Overall situation

The Hong Kong economy underwent a distinct slow-down over the course of 2001, amidst a worsening external environment prompted by the downturn in the US economy, and with the situation aggravated by the tragic event in the United States on 11 September. In the external sector, total exports of goods still maintained some growth in the early part of the year. But as the slump in global demand deepened, exports of goods to all the major markets successively receded. Exports of services fared better in the first half of the year, bolstered by sustained growth in offshore trade and inbound tourism. But with the 911 incident hitting severely the travel industry worldwide and the demand for trade-related and other business services in the region, exports of services likewise moderated towards the year-end. As imports of both goods and services came down in tandem with the setback in exports of goods and services, the combined visible and invisible trade account still yielded a further sizeable surplus for 2001 as a whole.

In the domestic sector, consumer spending grew steadily further in the first half of 2001, upon increased household income on account of the robust economic performance in 2000. Yet the rise in unemployment began to dampen consumer spending in July, and with the shock from the 911 incident, consumer spending moderated distinctly in the third quarter and more so in the fourth quarter. Investment spending slackened off abruptly after the first quarter of 2001, as the dim business outlook deterred machinery and equipment intake, and as building and construction output stayed weak amidst the subdued property market and the large cut-back in public housing production.

Overall, the Gross Domestic Product (GDP) decelerated sharply in growth, from 10.5% in real terms in 2000 to a mere 0.1% in 2001. GDP still registered increases by 2.2% and 0.8% respectively in real terms in the first and second quarters of 2001 over a year earlier, before receding to declines of 0.4% in the third quarter and 1.6% in the fourth quarter. On a seasonally adjusted quarter-to-quarter comparison, GDP was down by 0.5 % and 1.4% respectively in real terms in the first and second quarters of 2001, then rose back by 0.3% in the third quarter, but dropped again by 0.2% in the fourth quarter.

Along with the economic slow-down, labour market conditions slackened considerably over the course of 2001. As employment was unable to match the growth in labour supply amidst more widespread corporate downsizing and lay-offs, the seasonally adjusted unemployment rate surged from 4.5% in both the first and second quarters to 5.3% in the third quarter and 6.1% in the fourth quarter. The underemployment rate likewise rose distinctly, to 3.0% in the fourth quarter.

In the residential property market, sentiment was generally weak during most of 2001. The substantially reduced mortgage rate and considerably improved affordability did not render much stimulus to the market, as potential home buyers were restrained by concern over job security and income instability. The ample supply of new flats in the pipeline also affected buying interest. Then towards the end of the third quarter, sentiment was hit further by the shock from the 911 incident. In a move to boost sales, property developers stepped up their promotion and offered more flexible financing packages together with more attractive purchase terms. Trading in the primary market turned more active towards the year-end, but the secondary market largely remained quiet. Notwithstanding a modest pick-up in trading activity for the year as a whole, flat prices fell distinctly further, on average by 13% during 2001. The rental market likewise came under downward pressure, with rentals falling on average by 7% during 2001.

In the financial market, local interest rates came down markedly during 2001, matching closely the aggressive US interest rate cuts. The Hong Kong dollar held remarkably stable under the linked exchange rate system, despite volatilities in the global financial markets immediately after the 911 incident. With Hong Kong dollar loans reverting to a decline amidst the slow-down in economic activity, but with Hong Kong dollar deposits growing slightly further, the Hong Kong dollar loan-to-deposit ratio fell to a record low at end-2001. Much gyration occurred in the local stock market, along with generally reduced trading volume. The Hang Seng Index plunged to a near three-year low of 8 934 on 21 September, yet rebounded swiftly to above the 10 000 mark by 4 October. The Index closed 2001 at 11 397, 24% below the level at the end of 2000.

On consumer prices, there was a continued fall in the Composite Consumer Price Index, averaging at 1.6% in 2001, although it was somewhat lessened from the 3.8% drop in 2000. Some resurrection of domestic price pressure was apparent in the early part of the year, upon the moderate increase in wages and dissipation of the effect of the earlier rental decreases. But as the local resource balance loosened again amidst the economic slow-down, the price pressure subsided thereafter. External price pressure concurrently eased, with import prices showing an enlarged decline over the course of the year along with the slump in global demand and sustained strength of the US dollar. Together with the relief from the waiver of public housing rentals in December, the year-on-year rate of decline in the Composite CPI, having relatively improved at 2.0%, 1.3% and 1.0% respectively in the first three quarters of 2001, widened again to 2.1% in the fourth quarter.

Statistics on the Gross National Product (GNP) are available up to the third quarter of 2001. Both factor income inflow and outflow declined in the third quarter of 2001 over a year earlier. But with factor income inflow falling to a significantly lesser extent than factor income outflow, there was a distinct rise in net factor income inflow in that quarter. GNP thus went up by 1.9% in real terms in the third quarter of 2001 over a year earlier, as against a 0.4% fall in GDP in the same quarter. Net inflow of both portfolio investment income and other investment income fell in the third quarter of 2001 over a year earlier, amidst setback in the regional and local economies and markedly reduced interest rates. Nevertheless, net outflow of direct investment income was reduced markedly over the same period, with the inflow being bolstered by a surge in direct investment income from the mainland of China (the Mainland). For the first three quarters of 2001 as a whole, GNP recorded a 1.3% growth in real terms over a year earlier, slightly higher than the 0.8% growth in GDP in that period.

The external sector

With a significant worsening in the external economic environment hitting Hong Kong's merchandise exports, total exports of goods (comprising re-exports and domestic exports) fell by 3.0% in real terms in 2001, in contrast to a highly robust growth of 17.1% in 2000. On a year-on-year comparison, total exports of goods, which already slowed to a growth of only 4.2% in real terms in the first quarter of 2001, began to fall by 1.9% in the second quarter. The decline enlarged to 4.0% in the third quarter, and further to 8.8% in the fourth quarter, as the impact of the 911 incident filtered through. On a seasonally adjusted quarter-to-quarter comparison, total exports of goods fell by 2.4% and 2.8% respectively in real terms in the first and second quarters of 2001, yet rose back by 1.5% in the third quarter, before coming down by 6.4% in the fourth quarter.

Within total exports of goods, re-exports fell by 2.0% in real terms in 2001, also markedly down from the 18.5% growth in 2000. Re-exports still had a 6.5% increase in real terms in the first quarter of 2001 over a year earlier, but this was followed by enlarging declines of 1.0%, 3.0% and 8.6% respectively in the ensuing three quarters. On a seasonally adjusted quarter-to-quarter comparison, re-exports fell by 2.4% and 2.9% respectively in real terms in the first and second quarters of 2001, then rebounded to a 2.1% rise in the third quarter, but slackened again to a 6.7% fall in the fourth quarter.

Domestic exports plummeted more sharply, by 11.0% in real terms in 2001, the largest annual decline recorded since the respective statistical series was available from 1962. This contrasted sharply with a 7.5% increase in 2000. Domestic exports registered year-on-year declines throughout the four quarters of 2001, at 12.8%, 8.5%, 12.4% and 10.4% respectively in real terms. Apart from the slump in global demand, the plunge in domestic exports could have also been caused by the continued structural shift towards re-exports trade. The share of domestic exports in the total value of exports of goods shrank further, to 10% in 2001, from 12% in 2000 and 30% a decade ago. On a seasonally adjusted quarter-to-quarter comparison, domestic exports were on a downtrend throughout the four quarters of 2001, with declines of 2.8%, 1.5%, 3.3% and 4.1% respectively in real terms.

Analysed by region, the slackening in merchandise exports in 2001 was most distinct in the US and EU markets, while the East Asian market as a whole held up better. Exports of goods to East Asia as a whole still had a 2% growth in real terms in 2001, though sharply down from the 20% surge in 2000. Performance varied widely amongst the constituent markets, with exports to Japan and the Mainland still having modest increases, but with exports to Singapore, Taiwan and most of the other East Asian economies all falling markedly. Exports of goods to the United States fell by 9% in real terms in 2001, being the first decline since the respective series in real terms was available in 1991, and in stark contrast to the 14% increase in 2000. This largely mirrored the fall-off in US import demand during the year, amidst the significant downturn in the US economy. Exports of goods to the European Union were much dampened by waning import demand in the EU area as well as the weak euro. In 2001, these exports fell by 8% in real terms, reversing sharply the 13% rise in 2000 .

Imports of goods likewise shrank, by 2.3% in real terms in 2001. This was markedly down from the 18.1% growth in 2000. The trend of slackening was evident over the course of the year, with growth already moderated to 5.3% in real terms in the first quarter of 2001 over a year earlier, before going into enlarging declines of 0.7%, 3.4% and 9.1% respectively in the ensuing three quarters. The setback in imports of goods mirrored the downturn in both re-export trade and imports for local use. Specifically, retained imports had a 3.2% decline in real terms in 2001, in stark contrast to the 17.0% rise in 2000. Again reflecting the trend of slackening during the year, retained imports still had a 2.3% increase in real terms in the first quarter of 2001 over a year earlier, before coming down to a 0.1% growth in the second quarter and further to declines of 4.5% and 10.5% respectively in the third and fourth quarters. On a seasonally adjusted quarter-to-quarter comparison, imports of goods fell by 1.2% and 3.7% respectively in real terms in the first and second quarters of 2001, followed by a brief rebound to a 2.5% rise in the third quarter and then a relapse to an 8.0% decline in the fourth quarter. As to retained imports, they rose by 1.9% and 3.6% respectively in real terms in the first and third quarters of 2001, but dropped by 6.0% and 11.7% respectively in the second and fourth quarters.

As the value of total exports of goods fell slightly faster than the value of imports of goods, the visible trade deficit widened somewhat, to $87.2 billion or 5.6% of the value of imports of goods in 2001, from $85.3 billion or 5.1% in 2000.

On invisible trade, exports of services similarly slowed, but still recorded a modest increase of 3.5% in real terms in 2001. While this was also markedly down from the double-digit growth of 14.1% in 2000, exports of services had generally held up better than exports of goods during the year. In particular, exports of services still had a notable growth at 6.3% in real terms in both the first and second quarters of 2001 over a year earlier, though also decelerating distinctly to growth of only 1.6% in the third quarter and 0.5% in the fourth quarter. Amidst the slump in global trade, there was a setback in both regional business demand and exports of transportation services. The fall-off in inbound tourism after the 911 incident worsened the situation. On a seasonally adjusted quarter-to-quarter comparison, exports of services rose by 0.4%, 2.1% and 1.6% respectively in real terms in the first three quarters of 2001, before turning to a 2.0% decline in the fourth quarter.

Imports of services recorded a marginal growth of 0.1% in real terms in 2001, as against a 2.1% rise in 2000. Following increases of 3.9% and 1.0% respectively in real terms in the first and second quarters of 2001 over a year earlier, imports of services receded to declines of 2.0% and 2.3% respectively in the third and fourth quarters. In tandem with the fall-off in merchandise trade, imports of trade-related services came down visibly. Imports of travel services showed a distinctly weaker performance in the latter part of the year, upon the impact of the 911 incident. On a seasonally adjusted quarter-to-quarter comparison, imports of services rose by 0.4% in real terms in the first quarter of 2001, stayed flat in the second quarter, and then fell by 2.4% and 0.6% respectively in the third and fourth quarters.

As exports of services rose slightly while imports of services were virtually flat in value, the invisible trade surplus increased further, to $156.8 billion or 87.6% of the value of imports of services in 2001, from $149.3 billion or 83.2% in 2000. This more than offset the widened visible trade deficit, thus giving a combined surplus (including an estimate of imports of gold for industrial use) of $67.1 billion, equivalent to 3.8% of the total value of imports of goods and services, in 2001, up from $60.6 billion or 3.3% in 2000.

Domestic demand

Retail business still held up quite well in the first half of 2001, supported by higher household income in the local economy as well as sustained robust growth in inbound tourism. But faced with a worsening global economic downturn, local consumer spending eased off thereafter. Then upon the impact of the 911 incident, local consumer spending moderated even more, while inbound tourism was severely hit. Reflecting these adversities, the volume of retail sales, which still rose appreciably by 2.5% and 4.8% in the first and second quarters of 2001 over a year earlier, slowed markedly to only a 0.5% increase in the third quarter and further to a 2.9% decline in the fourth quarter. For 2001 as a whole, the volume of retail sales was up by 1.2%, much more modest than the 8.3% rise in 2000. On a seasonally adjusted quarter-to-quarter comparison, the volume of retail sales went up by 4.1% and 2.3% respectively in the first and second quarters of 2001, but came down visibly by 5.9% in the third quarter and further by 2.8% in the fourth quarter.

Mirroring closely the quarterly profile of retail sales, private consumption expenditure (PCE) still registered appreciable growth at 3.0% and 3.5% respectively in real terms in the first and second quarters of 2001 over a year earlier. The growth then slowed distinctly to 1.2% in the third quarter, and further to 0.3% in the fourth quarter. For 2001 as a whole, PCE with a 2.0% rise in real terms was much moderated from the 5.4% increase in 2000. On a seasonally adjusted quarter-to-quarter comparison, PCE went up by 2.3% in real terms in the first quarter of 2001 and further by 0.5% in the second quarter, before falling by 1.0% and 0.8% respectively in the third and fourth quarters.

Analysed by broad category of consumer spending, expenditure on durable goods posted the fastest increase in 2001, on the back of the large purchases of motor vehicles and electrical appliances in the early part of the year. Spending on both foodstuffs and services also rose further. Yet spending on non-durable goods had a modest decline. Spending by Hong Kong residents abroad picked up to a small growth.

Government consumption expenditure (GCE) reckoned on a national accounts basis showed faster growth at 6.2% and 6.1% respectively in real terms in the third and fourth quarters of 2001 over a year earlier, as compared to the growth of 3.9% and 4.1% in the first and second quarters. For 2001 as a whole, the growth at 5.1% in real terms was up from that of 2.1% in 2000. This pick-up was partly associated with the payments made for voluntary retirement of civil servants. On a seasonally adjusted quarter-to-quarter comparison, GCE, after surging by 5.4% in real terms in the first quarter of 2001, fell back by 1.7% in the second quarter, and then resumed growth at 2.0% and 0.4% respectively in the third and fourth quarters.

Overall investment spending, as represented by gross domestic fixed capital formation (GDFCF), had a mere 2.1% growth in real terms in 2001, after a 9.8% leap in 2000. Continuing the upsurge in 2000, GDFCF sustained double-digit growth at 11.5% in real terms in the first quarter of 2001 over a year earlier. But it eased sharply to increases of 1.2% and 3.2% respectively in the second and third quarters. It then weakened further to a decline of 6.4% in the fourth quarter.

The distinct weakening in overall investment spending during 2001 was largely driven by the fall-off in expenditure on machinery and equipment. It posted a further robust growth in the first quarter, upon the delivery of capital goods ordered earlier. It then slackened markedly thereafter, as the business outlook worsened along with the global economic downturn. The intake of aircraft rendered only a temporary lift in the third quarter. For 2001 as a whole, expenditure on machinery and equipment, whilst still up by 5.2% in real terms, fared distinctly less well than the 25.8% surge in 2000.

As to expenditure on building and construction, it continued to shrink in 2001, signifying the fourth consecutive year of decline. The slump was much related to the protracted downturn in the residential property market, causing a dearth of new projects in the private sector. In addition, there was a heavy scale-back in the Public Housing Programme. These more than offset the sustained strong increase in output from the Priority Railway Projects and also the pick-up in output from other Government projects. With activity in both the public and the private sector contracting further, expenditure on building and construction fell further by 2.5% for 2001 as a whole, following a 7.7% fall in 2000.

Along with the sluggish private sector building activity, real estate developers' margin likewise came down further, by 1.9% in real terms in 2001, though much less than the 9.4% decline in 2000.

Following the substantial build-up in 2000, there was a further accumulation of inventories in the first half of 2001. Yet the run-down in inventories in the second half of the year resulted in a reduction for 2001 as a whole, reflecting the slackening overall demand in the economy.

Implications of the preliminary GDP figure for the economy

Along with the marked deceleration in economic growth, per capita GDP declined by 1.2% in money terms to $187,748 in 2001. Yet taking into account the higher real purchasing power rendered by a lower price level, per capita GDP fell slightly less, by 0.7% in real terms in 2001.

Total final demand, excluding re-exports but with the re-export margin retained, fell back by 0.9% in real terms in 2001. Against a 0.1% growth in real terms in GDP, this suggested that the impact of the economic downturn was partly absorbed by downward adjustment on the import front.

Moreover, it could be seen that the setback in total final demand occurred largely in external demand. After a 16.7% surge in real terms in 2000, external demand fell by 2.1% in 2001, with exports of goods and services both slackening. Yet domestic demand, at only a marginal growth of 0.2% in real terms in 2001, also moderated distinctly from the 10.0% rise in 2000. Within domestic demand, private sector demand was down by 0.1% in real terms in 2001, taking into account the run-down in inventories during the year, while public sector demand rose moderately by 2.8% in real terms, supported by the solid growth in government consumption expenditure. Having regard also to differential price movements, the share of the public sector in GDP, reckoned on a national accounts basis and expressed in nominal terms, thus edged up to 14.8% in 2001, from 14.2% in 2000.

The property market

During 2001, the sales market for residential property was characterised by a sustained decline in flat prices, but a pick-up in transaction volume towards the year-end. In the first four months of the year, market sentiment was affected by a host of negative factors, including in particular the slow-down in economic activity, sharp correction in share prices, and abundant supply of new flats coming on stream. Trading was subdued, as potential home buyers mostly stayed on the sideline. In May and June, some renewed acquisition interest emerged, upon the successive and sizeable cuts in local interest rates (by a total of 2.5 percentage points in the first half of the year), as well as the more intense sales promotion pursued by property developers. Trading activity however tapered again in the ensuing few months, amidst greater worries about the worsening economic situation and larger increase in unemployment. The 911 incident dampened buyer confidence even further, bringing the sales market nearly to a standstill in late September and early October. This far outweighed the effects of an announcement in early September for suspension of flat sales under the Home Ownership Scheme/Private Sector Participation Scheme up to mid-2002, and of further cuts in local interest rates (by another 1.5 percentage points up to end-October). In response, property developers stepped up their sales promotion further, by offering heavier discounts on flat prices and more attractive financing arrangements to buyers. This helped stimulate a distinct rebound in sales in the primary market towards the year-end. Yet activity in the secondary market remained subdued.

On a quarter-to-quarter comparison, flat prices largely followed a downtrend in 2001. Apart from nil change in the second quarter, flat prices went lower in the first, third and fourth quarters, on average by 4%, 3% and 7% respectively. For 2001 as a whole, flat prices on average fell by 13%.

The rental market for private residential flats, having held broadly stable in the first three quarters of 2001, weakened noticeably in the fourth quarter upon a fall-off in lease demand amidst the economic downturn, concurrent with an increased supply of flats for lease from those hitherto for sale. On a quarter-to-quarter comparison, flat rentals on average fell by 1% each in the first three quarters of 2001, and then by 4% in the fourth quarter, giving a cumulative decline of 7% for the whole year.

On commercial property, the rental market for office space slackened visibly in 2001, amidst more extensive corporate downsizing and restructuring upon the impact of the economic downturn. Further dampening demand was continued consolidation of the information technology sector. Trading activity quietened particularly after the 911 incident. This had prompted many landlords to lower rent and extend the rent-free period in a move to improve occupancy. The sales market for office space was weak for most of the year, as acquisition interest waned amidst the economic downturn and an uncertain business outlook. The rental market for shopping space was subdued throughout 2001, amidst the moderation in retail business especially in the wake of the 911 incident. In order to boost occupancy, landlords were generally inclined to grant greater rental concessions and more flexible lease terms. On the sales market for shopping space, activity remained rather limited during the year, with acquisition interest concentrated in well-managed shopping arcades in more popular locations. On industrial property, the rental market stayed in the doldrums for most of 2001, amidst the weak performance of external trade and continued relocation of manufacturing processes outside the territory. Also relevant was the dissipated demand for modern industrial premises to be used as data centres and back-up service centres, upon further consolidation of the information technology sector. The sales market for industrial property was likewise quiet.

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, fell substantially further by 25% in 2001, after a 16% drop in 2000. Decreases of varying magnitudes were observed in all types of property. Specifically, planned developments of residential property dipped by 12% both in terms of units and in terms of total usable floor area in 2001, after decreases of 30% and 32% respectively in 2000. Planned developments of commercial property, industrial property, and property in the "others" category also plummeted, by 21%, 65% and 69% respectively in terms of total usable floor area in 2001. Yet this was partly due to a higher base of comparison in 2000, when planned developments of these three types of property surged by 17%, 52% and 91%.

The labour market

After a year of relative tightening in 2000, the local labour market slackened distinctly in 2001. Consequential to the economic setback and increased corporate downsizing, labour demand moderated markedly over the course of the year, especially in the wake of the 911 incident. Yet labour supply continued to rise. The seasonally adjusted unemployment rate, having edged higher from 4.4% in the fourth quarter of 2000 to 4.5% in both the first and second quarters of 2001, surged to 5.3% in the third quarter and further to 6.1% in the fourth quarter. Furthermore, the median duration of unemployment lengthened from 78 days to 82 days, while the proportion of persons unemployed for three months or more went up from 42% to 45%. The underemployment rate also rose appreciably, from 2.6% in the fourth quarter of 2000 to 3.0% in the fourth quarter of 2001. The increase again occurred predominantly in the latter part of the year, upon the impact of the 911 incident. For persons still in employment, work effort generally accentuated. The proportion of employed persons working for 50 hours or more per week went up further, from 34% in the fourth quarter of 2000 to 35% in the fourth quarter of 2001. For those working for 60 hours or more per week, the proportion showed a slightly larger rise, from 19% to 21%. The median hours of work stayed high during the year, mostly at 48 hours per week.

On the overall manpower resource balance, total employment as enumerated from households had a marked slow-down, with the year-on-year growth rate moderating from 3.2% in the first quarter of 2001 to -0.7% in the fourth quarter. Meanwhile, a moderation yet to a lesser extent was observed in the year-on-year growth rate of total labour force, from 2.0% to 1.1%. These differential growth rates likewise reflected a clear slackening in the labour market.

Labour income was slightly higher in the first three quarters of 2001 than a year earlier. Yet this was attributable to the pay increase effected in the early part of 2001, on the basis of improved business conditions in 2000. On a year-on-year comparison, overall earnings rose by 2% in money terms in the third quarter of 2001, and overall wages slightly less, by 1% in money terms in September 2001. Netting out the decline in consumer prices, earnings and wages gained by 3% and 2% respectively in real terms. These more recent increases were smaller than those seen at the beginning of the year.

Prices

Overall consumer prices fell for the third consecutive year in 2001, though to a distinctly smaller degree than in the preceding two years. A narrowing rate of decline was observed in the first seven months of 2001, when there was some resurrection in domestically generated price pressure along with a modest increase in labour wages and earnings as well as upward adjustments in certain Government fees and public utility charges, partly offsetting the effect of lower import prices. But the rate of decline widened again in the rest of the year, as local price pressure subsided amidst more instances of pay freeze or pay cuts as well as further easing in property rentals. Concurrently, import prices went even lower, due to the US dollar strengthening against the currencies of most of the major supplier economies and world commodity prices plummeting after the 911 incident. Furthermore, in face of moderated consumer spending, local retailers generally offered greater price discounts in order to promote sales. Certain public transport operators also began to grant concessions on their fares. Thus the negative inflation persisted.

For 2001 as a whole, the Composite Consumer Price Index was lower by 1.6%, considerably reduced from the 3.8% fall in 2000. The year-on-year decrease narrowed progressively, from 2.0% in the first quarter of 2001 to 1.3% in the second quarter and further to 1.0% in the third quarter, along with lesser declines in food prices and housing cost. Yet the year-on-year decrease widened again, to 2.1% in the fourth quarter. On a seasonally adjusted quarter-to-quarter comparison, the Composite CPI fell by 0.6% in the first quarter of 2001, held steady in the second quarter, but went down again in the third and fourth quarters, by 0.4% and 1.1% respectively. The distinctly larger decline in the fourth quarter on both comparisons was primarily due to the waiver of public housing rentals in December.

The GDP deflator, as a broad measure of overall price change in the economy, rebounded to a 0.5% rise in the fourth quarter of 2001 over a year earlier, after declining at a narrowing rate by 1.7%, 0.6% and 0.2% respectively in the first three quarters. This small rebound was almost entirely due to an improvement in the terms of trade. For 2001 as a whole, the GDP deflator fell by 0.5%, much reduced from the 6.5% decrease in 2000. This was mainly attributable to moderated decline in the price deflator for private consumption expenditure and rebound in the price deflator for government consumption expenditure. While the price deflator for exports of goods and services registered a widening decline over the course of the year, this was more than offset by an even larger decline in the price deflator for imports of goods and services. Within the GDP deflator, the total final demand deflator and the domestic demand deflator fell by 1.7% and 1.1% respectively in 2001, also reduced from the decreases of 3.1% and 5.6% in 2000. On a seasonally adjusted quarter-to-quarter comparison, the GDP deflator bounced back with a 2.9% rise in the first quarter of 2001, yet resumed decline in the ensuing three quarters, at 2.1%, 0.1% and 0.1% respectively.

The financial sector

In 2001, the Hong Kong dollar exchange and money markets held broadly stable, notwithstanding the marked deterioration in the global and regional economic environment during the year. The spot exchange rate of the Hong Kong dollar against the US dollar remained close to the linked rate throughout 2001, moving within a narrow range of 7.796 to 7.800 during the year. However, the spread between the twelve-month Hong Kong dollar forward rate and the spot rate against the US dollar reversed from a discount of 167 pips (each pip equivalent to HK$0.0001) at end-2000 to a premium of 235 pips at end-2001, amidst deepening financial crisis in Argentina and a significant depreciation of the Japanese yen towards the year-end.

Tracking closely the movements in the US dollar under the linked exchange rate system, the Hong Kong dollar appreciated against almost all the major currencies during 2001. The US dollar was still taken as a favoured currency amidst the synchronised global economic downturn. Specifically, the Hong Kong dollar rose by 2.9% against the pound sterling, 6.2% against the euro, and more significantly by 14.8% against the Japanese yen during 2001. Overall, the trade-weighted Nominal Effective Exchange Rate Index of the Hong Kong dollar rose from 102.9 at end-2000 to 105.9 at end-2001.

In the money market, local interest rates eased markedly along with the successive cuts in US interest rates, with the three-month HIBOR falling from 5.8% at end-2000 to 1.9% at end-2001. Upon the full interest rate deregulation on 3 July 2001, individual banks are free to set the savings deposit rate and indeed all the deposit interest rates. Nevertheless, interest rates in the local banking sector still followed the US interest rate cuts rather closely. The average savings deposit rate was reduced from 4.75% at end-2000 to 0.15% at end-2001, while the best lending rate offered by the major banks came down from 9.50% to 5.13%. The relatively larger decline in the savings deposit rate than in the best lending rate reflected ample liquidity in the local banking sector.

Hong Kong dollar deposits rose marginally by 0.2% during 2001, with time deposits falling throughout the four quarters whilst savings and demand deposits generally rising. On the other hand, Hong Kong dollar loans reverted to a slight decline of 0.3% during 2001, amidst the setback in business. Thus the Hong Kong dollar loan-to-deposit ratio fell to a record low of 89.0% at end-2001, from 89.4% at end-2000.

The local stock market underwent wide fluctuations during 2001, being affected much by the movements in the US stock market. The local stock market rallied at the beginning of the year, upon an unexpected cut in US interest rates on 3 January. Expectations for further interest rate cuts then pushed the Hang Seng Index to a high of 16 164 on 1 February. But as prices of telecom and technology shares worldwide plunged in March, share prices in the local stock market also tumbled. Sentiment in the local stock market improved during April and May, with inflow of funds pushing up the prices of Mainland-related shares. Then, with the deeper-than-expected US economic downturn increasingly overshadowing the global economic outlook, share prices in all the major stock markets resumed a downtrend in the summer months. The local stock market was likewise hit. Widespread anxieties in the global financial markets immediately after the 911 incident pushed down the Hang Seng Index further, to a near three-year low of 8 934 on 21 September, 14% lower than the pre-911 closing. It then swiftly recovered to above the 10 000 mark in early October and rose further towards the year-end, as the gyrations overseas gradually settled and as the US stock market regained some strength. Resurrection of some buying interest in the local residential property market also rendered support to the prices of property-related shares in the local stock market. The Hang Seng Index closed 2001 at 11 397, still 24% below the level of 15 096 at end-2000. Average daily turnover in the local stock market, at $8.2 billion in 2001, was distinctly below that of $12.7 billion in 2000.

Overview

The outlook for the Hong Kong economy in 2002 hinges crucially on the timing and pace of revival in the industrialised economies, the United States in particular. Lately, there are signs that the US economy is about to bottom out. If so, this should also help improve the economic situation in Europe and East Asia generally. The Japanese economy could still be in recession this year. The economy of the mainland of China (the Mainland) nevertheless should continue to grow robustly. It is generally believed that the austere external environment carried over from last year may gradually turn better over the course of this year. Henceforth, the Hong Kong economy may have better hope for a rebound within this year.

Hong Kong's exports of goods may still undergo a decline in the early part of 2002. But with the envisaged improvement in global demand, they may pick up progressively in the latter part of the year. Hong Kong's exports of services have been faring better than exports of goods in 2001, and should continue to be so in 2002, given the on-going structural shift from re-exports towards offshore trade, as well as the boost to inbound tourism brought about by removal of the quota on Mainland visitors as from 1 January 2002.

Locally, consumer demand will continue to come under the restraint of reduced pay and higher unemployment, while the marked decline in asset values during the course of last year has carried forth a noticeable negative wealth effect. Having regard to the trend and pattern of performance of retail sales in recent months, consumer spending seems likely to be subdued in 2002. Yet government consumption expenditure should have a fairly steady growth in 2002, in line with community needs. Investment spending would remain slack in 2002. Machinery and equipment acquisition may continue to be held back by the tardy business outlook, the surplus operating capacity, and the worsened corporate profits position consequential to the economic downturn. Building and construction activity may stay low, as the residential property market is still adjusting to the large overhang of supply, as public housing production continues to come down, and as the Priority Railway Projects have already passed their construction peaks.

Overall, Hong Kong's GDP is likely to stay on a decline in the early part of 2002, yet with a visible pick-up in the latter part of the year. For 2002 as a whole, GDP is forecast at a small growth of 1%, after a marginal increase of 0.1% in 2001.

Much of the downside risks in the forecast are from the external front, including a possible relapse in the US economy and hence in the global economy, and a further distinct strengthening in the US dollar impinging on Hong Kong's external competitiveness. On the domestic front, continually depressed demand and sentiment amongst consumers and businesses will tend to undermine the recovery process. Nevertheless, there may be upside potential from a sooner recovery in the US economy and from a stronger surge in Mainland visitors to Hong Kong.

The outlook for consumer prices in 2002 is for a further down-drift, being part and parcel of the adjustment process in the economy to weather the current setback. In the domestic sector, downward pressure on costs has accentuated again, with office rentals down by 7% and shop rentals down by 4% during last year, and also with wages softening in recent months. This is expected to filter through to dampen local retail prices. Moreover, competition through price cuts and other means in the local retail market is keen. Meanwhile, the rates concession from the 2001 Policy Address and other known developments will bring down the CPI more. On the external front, the decline in import prices has also been enlarging in the recent period, amidst the relative strength of the US dollar as well as deflation in Japan and the Mainland, the two leading suppliers of Hong Kong's imports. Moreover, the prices of imported foodstuffs from the Mainland on average can be expected to come down during the year, upon removal of the quota on export of chilled meat and chicken from the Mainland. The Composite CPI is thus forecast for a larger decline of 2.8% in 2002, following a 1.6% decrease in 2001.

External sector

Exports of goods and services

In view of the weak state of the world economy at present, Hong Kong's exports may still face a decline in the early part of 2002. But with the envisaged improvement in global demand, a progressive pick-up may come about in the latter part of the year. The relative strength of the US dollar may however restrain the export performance. For 2002 as a whole, Hong Kong's total exports of goods are forecast at zero growth, yet this would already represent a relative improvement from the 3.0% fall in 2001. Within this total, the trends of re-exports and domestic exports are influenced respectively by the further structural shift towards offshore trade, and by the further relocation of production processes outside the territory. Re-exports are expected to have a small growth of 0.5% in 2002, up from a 2.0% decline in 2001. Domestic exports are expected to show a further decline of 4% in 2002, albeit considerably smaller than the 11.0% plunge in 2001.

Analysed by major region, exports of goods to the United States are likely to remain on a distinct decline in the early part of 2002, as US imports continued to contract through the process of inventory adjustment. Exports to this market may also be undercut by the weakness in the Japanese yen and in many of the other East Asian currencies. Nevertheless, along with the envisaged revival in the US economy, exports to this market should progressively pick up in the latter part of the year. The outlook for exports of goods to the European Union is still rather dim in the early part of 2002, in face of the current slack in the EU economy. Yet these exports are also expected to fare better in the latter part of the year, as demand in the euro area gradually recovers.

In East Asia, the Mainland should continue to underpin Hong Kong's exports of goods in 2002. Exports to the Mainland for outward processing, whilst still slack in the near term, look set to improve once the global economic environment turns for the better. Exports to the Mainland for meeting its own demand are expected to be buoyed by the sustained domestic demand there, with added boost from further opening up of the Mainland market and lower import tariff upon China's accession to WTO. The major firms and organisations engaged in China trade are of the view that on the whole, Hong Kong's exports of goods to the Mainland should yield a further modest growth in 2002.

On the other hand, exports of goods to Japan are perceived to slacken further in 2002, continuing the downtrend in the latter part of 2001. The bleak outlook for exports to this market goes along with a further fall-off in Japan's import demand, given the recession now in the economy and the weakening of the Japanese yen. As to Hong Kong's exports of goods to the other East Asian economies, these exports are generally expected to pick up somewhat in due course, after a weak start in the early part of 2002.

Exports of services have persistently held up better than exports of goods in 2001, and should continue to be so in 2002, given the on-going structural shift from re-exports towards offshore trade, as well as the boost to inbound tourism brought about by the removal of quota on Mainland visitors as from 1 January 2002. With Mainland visitors now accounting for around one-third of Hong Kong's total visitor arrivals, and with their per capita visitor spending being higher than average, a freer entry of Mainland visitors will render a significant boost to tourist receipts. Also, visitors from other sources may gradually return to aid tourist receipts, as the impact of the 911 incident continues to diminish. On exports of trade-related services and transportation services, performance will hinge on improvement in global and regional demand. As to exports of financial, professional and other business services, support should come from advances in service demand in the Mainland and elsewhere in the region. Overall, exports of services are forecast to grow by 4.5% in 2002, following a 3.5% increase in 2001.

Imports of goods and services

Retained imports are forecast to decrease further, by around 4% in 2002, after a 3.4% decline in 2001. This mainly reflects the adjustment going on in the economy to restore external balance upon the recent downturn, and is also consistent with the continuing weakness envisaged in domestic demand. Analysed by end-use category, intake of material inputs will continue to be held back by the shrinkage in domestic exports. Intake of consumer goods seems likely to be curbed for some time, on account of falling retail sales and also after the substantial import last year. Intake of capital goods may ease more, amidst a dim business outlook in the near term. Together with the forecast for re-exports, total imports of goods are expected to fall by 0.7% in 2002, having dropped by 2.4% in 2001.

Imports of services are likewise perceived to remain modest in 2002, in line with the weak domestic demand. Expenditure of Hong Kong residents travelling abroad may come down further in the near term, as consumer spending slackens further along with the worsening employment situation. Imports of trade-related services and transportation services will continue to be curtailed by the weakness in merchandise trade, though with some possible improvement in the later months. Overall, imports of services are forecast to increase only slightly, by 0.5% for 2002, having recorded a 0.1% growth in 2001.

Domestic sector

Private consumption expenditure

The near-term outlook for local consumer spending will continue to depend on interplay of the employment, income and consumer confidence factors. The surge in unemployment as from the latter part of last year, marked by more frequent lay-offs and retrenchment, is already acting to restrain consumer spending in recent months. For many of those still in employment, their willingness to spend is likely to be curbed by wage cut, anticipated if not already realised, and by concern over job security. The distinct decline in asset value, with both local share prices and flat prices now more than 10% down from a year earlier, carries forth a noticeable negative wealth effect depressing consumer demand further. Amidst a downbeat sentiment, the earlier interest rate cuts may leave only a rather limited stimulus. Private consumption expenditure is thus forecast to decline marginally, by 0.5% in 2002, representing a further slow-down from the already modest growth of 2.0% in 2001.

Government consumption expenditure

On the basis of information contained in the Government's revised estimates of expenditure for financial year 2001-02 and the draft estimates of expenditure for financial year 2002-03, government consumption expenditure in national accounts terms is forecast at a 4% growth in 2002, following a 5.1% increase in 2001.

Gross domestic fixed capital formation

Expenditure on machinery and equipment by the private sector is expected to slacken further in 2002, given the tardy business outlook, the surplus operating capacity, and the worsened corporate profits position consequential to the economic downturn. Expenditure on machinery and equipment by the public sector will nevertheless render a further mild growth this year, mainly due to larger spending on computerisation and other equipment from the Government. Yet given the predominance of the private sector expenditure, total expenditure on machinery and equipment is still forecast to decline, by 6.4% in 2002, after a 5.2% rise in 2001.

The sluggishness in private sector building activity in 2001 is likely to protract into 2002. Amidst a large overhang of supply in the property market, building consents have been on a decline since the latter part of 2000. Judging from the dearth of new building projects over the past few quarters, building activity is expected to come down further in the near term. In addition, there is a scale-back in building activity under the Home Ownership Scheme, which is classified as private sector building output in the GDP estimates on the basis of ownership. On the other hand, intensification of work on the Container Terminal No. 9 and the Cyberport will render some offset. Taken together, private sector construction output seems likely to continue to fall in 2002.

As to the public sector, there will be an on-going downdrag from the sharp scale-back in the Public Housing Programme. Work on the MTR Tseung Kwan O Extension and the KCR West Rail, whilst still heavy in the coming months, have already passed their peak. Thus even with the intensification of work on the East Rail Extension in the period ahead, public sector construction output taken together is expected to shrink further in 2002.

With subdued activity in both the private and the public sector, overall expenditure on building and construction is forecast to fall by 3.2% in 2002, having declined by 2.5% in 2001.

Consistent with the dwindling private sector building output, services rendered by developers, as represented by real estate developers' margin, are forecast at a 4% decline in 2002, following a 1.9% fall in 2001.

Combining the forecasts for the individual components of investment expenditure, gross domestic fixed capital formation is forecast to contract by 5.1% in 2002, further down from the already modest growth of 2.1% in 2001.

Change in inventories

Inventories are expected to undergo a further depletion in 2002, along with the envisaged further slow-down in domestic demand. There should nevertheless be a modest replenishment towards the year-end, upon the envisaged improvement in external trade.

Gross Domestic Product

GDP at constant prices

Taking all the expenditure components together, GDP is forecast at a 1% growth in 2002, following a 0.1% increase in 2001. Local analysts in the private sector generally also expect the economy to return to positive growth during the year, with their forecasts of GDP growth mostly ranging from 1% to 2%, averaging at around 1.4%.

This improvement is conditioned upon an upturn in the external economic environment in the coming months. The key downside risks include a relapse in the US economy and hence in the global economy, a further distinct strengthening in the US dollar, and continually depressed demand and sentiment amongst consumers and businesses. Nevertheless, there may be upside potential from a sooner recovery in the US economy and from a stronger surge in Mainland visitors to Hong Kong.

GDP at current market prices

Putting the forecasts for real GDP and the GDP deflator together, nominal GDP is forecast to decline by 0.5% in 2002, having fallen slightly by 0.3% in 2001. Taking into account the projected overall population growth, per capita GDP is forecast to fall by around 2% in money terms in 2002, after a 1.2% decline in 2001. GDP at current market prices in 2002 is forecast at $1,256 billion, and the corresponding per capita GDP at $184,800 or US$23,700.

Prices

The pace of decline in consumer prices has enlarged somewhat in the latter part of 2001, and the outlook for 2002 is for a further down-drift in prices, being part and parcel of the adjustment process in the economy to weather the current setback. In the domestic sector, downward pressure on costs has accentuated again, with office rentals down by 7% and shop rentals down by 4% during last year, and also with wages softening in recent months. This is expected to filter through to dampen local retail prices. Moreover, competition through price cuts and other means in the local retail market is keen. Meanwhile, the rates concession from the 2001 Policy Address and other known developments will bring down the CPI more.

On the external front, the decline in import prices has also been enlarging in the recent period, amidst the relative strength of the US dollar as well as deflation in Japan and the Mainland, the two leading suppliers of Hong Kong's imports. Moreover, the prices of imported foodstuffs from the Mainland on average can be expected to come down during the year, upon removal of the quota on export of chilled meat and chicken from the Mainland. With both the domestic and the external factors pointing to lower prices, the Composite Consumer Price Index is forecast for a larger decline of 2.8% in 2002, following a 1.6% fall in 2001.

The movement in the GDP deflator depends on those in the price deflators for the individual GDP components. Domestically, in tandem with the envisaged downtrend in consumer prices, the private consumption expenditure deflator is forecast at a decline of 2.5% in 2002, further down from a 1.4% decrease in 2001. The government consumption expenditure deflator is forecast at a 0.5% decline in 2002, down from a 2.1% increase in 2001. As to the investment expenditure components, given the continued fall in tender prices in the past two years or so, the deflator for expenditure on building and construction is forecast to fall by 1.5% in 2002, having gone down by 2.5% in 2001. In the light of the recent weakening in the Japanese yen and in many of the other East Asian currencies, the deflator for expenditure on machinery and equipment is forecast to be 2% lower in 2002, similar to the 2.2% decrease in 2001.

Externally, in order to uphold competitiveness in the world market, the prices of exports of goods are expected to come down further, by around 2% in 2002, after a 2.9% fall in 2001. The prices of exports of services are also expected to ease further, by 1.5% in 2002, broadly similar to the 1.3% fall in 2001. Concurrently, the prices of imports of goods are envisaged to recede by around 3% in 2002, almost the same as the 3.2% decrease in 2001. The larger decline continuing for this year is mainly on account of the soft world commodity prices and the prevailing strength of the US dollar. The prices of imports of services are also envisaged to drift lower, by 1.0% in 2002, following a 0.3% decrease in 2001.

Taking the forecasts for these price deflators together, the GDP deflator is forecast for a somewhat larger decline of 1.5% in 2002, after a 0.5% fall in 2001. The domestic demand deflator is likewise expected to ease further, by around 2% in 2002, after a 1.1% fall in 2001.

Summary of forecast

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

	Preliminary figures for 2001 (%)	Forecast for 2002 (%)
Rate of change in real terms :		
Private Consumption Expenditure	2.0	-0.5
Government Consumption Expenditure	5.1	4
Gross Domestic Fixed Capital Formation	2.1	-5.1
of which:		
Building and construction	-2.5	-3.2
Real estate developers' margin	-1.9	-4
Machinery and equipment	5.2	-6.4
Total Exports of Goods	-3.0	0.0
Domestic exports	-11.0	-4
Re-exports	-2.0	0.5
Imports of Goods	-2.4	-0.7
Exports of Services	3.5	4.5
Imports of Services	0.1	0.5
Gross Domestic Product (GDP)	**0.1**	**1**
Per Capita GDP	-0.7	-0.1
Rate of change in money terms :		
GDP	-0.3	-0.5
Per Capita GDP	-1.2	-1.6
Rate of change in :		
GDP Deflator	-0.5	-1.5
Domestic Demand Deflator	-1.1	-1.9
Composite Consumer Price Index	**-1.6**[a]	**-2.8**

Note : (a) Final figure.