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Statement by Mr. Peretz on the United Kingdom - Hong Kong
Executive Board Meeting 94/12
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General

A number of factors have contributed to the strong economic performance of Hong Kong over many years. The favorable investment climate reflects a free international trade and finance regime, limited domestic regulation, low taxation rate and good fiscal discipline. It bears repeating that all these factors will remain in place after 1997. Under the Sino-British Joint Declaration, the Hong Kong Special Administrative Region will remain an international finance centre with free flow of capital into and out of the territory, and the Hong Kong dollar will continue to be a freely convertible currency. Hong Kong will have full autonomy in its external commercial relations and it will remain a separate customs territory.

In the past year, the Hong Kong economy has continued to perform well, with strong confidence, robust domestic demand and continued rapid growth in re-exports. GDP growth was about 5.5 per cent in 1993, and the prospects for 1994 remain highly favorable. The authorities agree with the staff's assessment that any easing in external demand could be absorbed without a major impact on activity.

The Hong Kong authorities expect China's economy to continue to show solid growth in both the short and medium term. Hong Kong businesses will continue to act as providers of financial and trade-related services to China and to make use of the productive capacity in China for outward processing activities.

Monetary and Exchange Rate Policies

The Hong Kong authorities welcome the staff's continued clear support for their commitment to the linked exchange rate system. The link has proved to be a firm and transparent anchor which has buttressed confidence, and greatly contributed to financial stability in Hong Kong over the last decade. The authorities also welcome the staff's support for the establishment of the Hong Kong Monetary Authority (HKMA), which over the past year has acted to ensure the continuity of monetary and banking policies and raised confidence in financial markets.

The authorities acknowledge the constraint which the exchange rate link places on the discretionary use of monetary policy. However, Hong Kong's present inflation arises mainly from the structural transformation of the economy. In view of the inevitable uncertainties in the period ahead, in the lead up to 1997, the authorities firmly believe that the linked exchange rate system will remain a crucial element in maintaining the stability and prosperity of Hong Kong.

Inflation

Consumer price inflation, as measured by the Consumer Price Index (A), has moderated to 8.5 per cent for 1993 as a whole. This represents a significant easing from the average of 12 per cent recorded in 1991 and 9.4 per cent in 1992. The authorities will continue with their efforts to contain inflation, mainly by tackling the supply constraints--labour and land. Apart from the continuing labour importation schemes, the labour market has also been helped by the reduction of emigration and the increasing number of returning landed emigrants. The authorities will continue to augment the supply of labour to meet the changing pattern of demand, by using re-training schemes and by bringing in foreign workers on a selective basis. The recent increase in land sales will also help alleviate inflationary pressures.

Fiscal policy

The Hong Kong authorities point out that their system of cash-limited expenditure generally results in some underspending against the medium term forecasts. Moreover, since revenue forecasts are based on the trend growth rate of the economy, it is inevitable that at times of strong economic activity, actual revenue will exceed the forecast. These factors suggest that forecasts of future deficits may well be overstated, particularly if the economy continues to grow in the way it has in 1992 and 1993.

The authorities are well aware of the volatile nature of the revenue sources which contributed to the improved financial performance in the past two years. Revenue forecasts have and will continue to recognise the need for prudence in forecasting these revenues. The authorities also appreciate the rationale for maintaining the level of fiscal reserves in real terms. It should however be noted that at the end of 1992/93 fiscal reserves stood at a historically high level, even before taking account of the balance in the Land Fund of the future HK Special Administrative Region (HKSAR) Government, which stood at more than HK \$44 billion at March 31, 1993.

Asset Prices and Financial Markets

The authorities note the staff's concern about the sharp increases in asset prices in Hong Kong and the implications for prudential supervision of the financial sector. Notwithstanding a recent tightening of lending policies, banks remain concerned about their exposure to the mortgage market and see a need to control the growth in their mortgage portfolio. In January 1994, two major banks in Hong Kong announced additional restraint measures, including a further reduction in loan to value ratios for more expensive properties. These measures will offer a cushion for banks in the event of property price falls.

The authorities accept that more comprehensive public disclosure requirements for banks are desirable, and are considering options for greater disclosure in conjunction with local banks. Legislative provisions

are also being drawn up to introduce a scheme that would give small depositors priority in the event of a bank failure.

Turning to the equities market, the authorities note that the rise reflects the re-rating of the Hong Kong market by major investment houses and is sustained by strong economic fundamentals and the reform measures introduced since the 1987 stock market crash. To address the concern about volatility in the financial markets generated by various initial public stock offerings, the HKMA has issued prudential guidelines to banks designed to limit the credit risks resulting from the lending and recycling of subscription monies for new share issues. The HKMA is also discussing with the banking sector measures to reduce inefficiencies in the recycling process, while securities regulators have introduced measures to enhance market transparency.

Pension Scheme

The authorities agree with the staff's suggestion that efforts be made to enhance the coverage and operation of private pension plans for the current working population. They have reaffirmed the merits of the present voluntary approach in the provision of retirement schemes, and will continue to promote these schemes vigorously, with small establishments as the key targets.

They also note the staff's suggestion for targeted income support for the elderly. They do not regard this as a sufficient means of providing financial security for elderly persons in Hong Kong. The authorities believe that a preferred scheme should be one that provides a degree of basic financial security for the majority of those elderly persons who have lost their earning power. The staff are concerned about the stimulative impact of the proposed scheme. However, the Hong Kong authorities do not expect private saving behavior to change to the extent that the staff suggest.

Trade Policy

The Hong Kong authorities welcome the conclusions of the Uruguay Round and look forward to participating and contributing constructively to its early implementation. However, they remain concerned about the use of unjustified anti-dumping actions for protectionist purposes by some of their trading partners.

Conclusion

Hong Kong continues to achieve economic success by following the kinds of policies which we regularly prescribe in the IMF board. As a result GDP per head in Hong Kong has now reached more than \$18,000. This was the fourth Article IV discussion of Hong Kong, and the authorities continue to find the process extremely valuable in helping them to analyse and formulate economic policy.

