

# **APPENDIX A**

## **MEDIUM RANGE FORECAST**

**2008–09 TO 2013–14**

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## SECTION I – FORECASTING ASSUMPTIONS AND BUDGETARY CRITERIA

1 A number of computer-based models are used to derive the Medium Range Forecast (MRF). These models use a wide range of assumptions about the factors affecting each of the components of Government's revenue and expenditure. Some are economic in nature (the general economic assumptions) while others deal with specific areas of Government's activities (the detailed assumptions). These are supported by studies of historical and projected trends.

### General Economic Assumptions

#### *Real Gross Domestic Product (real GDP)*

2 GDP is forecast to decrease by between 2% to 3% in real terms in 2009. We have used the mid-point of this range forecast in deriving the MRF. For planning purposes, in the four-year period 2010 to 2013, the trend growth rate of the economy in real terms is assumed to be 3.5% per annum.

#### *Price change*

3 The GDP deflator, measuring overall price change in the economy, is forecast to increase by 0.5% in 2009. For the four-year period 2010 to 2013, the GDP deflator is assumed to increase at a trend rate of 1% per annum.

4 The Composite Consumer Price Index (CCPI), measuring inflation in the consumer domain, is forecast to increase by 1.6% in 2009. Eliminating the effects of various one-off measures introduced in the 2008-09 and 2009-10 Budgets, the underlying CCPI is forecast to increase by 1.5% in 2009. For the ensuing period 2010 to 2013, the trend rate of increase for the underlying CCPI is assumed to be 2% per annum.

#### *Nominal Gross Domestic Product (nominal GDP)*

5 Given the assumptions on the rates of change in the real GDP and the GDP deflator, the GDP in nominal terms is forecast to decrease by between 1.5% to 2.5% in 2009, and the trend growth rate in nominal terms for the period 2010 to 2013 is assumed to be 4.5% per annum.

### Detailed Assumptions

6 The MRF incorporates a wide range of detailed assumptions on expenditure and revenue patterns over the forecast period, taking the following, amongst other factors, into account –

- estimated cash flow of capital projects,
- forecast completion dates of these capital projects and their related recurrent consequences in terms of staffing and running costs,
- estimated cash flow arising from new commitments and policy initiatives,
- the expected pattern of demand for individual services,
- the trend in yield from individual revenue sources, and
- new revenue/expenditure measures in the 2009-10 Budget.

### Budgetary Criteria

7 In addition to the above forecasting assumptions, there are a number of criteria against which the results of forecasts are tested for overall acceptability in terms of budgetary policy.

8 The following covers the more important budgetary criteria –

#### *Budget surplus/deficit*

The Government aims to achieve balance in the consolidated and operating accounts. The Government needs, over time, to achieve an operating surplus to partially finance capital expenditure.

#### *Expenditure policy*

The general principle is that, over time, expenditure growth should not exceed the growth of the economy. The Government aims to keep public expenditure at or below 20% of GDP. Capital expenditure, by its nature, will fluctuate from year to year.

#### *Revenue policy*

Account is taken of the need to maintain, over time, the real yield from revenue.

#### *Fiscal reserves*

The Government aims to maintain adequate reserves in the long run.

## SECTION II – THE MRF FOR 2008–09 TO 2013–14

9 The current MRF (*Note a*) is summarised in the following table which indicates the forecast financial position of the Government –

Table 1

(\$ million)	Original Estimate	Revised Estimate	Estimate	Forecast			
	2008–09	2008–09	2009–10	2010–11	2011–12	2012–13	2013–14
<b>Operating Account</b>							
Operating revenue ( <i>Note b &amp; f</i> )	212,269	240,387	206,703	215,155	235,366	254,347	274,689
Less: Operating expenditure ( <i>Note c</i> )	255,700	259,991	244,000	249,400	258,100	267,100	276,400
Deficit before investment income	(43,431)	(19,604)	(37,297)	(34,245)	(22,734)	(12,753)	(1,711)
Investment income ( <i>Note b</i> )	37,091	37,562	27,494	20,108	18,348	19,116	15,264
<b>Operating surplus/(deficit) after investment income</b>	<b>(6,340)</b>	<b>17,958</b>	<b>(9,803)</b>	<b>(14,137)</b>	<b>(4,386)</b>	<b>6,363</b>	<b>13,553</b>
<b>Capital Financing Statement</b>							
Capital revenue ( <i>Note d</i> )	53,138	25,832	23,506	41,416	39,429	41,587	44,436
Asset sales ( <i>Note d</i> )	87	68	85	77	10,475	10,298	10,270
Less: Capital spending ( <i>Note e</i> )	53,225	25,900	23,591	41,493	49,904	51,885	54,706
Deficit before investment income/interest expenses	(3,064)	(28,421)	(29,875)	(13,191)	(19,048)	(16,344)	(15,856)
Investment income ( <i>Note d</i> )	5,315	9,036	3,944	2,832	2,149	1,776	1,536
Less: Interest expenses ( <i>Note e &amp; f</i> )	754	754	642	576	577	576	577
<b>Surplus/(deficit) after investment income/interest expenses</b>	<b>1,497</b>	<b>(20,139)</b>	<b>(26,573)</b>	<b>(10,935)</b>	<b>(17,476)</b>	<b>(15,144)</b>	<b>(14,897)</b>
Less: Repayment of bonds and notes ( <i>Note e &amp; f</i> )	2,700	2,700	3,500	-	-	-	-
<b>Capital financing deficit after bond repayment</b>	<b>(1,203)</b>	<b>(22,839)</b>	<b>(30,073)</b>	<b>(10,935)</b>	<b>(17,476)</b>	<b>(15,144)</b>	<b>(14,897)</b>
<b>Consolidated Account</b>							
Fiscal reserves at 1 April	484,939	492,914	488,033	448,157	423,085	401,223	392,442
Operating surplus/(deficit)	(6,340)	17,958	(9,803)	(14,137)	(4,386)	6,363	13,553
Capital financing surplus/(deficit) before bond repayment	1,497	(20,139)	(26,573)	(10,935)	(17,476)	(15,144)	(14,897)
<b>Consolidated deficit</b>	<b>(4,843)</b>	<b>(2,181)</b>	<b>(36,376)</b>	<b>(25,072)</b>	<b>(21,862)</b>	<b>(8,781)</b>	<b>(1,344)</b>
Less: Repayment of bonds and notes	2,700	2,700	3,500	-	-	-	-
<b>Consolidated deficit after bond repayment</b>	<b>(7,543)</b>	<b>(4,881)</b>	<b>(39,876)</b>	<b>(25,072)</b>	<b>(21,862)</b>	<b>(8,781)</b>	<b>(1,344)</b>
<b>Fiscal reserves at 31 March</b>	<b>477,396</b>	<b>488,033</b>	<b>448,157</b>	<b>423,085</b>	<b>401,223</b>	<b>392,442</b>	<b>391,098</b>
As number of months of government expenditure	18	19	18	17	15	14	14
As a percentage of GDP	27.7%	29.1%	27.2%	24.6%	22.3%	20.9%	19.9%
Outstanding debts at 31 March							
Toll Revenue Bond	2,098	1,932	-	-	-	-	-
Other government bonds and notes	14,750	14,750	11,250	11,250	11,250	11,250	11,250

Notes –

(a) *Accounting policies*

- (i) The MRF is prepared on a cash basis and reflects forecast receipts and payments, whether or not they relate to operating or capital transactions.
- (ii) The MRF includes the General Revenue Account and the Funds (Capital Investment Fund, Capital Works Reserve Fund, Civil Service Pension Reserve Fund, Disaster Relief Fund, Innovation and Technology Fund, Land Fund, Loan Fund and Lotteries Fund).

(b) *Operating revenue*

- (i) The operating revenue has taken into account the revenue-concession measures proposed in the 2009-10 Budget, and is made up of –

	2008–09 Revised Estimate	2009–10 Estimate	2010–11 Forecast	2011–12 Forecast	2012–13 Forecast	2013–14 Forecast
(\$ million)						
Operating revenue before investment income	240,387	206,703	215,155	235,366	254,347	274,689
Investment income	37,562	27,494	20,108	18,348	19,116	15,264
Total	277,949	234,197	235,263	253,714	273,463	289,953

- (ii) Investment income under the Operating Account includes investment income of the General Revenue Account which is credited to revenue head Properties and Investments and investment income of the Land Fund. The rate of investment return for 2009 is 6.8% and for 2010 to 2013 is assumed to be in the range of 4.3% to 5.3% a year.

(c) *Operating expenditure*

This represents expenditure charged to the Operating Account of the General Revenue Account. The levels of operating expenditure in 2009-10 to 2013-14 represent the expenditure guideline for these years.

(d) *Capital revenue*

- (i) The breakdown of capital revenue is –

	2008–09 Revised Estimate	2009–10 Estimate	2010–11 Forecast	2011–12 Forecast	2012–13 Forecast	2013–14 Forecast
(\$ million)						
General Revenue Account	4,001	2,870	3,927	684	528	528
Capital Works Reserve Fund	17,047	16,634	33,366	34,539	36,639	39,240
Capital Investment Fund	1,811	872	812	770	802	821
Disaster Relief Fund	2	-	-	-	-	-
Innovation and Technology Fund	18	-	-	-	-	-
Loan Fund	1,992	2,131	2,259	2,324	2,444	2,606
Lotteries Fund	961	999	1,052	1,112	1,174	1,241
Capital revenue before asset sales and investment income	25,832	23,506	41,416	39,429	41,587	44,436
Asset sales	68	85	77	10,475	10,298	10,270
Investment income	9,036	3,944	2,832	2,149	1,776	1,536
Total	34,936	27,535	44,325	52,053	53,661	56,242

- (ii) For the purpose of the MRF, the annual land premium included under the Capital Works Reserve Fund is assumed to be around 1% of GDP in 2009-10 and 2% from 2010-11 onwards.
- (iii) Investment income under the Capital Financing Statement includes investment income of the Funds except Land Fund (i.e. Capital Investment Fund, Capital Works Reserve Fund, Civil Service Pension Reserve Fund, Disaster Relief Fund, Innovation and Technology Fund, Loan Fund and Lotteries Fund).

(e) *Capital spending*

The breakdown of capital spending is –

	2008–09 Revised Estimate	2009–10 Estimate	2010–11 Forecast	2011–12 Forecast	2012–13 Forecast	2013–14 Forecast
(\$ million)						
General Revenue Account	2,508	3,523	3,970	3,970	3,970	3,970
Capital Works Reserve Fund	47,166	43,884	44,558	59,525	58,885	61,651
Capital Investment Fund	209	380	535	250	250	250
Disaster Relief Fund	345	-	-	-	-	-
Innovation and Technology Fund	659	1,278	1,465	993	1,018	1,044
Loan Fund	2,492	2,592	2,935	3,044	3,592	3,250
Lotteries Fund	942	1,809	1,221	1,170	514	397
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Capital spending before interest on and repayment of government bonds and notes	54,321	53,466	54,684	68,952	68,229	70,562
Interest expenses	754	642	576	577	576	577
Repayment of bonds and notes	2,700	3,500	-	-	-	-
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Total	57,775	57,608	55,260	69,529	68,805	71,139

(f) *Government bonds and notes*

Interest expenses and repayment of bonds and notes are only in respect of the global bond issue and not the Toll Revenue Bond. The interest expenses and repayment of the Toll Revenue Bond are charged directly against the net toll revenue of the concerned tunnels and bridges. The toll revenue thus forgone has been taken into account in forecasting government operating revenue.

### SECTION III – RELATIONSHIP BETWEEN GOVERNMENT EXPENDITURE/PUBLIC EXPENDITURE AND GDP IN THE MRF

10 For monitoring purposes, expenditure of the Trading Funds and the Housing Authority (collectively referred to as “other public bodies”) is added to Government’s own expenditure in order to compare total public expenditure with GDP.

#### Government Expenditure and Public Expenditure in the Context of the Economy

Table 2

(\$ million)	Original Estimate	Revised Estimate	Estimate	Forecast			
	2008–09	2008–09	2009–10	2010–11	2011–12	2012–13	2013–14
Operating expenditure	255,700	259,991	244,000	249,400	258,100	267,100	276,400
Capital expenditure	56,694	54,866	53,728	54,725	69,279	68,555	70,889
<b>Total government expenditure</b>	312,394	314,857	297,728	304,125	327,379	335,655	347,289
Other public bodies expenditure	19,688	19,745	21,631	22,656	22,642	23,092	23,610
<b>Total public expenditure (Note a)</b>	332,082	334,602	319,359	326,781	350,021	358,747	370,899
<b>Gross Domestic Product (calendar year)</b>	1,725,625	1,678,514	1,644,734	1,718,747	1,796,692	1,878,172	1,963,347
<b>Growth in GDP (Note b)</b>							
Nominal terms		3.9%	-2.0%	4.5%	4.5%	4.5%	4.5%
Real terms		2.5%	-2.5%	3.5%	3.5%	3.5%	3.5%
<b>Growth in government expenditure (Note c)</b>							
Nominal terms		34.1%	-5.4%	2.1%	7.6%	2.5%	3.5%
Real terms		28.5%	-6.0%	-0.7%	6.7%	0.5%	0.9%
<b>Growth in public expenditure (Note c)</b>							
Nominal terms		32.6%	-4.6%	2.3%	7.1%	2.5%	3.4%
Real terms		27.0%	-5.2%	-0.4%	6.2%	0.5%	0.8%
<b>Public expenditure as a percentage of GDP</b>	19.2%	19.9%	19.4%	19.0%	19.5%	19.1%	18.9%

Notes –

- (a) Public expenditure comprises government expenditure (i.e. all expenditure charged to the General Revenue Account and financed by the Government’s statutory funds excluding Capital Investment Fund), and expenditure by the Trading Funds and the Housing Authority. It does not include expenditure by those organisations, including statutory organisations, in which the Government has only an equity position, such as the Airport Authority and the MTR Corporation Limited. Similarly, advances and equity investments from the Capital Investment Fund as well as repayment of government bonds and notes are excluded as they do not reflect the actual consumption of resources by the Government.
- (b) For 2009-10, the GDP growth in nominal terms of -2% represents the mid-point of the range forecast of nominal GDP growth at -1.5% to -2.5% for the calendar year 2009. Similarly, the growth in real terms of -2.5% represents the mid-point of the range forecast of real GDP growth at -2% to -3% for 2009.
- (c) The growth rates refer to year-on-year change. For example, the rates for 2008–09 refer to the change between revised estimate for 2008–09 and actual expenditure in 2007–08. The rates for 2009–10 refer to the change between the 2009–10 estimate and the 2008–09 revised estimate, and so forth.

11 Table 3 shows the relationship amongst the sum to be appropriated in the 2009-10 Budget, government expenditure and public expenditure. It also shows the effect of the Budget revenue measures on the overall fiscal position for 2009–10.

**Relationship between Government Expenditure  
and Public Expenditure in 2009–10**

(\$ million)

Table 3

Components of expenditure and revenue	Appropriation	Government expenditure and revenue			Public expenditure
		Operating	Capital	Total	
<b>Expenditure</b>					
General Revenue Account					
Operating					
Recurrent	227,603	227,603	-	227,603	227,603
Non-recurrent	16,397	16,397	-	16,397	16,397
Capital					
Plant, equipment and works	2,023	-	2,023	2,023	2,023
Subventions	1,500	-	1,500	1,500	1,500
	247,523	244,000	3,523	247,523	247,523
Transfer to Funds	15,409	-	-	-	-
Capital Works Reserve Fund	-	-	44,526	44,526	44,526
Innovation and Technology Fund	-	-	1,278	1,278	1,278
Loan Fund	-	-	2,592	2,592	2,592
Lotteries Fund	-	-	1,809	1,809	1,809
Trading Funds	-	-	-	-	3,837
Housing Authority	-	-	-	-	17,794
	262,932	244,000	53,728	297,728	319,359
<b>Revenue (before Budget revenue measures)</b>					
General Revenue Account					
Taxation		188,947	80	189,027	
Other revenue		41,683	2,790	44,473	
		230,630	2,870	233,500	
Land Fund		11,196	-	11,196	
		241,826	2,870	244,696	
Capital Works Reserve Fund		-	18,361	18,361	
Capital Investment Fund		-	928	928	
Civil Service Pension Reserve Fund		-	1,377	1,377	
Disaster Relief Fund		-	3	3	
Innovation and Technology Fund		-	251	251	
Loan Fund		-	2,302	2,302	
Lotteries Fund		-	1,443	1,443	
		241,826	27,535	269,361	
<b>Deficit before Budget revenue measures</b>		(2,174)	(26,193)	(28,367)	
<i>Less: Effect of Budget revenue measures</i>		(7,629)	-	(7,629)	
<b>Deficit after Budget revenue measures</b>		(9,803)	(26,193)	(35,996)	
<i>Less: Advances and equity investments from the Capital Investment Fund</i>		-	380	380	
<i>Repayment of bonds and notes</i>		-	3,500	3,500	
<b>Consolidated deficit</b>		(9,803)	(30,073)	(39,876)	



**SECTION IV – ESTIMATES OF CONTINGENT LIABILITIES**

12 The Government's contingent liabilities as at 31 March 2008, and estimates of these should they remain unsettled as at 31 March 2009 or 31 March 2010, are provided below as supplementary information to the MRF –

(\$ million)	2008	At 31 March 2009	2010
Guarantee to the Hong Kong Export Credit Insurance Corporation for liabilities under contracts of insurance	12,787	15,163	17,962
Guarantee provided under the Special Loan Guarantee Scheme	-	58,350	100,000
Guarantees provided under loan guarantee schemes for small and medium enterprises	4,089	4,118	4,118
Possible capital subscriptions to the Asian Development Bank	2,295	2,295	2,295
Guarantee provided for commercial loan of the Ocean Park Corporation	-	786	1,388
Litigation	42	44	44
Total	<u>19,213</u>	<u>80,756</u>	<u>125,807</u>