

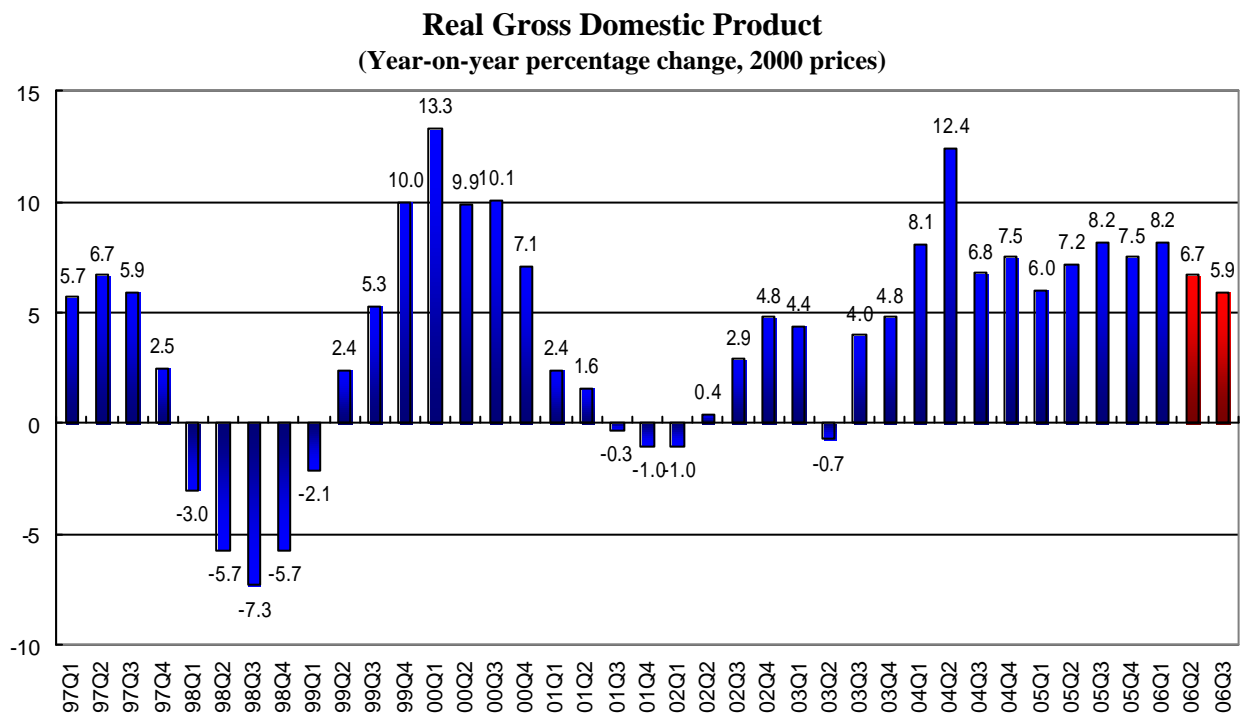
High Frequency Macroeconomic Forecasts

Current Quarter Model: 2006Q3

APEC Study Center
The University of Hong Kong

July 6, 2006

Economic Outlook



According to the High Frequency Macroeconomic Forecast conducted by the APEC Study Center of The University of Hong Kong, real GDP growth in the second quarter of 2006 is forecast to be 6.7% on a year-on-year basis. This growth estimate is an upward revision of the 5.5% forecast released on April 6, 2006, reflecting the strong growth in the first quarter of 2006. In the third quarter of 2006, real GDP growth is forecast to moderate to 5.9% when compared with the same period last year.

Professor Richard Wong Yue-Chim, Director of the APEC Study Center at The University of Hong Kong, said that “Reflecting the projected slowdown in the global economy brought on by tighter monetary conditions, Hong Kong's real GDP is expected to grow by 7.5% in the first half of this year, and slow down to 5.6% in the second half. The full-year growth estimate is around 6.5%, dropping from the 7.3% annual growth recorded last year.”

“The output growth in the third quarter is forecast to be 5.9%. The growth is broad-based, with private consumption spending and gross investment are estimated contributing 1.7 and 2.3 percentage point, respectively, to the overall growth, while net exports of goods and services contributing 1.9 percentage point. Despite the weaker external environment, external demand will still remain as an important growth driver for Hong Kong in the current quarter.” said Dr Alan Siu, Executive Director of the APEC Study Center at HKU.

The forecast details are in Table 1 and Table 2, and the forecasts of selected monthly indicators are in Table 3. All growth rates reported are on a year-on-year basis.

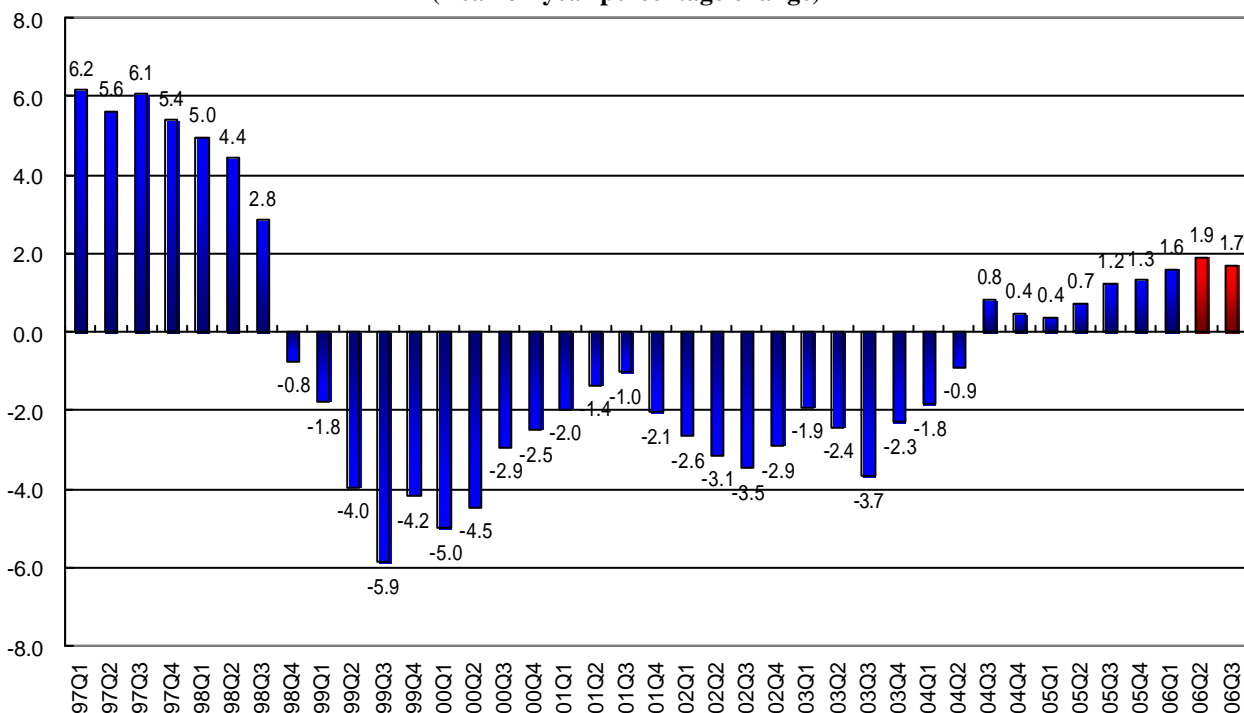
Forecast Highlights

The highlights of our current forecasts are:

- Underpinned by continued improvement in the labour market, and buoyed by a positive economic outlook, private consumption spending grew strongly by 4.5% in the first quarter of 2006, with spending in food, consumer goods and services growing by 5.5%, 3.7% and 5.8%, respectively. Consumption spending is expected to continue to grow but at a more moderate rate. It is forecast to grow by 3.9% in the second quarter and further moderate to 3.4% in the third quarter.
- The volume of retail sales in April 2006 recorded a year-on-year increase of 7.9%, with an across-the-board improvement amongst all categories. Department stores, durable goods and clothing, footwear and allied products growth rates were more apparent at 14.4%, 10.0% and 9.1% respectively. The volume of retail sales is forecast to grow by 7.7% in the second quarter of 2006, and creep up to 9.9% in the third quarter.
- Total export of goods has enjoyed double-digit growth for almost 4 years, with a high growth of 14.4% in the first quarter of 2006. The growth in total exports is expected to slow down due to a weaker external environment, with growth in Q2 forecast to be 7.8% and a further weakening to 7.2% in the third quarter.
- Domestic Exports recorded a spectacular growth of 44.4% in the first quarter of 2006, due to the 45.1% growth in machinery and transport equipment and 52.7% growth in miscellaneous manufacture articles. These two main categories accounted for 80% of total value of domestic exports. Domestic exports is forecast to grow by 26.0% and 11.1% in the second and third quarters, respectively.
- Re-exports grew by 12.8% in the first quarter of 2006. The rising competitiveness of ports in Shenzhen and a weaker external demand are two factors leading to a slowdown in the growth of Hong Kong's re-exports. Re-exports of goods is estimated to grow by 7.0% in both the second quarter and the third quarter.
- Service exports grew by 8.9% in the first quarter of 2006. Visitor arrivals have been growing steadily. Tourism continued to have good performance with the number of visitor arrivals growing by 7.3% in May 2006. The new opening of the Wetland Park and the upcoming Ngong Ping Skyrail, along with other theme parks in Hong Kong, will further promote tourism related sectors. Service exports is forecast to grow by 7.0% and 6.8% in the second and third quarters of 2006, respectively.

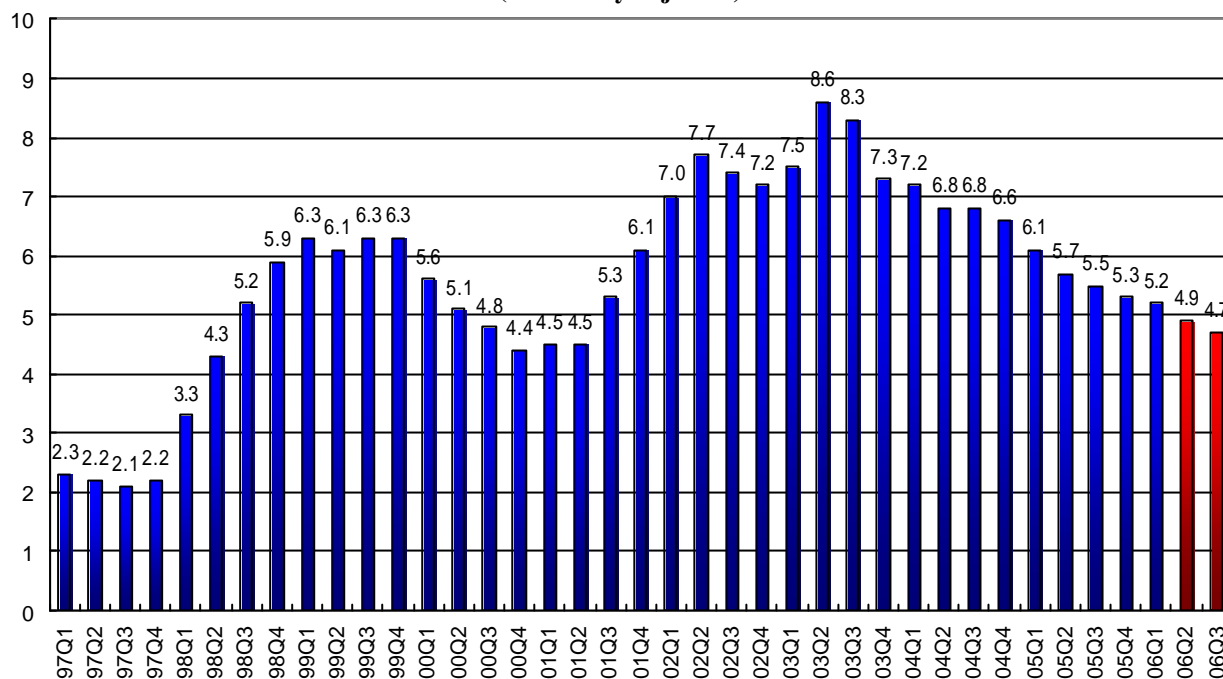
- Import of goods grew by 14.0% in the first quarter, due to the 15.9% strong growth in retained imports of goods. The growth of imports of goods is expected to be 7.2% in the second quarter and 6.9% in the third quarter of 2006.
- Import of services rose by 4.8% in the first quarter. Outbound tourism continues to be vibrant. Service imports is forecast to grow by 7.5% and 6.7% in the second and third quarters, respectively.
- The trade balance, as measured by the net exports of goods and services, is estimated to be 14.8% of GDP in the first quarter. It is forecast to be 14.8% of GDP in the second quarter of 2006, and expand to 19.6% of GDP in the current quarter.
- Gross fixed investment rose by 8.5% in the first quarter of 2006. It is expected to grow by 5.9% in the second quarter and 10.2% in the third quarter.
- Investment in land and construction went down by 11.3% in the first quarter of 2006. Construction related investment will remain weak. The investment in land and construction is forecast to drop by 13.0% in the second quarter and by 14.7% in the third quarter.
- Investment spending in machinery, equipment and computer software increased by 23.3% in the first quarter of 2006. It is estimated to grow by 16.7% in the second quarter and 24.2% in the current quarter.

Composite Consumer Price Index
(Year-on-year percentage change)



- Inflation, as measured by the year-on-year percentage change of the Composite CPI, grew by 1.6% in the first quarter, rising from the 1.3% increase in the fourth quarter of last year. Pulled up by increasing rentals, the consumer inflation rate is forecast to pick up to 1.9% in the second quarter and moderate to 1.7% in the current quarter.

Unemployment Rate (Seasonally adjusted)



- The provisional seasonally adjusted unemployment rate dropped further to 4.9% in the three months average ending in May 2006 from its previous estimate of 5.1% for the three months ending in April 2006. The median duration of unemployment for all industries dropped to 74 days which is the lowest in the first quarter period since 1996. The unemployment rate is forecast to be 4.9% in the second quarter of 2006, and improve further to 4.7% in the current quarter.

Concluding Remarks

Further monetary tightening is expected, with the Federal Fund Rate projected for increasing further, thus dragging down global economic growth. Despite a weakening in the external environment, Hong Kong's economy is forecast to continue to grow in the second half of this year due to robust growth in domestic demand. For the whole year, Hong Kong's real GDP is estimated to grow by 6.5%, with the consumer inflation rate rising to 2% by year-end.

About Hong Kong Macroeconomic Forecast Project

The Hong Kong Macroeconomic Forecast is based on research conducted by the APEC Study Center of the HKU's Faculty of Business and Economics. It aims to provide the community with timely information useful for tracking the short-term fluctuations of the economy. The current quarter macro forecasts have been released on a quarterly basis since 1999.

The high frequency forecasting system was originally developed in collaboration with Professor Lawrence Klein of the University of Pennsylvania in 1999-2000. Since then, the system has been maintained and further refined by the HKU APEC Study Center.

The project is sponsored by the HKU Foundation for Educational Development and Research. The Steering Committee is chaired by Dr Chow Yei-Ching, Chairman & Managing Director of Chevalier International Holdings Ltd, with Mr Michael Leung, Executive Chairman of Onwel Group, as Deputy Chairman. Both Dr Chow and Mr Leung are members of the Board of Directors of the HKU Foundation.

The Hong Kong Centre for Economic Research at HKU provides administrative support to the project. Researchers at the APEC Study Center are solely responsible for the accuracy and interpretation of the forecasts. Our quarterly forecasts can be accessed at <http://www.hku.hk/apec/>

High Frequency Macroeconomic Forecasts
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Table 1: Current Quarter Model Forecast
(Million of 2000 Dollar)

	2005					2006		
	Q1	Q2	Q3	Q4	Annual	Q1	Q2 (forecast)	Q3 (forecast)
Gross Domestic Product	377,589	387,621	419,379	435,394	1,619,983	408,606	413,731	444,207
Private Consumption Expenditure	208,788	213,477	213,264	224,301	859,830	218,256	221,847	220,455
Government Consumption Expenditure	34,515	30,614	32,337	32,333	129,799	34,975	30,767	32,499
Total Export of Goods	512,026	594,834	658,383	653,101	2,418,344	585,618	642,201	706,281
Domestic Export of Goods	25,938	30,251	43,607	47,576	147,372	37,455	38,126	48,439
Re-export of Goods	486,088	564,583	614,776	605,525	2,270,972	548,163	604,075	657,841
Import of Goods	522,364	603,790	653,217	650,329	2,429,700	595,278	647,247	698,175
Export of Services	118,720	117,309	137,065	141,005	514,099	129,240	125,513	146,378
Import of Services	56,424	54,990	63,232	60,727	235,373	59,144	59,096	67,481
Gross Fixed Capital Formation	86,838	92,599	93,914	95,043	368,394	94,243	98,082	103,472
GFCF in Land & Construction	37,097	33,715	33,861	32,134	136,807	32,893	29,344	28,891
GFCF in Machinery & Equip.	49,741	58,884	60,053	62,909	231,587	61,350	68,738	74,580
Changes in Inventories	-4,510	-2,432	865	667	-5,410	696	1,663	780

Date of Forecast: June 26, 2006

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Table 2: Current Quarter Model Forecast
Year-on-Year Growth Rate (%)

	2005					2006		
	Q1	Q2	Q3	Q4	Annual	Q1	Q2 (forecast)	Q3 (forecast)
Gross Domestic Product	6.0	7.2	8.2	7.5	7.3	8.2	6.7	5.9
Private Consumption Expenditure	4.1	2.4	3.6	3.4	3.4	4.5	3.9	3.4
Government Consumption Expenditure	-4.6	-2.3	-1.6	-3.8	-3.1	1.3	0.5	0.5
Total Export of Goods	9.0	11.1	12.8	11.4	11.2	14.4	7.8	7.2
Domestic Export of Goods	-9.6	-8.3	14.2	28.0	7.6	44.4	26.0	11.1
Re-export of Goods	10.2	12.3	12.7	10.3	11.4	12.8	7.0	7.0
Import of Goods	3.8	7.0	11.0	12.0	8.6	14.0	7.2	6.9
Export of Services	8.7	9.1	8.9	8.2	8.7	8.9	7.0	6.8
Import of Services	6.0	-0.1	3.5	2.3	2.9	4.8	7.5	6.7
Gross Investment	0.4	4.9	2.8	8.4	4.1	8.5	5.9	10.2
GFCF in Land & Construction	-0.1	-4.0	-4.0	-13.1	-5.3	-11.3	-13.0	-14.7
GFCF in Machinery, Equip. & Computer Software	0.8	10.7	7.1	24.0	10.6	23.3	16.7	24.2
GDP Deflator Growth Rate	-1.3	-0.6	0.2	0.7	-0.2	-0.5	-0.3	1.5
CPI (Composite) Inflation Rate	0.4	0.7	1.2	1.3	0.9	1.6	1.9	1.7
Unemployment Rate	6.1	5.7	5.5	5.3	5.7	5.2	4.9	4.7
Date of Forecast: June 26, 2006								

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Table 3: Selected Monthly Indicators
Year-on-Year Growth Rate (%)

	2005			2006								
	OCT	NOV	DEC	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP
Unit Value Trade Index (Domestic Exports)	-0.7	-0.3	-0.4	-2.2	-2.7	-3.7	-4.6	-4.4	-4.8	-3.7	-2.7	-2.9
Unit Value Trade Index (Imports of Foodstuffs)	-0.7	-0.6	0.0	-0.2	-0.6	-0.1	-0.4	-0.1	0.3	0.1	0.1	0.1
Unit Value Trade Index (Imports of Consumer Goods)	2.0	1.4	1.9	0.7	0.6	0.1	-0.5	-0.6	-0.9	-1.1	-1.5	-0.6
Unit Value Trade Index (Imports of Raw Materials & Semi-Manufactures)	1.0	2.7	0.7	1.1	0.5	1.7	1.0	1.2	1.6	1.1	1.7	1.0
Unit Value Trade Index (Imports of Fuels)	32.8	24.9	25.1	37.6	36.0	25.2	20.9	22.3	19.9	14.2	11.2	6.0
Unit Value Trade Index (Imports of Capital Goods)	-1.5	-0.7	-0.1	-1.5	-1.2	-1.5	0.7	2.0	2.7	3.1	3.4	4.4
Real Retained Imports of Foodstuffs	1.8	-2.2	15.2	-3.2	11.1	7.7	7.2	6.3	3.1	6.2	-8.2	9.8
Real Retained Imports of Consumer Goods	0.2	34.5	18.0	-43.0	104.5	19.8	34.0	30.5	30.3	35.2	16.9	5.8
Real Retained Imports of Raw Materials & Semi-Manufactures	-2.9	8.4	4.5	-4.1	12.7	2.5	5.9	-11.3	-7.6	-1.4	-8.2	-10.7
Real Retained Imports of Fuels	-32.8	5.6	6.3	6.6	7.1	5.9	-12.3	8.8	26.1	13.7	10.7	14.3
Real Retained Imports of Capital Goods	38.7	17.7	45.5	-2.0	72.7	40.8	21.9	13.2	28.5	40.2	18.0	33.8
Total Motor Vehicles Newly Registered	-5.1	-6.9	-22.4	-10.7	13.3	-5.2	-10.6	-7.1	-4.8	5.3	-0.4	-1.5
Private Cars Newly Registered	-4.8	-11.8	-28.4	-10.5	5.4	-0.9	3.9	-4.0	-1.8	13.4	1.5	1.1
Volume Index of Retail Sales	3.7	3.6	5.9	10.5	-4.9	7.7	7.9	7.6	7.7	9.0	10.8	9.8
Money Supply (M2)	7.1	4.4	5.1	6.8	8.8	8.5	10.7	15.2	16.3	17.0	18.2	19.2
Loans and Advances	9.7	7.1	7.2	5.2	9.9	6.6	7.2	8.1	5.2	5.9	7.3	5.8
Visitors Arrivals	6.4	5.6	5.5	15.6	10.9	14.8	9.5	7.3	15.0	17.9	23.4	25.8
Hong Kong Resident Departures	3.8	4.5	2.8	16.5	-3.3	-3.3	15.3	17.4	17.6	9.3	17.8	12.9
Electricity Consumption	11.0	6.4	-0.2	-6.0	-3.0	6.8	3.7	0.8	8.7	9.1	10.3	2.8
Gas Consumption	-2.0	0.4	3.8	1.0	-0.6	-4.5	-3.0	-0.3	-0.5	0.3	-0.5	-0.2

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