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IMF Concludes Article IV Consultation Held in 1998 with Portugal–Macau

On March 25, 1999, the IMF Executive Board for the first time considered a report on the Article IV consultation discussions with Portugal in respect to Macau, which were held in late 1998 ¹.

Background

Macau, a Chinese territory under Portuguese administration will become a Special Administrative Region (SAR) of the People's Republic of China (PRC) on December 20, 1999 under a joint declaration signed between Portugal and the PRC in 1987.

Macau has long embraced an outward oriented growth strategy, with no import tariffs or restrictions and with no exchange restrictions on current or capital international transactions. The economy is closely integrated with the economy of Hong Kong SAR and with that of southern China. Macau's currency, the pataca (MOP), has been pegged to the Hong Kong dollar under a currency board arrangement since 1977, and interest rates closely follow those in Hong Kong SAR. In addition, the Hong Kong dollar circulates widely in the Territory.

Over the years, Macau has transformed itself from a manufacturing economy centered on

¹Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

textiles into a more service-oriented economy focused on tourism (including gambling). In the early 1990s, the government further developed tourism and other services sectors and improve the territory's infrastructure, accompanied by a property market boom. As a result, output growth reached 13½ percent in 1992. Subsequently, however, growth slowed in the face of persistent weakness in the property market and the completion of major infrastructure projects, and in 1996 output contracted somewhat.

In the wake of the Asian crisis, real GDP did not grow in 1997 and declined by an estimated 3½ percent in 1998. Inflation declined from about 5 percent in 1996 to 3½ percent in 1997 and further to about ¼ percent in 1998. This, together with sharp increases in nominal interest rates in the last two years, led to increases in real interest rates, which in turn contributed to sluggish economic activity. The unemployment rate increased over the period, and evidence suggests that median monthly wages fell in the first half of 1998.

Macau's nominal and real effective exchange rates have remained broadly stable since 1990. Textiles and garments exports (about 80 percent of merchandise exports) were destined mainly to the U.S. and E.U. markets under protection of MFA quotas, limiting somewhat competition in these markets from third countries. Nevertheless, total exports declined by 2½ percent in 1998, reflecting lower economic activity in the region. The external current account remained in large surplus in 1998, offset by large capital outflows. Official international reserves stood at \$2.5 billion at end-1998, equivalent to about 12 months of imports of goods and nonfactor services.

Although the budget for 1998 was framed to be approximately balanced, the outturn was a deficit of 1½ percent of GDP, due mainly to a revenue shortfall, in particular lower-than-expected receipts from land leases and gambling—the important revenue sources.

The economic slowdown and the increase in interest rates were reflected in monetary aggregates. Broad money growth increased from 5 percent during 1997 to 10 percent during 1998, reflecting a small growth in narrow money, driven by the weakness in economic activity, and a large increase in quasi-money, induced by sharp increases in real interest rates. The growth of private sector credit declined from 10 percent during 1997 to negative 1½ percent during 1998, reflecting partly increases in lending rates in real terms and more generally sluggish economic activity.

The banking system remains well-capitalized, but there has been a sharp increase in *nonperforming loans*. At the same time, the ratio of loan-loss provisions to nonperforming loans has declined significantly in recent years. Banks' direct exposure to Chinese international trust and investment corporations and Chinese window companies in Macau has been moderate.

Executive Board Assessment

Executive Directors observed that Macau, despite stagnant economic activity in recent years, has maintained relative financial stability, characterized by moderate inflation and a strong external payments position. This owed much to the Macau government's success in

maintaining a cautious fiscal stance, and defending the pegged exchange rate regime in the face of the deepening adverse impact of the Asian crisis in 1997–98.

Directors considered that prospects for recovery for Macau's economy in 1999 would depend on recovery in the region, particularly in China and Hong Kong SAR. Against this uncertainty, Directors urged the government to avoid adopting an unduly restrictive fiscal stance and thought that the authorities have some scope to increase spending and should use this scope if the economy does not show signs of recovery. Directors concurred that over the medium term, maintaining a prudent fiscal stance will require improving the narrowly-based and nonbouyant tax system and that the government should explore broadening the tax base by expanding taxes on income and broadening the sales tax base.

Directors noted that the pegged exchange rate regime under the CBA has served the economy well. Moreover, given the close integration of the Macau economy with the economy of Hong Kong SAR and the limited use of the pataca in the domestic economy, there is no real alternative to maintaining the existing exchange rate regime for the time being. They considered that during this period, the government should be able to defend the regime given the flexibility in the labor market and product prices, as well as the strong external payments position and the virtual absence of sovereign external debt.

Executive Directors observed that in the longer term, Macau's ability to achieve sustained economic growth will hinge upon the success of its continuing efforts to improve productivity and diversify the economic base. In this regard, the preservation of the economy's position as a low-tax regime for business will be important. Directors generally concurred with the emphasis placed by the authorities on upgrading the skills of the workforce and on encouraging technology transfers and the development of the service sector.

Directors observed that the authorities have in recent years strengthened banking supervision and increased transparency and have established a better reporting system. However, in light of the deterioration in commercial banks' performance in recent years, Directors urged the authorities to further strengthen bank supervision and monitoring, in particular, of those institutions with high exposure to the real estate market.

Directors strongly supported the authorities' commitment to maintain a liberal trade policy and to adhere to the principles of the WTO. Such commitment would play an important role in helping to maintain the efficiency of Macau's trading sector as well as its domestic economy.

Executive Directors welcomed the authorities' acceptance of the General Data Dissemination System as the guiding principles to improve the financial and economic data base. In this connection, Directors supported the authorities' intention to improve the quality of their statistical base through Fund technical assistance, particularly in the area of the balance of payments.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Portugal—Macau: Selected Economic Indicators, 1995–98

	1995	1996	1997	Est. 1998
Output and prices		(In percent)		
Real GDP	3.6	-0.5	-0.1	-3.3
Consumer prices				
(Period average)	8.6	4.8	3.5	0.2
(End period)	7.3	4.7	2.2	-1.8
Budgetary operations		(As percent of GDP)		
Total revenue	14.6	14.7	17.2	15.5
Total expenditure	16.0	14.2	16.1	17.0
Current expenditure	9.3	10.7	12.7	13.3
Capital expenditure	6.6	3.5	3.4	3.7
Overall balance	-1.3	0.5	1.1	-1.5
Money and credit end of year		(Annual percentage change)		
Total domestic	7.8	4.8	6.2	1.3
Claims on private sector	4.8	6.7	9.9	-1.6
Broad money	13.6	7.8	4.9	10.0
External sector		(In millions of U.S. dollars)		
Exports, f.o.b.	1,989	1,987	2,141	2,088
Imports, f.o.b.	-2,051	-1,946	-2,022	-1,953
Current account	2,563	2,738	2,625	2,375
(In percent of GDP)	34.5	37.5	36.0	33.8
Overall balance	288	763	173	0
Gross official reserves	2,250	2,413	2,525	2,457
(In months of imports of goods and services)	10.7	11.8	11.6	11.9
Pataca per US\$ (end-period)	8.0	8.0	8.0	8.0

Sources: Data provided by the Macau authorities; and IMF staff estimates.