

SAR after SARS

The resilience of Hong Kong people has again been demonstrated in the SARS epidemic. The lives of local people are almost back to normal and confidence has been restored. However, the implications of the outbreak would reach beyond a healthier lifestyle. It points to some imbalances in our economy that need to be tackled for long-term development.

Revive Hong Kong

The initial impact of the disease was extremely wide spread. In particular, tourist arrivals plunged 66.3% from last year in April and May at the height of the SARS outbreak. We believe that tourism would not show substantial improvement until late third quarter. For retailers, there is likely some negative spillover from the decline in tourism since tourists now account for about 20% of their sales. The only silver lining is that demand from local people has recovered most of the lost grounds as the severity of the outbreak has dampened.



In response to the economic malaise that was brought about by SARS, the government has reacted in a timely manner. First came a HK\$11.8 billion-package, with salary tax rebates and rate concessions to households and businesses amounting to \$4.4 billion. Beside spreading money around, there have been efforts that aimed directly at the hiking unemployment rate. The administration has promised to spend over \$1 billion to create over 50,000 short-term employment and training opportunities. Efforts to perk up the sentiment among consumers are well justified after the enormous adverse shock, as confidence is hard to restore once it is lost.

We anticipate that the stimulus will take effects during the summer. Furthermore, fear and disruption caused by SARS will gradually fade away if there is no relapse, just like in the case of 911 terrorist attacks in the US. Also, the pent-up demand from tourists, particularly those from the Mainland, and sustained strength in exports would accelerate recovery pace in the fourth quarter. Therefore, we expect that GDP this year would still be able to post a respectable growth of 1.6%.

Refresh Hong Kong

There is little question that Hong Kong will pull through the present difficulty, just like other times in the past. Nevertheless, the aftermath of outbreak has led to a rethink about some imbalances that long existed even before the SARS attack.

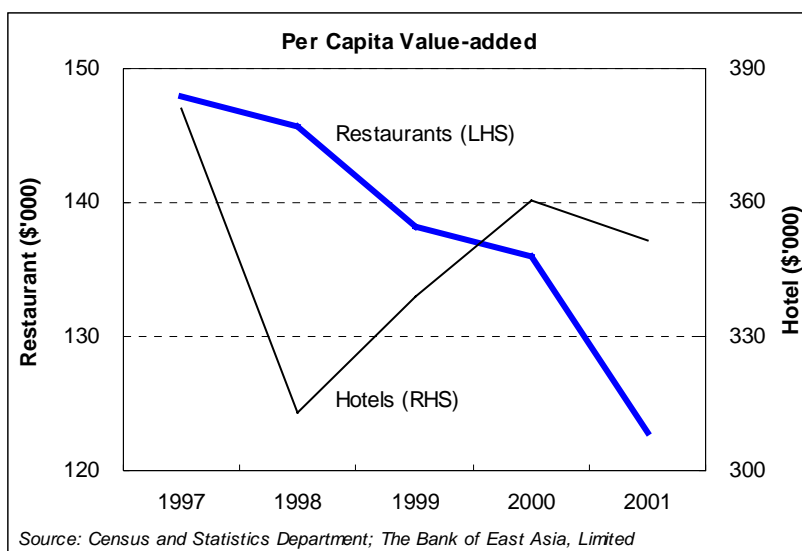
For one thing, there is much room for improvement if Hong Kong is to become as clean as a world-class city should be. Even though the outbreak was caused by a new kind of virus, the international community also related it to Hong Kong's dense population and poor hygiene habits. To maintain our reputation as a tourist and business hub, convenient and undisturbed international travels as well as high quality of living are essential factors. If foreigners feel otherwise, it will undermine their view on Hong Kong as an international city. The new Team Clean and review of outdated building regulations signaled the government's determination to develop a sustainable system to deal with the long-standing hygiene problem in Hong Kong.

It is inevitable that stricter enforcement of food and hygiene regulations is unwelcome, as it would increase expenses to business operations as well as for the households through higher cost of property maintenance. However, the cost of unsatisfactory hygiene practice on individual levels has actually been borne by the society as a whole. This negative externality has been ignored, leading to an inefficient outcome of under-spending in hygiene practice in the private sector. This must be rectified, and tightened enforcement will give the necessary incentive for everyone to shoulder his or her own responsibility of keeping the environment clean. This is especially important as the government, with the ballooning fiscal deficit, cannot bear the entire burden to build a cleaner city.

Re-launch Hong Kong

The sudden disruption to business accentuated some imbalances in the economy that hinder growth. For example, both restaurants and hotels have been among the hardest hit during the outbreak. However, it is paradoxical that restaurant closures have been more pronounced, considering businesses at restaurants are already back to 85% of the normal level in June while that for hotels remained under 40% of the norm.

The vast difference can be traced to the divergence in productivity and profitability in the two industries. Over the past few years, the value-added per capita in restaurants declined gradually from \$148,000 in 1997 to \$123,000 in 2001. In contrast, the figure in the hotel industry dropped sharply to \$313,000 in 1998 but subsequently rebounded to \$351,000 in 2001. Also, the ultra thin margin of restaurants, at 3.3% of total receipts compared to 14.1% for hotels, puts them in a vulnerable position in the event of adversity.



The story of decline in productivity and unreasonable profit margins in the restaurant industry is not unique; other domestic sectors such as construction are facing the same situation. Many businesses, like those in tourism and trade services, have restructured in response to the new market conditions, while firms that are left behind have been barely surviving, and an unexpected shock like the SARS epidemic would easily push them over the edge. It is hoped that the creative destruction process triggered by SARS would give the economy a fresh start. Instead of cutting prices and compromising quality when faced with dwindling demand, businesses should now concentrate efforts to improve the value of products offered and develop new markets rather than dive into already over-crowded segments.

On the other hand, a number of possible areas for further explorations also turned up. During the outbreak, for instance, when both inbound and outbound travel was brought to a halt, local tours organized by tour companies was a hit as few people had been aware of the local attractions and countryside. We believe that development in this area could stimulate more local spending, as well as provide more appeal to tourists than just shopping so they would extend their stay in Hong Kong. The government should provide the infrastructure and create more tourist destinations to help tour organizers to satisfy the unfulfilled demand.

On top of the creativity from the tourism industry, trends in sanitary services are also encouraging. The increased demand for cleaning services alongside the heightened awareness of hygiene should be another bright spot. The 2% rise in business since the SARS outbreak means there is still long way to go, as both the public and private sectors now understand the importance of hygiene. By spending more resources on cleaning up the city, not only jobs can be created, but the goal to improve the quality of life in the city is also achieved.

Conclusion

SARS rang an alarm and highlighted the importance of prioritizing. Efforts to retune our economy for healthy, sustainable growth require further investment from both the private and public sectors. Some measures can be costly and painful in the near term, but they are necessary in order to put Hong Kong back on track in the climb up the value-added ladder.