Kong economy went through a sharp gyration during the course of 2003. Continuing the revival impetus in late 2002, the economy grew quite strongly at the beginning of 2003. The growth was abruptly derailed by the spread of Severe Acute Respiratory Syndrome (SARS) in the second quarter. Yet overall economic activity staged a speedy and broad-based recovery in the third quarter after the waning of SARS, and the upswing spilled well into the fourth quarter upon a further lift in local sentiment. Thus, even with the profound setback caused by SARS during the year, the Hong Kong economy still attained an appreciable growth for 2003 as a whole, which was better than that in 2002.

In the external sector, inbound tourism and the travel-related sectors were badly shattered by the spread of SARS in the second quarter of 2003, yet bounced back swiftly in the third quarter and distinctly more in the fourth quarter. The remarkable turnaround was driven by a strong pick-up in visitor arrivals from the mainland of China (the Mainland), especially after the launch of the Individual Visit Scheme in late July. As to merchandise exports and offshore trade, they both displayed highly robust growth throughout 2003, bolstered by continued hectic growth in the Mainland economy, a visible pick-up in the global economy following the end of the war on Iraq, as well as a surge in intra-regional trade. Enhanced competitiveness of Hong Kong's exports, underpinned by distinct weakening in the US dollar and further domestic cost adjustments, as well as deriving from increasing competitiveness of Mainland products in the world market, rendered an additional boost to the export performance.

In the domestic sector, consumer spending was likewise severely hit by SARS in the second quarter of 2003, but was progressively resurrected in the third and fourth quarters. Consumer sentiment appeared especially upbeat towards the end of the year, boosted by the rally in the local stock market, a more active property market, and steady improvement in the overall employment situation. Investment spending on machinery and equipment bounced back to a notable growth in the latter part of 2003, on the back of improved economic conditions and brighter business outlook especially after the signing of the Closer Economic Partnership Arrangement (CEPA) between Hong Kong and the Mainland. Building and construction output however was weak all through.

For 2003 as a whole, the Gross Domestic Product (GDP) grew by 3.3% in real terms, up from the 2.3% growth in 2002. On a year-on-year comparison, GDP leaped by 4.5% in real terms in the first quarter of 2003, before relapsing to a 0.5% decline in the second quarter upon the spread of SARS. Yet GDP bounced up strongly to a 4.0% growth in the third quarter, and further to a 5.0% growth in the fourth quarter. On a seasonally adjusted quarter-to-quarter comparison, GDP fell by 0.5% and 2.6% respectively in real terms in the first and second quarters of 2003, yet rebounded sharply to increases by 6.6% in the third quarter and 1.5% in the fourth quarter.

The labour market slackened distinctly along with the abrupt fall-off in economic activity caused by SARS during the first half of 2003, with deterioration in the employment situation being most distinct in the consumption and tourism-related sectors. Then, as the economy turned up again, employment and vacancies also revived steadily in the second half of the year. The seasonally adjusted unemployment rate, having leaped from 7.2% in the fourth quarter of 2002 to a high of 8.7% in May - July 2003, fell back visibly to 7.3% in the fourth quarter. The underemployment rate surged from 3.1% in the fourth quarter of 2002 to a high of 4.3% in the second quarter of 2003, as many employees in the SARS-affected sectors were temporarily suspended from work at that time. Yet it also fell back visibly, to 3.3% in the fourth quarter, as these employees generally resumed work and as the work intensity rose along with economic upturn. Labour earnings remained soft, falling by 1.8% in money terms in the third quarter of 2003 over a year earlier.

The property market had manifestly turned around in late 2003, after the languish performance earlier in the year. On residential property, trading activity plunged in the second quarter, but rebounded visibly in the latter part of the year amidst growing optimism for the economy. Flat prices showed a distinct upturn in the fourth quarter, while flat rentals seemed to have ceased to decline towards the end of the year. On commercial property, leasing of office space likewise rose back towards the year-end, along with a distinct pick-up in the prices for office space and a lesser decline in office rentals. As to the market for shopping space, amidst the bounce in both inbound tourism and local consumer spending, the pick-up later in the year was even more distinct, with prices lifted visibly and rentals bottoming out. On industrial property, demand remained generally weak, yet with keener interest in converting some of the existing industrial sites into hotel use.

In the financial market, the spot exchange rate of the Hong Kong dollar against the US dollar persistently stayed on the strong side of the linked rate after September 2003, amidst strong fund inflow and keener demand for Hong Kong dollar. The spread of the twelve-month Hong Kong dollar forward rate against the spot rate also switched from premium to discount towards end-September 2003, and the discount widened in the fourth quarter. With ample liquidity in the local banking sector, the spread of the three-month HIBOR against the corresponding Euro-dollar deposit rate reversed from premium in the early part of 2003 to discount in the latter part of the year. As Hong Kong dollar loans fell while Hong Kong dollar deposits went up, there was a further marked decline in the loan-to-deposit ratio during the year.

The local stock market went through sharp swings during 2003. The Hang Seng Index, amidst the profound shock of SARS, plunged severely to a 4½-year low at 8 409 on 25 April. It bounced back visibly after mid-May, as the epidemic was progressively brought under control. Then it surged further to successive two-year highs towards the year-end. The upbeat market sentiment was boosted by the signing of CEPA, launch of the Individual Visit Scheme for Mainland visitors coming to Hong Kong, and rally in the US and regional stock markets. The Hang Seng Index reached a 28-month peak at 12 594 on 12 December, before closing 2003 at 12 576, up by 34.9% over end-2002. The average daily turnover in the local stock market also went markedly higher, from $6.7 billion in 2002 to $10.4 billion in 2003.

On consumer prices, the decline in the Composite Consumer Price Index continued in 2003, as local prices were kept down by the slack demand and profit margin squeeze especially during the course of the SARS threat, as well as by lower wages and rentals. The rates concession and waiver of water and sewage charges as the Government's relief measures also dragged down the CPI in the latter period. Yet as the downward effect from the relief measures was lessened, and as price discounts and other concessions on many of the consumer items were reduced along with steadily improving demand, the year-on-year decline in the Composite CPI narrowed appreciably to 2.3% in the fourth quarter of 2003, having widened from 2.0% in the first quarter to 2.5% and 3.6% respectively in the second and third quarters. Also relevant to the narrowed decline was firmer prices of retained imports amidst a weaker US dollar and uptrend in world commodity prices. For 2003 as a whole, the Composite CPI fell by 2.6%, modestly smaller than the 3.0% decline in 2002.

Yet the GDP deflator, as a broad measure of overall price change in the economy, had a more pronounced decline, by 5.1% in 2003, as against a 3.0% decrease in 2002. This was due in large part to a continued drag from deterioration in the terms of trade upon further weakening in the US dollar, aside from downward price pressure in the domestic sector especially amidst the SARS impact. The respective year-on-year declines in the four quarters of 2003 were 4.6%, 5.4%, 5.7% and 4.8%. Taking the GDP growth in real terms and the decline in the GDP deflator together, nominal GDP still had a 2.0% decline for 2003 as a whole, after a 0.8% slip in 2002.

Statistics on the Gross National Product (GNP) are available up to the third quarter of 2003. Both external factor income inflow and outflow fell further in the third quarter of 2003 over a year earlier. This was partly attributable to a further fall-off in interest income into and out of Hong Kong amidst a low interest rate environment globally. Balancing these flows, there was a net inflow of external factor income amounting to 1.8% of GDP in the third quarter of 2003. Adding this net inflow to GDP gives GNP, which picked up to a notable growth at 4.4% in real terms in the third quarter of 2003 over a year earlier, having slowed markedly in growth from 7.3% in the first quarter to 0.4% in the second quarter. Such a profile was broadly in line with that for GDP over the same period. For the first three quarters of 2003 as a whole, GNP went up by 4.1% in real terms over a year earlier, visibly faster than the 0.4% rise in 2002.

Within external factor income, net direct investment income outflow fell in the third quarter of 2003 over a year earlier, largely due to decreased earnings of some prominent multinational enterprises from investment in Hong Kong. Net portfolio investment income inflow declined, on account of increased dividend pay-outs by resident companies to foreign investors. Net income inflow on other investment likewise shrank, upon a greater reduction in interest income from loans and deposits placed abroad by local banks.

The external sector

According to the merchandise trade statistics, total exports of goods (comprising re-exports and domestic exports) picked up distinctly further to a 14.0% surge in real terms in 2003, further up from the already notable growth of 8.6% in 2002. Total exports of goods were buoyant all through the year, with year-on-year increases by 19.1%, 14.3%, 9.8% and 14.2% respectively in real terms in the four quarters. This strong performance had benefited much from the generally improved global economic environment during the year, enhanced price attractiveness of Hong Kong's exports stemming from the exchange rate movements and the domestic cost adjustments, as well as ascending competitiveness of Mainland products as the main source of Hong Kong's re-exports to the overseas markets. The war on Iraq and the outbreak of SARS had inflicted only brief and limited impact on Hong Kong's exports. The growth in exports in the third and fourth quarters remained distinct even upon a higher base of comparison in the same period a year earlier. On a seasonally adjusted quarter-to-quarter comparison, total exports of goods rose further by 3.4%, 1.9% and 1.5% respectively in real terms in the first three quarters of 2003, and then picked up more sharply to a 6.2% increase in the fourth quarter.

Re-exports remained the key driver of growth, surging by 16.1% in real terms in 2003, considerably up from the already distinct growth at 10.9% in 2002. There was double-digit growth in all four quarters of 2003, with increases by 22.3%, 17.0%, 11.3% and 15.4% respectively in real terms over a year earlier. On a seasonally adjusted quarter-to-quarter comparison, re-exports likewise rose further, by 4.0%, 2.3% and 1.2% respectively in real terms in the first three quarters of 2003, and then likewise picked up more sharply, to a 6.7% increase in the fourth quarter.

On the other hand, the on-going structural shift towards re-exports and offshore trade continued to hold down domestic exports, which plunged further by 7.4% in real terms in 2003, though narrowed from the 11.3% shrinkage in 2002. The year-on-year declines were particularly marked in the first and second quarters of 2003, by 12.0% and 12.6% respectively in real terms, then narrowed to 5.4% and 0.4% in the third and fourth quarters. On a seasonally adjusted quarter-to-quarter comparison, domestic exports fell further by 3.0% and 2.5% respectively in real terms in the first and second quarters of 2003, before turning up to increase by 5.6% in the third quarter, and then falling back slightly by 0.2% in the fourth quarter.

Total exports of goods to East Asia as a whole were buoyant throughout the year, picking up further to pronounced growth at 20.9% in real terms in 2003, from a 13.4% growth in 2002. The strong growth impetus was again led by vibrant exports to the Mainland, which maintained highly robust growth all through the year. Exports to Japan, the Republic of Korea, Singapore, Taiwan and Indonesia registered double-digit growth of various magnitudes. On the other hand, exports to Malaysia and Thailand eased back in growth, after the sharp increases in the preceding year. Total exports of goods to North America fell by 1.4% in real terms in 2003, having risen moderately by 3.9% in 2002.

Exports to North America were also robust early in the year, but the growth momentum ran out of steam after the first quarter, along with a distinct deceleration in US import intake in around the middle of the year. Conceivably, there was some cut-back in orders at a time when the war tension in Iraq loomed high. In addition, the increasing tendency for finished products to be shipped out directly from the Shenzhen ports after outward processing in South China also weighed down Hong Kong's exports to this region. Total exports of goods to the European Union surged by 14.1% in real terms in 2003, in contrast to the 0.4% decline in 2002. Enhanced price attractiveness of Hong Kong's exports brought about by the strength of the euro seemed to have outweighed the sluggishness in domestic demand in this region.

Imports of goods were likewise robust, leaping by 12.8% in real terms in 2003, also distinctly up from the 7.8% increase in 2002. Imports of goods had the most distinct growth in the first quarter of 2003, at 18.7% in real terms over a year earlier. Growth was still robust in the second quarter, at 10.6%, upon the continued strength in re-export trade and even with the spread of SARS severely dampening import intake for local use. With the moderation in re-export growth in the third quarter partly offset by a revival in import intake for local use, imports of goods grew by 7.9% in the third quarter. This was followed by a much faster growth at 15.0% in the fourth quarter, as re-exports re-accelerated while import intake for local use picked up sharply. As to the growth profile in imports for local use, retained imports surged by 11.5% in real terms in the first quarter of 2003 over a year earlier, but tumbled to a 1.9% decline in the second quarter upon the profound impact of SARS. Then, along with the progressive recovery in domestic demand, retained imports turned up mildly to a 0.6% increase in the third quarter and surged further by 14.1% in the fourth quarter. For 2003 as a whole, retained imports attained a 5.8% growth in real terms, up from the 1.8% increase in 2002. On a seasonally adjusted quarter-to-quarter comparison, imports of goods rose by 2.9% in real terms in the first quarter of 2003, yet moderating to a 0.9% increase in the second quarter, before picking up again to increases by 2.6% and 7.0% respectively in the third and fourth quarters. Retained imports had a broadly parallel profile during the year, initially rising by 0.4% in real terms in the first quarter of 2003, then falling back by 2.1% in the second quarter, before surging by 6.0% and 7.9% respectively in the third and fourth quarters.

With the increase in value of imports of goods exceeding that of total exports of goods, the visible trade deficit reckoned on a GDP basis widened in absolute terms, to $45.0 billion or 2.5% of the value of imports of goods in 2003, from

$39.4 billion or 2.5% in 2002.

On invisible trade, the strong growth momentum in exports of services in the first quarter of 2003 was dented severely by the spread of SARS in Hong Kong in the second quarter. Yet with a swift rebound in the third quarter and a further pick-up in the fourth quarter, exports of services still attained appreciable growth at 5.5% in real terms in 2003, albeit milder than the 12.2% surge in 2002. On a year-on-year comparison, exports of services soared by 12.7% in real terms in the first quarter of 2003, before falling abruptly by 12.0% in the second quarter as inbound tourism and related business plummeted upon the SARS impact. As such business rebounded strongly thereafter, exports of services resumed growth, rising by 7.8% in the third quarter, and then distinctly more by 11.8% in the fourth quarter. On a seasonally adjusted quarter-to-quarter comparison, exports of services still rose by 0.9% in real terms in the first quarter of 2003, before plummeting by 19.7% in the second quarter. A sharp turnaround ensued, with a 33.5% surge in the third quarter and a further 2.2% increase in the fourth quarter.

Imports of services were likewise severely affected by SARS in the second quarter. Even with the subsequent rebound, imports of services still fell by 4.4% in real terms in 2003, following a meagre 0.2% rise in 2002. On a year-on-year comparison, imports of services shrank by 3.9% and 19.6% respectively in real terms in the first and second quarters of 2003, before turning up to increase by 0.5% and 4.2% respectively in the third and fourth quarters. On a seasonally adjusted quarter-to-quarter comparison, imports of services slipped by 3.8% in real terms in the first quarter of 2003 and then slumped by 17.8% in the second quarter, before rebounding strongly by 27.8% in the third quarter and rising further by 2.9% in the fourth quarter.

As exports of services rose while imports of services declined, the invisible trade surplus reckoned on a GDP basis rose further to $161.1 billion or 85.1% of the value of imports of services in 2003, from $144.5 billion or 74.7% in 2002. This more than offset the enlarged visible trade deficit to yield a combined surplus of $116.1 billion in 2003, equivalent to 5.9% of the total value of imports of goods and services in that year, as compared to $105.1 billion or 5.9% in 2002.

Domestic demand

Local consumer spending suffered a severe blow in the second quarter of 2003 upon the spread of SARS, as many people avoided going to the busy shopping areas for fear of being contracted. Then, with the epidemic brought under control, local consumer spending revived progressively in the third quarter, followed by an even more visible pick-up in the fourth quarter. Coupling this revival with the strong resurgence in inbound tourism, the volume of retail sales turned up to increase by 1.2% in the third quarter of 2003 over a year earlier, and rose more distinctly by 5.2% in the fourth quarter, in contrast to the decreases by 0.8% and 7.7% in the first and second quarters. For 2003 as a whole, the volume of retail sales still went down marginally by 0.6%, yet this already represented a noticeable improvement from the 2.6% decrease in 2002. The rebound in retail sales towards the year-end was rather broad-based, with significant double-digit increases in sales of high-value items such as electrical goods and photographic equipment, and furniture. This apart, sales of the more regular items such as food, alcoholic drinks and tobacco, and clothing and footwear also turned up. On a seasonally adjusted quarter-to-quarter comparison, the volume of retail sales increased by 1.0% in the first quarter of 2003, slipped to a 7.5% plunge in the second quarter, and then bounced back to notable increases by 8.4% and 3.9% respectively in the third and fourth quarters.

Private consumption expenditure (PCE) likewise exhibited a distinct turnaround after the waning of SARS. On a year-on-year comparison, PCE fell by 1.8% and 3.5% respectively in real terms in the first two quarters of 2003, but rebounded to growth at 1.6% in the third quarter, the first increase since the fourth quarter of 2001. As consumer sentiment improved further in tandem with the upturn in the economy, rally in the local stock market and turnaround in the property market, growth in PCE accentuated to 3.6% in the fourth quarter. For 2003 as a whole, PCE showed virtually no change in real terms, having declined by 1.2% in 2002. The pick-up in consumer spending in late last year was manifested in all major consumer goods and services. On a seasonally adjusted quarter-to-quarter comparison, PCE fell by 0.1% and 1.4% respectively in real terms in the first two quarters of 2003, and then turned up to increases by 3.9% and 1.2% respectively in the third and fourth quarters.

Amidst the fiscal restraint, government consumption expenditure (GCE) reckoned on a national accounts basis registered only modest growth in the first three quarters of 2003, by 1.3%, 0.4% and 0.5% respectively in real terms over a year earlier. The growth then picked up to 5.6% in the fourth quarter. Yet this was partly due to lower base of comparison a year earlier. Also contributed were the one-off compensatory payments made to those Civil Servants retiring under the Second Voluntary Retirement Scheme. For 2003 as a whole, GCE grew by 1.9% in real terms, still slower than the 2.4% growth in 2002. On a seasonally adjusted quarter-to-quarter comparison, GCE rose throughout the four quarters of 2003, by 1.0%, 0.1%, 1.3% and 3.0% respectively in real terms.

Overall investment spending, as represented by gross domestic fixed capital formation (GDFCF), regained some strength in the latter part of last year, after the setback amidst the SARS impact in the earlier months. GDFCF still grew by 3.5% in real terms in the first quarter of 2003 over a year earlier, but relapsed to a sharp decline by 5.7% in the second quarter as business conditions faltered upon the spread of SARS. Then, with the ensuing pick-up in economic activity, GDFCF had only a 0.6% fall in the third quarter, and rebounded to a 2.5% rise in the fourth quarter. For 2003 as a whole, GDFCF declined only marginally by 0.1% in real terms, visibly improved from the 4.3% dip in 2002.

There was renewed interest in acquisition of machinery and equipment during the year, except for a temporary relapse in the second quarter. On a year-on-year comparison, expenditure on machinery, equipment and computer software surged by 11.9% in real terms in the first quarter of 2003, fell by 2.0% in the second quarter, and then bounced back to distinct growth at 4.9% in the third quarter and 10.2% in the fourth quarter as business outlook brightened. Intake of several aircraft in the second half of the year had also helped. For 2003 as a whole, expenditure on machinery, equipment and computer software had an increase of 6.1% in real terms, in stark contrast to the 9.1% decrease in 2002.

On the other hand, building and construction output in overall terms remained subdued throughout the year. Expenditure on building and construction fell back by 6.9% in real terms in 2003, after a small increase by 1.2% in real terms in 2002. On a year-on-year comparison, the decreases were 3.5%, 8.4%, 6.7% and 9.3% respectively in real terms in the four quarters of 2003. The slump was mostly due to a distinct fall-off in private sector building work, despite a rise in consents for new building projects during the year. The increase in private sector civil engineering work during the year rendered only a marginal offset. Public sector expenditure on building and construction was also slack in the first half of the year, upon the winding down of work on the KCR West Rail and Ma On Shan Extension. Nevertheless, it regained some momentum in the second half of the year, upon commencement of several new infrastructural projects including the Hong Kong Section of Hong Kong-Shenzhen Western Corridor and Deep Bay Link.

Inventories went up further in the first and second quarters of 2003. Yet this was manifestly involuntary particularly for the second quarter, in face of an abrupt fall-off in demand upon the SARS impact. Following a moderate depletion in the third quarter, inventories were replenished distinctly in the fourth quarter, concurrent with a surge in import intake to meet the reviving demand. For 2003 as a whole, there was a net accumulation of inventories equivalent to 0.6% of GDP, up from that of 0.2% in 2002.

Implications of the preliminary GDP figures for the economy

Nominal GDP fell further, by 2.0% to $1,235 billion in 2003, following a 0.8% decrease in 2002. This was due to a more pronounced fall in overall prices as reflected by the GDP deflator, more than offsetting the rise in real GDP. On a year-on-year comparison, nominal GDP fell slightly by 0.2% in the first quarter of 2003, and more significantly by 5.9% in the second quarter upon the SARS impact. It then showed a much narrowed decline by 1.9% in the third quarter, followed by virtually nil change in the fourth quarter.

Per capita GDP rose by 3.1% in real terms in 2003, up from the 1.3% rise in 2002. Yet with a larger decline in the overall price level as measured by the GDP deflator, per capita GDP was still down by 2.2% in nominal terms to $181,500 in 2003. This came after a 1.7% fall in 2002.

Total final demand, excluding re-exports but with the re-export margin retained, grew by 3.3% in real terms in 2003, representing a further improvement from the 1.9% increase in 2002. It was in line with the 3.3% growth in real terms in aggregate supply as denoted by GDP.

The growth in total final demand last year was mainly propelled by a further pick-up on the external front. After an already distinct growth at 9.3% in 2002, external demand surged even more, by 12.7% in real terms in 2003. This in turn was underpinned by double-digit increase in exports of goods for the year as a whole, as well as by a strong resurgence in exports of services in the second half of the year. As to domestic demand, having declined by 1.1% in 2002, it also revived visibly, to a 0.6% growth in real terms in 2003. There was a pick-up in both consumption and investment demand in the second half of the year, particularly so in the fourth quarter. Within the total, private sector demand rebounded to a modest increase by 0.5% in real terms in 2003, from a 1.5% decrease in 2002, while public sector demand continued to rise moderately, by 1.6% in real terms in 2003, after a 1.0% increase in 2002.

The Government account

According to the cash-based Consolidated Government Accounts for the financial year 2003/04, the revised estimate of government revenue stands at \$203.8 billion, up by 14.2% in money terms from the outturn of \$178.4 billion in the financial year 2002/03. Within the total for the financial year 2003/04, revenue from profits tax bounced back significantly, as business profits in 2002/03 generally improved over 2001/02, and as a higher tax rate was charged in respect of provisional profits tax for 2003/04. Revenue from stamp duties leaped, upon a surge in transactions in both the stock and property markets in the latter part of 2003 and the early part of 2004. Revenue from general rates in 2003/04 bounced up from the low base in 2002/03 brought about by the rates concession granted for the entire year of 2002, even though there was a temporary dip in the July-September 2003 quarter brought about by another rates concession to tide over the SARS impact. Concurrently, revenue from business registration, estate duty, as well as bets and sweeps tax rose back by various magnitudes. These more than offset a visible decrease in revenue from salaries tax and personal assessment, mainly on account of a \$2.3 billion salaries tax rebate granted in July 2003 under the package of relief measures to tide over the SARS impact.

The revised estimate of government spending in the financial year 2003/04 stands at \$252.9 billion, up by 5.3% in money terms from the outturn of \$240.1 billion in the financial year 2002/03. Within this total, operating expenditure rose by 3.2% to \$206.7 billion, including the extra expenditure incurred to re-vitalise the economy and to provide additional employment and training opportunities after the SARS impact. Capital spending surged by 15.9% to \$46.1 billion, mainly reflecting increased allocation to the Capital Works Reserve Fund and Capital Investment Fund.

The revised estimate of fiscal balance gives a deficit of \$49.0 billion in the financial year 2003/04, equivalent to 4.0% of GDP. These were narrowed appreciably from the corresponding deficit figures of \$61.7 billion and 4.9% in the financial year 2002/03. The improvement was helped by the progressive upturn in the economy and the asset markets since the middle of last year, as well as by a significant gain in investment income, which more than offset the decrease in revenue and increase in spending arising from the two packages of relief and support measures announced in April and June 2003 to tide over the SARS impact.

The property market

The property market as a whole showed a significant turnaround in the later months of 2003. The markets for residential property and shopping space improved distinctly in the second half of the year. This occurred in tandem with better performance of the overall economy and rally in the stock market. The signing of CEPA in June and implementation of the Individual Visit Scheme for Mainland visitors to Hong Kong in July provided further support. The market for office space also showed some improvement towards the end of the year.

The sales market for residential property picked up in the second half of 2003, having remained sluggish in the first half of the year. This was supported by a distinct improvement in the outlook for the economy, following the signing of CEPA and implementation of the Individual Visit Scheme, and amidst a more sanguine global economic environment. Developers actively resumed sales in the primary market as the SARS impact waned, and the sales were generally met with a good response. Hence many developers had proceeded to reduce or withdraw the price discounts and other concessions offered earlier. Moreover, there was a notable revival in activity in the secondary market. Flat prices bottomed out in the third quarter, and rebounded visibly in the fourth quarter. In the luxury end of the market, strong buying interest emerged in the latter part of the year, leading to a more pronounced rebound. Purportedly, the Government's new policy measure to attract investment immigrants to Hong Kong rendered some lift to this segment.

On a quarter-to-quarter comparison, flat prices on average decreased by 4%, 5% and 1% respectively in the first three quarters of 2003, before increasing distinctly by 8% in the fourth quarter. For 2003 as a whole, flat prices on average fell by 2%, much narrowed from the 12% fall in 2002. Compared with the peak level in the third quarter of 1997, flat prices in the fourth quarter of 2003 remained substantially lower, by an average of 62%. In the first half of 2003, with flat prices still falling and with the mortgage rate staying at a low level, and notwithstanding reduced household income, home purchase affordability improved further, after the substantial improvement over the past several years. Yet in the second half of the year, the distinct rebound in flat prices led to some reduction in home purchase affordability.

As to the rental market for residential property, leasing activity likewise turned more active in the second half of 2003, after remaining quiet in the first half of the year. Flat rentals had tended to stabilise in the fourth quarter. On a quarter-to-quarter comparison, private housing rentals on average declined by 3%, 4% and 2% respectively in the first three quarters of 2003, yet showed little change in the fourth quarter. For the year as a whole, there was on average a fall of 9%, also narrowed from the 14% fall in 2002. Against the peak level in the third quarter of 1997, private housing rentals were significantly down in the fourth quarter of 2003, by an average of 48%. Mainly as a result of the marked decline in flat rentals, lease affordability likewise improved over the past few years.

On commercial property, the rental market for office space weakened further during most of 2003, yet turned more active in the rest of the year. The abundant supply of new and existing office space, coupled with the SARS impact, exerted much downward pressure on rentals in the first half of the year. Yet after the waning of SARS, such downward pressure on rentals tended to lessen in the second half. With rentals for Grade A office space having fallen to a more attractive level and with an upturn in business sentiment, leasing demand for office space strengthened somewhat more recently. Also, more tenants were willing to relocate their offices from buildings which were older or in secondary locations to better ones. As to the sales market, investor interest was rekindled markedly in the second half of the year, stimulated in part by the signing of CEPA in June and perhaps more so by the better economic outlook. The rental market for shopping space, having been hard hit by the spread of SARS in the second quarter of 2003, generally revived in the second half of the year. This was supported by the pick-up in local consumer demand, as well as in inbound tourism following initiation of the Individual Visit Scheme in July. Yet there was a mixed performance amongst different retail premises amidst the revival, depending on location and management quality. Retail premises in popular locations and in better-managed shopping malls had been faring much better. The sales market showed a more distinct improvement, as investor interest became much keener in the second half of the year. There were reportedly a number of transactions involving short-term re-sale with profits.

On industrial property, the rental market remained generally weak in 2003. Demand for conventional factory space continued to be undermined by the further contraction in local manufacturing activity. Modern industrial premises that could be used as back-up service centres also faced competition from office space in the fringe areas, as rentals for such office space fell to an even lower level. As to the sales market, support came mainly from projects involving the conversion of industrial sites to hotel use, amidst the rebound in inbound tourism.

Planned developments of all types of property in the private sector, as indicated by the total usable floor area on building plans with consent to commence work, went up by 23% in 2003, after a marginal decrease by 1% in 2002. Analysed by main type of property and on a year-on-year comparison, planned developments of private residential property surged by 69% in terms of units or by 31% in terms of total usable floor area in 2003, reversing the corresponding decreases of 35% and 21% in 2002. On the other hand, planned developments of commercial property plummeted by 45% in 2003, after a 38% increase in 2002. Planned developments of industrial property plunged by 99% in 2003, having risen by 134% in 2002 over a low base. Planned developments of property in the "others" category soared by 306% in 2003, following a 46% increase in 2002, mainly due to a surge in hotel projects.

The labour market

Though still slack in overall terms towards the year-end, the labour market showed a progressive turnaround in the second half of 2003, from the distinct setback in the first half of the year, mostly in the second quarter. Indicating this, the seasonally adjusted unemployment rate rose from 7.2% in the fourth quarter of 2002 to 7.5% in the first quarter of 2003, and sharply further to 8.6% in the second quarter and then to a peak of 8.7% in May - July, consequential to an abrupt downturn in the economy under the impact of SARS. Nevertheless, as overall economic activity and in particular inbound tourism and local consumer spending bounced up after SARS waned, the seasonally adjusted unemployment rate fell back to 8.3% in the third quarter and markedly further to 7.3% in the fourth quarter. For 2003 as a whole, the unemployment rate averaged at 7.9%, which however was still appreciably above that in 2002, at 7.3%. Furthermore, there was a clear lengthening in the median duration of unemployment, from 90 days in the fourth quarter of 2002 to 109 days in the fourth quarter of 2003, as well as a surge in the proportion of persons unemployed for six months or more, from 30% to 36%.

The underemployment rate exhibited a broadly parallel profile. It soared to a peak of 4.3% in the second quarter of 2003, after a modest decline from 3.1% in the fourth quarter of 2002 to 2.9% in the first quarter of 2003. Conceivably, this was due to a considerable proportion of employees having been temporarily suspended from work or asked to take no-pay leave during the SARS period. Yet as SARS waned and the affected employees gradually returned to their jobs, the underemployment rate came down again, to 3.6% in the third quarter and further to 3.3% in the fourth quarter. For 2003 as a whole, the underemployment rate averaged at 3.5%, which however was also appreciably higher than that in 2002, at 3.0%.

On a quarter-to-quarter comparison, total employment as enumerated from households went up by 1.3% in the fourth quarter of 2003, reversing the downtrend seen earlier in the year. Employment gain was most appreciable in the import/export trade, backed by the robust performance of external trade. More appreciable increases in employment were also observed in the retail trade, restaurants, hotels, transport, and amusement and recreational services, along with the surge in inbound tourism and revival in local consumer spending, as well as in real estate and in decoration and maintenance, in line with a more active property market. On the other hand, total labour force shrank for most of the year. On a quarter-to-quarter comparison, there was a slight decrease by 0.1% in the fourth quarter of 2003. This was attributable entirely to a fall in the labour force participation rate, especially that for younger persons aged 15-29 and middle-aged males at 40-49. As the gain in total employment went together with a contraction in total labour force, this led to an improvement in the overall manpower resource balance and hence a drop in unemployment rate towards the end of the year. On a year-on-year comparison, total employment and total labour force had broadly similar decreases, by 0.6% and 0.5% respectively in the fourth quarter of 2003. This contrasted with the situation in the preceding three quarters, when total employment either rose more slowly than or fell by more than total labour force, by 0.8%, 0.5% and -1.7% as against 1.3%, 1.5% and -0.7%.

Labour income in money terms continued to ease. On a year-on-year comparison, labour earnings fell by an average of 2.1% in money terms in the first three quarters of 2003, with a more distinct fall in the second quarter under the SARS impact. This came after the 1.1% decline in 2002. Yet netting out the decrease in consumer prices as measured by the Composite CPI, labour earnings still registered a modest gain by an average of 0.6% in real terms in the first three quarters of 2003. This however was less than the 2.0% gain in 2002. On a year-on-year comparison, labour wages were also reduced by an average of 2.1% in money terms in the first nine months of 2003, with a more distinct fall towards mid-year under the SARS impact. This followed a 1.0% decline in 2002. Netting out the fall in consumer prices as measured by the CPI(A), labour wages likewise edged up, by an average of 0.3% in real terms in the first nine months of 2003. Yet this was likewise lesser than the 1.3% increase in 2002.

Prices

Overall consumer prices, whilst kept coming down for the fifth consecutive year since late 1998, had a smaller decrease in 2003 than in 2002. The moderation in price decline took place in the first and fourth quarters of 2003, outweighing the accentuated falls in the second and third quarters, which were mainly brought about by first, the severe blow of SARS on consumer demand, and then, by the special relief measures granted by the Government to alleviate the SARS impact. The moderation was more appreciable towards the year-end, when both property rentals and labour wages tended to stabilise amidst the generally improved economic conditions. Also, in face of the surge in inbound tourism and revival in local consumer spending, some of the local retailers and service providers reduced the price discounts and other concessions on their goods and services, and some others even raised the prices modestly. A rebound in the prices of retained imports over the past year, amidst a weaker US dollar and uptrend in world commodity prices, should have contributed as well.

For 2003 as a whole, the Composite Consumer Price Index went down by 2.6%, smaller than the 3.0% decline in 2002. The year-on-year decrease actually narrowed to 2.0% in the first quarter of 2003, from 2.9% in the fourth quarter of 2002, although this was largely attributable to a low base of comparison owing to the rates concession by the Government in 2002. The decrease then widened to 2.5% in the second quarter under the impact of SARS, and further to 3.6% in the third quarter on account of the new rates concession as well as the waiver of water and sewage charges granted as relief measures by the Government. The decrease narrowed again, to 2.3% in the fourth quarter, upon firming up in retail prices of some of the goods and services, and lapse of the special relief measures.

The GDP deflator, as a broad measure of overall price change in the economy, dipped by 5.1% in 2003, larger than the 3.0% decrease in 2002. Yet the year-on-year decline in the fourth quarter of 2003, by 4.8%, was narrowed from the widening declines in the second and third quarters, by 5.4% and 5.7% respectively. The larger fall in the GDP deflator in 2003 than in 2002 was mainly attributable to a worsening in the terms of trade in goods and services as well as accentuated decline in the price deflator for government consumption expenditure, which more than offset moderated decline in the price deflators for gross domestic fixed capital formation and private consumption expenditure. Within the GDP deflator, the domestic demand deflator and the total final demand deflator nevertheless had lesser decreases in 2003 than in 2002, by 3.8% and 2.4% respectively as against 4.5% and 3.5%. On a seasonally adjusted quarter-to-quarter comparison, the decline in the GDP deflator moderated in the latter part of the year, to 1.3% in the third quarter of 2003 and further to 0.8% in the fourth quarter, having accentuated from 1.3% in the first quarter to 1.5% in the second quarter.

The financial sector

The spot exchange rate of the Hong Kong dollar against the US dollar stayed close to the linked rate up to late September 2003, but strengthened visibly since then. It reached a high of 7.712 on 7 October, before easing back to 7.763 at the end of the year. The spread of the twelve-month Hong Kong dollar forward rate above the spot rate widened briefly to 355 pips (each pip equivalent to HK$0.0001) in late April, amidst concern about the adverse impact of SARS on the economy, but soon narrowed back as SARS was brought under control. The premium switched into a discount as from late September, initially being influenced by increased speculation for revaluation of the renminbi and later under strong inflow of funds. The discount widened to 595 pips at end-2003, in contrast to a premium of 169 pips at end-2002.

Under the linked exchange rate system, movements in the exchange rates of the Hong Kong dollar against other major currencies follow closely those in the US dollar. During 2003, the US dollar weakened against most of the other major currencies. This was initially triggered by uncertainties surrounding the US-led war on Iraq and concern about the pace of US economic recovery, and subsequently aroused by increasing market attention on the much enlarged US current account and fiscal deficits despite the clearer US economic upturn. The burden of adjustment in the US dollar was largely borne by the euro, with the dollar-euro rate weakening by 16.5% to an average of 1.132 in 2003, from that of 0.946 in 2002 (the rate moved to 1.259 at end-2003, from 1.050 at end-2002). Other major currencies also appreciated against the US dollar, albeit to a lesser extent. The dollar-pound sterling rate, at an average of 1.635 in 2003, weakened by 8.1% from that of 1.503 in 2002 (the rate moved to 1.786 at end-2003, from 1.612 at end-2002). The yen-dollar rate, at an average of 115.9 in 2003, strengthened by 7.4% from that of 125.2 in 2002 (the rate moved to 107.4 at end-2003, from 118.8 at end-2002). Most of the major East Asian currencies, except the Hong Kong dollar and renminbi, likewise appreciated against the US dollar in 2003. Taking the various currency movements together, the trade-weighted Nominal Effective Exchange Rate Index of the Hong Kong dollar fell by 3.2% to an average of 100.7 in 2003, from that of 104.0 in 2002 (the

Nominal Index moved to 98.8 at end-2003, from 102.0 at end-2002). After adjusting for changes in the respective consumer price indices, the trade-weighted Real Effective Exchange Rate Index of the Hong Kong dollar was down by 7.0% to an average of 89.4 in 2003, from that of 96.1 in 2002 (the Real Index moved to an average of 86.4 in December 2003, from that of 93.2 in December 2002).

Affected by changes in the spread between the Hong Kong dollar spot rate and forward rate, local inter-bank interest rates rose briefly in April 2003, but fell progressively during the rest of the year. At end-2003, the three-month HIBOR was at a discount of 104 basis points against the corresponding Euro-dollar deposit rate, in contrast to a premium of 9 basis points at end-2002. Following the movements in the US Fed Funds target rate, the Base Rate under the Discount Window operated by HKMA was reduced by 25 basis points to 2.5% in late June 2003, and stayed at that level since then. The best lending rate remained unchanged at 5.00% throughout 2003, while the savings deposit rate offered by the major commercial banks was lowered to 0.02% in October and further to 0.01% in December. The spread of the best lending rate over the three-month time deposit rate widened, from an average of 4.71 percentage points in 2002 to that of 4.93 percentage points in 2003.

Hong Kong dollar deposits, having shrunk by 1.6% during 2002, turned up to increase by 5.8% during 2003. Yet Hong Kong dollar loans had an enlarged decrease, from 1.9% to 2.6%. As Hong Kong dollar loans continued to contract while Hong Kong dollar deposits expanded during 2003, the Hong Kong dollar loan-to-deposit ratio moved down much more, to 81.5% at end-2003, from 88.5% at end-2002.

The local stock market, having consolidated in the early part of last year, staged a strong rally in the remainder of the year. In the early months of 2003, market sentiment was dampened by concern over the US-led war on Iraq, uncertain outlook for the US economy, and poor performance of the major stock markets overseas. The outbreak of SARS in March dealt another blow to investor confidence. In consequence, the Hang Seng Index plummeted to a 4½-year low at 8 409 on 25 April, representing a 9.8% fall from the level at end-2002. Yet as SARS was brought under control, and as the performance and near-term outlook of the major overseas economies improved after the war on Iraq fairly quickly ended, local share prices rebounded appreciably in May. Additional boost came from the signing of CEPA with the Mainland in late June. Further lifting sentiment was a series of positive developments occurring in the second half of the year, including launch of the Individual Visit Scheme for Mainland visitors to

Hong Kong thereby bolstering inbound tourism, rebound in the property market, and influx of funds. The rally in the US stock market fuelled the market upturn. As a result, the Hang Seng Index surpassed the 11 000 mark in September and then the 12 000 mark in October, to reach a 28-month high at 12 594 on 12 December. It closed 2003 at 12 576, up substantially by 34.9% over the level of 9 321 at the end of 2002. (The Hang Seng Index broke the 13 000 mark in early January 2004, and reached another high at 13 928 on 18 February, amidst growing optimism about the near-term outlook for the economy generally and the property market in particular. It closed at 13 907 on 27 February.)

Overview

On current indications, the revival in the Hong Kong economy is well on track, and should become more entrenched in the coming months. Growth in 2004 looks likely to be the fastest after the particularly strong surge in 2000.

Externally, following the distinct improvement in the latter part of last year, the global economy is expected to continue on an upturn this year. The US economy should maintain a strong growth momentum in 2004, supported by continued strength in consumer spending, better corporate profitability, and further tax reliefs in the pipeline. The EU economy is also envisaged to improve in 2004, aided by a more sanguine global economic environment.

In East Asia, the economy of the mainland of China (the Mainland) is poised for further robust growth in 2004, amidst vibrant domestic demand and rising competitive edge in its exports. As to the Japanese economy, the recovery process seems likely to continue in 2004, amidst a more upbeat business sentiment and a more sanguine global economy. The other export-dependent East Asian economies should likewise benefit from the global economic upturn, and assuming that the economic impact of avian flu is only limited and confined, should be able to attain a faster and more broad-based growth in 2004.

On Hong Kong's external price competitiveness, the weakness of the US dollar, coupled with the down-drift in local costs and prices in the earlier period, will bode well for Hong Kong's exports in the near term. Implementation of the Closer Economic Partnership Arrangement (CEPA) between Hong Kong and the Mainland as from the beginning of this year will accord Hong Kong products with an added competitive edge in the Mainland market. Together with the favourable global demand conditions, Hong Kong's exports of goods are set for a further distinct growth in 2004.

Hong Kong's exports of services also look good in 2004. In particular, inbound tourism is expected to continue to surge. Visitor arrivals from the Mainland should remain as the key source of growth this year, more so with further extension of the Individual Visit Scheme. Visitor arrivals from other major sources may also recover further from the earlier decline due to SARS, though perhaps with a brief drag owing to the spread of avian flu across the region. Offshore trade should stay robust, on the back of the Mainland's vibrant trade flows and further structural shift from re-exports towards offshore trade.

Locally, with the unemployment rate coming down visibly in tandem with the economic upturn, and with recent positive developments in the asset markets also lifting consumers' inclination to spend, private consumption expenditure looks set for a stronger rebound in 2004. As to government consumption expenditure, growth is expected to remain modest in 2004, in face of tight fiscal restraint.

Overall investment spending, after two years of setback, is also poised for a pick-up in 2004. Within this total, acquisition of machinery, equipment and computer software should go for a faster increase this year, as brighter business outlook and improved corporate profitability should re-activate the need for capacity expansion. On building and construction activity, the distinct rebound in building consents last year can be expected to translate into greater building output in the private sector in due course. But construction work in the public sector is likely to remain subdued, on account of lesser workload from infrastructural projects in the near term.

With the external and local economic environment both generally upbeat, Hong Kong's GDP is forecast to pick up notably further, to a 6% growth in 2004, from a 3.3% growth in 2003.

There are however certain caution factors to watch over. The spread of avian flu in the region, if to worsen significantly, may begin to induce threat on broader economic activity. Also, unease about geo-political volatility and terrorist activities continues to cast a shadow on the global climate. Moreover, there continues to be attention on China-US trade relations, as well as on the tracks in US dollar exchange rate and interest rates influencing the global financial and economic scene.

The Consumer Price Index may still be on a decline in the near term. This is chiefly because the lagged effect from the marked fall-off in private housing rentals earlier on continues to feed through into the housing cost component of the CPI. Yet the decline in housing rentals in the market has by and large been arrested towards the end of last year. Also, the downward pressure on labour wages may recede sooner, as the employment conditions improve further. Amidst strengthening demand, local retailers and service providers are likely to continue to reduce the price discounts and other concessions on their goods and services, and some of them may proceed to make modest upward adjustment to the prices. Moreover, there is going to be greater price pressure from the external front, stemming from the weaker US dollar and firmer world commodity prices, and this is likely to gradually feed through to the local economy in the coming months.

Taking these factors together, the year-on-year rate of decline in the Composite CPI seems likely to taper quite distinctly further over the course of this year. For 2004 as a whole, the Composite CPI is forecast to decline by an average of 1%, much narrowed from the 2.6% fall in 2003.

External sector

Exports of goods and services

With the global economy going for a further upturn this year, with the Mainland economy sustaining robust growth, and with the weakness in the US dollar lifting the price competitiveness of Hong Kong's exports, the outlook for exports in 2004 should be rather favourable. Total exports of goods are thus forecast for a further distinct growth at 7.7% in 2004, having already soared by 14.2% in 2003. Within this total, re-exports are forecast to leap by 8.5% in 2004, following a 16.3% surge in 2003, but domestic exports are forecast to decline by 2% in 2004, following a 7.3% fall in 2003. Even with some possible positive effect from the implementation of CEPA, domestic exports are still reckoned for a further decline, mainly in the light of the on-going structural shift to re-exports and offshore trade.

Analysed by major region, exports of goods to East Asia should remain a key driving force for Hong Kong's total exports of goods in 2004. The Mainland economy will continue to be the bright spot this year, with its domestic demand remaining vibrant, external trade sustaining strong growth, and inward foreign direct investment continuing apace. Hong Kong's exports to the Mainland for meeting its own demand are poised to benefit from the strong demand there. At the same time, Hong Kong's exports to the Mainland for outward processing are to be buoyed by the global economic upswing. Progressive trade liberalisation in the Mainland in accordance with China's commitments under WTO, coupled with implementation of CEPA, should render a further boost to Hong Kong's trade involving the Mainland. The major firms and organisations engaged in China trade that have been consulted are all upbeat about the outlook for Hong Kong's exports of goods to the Mainland in 2004.

Exports of goods to Japan look set for further notable growth in 2004. There should be support from continued growth and sustained import demand in the Japanese economy, as well as from the relative strength of the yen. Also of relevance is the ascending prominence of Mainland products in the Japanese market, which should in turn lift Hong Kong's re-exports of Mainland origin to this market. The outlook for exports of goods to the other East Asian economies is expected to be underpinned by the further pick-up in regional economic growth and continued surge in intra-regional trade, barring any noticeable impact to emerge from avian flu on broader economic activity.

As to the conventional overseas markets, exports of goods to the United States fell off after the first quarter of 2003. Despite its improved import intake later in the year, exports to this market remained weak to the year-end. Conceivably, this was due to a more pronounced structural shift towards offshore trade destined for the country, upon the further expansion of port capacity in South China more recently. Such structural shift continuing apace is likely to further dampen exports to this market. On the other hand, US import demand is expected to pick up more along with its economic upswing. Also, the relative strength in the East Asian currencies against the US dollar will tend to make Hong Kong’s exports more attractive in price terms in the US market. On the whole, exports of goods to the United States are still expected to stage a mild rebound during 2004. On exports of goods to the European Union, the outlook for 2004 looks quite positive, in the light of the prevailing strength of the euro and the envisaged better economic recovery in the area.

Exports of services, after a much retarded growth in 2003, should again outperform exports of goods in 2004. The growth is forecast at 15% in 2004, markedly up from the 5.5% rise in 2003. In particular, inbound tourism is expected to continue with a strong momentum in 2004. Mainland visitors should remain as the key source of growth, underpinned by strong income increase in the Mainland, keen desire for outward travel amongst Mainland residents, and further extension of the Individual Visit Scheme. Visitor arrivals from other major sources should also recover further from the earlier decline due to SARS, though perhaps with a brief drag owing to the spread of avian flu across the region. Exports of transportation services are set to bounce back visibly in 2004, in tandem with continued notable growth in cargo movements and resurgence in air passenger movements from the distinct trough last year. Offshore trade should stay robust, on the back of the Mainland’s vibrant trade flows and further structural shift from re-exports towards offshore trade. Exports of financial, business and other services are also expected to rise further in 2004, along with thriving regional business demand. Moreover, the implementation of CEPA in respect of trade in services should render an added boost.

Imports of goods and services

Retained imports are forecast to pick up distinctly further, to an increase of 10.6% in 2004, after a 6.2% rise in 2003. This is in line with the envisaged further recovery in domestic demand and further build-up in inventories. Amongst the major end-use categories, retained imports of consumer goods should increase visibly further, in tandem with greater spending from both the local consumption and inbound tourism fronts. Retained imports of capital goods should also expand, along with extended growth in machinery and equipment investment. Retained imports of material inputs may likewise fare better, in line with an envisaged lesser decline in domestic exports and further upturn in domestic economic activity. Together with the forecast increase in re-exports, total imports of goods are forecast for a further notable growth at 9.1% in 2004, following a 13.1% increase in 2003.

Imports of services are forecast to rebound distinctly to a 9.5% rise in 2004, after a 4.4% decline in 2003. This is expected to be underpinned by a pick-up in outward travel of local residents, particularly when set against the trough last year due to SARS. There should be more support from the steadier employment and income conditions. Imports of transportation services should likewise bounce up, on the back of the envisaged upturn in outbound tourism and notable growth in merchandise trade. Imports of trade-related services should also rise further, in tandem with a further leap in offshore trade.

Domestic sector

Private consumption expenditure

Consumer demand has embarked on a steady revival after mid-2003 and looks set for a more solid growth during 2004. Amidst a much improved consumer sentiment and steadier employment conditions, there has been an across-the-board rebound in spending on consumer goods and services in the latter part of last year. The pick-up in spending on durable goods such as electrical appliances and furniture, and in spending on luxury items such as jewellery and watches, was particularly distinct. The overall economic upturn, coupled with the sentiment lift from the more active stock and property markets giving resurrected asset prices, should support a stronger rebound in consumer spending this year. Overall, private consumption expenditure is forecast for a notable growth at 6% in 2004, up from virtually no change in 2003.

Government consumption expenditure

On the basis of information contained in the Government's revised estimates of expenditure for the financial year 2003/04 and the draft estimates of expenditure for the financial year 2004/05, government consumption expenditure in national accounts terms is forecast to increase modestly, by 1.5% in 2004, after a 1.9% rise in 2003.

Gross domestic fixed capital formation

With the business outlook turning brighter and with corporate profitability improved, investment intentions are likely to be activated more over the course of this year. Expenditure on machinery, equipment and computer software by the private sector should go for a faster increase in 2004, having already resumed growth in 2003. Expenditure on machinery, equipment and computer software by the public sector is however expected to fall further in 2004, largely due to completion of equipment intake for the KCR West Rail last year. Yet given the predominance of the private sector expenditure, total expenditure on machinery, equipment and computer software is still forecast for a distinct further pick-up, to an 11% increase in 2004, after turning up to a 6.1% rise in 2003.

Affected by the earlier setback in the property market, private sector building output was on a distinct down-drift throughout 2003. Nevertheless, there was a distinct rebound in building consents by 23% last year, which reversed the downtrend since late 1999 and was also the first annual double-digit increase since 1996. Major projects by private developers that are due to start or intensify in the current year include Residence Oasis, Yoho Town, The Pacifica, Parc Palais, The Cairnhill, hotel development in Hung Hom, and other residential and commercial developments in West Kowloon, Kennedy Town, Sheung Shui and Sai Kung. Induced by a more active property market, private sector expenditure on building and construction is expected to bottom out and resume growth in 2004.

As to building and construction output in the public sector, the slack is likely to continue in the near term, following the scale-back in public housing erection and with few predominant civil engineering projects under construction, though with still many architectural projects in progress. Output from newly commenced infrastructural projects like the Hong Kong Section of Hong Kong-Shenzhen Western Corridor and the Deep Bay Link could provide only a partial offset. The KCR Sha Tin to Central Link and Kowloon Southern Link are scheduled to commence work in this year, yet the output tends to be small at the early stage of work.

Taking the private and the public sectors together, total expenditure on building and construction is still forecast to turn up to a small increase by 1.5% in 2004, from a 6.9% decline in 2003.

Combining the forecasts for the individual components of investment expenditure, gross domestic fixed capital formation is forecast to pick up distinctly to an increase of 7.1% in 2004, after a marginal decline by 0.1% in 2003.

Change in inventories

Along with the envisaged upturn in the economy, there should be a further build-up in inventories in 2004.

Prices

The Consumer Price Index may still be on a decline in the near term. This is chiefly because the lagged effect from the marked fall-off in private housing rentals earlier on continues to feed through into the housing cost component of the CPI. Yet the decline in housing rentals in the market has by and large been arrested towards the end of last year. Also, the downward pressure on labour wages may recede sooner, as the employment conditions improve further. Amidst strengthening demand, local retailers and service providers are likely to continue to reduce the price discounts and other concessions on their goods and services, and some of them may proceed to make modest upward adjustment to the prices. Moreover, there is going to be greater price pressure from the external front, stemming from the weaker US dollar and firmer world commodity prices, and this is likely to gradually feed through to the local economy in the coming months.

Taking these factors together, the year-on-year rate of decline in the Composite CPI seems likely to taper quite distinctly further over the course of this year. For 2004 as a whole, the Composite CPI is forecast to decline by an average of 1%, much narrowed from the 2.6% fall in 2003.

The movement in the GDP deflator depends on those in the price deflators for the individual GDP components. Domestically, the private consumption expenditure deflator is forecast for a decline of around 1.5% in 2004, lesser than the 3.0% fall in 2003, as is broadly in line with the expected movements in consumer prices. The government consumption expenditure deflator is forecast for a 2.5% decline in 2004, after a 2.8% decrease in 2003, mainly in the light of the Civil Service pay cut implemented since January this year. As to the investment components, the deflator for expenditure on building and construction is forecast to be broadly unchanged in 2004, having fallen by 5.4% in 2003. The deflator for expenditure on machinery, equipment and computer software is also forecast for nil change in 2004, following a 5.9% fall in 2003, as the prices of retained imports of capital goods are expected to pick up amidst the relative strength in the yen and the euro.

Externally, the prices of exports of goods are forecast to decline modestly further by 1.5% in 2004, having narrowed to a 2.0% decrease in 2003. The prices of imports of goods are forecast to bottom out to virtually no change in 2004, after a 0.9% decline in 2003, amidst a weak US dollar and higher world commodity prices. The prices of exports of services are forecast to rise back by 1% in 2004, following three consecutive years of decline and a 1.8% decrease in 2003. The prices of imports of services are forecast to increase further by 3% in 2004, after a 2.4% rise in 2003.

Putting the forecasts for all these price deflators together, the GDP deflator is forecast to decline by 3% in 2004, much lessened from the 5.1% fall in 2003. The domestic demand deflator is forecast for a 1.1% decline in 2004, also distinctly smaller than the 3.8% decrease in 2003.

Gross Domestic Product

GDP at constant prices

Taking all the expenditure components together, the Gross Domestic Product is forecast to ascend to a 6% growth in 2004, from the 3.3% growth in 2003. The prevailing forecasts of Hong Kong's GDP growth for 2004 by the private sector, whilst quite diverse, are commonly upbeat, ranging mostly from 4.5% to 7%, averaging at slightly below 6%.

GDP at current market prices

With the distinctly faster growth expected for real GDP and also with the smaller decline envisaged for the GDP deflator, nominal GDP is forecast to resume growth, at 2.8% in 2004, having been down for three consecutive years and fallen by 2.0% in 2003. Taking into account the projected overall population growth for this year, per capita GDP is forecast to increase by 1.6% in money terms in 2004, after a 2.2% decline in 2003. GDP at current market prices in 2004 is forecast at HK$1,270 billion, and the corresponding per capita GDP at HK$184,500 or US$23,700.

Summary of forecast

Rates of change in the Gross Domestic Product and its expenditure components and in the main price indicators

	Preliminary figures for 2003 (%)	Forecast for 2004 (%)
Rate of change in real terms :		
Private Consumption Expenditure	*	6
Government Consumption Expenditure	1.9	1.5
Gross Domestic Fixed Capital Formation	-0.1	7.1
of which:		
Building and construction	-6.9	1.5
Machinery, equipment and computer software	6.1	11
Total Exports of Goods	14.2	7.7
Imports of Goods	13.1	9.1
Exports of Services	5.5	15
Imports of Services	-4.4	9.5
Gross Domestic Product (GDP)	**3.3**	**6**
Per Capita GDP	3.1	4.7
Rate of change in money terms :		
GDP	-2.0	2.8
Per Capita GDP	-2.2	1.6
Rate of change in :		
GDP Deflator	-5.1	-3
Domestic Demand Deflator	-3.8	-1.1
Composite Consumer Price Index	**-2.6**[a]	**-1**

Notes : (a) Final figure.

(*) Change of less than 0.05%.