CHINA ECONOMY

REVIEW OF 2001

China had another robust year in 2001. During the year, China's GDP increased by 7.3% for the whole year, which was lower than the 8% recorded in 2000. This was due to the higher base effect as compared to the previous year. Indeed, China's GDP growth is one of the fastest among Asian countries. Fixed asset investment was up 12.1% as compared with 9.3% in 2000. Industrial output and retail sales showed improvements in 2001, as year-on-year growth of 9.7% and 10.1% were recorded. Domestic consumption was stronger than last year due to improved economic conditions and the low interest rate environment. The consumer price index ("CPI") showed a positive level of 0.7%, showing signs of turning around. Foreign direct investments ("FDI") surged due to China's accession to the World Trade Organization ("WTO"). Both actual and contracted FDI rose by 10.4% and 14.9 year-on-year respectively. On the foreign trade front, however, exports growth was negatively affected by the global economic downturn, especially after the 9.11 incident. Imports growth sustained better as the government eased its monetary supply, exports and imports grew by 6.8% and 8.2% respectively. Trade surplus contracted to US$22.5 billion. Foreign exchange reserve stood at US$212.2 billion at the end of 2001 as compared to US$165.6 billion in 2000, which was sufficient to defend the stability of Renminbi ("RMB").

China cleared the hurdle by reaching agreements with Mexico and other WTO members on outstanding issues in the third quarter, and in December, China and Taiwan became official members of the WTO after the Fourth Ministerial Conference held in Qatar the month earlier. Cross-strait economic activities are expected to boom after the Taiwan government loosened its investment restrictions in China. Foreign investments in China are expected to increase, as foreign companies try to gain market shares in China's post-WTO era. The 9.11 incident in the U.S. had a ripple effect on the already receding world economy and China was not totally immune to that impact either. Fortunately, recent indicators showed that the U.S. economy appears to be on the rise again and general sentiment shares the optimism that the global economy will soon bottom-out.

The government's measures on market liberalization and State Owned enterprises ("SOE") reform showed signs of success during the year. Efforts to restructure and privatize SOEs continue to improve their profitability and efficiency. Inefficient SOE are either wound up or acquired, thereby greatly reducing their numbers. In order to face fierce competition in the post-WTO era, the Chinese government is expected to administer measures to speed up reforms in sectors like aviation, telecommunications, media, automotive, and financial services. Reform in banking sector was encouraging as state banks continue to clean up their balance sheets and improve asset qualities. State banks' non-performing loans ("NPL") were significantly reduced, and their capital adequacy ratios improved. Reform in the telecommunication sector will be in accordance with plans announced by the Ministry of Information Industry. The number of licenses for wireless telephone operators in China will be increased to four. Meanwhile, the "west-to-east" pipeline project to transport natural gas from Xinjiang province to Shanghai attracted investments from global oil giants. All these blue prints for market reform and infrastructure projects, together with the imminent opening up of the banking and insurance industry to foreign participation present good investment opportunities to foreign investors.

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The first 3 quarters of 2001 witnessed continuance of upward trend of domestic consumption and easing of deflationary pressure. In the fourth quarter, deflationary pressure increased slightly due to global economic slowdown and weakening of the yen. Yet domestic consumption remains strong, contributing to a potential rise of the CPI.

During the year, the People's Bank of China has cut interest rates in more than one occasion, helping a faster economic recovery. The China Securities Regulatory Commission ("CSRC") initiated capital market reform. In March, it opened up the B-share market to domestic investors. Domestic investment in stock market increased. More H-share companies started to issue A-shares in view of more favourable valuations in the domestic capital market. The Chinese equity markets performed poorly in the second half of 2001 resulting in part from investigation by CSRC into market misconduct committed by brokerage houses and market participants on the one hand, and adjustment from overvaluation of equities after the wild rally in the second quarter on the other.

On the other hand, 2001 has been a difficult one for Hong Kong. The sluggish economic recovery was dampened by the global slowdown after the 9.11 attack in the U.S. Since the Hong Kong dollar is pegged to the U.S. dollar, Hong Kong's competitive advantage was diminished against a strong U.S. dollar. Deteriorating performance in the global telecommunication, media and technology ("TMT") sectors prompted companies to re-evaluate their investments in TMT related projects. This led to substantial provisions on their income statements and affected bottom lines for Hong Kong corporations. Unemployment rate surged while consumption continued to plunge. The number of personal bankruptcies filed reaches historic high. Banks made larger provisions on non-performing loans and affected their net profit negatively; substantiated by GDP and CPI figures published during the period. The slow recovery revealed the structural nature of Hong Kong's economic problem in its paradigm shift. Thus, the overall performance was the culmination of high real interest rate, deflationary pressure, poor corporate earnings and weak consumption. Also, according to the latest government forecast, Hong Kong is likely to record a fiscal deficit of HK$66 billion for fiscal year 2001-2. All wisdom points to the dire need for a major overhaul of the governmental setup and the need to broaden the tax base. Property prices stabilised slowly and buying interest grew modestly in the primary residential sector, resulting from low mortgage rates, cash rebates and other sales gimmick.

Nevertheless, after China's accession to the WTO, foreign investments in Hong Kong were expected to increase due to its bridgehead position as China's window in the south, not to mention its more transparent corporate governance, well-established capital market and Common law based legal system. Also, the government's plan to reduce supply of residential units by trimming the Home Ownership Scheme ("HOS") helped to stabilize residential property prices. When business activities pick up, demand for commercial properties will also be increased.

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OUTLOOK FOR 2002

After China becomes a member of the WTO, foreign investments are expected to be on the increase. To rise up to such challenge, the Chinese government continues to dedicate its efforts on market liberalization, industry deregulation and reforms in banking, capital market and SOE. Private enterprise will play an increasingly important role as China moves towards a more market-oriented economy. SOE reforms are expected to continue in 2002, in the form of mergers and acquisitions, labour cuts, and privatization. Growth in the private sector will also speed up. To compete with global banking groups and to meet international standards, banking reform is inevitable and in great haste. State-owned financial institutions continue to improve their balance sheets, NPL and capital adequacy ratios. More SOEs, state-owned banks and private enterprises will seek listings both domestically and abroad to fund their expansion and restructuring plans.

Meanwhile, CSRC will impose new regulatory policies in 2002, including the restrictions on indigenous securities houses to engage in proprietary trading in B shares. It is hoped this will minimize market irregularities and misconduct committed by local brokerage houses, and promote the reputation of the market. The Chinese government plans to dispose state-owned shares of SOEs into the market. That will create a short-term depression in the stock market but have positive long run effect as equity valuation will become more reasonable and enable more investors to participate in the market. The extent of the negative impact will depend on the method of disposal.

On the macro side, China's central bank had announced a cut of 54 basis points and 27 basis points in February 2002 for one-year lending rate and on-year deposits rate respectively. Economists believe that the interest rate cut can be the government's effort to stimulate the economy to attain its 7% GDP growth target. Exports will increase as RMB is likely to depreciate slightly following the rate cut. Domestic consumption and the stock market will also benefit from this policy. The 9th National People's Congress will convene in 2002, and it is widely speculated that the transfer of power from current leaders to their protégé will either be gauged or announced. That designation of the next generation of leadership helps to eliminate the overhang on political uncertainties and will boost investment sentiment.

Cross-strait economic activities are expected to increase in the post-WTO era. Direct links between China and Taiwan will remain on the agenda and is expected to have its final approval in the medium future. More and more Taiwan companies will set up their businesses in China. Lower labor costs and preferential policies offered by the Chinese government have attracted a few Taiwan companies to invest in the semiconductor industry along the coastal provinces. Cooperation between Chinese and Taiwan firms will increase, as was demonstrated by the recent agreement signed between the Sampo Group of Taiwan and Haier Group of China in household electric appliances. In conclusion, the post-WTO outlook of the Chinese economy remains robust, as increasing foreign investments, economic reforms, and strong domestic consumption attest to support China's high GDP growth.

CHINA ECONOMY *(Cont'd)*

Hong Kong Economy

Hong Kong's economy is expected to bottom out in 2002, especially when global economic recovery begins in the second half. Earnings recovery of Hong Kong corporations and banks is widely expected in 2002. Personal bankruptcies will remain high for the short to medium term. The recovery of private consumption and retail sales will remain slow. Property prices will rise moderately in 2002, benefiting primarily from the government's cut in its HOS supply and guidelines issued by the Hong Kong Monetary Authority on mortgage refinancing to help negative-equity homeowners. The government will implement policies among other measures to increase infrastructure spending and to reform the education system. All efforts highlight the government's determination to foster Hong Kong's economy to change into a knowledge-based one while creating jobs for the unemployed.

With Mr. Tung Chee Hwa's cinch to serve his second term as Chief Executive by a landslide in the Electoral Committee, he is expected to be more assertive in reforming the governmental set-up and other issues. Streamlining the big government bureaucracy and civil service system and adopting accountability for senior officials are widely expected, which when implemented will trim the fiscal deficit in the next few years.