

# **APPENDIX A**

## **MEDIUM RANGE FORECAST**

**2007–08 TO 2012–13**

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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 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

| (\$ million)   | Original Estimate | Revised Estimate | Estimate       | Forecast       |                |                |                |
|--|-------------------|------------------|----------------|----------------|----------------|----------------|----------------|
|  | 2007–08           | 2007–08          | 2008–09        | 2009–10        | 2010–11        | 2011–12        | 2012–13        |
| <b>Operating Account</b>   |                   |                  |                |                |                |                |                |
| Operating revenue (Note b & f)                                     | 201,524           | 248,296          | 212,269        | 254,140        | 272,196        | 289,200        | 306,575        |
| Less: Operating expenditure (Note c)                               | 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 (Note b)   | 19,882            | 21,842           | 37,091         | 38,832         | 37,033         | 39,836         | 47,180         |
| <b>Operating surplus/(deficit) after investment income</b>         | <b>7,206</b>      | <b>63,715</b>    | <b>(6,340)</b> | <b>55,672</b>  | <b>57,729</b>  | <b>61,236</b>  | <b>67,255</b>  |
| <b>Capital Financing Statement</b>                                 |                   |                  |                |                |                |                |                |
| Capital revenue (Note d)   | 46,048            | 76,733           | 53,138         | 55,219         | 55,389         | 58,346         | 62,260         |
| Asset sales (Note d)   | 299               | 63               | 87             | 902            | 926            | 1,312          | 1,217          |
| Less: Capital spending (Note e)                                    | 46,347            | 76,796           | 53,225         | 56,121         | 56,315         | 59,658         | 63,477         |
| Surplus/(deficit) before investment income/interest expenses       | 33,438            | 30,068           | 56,289         | 62,677         | 62,127         | 57,237         | 59,278         |
| Investment income (Note d)   | 12,909            | 46,728           | (3,064)        | (6,556)        | (5,812)        | 2,421          | 4,199          |
| Less: Interest expenses (Note e & f)                               | 6,092             | 6,033            | 5,315          | 4,233          | 3,581          | 3,675          | 4,085          |
| Surplus/(deficit) after investment income/interest expenses        | 799               | 801              | 754            | 642            | 576            | 577            | 576            |
| <b>Surplus/(deficit) after investment income/interest expenses</b> | <b>18,202</b>     | <b>51,960</b>    | <b>1,497</b>   | <b>(2,965)</b> | <b>(2,807)</b> | <b>5,519</b>   | <b>7,708</b>   |
| Less: Repayment of bonds and notes (Note e & f)                    | -                 | -                | 2,700          | 3,500          | -              | -              | -              |
| <b>Capital financing surplus/(deficit) after bond repayment</b>    | <b>18,202</b>     | <b>51,960</b>    | <b>(1,203)</b> | <b>(6,465)</b> | <b>(2,807)</b> | <b>5,519</b>   | <b>7,708</b>   |
| <b>Consolidated Account</b>  |                   |                  |                |                |                |                |                |
| 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          |
| <b>Consolidated surplus/(deficit)</b>                              | <b>25,408</b>     | <b>115,675</b>   | <b>(4,843)</b> | <b>52,707</b>  | <b>54,922</b>  | <b>66,755</b>  | <b>74,963</b>  |
| Less: Repayment of bonds and notes                                 | -                 | -                | 2,700          | 3,500          | -              | -              | -              |
| <b>Consolidated surplus/(deficit) after bond repayment</b>         | <b>25,408</b>     | <b>115,675</b>   | <b>(7,543)</b> | <b>49,207</b>  | <b>54,922</b>  | <b>66,755</b>  | <b>74,963</b>  |
| <b>Fiscal reserves at 31 March</b>                                 | <b>391,155</b>    | <b>484,939</b>   | <b>477,396</b> | <b>526,603</b> | <b>581,525</b> | <b>648,280</b> | <b>723,243</b> |
| 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<br>Revised<br>Estimate | 2008–09<br>Estimate | 2009–10<br>Forecast | 2010–11<br>Forecast | 2011–12<br>Forecast | 2012–13<br>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                                      | 270,138                        | 249,360             | 292,972             | 309,229             | 329,036             | 353,755             |

- (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<br>Revised<br>Estimate | 2008–09<br>Estimate | 2009–10<br>Forecast | 2010–11<br>Forecast | 2011–12<br>Forecast | 2012–13<br>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 | 76,733                         | 53,138              | 55,219              | 55,389              | 58,346              | 62,260              |
| 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  | 82,829                         | 58,540              | 60,354              | 59,896              | 63,333              | 67,562              |

- (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<br>Revised<br>Estimate | 2008–09<br>Estimate | 2009–10<br>Forecast | 2010–11<br>Forecast | 2011–12<br>Forecast | 2012–13<br>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                 |
|   | <hr/>                          | <hr/>               | <hr/>               | <hr/>               | <hr/>               | <hr/>               |
| Capital spending before<br>interest on and repayment of<br>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               | -                   | -                   | -                   |
|   | <hr/>                          | <hr/>               | <hr/>               | <hr/>               | <hr/>               | <hr/>               |
| 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

| (\$ million)                                     | Original Estimate | Revised Estimate | Estimate  | Forecast  |           |           |           |
|--|-------------------|------------------|-----------|-----------|-----------|-----------|-----------|
|  | 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    |
| <b>Total government expenditure</b>              | 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    |
| <b>Total public expenditure (Note a)</b>         | 267,845           | 255,858          | 332,082   | 320,701   | 335,274   | 347,530   | 368,963   |
| <b>Gross Domestic Product (calendar year)</b>    | 1,538,176         | 1,612,598        | 1,725,625 | 1,846,575 | 1,976,002 | 2,114,500 | 2,262,706 |
| <b>Growth in GDP (Note b)</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%      |
| <b>Growth in government expenditure (Note c)</b> |                   |                  |           |           |           |           |           |
| 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%      |
| <b>Growth in public expenditure (Note c)</b>     |                   |                  |           |           |           |           |           |
| 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%      |
| <b>Public expenditure as a percentage of GDP</b> | 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   |                    |
| <b>Expenditure</b>   |               |                                    |         |         |                    |
| 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            |
| <b>Revenue (before Budget revenue measures)</b>                        |               |                                    |         |         |                    |
| General Revenue Account  |               |                                    |         |         |                    |
| Taxation   |               | 220,930                            | 85      | 221,015 |                    |
| Other revenue  |               | 47,756                             | 4,878   | 52,634  |                    |
| Land Fund  |               | 268,686                            | 4,963   | 273,649 |                    |
|  |               | 14,144                             | -       | 14,144  |                    |
| Capital Works Reserve Fund   |               | 282,830                            | 4,963   | 287,793 |                    |
| Capital Investment Fund  |               | -                                  | 45,711  | 45,711  |                    |
| Civil Service Pension Reserve Fund                                     |               | -                                  | 1,797   | 1,797   |                    |
| Disaster Relief Fund   |               | -                                  | 1,740   | 1,740   |                    |
| Innovation and Technology Fund   |               | -                                  | 3       | 3       |                    |
| Loan Fund  |               | -                                  | 378     | 378     |                    |
| Lotteries Fund   |               | -                                  | 2,230   | 2,230   |                    |
|  |               | -                                  | 1,718   | 1,718   |                    |
|  |               | 282,830                            | 58,540  | 341,370 |                    |
| <b>Surplus before Budget revenue measures</b>                          |               | 27,130                             | 1,846   | 28,976  |                    |
| Less: Effect of Budget revenue measures                                |               | 33,470                             | -       | 33,470  |                    |
| <b>Surplus/(deficit) after Budget revenue measures</b>                 |               | (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   |                    |
| <b>Consolidated deficit</b>  |               | (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<br>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   | 19,494 | 19,897              | 21,420 |