Overall situation

The Hong Kong economy entered into a full-fledged upturn in 2004, following a V-shaped rebound in the second half of 2003 after the waning of the negative impacts due to the Severe Acute Respiratory Syndrome (SARS). This once again demonstrated the resilience and strength of the economy. The activity upturn in 2004 was broad-based, marked by thriving exports and offshore trade, vibrant inbound tourism, strong pick-up in consumer spending, and visible bounce-back in investment. While external trade had benefitted much from the global trade boom, the domestic economy also revived along with the return of both consumer and investor confidence.

For 2004 as a whole, the Gross Domestic Product (GDP) grew by a remarkable 8.1% in real terms, distinctly faster than the 3.2% growth in 2003. The growth was the second fastest since 1987, just after the exceptionally high growth in 2000. On a year-on-year comparison, after growing by 7.0% in the first quarter of 2004, real GDP surged further by 12.1% in the second quarter against a low base last year due to SARS and sustained notable growth at 6.8% and 7.1% in the third and fourth quarters. On a seasonally adjusted quarter-to-quarter comparison, GDP expanded throughout the four quarters, by 2.0%, 2.5%, 1.6% and 0.6% respectively in real terms.

Table 1.1 : Gross Domestic Product and its main expenditure components and the main price indicators (year-on-year rate of change (%))

	2003#	2004+	2003 Q1#	2003 Q2#	2003 Q3#	2003 Q4#	2004 Q1#	2004 Q2#	2004 Q3#	2004 Q4+
Change in real terms of GDP and its main expenditure components (%)										
Private consumption expenditure@	-0.3	6.7	-2.7	-3.8	0.9	4.4	5.4	10.7	5.0	5.7
			(-0.4)	(-2.1)	(4.9)	(1.8)	(1.0)	(2.5)	(-0.1)	(1.9)
Government consumption expenditure	1.9	0.5	1.0	0.5	0.5	5.5	5.4	-0.2	-1.4	-1.8
			(-0.1)	(1.8)	(1.5)	(2.1)	(-0.2)	(-3.3)	(0.2)	(1.4)
Gross domestic fixed capital formation	0.1	4.5	4.2	-5.3	*	1.9	5.5	12.7	2.7	-2.0
			(N.A.)	(N.A.)	(N.A.)	(N.A.)	(N.A.)	(N.A.)	(N.A.)	(N.A.)
of which :										
Building and construction	-7.0	-10.3	-3.2	-8.5	-6.6	-9.9	-11.6	-10.1	-13.7	-5.2
Machinery, equipment and computer software	6.5	12.2	12.8	-1.1	5.6	9.3	16.0	26.1	12.2	-2.4
Total exports of goods	14.2	15.3	19.1	14.3	10.0	14.7	15.0	18.7	15.3	12.6
			(2.6)	(2.0)	(2.8)	(6.5)	(2.5)	(5.8)	(0.6)	(2.9)
Imports of goods	13.1	14.1	18.8	10.9	8.2	15.7	16.3	20.3	14.2	7.0
			(3.4)	(-0.5)	(3.6)	(8.0)	(3.7)	(3.6)	(-1.1)	(0.6)
Exports of services@	5.7	14.9	13.0	-10.4	8.7	10.2	14.0	32.8	11.1	7.3
			(-1.0)	(-15.2)	(27.2)	(3.0)	(1.8)	(-0.4)	(6.0)	(-0.5)
Imports of services	-4.6	10.5	-5.4	-16.8	-0.3	3.1	4.1	30.3	6.1	6.0
			(-5.5)	(-15.4)	(25.3)	(2.4)	(-3.7)	(5.1)	(2.4)	(1.6)
Gross Domestic Product	**3.2**	**8.1**	**4.4**	**-0.6**	**3.9**	**4.8**	**7.0**	**12.1**	**6.8**	**7.1**
			(-0.2)	**(-2.4)**	**(6.6)**	**(0.7)**	**(2.0)**	**(2.5)**	**(1.6)**	**(0.6)**
Change in the main price indicators (%)										
GDP deflator	**-5.3**	**-2.8**	**-4.4**	**-5.7**	**-6.1**	**-4.8**	**-4.0**	**-2.7**	**-2.5**	**-2.1**
			(-1.1)	**(-2.2)**	**(-1.1)**	**(-0.6)**	**(-0.3)**	**(-0.7)**	**(-0.8)**	**(-0.3)**
Composite Consumer Price Index	**-2.6**	**-0.4**	**-2.0**	**-2.5**	**-3.6**	**-2.3**	**-1.8**	**-0.9**	**0.8**	**0.2**
			(-0.2)	**(-1.1)**	**(-1.8)**	**(0.8)**	**(0.3)**	**(-0.1)**	**(-0.2)**	**(0.3)**
Change in **nominal GDP** *(%)*	**-2.2**	**5.1**	**-0.2**	**-6.4**	**-2.3**	**-0.2**	**2.6**	**9.1**	**4.1**	**4.8**

Notes : (#) Revised figures.

(+) Preliminary figures.

(@) Figures for 2004 have been revised following the release of enhanced estimates on tourism expenditure by Mainland visitors by the Hong Kong Tourism Board. Estimates for 2002 and 2003 were revised accordingly to enable comparability of the data series. The overall GDP nevertheless is not affected.

( ) Seasonally adjusted quarter-to-quarter rate of change.

N.A. Not applicable, as no clear seasonal pattern is found in gross domestic fixed capital formation, due to the presence of considerable short-term fluctuations.

(*) Change of less than 0.05%.

The external sector

Merchandise exports sustained remarkable growth throughout 2004, boosted by the sturdy demand in all major markets including East Asia, the European Union and US, as well as the Mainland's buoyant external trade and robust domestic demand. Apart from this, increasing competitiveness of Mainland products in the world market, coupled with the weakness of the US dollar, has rendered a further boost to Hong Kong's exports. Total exports of goods attained double-digit growth in all the four quarters of 2004, yielding an annual growth of 15.3% in 2004, up further from the already strong growth of 14.0% in 2003. This was also the second consecutive year that exports had a double-digit growth, the first time since 1995.

On invisible trade, inbound tourism was vibrant, with the number of incoming visitors hitting successive new monthly highs in the latter part of the year. For 2004 as a whole, the number of visitor arrivals had a 40% growth over 2003. If compared with 2002 to remove the distortion caused by SARS, the growth was also phenomenal, at 32%, reflecting that the tourism sector has not only fully recovered from SARS, but also that it is now back on a full upswing. While the extension of the Individual Visit Scheme added impetus to the surge in the number of Mainland visitors, the number of visitors from most other major sources also rose considerably. Coupled with the thriving offshore trade brought forth particularly from strong trade flows in the region, exports of services were buoyant all through 2004, giving a remarkable 14.9% growth for the year as a whole, distinctly up from that of 5.7% in 2003.

The domestic sector

While external trade was buoyant throughout 2004, the domestic sector had also picked up further in the year. On the consumption front, local consumer spending maintained notable growth throughout the year, as consumers' willingness to spend was well underpinned by optimism over the economic outlook, improving labour market conditions, as well as the wealth effect stemming from the rebound in property prices. Private consumption expenditure (PCE) grew by 5.4%, 10.7%, 5.0% and 5.7% respectively in real terms in the four quarters over a year earlier, giving a 6.7% growth for 2004 as a whole, the fastest since 1993. The particularly distinct growth in the second quarter was in part inflated by an exceptionally low base caused by SARS in 2003. On a seasonally adjusted quarter-to-quarter comparison, PCE grew by 1.0% and 2.5% in real terms in the first and second quarters, edged down by 0.1% in the third quarter, and then picked up again to a 1.9% growth in the fourth quarter.

Investment demand strengthened as investor confidence returned. Overall investment spending in terms of gross domestic fixed capital formation attained a 4.5% growth in real terms in 2004, the fastest since 2000, as the activity upturn and brighter business outlook prompted a broad-based surge in machinery and equipment investment to cater for the growing business. Particularly worth-noting was that investment in industrial machinery for manufacturing use, which had been on a general fall-off in recent years, also rebounded significantly in the year. However, building and construction output was still in a lull in the year, due to the earlier fall-off in new private building projects, the scale-back of the Public Housing Programme, as well as the completion of works on priority railway projects.

The labour sector

The labour market improved progressively on a broad front throughout 2004. As the economic recovery gathered pace, total employment expanded notably, by 2.1% in 2004. By the fourth quarter of 2004, the total number reached an all-time high of 3.33 million, a gain of 139 400 over the trough in 2003. Reflecting improved employment conditions, the seasonally adjusted unemployment rate fell back successively from a high of 8.6% in the second quarter of 2003 to a near three-year low of 6.5% in the fourth quarter of 2004. The underemployment rate also fell from a high of 4.3% in the second quarter of 2003 to 3.1% in the fourth quarter of 2004. Vacancies surged across many sectors, with particularly distinct rises in trade-related and tourism-related sectors such as freight transport services, retail trade, and restaurants and hotels. Downward pressures on wages and labour earnings, which were still pronounced in 2003, began to recede in 2004, though only gradually.

Property market

The residential property market picked up distinctly further in early 2004, marked by active trading and further gains in property prices. While primary sales of flats in many developments received enthusiastic response, the secondary market was also active. The market went through a brief consolidation during May-July, as flat prices fell back somewhat after the hefty gains in the earlier months, and also amidst concern over an imminent interest rate rise in the US, the economic tightening measures in the Mainland and the oil price upsurge. But as the economic upturn proceeded, in tandem with improving household incomes and the end of the deflation era, buying interest soon returned, and flat prices were back on the rise again after the summer months. Buying interests in the mass residential market were keen, as affordability still stood at quite an attractive level, supported by the government's measures to extend mortgage financing to home buyers. The luxury end of the market had a more hefty rise, fuelled by abundant liquidity, apart from general optimism over Hong Kong's economic outlook. By December 2004, flat prices were 27% higher than a year ago, though still 52% lower when compared with the peak in 1997. Flat rentals also rose, by 11% at end-2004 over a year earlier.

On commercial property, both the sales and rental markets for office space were active, particularly for office space in prime locations amidst the upturn in business activity. The market for shopping space in major shopping areas also firmed up, as demand was boosted by buoyant inbound tourism and pick-up in local consumer spending. The demand for industrial property also showed some revival with strengthened demand amidst buoyant export growth and as investor sentiment reportedly was lifted by the implementation of CEPA.

Stock market

The local stock market went down along with the overseas markets in the early months of 2004, being much weighed down by the uncertainties stemming from surging oil prices and the US interest rate up-cycle. Market sentiment subsequently improved, underpinned by optimism over the economic outlook, favourable land auction results, and ample liquidity amidst substantial funds inflow thereby driving local interest rates to near zero level. Receding crude oil prices and the rally in overseas stock markets rendered a further boost towards the year-end. The Hang Seng Index was on a general rise in the second half of the year, hitting a 45-month high of 14 266 on 29 December and closing the year at 14 230, distinctly up by 13.2% over end-2003. The average daily turnover likewise surged, to a record high of $16.0 billion in 2004, up from the $10.4 billion in 2003 and $15.5 billion in the previous peak in 1997.

Prices

The economy finally came out of deflation that had lasted for 68 months. As the pricing power of retailers returned along with the economic recovery, the rise in import prices stemming from a weak dollar and firming world commodity prices was more readily passed through to the retail price level. Prices of a wide range of consumer goods and services have thus resumed increases since early 2004. But the pace of upturn in consumer prices was only gradual, being kept down by very modest housing cost due to the distinct fall-offs in flat rentals in the earlier period. On a year-on-year basis, the decline in the Composite Consumer Price Index tapered distinctly from 1.8% in the first quarter to 0.9% in the second quarter, and then reverted to a small increase of 0.8% in the third quarter and 0.2% in the fourth quarter. In general, price pressures on the consumption front were modest all through the second half of 2004, as wages and earnings were still subdued in overall terms, while the rebound in property rentals over the past year had yet to show up fully.

As to the GDP deflator, the year-on-year rate of decline also tapered successively over the course of the year, from 4.0% in the first quarter to 2.7%, 2.5% and 2.1% in the ensuing three quarters, along with the rebound in consumer prices and a pick-up in the price deflator for investment, the latter reflecting the distinct rise-back in the price deflator for construction investment. The pace of upturn in the GDP deflator was considerably slower than that of Composite CPI, due to the drag from a worsened terms of trade caused by the further weakening of the US dollar in the year.

Economic policy

The Government of HKSAR believes in free market, and adopts "market leads, government facilitates" as the guiding principle of its economic policy. Over the past few years, the Government has taken a proactive role to create a conducive environment for business and to facilitate economic development, particularly to enhance Hong Kong's competitiveness and to reduce rigidities in the economy. While the above measures carry a longer-term target, they have also aided the swift revival of the Hong Kong economy after SARS and also the further pick-up in 2004.

Proximity to the Mainland as a huge and dynamic economic hinterland is a key edge that Hong Kong possesses over its neighbouring economies. Over the past two decades, economic relations between the two places continued to strengthen. Bilateral trade has grown by leaps and bounds. Two-way visitors flow have surged, more so upon the Mainland's progressive liberalisation on residents travelling abroad. Hong Kong and the Mainland are each other's largest source of external direct investment. In the financial sector, cross-boundary fund flows have risen markedly over the past decade. Hong Kong is an important fund raising centre for Mainland's state-owned enterprises and recently also private enterprises.

In order to reap more fully the enormous opportunities being accorded by rapid growth and further liberalisation in the Mainland economy, Hong Kong will clinch well to the growth impetus in the Mainland, whilst making effective use of its international business perspective to meet the Mainland's development needs. Thus, it is essential to foster as much as possible the multitude of inter-flows, more specifically those of people, goods, capital, information and services, between the two places.

The signing of CEPA signifies a major milestone towards advancing the economic interface between Hong Kong and the Mainland. On trade in goods, the zero tariff concession on Hong Kong's domestic exports, which has become substantially effective since 1 January 2004, has helped lift the competitiveness of Hong Kong's products in the Mainland market, as compared to products imported from other places. On trade in services, by giving Hong Kong companies a "first mover" advantage in a large number of sectors, it should facilitate expansion of Hong Kong's services across the boundary and open up more opportunities for business in the Mainland. As to trade and investment facilitation, it will help promote and streamline trade, investment and other business flows between the two places.

CEPA adopts a building block approach wherein more measures will be added as necessary in the future. The signing of CEPA II on 27 August 2004 provides further liberalisation measures to be implemented from 1 January 2005. Under CEPA II, tariff elimination is to be applied to another 713 products as from January 2005. Moreover, for the 18 services sectors to which preferential treatments have already been provided under CEPA I, the liberalisation is to be broadened for 11 of them under CEPA II. In addition, new liberalisation measures are to be granted to 8 new service areas. CEPA II will further broaden the scope for Hong Kong products to penetrate into the Mainland market. Moreover, more Hong Kong companies would enjoy the "first mover" advantage in venturing into the services sectors in the Mainland.

The launch and progressive extension of the Individual Visit Scheme for Mainland residents coming to Hong Kong has been adding fuel to the already strong upturn in Mainland visitor inflow. In 2004, there were nearly 4.3 million Mainland visitor arrivals to Hong Kong under this scheme, accounting for over one-third of overall visitor arrivals from this source in the year. This is rendering an important invigorating force to Hong Kong's inbound tourism.

Focusing on areas where Hong Kong has clear comparative advantage is the only way to compete with the rest of the world. Financial services; trading and logistics; tourism; and producer and professional services are the sectors that possess comparative edge. They are not only the key driving force of Hong Kong's economic growth, they have also been providing the key impetus to job creation. In 2003, these key industries taken together contributed to 54.9% of GDP and 44.3% in terms of total employment.

Over the past year, a number of measures have been put in place to foster the development of these key industries. On the development of Hong Kong as an international financial centre, measures were initiated to improve our regulatory regime and reinforce corporate governance of listed companies and professional standards of intermediaries. The securitisation of government toll tunnels and bridge has helped promote development of the bond market and generated one-off revenue to the government coffer. To enhance Hong Kong's position as a regional logistics centre, progressive liberalisation of airline services was made, and measures were implemented to reduce cross boundary trucking cost in order to enhance efficiency of our port services. The HKSAR government has drawn up a concept plan on development of Lantau for public consultation with a view to strengthening Hong Kong's function as a regional transportation, logistics and tourism hub.

The Hong Kong economy has also benefited from several policy measures initiated by the Central Government in 2004. In early 2004, the central government has agreed to enable Hong Kong's local banks to operate personal renminbi businesses, including deposit, exchange, remittances and renminbi bank cards. The initiation of personal renminbi business by the banks in Hong Kong marks the opening of a new venue towards further enhancing the role of Hong Kong as a key financial centre for the Mainland. In August, measures were introduced to facilitate Mainland enterprises investing in Hong Kong and Macao. The Central Government's other relaxation measures, though not exclusive to Hong Kong, will also benefit the Hong Kong economy by facilitating the inflow of Mainland capital. For instance, Mainland insurance companies are now allowed to invest in overseas capital markets, and it is reckoned that Hong Kong will be the key beneficiary. Hong Kong also stands to benefit from other measures, such as relaxation of restrictions on outward remittance associated with emigration of Mainland residents and Mainland students studying overseas, and raising of the limit on the amount of renminbi cash Mainlanders are allowed to carry on their overseas trips.

The vision of the Hong Kong Government is to build Hong Kong as Asia's world city, by consolidating Hong Kong's unique position in the region as well as its role as a gateway to the Mainland. Reflecting the prominent role of Hong Kong as a business hub in the region, the number of both overseas and Mainland companies to set up operations in Hong Kong has continued to rise in recent years, more so after the launch of CEPA. Specifically, both the number of regional headquarters and regional offices set up in Hong Kong surged in 2004 to hit new highs. Within this total, the number of regional headquarters set up by Mainland companies in Hong Kong had a more distinct increase, as many of these Mainland companies set up business operations or join forces with local enterprises to tap the vast market potential of CEPA. The envisaged benefits of setting up operations in Hong Kong under CEPA are also one of the factors considered by many overseas companies in investing in Hong Kong.

Outlook for the Hong Kong economy in 2005

Looking ahead, with the global economic environment on the whole still sanguine, and with the revival in the domestic sector gathering more and more foothold, the Hong Kong economy is poised for another year of solid growth in 2005. By now, the domestic sector has completely shrugged off the earlier sluggishness, economic growth this year will be characterised by balanced growth in both external and domestic demand, a sign that the economy has finally entered into a full upswing.

Externally, the trade outlook remains good in 2005. With the global economy expected to attain above-trend growth this year, and with the regional trade boom and a vibrant Mainland economy, there should be plenty of good trading and business opportunities for Hong Kong traders. On the competitiveness front, the general weakness of the dollar, coupled with still modest cost pressures in Hong Kong, should continue to bode well for external price competitiveness. On top of these, the implementation of CEPA II will accord Hong Kong products with an added competitive edge in the Mainland market.

There are however some uncertainties about the impact of the removal of quotas on textile and clothing under the WTO Agreement on Textiles and Clothing. But on the whole, it is believed that while Hong Kong's domestic exports of T&C products might have a noticeable decline this year, there would also be an offsetting boost from re-exports and offshore trade sourced from the Mainland, as China would very likely be a major beneficiary of the quota liberalisation move. Against this backdrop, total exports of goods look set for a further distinct growth in 2005, with re-exports still the key growth driver, though with domestic exports likely to show a much more moderate performance.

Exports of services look even more promising. The opening of the Disneyland theme park in September 2005 will add a major tourist attraction to Hong Kong, which will undoubtedly render a strong boost to incoming visitors, especially those from the Mainland. Exports of trade-related services comprising mainly offshore trade should continue to forge ahead in tandem with the Mainland's vibrant trade flows, apart from the usual boost from the on-going structural shift from re-exports to offshore trade. Exports of transportation services should likewise fare well, given the huge demand for logistic services amidst the vibrant trade flows. Exports of finance, business and other services should also flourish, as more business demand is generated upon further liberalisation of trade in services under CEPA and the stepping up in regional economic co-operation.

Locally, private consumption expenditure is likely to advance further in 2005 after the notable pick-up in 2004. The return of consumer confidence has become more evident, underpinned by the solid recovery of the economy and steadily improving employment conditions. The positive wealth effect stemming from the strong rebound in property prices over the past year and to a certain extent also from the buoyant stock market should render an added boost to local consumer spending.

Investment spending in overall terms was back to growth in 2004, and the outlook in 2005 is for a further solid growth. On the back of brighter business prospects and improved profitability, more companies are likely to increase their investment in production capacity, so as to tap the anticipated growth in business. Abundant bank liquidity and the still low interest rates should help in this regard. Investment expenditure on machinery, equipment and computer software is likely to remain strong, as the cost-conscious companies are keen to boost productivity amidst an increasingly competitive environment. On the other hand, the slack in construction output is expected to continue in 2005, as the distinct fall-off in building consents in 2004 would hold back new construction activity for some time, and as public sector construction output would have to face a temporary lull upon the completion of the West Rail and the Ma On Shan Extension of the East Rail.

Overall, the Gross Domestic Product is expected to attain growth of 4.5-5.5% in real terms this year, which if achieved would represent another year of above-trend growth as against the average growth of 3.5% over the past ten years. The forecast is largely in line with the prevailing forecasts of Hong Kong's GDP growth for 2005 by the private sector, which range mostly from 4.0% to 6.0%, averaging at 4.7%. Taking into account the projected overall population growth for 2005, per capita GDP is forecast to increase by 3.7-4.7% in real terms in 2005, after a 6.9% increase in 2004.

After the end of the 68-month long deflationary spiral in mid-2004, consumer price inflation has been hovering at near zero level over the past few months. The outlook in 2005 is for a modest inflation of 1.5%, marking the first annual increase after six long years of deflation since 1999. On the cost front, the drag from the earlier fall-off in housing rental is waning, and given the typical 2-year period of leasing contract the drag should pass out fully by around the second quarter of 2005. By that time the rebound in property rental in 2004 should begin to show up to lift the housing cost component within the CPI. Rentals for office space and shopping space are moving up, which would also pass through to the retail price level, now that consumers' spending power has improved in tandem with the economic upturn. Also, the downward pressures on wages and labour earnings are likely to recede further; labour earnings at the upper end of the job hierarchy are expected to come under upward pressure in 2005. Externally, world commodity prices, which were sustained at high levels throughout 2004, will continue to contribute to local inflation in 2005. The weakening of the US dollar towards late 2004 would also lead to some further firming of import prices in the near term.

Taking these factors together, consumer price inflation in terms of the year-on-year rate of increase in the Composite CPI is likely to edge up progressively over the course of the year. Yet for 2005 as whole, inflation would still be very mild, mainly on account that the CPI in the near term will continue to be kept down by the earlier rental fall-off and that wage pressures in overall terms would still be mild through the year.

The pace of upturn in the GDP deflator is however likely to be visibly slower than that of the Composite CPI, as the deflator in the near term would still be dragged by lower terms of trade stemming from the further weakening of the US dollar towards late 2004. Also worth-noting is the fact that the GDP deflator still had a fairly notable decline of 2.1% in the fourth quarter of 2004, and it is quite unlikely that the deflator will turn around shortly. However, as and when the terms of trade effect reverses, the GDP deflator is poised for an upturn, though probably still slower than that of the Composite CPI. For 2005 as a whole, the GDP deflator is thus forecast to edge down by 1%, which nevertheless represents a distinct tapering from the 2.8% fall in 2004. The 1% decline expected for 2005 merely reflects the fact that it would take time for the terms of trade effect to pass out. In fact, the deflators for other individual demand components are all expected to rise further in 2005.

Taking the forecast growth in real GDP and the change in the GDP deflator, nominal GDP is forecast to grow further by 3.5-4.5% in 2005, following a 5.1% increase in 2004. The per capita GDP at current market prices is forecast at HK$191,400 – 193,300 or US$24,500 – 24,800.

The forecasts for the key economic indicators are summarised in the table below:

Forecast rate of change in 2005 (%)

Gross Domestic Product (GDP)	
Real GDP	4.5-5.5
Nominal GDP	3.5-4.5
Per capita GDP, in real terms	3.7-4.7
Per capita GDP at current market prices	HK$191,400-193,300 (US$24,500-24,800)
Composite Consumer Price Index	**1.5**
GDP Deflator	**-1**

Medium-term outlook for the Hong Kong economy

The medium-term prospect for the Hong Kong economy is bright, as Hong Kong continues to reinforce its existing strengths and identify new areas for development. This, coupled with envisaged benefits derived from further integration and co-ordination with the Mainland economy, will help Hong Kong speed up the process of economic restructuring towards higher value-added services and knowledge-based economy in the coming years.

Hong Kong possesses many strengths as a business hub and financial centre in Asia – first-class port and airport infrastructure; creativity and entrepreneurship of our businessmen; high degree of internationalism with extensive business networking with the rest of the world; and sound legal system and financial regulatory framework. But there is no room for complacency. Hong Kong will strive to be an international financial centre through enhancing infrastructure of the financial markets. On the logistics front, Hong Kong looks set to benefit from the vibrant trade flows in the region, aided further by enhancement of Hong Kong's competitiveness as a regional trade and services hub. Tourism will remain a bright spot of the Hong Kong economy over the next few years, thanks to further extension of the Individual Visit Scheme and additions of key tourist attractions.

The Hong Kong SAR Government will, as always, strive to maintain the rule of law, a level playing field, corruption-free government, free flow of information and simple tax regime, these institutional strengths being the key aspects of Hong Kong's competitiveness. Furthermore, in order to win the war for talents, the Government will continue to invest substantially in education for upgrading the skills of the local workforce. At the same time, the Government will engage a more flexible population policy to attract Mainland and overseas talents to increase the overall economic vitality and to create more jobs. This is imperative if Hong Kong is to go up the value chain and meet the challenges of a knowledge-based economy.

Furthermore, co-operation among Hong Kong and other Mainland provinces and cities in the Pan-Pearl River Delta will enhance Hong Kong's role as an intermediary for external economic co-operation over the medium term. On top of this, the "going global" development strategy and measures formulated by the Central Government presents much opportunities for Hong Kong to attract Mainland enterprises to set up businesses here.

All in all, the future of Hong Kong hinges on whether the economy could go up the value chain and stay competitive, and on how best Hong Kong could leverage on the enormous business opportunities in the fast growing Mainland economy. The strategy of the Hong Kong SAR Government to stay competitive is to foster the development of high value-added sectors, to upgrade the quality of its workforce, and to facilitate even closer economic collaboration with the Mainland. With various measures put in place over the past two years and the launch of CEPA II, coupled with a highly flexible labour market and the vitality of Hong Kong's business sector, Hong Kong will continue to shift towards higher value-added services and knowledge-based economy. The productivity growth achieved in the process will help the economy attain a 4% trend GDP growth over the next four years 2006-2009.