

HONG KONG, CHINA

Although the economy is less reliant on electronics exports than the other NIEs, the export sector still suffered from the impact of weaker than anticipated external demand, leading to a downward revision of near-term growth forecasts. A recovery in the near term will depend on a rebound in global economic activity and on steady expansion in the PRC.

Economic Indicator (percent)	1998	1999	2000	2001		2002	
				Current	ADO 2001	Current	ADO 2001
GDP growth	-5.3	3.0	10.5	-0.4	4.0	2.0	5.5
Inflation rate	2.8	-4.0	-3.8	-1.4	1.0	0.3	4.0
Central government budget/GDP	-1.8	0.8	-0.6	-1.9	-0.2	-1.0	-0.1

Economic Assessment. Amid a global economic slowdown, GDP of Hong Kong, China in the second quarter of 2001 contracted by 1.7 percent on a seasonally adjusted quarter-on-quarter basis, following flat growth in the first quarter. As a result, year-on-year growth in the first half of 2001 moderated to 1.4 percent as against a 10.5 percent increase in 2000. The stronger than expected deceleration stemmed mainly from a pronounced slackening in merchandise exports and a weakening of domestic demand.

Private consumption grew by a modest 3.8 percent in the first half of 2001, supported by higher labor income. Nevertheless, a rising unemployment rate, depressed asset prices, and a weak property market undermined consumer confidence and slowed consumption growth from its pace of 5.5 percent in 2000. With the deteriorating business outlook, gross fixed capital formation averaged 5.8 percent expansion year on year during the first two quarters of 2001, compared to a 9.8 percent increase in 2000. The moderation was attributed mainly to a sharp slowdown in the growth of machinery and equipment acquisition during the second quarter of 2001, relative to the first. Expenditure on building and construction registered a 0.1 percent rise in the second quarter of 2001, after 11 consecutive quarters of contraction. However, the pace of inventory buildup slowed from the substantial accumulation in 2000, as a result of weakness in demand.

Manufacturing contracted by 0.1 percent in volume during the first half of 2001 compared to a year earlier, with a marked falloff in fabricated metal and plastic products, and a further decline in the consumer electrical and electronics industry. Growth in the dominant services sector moderated, with all segments posting lower growth. Expansion in the import/export trade and in transport slackened amid sagging global trade, while the nonbanking finance sector was dampened by a slowdown in stock market activity. The communications sector contracted by 11.3 percent in value terms in the first two quarters of 2001 from a year earlier, having increased by 8.7 percent in the previous year. In value terms, in the first half of 2001 real estate contracted

by 22.9 percent, while banking slipped to 1.3 percent growth, over the corresponding period of 2000, due to the weakening of the property market and of banks' loan business.

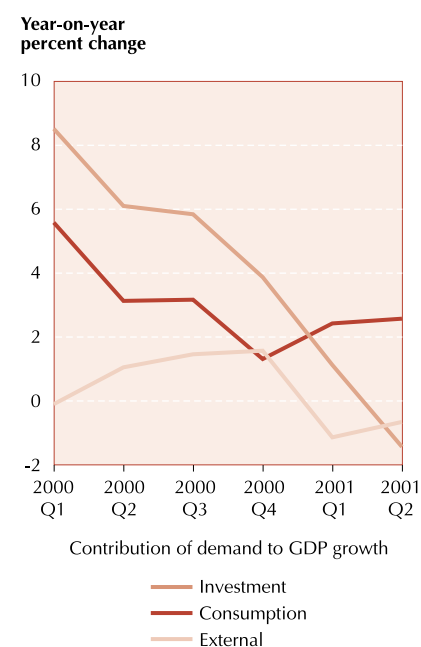
With the downturn in economic activity, the seasonally adjusted unemployment rate, having trended downward from 6.3 percent in the first quarter of 1999 to 4.4 percent in the fourth quarter of 2000, edged up to 5.3 percent in the third quarter of 2001. The steady decline in consumer prices since 1999 leveled off to an annual rate of 1.5 percent in the first nine months of 2001. However, deflationary pressures persisted, reflecting the effects of the current economic slowdown.

The slump in global demand, accompanied by a falloff in regional trade and the strengthening of the Hong Kong dollar along with the US dollar, hampered the economy's exports. Year-on-year growth of merchandise exports in the first six months of this year decelerated sharply to 1.0 percent from 17.1 percent in 2000. Domestic exports tumbled by 10.7 percent, reversing a 7.5 percent increase in 2000. Reflecting the export capability of the PRC, reexports, which accounted for 90 percent of the total value of merchandise exports over the period, posted a 2.8 percent rise, after soaring by 18.5 percent in 2000. Mirroring sluggish reexports and lackluster domestic demand, imports of goods slowed to 2.1 percent growth during the first half of 2001, against a surge of 18.1 percent in 2000. The growth in services exports decelerated to 5.7 percent in the first half of 2001, on account of the slackening in exports of trade-related and other business services, while that in services imports recorded a 3.0 percent rate in the same period. Taken together, the combined visible and invisible trade surplus narrowed from HK\$14.5 billion in the first half of 2000 to HK\$11.3 billion in the corresponding period of this year, equivalent to 1.8 percent of GDP.

Under the currency link to the US dollar, the Hong Kong dollar appreciated against most major currencies during the first nine months of 2001. Money market interest rates fell considerably in the same period, in response to aggressive monetary easing by the US Federal Reserve and to excess liquidity in the domestic market. In line with the movements in the major global stock markets, the Hang Seng Index tumbled to 10,131 by 15 October 2001.

Economic Management Issues. The authorities have been running operating deficits since fiscal year 1998/99 (ending 31 March 1999). The operating deficit is projected to reach HK\$16.6 billion in fiscal year 2001/02 and to gradually fall over the medium term. The sources of fiscal revenues, some one fifth of which are projected to rely on land sales and investment returns, have fallen along with the slump in the property market. Moreover, social expenditures, including social welfare, health, and education, are expected to surge over the longer term, due to an aging population and the need to upgrade human capital. In an attempt to contain public expenditures, the fiscal year 2001/02 budget includes a proposal to increase private sector involvement in the delivery of public services. To improve economic efficiency and long-term development prospects of public finance, the authorities will

The components of demand act in different ways

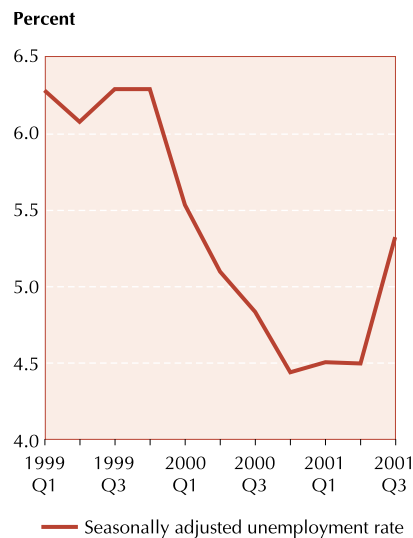


Source: www.info.gov.hk/censtatd

have to undertake further efforts to broaden the tax base, optimize the revenue structure, and reform the allocation of resources.

In August 2001, the authorities outlined a HK\$18 billion investment package over the next five years to promote tourism and contribute toward economic growth. Some HK\$16 billion of the stimulus package, designated for the Disney Theme Park, had been included in the budget plan of March 2001. As the economic outlook worsened, and to sustain the long-term development of Hong Kong, China the Chief Executive's October policy address proposed measures worth HK\$15 billion to provide tax relief, to support small and medium enterprises, to develop professional services, to promote continuing education and social services development, and to invest in the construction of a new exhibition center. Other plans involved the creation of additional job opportunities in the short term. Moreover, the authorities announced a capital expenditure program on infrastructure projects of over HK\$400 billion.

After falling, unemployment begins to rise again



Source: www.info.gov.hk/censtatd

Forecast. Given gloomier trade prospects with the delayed recovery in the global economy and the fallout of the 11 September attacks on the US, real GDP is forecast to contract by 0.4 percent over the whole of 2001. In spite of continuing infrastructure investment, domestic demand will remain subdued for the rest of the year, with private consumption moderating as a result of the weak stock and housing markets and further easing in local employment. Trade- and travel-related services sectors, such as transport and tourism, will be hit hard by the recent fall in confidence and the increases in transaction costs in industry. Domestic exports are estimated to fall by 5.9 percent this year, as the US economy, a key export market for Hong Kong, China, slackens amid a protracted downturn in the ICT sector and faltering household spending. Due to the deterioration in the trade balance, the current account surplus is expected to narrow further. Corporate streamlining, resulting from a further fall in profits, will weigh continually on the labor market. Rising unemployment, coupled with depressed consumer sentiment, will hinder general price recovery, keeping annual inflation in negative territory in 2001.

With the cyclical downturn expected to be over by mid-2002, the economy is projected to recover to 2.0 percent growth in 2002. The current account balance is expected to improve, along with a gradual recovery in exports. Prices will likely firm up, on the back of an improvement in external demand and price increases in the PRC, the main supplier of goods imported for local use. Growth in private capital investment will probably be sustained, based on expected opportunities related to the PRC's accession to WTO. In the medium term, the stimulus to liberalization and better corporate governance in the PRC after WTO accession will expand and deepen its demand for high value-added financial, technical, and professional services from Hong Kong, China. Nonetheless, competition resulting from the increased integration of the PRC into the world economy will pose a challenge to Hong Kong, China's transshipment trade and manufacturing activities.