

APPENDIX A

MEDIUM RANGE FORECAST

2007–08 TO 2012–13

CONTENTS

SECTION I – FORECASTING ASSUMPTIONS AND BUDGETARY CRITERIA

SECTION II – THE MRF FOR 2007-08 TO 2012-13

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

SECTION IV – ESTIMATES OF CONTINGENT LIABILITIES

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 reflect a wide range of assumptions about the factors determining 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 anticipated trends.

General Economic Assumptions

Real Gross Domestic Product (real GDP)

2 GDP is forecast to increase by 4% to 5% in real terms in 2008. For planning purposes, over the ensuing four-year period 2009 to 2012, the trend growth rate of the economy in real terms is assumed at 4.5% per annum. We have made reference to the mid-point of the range forecast of GDP growth rate for 2008 in deriving the MRF.

Price change

3 The GDP deflator, measuring overall price change in the economy, is forecast to increase by 2.5% in 2008. For the four-year period 2009 to 2012, the GDP deflator is assumed to increase at a trend rate of 2.5% per annum.

4 The Composite Consumer Price Index (CCPI) measuring inflation in the consumer domain, is forecast to increase by 3.4% in 2008. Eliminating the effects of various one-off measures introduced in the 2008-09 Budget, the underlying CCPI is forecast to increase by 4.5% in 2008. For the ensuing period 2009 to 2012, the trend rate of increase for the underlying CCPI is assumed to be 4% per annum.

Nominal Gross Domestic Product (nominal GDP)

5 Taking the assumptions on the rates of change in the real GDP and the GDP deflator together, the growth rate of GDP in nominal terms is forecast at 6.5% to 7.5% in 2008, and the trend growth rate in nominal terms for the period 2009 to 2012 is assumed at 7% 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 2008-09 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 sustain 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 2007–08 TO 2012–13

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

Table 1

	Original Estimate	Revised Estimate	Estimate	Forecast			
(\$ million)	2007–08	2007–08	2008–09	2009–10	2010–11	2011–12	2012–13
Operating Account							
Operating revenue (<i>Note b & f</i>)	201,524	248,296	212,269	254,140	272,196	289,200	306,575
Less: Operating expenditure (<i>Note c</i>)	214,200	206,423	255,700	237,300	251,500	267,800	286,500
Surplus/(deficit) before investment income	(12,676)	41,873	(43,431)	16,840	20,696	21,400	20,075
Investment income (<i>Note b</i>)	19,882	21,842	37,091	38,832	37,033	39,836	47,180
Operating surplus/(deficit) after investment income	7,206	63,715	(6,340)	55,672	57,729	61,236	67,255
Capital Financing Statement							
Capital revenue (<i>Note d</i>)	46,048	76,733	53,138	55,219	55,389	58,346	62,260
Asset sales (<i>Note d</i>)	299	63	87	902	926	1,312	1,217
	46,347	76,796	53,225	56,121	56,315	59,658	63,477
Less: Capital spending (<i>Note e</i>)	33,438	30,068	56,289	62,677	62,127	57,237	59,278
Surplus/(deficit) before investment income/interest expenses	12,909	46,728	(3,064)	(6,556)	(5,812)	2,421	4,199
Investment income (<i>Note d</i>)	6,092	6,033	5,315	4,233	3,581	3,675	4,085
Less: Interest expenses (<i>Note e & f</i>)	799	801	754	642	576	577	576
Surplus/(deficit) after investment income/interest expenses	18,202	51,960	1,497	(2,965)	(2,807)	5,519	7,708
Less: Repayment of bonds and notes (<i>Note e & f</i>)	-	-	2,700	3,500	-	-	-
Capital financing surplus/(deficit) after bond repayment	18,202	51,960	(1,203)	(6,465)	(2,807)	5,519	7,708
Consolidated Account							
Fiscal reserves at 1 April	365,747	369,264	484,939	477,396	526,603	581,525	648,280
Operating surplus/(deficit)	7,206	63,715	(6,340)	55,672	57,729	61,236	67,255
Capital financing surplus/(deficit) before bond repayment	18,202	51,960	1,497	(2,965)	(2,807)	5,519	7,708
Consolidated surplus/(deficit)	25,408	115,675	(4,843)	52,707	54,922	66,755	74,963
Less: Repayment of bonds and notes	-	-	2,700	3,500	-	-	-
Consolidated surplus/(deficit) after bond repayment	25,408	115,675	(7,543)	49,207	54,922	66,755	74,963
Fiscal reserves at 31 March	391,155	484,939	477,396	526,603	581,525	648,280	723,243
As a number of months of government expenditure	19	25	18	21	22	24	25
As a percentage of GDP	25.4%	30.1%	27.7%	28.5%	29.4%	30.7%	32.0%
Outstanding debts at 31 March							
Toll Revenue Bond	2,820	2,638	2,098	790	790	-	-
Other government bonds and notes	17,450	17,450	14,750	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 2008-09 Budget, and is made up of –

	2007–08 Revised Estimate	2008–09 Estimate	2009–10 Forecast	2010–11 Forecast	2011–12 Forecast	2012–13 Forecast
(\$ million)						
Operating revenue before investment income	248,296	212,269	254,140	272,196	289,200	306,575
Investment income	21,842	37,091	38,832	37,033	39,836	47,180
Total	<u>270,138</u>	<u>249,360</u>	<u>292,972</u>	<u>309,229</u>	<u>329,036</u>	<u>353,755</u>

- (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 2008 is 9.4% and for 2009 to 2012 is assumed to be in the range of 7.5% to 9.3% a year.

(c) Operating expenditure

This represents expenditure charged to the Operating Account of the General Revenue Account. The levels of operating expenditure in 2008-09 to 2012-13 represent the expenditure guidelines for these years.

(d) Capital revenue

- (i) The breakdown of capital revenue is –

	2007–08 Revised Estimate	2008–09 Estimate	2009–10 Forecast	2010–11 Forecast	2011–12 Forecast	2012–13 Forecast
(\$ million)						
General Revenue Account	8,319	4,963	4,469	1,287	554	528
Capital Works Reserve Fund	63,145	43,240	46,154	49,385	52,841	56,540
Capital Investment Fund	2,184	1,782	1,105	1,021	998	1,002
Disaster Relief Fund	1	-	-	-	-	-
Innovation and Technology Fund	20	-	-	-	-	-
Loan Fund	1,972	2,004	2,281	2,421	2,610	2,775
Lotteries Fund	1,092	1,149	1,210	1,275	1,343	1,415
Capital revenue before asset sales and investment income	<u>76,733</u>	<u>53,138</u>	<u>55,219</u>	<u>55,389</u>	<u>58,346</u>	<u>62,260</u>
Asset sales	63	87	902	926	1,312	1,217
Investment income	6,033	5,315	4,233	3,581	3,675	4,085
Total	<u>82,829</u>	<u>58,540</u>	<u>60,354</u>	<u>59,896</u>	<u>63,333</u>	<u>67,562</u>

- (ii) For the purpose of the MRF, the annual land premium included under the Capital Works Reserve Fund is assumed at 2.5% of GDP throughout the MRF period.
- (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 –

	2007–08 Revised Estimate	2008–09 Estimate	2009–10 Forecast	2010–11 Forecast	2011–12 Forecast	2012–13 Forecast
(\$ million)						
General Revenue Account	2,117	2,726	3,970	3,970	3,970	3,970
Capital Works Reserve Fund	22,640	48,250	53,831	53,424	48,605	50,038
Capital Investment Fund	123	349	450	353	250	250
Disaster Relief Fund	293	-	-	-	-	-
Innovation and Technology Fund	519	879	821	760	796	866
Loan Fund	3,505	2,994	2,913	3,214	3,197	3,807
Lotteries Fund	871	1,091	692	406	419	347
Capital spending before interest on and repayment of government bonds and notes	30,068	56,289	62,677	62,127	57,237	59,278
Interest expenses	801	754	642	576	577	576
Repayment of bonds and notes	-	2,700	3,500	-	-	-
Total	30,869	59,743	66,819	62,703	57,814	59,854

(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, Government's own expenditure is consolidated with expenditure of the Trading Funds and the Housing Authority (collectively referred to as "other public bodies") in order to compare total public expenditure with GDP.

Government Expenditure and Public Expenditure in the Context of the Economy

Table 2

	Original Estimate	Revised Estimate	Estimate	Forecast			
(\$ million)	2007–08	2007–08	2008–09	2009–10	2010–11	2011–12	2012–13
Operating expenditure	214,200	206,423	255,700	237,300	251,500	267,800	286,500
Capital expenditure	34,237	30,746	56,694	62,869	62,350	57,564	59,604
Total government expenditure	248,437	237,169	312,394	300,169	313,850	325,364	346,104
Other public bodies expenditure	19,408	18,689	19,688	20,532	21,424	22,166	22,859
Total public expenditure (Note a)	267,845	255,858	332,082	320,701	335,274	347,530	368,963
Gross Domestic Product (calendar year)	1,538,176	1,612,598	1,725,625	1,846,575	1,976,002	2,114,500	2,262,706
Growth in GDP (Note b)							
Nominal terms		9.3%	7.0%	7.0%	7.0%	7.0%	7.0%
Real terms		6.3%	4.5%	4.5%	4.5%	4.5%	4.5%
Growth in government expenditure (Note c)							
Nominal terms		6.0%	31.7%	-3.9%	4.6%	3.7%	6.4%
Real terms		2.8%	30.5%	-7.7%	1.4%	0.2%	3.2%
Growth in public expenditure (Note c)							
Nominal terms		5.8%	29.8%	-3.4%	4.5%	3.7%	6.2%
Real terms		2.7%	28.5%	-7.2%	1.4%	0.2%	3.0%
Public expenditure as a percentage of GDP	17.4%	15.9%	19.2%	17.4%	17.0%	16.4%	16.3%

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. But *not* included is 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 2008-09, the GDP growth in nominal terms of 7% represents the mid-point of the range forecast of nominal GDP growth at 6.5% to 7.5% for the calendar year 2008. Similarly, the growth in real terms of 4.5% represents the mid-point of the range forecast of real GDP growth at 4% to 5% for 2008.
- (c) The growth rates refer to year-on-year change. For example, the rates for 2007–08 refer to the change between revised estimate for 2007–08 and actual expenditure in 2006–07. The rates for 2008–09 refer to the change between the 2008–09 estimate and the 2007–08 revised estimate, and so forth.

11 Table 3 shows the relationship amongst the sum to be appropriated in the 2008-09 Budget, government expenditure and public expenditure. It also shows the effect of the Budget revenue measures on the overall fiscal position for 2008–09.

**Relationship between Government Expenditure
and Public Expenditure in 2008–09**

(\$ million)

Table 3

Components of expenditure and revenue	Appropriation	Government expenditure and revenue			Public expenditure
		Operating	Capital	Total	
Expenditure					
General Revenue Account					
Operating					
Recurrent	214,647	214,647	-	214,647	214,647
Non-recurrent	41,053	41,053	-	41,053	41,053
Capital					
Plant, equipment and works	1,390	-	1,390	1,390	1,390
Subventions	1,336	-	1,336	1,336	1,336
	258,426	255,700	2,726	258,426	258,426
Transfer to Funds	740	-	-	-	-
Capital Works Reserve Fund	-	-	49,004	49,004	49,004
Innovation and Technology Fund	-	-	879	879	879
Loan Fund	-	-	2,994	2,994	2,994
Lotteries Fund	-	-	1,091	1,091	1,091
Trading Funds	-	-	-	-	3,920
Housing Authority	-	-	-	-	15,768
	259,166	255,700	56,694	312,394	332,082
Revenue (before Budget revenue measures)					
General Revenue Account					
Taxation		220,930	85	221,015	
Other revenue		47,756	4,878	52,634	
		268,686	4,963	273,649	
Land Fund		14,144	-	14,144	
		282,830	4,963	287,793	
Capital Works Reserve Fund		-	45,711	45,711	
Capital Investment Fund		-	1,797	1,797	
Civil Service Pension Reserve Fund		-	1,740	1,740	
Disaster Relief Fund		-	3	3	
Innovation and Technology Fund		-	378	378	
Loan Fund		-	2,230	2,230	
Lotteries Fund		-	1,718	1,718	
		282,830	58,540	341,370	
Surplus before Budget revenue measures		27,130	1,846	28,976	
Less: Effect of Budget revenue measures		33,470	-	33,470	
Surplus/(deficit) after Budget revenue measures		(6,340)	1,846	(4,494)	
Less: Advances and equity investments from the Capital Investment Fund		-	349	349	
Repayment of bonds and notes		-	2,700	2,700	
Consolidated deficit		(6,340)	(1,203)	(7,543)	

SECTION IV – ESTIMATES OF CONTINGENT LIABILITIES

12 The Government's contingent liabilities as at 31 March 2007, and estimates of these should they remain unsettled as at 31 March 2008 or 31 March 2009, are provided below as supplementary information to the MRF –

(\$ million)	2007	At 31 March 2008	2009
Guarantee to the Hong Kong Export Credit Insurance Corporation for liabilities under contracts of insurance	12,304	13,448	14,389
Possible capital subscriptions to the Asian Development Bank	2,115	2,115	2,115
Guarantees provided under loan guarantee schemes for small and medium enterprises	5,075	4,334	3,827
Guarantee provided for commercial loan of the Ocean Park Corporation	-	-	1,089
Total	<u>19,494</u>	<u>19,897</u>	<u>21,420</u>