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The Chairman's Summing Up at the Conclusion of the 1993
Article IV Consultation Discussions with the United Kingdom - Hong Kong
Executive Board Meeting 94/12 - February 15, 1994

Executive Directors welcomed the continued strong performance of the Hong Kong economy in 1993. Domestic demand and re-exports had led the expansion, reflecting easy financial conditions and strong confidence in Hong Kong's economic prospects, owing to the benefits to be derived from rapid growth in China. However, with the economy operating at close to capacity, underlying inflation pressures persisted.

On the inflationary process in Hong Kong, Directors observed that rising prices could be attributed in part to the surge in demand for Hong Kong's financial and trade-related services arising from China's growing external trade. Strong private demand, fueled in part by wealth effects of asset price increases, had also been an important source of inflationary pressures. Despite the recent moderation in inflation, much of which had been due to lower import prices, the gap between Hong Kong's inflation rate and that in most trading partners had led to a further appreciation of the real exchange rate.

On monetary and exchange rate policies, the link to the U.S. dollar was seen to have served Hong Kong well by helping to underpin financial confidence and stability. While the linked-rate system ruled out the use of monetary policy to contain inflationary pressures, Directors supported the authorities' continued commitment to the link, given the need to maintain a transparent policy anchor in the period ahead.

Under the linked-rate system, the burden of containing demand pressures fell primarily on fiscal policy. At the same time, Directors recognized that substantial investments in trade and transport infrastructure would be necessary to ensure a satisfactory longer-term economic growth rate. Given these considerations, Directors emphasized the need for the authorities to remain prudent in their fiscal actions. In addition, several Directors cautioned the authorities to proceed carefully on the proposed public pension scheme, which, as currently envisaged, could well add to current demand pressures and complicate the management of public finances over the longer term.

Directors also commented on the sharp movements in asset prices over the past year. The surge in equity prices was for the most part driven by a re-evaluation of the Hong Kong market by international investors and the consequent large capital inflows, in common with the experience of several other countries in the region. While this inflow was consistent with

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Hong Kong's strong economic fundamentals, Directors nonetheless cautioned the authorities to remain vigilant, as Hong Kong, with its open capital markets and its dependence on external developments, was particularly subject to swings in investor sentiment, which could complicate economic management.

It is expected that the next Article IV consultation discussions with Hong Kong will be held on the standard 12-month cycle.