

Press Release

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Economic Situation in the First Quarter of 2003 and Updated GDP and Price Forecasts for 2003

The Government released today (Friday) the First Quarter Economic Report 2003, together with the preliminary figure on Gross Domestic Product for the first quarter of 2003.

The Government Economist, Mr K Y Tang, described the economic situation in the first quarter of 2003 and provided updated GDP and price forecasts for the year, taking into account the adverse impact on the economy brought about by the spread of Severe Acute Respiratory Syndrome (SARS) since mid-March.

MAIN POINTS

- * The Hong Kong economy continued to display strong growth momentum at the beginning of 2003, after the distinct pick-up in the latter part of 2002. While the external sector remained the key driver of growth, the domestic sector also showed signs of improvement in the first two months of this year. However, the economic situation worsened abruptly since mid-March upon the spread of SARS, with inbound tourism and local consumer spending being particularly hard hit.
- * For the first quarter of 2003 as a whole, GDP still attained solid growth at 4.5% in real terms over a year earlier, albeit somewhat slower than the 5.1% growth in the fourth quarter of 2002 (latter figure revised slightly up from the 5.0% growth put out earlier). On a seasonally adjusted quarter-to-quarter comparison, GDP declined by 0.3% in real terms in the first quarter of 2003, after a 1.7% increase in the fourth quarter of 2002 (latter figure unchanged from the estimate put out earlier).
- * On the external front, East Asia as a whole had continued to provide the key impetus to growth in Hong Kong's merchandise exports. Total exports of goods surged by 19.1% in real terms in the first quarter of 2003 over a year earlier. Exports of services likewise attained further double-digit growth, at 12.2% in real terms in the first quarter of 2003 over a year earlier, as exports of transportation services and offshore trade were both strong, and as inbound tourism stayed robust in most of the quarter.
- * On the domestic front, consumer spending had tended to improve at the beginning of the year, but receded abruptly since mid-March upon the spread of SARS, giving a 2.1% decline in real terms for the first quarter of 2003 as a whole over a year earlier. Yet investment spending rose modestly, by 3.9% in real terms in the first quarter of 2003 over a year earlier, underpinned by a marked rebound in intake of machinery and equipment, which more than offset the further decline in building and construction output. Inventories went up further in the first quarter of 2003.

- * The labour market slackened again in the first quarter of 2003, mainly due to worsening employment situation in the construction sector. 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 further to 7.8% in the three months ending April 2003, upon the impact from the spread of SARS). The underemployment rate fell from 3.1% to 2.9% between these two quarters (but went up to 3.2% in the three months ending April 2003, likewise under the SARS impact).
- * Total exports of goods still held up quite well in April, rising by around 10% in real terms over a year earlier. Yet the growth pace was lesser than that in the first quarter. Looking to the months ahead, in face of a generally dimmer regional economic outlook and reduced business travel for participating in trade fairs and placing orders consequential to the spread of SARS, exports of goods in the latter part of the year are likely to feel the pinch.
- * As to exports of services, the number of incoming visitors, having already relapsed to a 10% decline in the second half of March over a year earlier upon the spread of SARS in the territory, plunged even more sharply by 65% in April. The hotel room occupancy rate, which is normally over 80%, has recently been running at around 20%. The imminent outlook for inbound tourism remains unclear, even though the World Health Organisation (WHO) has lately lifted its travel advisory against non-essential travel to Hong Kong. One important factor is when the inflow of Mainland visitors, particularly those on group tours, is going to revive. Nevertheless, the continued expansion in offshore trade and in exports of other business services should provide much offset. Taken together, exports of services after the initial plunge seem likely to remain on a decline in the latter part of the year.
- * Domestically, the negative impact of SARS on consumption is known to have been rather profound in April, and still markedly so in May. Yet with WHO's travel advisory lifted, consumer sentiment can be expected to improve steadily. Strong promotion by the affected trades complemented with relaunch by the Government can render a useful boost. On the other hand, investment intentions may still be weak before business returns fully to normal. For 2003 as a whole, both consumption and investment expenditures are forecast for further appreciable declines mostly because of SARS.
- * Overall, the impact of SARS is reckoned to drag down GDP in 2003 by around 1.8 percentage points, while the Government's relief measures announced on 23 April are reckoned to cushion it by slightly more than 0.2 of a percentage point. Incorporating the better-than-expected outturn of a 4.5% GDP growth in the first quarter, the forecast growth rate in real terms of GDP in 2003 is trimmed down to 1.5%, from 3% in the Budget round.
- * The short-term economic outlook is subject to uncertainties on both the external and domestic fronts. With regard to exports, even though the end of the war on Iraq is a

positive development, the situation in the US economy, including its slackened labour market, slow business investment and enlarged fiscal deficit, continues to attract concern. Also, the situation in the European and the Japanese economies remain subdued. Within the region, the fact that SARS has weakened demand in the mainland of China (the Mainland), Taiwan and Southeast Asia will carry effect on Hong Kong's trade performance. With regard to inbound tourism, the SARS situation elsewhere in the region will continue to hold back visitor inflow in the meantime. In the domestic economy, the income loss, unemployment hike and greater deflation emanating from SARS impact so far are likely to keep down demand, even as the SARS situation locally has shown progressive improvement.

- * On the price front, price competition in the local market has turned even keener as business conditions falter upon the spread of SARS, while wages and rentals come down even further in the process of adjustment. Amongst the Government's relief measures, those with downward effect on the CPI are reckoned to lower the Composite CPI by around 0.3 of a percentage point for 2003 as a whole. Also, the various concessions announced by the public utilities recently are reckoned to lower the Composite CPI by another 0.1 of a percentage point in 2003. On the other hand, import prices may pick up somewhat, upon a weaker US dollar and a firming up in world commodity prices. Yet in overall terms, the price reduction effect in the local market is expected to be predominant.
- * The forecast rate of change in the Composite CPI for 2003 is thus revised down by one percentage point to -2.5%, from -1.5% in the Budget round. The forecast rate of change in the GDP deflator for 2003, recognising in addition the downward effect of a possible deterioration in the terms of trade in the near term upon the latest further weakening in the US dollar, is scaled down more, by 1.5 percentage points to -3.5%, from -2% in the Budget round.

DETAIL

GDP

According to the preliminary figure on *Gross Domestic Product (GDP)* released today by the Census and Statistics Department, the economy attained solid growth at 4.5% in real terms in the first quarter of 2003 over a year earlier, albeit somewhat slower than the 5.1% growth in the fourth quarter of 2002 (latter figure revised slightly up from the 5.0% growth put out earlier). On a seasonally adjusted quarter-to-quarter comparison, GDP declined by 0.3% in real terms in the first quarter of 2003, after a 1.7% increase in the fourth quarter of 2002 (latter figure unchanged from the estimate put out earlier) (*Chart*).

2. The latest figures on GDP and its major expenditure components up to the first quarter of 2003, including the year-on-year changes in the original series and the quarter-to-quarter changes in the seasonally adjusted series, are presented in *Tables 1 and 2*. Developments in different segments of the economy in the first quarter of 2003 are described below.

External trade

3. According to the merchandise trade statistics, *total exports of goods* (comprising re-exports and domestic exports) continued to grow strongly, by 19.1% in real terms in the first quarter of 2003 over a year earlier, further to an already robust growth of 18.3% in the fourth quarter of 2002. On a seasonally adjusted quarter-to-quarter comparison, total exports of goods increased further by 3.2% in real terms in the first quarter of 2003, following a 4.0% rise in the fourth quarter of 2002.

4. The region continued to provide the key impetus to export growth in the first quarter of 2003, with total exports of goods to *East Asia* as a whole surging by 23.6% in real terms over a year earlier. There was an almost across-the-board double-digit growth in exports to the East Asian markets. Exports to the Mainland and Taiwan rose by well in excess of 20% in real terms in the first quarter. Exports to Japan also picked up distinctly in growth in the first quarter. But exports to Singapore and the Republic of Korea showed some moderation recently, though with still notable increases for the first quarter as a whole. Total exports of goods to *North America* remained generally robust, as import intake in the United States and Canada continued to improve steadily. Enhanced price competitiveness of Hong Kong's exports on the back of a weaker US dollar should have also helped. Total exports of goods to this area leaped by 9.1% in real terms in the first quarter of 2003 over a year earlier. Total exports of goods to the *European Union* accentuated distinctly further in the early part of this year, supported by steadier import demand there and perhaps more by a stronger euro. Total exports of goods to this area had a 17.8% increase in real terms in the first quarter of 2003 over a year earlier.

5. *Imports of goods* likewise soared, rising by 18.7% in real terms in the first quarter of 2003 over a year earlier, similar to an 18.1% increase in the fourth quarter of 2002. On a seasonally adjusted quarter-to-quarter comparison, imports of goods rose further by 3.6% in real terms in the first quarter of 2003, following a 2.9% rise in the fourth quarter of 2002.

6. On invisible trade, *exports of services* attained a further marked growth of 12.2% in real terms in the first quarter of 2003 over a year earlier, following an 18.1% growth in the fourth quarter of 2002. Exports of services stayed robust in January, February and the first half of March, bolstered by continued surge in inbound tourism, exports of transportation services and offshore trade. However, inbound tourism fell off abruptly in the second half of March upon the spread of SARS in Hong Kong, thus retarding somewhat the growth in exports of services for the first quarter as a whole. On a seasonally adjusted quarter-to-quarter comparison, exports of services fell back noticeably, by 3.7% in real terms in the first quarter of 2003, having risen by 5.1% in the fourth quarter of 2002.

7. *Imports of services* slackened again, falling by 4.0% in real terms in the first quarter of 2003 over a year earlier, in contrast to the 3.4% rise in the fourth quarter of 2002. The outbreak of SARS in Hong Kong towards the end of the first quarter hit severely the already modest trend in residents' spending abroad. On a seasonally adjusted quarter-to-quarter comparison, imports of services fell back distinctly by 7.0% in real terms in the first quarter of 2003, after a 1.1% increase in the fourth quarter of 2002.

8. On the trade balance, with a faster growth in imports of goods than in total exports of goods in value, the *visible trade deficit* reckoned on a GDP basis widened to \$16.0 billion or 4.0% of the value of imports of goods in the first quarter of 2003. Concurrently, the *invisible trade surplus*, also reckoned on a GDP basis, enlarged further to \$40.1 billion or 85.7% of the value of imports of services in the first quarter of 2003. The *combined visible and invisible trade surplus* still expanded, to \$24.1 billion in the first quarter of 2003, equivalent to 5.4% of the total value of imports of goods and services in that quarter, from the corresponding surplus figures of \$18.7 billion and 4.9% in the same quarter in 2002.

Domestic demand

9. Local consumer spending showed signs of improvement at the beginning of the year, but receded abruptly towards the end of the first quarter under the shock impact of SARS since mid-March. On a year-on-year comparison, *private consumption expenditure (PCE)* declined by 2.1% in real terms in the first quarter of 2003 over a year earlier, having fallen by 1.8% in the fourth quarter of 2002. On a seasonally adjusted quarter-to-quarter comparison, PCE dipped by 0.3% in real terms in the first quarter of 2003, having decreased by 0.9% in the fourth quarter of 2002.

10. *Government consumption expenditure (GCE)* reckoned on a national accounts basis continued to rise modestly, by 1.1% in real terms in the first quarter of 2003 over a year earlier, after a 0.8% increase in the fourth quarter of 2002. On a seasonally adjusted quarter-to-quarter comparison, GCE recorded virtually zero change in real terms in the first quarter of 2003, following a 1.2% decline in the fourth quarter of 2002.

11. Overall investment spending, as represented by *gross domestic fixed capital formation (GDFCF)*, had a modest growth of 3.9% in real terms in the first quarter of 2003 over a year earlier, after a 0.7% decline in the fourth quarter of 2002. *Expenditure on building and construction* shrank further, by 2.7% in real terms in the first quarter of 2003 over a year earlier, having fallen by 6.2% in the fourth quarter of 2002. Private sector expenditure on building and construction fell further in the first quarter, as output under the Home Ownership Scheme and Private Sector Participation Scheme (which is classified as private sector building output in the GDP estimates on the basis of ownership) plunged sharply further, as work on Container Terminal No. 9 had passed its peak, and as there was a dearth of new building projects. Concurrently, public sector expenditure on building and construction fell back, amidst heavy cut in the Public Housing Programme and winding down of the major railway projects. On the other hand, *expenditure on machinery, equipment and computer software* picked up markedly further, to an 11.9% increase in real terms in the first quarter of 2003 over a year earlier, having risen by 3.2% in the fourth quarter of 2002. This was nevertheless partly helped by a low base of comparison in the first quarter of 2002, when such expenditure slumped by 19.8% in real terms.

12. *Inventories* went up further in the first quarter of 2003, representing the fourth consecutive quarter of accumulation. However, the inventory build-up in the first quarter was likely to be partly involuntary, as local consumption and inbound tourism unexpectedly fell off upon the spread of SARS.

The property market

13. The sales market for *residential property* remained generally slack in the first quarter of 2003. Following the Government's promulgation of nine policy measures to stabilise the housing market in late 2002, transactions went up briefly in January, but receded to a distinctly lower level in February and March, as worries over job security and income stability surfaced again to deter demand. Acquisition interest was curtailed further since mid-March, first in the light of the uncertainties stemming from the war on Iraq, and then upon the severe impact of the spread of SARS in Hong Kong. Also, the ample supply of new flats in the mass market continued to pose a drag. Amidst the austere situation, developers either withheld sales or staged more intensive promotion, by offering larger price discounts and more sweeteners to prospective flat buyers. Meanwhile, the luxurious end of the market turned slightly more active, stimulated in part by the Government's new policy measure to attract investment immigrants announced in

February. As to the rental market for residential property, performance remained lacklustre in overall terms, given the still subdued user demand and increased supply of flats for lease.

14. On *commercial property*, both the sales and rental markets for *office space* remained weak in the first quarter of 2003, upon further consolidation and downsizing in the corporate sector amidst an uncertain business outlook. The market for Grade A office space, especially in the central business district, continued to be pulled down by abundant supply with the completion of some new projects, as well as by reduced demand with the relocation of more companies to the secondary districts for saving costs. The sales and rental markets for *shopping space* likewise remained bleak in the first quarter of 2003, owing to the still subdued retail business, mostly in the segment serving local consumers. Since mid-March, the markets turned even dimmer, as both inbound tourism and local consumption were severely hit by the spread of SARS in Hong Kong. Landlords of such premises were under a widespread plea to grant temporary rental concessions to help ease the financial difficulties facing the operators, particularly those in the restaurant and entertainment businesses which were being affected most. On *industrial property*, the rental and sales markets remained stagnant in overall terms in the first quarter of 2003, on the back of a continued downtrend in local manufacturing activity.

The labour market

15. The labour market, having shown some improvement in the second half of 2002, slackened again in the first quarter of 2003. This was mainly due to a marked reduction in employment in the construction sector, which in turn led to a larger contraction in overall employment than in total labour force in that quarter. The *seasonally adjusted unemployment rate* went up to 7.5% in the first quarter of 2003, from 7.2% in the fourth quarter of 2002. The *underemployment rate* nevertheless edged lower, to 2.9% in the first quarter of 2003, from 3.1% in the fourth quarter of 2002. Conceivably, this was attributable to less temporary or part-time workers being employed, especially those engaged in construction. (In the three months ending April 2003, both the seasonally adjusted unemployment rate and the underemployment rate went up distinctly, to 7.8% and 3.2% respectively, reflecting in most part the adverse impact on the labour market brought about by the spread of SARS since mid-March.)

16. On a quarter-to-quarter comparison, *total employment* as enumerated from households shrank by 0.7% in the first quarter of 2003, exceeding the 0.4% fall in *total labour force*. These reversed the corresponding increases of 0.6% and 0.2% in the fourth quarter of 2002. With a larger decrease in employment than in labour force, there was a loosening in the overall manpower resource balance, resulting in a pick-up in unemployment rate in the more recent months. On a year-on-year comparison, total employment, whilst still up in the first quarter of 2003, rose to a lesser extent than total labour force, by 0.7% as against 1.3%. In

the fourth quarter of 2002, the differential in the respective increases was wider, by 0.8% as against 2.0%.

17. Overall labour income remained on a moderating trend in money terms. Specifically, *labour earnings* fell by 1.2% in money terms in the fourth quarter of 2002 over a year earlier, further to a 1.5% decline in the third quarter. Yet netting out a fall in the Composite CPI, labour earnings were still higher by 1.8% in real terms in the fourth quarter of 2002 over a year earlier, following a 2.1% increase in the third quarter.

Prices

18. Overall consumer prices, though still on a continuous downtrend, had a smaller year-on-year decrease in the first quarter of 2003 than in the fourth quarter of 2002. This was mainly attributable to a lower base of comparison in 2002, caused by the rates concession granted by the Government in that year. Also relevant was a rebound in the prices of retained imports in the more recent months, upon a firming up in world commodity prices and the earlier weakening in the US dollar. These offset in part the effects of lower labour wages and property rentals, as well as further price discounts offered by many retailers in face of subdued local consumer demand. (The spread of SARS since mid-March could have begun to exert dampening impact on local consumer prices in the affected trades in the latter part of that month. The impact tended to become more apparent in April, with enlarged decreases seen in the prices of such items as clothing and footwear as well as durable goods.)

19. Comparing the first quarter of 2003 with a year earlier, the *Composite CPI* was lower by 2.0%, yet this was lesser than the 2.9% drop in the fourth quarter of 2002. On a quarter-to-quarter comparison, the seasonally adjusted Composite CPI declined only marginally, by 0.1% in the first quarter of 2003, having dipped by 0.6% in the fourth quarter of 2002. The moderated decline was mainly attributable to dissipation of the downward effect of the rates concession granted by the Government upon its expiry at end-2002. This outweighed the downward effect of a one-off rebate of electricity charges granted by a power company in January and February 2003.

20. The *GDP deflator*, as a broad measure of overall price change in the economy, declined by 4.7% in the first quarter of 2003 over a year earlier, enlarged from the 4.1% drop in the fourth quarter of 2002. This was mainly due to a renewed deterioration in the terms of trade in goods and services, more than offsetting lesser decreases in the price deflators for private consumption expenditure and for gross domestic fixed capital formation. On a seasonally adjusted quarter-to-quarter comparison, the GDP deflator went down by 1.5% in the first quarter of 2003, similar to the decrease of 1.6% in the fourth quarter of 2002.

The financial sector

21. The spot *exchange rate of the Hong Kong dollar* against the US dollar stayed within a very narrow range of 7.799 to 7.800 during the first quarter of 2003, which was virtually the same as the linked rate. The premium of the twelve-month forward rate over the spot rate held steady up to early March, and then narrowed to close the month at 136 pips (each pip equivalent to HK\$0.0001), down from 169 pips at end-2002.

22. Under the linked exchange rate system, the movements in the exchange rates of the Hong Kong dollar against other major currencies follow closely those in respect of the US dollar. During the first quarter of 2003, the US dollar depreciated against quite a number of major currencies, triggered by concern over the US-led war on Iraq and its possible implications for the US economy. Meanwhile, many of the East Asian currencies generally held stable against the US dollar. Taking these currency movements together, the trade-weighted *Nominal Effective Exchange Rate Index of the Hong Kong dollar* declined slightly, by 0.9% from a monthly average of 102.7 in December 2002 to that of 101.8 in March 2003. After adjusting for changes in the respective consumer price indices, the trade-weighted *Real Effective Exchange Rate Index of the Hong Kong dollar* had a larger decrease, by 1.2% from 93.3 to 92.1 over the same period.

23. Local short-term *interest rates* continued to edge lower during the first quarter of 2003. The three-month HIBOR stood at 1.3% at end-March 2003, marginally below that of 1.4% at end-2002. Over the same period, the premium of the three-month HIBOR over the corresponding Euro-dollar deposit rate narrowed slightly, from 9 basis points to 4 basis points. Since the cut in the US Fed Funds target rate in November 2002, the Base Rate under the Discount Window operated by the Hong Kong Monetary Authority (HKMA) has been maintained at 2.75%. Throughout the first quarter of 2003, the best lending rate and savings deposit rates offered by the major commercial banks were kept at 5.00% and 0.03% respectively. As to the average spread of the best lending rate over the three-month time deposit rate, there was only a modest widening, from 4.80 percentage points in the fourth quarter of 2002 to 4.91 percentage points in the first quarter of 2003. (The US Fed Funds target rate was kept unchanged at 1.25% on 6 May. The Base Rate, the best lending rate and savings deposit rates were hence maintained.)

24. *Hong Kong dollar deposits* fell back by 1.2% during the first quarter of 2003, while *Hong Kong dollar loans* went down less, by 0.4% during the same quarter. As a result, the Hong Kong dollar loan-to-deposit ratio moved up from 88.5% at end-2002 to 89.3% at end-March 2003.

25. Though with some occasional fluctuations, the local *stock market* was mostly on a downtrend during the first quarter of 2003. The Hang Seng Index

started the year on a strong note, reaching an almost six-week high of 9 873 on 15 January. To a large extent, this mirrored the rally in the US stock market. Local share prices subsequently retreated, in tandem with the weakening in most of the other stock markets overseas. Increased concern over the US-led war on Iraq and an uncertain US economic outlook were the major factors dampening market sentiment. The decline steepened in March, as the spate of sluggish US economic data and the spread of SARS in Hong Kong undermined investor confidence further. The Hang Seng Index plummeted to a 4½-year low of 8 634 at end-March 2003, down by 7.4% from the level at end-2002. (The local stock market drifted lower in April, amidst intensified worries about the adverse economic impact from the spread of SARS. Yet with improvement in the situation more recently and also with WHO's travel advisory against non-essential travel to Hong Kong lifted lately, the Hang Seng Index rebounded from a further low of 8 409 on 25 April to 9 509 on 29 May.)

Impact of SARS on the economy

26. The spread of SARS since mid-March has hit the economy on many fronts. The blow to inbound tourism has been particularly severe. The number of incoming visitors came down abruptly by 10% in the second half of March over a year earlier, followed by a 65% plunge in April. This was in stark contrast to a 29% surge in January and February combined and a 19% leap in the first half of March. The severe setback in visitor arrivals in turn has resulted in a heavy slump in the airline, travel and hotel businesses. It has also hurt the retail and restaurant businesses considerably. In April and most of May, passenger load of the two local airlines has come down by around 70%. The hotel room occupancy rate, which is normally over 80%, has recently been running at around 20%.

27. Outbound tourism has also been drastically curbed. The number of Hong Kong residents travelling abroad plummeted by 29% in April over a year earlier. Within this total, outbound trips to the Mainland plunged by 29%, and those to the rest of Asia by 32%.

28. Locally, the spread of SARS has derailed the nascent recovery in consumption demand. The fall-off in local consumer spending was extensive, including not only shopping for durable goods and the more expensive items, but also for even some of the daily necessities. Also hard hit were eating out at restaurants and going for entertainment. Yet spending on medical and hygiene products went up. Taking this together with the fall-off in tourist spending, the volume of retail sales, having resumed growth at 0.7% in January and February combined over a year earlier, receded back by 3.7% in March. It is likely to have receded more in April.

29. With WHO's travel advisory against non-essential travel to Hong Kong lifted on 23 May, local sentiment is seen to have turned more active. Coupled with strong promotion by the affected trades and relaunch by the Government, this

should help resurrect local consumer spending in the coming months. In comparison, outbound tourism may revive more slowly, on account of the SARS situation elsewhere in the region. For the same reason, and additionally for the lengthier time needed for many of the visitor sources to realise clearly the improvement in Hong Kong, inbound tourism may be still slower to recover fully.

30. Total exports of goods still held up quite well in April, rising by around 10% in real terms over a year earlier. Yet the growth pace was lesser than that in the first quarter. Looking to the months ahead, in face of a generally dimmer regional economic outlook and reduced business travel for participating in trade fairs and placing orders consequential to the spread of SARS, exports of goods in the latter part of the year are likely to feel the pinch.

31. In the labour market, the impact of SARS on the affected trades has resulted in accentuation of both unemployment and underemployment rates. The more common practice of asking employees to take no-pay leave not only raises the underemployment rate but also slashes take-home pay. In general, income is reduced consequential to the business setback. These adverse effects on the workforce are expected to persist in the coming months.

32. Overall, the impact of SARS is reckoned to drag down GDP in 2003 by around 1.8 percentage points, while the Government's relief measures announced on 23 April are reckoned to cushion it by slightly more than 0.2 of a percentage point.

Updated GDP and price forecasts for 2003

33. Though with the war on Iraq ended, the global economic environment remains lacklustre. Major international agencies like IMF, OECD and the World Bank have lowered the growth forecasts for the global economy and the leading industrialised economies in 2003. In East Asia, the impact of SARS poses an exceptional drag, upsetting an otherwise relatively more sanguine economic scene, and the growth forecasts for economies in the region have generally been lowered even more.

34. Following regular practice, the GDP and price forecasts for 2003 have been reviewed by individual components. The updated forecasts are presented in *Table 3*.

35. On visible trade, *total exports of goods*, whilst still robust so far, may moderate in growth in the months ahead. Apart from a dimmer demand outlook in the region due to SARS, there is the possibility that the spread of SARS has led to some diversion of orders thereby affecting exports later in the year. In addition, there is a much higher base of comparison in the latter part of last year. Thus, even with a better-than-expected outturn in the first quarter, and notwithstanding the boosting effect from the latest further weakening in the US dollar, the forecast

growth rate in real terms of total exports of goods in 2003 is still trimmed down, by 1.1 percentage points to 5.5%, from the earlier forecast of a 6.6% growth. Within the total exports of goods, the forecast increase in real terms in *re-exports* is lowered to 7.5% from 8%, and the forecast decline in real terms in *domestic exports* is lowered to 15% from 8%.

36. *Imports of goods* are forecast to increase by 2.9% in real terms in 2003, down from the 6.3% rise in the earlier forecast. This is in view of slower growth now expected for both re-exports and retained imports.

37. On invisible trade, the forecast rate of change in real terms in *exports of services* in 2003 is reduced markedly to -2%, from 8% put out earlier. This is mainly on account of the plunge in visitor arrivals and hence tourist receipts since mid-March. Although WHO has lifted its travel advisory against non-essential travel to Hong Kong, inbound tourism and its related service exports may still take some time to recover. On the other hand, the continued expansion in offshore trade and in exports of other business services should provide much offset.

38. The forecast rate of change in real terms in *imports of services* in 2003 is slashed even more, to -13.5% from 1.5%. This is in the light of the plunge in outbound tourism and its related service imports. The travel components carry greater weight in the total for imports of services than in the total for exports of services.

39. In the domestic sector, the forecast rate of change in real terms in *private consumption expenditure* in 2003 is scaled down to -3%, from nil change as put out earlier. The impact of SARS on local consumer spending is expected to be most profound in the second quarter. While local sentiment is now improving, it may still take a while for consumer spending to return fully to normal. The blow to income and employment in the affected trades could continue to drag down consumer demand in the near term.

40. The forecast growth rate in real terms of *government consumption expenditure* in 2003 is nevertheless raised to 4%, from 2.5% in the earlier forecast. This has incorporated the expected increase in government spending arising from the Government's relief measures announced in April.

41. Overall investment spending in the economy, as represented by *gross domestic fixed capital formation*, is now forecast to decline by 5.5% in real terms in 2003, distinctly down from the 0.9% growth forecast earlier.

42. Within the overall investment spending, *expenditure on machinery, equipment and computer software*, despite a better-than-expected outturn in the first quarter, is now expected to decline by 3.6% in real terms in 2003, markedly down from the earlier forecast of a 6.8% increase. The prevailing subdued

business environment as well as the drain in cashflow in the affected companies are envisaged to hold back capital expenditure.

43. As to *expenditure on building and construction*, it is now expected for a larger decline, by 7.4% in real terms in 2003, as against a 5.9% fall forecast earlier. New construction works in the private sector are being deterred by the sluggish property market conditions, more so upon the spread of SARS. Building and construction output in the public sector is envisaged to remain weak, given further cut in the Public Housing Programme and near completion of the KCR West Rail.

44. *Inventories* are expected to run down in the rest of the year, in face of much weaker demand in the local market.

45. Overall, the forecast growth rate in real terms of *GDP* for 2003 is now put at 1.5%, 1.5 percentage points down from that of 3% in the Budget round. This mainly reflects the adverse impact of SARS on the economy, overwhelming the better-than-expected performance in the first quarter of the year.

46. The short-term economic outlook is subject to uncertainties on both the external and domestic fronts. With regard to exports, even though the end of the war on Iraq is a positive development, the situation in the US economy, including its slackened labour market, slow business investment and enlarged fiscal deficit, continues to attract concern. Also, the situation in the European and the Japanese economies remain subdued. Within the region, the fact that SARS has weakened demand in the Mainland, Taiwan and Southeast Asia will carry effect on Hong Kong's trade performance. With regard to inbound tourism, the SARS situation elsewhere in the region will continue to hold back visitor inflow in the meantime. In the domestic economy, the income loss, unemployment hike and greater deflation emanating from the SARS impact so far are likely to keep down demand, even as the SARS situation locally has shown progressive improvement.

47. For comparison, the forecasts on Hong Kong's GDP made by a selection of international organisations and local analysts are depicted in **Table 4**. Seeing the shock impact of SARS on the economy, almost all the forecasters have trimmed down their GDP growth forecasts for Hong Kong in 2003. The impact of SARS is reckoned by most of them to drag down GDP in 2003 by 0.5 to 2.5 percentage points. The latest forecast growth rates in real terms of GDP for 2003 from those private sector analysts range from 0% to 3.1%, averaging at 1.4%. This is 1.4 percentage points down from the corresponding average of 2.8% before the outbreak of SARS.

48. On the price front, price competition in the local market has turned even keener as business conditions falter upon the spread of SARS, while wages and rentals come down even further in the process of adjustment. Amongst the Government's relief measures, those with downward effect on the CPI are

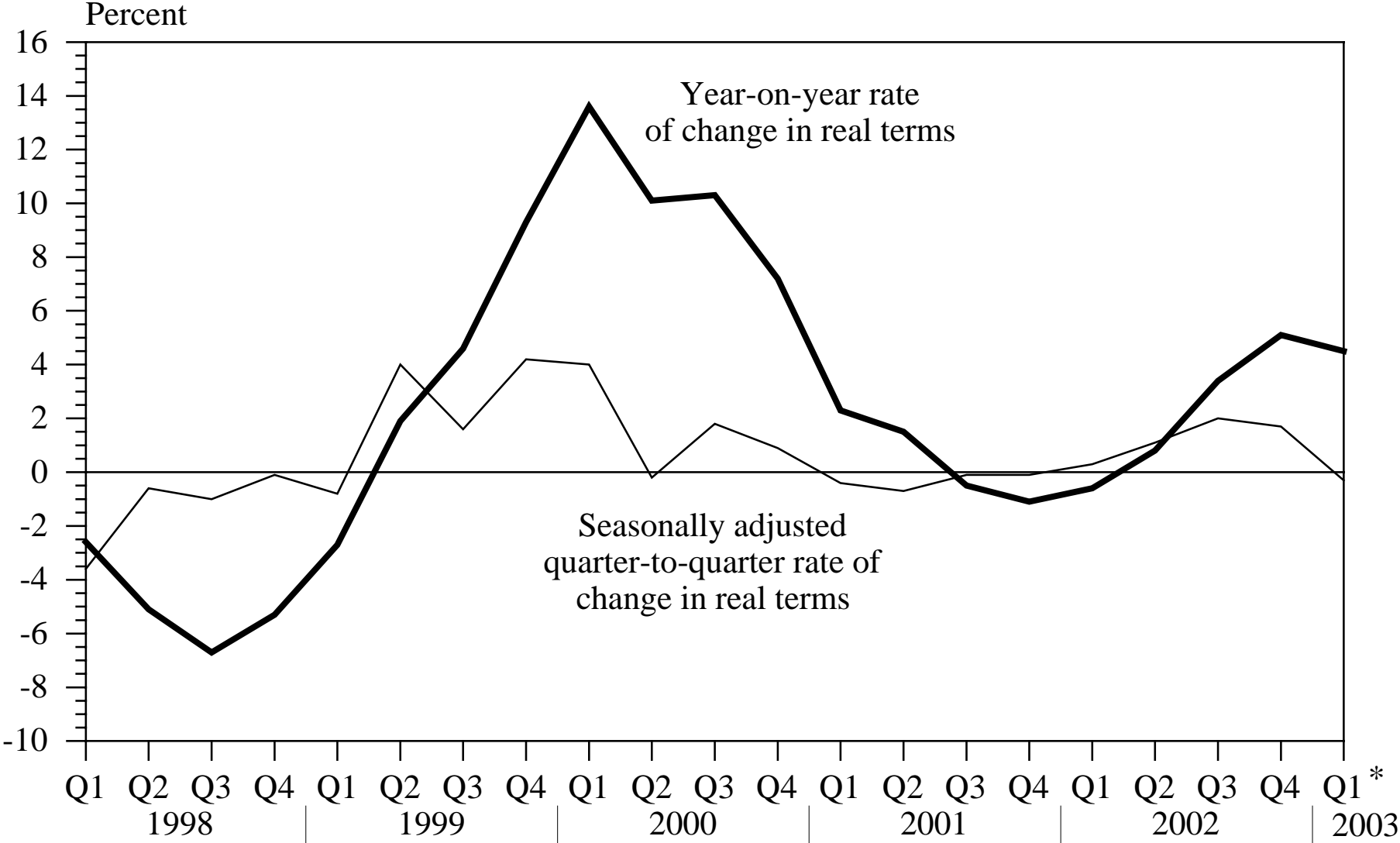
reckoned to lower the *Composite CPI* by around 0.3 of a percentage point for 2003 as a whole. Also, the various concessions announced by the public utilities recently are reckoned to lower the Composite CPI by another 0.1 of a percentage point in 2003. On the other hand, import prices may pick up somewhat, upon a weaker US dollar and a firming up in world commodity prices. Yet in overall terms, the price reduction effect in the local market is expected to be predominant.

49. The forecast rate of change in the Composite CPI for 2003 is thus revised down by one percentage point to -2.5%, from -1.5% in the Budget round. The forecast rate of change in the *GDP deflator* for 2003, recognising in addition the downward effect of a possible deterioration in the terms of trade in the near term upon the latest further weakening in the US dollar, is scaled down more, by 1.5 percentage points to -3.5%, from -2% in the Budget round.

(The First Quarter Economic Report 2003 is now on sale at the Government Publications Centre on Ground Floor, Low Block, Queensway Government Offices, at \$88 a copy. Both the hard and soft copies of the report can be purchased on-line at http://www.statisticalbookstore.gov.hk/desc_eng.htm at the same price, yet with a postage charge for the hard copy.)

(The GDP figures up to the first quarter of 2003 are published in the Report of the Gross Domestic Product, First Quarter 2003, which is now also on sale at the Government Publications Centre at Queensway, at \$30 per copy. Both the hard and soft copies of the report can also be purchased on-line at http://www.statisticalbookstore.gov.hk/desc_eng.htm at the same price, yet with a postage charge for the hard copy.)

Hong Kong's Gross Domestic Product



Note : (*) Preliminary figures.

Table 1

**Gross Domestic Product and its main expenditure components
and the main price indicators
(year-on-year rate of change (%))**

	<u>2001</u> [#]	<u>2002</u> [#]	<u>Q1</u> [#]	<u>2002</u>			<u>2003</u>
				<u>Q2</u> [#]	<u>Q3</u> [#]	<u>Q4</u> [#]	<u>Q1</u> ⁺
<i>Change in real terms of GDP and its main expenditure components (%)</i>							
Private consumption expenditure	1.6	-1.3	-0.1	-2.2	-1.2	-1.8	-2.1
Government consumption expenditure	6.1	2.4	2.3	3.0	3.5	0.8	1.1
Gross domestic fixed capital formation	2.7	-4.3	-11.8	-0.2	-4.3	-0.7	3.9
<i>of which :</i>							
Building and construction	-1.1	1.2	-3.2	7.6	8.2	-6.2	-2.7
Machinery, equipment and computer software	6.2	-9.1	-19.8	-6.7	-12.2	3.2	11.9
Total exports of goods	-3.3	8.7	-2.4	5.9	11.5	18.4	19.1
Re-exports	-2.4	11.0	-1.4	8.4	13.7	22.2	22.3
Domestic exports	-10.2	-11.2	-11.1	-13.6	-7.5	-12.9	-12.0
Imports of goods ^(a)	-1.9	7.9	-4.0	6.0	10.8	18.2	18.8
Exports of services	6.9	11.7	6.0	7.7	13.9	18.1	12.2
Imports of services	2.0	0.2	-0.7	-3.8	2.0	3.4	-4.0
Gross Domestic Product	0.5	2.3	-0.6	0.8	3.4	5.1	4.5
<i>Change in the main price indicators (%)</i>							
GDP deflator	-1.9	-3.0	-2.3	-2.2	-3.1	-4.1	-4.7
Composite Consumer Price Index ^(b)	-1.6	-3.0	-2.6	-3.2	-3.5	-2.9	-2.0
Consumer Price Index (A) ^(b)	-1.7	-3.2	-2.8	-3.6	-4.1	-2.4	-1.8
<i>Change in nominal GDP (%)</i>	-1.4	-0.8	-3.0	-1.4	0.2	0.8	-0.4
GDP at current market prices (\$ billion)	1,270	1,260	298	306	325	331	297
GDP at constant (2000) market prices (\$ billion)	1,294	1,324	310	318	343	353	324
Changes in inventories at constant (2000) market prices (\$ billion)	-5	3	-3	1	1	3	3

Notes : (#) Revised figures.

(+) Preliminary figures.

(a) Here imports of goods are valued on f.o.b. basis, instead of on c.i.f. basis as is the on-going practice for the merchandise trade statistics.

(b) Final figures.

Table 2

**Gross Domestic Product and its main expenditure components
and the main price indicators
(seasonally adjusted quarter-to-quarter rate of change (%))**

	<u>2002</u>				<u>2003</u>
	<u>Q1[#]</u>	<u>Q2[#]</u>	<u>Q3[#]</u>	<u>Q4[#]</u>	<u>Q1⁺</u>
<i>Change in real terms of GDP and its main expenditure components (%)</i>					
Private consumption expenditure	0.5	-0.7	-0.3	-0.9	-0.3
Government consumption expenditure	0.4	-0.2	2.3	-1.2	*
Gross domestic fixed capital formation	N.A.	N.A.	N.A.	N.A.	N.A.
Total exports of goods	4.6	5.7	4.1	3.9	3.1
Re-exports	5.8	6.6	4.6	4.7	3.9
Domestic exports	-5.5	-2.0	-0.6	-4.3	-6.3
Imports of goods ^(a)	4.6	5.9	4.6	3.0	3.7
Exports of services	1.9	4.3	6.1	5.1	-3.7
Imports of services	0.4	-1.6	3.8	1.1	-7.0
Gross Domestic Product^(b)	0.3	1.1	2.0	1.7	-0.3
<i>Change in the main price indicators (%)</i>					
GDP deflator	-0.7	-0.8	-0.9	-1.6	-1.5
Composite Consumer Price Index^(c)	-1.1	-0.6	-0.7	-0.6	-0.1
Consumer Price Index (A) ^(c)	-0.6	-0.6	-0.7	-0.6	*

Notes : (#) Revised figures.

(+) Preliminary figures.

(*) Change of less than 0.05%.

N.A. Not applicable, as no clear seasonal pattern is found in gross domestic fixed capital formation, due to the presence of considerable short-term fluctuations.

(a) Here imports of goods are valued on f.o.b. basis, instead of on c.i.f. basis as is the on-going practice for the merchandise trade statistics.

(b) As gross domestic fixed capital formation does not exhibit a clear seasonal pattern, the seasonally adjusted series of GDP is compiled separately at the overall level.

(c) Final figures.

Table 3**Forecast growth rates of the Gross Domestic Product
and its main expenditure components and forecast rates of change
in the main price indicators for 2003**

	Forecast for 2003 as released <u>on 5.3.2003</u> (%)	May update of the forecast for 2003 released <u>on 30.5.2003</u> (%)
<i>Growth rate in real terms of :</i>		
Private Consumption Expenditure	0	-3
Government Consumption Expenditure	2.5	4
Gross Domestic Fixed Capital Formation	0.9	-5.5
<i>of which :</i>		
Building and construction	-5.9	-7.4
Machinery, equipment and computer software	6.8	-3.6
Total Exports of Goods	6.6	5.5
Re-exports	8	7.5
Domestic exports	-8	-15
Imports of Goods	6.3	2.9
Exports of Services	8	-2
Imports of Services	1.5	-13.5
Gross Domestic Product (GDP)	3	1.5
<i>Rate of change in :</i>		
GDP Deflator	-2	-3.5
Composite Consumer Price Index	-1.5	-2.5
<i>Rate of change in Nominal GDP :</i>	1	-2

Table 4

**2003 GDP and price forecasts for Hong Kong put out by
selected international organisations and private sector analysts**

	Date of release	GDP (growth	Private consumption expenditure rate	Gross domestic fixed capital formation in real	Total exports of goods terms	Exports of services (%)	Rate of change in consumer prices (%)	Reference source
International organisations:								
IMF	Sep 2002	3.4	--	--	--	--	-0.5	World Economic Outlook, Sep 2002.
	Feb 2003	3	--	--	--	--	--	Asian Wall Street Journal, 26 Feb 2003.
	Apr 2003	3	--	--	--	--	-1.6	World Economic Outlook, Apr 2003.
ADB	Sep 2002	3.5	--	--	--	--	0.5	Asian Development Outlook, 2002 Update, Sep 2002.
	Dec 2002	2.8	--	--	--	--	--	Media Briefing Note, Dec 2002.
	Apr 2003	2	--	--	--	--	-1.5	Asian Development Outlook 2003.
	May 2003	-1.4 to 0.8	--	--	--	--	--	News Release, No. 065/03, 9 May 2003.
World Bank	Apr 2002	4.3	--	--	--	--	--	East Asia Update, Apr 2002.
	Nov 2002	2.7	--	--	--	--	--	East Asia Update, Nov 2002.
	Apr 2003	2	--	--	--	--	--	East Asia Update, Apr 2003.
Private sector analysts:								
<i>(a) Major local banks</i>								
Hongkong Bank	Oct 2002	1.6	-0.9	-0.8	--	--	-0.8	Asian Economic Insight, 24 Oct 2002.
	Mar 2003	1.6	-0.9	-0.8	--	--	-1.5	Asian Economics, Q2 2003.
	Apr 2003	0.5	-3	-0.6	--	--	-2	Asian Economic Insight, 25 Apr 2003.
Standard Chartered Bank	Oct 2002	3.5	--	--	--	--	-0.5	Hong Kong Snapshot, 22 Oct 2002.
	Apr 2003	0.5	--	--	--	--	-2	Asian Economic Focus, May 2003.
Hang Seng Bank	Dec 2002	2.3	-0.5	-1.7	6.8	8.7	-1	Hang Seng Economic Monthly, Nov/Dec 2002.
Bank of China (HK)	Dec 2002	2.8	0.5	-0.3	7.8	12.5	-2	BOC Economic Review Monthly, Vol. 1 No.12, 2002.
	Apr 2003	0 to 1.5	-3 to -5	-1.2 to -2	3.7 to 4.7	3 to 4.5	-2.3 to -2.5	BOC Economic Review Monthly, Vol. 1 No. 4 2003.

Table 4 (cont'd)

2003 GDP and price forecasts for Hong Kong put out by selected international organisations and private sector analysts

	Date of release	GDP	Private consumption expenditure		Gross domestic fixed capital formation		Total exports of goods terms	Exports of services (%)	Rate of change in consumer prices (%)	Reference source
			(growth	rate	in	real				
Bank of East Asia	Nov 2002	3	--	--	--	--	--	-1.5	Economic Research Department, Nov 2002.	
	Dec 2002	2	--	--	--	--	--	-1.5	Economic Research Department, Dec 2002.	
	Jan 2003	2	0.5		1	5.9	9.3	--	Economic Analysis, Jan 2003.	
	Apr 2003	1.6	--	--	--	--	--	--	Sing Pao, 14 Apr 2003.	
	May 2003	1.6	-1.2		-1	7.1	7	-2.5	Economic Research Department, 28 May 2003.	
<i>(b) Investment banks</i>										
JP Morgan Chase	Dec 2002	3.7	--	--	--	--	--	--	Hong Kong Economic Journal, 12 Dec 2002.	
	Apr 2003	1.6	--	--	--	--	--	--	Hong Kong Economic Times, 12 Apr 2003.	
	May 2003	1	--	--	--	--	--	--	Hong Kong Economic Journal, 21 May 2003.	
Goldman Sachs Asia	Dec 2002	3	--	--	--	--	--	-1.2	Hong Kong Economic Journal, 13 Dec 2002.	
	Apr 2003	1.7	--	--	--	--	--	--	Hong Kong Economic Journal, 3 Apr 2003.	
Morgan Stanley Asia	Dec 2002	3.2	--	--	--	--	--	--	Apple Daily, 11 Feb 2003.	
	Feb 2003	2.7	--	--	--	--	--	--	Apple Daily, 26 Feb 2003.	
	Apr 2003	2.1	0.5		2.2	--	--	-1.2	Hong Kong Economics, 1 Apr 2003.	
Merrill Lynch	Nov 2002	3.7	2.7		7.3	--	--	-1.4	The Asian Equity Economist, 20 Nov 2002.	
	Feb 2003	3.9	--	--	--	--	--	-1.4	The Asian Equity Economist, 14 Feb 2003.	
	Mar 2003	4.6	--	--	--	--	--	-1.4	Economics, 5 Mar 2003.	
	Apr 2003	4	--	--	--	--	--	--	Hong Kong Economic Journal, 3 Apr 2003.	
	Apr 2003	3.1	--	--	--	--	--	--	Hong Kong Economic Times, 15 Apr 2003.	
	May 2003	3.1	--	--	--	--	--	-1.9	The Asian Equity Economist, 13 May 2003.	

Table 4 (cont'd)

2003 GDP and price forecasts for Hong Kong put out by selected international organisations and private sector analysts

	<u>Date of release</u>	<u>GDP</u> (growth	Private consumption expenditure rate	Gross domestic fixed capital formation		Total exports of goods terms	Exports of services (%))	Rate of change in consumer prices (%)	Reference Source
				in	real				
Credit Suisse First Boston	Nov 2002	1.4	0.8		2.9	--	--	-1.7	Asian Daily, 27 Nov 2002.
	Feb 2003	2.6	2		3.2	--	--	-1.7	Asian Daily, 19 Feb 2003.
	Apr 2003	2	--		--	--	--	--	Emerging Markets Economics Daily Non-Japan Asia, 7 Apr 2003.
	Apr 2003	1.8	--		--	--	--	-2.7	Emerging Markets Economics Research, 29 Apr 2003.
<i>(c) Others</i>									
Economist Intelligence Unit	Sep 2002	4	0.5		5	--	--	-1	Country Forecast, Sep 2002.
	Nov 2002	2.3	0.2		3	--	--	-1.5	Country Forecast, Nov 2002.
	Dec 2002	2.5	0		3.5	--	--	-1.5	Country Forecast, Dec 2002.
	Feb 2003	2.5	0.1		3.5	--	--	-1.6	Country Forecast, Feb 2003.
	Mar 2003	2.7	0.2		3.5	--	--	-1.5	Country Forecast, Mar 2003.
	Apr 2003	0.3	-1		-8	--	--	-2.5	Country Forecast, Apr 2003.
Hong Kong General Chamber of Commerce	Nov 2002	2.1	--		--	--	--	-1.5	Hong Kong Business Summit, 27 Nov 2002.
	Apr 2003	1.5	--		--	--	--	-3	Chief Economist, HKGCC, 24 Apr 2003.

Observation :

With the spread of SARS since mid-March, almost all the forecasters have trimmed down their GDP growth forecasts for Hong Kong in 2003. The impact of SARS is reckoned by most of them to drag down Hong Kong's GDP in 2003 by 0.5 to 2.5 percentage points. The latest forecasts of the growth rate in real terms of GDP for 2003 from the private sector analysts listed above range from 0% to 3.1%, averaging at 1.4%.