

14 September, 1977

S. L. M. P.

5pc growth in exports tipped

This is the second part of the full text of a speech given by the acting Chief Secretary, Mr Philip Haddon-Cave, at the Hongkong Management Association dinner on Friday. It will be continued tomorrow and on Thursday.

Part II Present economic position and immediate outlook.

Revised preliminary estimates of GDP in 1976

Turning now to my second question: How are we doing so far this year and what are our immediate prospects?

In my mid-year report last year ("The Hongkong Economy: the Adjustment Process, 1973-76," paper read to the Hongkong Society of Security Analysts), as my Budget speech forecasts were so wildly out, I indulged in a long preambular apology to soften the impact of the revised figures.

I have no need for such an apology this year. So I shall start by giving you some numbers for both last year and this year (see Table 1).

I announced in this year's Budget speech on March 2 that the preliminary estimate of expenditure on the GDP for 1976 was \$47.1 billion, or 26 per cent up on 1975. This estimate was based on actual figures for the first three quarters of the year and a forecast for the fourth quarter.

Using actual statistics for the whole year suggests that this forecast underestimated the real growth of the GDP in that quarter.

So the revised preliminary estimates of the GDP for 1976 at current market prices is HK\$47.7 billion, or 28 per cent up on 1975. In real terms, that is, at constant (1966) prices, the revised preliminary estimates is \$23.8 billion, or 17.8 per cent up on 1975. This compares with the preliminary estimate given in the Budget speech of \$23.6 billion, or 16.2 per cent up on 1975.

Most of the additional increase is a result of higher exports and higher consumption. The real growth in exports was 28 per cent, and not 27 per cent, up on 1975 and private consumption expenditure was 12 per cent, and not 10 per cent, up on 1975. There was some offset because the real growth in imports was a little higher also.

The GDP forecast for 1977:

Exports
In the first half of the year, exports in real terms were 3 per cent higher than the first half of 1976. Despite the exceptionally large volume of exports in the second half of 1976, I expect that a growth rate of 4 to 5 per cent can be achieved for the rest of the year (see Table 2).
The rather encouraging trade figures for July this year (and probably for August too) confirmed this possibility. However, these growth rates will only give an overall increase of 4 per cent in real terms for the whole of 1977, compared with 8 per cent given in the Budget forecast.

Table 1

A note on the various estimates of GDP from the forecast released in the Budget speech to the final estimate published in the half-yearly Economic Report for the following year but one is annexed. In summary:

Forecast (for, say, 1977)	Budget Speech, 1977
Revised forecast	Speech at a public function around September
Preliminary	Budget Speech and Economic Background, 1978
Revised Preliminary	Half-Yearly Economic Report, 1978
Provisional	Budget Speech and Economic Background, 1979
Final	Half-Yearly Economic Report, 1979

Table 2

The quantum indexes of domestic exports up to the second quarter of 1977 are as follows:

Q1	113	1976	1977
Q2	128	114	134
Q3	139	152(forecast)	
Q4	137	137(forecast)	

This is also much less than the increase in the volume of exports for 1976 of 28 per cent.

Government consumption expenditure

In the Budget speech I forecast a growth rate of 10 per cent for Government consumption expenditure in real terms. I see no need to change this forecast; it will produce a level of \$1.7 billion at constant prices. This reflects our commitment to employing sufficient number in the public service to implement the Government's programmes and policies.

Private consumption expenditure

Private consumption expenditure started to accelerate in the second half of 1976 and continued to show a high growth rate in the first half of 1977 when it was 14 to 15 per cent higher than in the first half of last year. The growth of imports of consumer goods now shows signs of slowing down, but, nevertheless, present indications are that the Budget forecast of a 10 per cent real growth for the year as a whole may be too low.

An analysis of export trade declarations that have come in during July and August suggests a fairly high volume of exports in the third quarter. But the very high level of exports in the fourth quarter of 1976 and the present state of order books suggest that the volume of exports in the fourth quarter of this year will be no higher than a year ago.

Table 3

Forecasts for imports by their end-use categories are as follows:

	Value of imports in 1976 (\$ millions)	Budget speech forecast for 1977 in real terms	Revised forecast increase for 1977 in real terms	percentage
Foodstuffs	6,925	6	7	
Consumer goods	9,265	10	12	
Fuels	2,550	7	11	
Raw materials	19,103	10	5	
Capital goods	5,450	12	16	
	43,293	10	9	

So, consistent with the upward revision in the revised preliminary estimate of GDP in 1976 and the view that the growth in consumption lags behind the growth in incomes, I am now forecasting private consumption expenditure in 1977 to increase by roughly the same rate as in 1976, that is, by 12 per cent in real terms.

Investment
In the Budget speech, I forecast that investment in plant and machinery would grow by 12 per cent in real terms. I now believe this forecast should be raised to 15 per cent. A part of this increase can be attributed to lumpy and, therefore, unpredictable investments in the first half of 1977.

A large proportion of investment in plant and machinery has been, and will continue to be for a while, associated with the high level of activity in the construction industry, including the MTR project.

The very heavy demands being placed on the building and construction industry appear to be stimulating a higher level of output than I was thought possible when I made my forecast for investment in building and construction in the Budget speech. Rather than a forecast of a 12 per cent increase in construction wages have attracted many people to join the industry. (In July 1977 the index of construction wages stood at 287 compared with a year ago - an 18 per cent increase).

S. C. M. P.

14 September, 1977

(2)

This has been facilitated by the relatively slack conditions in the manufacturing sector. Of the total employed by the building and construction industry at any time, roughly 50 per cent are on new sites

and the numbers so employed are now probably some 30 per cent to 40 per cent higher than a year ago.

Although the numbers employed off-site and on maintenance and conversion works may not have grown as rapidly and the overall productivity of the industry may have been lowered because of the newcomers into the industry, the level of building and construction activity in 1977 is likely to be higher than the level in 1976 by substantially more than 13 per cent I forecast in the Budget speech.

One difficulty we have encountered in revising the forecast arises from the fact that, thanks to the MTR project, the mix of building and construction activity in 1977 has become rather different from previous years. Nevertheless, I have decided to assume an increase of 30 per cent in building and construction investment in real terms.

Imports

The volume of imports is now expected to grow by 9 per cent in 1977, slightly less than the Budget speech forecast of 10 per cent.

This is consistent with the level and composition of economic activity in 1977, in as much as the revised forecast for consumer goods is for a 12 per cent rather than a 10 per cent increase; and for raw materials, which account for 44 per cent of total imports, the revised forecast is for a 5 per cent rather than a 10 per cent increase (see Table 3). This lower forecast for raw materials reflects, of course, our export prospects.

Other expenditure components

The balance between exports and imports of services for the first half of this year was some 34 per cent less than the corresponding half in 1976. For the year as a whole, I now expect there will be a fall in this component amounting to 30 per cent compared with the Budget speech forecast of an unchanged balance compared with last year.

Finally, as regards changes in stocks; stock building in the first half of the year appears

to have been substantial in particular in the textile industry. But this is unlikely to continue given the uncertainties surrounding the textile trade in 1978.

These uncertainties derive from the lack of progress on the multilateral negotiations in Geneva on the future of the Multi-Fibre Arrangement due to expire at the end of this year. There has been much activity in Geneva but, as yet, no conclusion has been reached.

The Hongkong Government has stuck firmly to the policy of advocating a straight extension of the present arrangement.

Parenthetically, may I say that these uncertainties are compounded by the fact that our bilateral agreement on textiles with the European Economic Community is also due to expire at the end of this year. The significance of this bilateral agreement is that the EEC takes about one third of our exports of textiles and clothing at the present time. The Community has already been stating views publicly that would be extremely difficult for Hongkong to accept.

But one other major uncertainty has been removed by the conclusion of a renegotiated bilateral agreement with the United States.

I do not propose to dwell further on the textiles scene. My immediate concern is that the uncertainties involved lead me to the conclusion that the building up of stocks by the textile industry will not continue in the second half of this year at the same rate as in the first half of the year.

So I now assume stock building as a whole in 1977 will be at a level roughly equal to that in 1976, compared with the Budget speech forecast of roughly half the increase in 1976.

Prices

In the Budget speech I forecast a 5 to 6 per cent increase in the consumer price index for 1977 over 1976. There was an increase of 7 per cent in the first half of 1977 over the first half of 1976. Any forecast for the rest of 1977 is very dependent

on future movements in the exchange value of the Hongkong dollar.

For obvious reasons, I am not prepared to speculate about the course of these movements over the next few months. But I can say I would be surprised if the average increase in the consumer price index in 1977 compared with 1976 was much more than 7 per cent. The GDP deflator may well be a little less than the Budget speech forecast of 7 per cent due to the stability of export prices so far this year.

The Budget speech forecast revised.

The Budget speech forecast for expenditure on the GDP in real terms in 1977 was for a growth rate of 7 per cent. The changes in the outlook for the various components of expenditure I have just mentioned combine to produce a revised forecast of the growth rate of 8 per cent. Although this is one percentage point higher than the Budget speech forecast, it is still within my forecast range of 6 to 8 per cent.

Because the revised preliminary estimate for 1976 is now higher than stated in the Budget speech and the forecast for 1977 is also higher, the forecast level of GDP in real terms for 1977 is \$25.9 billion, instead of \$25.3 billion. But this year's growth is much more dependent on domestic sector activity than on exports and that worries me.

The operation of the economy in 1976 and 1977 Export-led recovery in 1976

The question is: Why does

it? Before answering this question I must consider the course of events in 1976. The recovery of the Hongkong economy which began towards the end of the first quarter of 1975 was produced by a very rapid growth of exports.

This stemmed from moves by importers in our main markets to build up stocks of consumer goods. Hongkong's competitive edge was very favourable because the recession had been sharp and had put a stop to the rapid increase in costs seen in 1973.

The demand for certain consumer goods, particularly clothing, calculators and watches, was so strong that the foreign currency prices of our exports rose; the unit value index of exports was 10 per cent higher in 1976 than in 1975 and, in addition, the average effective exchange rate that is to say, based on movements of the weighted average of exchange rates of the Hongkong dollar against the currencies of 15 principal trading parties in 1976 was about 4 per cent higher than the average rate in 1975.

Thanks partly to the strength of the Hongkong dollar, the Hongkong dollar prices of imports did not rise as fast, with the unit value index increasing by only 4 per cent between 1975 and 1976. Over and above this improvement in our terms of trade, the volume of imports increased by less than the volume of exports: the volume of imports increased by 25 per cent and of exports by 28 per cent.