

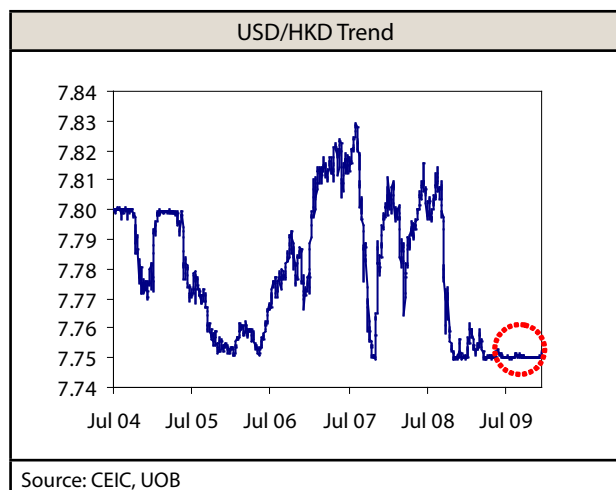
Hong Kong

UOB Economics Projections	2007	2008	2009F	2010F
GDP	6.4	2.4	-3.3	4.0
CPI (average, y/y)	2.0	4.3	0.5	2.2
Unemployment rate (%)	3.4	4.1	5.0	4.6
Current account (% of GDP)	12.1	14.5	10.3	7.1
Fiscal balance (% of GDP)	7.5	0.1	-3.9	-1.5

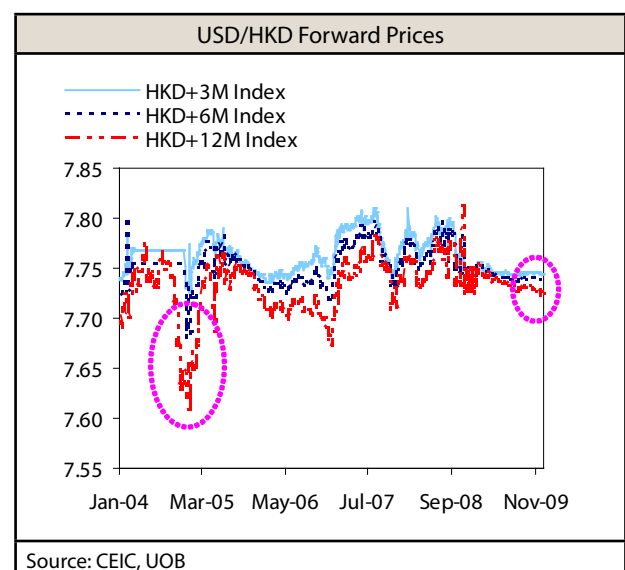
- USD/HKD saw significant downward pressured during 4Q, which unsurprisingly prompted the HKMA to step up interventions to maintain the peg range. With lack of clear alternative, we continue to see the HKD peg remaining for the foreseeable future.
- One main consequence of having the HKD pegged to the USD is that, Hong Kong effectively adopts US Fed monetary policy, resulting in the main HKD interbank rates hitting near record lows. We expect to see HKD interbank interest rates to stay flat in the 0.1-0.2% range for the 3-month HIBOR in first half 2010, and turn up in the second half of 2010 only if there are signs that the US Fed would begin to reverse its ultra-loose policy stance.
- HK's 3Q GDP report reaffirms that the worst is over, with recovery seen across the board in terms of domestic demand. With a relatively milder correction in the labour market and data flows globally turning mostly positive, we anticipate HK's 4Q GDP to return to positive growth of about 0.3%/y, implying full year contraction of 3.3%, which is better than our earlier projection of -3.8%. For 2010, we are revising up HK's GDP growth to 4.0%, from 3.5% previously.

Monetary Policy: USD Link Keeps Domestic Interest Rates Suppressed

The USD/HKD pair saw significant downward pressured during 4Q, as the USD was widely perceived to continue to weaken as the "dollar carry trade" fueled asset price rises globally. This has prompted the HKMA to step up its frequency and extent of interventions to keep the pair within the Convertibility Undertaking band of 7.75-7.85. We estimate that the HKMA injected about USD25.5bn during 4Q09, extending the net USD10.9bn in 3Q09.



This net injection of liquidity into HK's financial system means that domestic liquidity is significantly flush - despite signs of improvements in terms of economic recovery - to the extent that the HIBOR 3 month interest rate is hovering near record low at 0.11% in mid-Dec (the record low was in early 2004, when the 3-month HIBOR hovered at 0.07% after the US Fed brought the Fed funds rate down to the

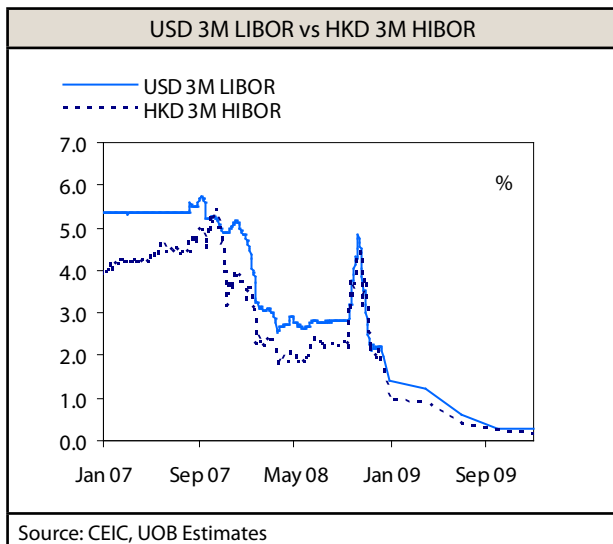


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then-record low of 1%).

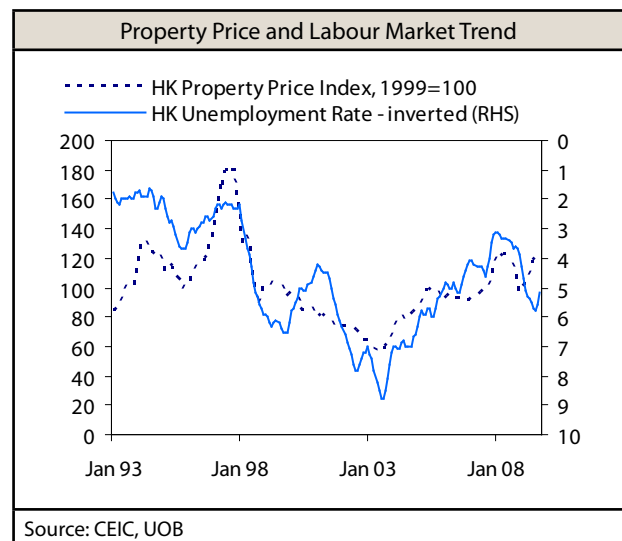
With the lack of clear alternative currently we expect the HKD link to the USD to remain unchanged for some time, despite speculation earlier that the new HKMA Chief Norman Chan, who came took over from Joseph Yam on 1 Oct, would review the HKD peg arrangement. The new HKMA chief has pledged to keep the existing arrangement after taking over the job. This means that USD/HKD would continue to hover within the 7.75-7.85 range, and continued intervention from HK authorities against a backdrop of USD weakness. The low risk of a change in the HKD arrangement is also reflected in the relative steady prices in the HKD forward market, compared to previous episodes of huge volatility.

One main consequence of having the HKD pegged to the USD is that, like China currently, Hong Kong effectively synchronizes its monetary policy with that of the US Fed, i.e. subjecting to its quantitative easing and the pledge that low interest rate would remain for an "extended period". As such, we expect to see HKD interbank interest rates to stay flat in the 0.1-0.2% range for the 3-month HIBOR in first half 2010, and turn up in the second half of 2010 only if there are signs that the US Fed would begin to reverse its ultra-loose policy stance.



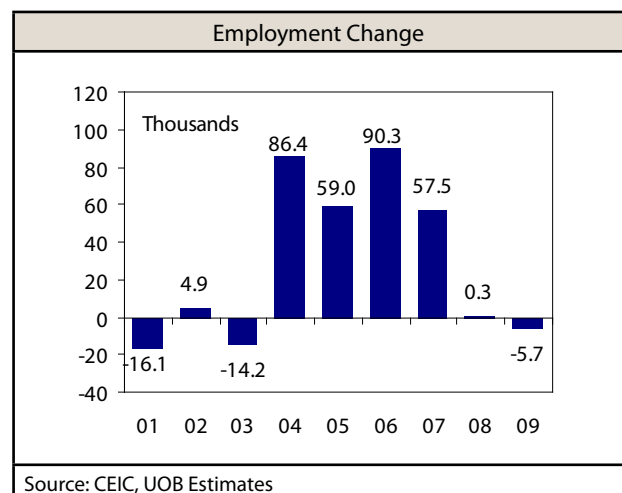
The effect of having a loose monetary policy is apparent in asset market, especially in housing market where the domestic premises price index has risen 24% YTD to Oct just as the economy entered into a recession, and the index value of 130.2 has exceeded the 2008 peak of 126.6 in Jun 2008 before the onset of the global financial crisis send the index down 17% by end-2008. With the monetary policy option eliminated, HK government has moved to use

administrative measures to prevent a potential property sector bubble and the impact on banking sector. Some of the recent measures include lowering the loan-to-value (LTV) ratios for luxury residential properties (HKD20mn and above) to max of 60%, and for properties valued below HKD20mn, the 70% LTV ratio remains but the maximum loan amount is capped at HKD12mn. Other measures include shortening the property pre-sale period to nine months from fifteen months, raising stamp duty to deter speculation, tightening of mortgage approval guidelines, among others.



Domestic Economic Activities on Path to Recovery

Hong Kong's 3Q GDP growth came in at -2.4%/y, below expectation of -1.4% but an improvement over the -3.6% pace seen in 2Q. But what is encouraging is in the details of the GDP report, which saw broad based recovery in private spending, investment, and inventory building after at least three quarters of y/y declines. These data clearly

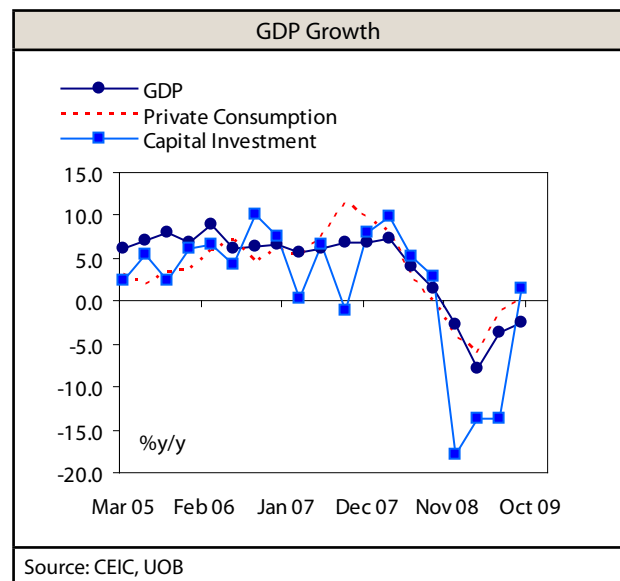


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suggest that the worst is over for HK and we anticipate the momentum to continue into at least the first half of 2010, where favourable base effect will further boost the recovery prospects. In particular, domestic demand returned to positive growth of 5.7%/y/y in 3Q, after contracting three consecutive quarters.

Underscoring the recovery in domestic demand is the resilient labour market, where jobless rate for Aug-Oct edged down further to average 5.2% sa, from 5.3% for the Jul-Sep period. Meanwhile, the number of unemployed fell by an average of 2,900 sa during Aug-Oct, following the average decline of 3,700 for the three months ending Sep. Overall, job losses in HK so far this year is about 5,700, after just marginal gain in 2008. However, in the context of the severity of the global recession, this figure is in line with most Asian countries. In addition, the decline experience in the current cycle is much milder relative to the SARS period in 2003 (14,200 job losses) and in 2001 (global tech bubble burst, 16,100 job losses).

With a relatively milder correction in the labour market and data flows globally turning mostly positive, we anticipate



HK's 4Q GDP to return to positive growth of about 0.3%/y/y, implying full year contraction of 3.3%, which is better than our earlier projection of -3.8%. For 2010, we are revising up HK's GDP growth to 4.0%, from 3.5% previously.