

# Hong Kong's Economy in 2001: Another Good Year?

## 1. Introduction

Being a small and open economy, Hong Kong resembles a yacht drifting in the stormy seas of the international financial markets. Now, emerging from the storm of the 1997-98 Asian financial crisis, Hong Kong has already gripped the helm of economic recovery. Gross domestic product (GDP) grew by 11.7% year-on-year (yoy) in real terms in the first three quarters of 2000. However, some have argued that the current "V-shaped" economic recovery is, to a certain extent, a bit of a "Paper Tiger" or a "Number Game". The benefits of GDP growth simply have not trickled down to the ordinary people.

The prospects for economic growth in 2001 are not overwhelmingly optimistic, given the current internal and external business environment. Assuming there will not be a global recession or significant slowdown, Hong Kong's economy can be expected to grow by 4% for the full year 2001.

## 2. "V-shaped" Recovery in 2000

The current "V-shaped" economic recovery is an "Uneven Expansion" or a "Cyclical Recovery" in the aftermath of the Asian financial crisis, being mainly driven by external trade, rather than the domestic sector.

### 2.1 External trade

The performance of external trade has been very promising since mid-1999. Total exports of goods jumped by 18.8% in the first ten months of 2000 (see *Table 1*). External trade has become the major driving force of the robust growth.

### 2.2 Gross domestic fixed capital formation

The substantial slump in property prices, the completion of large-scale government and private-sector construction projects, and the 24-month-long bout of deflation have restrained the growth of fixed asset investment.

**Table 1: Hong Kong's trade performance (1999-2000)**

Indicators	1999		Jan-Oct, 2000	
	Volume (US\$ bn)	Change (+/-, %)	Volume (US\$ bn)	Change (+/-, %)
Total exports of goods	172.95	0.1	167.70	18.8
Domestic exports	21.87	-9.5	19.51	9.5
Re-exports	151.08	1.7	148.19	20.1
Imports of goods	178.55	-2.5	176.55	21.4
Total trade of goods	351.50	-1.3	344.25	20.1
Trade balance	-5.60		-8.85	
Exports of services	37.65	4.6	30.98*	14.6*
Imports of services	23.23	-0.6	17.89*	2.5*
Total trade of services	60.88	2.6	48.87*	9.8*
Trade balance	14.42		13.09*	

Note : \* Figures for Jan-Sept 2000  
Source: Census & Statistics Department (2000), *Hong Kong External Trade*, November 2000; Hong Kong Trade Development Council.

### 2.3 Domestic consumption

Stagnant wages, high unemployment (especially among the lower-skilled), persisting deflation and the diversity of consumption<sup>1</sup> have not augured well for private consumption and local retail sales this year. Government statistics indicated that retail sales grew by 4.3% in value terms in the first ten months of 2000, while transactions advanced by 9.4%, illustrating how much harder local retailers must work for their earnings.

Though moderating growth is expected in the fourth quarter, the economy is likely to record an advance of 11% for the full year. This could make Hong Kong the fastest growing economy in the world, not only outperforming other advanced economies like the US, but also those of the Mainland and other Southeast Asian economies that have been struggling to come out of the doldrums (see *Fig. 1*).

### **3. Robust Growth: Just A “Paper Tiger”?**

We simply are not feeling the good times that should follow the dizzy GDP growth in the year 2000. Public sentiment is dampened by a general freeze in wages, deflation and the vaporization of wealth in the property and stock markets over the past three years. Moreover, the export-driven nature of this expansion has so far limited the multiplier-effect upon the domestic sector.

#### **3.1 Domestic psychology: “not feeling good”**

The income level of ordinary Hong Kong people is barely creeping upwards, if not falling. In addition, a distortion in the labour market, which is biased toward personnel with expertise in information technology and investment banking, has intensified the polarization of the haves and have-nots. Those with knowledge- and technical-based skills gain the upper hand in the era of the New Economy, while those in the manufacturing and service industries suffer.

Deflation has clouded the local economy since November 1998, adversely affecting domestic investment and private consumption sentiment and confidence. During this two-year period, the composite consumer price index (CPI) averaged -3.7% (see *Fig. 2*).

The property and stock markets have plunged to lower levels. In fact, Hong Kong property prices have retreated to 1992-93 levels. The negative-wealth effect that ensued effectively tightened the purse strings of both investors and consumers. In consideration of the time-lag effect, the internal fundamentals of the local economy are still fragile.

#### **3.2 Export-driven recovery**

Those that say the expansion of the local economy is a sort of “Number Game” do have a point, as the base of comparison in 1999 was very low.

The current economic recovery is export-driven, spurred by the robust growth in re-exports, transshipment and offshore trade. Approximately half of the growth in GDP in the first three quarters can be traced to the momentum of the external sector, while the contribution of private consumption, which has shrunk significantly as compared to the pre-crisis level, constituted only one third of the growth.

The multiplier-effect of re-exports (at 88% of total exports) toward domestic consumption is not as high as that of direct investment or domestic exports. Thus, private consumption and investment are not getting the kick they need.

The nature of the recovery is different from 1976 and 1986, when growth rates hit 16.2% and 10.8% respectively. Then, the recoveries were mainly driven by domestic exports, investment and consumption.

### **4. Another Optimistic 2001?**

Every Hong Kong resident longs for a “Better New Year” to maximize their gains from economic expansion. Whether the local economy will continue to excel in 2001 depends on the internal and external business environment.

#### **4.1 Domestic sectors: recovering**

Domestic consumption has been chugging toward a recovery since early 1999, though retail sales in value terms are still 25% lower than those in 1997. A possible salary rise of 1-4% at large corporations in 2001 may, to a certain extent, help to boost consumer confidence and hence private consumption, though the lingering problem of “negative assets”<sup>iii</sup> will continue to restrain actual consumption.

In addition, consumer confidence of those in the lower- and medium-income category will remain low, and their consumption is likely to be stagnant. Their employment prospects remain a concern. Those working in small- and medium-sized enterprises are still squeezed by the pressures of a wage freeze and longer working hours. Any rise in wages, accompanied by a willingness of Government and business to forgo price increases, would have a significant impact on the spending habits of this group.

There are also signs indicating difficulties in the current operational environment. An increasing number of listed companies, including property developers, hi-tech companies, and even conglomerates, have been issuing profit and sales warnings recently. Moreover, many of the dot.com companies are undergoing restructuring, and will probably continue to lay off employees.

On the domestic investment front, though upside growth of fixed asset investment has lost some momentum under the current business environment, there is some incentive to speed up investment. A number of large projects, such as the Cyberport and Disneyland, will probably help boost investment in machinery and construction. However, as a whole, the

engineering and construction industries face slack demand. Time is still needed for the territory's investment atmosphere to further improve.

#### **4.2 External environment: clouded by uncertainty**

Globalisation has linked countries and regions more closely together. Any ripples in the global markets will affect the performance of Hong Kong's exports and her economy, as a result of her distinctive external openness.

##### *The United States*

The growth of the US economy has slowed from 5.6% in the second quarter to 2.4% in the third quarter of 2000. Some economists have predicted that US economic growth could drop from 5.1% in 2000 to 3.2% in 2001, the lowest in the past six years.

The volatility and plunges in the Nasdaq and Dow Jones suggest that the ever-booming hi-tech industry has entered an era of "the stronger drags out the weaker". The negative-wealth effect of the bearish stock market may decrease spending and may cut 1-2% from national output, though with a time-lag<sup>iii</sup>. The risk of a further slowdown or even recession in the US will certainly darken Hong Kong's immediate export outlook.

##### *The European Union (EU)*

The weakness of the euro against the US dollar may have served in practice to boost European exports. In 2000, Euroland may maintain its pace of more than 3% annual growth. However, European manufacturers have been under pressure from higher energy costs and the tight credit conditions following seven interest rate hikes by the European Central Bank (ECB) since June 1998. The EU economy may be able to grow moderately by 2.8-3% in 2001, on the condition that the global financial markets remain stable.

##### *Japan*

There is still a long way to go for Japan to get out of the "bubble economy", even after more than 10 years of restructuring. The Japanese economy grew by 1.4% (yoy) in the third quarter of 2000, while the unemployment rate remains stuck at 4.7%. Domestic sales have registered more than 47 consecutive months of decline. Deflationary pressure is still in place. However, some economists have predicted that the Japanese economy could grow by 1.5% in real terms for the whole year of 2001.

##### *Southeast Asia*

Southeast Asia is still suffering from political and economic uncertainty and chronic weaknesses that have kept, and will continue to keep, its growth rate lower than those of other Asian economies, particularly in the Northeast. Indeed, more radical progress needs to be made for a full revival in this region.

##### *The Chinese Mainland*

Stimulated by the government's expansionary fiscal and monetary policies, the Mainland economy has performed a lovely turn-around. The economy grew by 8.2% in the first three quarters of 2000, on the back of strong consumer confidence, buoyant exports and flourishing property and stock markets. It is anticipated that the Chinese economy will continue to expand at a rate of 8-8.5% in 2001, boosted by the ongoing "Go West" strategy and the imminent accession to the World Trade Organization (WTO), which will provide Hong Kong with new business opportunities. There is no doubt that the "China factor" will become one of the major driving forces for the territory's economic expansion in 2001.

### **5. Economy in 2001: Moderate Growth**

The International Monetary Fund (IMF) has predicted that global trade growth may drop from 10% in 2000 to 7% in 2001. And it warns that every US\$5 increase in the price of oil will peel off 0.2 percentage point of GDP growth for the industrialized economies.

The key to a sustainable and solid expansion will depend on, internally, the revival of domestic consumption by an increase in people's disposable income; and, externally, the economic benefits from China's robust economic performance.

Assuming the global financial markets remain stable and there will not be a global recession, the Hong Kong economy will grow moderately by 4% in 2001 (see *Table 2*).

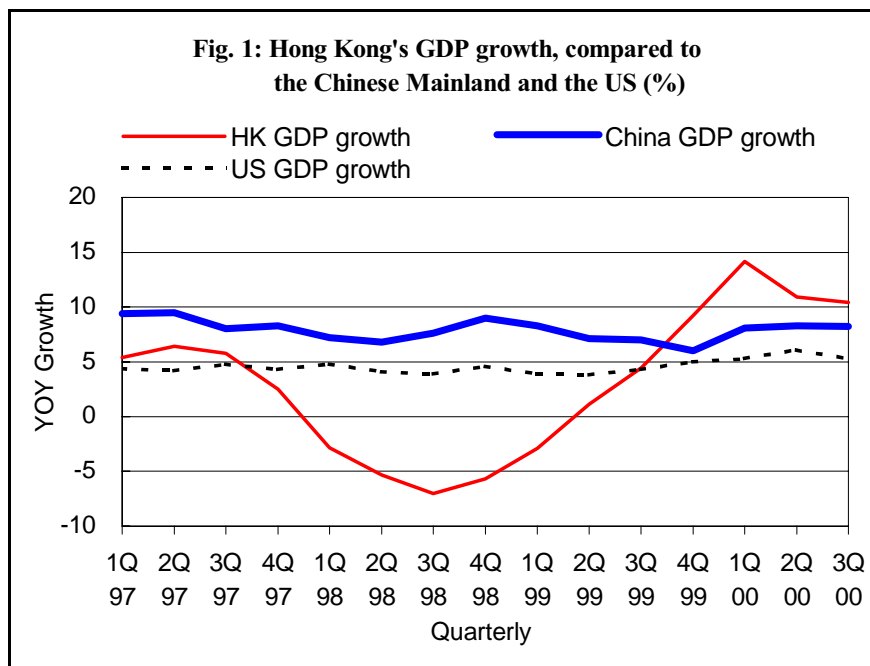
In the medium- and long-run, only if Hong Kong can speed up corporate restructuring; create more job opportunities; increase income and improve the living standards of the poor to ease income polarization; raise service quality and lower operating costs; and move toward a closer economic integration with Guangdong, can we then sharpen our competitive edge,

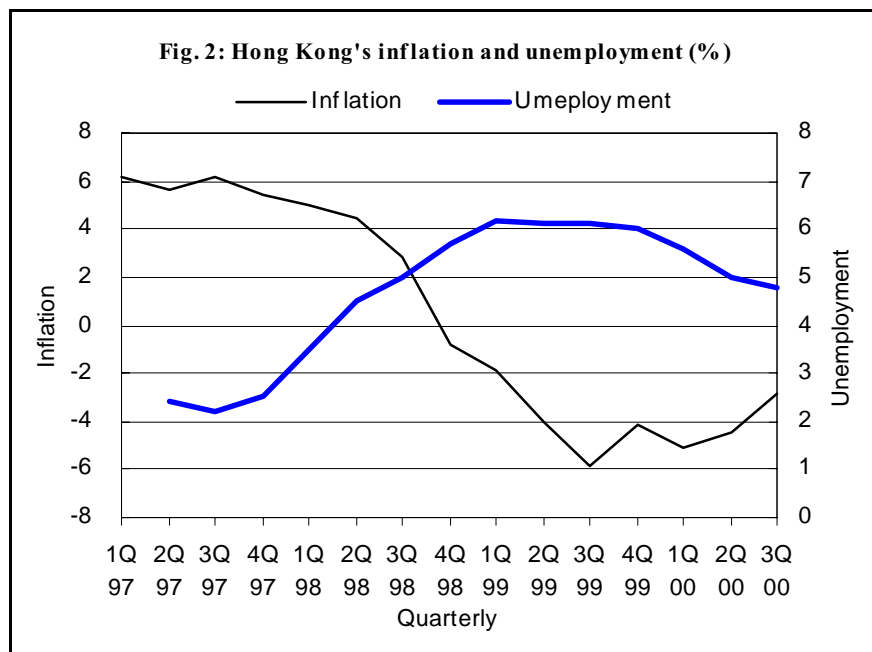
sustain our economic growth and reap the most from China's entry to the WTO in early 2001. By doing so, Hong Kong's status as the "Dragon Head" of Asia's "Four Small Dragons" can be enhanced.

**Table 2: Forecast of Hong Kong's major economic indicators**

Major Indicators (%)	Year	2000		2001@
		Government forecast#	BEA forecast	
Private consumption		6.0	6.0	4.5
Gov't consumption		2.5	2.5	3.0
Fixed capital formation		7.9	7.7	6.5
Total exports of goods		16.8	18.0	8.0
Domestic export		8.5	10.0	4.5
Re-exports		18.0	19.1	8.5
Imports of goods		18.1	18.8	9.1
Exports of services		13.5	14.3	8.0
Imports of services		3.0	2.5	4.0
<b>GDP (in real terms)</b>		10.0	11.0	4.0
<b>CPI Inflation</b>		-3.7	-3.8	1.0
<b>Unemployment Rate</b>		-	4.5	4.0

Note: (1) # SAR government's adjusted forecast;  
 (2) @ Forecast by the BEA Economic Research Department





<sup>i</sup> A recent survey suggests that Hong Kong people spent around HK\$27 billion in neighbouring Guangdong province in 1999, about HK\$4,000 per capita per year, and accounted for 32% of the total amount spent abroad by Hong Kong people. It is estimated that over 220,000 Hong Kong people spend in our northern neighbour Guangdong every weekend and public holiday. It is no exaggeration that Hong Kong retail sales will be seriously affected (Source: *Ming Pao Daily News*, 16<sup>th</sup> November 2000).

<sup>ii</sup> According to the latest estimate, the recent 5% drop in property prices has sent the number of “negative asset” apartments to 190,000, while the number of apartments owned by local banks for auction will probably maintain at 5,000 throughout 2001. As property prices in Shenzhen are much cheaper than the territory and the investment return ranges from 6% to 10% (higher than bank deposits and property investment in Hong Kong), more than 12,000-13,000 apartments (involving 11.13 million square meters) are purchased by Hong Kong residents in Guangdong province every year. Hong Kong’s relatively higher property prices and lower investment returns have forced local residents to buy apartments across the border, thus diluting the purchasing power in the territory.

<sup>iii</sup> Alan Greenspan once cited long-term studies showing that, for every US dollar made in the stock markets, 3-4 cents would be spent in restaurants, vacations, home decoration and other goods and services in the real economy. See Daniel Kadee (2000), “Who’s Going too Fast”, *Time*, No.13, Vol.155, 30<sup>th</sup> April 2000.

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