

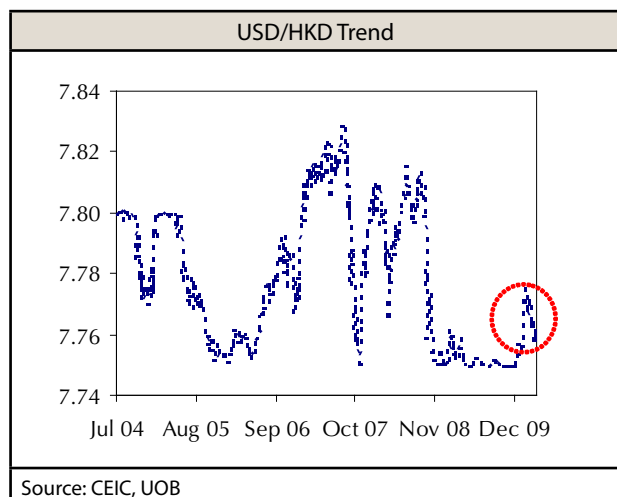
UOB Economics Projections	2008	2009	2010F	2011F
GDP	2.4	-2.7	4.0	4.5
CPI (average, y/y)	4.3	0.5	2.2	3.0
Unemployment rate (%)	4.1	4.9	4.0	3.4
Current account (% of GDP)	14.5	9.2	7.0	8.9
Fiscal balance (% of GDP)	0.1	0.9	0.5	0.4

- With the USD rebounding in recent months, the pressure on USD/HKD peg has faded again into the background. Our view remains that the USD/HKD peg is likely to stay intact for sometime given the lack of alternative and that the RMB is looming in the background.
- As a consequence of the HKD peg, monetary policy is synchronized with the US Fed's policy direction, regardless of domestic economic conditions. As we expect the US Federal Reserve to begin tightening only late this year, this means that the 3-month HIBOR would remain at current near record low level of around 0.15% through 3Q2010.
- Recent data suggest that growth momentum continues to point to the positive direction in the coming year, boosted by low base in 1H09. We expect economic activity to continue to accelerate in the quarters ahead, and maintain our full year growth forecast of 4%.

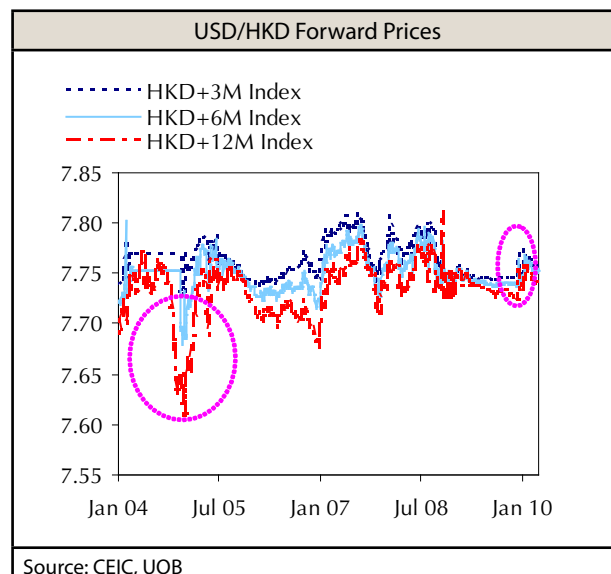
HKD Peg Keeping a Lid on HIBOR Rates

USD/HKD has begun moving away from the floor of the 7.75-7.85 range at end-2009, as USD strengthened across the board on a mixture of risk aversion and concerns about sovereign debt situation in Europe. This has lessened significantly the need for the HKMA to intervene in the currency market to support USD/sell HKD, unlike the case for most of last year.

This also means that the pressure on USD/HKD peg has faded again into the background, with the 12-month USD/HKD forward discounts improving to around -180 to -190 recently, compared to an average of -230 in Dec.



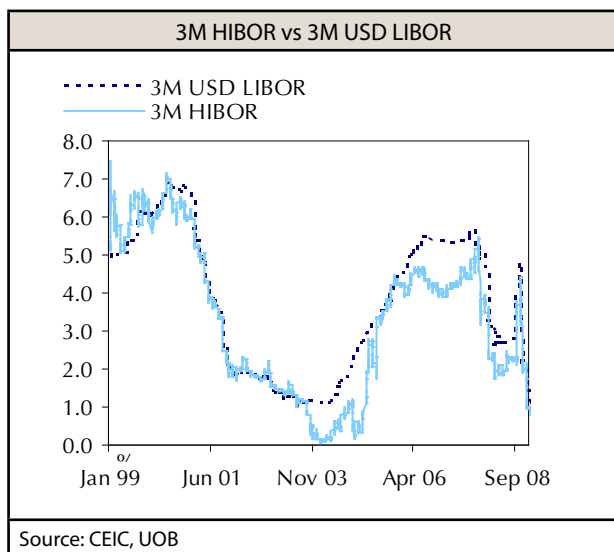
Even with the recent heated international rhetoric on RMB, our view remains unchanged that USD/HKD peg would stay intact for sometime. The current weakness and volatility in EUR (as a result of the fiscal and debt issues in Greece and the rest) suggests that there is a lack of alternative to the USD even if there is a desire to change HKD peg. More importantly, as part of sovereign China, it is natural for HK to be aligned with the Chinese currency. However, it would not be possible until and unless RMB becomes fully convertible and freely traded. In the interim then, status quo for the HKD remains the only viable choice.



Hong Kong

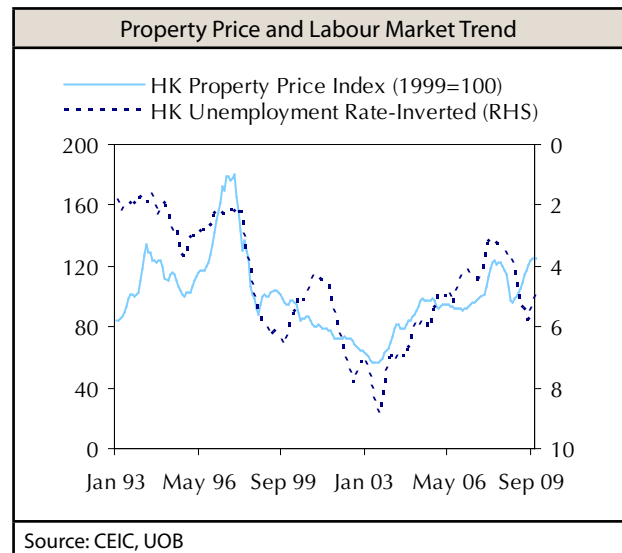
However, one consequence of the HKD peg is that monetary policy in HK is synchronized with the US Fed's policy direction, regardless of domestic economic conditions and pace of economic activities. With the Fed keeping its policy interest rates at near zero and injection of liquidity through its various securities purchase programs, short term US\$ interest rates e.g. USD LIBOR is near record lows level. 3-month USD LIBOR is currently hovering around 0.29% (30 Mar) and just 4bps above historic low of 0.25% at end-Dec.

This means that HIBOR interest rates also follow in tandem given their close correlation. Our regression of the 3-month USD LIBOR and HKD HIBOR yielded an R-squared of nearly 0.90 for the period between 1999 to 2007 (just prior to the onset of the global financial crisis), and even higher R-squared was obtained for 2007 to 2009. As we expect the US Federal Reserve to begin tightening only late this year, this suggests that the 3-month HIBOR would remain at current level of around 0.15% through 3Q2010 unless there is a spike in USD LIBOR before then.



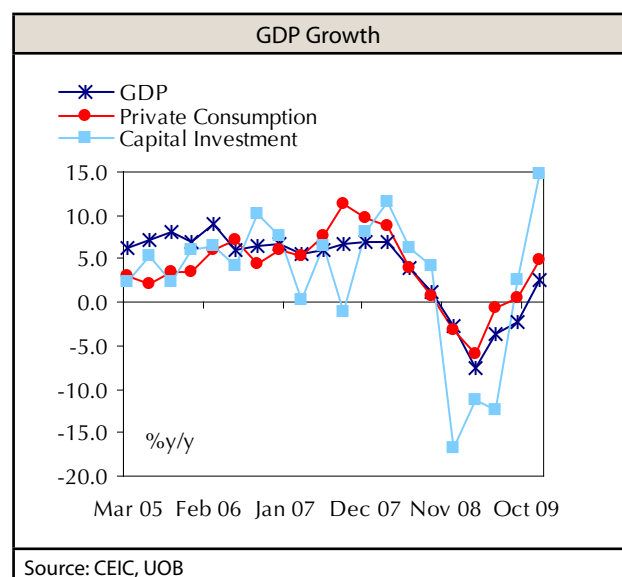
Low interest rates and a recovery in economic activity have pushed up property prices, making affordability an issue in HK, just like in China and elsewhere in Asia. One measure of housing affordability is the house price-to-income ratio, where it is generally recognized that 4-6x of income is considered affordable in developed markets. In HK, the ratio is around 8x in late 2009, more than doubled the ratio of 4x in 2002/03, but down from the extreme levels of 12x during the 1997 peak. Another measure is mortgage servicing ratio, where our estimates show that the figure has nearly doubled from low of 20% of household income in the early 2000s to about 39% currently, even with current low interest rates. Issues on affordability and potential price

bubbles in the housing market have garnered attention from government officials. HK government, like other Asian governments, has implemented a number of measures in recent month, although the effect remains limited given that the low interest rate environment is likely to remain for some time.



Economic Growth on Track After Dismal Year

Hong Kong's economy shrank 2.7% in 2009, hit by the global financial crisis. However, the contraction is actually less severe than the 6% decline in 1998, at the depth of the Asian financial crisis. Like a number of Asian economies, HK has fared better this time round despite the severity of the crisis, due to high savings, low leverage, and other structural reforms that have been built up in the past decade.



Hong Kong

Recent data suggest that growth momentum continues to point to the positive direction in the coming year, with low base in 1H09 adding to the headline figures. Hong Kong's 4Q09 GDP growth came in much better than expected, at +2.6%/y vs. consensus view of 1.5% and -2.2% in 3Q. We expect economic activity to continue to accelerate in the quarters ahead, and continue to maintain our full year growth forecast of 4%.

The labour market saw relatively smaller impact during the current crisis, with jobless rate easing to 4.6% sa in Feb, from 4.9% in Jan. What is even more significant is that employment creation continues to trend higher, with jobs created in four out of the 6 months as activities pick up. So far this year, already 16,500 jobs have been created, offsetting more than half of the 23,600 jobs lost in 2009. We expect the jobless rate to trend lower to 4% by end-2010, the level that prevailed at the onset of the global financial crisis in 2008.

