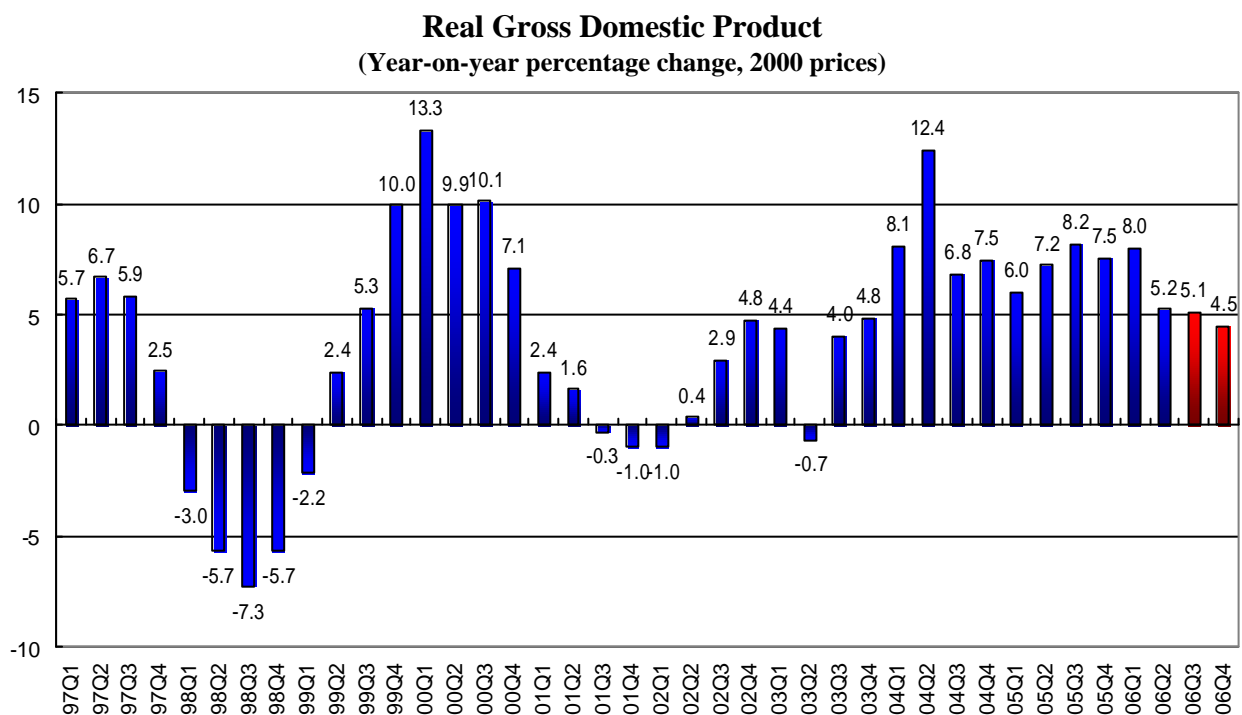


# High Frequency Macroeconomic Forecasts Current Quarter Model: 2006Q4

APEC Study Center  
The University of Hong Kong

October 10, 2006

## Hong Kong Economic Outlook



The APEC Study Center of the University of Hong Kong (HKU) released its quarterly Hong Kong Macroeconomic Forecast today. According to its High Frequency Macroeconomic Forecast, real GDP growth in Q3 of 2006 is estimated to be 5.1% on a year-on-year basis. This growth estimate is a downward revision of the 5.9% forecast released on July 6, 2006 due to the weakening in fixed capital formation. In the fourth quarter of 2006, real GDP growth is forecast to moderate to 4.5% when compared with the same period last year.

Professor Richard Wong Yue-Chim, Director of the APEC Study Center at HKU said that, "Hong Kong's economy is expected to grow with real GDP growing by 4.8% in the second half of this year, dropping from the 6.6% growth in the first half. For the year as a whole, real GDP is likely to grow by 5.7%."

"The labour market will improve slowly. The unemployment rate is expected to drop slightly to 4.7% in the current quarter. Rising import prices and rents will continue to pull up consumer prices. Inflation rate is forecast to increase to 2.6% in the current quarter," according to 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.

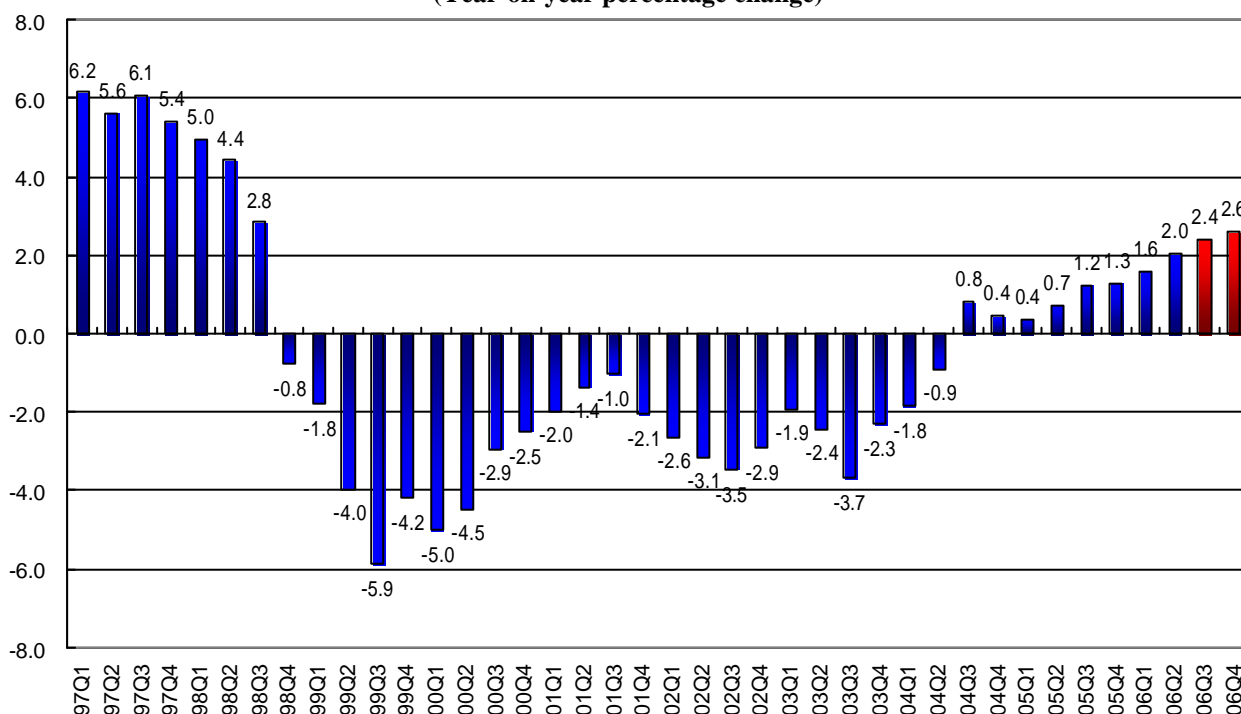
## Forecast Highlights

The highlights of our current forecasts are:

- Private consumption spending grew by 5.0% in Q2. Consumer sentiment and employment prospect continue to improve. Nominal wages have been increasing since the first quarter of 2005. Private consumption expenditure is estimated to grow by 4.5% in Q3 and further pick up to 5.2% in Q4. For the year as a whole, private consumption spending is estimated to grow by 4.8%
- The volume of retail sales in August 2006 registered a broad-based increase of 6.4% when compared with same period last year. Clothing, footwear and allied products, consumer durable goods and other consumer goods grew at 4.2%, 14.8% and 7.1% respectively. The volume of retail sales is forecast to grow by 6.9% in Q3 and 7.5% in Q4 of 2006. For 2006 as a whole, it is expected to rise by 6.4%.
- Total exports growth moderated to 6.7% in Q2, from the 13.3% growth in Q1. It is expected to re-gain momentum in the second half of 2006. It is estimated to be 9.8% in Q3 and forecast to be 9.2% in Q4. For the year as a whole, total exports are projected to grow by 9.7% in 2006.
- After rising by 44.4% and 25.7% in Q1 and Q2 respectively, domestic exports are projected to slowdown in the second half of 2006, moderated to 2.0% growth in Q3 and a sharp turnaround into 9.8% decline in Q4. Domestic exports are forecast to grow by 10.5% in 2006 for the year as a whole.
- Re-exports grew by 5.3% in Q2, decelerated from the 12.8% increase in Q1, but is forecast to pick up again in the second half of this year. It is estimated to grow by 11.0% in Q3 and 11.5% in Q4. For the year as a whole, it is projected to grow by 10.1%.
- Service exports grew by 8.6% in Q2. The number of visitor arrivals increased by 11.2% in August 2006, when compared with the same period last year. Inbound tourism is expected to continue to perform well for the rest of this year. Service exports is forecast to expand by 6.9% and 6.1% in Q3 and Q4 of 2006 respectively. The annual growth is estimated to be 7.6% in 2006.
- Imports of goods grew by 6.7% in Q2. With the strengthening of RMB and high oil prices, import prices have been rising since the end of 2004, thus dampening real import growth in Q2. The growth of imports of goods is estimated to be 10.8% in Q3 and 9.7% in the current quarter. The growth is forecast to be 10.2% for 2006.
- Import of services increased by 7.9% in Q2. Service imports is forecast to grow by 5.5% and 7.0% in Q3 and Q4, respectively. It is estimated to grow by 6.3% in the whole year of 2006.
- The trade balance, as measured by the net exports of goods and services, is estimated to be 13.8% of GDP in Q2. It is forecast to be 18.8% of GDP in Q3 of 2006, 19.6% of GDP in the current quarter and 16.9% of GDP for the year of 2006.

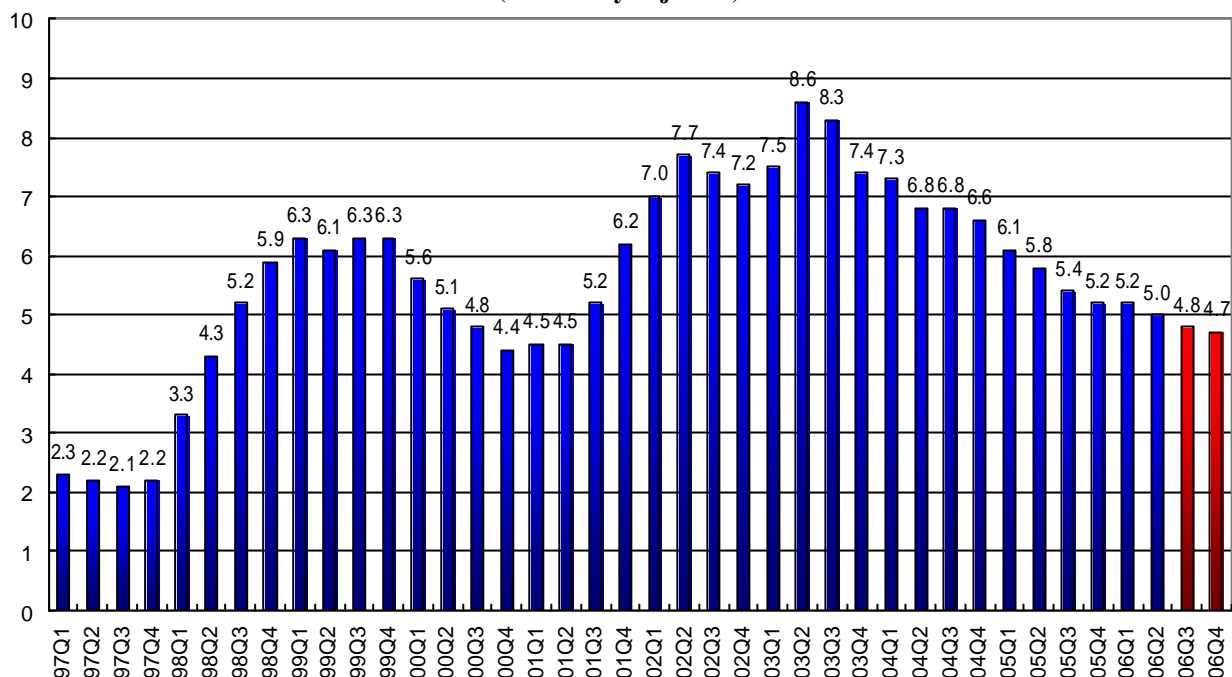
- Gross fixed investment rose by 4.3% in Q2 of 2006. The growth is expected to grow by 7.0% in Q3 and 1.3% in Q4 of 2006. The annual growth is estimated to be 5.0%.
- Investment in land and construction dropped by 10.6% in Q2 of 2006, and is expected to remain weak due to the lack of commencement of major infrastructure projects and the slowdown in private investment in building construction. The investment in land and construction is forecast to drop by 16.5% in Q3 and by 14.3% in Q4 of 2006. The annual decrease of 2006 is estimated to be 13.7%.
- Investment spending in machinery, equipment and computer software surged by 12.8% in Q2 of 2006. Underpinned by the expectation of continued economic growth, machinery and equipment investment growth is expected to remain strong in the second half of this year. It is estimated to grow by 20.2% in Q3, 9.2% in Q4 and 16.0% for the year as a whole.

**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 2.0% in Q2, accelerating from the 1.6% increase in Q1. The Composite CPI rose by 2.5% in August, with the housing component contributed 1.4 percentage point to the increase. With rising rents and wages, inflation rate is forecast to be 2.4% in Q3 and further expand to 2.6% in the current quarter. For the year as a whole, inflation is expected to be 2.2%.

## Unemployment Rate (Seasonally adjusted)



- The provisional seasonally adjusted unemployment rate improved to 4.8% in the three months average ending in August 2006, from the previous estimate of 4.9% for the three months ending in July 2006. The median duration of unemployment stood at 75 days in Q2 which was a marked improvement from the 83 days average in 2005. In tandem with the growing economy, the unemployment rate is forecast to be 4.8% in Q3 of 2006, and drop slightly to 4.7% in the current quarter.

### Concluding Remarks

Despite a weaker external trade environment, Hong Kong real GDP is forecast to grow by 5.7% in the current year. The growth is broadly-based and is primarily driven by a further strengthening in domestic demand which is estimated to contribute 3.9 percentage point to the overall growth. After three consecutive years of above trend growth, the Hong Kong economy is expected to revert to its trend growth path in next year, growing by around 4.5%, and inflation rate is forecast to pick up to 2.5% to 3.0%.

## **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/>

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Table 1: Current Quarter Model Forecast  
(Million of 2000 Dollar)

	2005			2006			
	Q3	Q4	Annual	Q1	Q2	Q3 (forecast)	Q4 (forecast)
Gross Domestic Product	419,379	435,394	1,619,983	407,793	407,919	440,860	455,101
Private Consumption Expenditure	213,264	224,301	859,830	218,192	224,049	222,877	235,982
Government Consumption Expenditure	32,337	32,333	129,799	34,930	30,207	33,922	33,917
Total Export of Goods	658,383	653,101	2,418,344	585,618	632,683	727,017	717,839
Domestic Export of Goods	43,607	47,576	147,372	37,455	38,033	44,483	42,926
Re-export of Goods	614,776	605,525	2,270,972	548,163	594,650	682,534	674,914
Import of Goods	653,217	650,329	2,429,700	595,278	644,416	723,902	713,255
Export of Services	137,065	141,005	514,099	129,299	127,406	146,585	149,647
Import of Services	63,232	60,727	235,373	59,185	59,358	66,684	64,953
Gross Fixed Capital Formation	93,914	95,043	368,394	93,460	96,537	100,484	96,254
Investment in Land & Construction	33,861	32,134	136,807	32,106	30,126	28,281	27,537
Investment in Machinery & Equip.	60,053	62,909	231,587	61,354	66,411	72,204	68,718
Changes in Inventories	865	667	-5,410	757	811	561	-332
Date of Forecast: October 4, 2006							

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

	2005			2006				
	Q3	Q4	Annual	Q1	Q2	Q3 (forecast)	Q4 (forecast)	Annual (forecast)
Gross Domestic Product	8.2	7.5	7.3	8.0	5.2	5.1	4.5	5.7
Private Consumption Expenditure	3.6	3.4	3.4	4.5	5.0	4.5	5.2	4.8
Government Consumption Expenditure	-1.6	-3.8	-3.1	1.2	-1.3	4.9	4.9	2.4
Total Export of Goods	12.1	10.8	10.7	13.3	6.7	9.8	9.2	9.7
Domestic Export of Goods	14.2	28.0	7.6	44.4	25.7	2.0	-9.8	10.5
Re-export of Goods	12.7	10.3	11.4	12.8	5.3	11.0	11.5	10.1
Import of Goods	11.0	12.0	8.6	14.0	6.7	10.8	9.7	10.2
Export of Services	8.9	8.2	8.7	8.9	8.6	6.9	6.1	7.6
Import of Services	3.5	2.3	2.9	4.9	7.9	5.5	7.0	6.3
Gross Fixed Capital Formation	2.8	8.4	4.1	7.6	4.3	7.0	1.3	5.0
Investment in Land & Construction	-4.0	-13.1	-5.3	-13.5	-10.6	-16.5	-14.3	-13.7
Investment in Machinery & Equip.	7.1	24.0	10.6	23.3	12.8	20.2	9.2	16.0
GDP Deflator Growth Rate	0.2	0.7	-0.2	-0.2	-0.1	-0.4	-0.1	-0.2
CPI (Composite) Inflation Rate	1.2	1.3	0.9	1.6	2.0	2.4	2.6	2.2
Unemployment Rate	5.4	5.2	5.6	5.2	5.0	4.8	4.7	4.9

Date of Forecast: October 4, 2006

# High Frequency Macroeconomic Forecasts

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

	2006											
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Unit Value Trade Index (Domestic Exports)	-2.2	-2.7	-3.7	-4.6	-3.6	-3.4	-2.2	-1.0	-1.1	-1.0	-1.2	-1.6
Unit Value Trade Index (Imports of Foodstuffs)	-0.2	-0.6	-0.1	-0.4	0.7	1.5	1.2	1.5	1.6	1.4	1.4	1.0
Unit Value Trade Index (Imports of Consumer Goods)	0.7	0.6	0.1	-0.5	0.4	0.4	0.0	-0.2	0.4	0.8	1.4	1.3
Unit Value Trade Index (Imports of Raw Materials & Semi-Manufactures)	1.1	0.5	1.7	1.0	2.4	3.4	4.1	4.9	4.6	5.6	3.6	5.9
Unit Value Trade Index (Imports of Fuels)	37.6	36.0	25.2	20.9	26.7	23.0	19.9	17.1	11.2	11.0	19.0	28.5
Unit Value Trade Index (Imports of Capital Goods)	-1.5	-1.2	-1.5	0.7	1.3	2.2	1.7	1.6	2.6	2.8	2.2	2.1
Real Retained Imports of Foodstuffs	-3.2	11.1	7.7	7.2	6.4	3.1	0.8	-9.1	8.3	3.0	8.7	-2.0
Real Retained Imports of Consumer Goods	-43.0	104.5	19.8	34.0	33.2	38.6	10.7	17.0	0.0	18.9	0.8	6.0
Real Retained Imports of Raw Materials & Semi-Manufactures	-4.1	12.7	2.5	5.9	-14.0	0.4	-13.7	-9.7	-14.1	-3.2	-1.5	-17.6
Real Retained Imports of Fuels	6.6	7.1	5.9	-12.3	7.2	-5.5	-3.6	2.5	5.0	31.3	-4.5	-8.7
Real Retained Imports of Capital Goods	-2.0	72.7	40.8	21.9	11.0	16.5	36.2	12.5	27.9	10.7	12.9	6.6
Total Motor Vehicles Newly Registered	-10.7	13.3	-5.2	-10.6	-12.5	-4.7	-1.1	-4.4	-5.3	-1.9	-9.3	8.7
Private Cars Newly Registered	-10.5	5.4	-0.9	3.9	-11.9	-2.1	3.0	-4.5	-4.8	-0.3	-4.7	21.6
Volume Index of Retail Sales	11.6	-3.9	8.9	9.0	3.6	3.4	5.2	6.4	9.5	8.5	9.4	5.1
Money Supply (M2)	6.8	8.8	8.6	10.8	17.7	11.3	11.5	15.0	15.0	15.1	15.9	15.8
Loans and Advances	5.2	9.9	6.7	7.4	15.3	7.1	7.3	10.4	7.7	7.1	9.1	7.1
Visitors Arrivals	15.6	10.9	14.8	9.5	7.3	8.3	5.7	11.2	16.4	14.4	16.8	17.9
Hong Kong Resident Departures	16.5	-3.3	-3.3	15.3	1.3	2.6	2.0	4.7	6.4	7.4	9.1	9.9
Electricity Consumption	-6.0	-3.0	6.8	3.7	1.0	4.0	15.0	11.4	3.8	5.5	-0.2	2.8
Gas Consumption	1.0	-0.6	-4.5	-3.0	-0.3	-1.4	0.9	0.8	0.5	2.3	0.4	-0.5

Date of Forecast: October 4, 2006