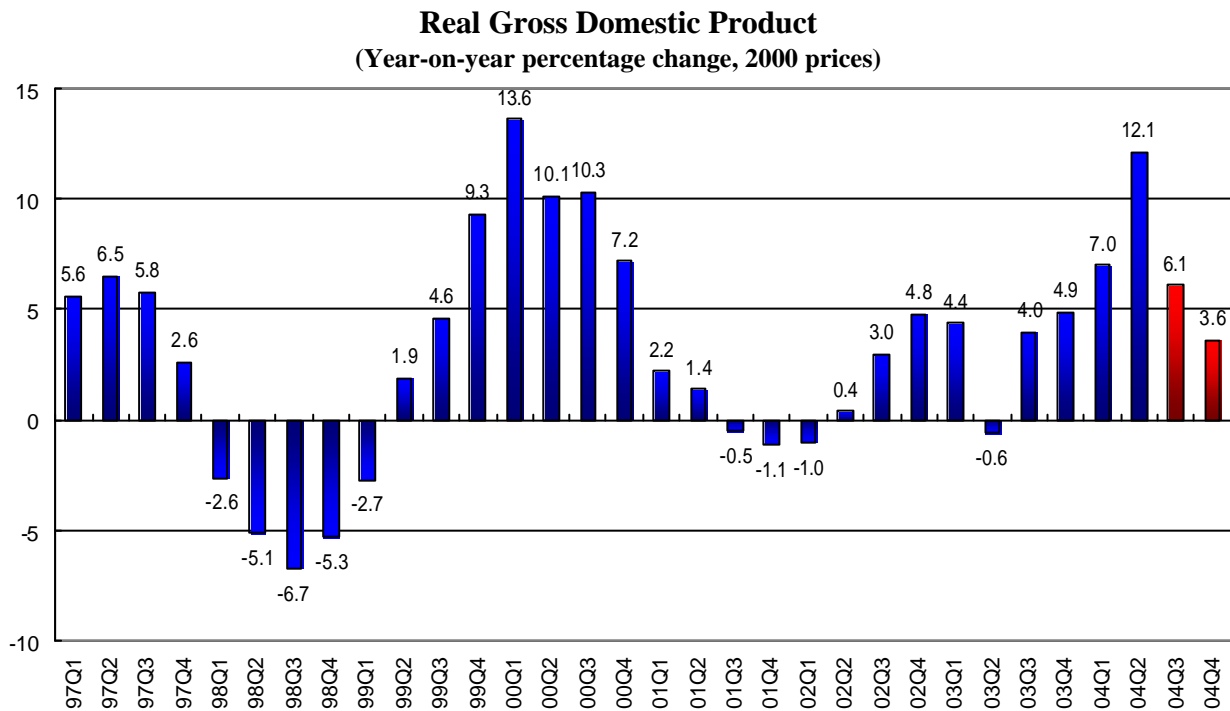


High Frequency Macroeconomic Forecasts Current Quarter Model: 2004Q4

APEC Study Center
The University of Hong Kong

October 6, 2004

Sustained Economic Growth



Following the spectacular performance in the first half of 2004, with output growing by 7.0% and 12.1% in the first and second quarter respectively, GDP growth is expected to continue but at a more moderate pace. According to the High Frequency Macroeconomic Forecast conducted by the APEC Study Center of The University of Hong Kong, real GDP growth in the third quarter is forecast to be 6.1% when compared to the same period last year. This growth estimate is an upward revision of the 5.4% forecast released on July 8, 2004 due to the accelerated growth in private consumption in the second quarter of 2004. In the fourth quarter, economic growth is expected to be 3.6% on an annual basis. For the year as a whole, real GDP is forecast to grow by 7.0% on a year-on-year basis.

In the first half of this year, together with the global economic recovery, the Hong Kong economy rebounded strongly and recouped the output loss due to the SARS outbreak last year. The moderation in growth in the second half is due to a softening in external demand. The sharp increase in oil prices, as well as the tightening of monetary conditions in the U.S. dampens the growth momentum, with the US economy projected to grow by only by 1.3% in the fourth quarter, down from the estimated 3% in the third quarter.

The forecast details are in Table 1 and Table 2, and the forecasts of selected monthly indicators are in Table 3.

Forecast Highlights

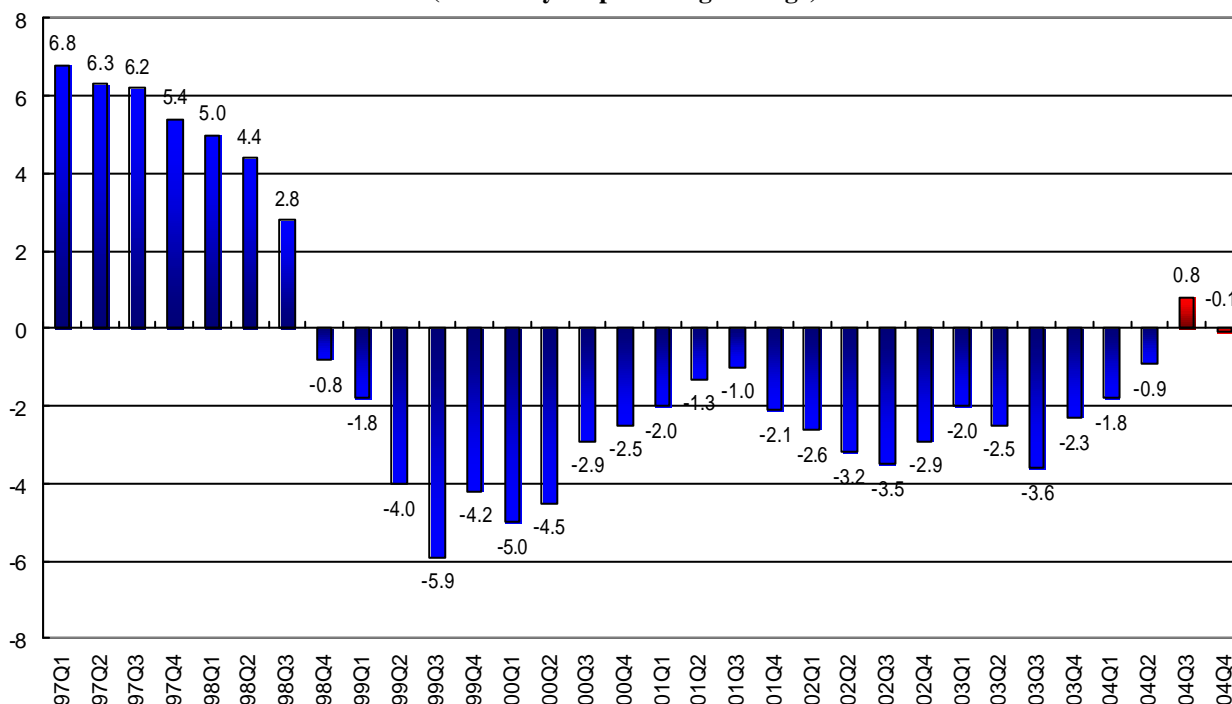
The highlights of our current forecasts are:

- Boosted by better consumer sentiment and the lower base of comparison due to the SARS epidemic last year, private consumption spending surged by 11.0% in the second quarter of 2004. It is projected to grow by 6.3% in the third quarter and by 5.2% in the fourth quarter of 2004, both on a year-on-year basis. For the year as a whole, it is projected to grow by 7.1%.
- Comparing with last year, the volume of retail sales grew by 8.1% year-on-year in July 2004, rising for the twelfth consecutive months. Buoyed by improving domestic demand and the influx of Mainland visitors, the volume of retail sales is forecast to grow in the third and fourth quarters of 2004 by 8.1% and 4.9% respectively, both on a year-on-year basis
- Domestic exports registered an increase of 5.0% in the second quarter of 2004. It is expected to revert back to decrease in the third and fourth quarters of 2004 at 0.9% and 0.4% on a year-on-year basis. For the year as a whole, it is projected to grow annually by 1.0%.
- Re-exports grew by 20.3% in the second quarter of 2004 along with the improving global economy. The double-digit growth in re-exports is expected to be maintained, growing by 18.0% in the third quarter, but moderating to 11.7% in the fourth quarter, both on a year-on-year basis. The annual growth of 2004 is estimated to be 16.2%.
- Given the sustainable growth in the number of visitors from the Mainland, exports of services surged by 31.3% in the second quarter of 2004, partly due to the lower base of comparison. Comparing with the same period last year, the total number of visitor arrivals surged by 54.1% and 25.6%, with hotel occupancy rate kept at 92% and 90%, in July and August 2004 respectively. The export of services is estimated to rise by 9.2% and 5.6% in the third and fourth quarter of 2004. For the year as a whole, it is projected to grow by 13.9%.
- Imports of goods expanded by 20.3% in the second quarter of 2004 in order to support the rapid growth in re-exports. Retained imports also keep growing to meet rising domestic demand. In tandem with the high global demand for re-exports, the growth in the imports of goods is projected to be 17.7% in the third quarter of 2004. The growth is expected to moderate to 11.0% in the fourth quarter of 2004. It is forecast to grow by 16.1% for the whole year.
- Imports of services went up by 30.1% in the second quarter of 2004, partly due to the lower base of comparison. The number of resident departures grew by 12.4% and 0.7% in July and August 2004 respectively. The slowdown in August was mainly due to the discount for traveling package offered last year. Service imports is projected to pick up by 10.9% in the

third quarter of 2004. The growth will moderate to 2.9% in the fourth quarter 2004. For the year as a whole, it is projected to grow by 10.9% in 2004.

- The trade balance, as measured by the net exports of goods and services, was 5.1% of GDP in the second quarter of 2004. The net trade balance is estimated to be 9.9% of GDP in the third quarter of 2004 and 10.7% of GDP in the fourth quarter of 2004. For the year of 2004, it is estimated to be 7.8% of GDP.
- Investment in land and construction dropped by 1.7% in the second quarter of 2004. Construction activities are picking up, with the investment in land and construction forecasted to grow by 0.1% in the third quarter and 2.8% in the fourth quarter of 2004. The annual rate is projected to decrease by 1.3% in the year of 2004.
- Investment spending in machinery, equipment and computer software rose remarkably by 26.1% in the second quarter of 2004. It is estimated to moderate to 14.6% in the third quarter of 2004 and further limited to a 9.6% growth in the fourth quarter of 2004 on a year-on-year basis. It is forecasted to grow by 16.2% on an annual basis in 2004.

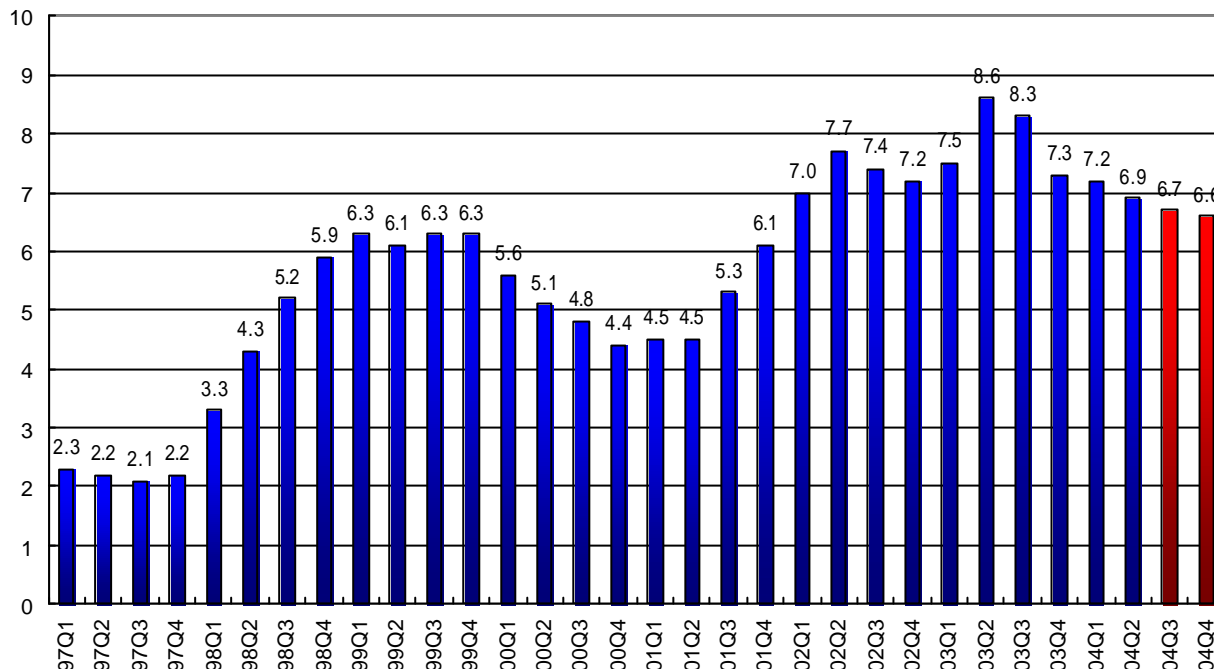
Composite Consumer Price Index
(Year-on-year percentage change)



- Deflation, as measured by the year-on-year percentage change of the Composite Consumer Price Index, has come to an end in the third quarter of 2004. Improved consumer sentiment and rising import prices eased the deflationary pressure. In August 2004, the general price level rose, despite still being dragged down by the CPI housing component, when comparing with the same period last year. The CPI housing component still lags behind due to the binding rental contracts signed before the economic revival. The Composite CPI is estimated to increase by 0.8% in the third quarter, and decrease by a 0.1% in the fourth

quarter of 2004. For the year as a whole, the price level is projected to decrease by 0.5% on average during 2004.

Unemployment Rate (Seasonally adjusted)



- The provisional seasonally adjusted unemployment rate dropped by a modest 0.2 percentage point from 6.9% in the three months ending July 2004 to 6.7% in the three months ending August 2004. The median duration of unemployment decreased from 103 days in the first quarter of 2004 to 97 days in the second quarter of 2004. The unemployment level is expected to continue to fall slowly, with the unemployment rate forecasted to be 6.7% in the third quarter of 2004 and 6.6% in the fourth quarter of 2004. Unemployment rate is estimated to be on average at 6.9% for the whole year of 2004.

Concluding Remarks

Despite the moderation in growth in the second half, the economy is still projected to grow by 7% for the year as a whole. Stable property prices and improving employment prospects are shoring up local consumer spending. Investment spending is strengthening due to the increase business opportunities brought about by CEPA, as well as the expected lowering of real interest rates. Strong domestic demand, coupled with the continued global economic recovery, will help drive Hong Kong's economy forward.

About Hong Kong Macroeconomic Forecast Project

The Hong Kong Macroeconomic Forecast is based on research conducted by the APEC Study Centre 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 Centre.

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)

	2003					2004				
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3 (forecast)	Q4 (forecast)	Annual (forecast)
Gross Domestic Product	322,001	314,677	355,273	369,262	1,361,213	344,382	352,859	376,990	382,545	1,456,776
Private Consumption Expenditure	184,583	184,460	190,340	200,018	759,401	195,623	204,665	202,305	210,419	813,012
Government Consumption Expenditure	34,229	31,325	33,292	34,210	133,056	36,063	31,315	33,791	34,723	135,892
Domestic Exports of Goods	28,470	31,416	38,419	35,505	133,810	28,685	32,991	38,092	35,365	135,133
Re-exports of Goods	380,121	419,908	467,819	485,101	1,752,949	441,279	502,617	551,803	541,965	2,037,664
Imports of Goods	432,701	468,962	515,205	542,735	1,959,603	503,287	564,271	606,160	602,335	2,276,053
Exports of Services	88,420	73,357	103,322	113,399	378,498	100,556	97,797	112,874	119,749	430,976
Imports of Services	48,126	39,430	53,547	52,383	193,486	50,121	51,283	59,371	53,894	214,669
Investment in Land & Construction	39,454	36,984	39,006	37,169	152,613	37,100	36,340	39,036	38,200	150,676
Investment in Machinery & Equip.	42,721	42,554	50,886	52,068	188,229	49,569	53,672	58,328	57,085	218,654
Changes in Inventories	4,830	3,065	941	6,910	15,746	8,915	9,016	6,291	1,268	25,490

Date of Forecast: September 30, 2004.

High Frequency Macroeconomic Forecasts
APEC Study Center
The University of Hong Kong

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

	2003					2004				
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	Q3 (forecast)	Q4 (forecast)	Annual (forecast)
Gross Domestic Product	4.4	-0.6	4.0	4.9	3.2	7.0	12.1	6.1	3.6	7.0
Private Consumption Expenditure	-3.2	-4.1	0.1	3.7	-0.9	6.0	11.0	6.3	5.2	7.1
Government Consumption Expenditure	1.0	0.5	0.5	5.5	1.9	5.4	0.0	1.5	1.5	2.1
Domestic Exports of Goods	-12.0	-12.6	-5.2	-0.2	-7.3	0.8	5.0	-0.9	-0.4	1.0
Re-exports of Goods	22.3	17.0	11.5	16.0	16.3	16.1	19.7	18.0	11.7	16.2
Imports of Goods	18.8	10.9	8.2	15.7	13.1	16.3	20.3	17.7	11.0	16.1
Exports of Services	12.6	-10.8	7.6	12.0	5.7	13.7	33.3	9.2	5.6	13.9
Imports of Services	-5.4	-16.8	-0.3	3.1	-4.6	4.1	30.1	10.9	2.9	10.9
Investment in Land & Construction	-3.8	-9.8	-6.5	-6.9	-6.7	-6.0	-1.7	0.1	2.8	-1.3
Investment in Machinery, Equip. & S.W.	12.8	-1.1	5.6	9.3	6.5	16.0	26.1	14.6	9.6	16.2
GDP Deflator Growth Rate	-4.4	-5.8	-6.1	-4.8	-5.3	0.0	-2.9	-1.0	-1.6	-1.4
CPI (Composite) Inflation Rate	-2.0	-2.5	-3.6	-2.3	-2.6	-1.8	-0.9	0.8	-0.1	-0.5
Unemployment Rate	7.2	8.6	8.3	7.3	7.9	7.2	6.9	6.7	6.6	6.9
Date of Forecast: September 30, 2004.										

High Frequency Macroeconomic Forecasts

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

	2004											
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
Unit Value Trade Index (Domestic Exports)	-0.8	-0.2	-0.8	0.3	0.5	-0.3	1.0	1.2	1.9	1.8	2.1	1.7
Unit Value Trade Index (Imports of Foodstuffs)	3.6	3.7	4.4	3.5	3.6	3.5	4.3	4.4	4.6	5.1	4.2	3.7
Unit Value Trade Index (Imports of Consumer Goods)	0.6	0.6	0.1	-0.1	0.6	1.0	0.9	1.6	1.7	1.9	2.2	1.6
Unit Value Trade Index (Imports of Raw Materials & Semi-Manufactures)	3.0	3.6	3.8	4.7	5.3	5.9	6.7	6.5	6.5	6.9	6.2	5.7
Unit Value Trade Index (Imports of Fuels)	9.6	2.5	3.2	14.2	29.7	30.0	32.3	29.1	30.3	28.5	26.5	30.7
Unit Value Trade Index (Imports of Capital Goods)	-4.8	-3.5	-2.2	-1.4	-1.9	-0.9	0.5	1.3	1.3	1.5	1.6	1.7
Real Retained Imports of Foodstuffs	3.4	6.9	7.7	13.4	17.3	25.3	6.1	5.4	9.5	6.8	-9.3	-4.5
Real Retained Imports of Consumer Goods	-58.4	78.6	3.9	19.8	6.9	37.5	4.1	7.7	7.6	1.6	14.3	5.4
Real Retained Imports of Raw Materials & Semi-Manufactures	35.5	25.5	11.7	23.3	32.5	-7.4	5.6	11.4	59.5	-6.5	-12.4	-4.6
Real Retained Imports of Fuels	23.6	-15.3	24.9	47.9	-2.7	37.4	13.9	15.3	6.2	10.8	-4.9	-0.9
Real Retained Imports of Capital Goods	2.4	42.7	15.4	39.1	10.9	36.7	18.5	22.6	8.6	20.9	0.8	2.4
Total Motor Vehicles Newly Registered	-28.5	-17.5	53.8	32.6	36.7	36.1	16.2	25.3	17.0	11.3	24.2	0.6
Private Cars Newly Registered	-25.1	-21.2	65.0	54.9	47.7	40.9	21.4	27.2	22.7	20.8	31.6	10.5
Volume Index of Retail Sales	3.0	11.3	9.0	20.0	15.7	11.4	8.1	7.2	9.0	5.1	5.6	4.0
Money Supply (M2)	10.6	11.7	8.7	7.6	6.6	6.8	5.9	6.4	6.5	4.7	6.6	6.3
Loans and Advances	0.9	3.0	-0.9	-0.1	-0.2	1.1	1.3	1.7	1.4	-1.0	1.3	0.3
Electricity Consumption	3.6	3.0	1.8	4.5	-7.1	6.6	2.5	-0.1	0.7	-2.6	7.6	-2.0
Gas Consumption	1.2	2.8	3.7	2.0	0.9	0.8	0.5	-0.6	1.5	4.3	2.8	-0.2
Visitors Arrivals	13.1	3.3	28.6	251.8	296.6	127.0	54.1	25.6	24.1	23.9	22.0	24.6
Hong Kong Resident Departures	2.0	-1.4	9.5	69.9	41.2	19.1	12.4	0.7	7.6	2.8	5.8	6.8
Effective Exchange Rate Index	-3.13	-3.38	-3.2	-3.4	-1.5	-1.8	-2.2	-2.2	-1.9	-1.0	-0.9	-0.3

Date of Forecast: September 30, 2004.