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March 3, 1999

To: Members of the Executive Board

From: The Secretary

Subject: **Portugal—Macau—Staff Report for the 1998 Article IV Consultation
Discussions**

Attached for consideration by the Executive Directors is the staff report for the Article IV consultation discussions held in 1998 in respect of Macau, which will be brought to the agenda for discussion on a date to be announced.

Mr. Otani (ext. 37305) or Mr. Krelove (ext. 38692) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

PORTUGAL-MACAU

Staff Report for the 1998 Article IV Consultation Discussions¹

Prepared by the Staff Representatives for the Consultation Discussions Held
in 1998 in Respect to Macau

Approved by Wanda Tseng and G. Russell Kincaid

March 2, 1999

- In response to a request by the Portuguese authorities on behalf of the Macau authorities, and with the support of the Chinese authorities, the first Article IV consultation discussions with respect to Macau were held in Macau during November 16-25, 1998.
- The staff team comprised Mr. Otani (Head), Mr. Krelove, Ms. Uranbileg, all APD, and Mr. Basanti (STA). Mr. Santos (OED, for Portugal) and Ms. Lu (OED, for China) attended the meetings.
- The mission met with Mr. Pessoa, Secretary for Economic Coordination, Mrs. Morgado, Chairwoman, Monetary and Foreign Exchange Authority of Macau (AMCM), and Mr. Troni, Secretary for Social Issues and the Budget, as well as representatives of other economic agencies and the private sector, including the commercial banks.
- Macau's currency, the pataca, is pegged to the Hong Kong dollar under a currency board arrangement (CBA). Macau has no restrictions on the making of payments and transfers for current or capital account international transactions.
- The principal authors of this report are Messrs. Otani and Krelove.

¹The term "country" as used in this report does not in all cases refer to a territorial entity that is a state as understood by international law and practice; the term also covers some territorial entities that are not states, but for which statistical data are maintained and provided internationally on a separate and independent basis.

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EXECUTIVE SUMMARY

- Preparations for transferring sovereignty over Macau to China on December 20, 1999 are proceeding smoothly. Thereafter, Macau will become a Special Administrative Region (SAR) of China.
- Despite stagnant economic activity during 1996–98, Macau has maintained relative financial stability, owing mainly to the authorities' success in adhering to a cautious fiscal stance and defending the pegged exchange rate regime despite the adverse impact of the Asian crisis.
- The Macau economy will rebound in 1999 if the recovery in the region is firmly established, but prospects are uncertain as China and Hong Kong SAR face a number of down-side risks. If economic activity remains weak, the authorities need to adopt a pro-active fiscal stance to support aggregate demand. Inflation is expected to continue to be moderate, while the external payments position will remain strong.
- The tax base needs to be broadened to compensate for the decline in relative importance of land-lease revenue, to reduce the heavy reliance on gambling taxes, and to support future expenditure requirements, particularly for improving the skills and technical expertise of the workforce.
- The authorities have recently strengthened banking supervision, put in place a sound legal framework, and adopted internationally accepted banking standards as recommended by the Basle Committee. However, given the worrisome deterioration in banks' performance, the authorities need to further strengthen bank supervision and monitoring.

I. INTRODUCTION

1. **Macau is currently a dependent territory under Portuguese administration** (Annex II). It will become a Special Administrative Region (SAR) of China on December 20, 1999 under a joint declaration signed between Portugal and China in 1987, similar to that for Hong Kong SAR (Box 1).² Preparations for the transfer of sovereignty to China are proceeding smoothly. The successful transition process experienced by Hong Kong SAR since July 1997 has given confidence to the Macau authorities that their own transition will be a smooth one.

2. **With its strategic location and small domestic market, Macau has long embraced an outward oriented growth strategy.** Compared with Hong Kong SAR, Macau's land area is only one fiftieth, the population less than one tenth, and GDP about one twentieth. In 1997, Macau's per capital GDP, at about US\$17,500, was approximately two thirds of Hong Kong SAR's. Macau has no import tariffs or restrictions (except those for health, security, and environmental reasons) and no exchange restrictions on current or capital international transactions. With the liberal exchange system in place, the authorities have not required the private sector to report on its external income and transfer flows nor on foreign capital transactions or external debt obligations.³ Macau's economy is closely integrated with the economy of Hong Kong SAR and with that of southern China (particularly the Zhuhai Special Economic Zone directly north of Macau), to which Macau serves as an entrepot. Macau's currency, the pataca (MOP), has been pegged to the Hong Kong dollar under a currency board arrangement since 1977 (Box 2), and interest rates closely follow those in Hong Kong SAR. The Hong Kong dollar also circulates widely in the Territory.

II. BACKGROUND AND RECENT DEVELOPMENTS

3. **Over the last 30 years, Macau has transformed itself from a manufacturing economy centered on textiles into a more service-oriented economy focused on tourism (mainly gambling related).** In the 1970s, Hong Kong SAR's export industries, particularly textiles and light manufactures, relocated to Macau as Hong Kong SAR faced quota restrictions imposed by industrial countries and rising labor and land costs. Macau's manufacturing base became less diversified in the 1980s as its own labor and land costs were

²As such, the consultation discussions with Macau form a part of the Article IV Consultation with Portugal until December 20, 1999.

³As a consequence, balance of payments data are seriously incomplete and do not permit detailed analysis. Large errors and omissions may include misclassification of transactions on the current account. In this report, the external current account refers essentially to the balance on goods and nonfactor services, with only very small income and transfer flows recorded.

higher than in mainland China—which had begun the process of opening-up—and most manufacturing besides textiles and garments relocated. In the early 1990s, the government began to emphasize the development of tourism and other services sectors and to improve the territory's infrastructure. Activity was further boosted by heavy property investment, including by Hong Kong SAR and mainland Chinese investors. The boom ended in the wake of the tight credit policy introduced by the Chinese authorities in 1993 to address overheating in China. As a result, output growth, after reaching a peak rate of 13½ percent in 1993, slowed initially in subsequent years and then output actually contracted in the face of persistent weakness in the property market and the completion of major infrastructure projects (Chart 1).

4. Property market weakness was reflected in the fall off in supply of new land to the market and government land lease revenue.⁴ Between 1989 and 1992, land lease revenue rose from 15 percent of total government revenue to almost 40 percent (from 2 percent of GDP to 8¼ percent), before leveling off at about 25 percent of revenue (5 percent of GDP) in 1993 and 1994.⁵ During 1995–98, however, cash revenue from land fell sharply, averaging only 6 percent of revenue (1 percent of GDP), reflecting lower lease prices, reduced supply of new land, and a buildup of arrears.⁶ To reduce the stock of unoccupied housing units, the government introduced in 1996 a program of preferential interest rates for home-buyers.⁷

5. Tourism has become increasingly important in employment, national income, and government revenue. The share of employment in the service sector⁸ increased from 62 percent in 1992 to 73 percent in 1998. The share of income generated by gambling is estimated to have increased from less than 25 percent in 1989 to about 30 percent in 1997, as the share of receipts from tourism in total exports of goods and nonfactor services rose as high

⁴The government owns over 95 percent of the land in Macau and controls land reclamation projects.

⁵Land lease agreements run generally for more than 20 years, and lease payments under the agreements are usually heavily front-end loaded.

⁶Land lease arrears totaled MOP2.5 billion (4½ percent of GDP) at end-1998. About half of these arrears have been rescheduled.

⁷The mortgage interest program subsidizes interest costs on approved housing loans; thus far about MOP2.5 billion has been borrowed from banks under the scheme, and the cost to the government for 1998 (up to November) was MOP44 million (about 0.1 percent of GDP).

⁸Comprising wholesale, retail trade, restaurants, hotels, gambling, transportation, warehousing, communication, banks and other financial services, and social services.

as 47 percent (Box 3). Tax revenue from gambling increased from under 50 percent of current revenue in 1989 to about 60 percent in 1998.

6. **External demand, which contributed strongly to growth in 1995 and 1996, weakened sharply with the onset of the Asian crisis (Chart 2).** Moreover, a widely-publicized activities of criminal gangs have also contributed to the falloff in tourism and adversely affected the investment climate.⁹ The surplus of nonfactor services—overwhelmingly tourism—declined from 37 percent of GDP in 1996 to 35 percent of GDP in 1997, and further to 32 percent in 1998. As a consequence, real GDP did not grow in 1997 and declined by about 3½ percent in 1998 (Table 1). Inflation decelerated to 3½ percent (annual average) in 1997, and continued to decline, to about ¼ percent for 1998. This, together with sharp increases in nominal interest rates in the past two years (Chart 3), led to increases in real interest rates, which in turn contributed to sluggish economic activity. The unemployment rate increased over two percentage points during 1998, to about 5½ percent in October. The bulk of this increase was concentrated in the hotel, restaurant, and trade sectors. While firm data on wage developments are not available, anecdotal evidence points to a moderation in wage growth, and there is evidence that median monthly wages fell in the first half of 1998 in several sectors.

7. **Macau's nominal and real effective exchange rates have remained broadly stable since 1990.** In the aftermath of the Asian crisis, the nominal and real effective rates appreciated by less than 1 percent between July 1997 and September 1998, reflecting the large weights of the Hong Kong dollar and the Chinese renminbi in the calculation of the effective exchange rates. Thus, the external competitiveness of Macau's export sector as a whole has not been adversely affected. Moreover, about 80 percent of merchandise exports are of textiles and garments that are sold to the U.S. and E.U. markets under protection of Multifiber Agreement (MFA) quotas that have the effect of limiting somewhat competition in these markets from third countries.

8. **Nevertheless, total exports declined by 2½ percent in 1998 (following an increase of 17½ percent in 1997), reflecting lower economic activity in the region.** Reductions in exports were concentrated in unprotected markets and in non-textiles, especially in light manufactures, leather goods, and toys.

9. **The authorities have implemented a number of measures to mitigate the effects of the contraction in economic activity in recent years.** These included preferential interest

⁹Crime rates, including for violent crimes, have decreased in many categories in the first 10 months of 1998 over the corresponding period in 1997. The authorities have increased efforts to fighting crime, especially organized crime, and have improved cooperation with bordering jurisdictions in China to do so more effectively.

rates for approved investments,¹⁰ a MOP50 million (0.1 percent of GDP) employment support fund, as well as new tourism and foreign investment campaigns abroad.¹¹

10. **Conservative budgetary policies throughout the 1990s, reinforced by statutory requirements for a balanced budget¹², led to budget surpluses for most years and the accumulation of a sizable fiscal reserve (Chart 3).¹³** Surpluses declined sharply after 1994, however, driven mainly by the fall in land lease revenue. Total revenue grew strongly in 1997, boosted by the retroactive collection of gambling revenue in connection with the renegotiation of gambling concession contracts, and the budget recorded a surplus of about 1 percent of GDP. For 1998, although the budget 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, which in turn reflected the continuing weakness in the property market and the slowdown in tourism (Table 3). In response to the revenue shortfall, the government limited expenditures below budgeted amounts in a number of categories, including in the wage bill and in budgeted

¹⁰The program, which started in 1996, is targeted at investments in the service sectors and involves annual interest subsidies ranging from 4 percentage points to 6 percentage points. The government's payments under this scheme for 1998 (up to November) totaled MOP5.8 million.

¹¹Some of these measures were undertaken by autonomous funds whose operations are off-budget.

¹²The Organic Law of Macau and Law No. 41/83M specify that budgeted revenue should cover budgeted expenditure, and that current revenue should at least cover current expenditure. The authorities have interpreted these provisions to mean inter alia that the deficit in any year should not exceed accumulated surpluses in government accounts. Macau has no public debt in the form of bonds, although it has guaranteed part of the domestic and external debt for the new airport.

¹³Fiscal reserve comprises the accumulated surplus in government accounts and the separate Land Fund. As specified by the Joint Declaration of 1987, the Land Fund, similar to that for Hong Kong SAR, receives one half of revenue from new and renewed leases on government-owned land for use by Macau SAR after sovereignty over Macau is transferred to China. At end-1998, the total assets in the Land Fund are estimated to be about MOP8.5 billion (15 percent of GDP), while the accumulated surplus in government accounts totaled MOP2.8 billion (5 percent of GDP).

current expenditures, transfers, and capital spending.¹⁴ The fiscal impulse for 1998 was 1¾ percent of GDP, the first positive stimulus since 1995.

11. **The economic slowdown and the increase in interest rates were reflected in the monetary and credit aggregates (Chart 3).** Broad money growth increased from 5 percent during 1997 to 7½ percent in the year to September 1998 (Table 4). This acceleration was the combined result of a continuing fall in narrow money, driven by the weakening in economic activity, and of a large increase in quasi-money, induced by sharp increases in real interest rates on deposits. In the meantime, the growth of credit to the private sector declined from 10 percent during 1997 to about 1 percent in the year to September 1998, reflecting partly increases in lending rates in real terms and more generally sluggish economic activity.

12. **The banking system remains well-capitalized, but there has been a sharp increase in nonperforming loans in 1998.** Between 1994 and September 1998, the ratio of pretax profits to total assets dropped by half to about 1 percent and the ratio of nonperforming loans to total loans increased nearly nine-fold (text table below). While the risk-weighted capital adequacy ratio remained at or above 15 percent since 1996, the ratio of

Macau: Banking Sector Indicators, 1994-98
(In percent)

| | 1994 | 1995 | 1996 | 1997 | 1998 Sep |
|--|------|------|------|------|-------------|
| Earnings | | | | | |
| Average lending spread (lending-deposit) | 3.7 | 4.7 | 2.9 | 2.4 | 1.8 |
| Average pretax profits on assets 1/ | 1.5 | 1.2 | 1.0 | 1.0 | 0.8 |
| Capital adequacy | | | | | |
| Risk-weighted capital/assets | 12.4 | 14.5 | 15.0 | 15.2 | 15.7 |
| Nonperforming loans/total loans | 1.0 | 1.6 | 4.7 | 4.0 | 8.9 |
| Provisions for loan losses/total loans | 2.3 | 3.1 | 3.1 | 3.0 | 3.5 |
| Concentration | | | | | |
| Real estate/total loans | 18.7 | 16.0 | 18.6 | 20.5 | 20.8 |
| Liquidity | | | | | |
| Loan/deposits | 71.5 | 64.6 | 59.3 | 61.6 | 58.5 |

Source: The Monetary and Foreign Exchange Authority of Macau (AMCM).

1/ Excluding offshore operations.

¹⁴Wages for civil servants were frozen for 1998, and the number of employees was reduced through attrition. While public investment fell short of the budgeted amount, the outturn, at almost 3 percent of GDP, represented a historically high level.

loan-loss provisions to nonperforming loans declined from about 2½ in 1994 to about ½ in September 1998. Banks' direct exposure to property investments has remained low, while their participation in loans to Chinese international trust and investment corporations is reported to be minimal.¹⁵

III. ECONOMIC OUTLOOK

13. **Macau's growth prospects are tied to developments in China and Hong Kong SAR, and more broadly in the Asian region.** The outlook for 1999 remains subject to a number of uncertainties in view of the unsettled conditions. There have been some signs of recovery in tourism in 1998, and this sector could rebound in course of 1999 if nominal interest rates decline as expected by the authorities and if the projected pick-up in activity in the region takes hold.¹⁶ As a result, the external current account surplus is expected to contribute positively to output growth, more than offsetting a negative contribution from domestic demand. Real GDP is projected to grow by ½ percent for 1999. Inflation in terms of the GDP deflator is likely to remain moderate, at about 1¼ percent for the year. Over the medium term, Macau's real GDP growth could strengthen and increase gradually to about 3 percent, close to Macau's potential (Table 5).¹⁷ During this period, inflation is projected to be in a range of 1–2½ percent, while the level of official international reserves is expected to remain at about 12 months of imports of goods and nonfactor services.

IV. REPORT ON THE DISCUSSIONS

14. **Macau's strong growth accompanied by relative financial stability in the early 1990s was largely a result of its commitment to a pegged exchange rate and a prudent fiscal policy.** The economic stagnation in recent years and the effects of the Asian crisis make restoring growth a key policy challenge. Consequently, the discussions focussed on: (i) the required stance of fiscal policy in 1999 given recent cyclical developments; (ii) how to maintain a strong fiscal position in the medium term given weakness in traditional revenue sources; (iii) the implications of the exchange rate peg for the development of the exports sector and for growth; and (iv) maintaining the soundness of the banking system.

¹⁵The Nam Yue Group, the Macau window company for Guandong province, was declared insolvent in mid-January 1999, and will be restructured. The uncollateralized exposure of Macau banks to this company—which has debts estimated at US\$330 million—has not yet been determined.

¹⁶Other assumptions include: (i) the stance of fiscal policy remains unchanged; (ii) the external environment is the same as assumed in the end-1998 WEO exercise; and (iii) tourism will grow in line with projected domestic demand growth in Hong Kong SAR.

¹⁷Domestic demand growth is assumed to roughly follow growth in Hong Kong SAR.

A. Fiscal Policy

15. **The government has over the years given priority to prudent fiscal policy.** The authorities have aimed at balancing the objectives of keeping taxes low to support private sector activity while providing adequate public services. As a result, and given the highly open economy, the scope for using fiscal policy for demand management is limited. For 1999, although the budget had not yet been approved by the Legislative Assembly before the mission's departure from Macau, the government had announced the budgetary framework.¹⁸ Total revenue is envisaged to increase by about 7¼ percent to 16½ percent of GDP, primarily reflecting a recovery in land lease revenue and in taxes on income and profits.¹⁹ Expenditure is budgeted to fall slightly in relation to GDP, to about 16½ percent. The details of expenditures were not finalized at the time of the discussions with the authorities. However, total expenditure reflected a reduction in the number of personnel from 17,000 to 16,000, and lower capital spending; the latter in turn reflected the government's desire that no major investment projects should be left unfinished before the handover of sovereignty to China. Broad balance is budgeted, and the fiscal impulse is estimated to be contractionary (about 1¾ percent of GDP).

16. **The mission noted that a contractionary fiscal impulse at this juncture could aggravate the current weakness in the economy.** The staff team argued that budgeted fiscal withdrawal appeared excessive and suggested that some portion of the fiscal reserve could be productively utilized, particularly if it became apparent in the first half of 1999 that the economy had not yet picked up. The authorities agreed with this view. However, given problems associated with identification of productive spending projects, the staff suggested that additional spending should be limited to the amount necessary to establish a neutral fiscal stance, and that the stimulus should be framed as a temporary policy within a medium-term framework embodying budget balance.

17. **The authorities have responded to the increased social safety net needs arising from the slowdown in activity.** In addition to the new labor training program mentioned earlier, coverage of the Social Security Fund was expanded, and improvements were made to welfare programs that aid those worst affected, especially children, those with medical difficulties, and single parent families. The authorities were of the view that, with these programs, which complemented major improvements in the accessibility of education and health care made during the 1990s, the government had provided a generally adequate social safety net and that the system had been able to handle the need arising from the increase in unemployment.

¹⁸In the authorities' presentation of the budget, the accumulated surplus in government accounts is included in the budget as both revenue and expenditure (as a contingency fund). This is excluded in the present description.

¹⁹Recovery in land lease revenue depends in part on an expected increased rate of collection of arrears.

18. **From a medium-term perspective, the government is likely to face a number of structural budgetary problems.** There is the continuing reduction in the relative importance of land lease revenue, and, in addition, there is a heavy reliance on gambling revenue, which is likely to exhibit a lack of buoyancy. Moreover, for Macau to remain competitive, particularly vis-a-vis Hong Kong SAR, the authorities believe that efforts are required to improve the skills and technical knowledge of the workforce, necessitating higher spending on education and training. The mission emphasized that, unless other revenue sources could be found, the fiscal position could deteriorate over the medium term, as fiscal deficits may widen by about ½ percent of GDP on average, which could be inconsistent with the Basic Law requirement of maintaining a balanced budget.²⁰ Against this background, the mission stressed the importance of exploring the scope for broadening the tax base (e.g. expanding taxes on income and introducing a broader-based sales tax). While the authorities concurred with the mission's view, they emphasized that concrete measures to mobilize domestic resources need to be reviewed by the Macau SAR government following the handover.

B. Monetary and Exchange Rate Policies

19. **The authorities noted that, in recent years, Macau's interest rates, money supply, prices, and the level of economic activity adjusted to be consistent with the pegged exchange rate under the CBA.** They stressed that such an adjustment was at times painful, as demonstrated by sharp increases in domestic interest rates in the fall of 1997 and again in the summer of 1998. Nevertheless, they thought that the pegged exchange rate regime had by and large served the economy well. At the same time, the authorities sought the mission's view on whether the current exchange rate regime would still be appropriate in the future given the unfolding Asian crisis and more generally in an uncertain external environment.

20. **The mission took the view, and the authorities concurred, that, for the time being, there is no viable alternative to a firm commitment to the pegged exchange rate, for several reasons:**

- Macau's economy will continue to be closely integrated with Hong Kong SAR's.
- The Hong Kong dollar circulates widely in Macau and currently accounts for over half of the measured broad money of the banking system.

²⁰Article 105 of the Basic Law calls for Macau SAR to follow the principle of balancing the budget and to keep the budget commensurate with the growth rate of GDP. The authorities indicated that the interpretation of these requirements will be made by Macau SAR after the handover.

- It is crucial to maintain public confidence in the stability of the pataca exchange rate in the wake of the Asian crisis and the forthcoming transfer of sovereignty to China.
- Any alternative that would inevitably increase the possibility of a change in the exchange rate or in its regime would, under the circumstances, likely increase the threat of de-stabilizing flows out of the pataca.
- Given the high level of international reserves in relation to imports and a virtual absence of sovereign external debt, the authorities' ability to defend the pataca is great.

This view was confirmed by representatives of the commercial banks, who emphasized that, if there were signs of possible changes in the exchange rate regime, confidence in the pataca would be shaken badly, creating further uncertainty and possibly undermining the viability of the banking system.

21. **The authorities noted that, with the pegged exchange rate, the maintenance of external competitiveness required improvements in productivity and diversification of the export sector and tourism over the medium term, including technology services industries (e.g., telecommunications). The staff generally agreed with the authorities' view, in particular, on the need to plan for the eventual decline in textile markets with the phasing out of quota restrictions,²¹ although it pointed out that the recent moderation of inflation and wage increases, as well as wage decreases in several sectors, indicated that the economy possessed a degree of flexibility to adjust to developments in the effective exchange rate.**

C. Structural Reform and other Issues

Bank supervision

22. **Macau has taken a number of steps to improve banking supervision in recent years.** The authorities, in particular,

- developed and began implementing banking supervision standards recommended by the Basle Committee;

²¹The Uruguay Round Agreement on Textiles and Clothing introduced the phasing-out of quantitative restrictions maintained under bilateral textile agreements under the MFA by January 1, 2005. Under this agreement, the restrictions on the bulk of Macau's exports will be lifted toward the end of 2004.

- strengthened compliance with the legal framework consistent with the 1993 Financial System Act of Macau;²²
- established supervisory practices, monitoring compliance through both on-site and off-site reviews and prudential meetings with the banks;
- established a reporting system for banking activities, with a plan to strengthen the system in the area of identifying the residency of cross-border transactions;
- established and implemented guidelines for prevention of money laundering in mid-1996 (supplemented by two legal instruments in 1997–98) and, in line with regional and international conventions, revised the regulations for prevention of money laundering while maintaining free flows of capital; and
- established collaboration in bank supervision with the Bank of Portugal, the Hong Kong Monetary Authority, and the People's Bank of China.

23. **In light of the sharp increase in nonperforming loans in 1998 and the decline in the return on assets, the mission urged the authorities to intensify monitoring of financial institutions.** The authorities were keenly aware of the need to further strengthen banking supervision and monitoring and agreed with the mission's suggestion that efforts in this area need to be bolstered. Indeed, they initiated in 1998 monthly surveys of the construction loan portfolio and have been urging banks to increase their provisions for bad loans.

Trade policy

24. **Macau, a founding member of the WTO, is committed to making an open trade system.** In 1999, legislation on intellectual property rights is planned to be completed and made compatible with the WTO's "Agreement on Aspects of Intellectual Property Rights Relating to Trade." Also, the government will introduce more stringent mechanisms to supervise the protection of copyrights.

²²The Financial System Act of 1993 (Box 2), which was drawn up in accordance with the recommendations of the Basle Committee on Banking Supervision, spells out regulations on licensing, registration, and liquidation of credit institutions and intermediaries, as well as rules and procedures pertaining to their financial structure, management, accounting and audit, and prudential supervision by the AMCM.

Statistical issues

25. **Reporting statistical information to the Fund commenced with the first Article IV consultation discussions held in November 1998.** The mission encouraged the authorities to adopt standard methodologies for regular reporting to the Fund for surveillance and publication purposes. In this connection, the mission recommended, and the authorities accepted, that further development of statistical methodologies be guided by the General Data Dissemination System. The authorities have requested Fund technical assistance in the area of statistics, particularly with respect to major statistical problems in the balance of payments.

V. STAFF APPRAISAL

26. **Macau, despite stagnant economic activity in recent years, has maintained relative financial stability, characterized by moderate inflation and a strong external payments position.** This owes much to the authorities' 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.

27. **Prospects for recovery for Macau's economy in 1999 depend on recovery in the region, particularly in China and Hong Kong SAR.** Against this uncertainty, the staff urges the authorities to avoid adopting an unduly restrictive fiscal stance. The authorities have some scope to increase spending and should use this scope if the economy does not show signs of recovery.

28. **Over the medium term, maintaining a prudent fiscal stance will require improving the narrowly-based and nonbouyant tax system.** The authorities should explore broadening the tax base by expanding taxes on income and broadening the sales tax base.

29. **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. During this period, the authorities 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.

30. **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. The staff generally concurs 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.

31. **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, the authorities need to further strengthen bank supervision and monitoring, in particular, of those institutions with high exposure to the real estate market.

32. **The staff strongly supports 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.

33. **The authorities' acceptance of the General Data Dissemination System as the guiding principles to improve the financial and economic data base is welcome.** In this connection, the staff supports the authorities' intention to improve the quality of their statistical base through Fund technical assistance, particularly in the area of the balance of payments.

34. The staff recommends that the next Article IV consultation discussions with respect to Macau SAR take place in accordance with the 24 month cycle.

Box 1. Macau: Transfer of Sovereignty

China and Portugal began talks on the future of the territory of Macau in May 1985, and signed a **Joint Declaration** on April 13, 1987. According to the Joint Declaration, China will resume sovereignty over Macau on December 20, 1999. The agreement provides that Macau will be governed by a **Basic Law** on the Macau Special Administrative Region (SAR), which will preserve the present social and economic system of Macau SAR for 50 years until 2049, within the framework of the Chinese formula of "one country, two systems."¹ Macau SAR, administered by the Macau SAR Government, will remain a free port and a separate customs territory. Capital will continue to flow freely and the Macau currency, the pataca, will remain freely convertible. Macau SAR will run its own finances independently and the central Government of China will not levy taxes in Macau SAR.

Macau SAR will possess executive, legislative, and independent judicial powers and will conduct its own external relations in the fields of economy, education, science, technology and culture and can conclude agreements with other countries and international organizations in these areas. It can also issue its own travel documents. Only foreign and defense affairs will be the responsibility of the central Government in Beijing. Portuguese and Chinese will both be official languages of Macau SAR.

The political structure of Macau SAR will comprise: the Chief Executive; an Executive Council, a consultative body which must be heard by the Chief Executive before important decisions are taken; a Government, headed by the Chief Executive and responsible to the legislative body; an Legislative Assembly composed of 8 directly elected members and 8 indirectly elected members, as well as seven members appointed by the Chief Executive.

The implementation of the Joint Declaration is overseen by a Sino-Portuguese **Joint Liaison Group**—a liaison, consultation and information-exchange body, which was created at the time of the Joint Declaration and will remain in operation until January 2000. As foreseen in the Basic Law, a **Preparatory Committee** under Chinese jurisdiction was established in mid-1998 to prepare for the selection of the administration of Macau SAR.

In addition, a Sino-Portuguese **Land Group** was set up to deal with land concession contracts and other related matters in Macau. The functions of this group are: to decide upon the total area of land concession to be granted beyond 20 hectares (the Governor has the exclusive right to decide up to a limit of 20 hectares per year); to decide upon the use of net revenues thereby obtained, divided equally between the current administration and the future administration of Macau SAR; and to prepare a proposal for the future use of land revenues, which, after 1999, will belong to Macau SAR.

¹The Basic Law of the Macau SAR, approved by the National People's Congress of China in March, 1993, is to function as a mini-constitution which contains the statutes concerning the territory's autonomy, the exclusive powers of the Chinese central authorities, the statute on rights of permanent residents of the Macau SAR, the political structure and the economic, cultural and social affairs of the region.

Box 2. Macau: Monetary Institutions and Arrangements

- The Monetary and Foreign Exchange Authority of Macau (AMCM, Autoridade Monetaria e Cambial de Macau) was established in mid-1989 as the successor institution of the Instituto Emissor de Macau (IEM). The Financial Systems Act of 1993 consolidated all previous rules and regulations relating to the banking and related sectors. Under the Act, the AMCM's main functions are to: assist the Governor in the formulation and conduct of monetary, financial, exchange-rate policies; monitor and supervise the banking and insurance markets; act as a central depository of gold reserves and other foreign assets; and promote the use of the local currency—the pataca.
- The Banco Nacional Ultramarino (BNU), a Portuguese bank with a long tradition in Macau, was for 75 years the sole issuer of pataca banknotes. In 1995, the Bank of China was also permitted to issue pataca banknotes. Under the currency-issuing arrangement, these two banks are required to surrender to the AMCM the foreign exchange equivalent of the pataca banknotes it issues. Since 1977 the pataca has been pegged to the Hong Kong dollar, which also circulates widely in Macau and accounts for around one-half of measured broad money.
- The AMCM supports the use of the pataca by promoting its liquidity in a number of ways: by issuing monetary bills that allow banks to invest their excess liquidity in patacas; by conducting foreign exchange operations and currency swaps that enable smaller banks to obtain local currency; and by entering into repurchase agreements in monetary bills. In addition, AMCM has offered banks involved in large infrastructure projects medium- and long-term currency swaps.
- There are currently 22 registered commercial banks with 132 branches; 9 are locally incorporated while the rest are branches of banks with head offices abroad, including one offshore banking unit; in addition, there are 3 finance companies authorized and supervised by the AMCM.
- Macau's interbank money market is characterized by a high degree of liquidity, but relatively low turnover. Interest rates in the interbank market (Maibor) closely parallel corresponding interbank rates in the Hong Kong SAR market, where many of Macau's banks transact extensively.
- There are no exchange controls in Macau, nor restrictions on capital flows. However, exporters are required to sell to banks 40 percent of foreign exchange proceeds from merchandise exports.

Box 3. Macau: Gambling Monopoly and its Associated Business Activities

- The Government of Macau granted monopoly rights to all casino-style gambling in Macau for the first time in 1934. The gambling monopoly was passed on to the Sociedade de Turismo e Diversoes de Macau (STDM), a privately held corporation, in 1962. The STDM's contract was renewed several times with the latest signed in 1996, which runs through 2001. The STDM expanded the gambling business and currently operates nine casinos in Macau while a tenth is under construction. The majority of gamblers come from Hong Kong SAR for the weekend.
- The key elements of the current contract are as follows. The STDM must: (1) pay to the government a special tax equivalent to about 32 percent of gambling receipts; (2) guarantee the operations of the marine transport; (3) cover the cost of several public works including clearing and dredging the river and developing the public facilities in the reclaimed zones in the vicinity of the port; (4) match any government spending in tourism promotion; (5) contribute 1.6 percent of gambling proceeds to the Cultural Center (operated by an academic, social, and cultural foundation); and (6) ensure the viability of the marine vessel maintenance facilities at the terminal. In return, the STDM is exempt from taxes on all operations related to gaming in Macau and on the non-gambling activities included in its contract.
- The STDM is a major shareholder in the airport, the marine terminal, and the electricity company, and has recently taken over a supermarket chain. The STDM has shares in all the major hotels, a bank, and several real estate ventures. There is no published information on the total value of STDM's assets or its business turnover.
- In 1998, government revenue from gambling accounted for 60 percent of current revenue. Gambling activity spills over to other tourism services such as hotel and restaurant activities. Overall tourism is estimated to contribute about 40 percent to GDP, with gambling currently contributing around one third of GDP, compared with about a quarter of GDP in 1989.

Table 1. Macau: Selected Economic Indicators, 1994-99 1/

Nominal GDP (1997): \$7.3 billion
 Population (1997): 422,000
 GDP per capita (1997): \$17,500

| | 1994 | 1995 | 1996 | 1997 | 1998 Est. | 1999 Proj. |
|---|------------------------------|-------|-------|-------|--------------|---------------|
| GDP, prices and labor market | | | | | | |
| Gross domestic product (in billions of patacas) | 53.4 | 59.3 | 58.3 | 58.5 | 57.3 | 57.6 |
| GDP real growth rate (in percent) | 4.6 | 3.6 | -0.5 | -0.1 | -3.3 | 0.5 |
| <i>Of which:</i> | | | | | | |
| Contributing factors | | | | | | |
| Domestic demand | 4.4 | -1.8 | -5.1 | 1.5 | -0.9 | -1.6 |
| External balance | 0.1 | 5.4 | 4.7 | -1.6 | -2.4 | 2.1 |
| CPI inflation rate (in percent) | | | | | | |
| Annual average | 6.3 | 8.6 | 4.8 | 3.5 | 0.2 | 1.3 |
| End of period | 7.0 | 7.3 | 4.7 | 2.2 | -1.8 | 2.4 |
| Unemployment rate (in percent) 2/ | 2.5 | 3.6 | 4.3 | 3.2 | 5.4 | ... |
| | (In percent of GDP) | | | | | |
| Public finance 3/ | | | | | | |
| Revenue 4/ | 18.9 | 14.6 | 14.7 | 17.2 | 15.5 | 16.5 |
| <i>Of which:</i> | | | | | | |
| Gambling | 8.7 | 8.9 | 8.5 | 10.3 | 8.5 | 9.2 |
| Expenditures 4/ | 13.4 | 16.0 | 14.2 | 16.1 | 17.0 | 16.5 |
| Current | 10.2 | 9.3 | 10.7 | 12.7 | 13.3 | 13.6 |
| <i>Of which:</i> | | | | | | |
| Wages and salaries | 4.3 | 3.9 | 4.4 | 4.8 | 5.2 | ... |
| Capital | 3.2 | 6.6 | 3.5 | 3.4 | 3.7 | 2.9 |
| Overall balance | 5.5 | -1.3 | 0.5 | 1.1 | -1.5 | 0.1 |
| | (12-month percentage change) | | | | | |
| Money and banking | | | | | | |
| Credit to the private sector 5/ | 10.3 | 4.8 | 6.8 | 9.9 | 0.8 | 5.2 |
| Broad money 5/ | 13.0 | 13.6 | 7.9 | 4.8 | 7.4 | 5.0 |
| <i>Of which:</i> | | | | | | |
| Foreign currency (percent of broad money) | 72.9 | 71.0 | 69.4 | 69.2 | 70.5 | ... |
| Interest rate (3-month interbank offered rate, end of period) | 6.5 | 6.0 | 5.6 | 9.3 | 5.2 | ... |
| International trade and tourism | | | | | | |
| Merchandise exports (in millions of US\$) | 1,857 | 1,989 | 1,987 | 2,141 | 2,088 | 2,108 |
| Merchandise imports (in millions of US\$) | 2,116 | 2,051 | 1,946 | 2,022 | 1,953 | 1,905 |
| Hotel occupancy rate (in percent) 6/ | 55.6 | 57.0 | 60.8 | 50.2 | 51.1 | ... |
| Number of arrivals (in thousands) 6/ | 5,959 | 7,752 | 8,151 | 7,000 | 6,343 | ... |
| Official reserves at AMCM (in millions of US\$) | ... | 2,250 | 2,416 | 2,531 | 2,531 | 2,531 |
| (In months of imports of goods and nonfactor services) | ... | 10.7 | 11.8 | 11.6 | 11.9 | 12.1 |
| Exchange rate (patacas per US\$) | 8.0 | 8.0 | 8.0 | 8.0 | 8.0 | 8.0 |

Sources: Directorate of Statistics and Census Services (DSEC); Directorate of Finance Services (DSF); Monetary and Foreign Exchange Authority of Macau (AMCM); and Fund staff estimates.

1/ Although Macau has no public external debt, it has a small amount of publicly-guaranteed external debt.

2/ For year 1998, actual for October.

3/ For year 1999, the budget proposal.

4/ Excluding autonomous funds and, for 1999, excluding an extraordinary provision of MOP 2.4 billion (about 4 percent of GDP).

5/ For year 1998, actual for September.

6/ For year 1998, actual through November.

Table 2. Macau: Balance of Payments, 1995-99

| | 1995 | 1996 | 1997 | 1998 Est. | 1999 Proj |
|--|--------------------------|--------|--------|--------------|--------------|
| | (In billions of patacas) | | | | |
| Current Account Balance | 20.5 | 21.9 | 21.0 | 19.0 | 19.6 |
| Goods and Services | 20.8 | 22.1 | 21.3 | 19.2 | 19.9 |
| Trade Balance | -0.5 | 0.3 | 1.0 | 1.1 | 1.6 |
| Exports, f.o.b. | 15.9 | 15.9 | 17.1 | 16.7 | 16.9 |
| <i>Of which: textiles</i> | (12.4) | (12.8) | (14.6) | (...) | (...) |
| Imports, f.o.b. | -16.4 | -15.6 | -16.2 | -15.6 | -15.2 |
| Service (net) | 21.2 | 21.8 | 20.3 | 18.1 | 18.3 |
| Credits | 25.1 | 25.8 | 25.0 | 23.0 | 23.2 |
| <i>Of which: gambling receipts</i> | (16.8) | (15.9) | (17.2) | (15.6) | (15.7) |
| Debits | -3.8 | -4.0 | -4.7 | -4.9 | -4.9 |
| Income (net) | 0.4 | 0.3 | 0.4 | 0.4 | 0.2 |
| <i>Of which: other interest on bonds and notes</i> | (0.4) | (0.3) | (0.4) | (0.4) | (0.2) |
| Transfers (net) | -0.6 | -0.6 | -0.6 | -0.6 | -0.6 |
| Capital and financial account balance | -18.2 | -20.5 | -20.1 | -19.0 | -19.6 |
| Capital account | ... | ... | ... | ... | ... |
| Financial account (commercial banks only) | -4.4 | -2.7 | 1.4 | -6.6 | -1.9 |
| Errors and omissions | -13.8 | -17.8 | -21.5 | -12.4 | -17.7 |
| Overall balance | 2.3 | 1.3 | 0.9 | 0.0 | 0.0 |
| Change in official reserves | -2.3 | -1.3 | -0.9 | 0.0 | 0.0 |
| | (In units shown below) | | | | |
| Memorandum items: | | | | | |
| Gross official reserves (billion patacas) | 18.0 | 19.3 | 20.2 | 20.2 | 20.2 |
| In billions of US dollars | 2.3 | 2.4 | 2.5 | 2.5 | 2.5 |
| Reserves/Imports of goods and nonfactor services (in months) | 10.7 | 11.8 | 11.6 | 11.9 | 12.1 |
| | (In percent) | | | | |
| Current account balance/GDP | 34.5 | 37.5 | 36.0 | 33.8 | 34.2 |
| Textile exports /GDP | 20.8 | 21.9 | 24.9 | ... | ... |
| Gambling receipts/GDP | 28.3 | 27.3 | 29.4 | 27.7 | 27.5 |
| Errors and omissions/GDP ("-" for outflow) | -23.3 | -30.6 | -36.8 | -22.0 | -30.9 |
| Exchange rate (pataca/US\$) 1/ | 8.0 | 8.0 | 8.0 | 8.0 | 8.0 |

Sources: Directorate of Statistics and Census Services (DSEC); Monetary and Foreign Exchange Authority of Macau (AMCM); Directorate of Finance Services (DSF); and staff estimates and projections.

1/ For 1999, an assumption.

Table 3. Macau: Government Finance, 1994-99

| | 1994 | 1995 | 1996 | 1997 | 1998 | | 1999 Budget |
|--|--------|-------|-------|--------|--------|-------|----------------|
| | | | | | Budget | Prel. | |
| (In millions of patacas) | | | | | | | |
| Total revenue 1/ | 10,087 | 8,671 | 8,570 | 10,073 | 10,393 | 8,890 | 9,536 |
| Current revenue | 10,000 | 8,558 | 8,448 | 10,035 | 10,050 | 8,658 | 9,323 |
| Direct taxes from gambling | 4,636 | 5,269 | 4,954 | 6,013 | 5,868 | 4,886 | 5,400 |
| Other direct taxes | 1,424 | 1,447 | 1,472 | 1,577 | 1,445 | 1,470 | 1,768 |
| Indirect taxes | 801 | 559 | 609 | 553 | 551 | 494 | 513 |
| Revenue from equity and property | 2,521 | 759 | 851 | 674 | 1,636 | 990 | 1,219 |
| Other revenue | 618 | 524 | 562 | 1,218 | 550 | 818 | 424 |
| Capital revenue and reimbursements | 87 | 113 | 122 | 38 | 343 | 232 | 214 |
| Total expenditure 1/ | 7,156 | 9,469 | 8,266 | 9,406 | 10,313 | 9,740 | 9,486 |
| Current expenditure | 5,456 | 5,541 | 6,245 | 7,408 | 7,878 | 7,615 | 7,836 |
| Wages and benefits | 2,298 | 2,327 | 2,579 | 2,815 | 3,175 | 3,000 | ... |
| Goods and services | 467 | 470 | 526 | 591 | 652 | 570 | ... |
| Current transfers 2/ | 2,646 | 2,681 | 2,965 | 3,806 | 3,382 | 3,480 | ... |
| Other current expenditure | 45 | 63 | 175 | 196 | 669 | 565 | ... |
| Capital expenditure | 1,700 | 3,928 | 2,021 | 1,998 | 2,436 | 2,125 | 1,650 |
| Public Investment Plan | 1,019 | 1,244 | 1,343 | 1,474 | 1,900 | 1,650 | 1,200 |
| Other capital expenditure and net lending | 681 | 2,684 | 678 | 524 | 536 | 475 | 450 |
| Balance | 2,931 | -798 | 304 | 667 | 79 | -850 | 50 |
| (In percent of GDP) | | | | | | | |
| Total revenue | 18.9 | 14.6 | 14.7 | 17.2 | 18.1 | 15.5 | 16.5 |
| Of which: | | | | | | | |
| Direct taxes from gambling | 8.7 | 8.9 | 8.5 | 10.3 | 10.2 | 8.5 | 9.2 |
| Revenue from equity and property | 4.7 | 1.3 | 1.5 | 1.2 | 2.9 | 1.7 | 2.1 |
| Total expenditure | 13.4 | 16.0 | 14.2 | 16.1 | 18.0 | 17.0 | 16.5 |
| Current expenditure | 10.2 | 9.3 | 10.7 | 12.7 | 13.7 | 13.3 | 13.6 |
| Public Investment Plan | 1.9 | 2.1 | 2.3 | 2.5 | 3.3 | 2.9 | 2.1 |
| Other capital expenditure | 1.3 | 4.5 | 1.2 | 0.9 | 0.9 | 0.8 | 0.8 |
| Balance | 5.5 | -1.3 | 0.5 | 1.1 | 0.1 | -1.5 | 0.1 |
| Cyclically adjusted balance | 4.7 | -2.2 | 0.3 | 1.5 | ... | -0.1 | 1.7 |
| Fiscal impulse | -0.3 | 6.4 | -2.5 | -1.1 | ... | 1.7 | -1.8 |
| Memorandum items: | | | | | | | |
| Transfer to Land Fund (MOP millions) | 1,371 | 562 | 273 | 307 | 480 | 240 | 449 |
| Autonomous bodies and funds revenue (MOP millions) | 2,724 | 5,420 | 6,142 | 4,528 | 5,360 | 5,360 | 5,100 |
| Autonomous bodies and funds expenditure (MOP millions) | 2,724 | 5,420 | 6,142 | 4,528 | 5,360 | 5,360 | 5,100 |
| Revenue including autonomous bodies and funds (percentage of GDP) | 24.0 | 23.8 | 25.3 | 25.0 | 27.5 | 24.9 | 25.4 |
| Expenditure including bodies and funds (percentage of GDP) | 18.5 | 25.1 | 24.7 | 23.8 | 27.4 | 26.4 | 25.3 |

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

1/ For 1999, excludes MOP 2,400 million (4.2 percent of GDP) set aside for contingencies.

2/ Excluding transfer to Land Fund.

Table 4. Macau: Summary of Monetary Developments, 1994-98

| | 1994 | 1995 | 1996 | 1997 | 1998 | | |
|--|------|------|------|------|------|-------|------|
| | | | | | Mar | Jun | Sep |
| (Twelve-month percentage change) | | | | | | | |
| Operations of the AMCM 1/ | | | | | | | |
| Net foreign assets | 25.5 | 14.7 | 6.8 | 5.3 | 3.8 | 1.5 | -5.0 |
| Reserve money | 12.1 | 14.5 | 30.1 | -1.9 | -5.3 | -9.4 | -1.6 |
| Monetary Survey | | | | | | | |
| Net foreign assets | 15.2 | 20.6 | 9.9 | -0.9 | 8.0 | 12.3 | 11.4 |
| Net domestic assets | 10.5 | 5.6 | 5.0 | 12.7 | 5.3 | -1.7 | 2.1 |
| Domestic credit | 9.9 | 7.8 | 4.8 | 6.2 | 2.6 | 0.5 | 0.1 |
| Private sector credit | 10.3 | 4.8 | 6.7 | 9.9 | 6.6 | 4.0 | 0.8 |
| Broad money | 13.0 | 13.6 | 7.8 | 4.9 | 6.7 | 5.8 | 7.4 |
| Narrow money | -8.7 | 1.1 | 7.6 | -7.3 | -5.6 | -11.8 | -9.9 |
| Quasi-money | 26.3 | 19.2 | 8.0 | 9.4 | 10.9 | 12.3 | 13.1 |
| (Twelve-month change as percent of initial stock of broad money) | | | | | | | |
| Operations of the AMCM | | | | | | | |
| Net foreign assets | 5.9 | 3.8 | 1.8 | 1.1 | 1.0 | 0.4 | -1.4 |
| Monetary survey | | | | | | | |
| Net foreign assets | 8.0 | 11.0 | 5.6 | -0.5 | 4.4 | 6.6 | 6.5 |
| Net domestic assets | 5.0 | 2.6 | 2.2 | 5.4 | 2.4 | -0.8 | 0.9 |
| Domestic credit | 5.7 | 4.4 | 2.6 | 3.2 | 1.4 | 0.3 | 0.1 |
| Net credit to government | -1.1 | 1.3 | -1.4 | -2.7 | -2.5 | -2.2 | -0.5 |
| Private sector credit | 6.9 | 3.1 | 4.0 | 5.9 | 3.9 | 2.5 | 0.5 |
| Memorandum items: | | | | | | | |
| Money multiplier | 25.9 | 25.7 | 21.3 | 22.8 | 24.6 | 26.0 | 24.4 |
| Income velocity of broad money | 0.9 | 0.9 | 0.8 | 0.7 | ... | ... | ... |
| Share of MOP in broad money (percent) | 27.1 | 29.0 | 30.5 | 30.9 | 30.5 | 30.6 | 29.5 |
| Share of HKD in broad money (percent) | 55.5 | 56.3 | 54.9 | 53.1 | 53.2 | 53.1 | 52.8 |
| Share of MOP in domestic credit (percent) | ... | 24.4 | 25.6 | 25.5 | ... | ... | 28.4 |
| Share of HKD in domestic credit (percent) | ... | 65.4 | 66.8 | 67.5 | ... | ... | 62.4 |

Source: Data provided by the Macau authorities.

1/ Monetary and Foreign Exchange Authority of Macau.

Table 5. Macau: Medium-Term Scenario, 1999-2003

(In percent, unless otherwise stated)

| | 1999 | 2000 | 2001 | 2002 | 2003 | 1993-95 | 1996-98 | 1999-2003 |
|---|-------------|------|------|------|------|---------|---------|-----------|
| | Projections | | | | | Average | | |
| Nominal GDP growth | 1.8 | 3.8 | 4.9 | 5.6 | 5.8 | 12.1 | -1.7 | 4.4 |
| Growth in GDP deflator | 1.3 | 2.0 | 2.0 | 2.5 | 2.5 | 7.3 | -0.4 | 2.1 |
| Real GDP growth | 0.5 | 1.7 | 2.8 | 3.0 | 3.2 | 4.5 | -1.3 | 2.3 |
| Contributing factors to real GDP growth | | | | | | | | |
| Domestic demand | -1.6 | 1.9 | 2.9 | 2.9 | 3.1 | 2.2 | -1.5 | 1.8 |
| External balance | 2.1 | -0.1 | 0.0 | 0.1 | 0.1 | 2.2 | 0.2 | 0.4 |
| External current account balance/GDP | 33.6 | 32.5 | 31.5 | 30.5 | 29.7 | 31.7 | 35.8 | 31.6 |
| Official international reserves in months of imports of goods and nonfactors services | 12.2 | 12.1 | 12.2 | 12.2 | 12.2 | 9.5 | 11.8 | 12.2 |
| Government budget (percent of GDP) | | | | | | | | |
| Revenue | 16.5 | 16.6 | 16.5 | 16.5 | 16.5 | 17.9 | 15.8 | 16.5 |
| <i>Of which: Tourism</i> | 9.2 | 9.1 | 9.1 | 9.2 | 9.2 | 9.1 | 9.1 | 9.2 |
| Expenditure 1/ | 16.5 | 16.9 | 17.1 | 17.3 | 17.4 | 15.8 | 16.2 | 17.1 |
| Balance 2/ | 0.1 | -0.4 | -0.6 | -0.8 | -0.9 | 1.2 | -0.4 | -0.5 |
| Fiscal reserves 3/ | 20.0 | 19.5 | 18.5 | 17.3 | 16.0 | ... | ... | 18.3 |
| Memorandum items: | | | | | | | | |
| Real GDP growth in China | 6.6 | 7.0 | 7.5 | 8.0 | 8.0 | 12.2 | 8.5 | 7.4 |
| Consumer prices in China | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 18.6 | 3.4 | 2.0 |
| Real GDP growth in Hong Kong SAR | -1.0 | 3.1 | 3.9 | 4.1 | 4.1 | 5.4 | 1.7 | 2.8 |
| GDP deflator in Hong Kong SAR | -2.5 | -0.4 | 1.4 | 3.5 | 4.0 | 6.0 | 5.4 | 1.2 |

Sources: The Macau authorities; WEO file; and staff estimates.

1/ Including transfer to Land Fund.

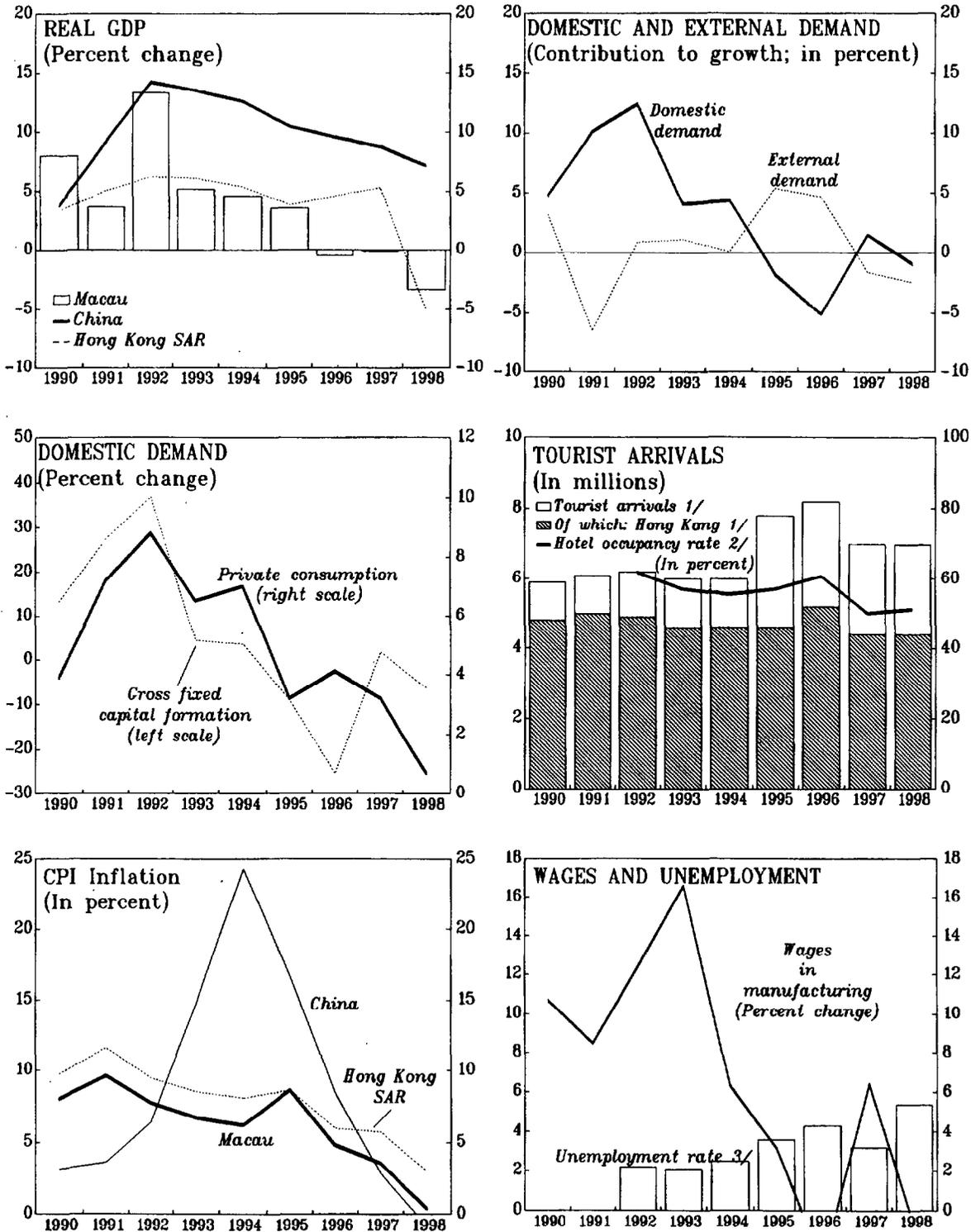
2/ After transfer to the Land Fund.

3/ Accumulated government surpluses plus Land Fund.

CHART 1

MACAU

SELECTED ECONOMIC ACTIVITIES AND PRICES, 1990-98



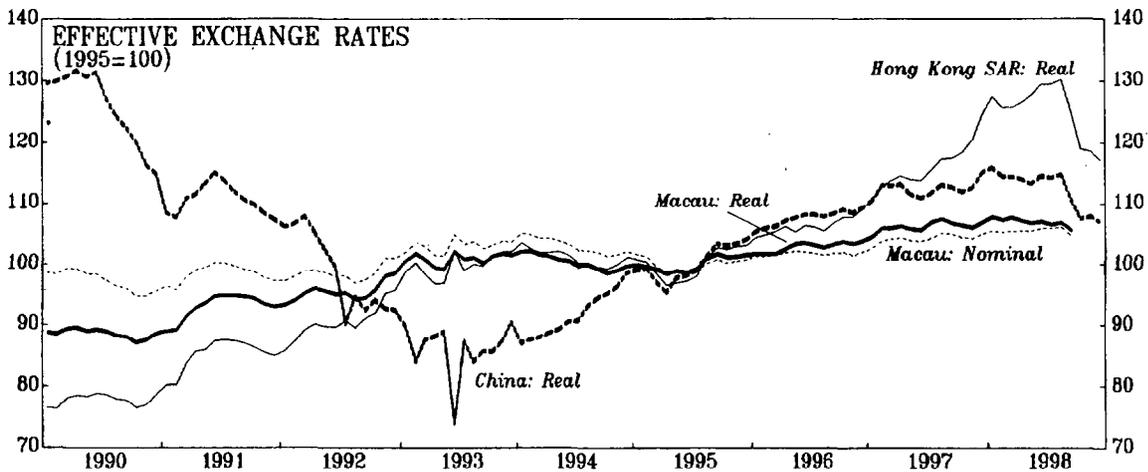
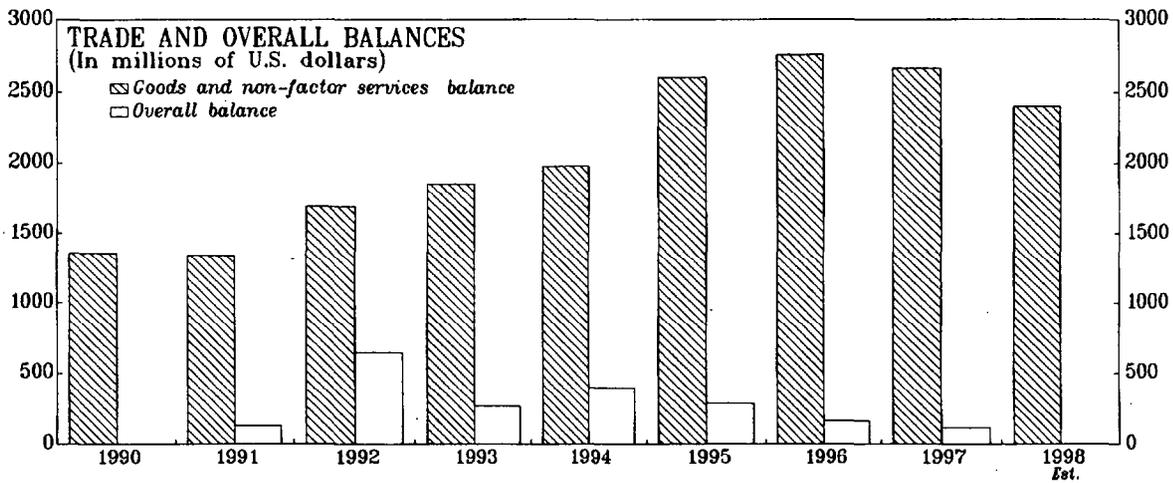
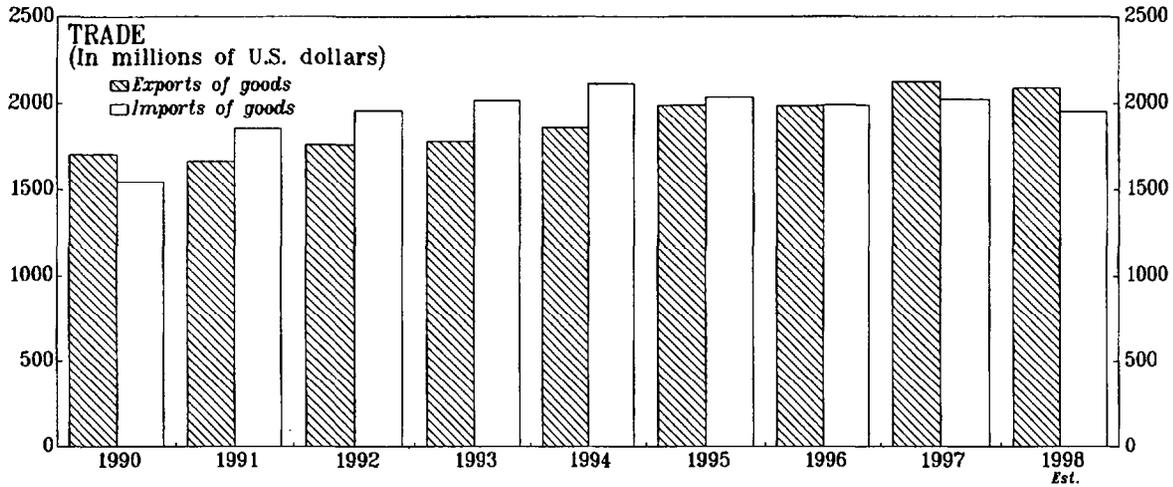
Sources: Census and Statistics Department, Yearbook of Statistics (various issues); Selected Economic and Financial Indicators, 1994-98; and IMF:WEO database.

1/ For 1998, first nine months at annual rate.

2/ For 1998, through November.

3/ For 1998, October.

CHART 2
MACAU
EXTERNAL INDICATORS, 1990-98

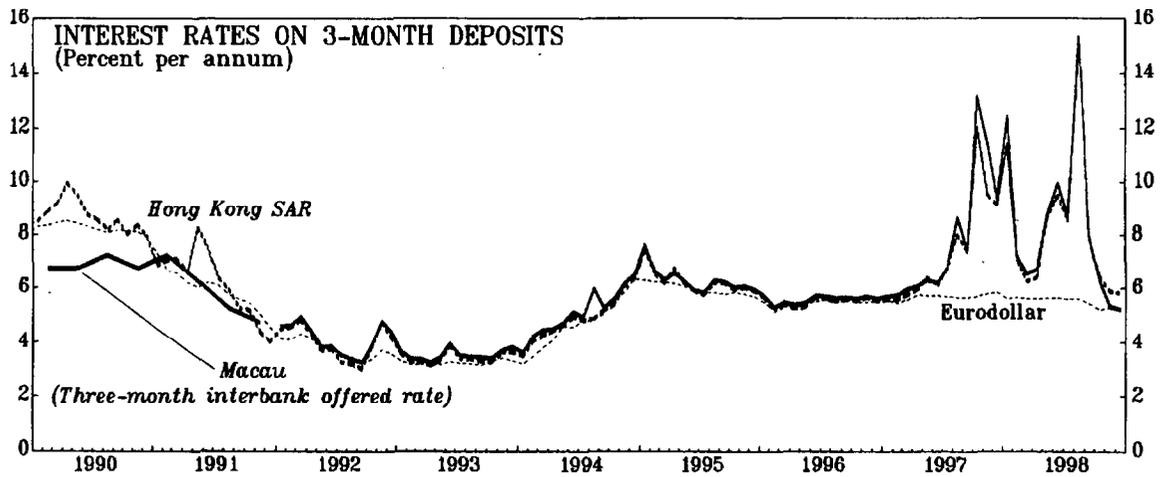
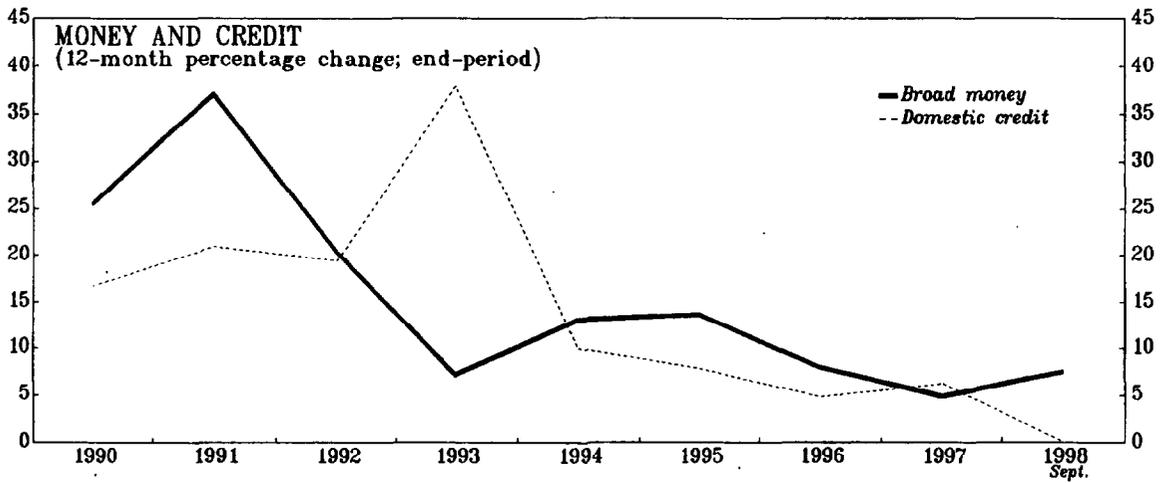
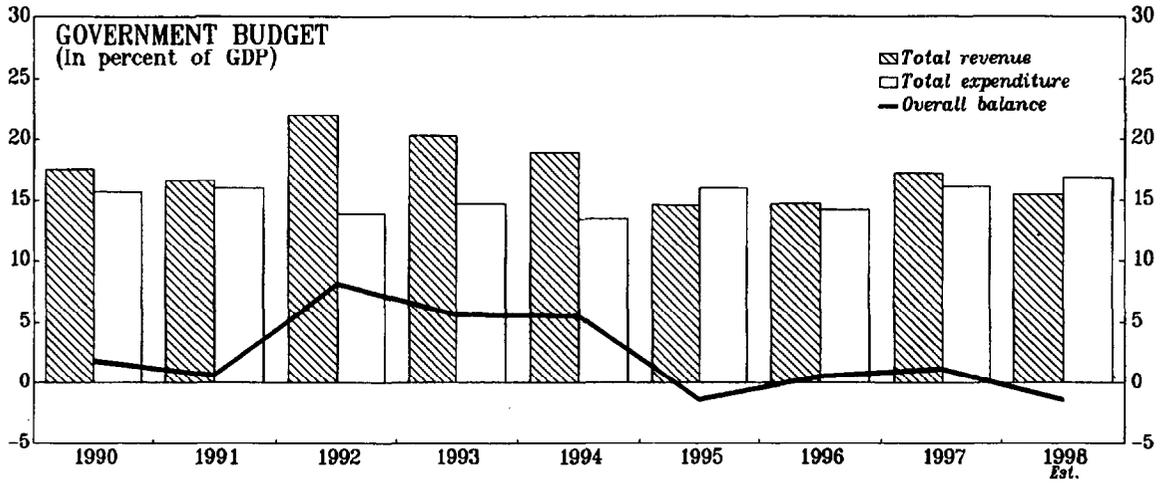


Sources: Census and Statistics Department, Yearbook of Statistics (various issues); Selected Economic and Financial Indicators, 1994-98; IMF: Information Notice System.

CHART 3

MACAU

FISCAL AND MONETARY INDICATORS, 1990-98



Sources: Census and Statistics Department, Yearbook of Statistics (various issues); Selected Economic and Financial Indicators, 1994-98; and IMF: IFS database.

Macau: Fund Relations and Exchange Rate Arrangements

Membership Status

Macau has the status of a dependent territory under the Portuguese administration and is not a member of the Fund. During the Hong Kong SAR Annual Meetings (September 1997), the Macau authorities requested, through the Portuguese Finance Minister, that the Fund conduct the Article IV consultations with Macau. During this year's Annual Meetings in Washington D.C., the Macau authorities met with Mr. Sugisaki and APD staff. The Fund management expressed willingness to conduct consultation discussions. The Chinese authorities have indicated their support for the consultation discussions.

Exchange Rate Arrangements

On April 9, 1977, the exchange rate of Macau's currency, the pataca, was formally de-linked from the Portuguese escudo and linked to the Hong Kong dollar at a central rate of MOP 107.5 = HK\$ 100, and the transaction rates were allowed to deviate from this rate as long as they were within a band of plus one percent and minus one percent of the central rate. Effective January 2, 1979, the central rate of the pataca was set at MOP 100.25 = HK\$100, and the transaction rates were to take place within a band not exceeding 4 percent on either side of the central rate. This arrangement continued through May 10, 1987. Since May 11, 1987, the Monetary and Foreign Exchange Authority has maintained its commitment to transact with local banks at MOP 103.1 = HK\$ 100 for buying patacas and at MOP 102.9 = HK\$ 100 for selling patacas, which fall within the legal fluctuation band. There are no restrictions on the making of payments for current or capital international transactions.

Macau: Structure of the Government

In accordance with the autonomy consecrated in the Organic Statute of Macau, promulgated by the Portuguese Parliament in 1976 and revised in 1990 and in 1996, the Governor of Macau has both executive and legislative authority. Legislative authority is shared with the Legislative Assembly. The Governor is Portugal's representative in Macau and is accountable to the President. The Legislative Assembly is a body of mixed representation; eight deputies are directly elected by the people, another seven deputies are appointed by the Governor from among those residents held in high esteem by the community, and eight deputies are elected by functional constituencies.¹

The Governor is appointed by the President of Portugal, after consultation with the Legislative Assembly and bodies representing local interests in Macau. In exercising the executive and legislative functions, the Governor is assisted by the Consultative Council, which consists of five members appointed by the Governor and five who are indirectly elected. The Governor ensures political coordination with the help and advice of seven under-secretaries, who are nominated by the President of Portugal at the Governor's recommendation.²

The unicameral Legislative Assembly comprise 23 deputies elected for four-year terms.³ The duties of the Legislative Assembly include: to ensure that constitutional and statutory norms and laws are complied with; to make recommendations and propose alterations to the Organic Statute of Macau; to legislate on matters falling within its jurisdiction, to grant legislative authorization to the Governor and ratify or modify any bill proposed by the Governor on matters which are not the Governor's exclusive responsibility; to authorize the Governor to raise loans; to appraise the actions of the Governor, the under-secretaries and the administration; and, on the basis of detailed justification, to veto government actions.

With regard to the judicial system, Portuguese law operates; the territory is part of the judicial system of Portugal although it operates its own court of first instance and the power of final adjudication is now vested in the Supreme Court of Macau.

¹The functional constituencies represent economic, labor, professional, cultural, educational, and social interests.

²Portfolios comprise: Administration, Education, and Youth; Communications, Tourism, and Cultural Affairs; Economic Affairs; Health and Social Affairs; Justice; Public Security; and Public Works.

³The next election is scheduled for September 2000.

Macau: Statistical System and Issues

A. Statistical System

The *System of Statistical Information of Macau* (SIEM) was established in 1984, to provide the government of the Territory and the public with relevant statistical data. According to the Law 62/96/M of October 14, 1984 the SIEM is comprised of the **Consultative Committee for Statistics (CCE)** and **statistical production units**.

The CCE is a committee that serves as a link between suppliers, producers, and users of the statistical data. Apart from supervising the activities of the System, the CCE is also responsible for: (a) evaluating all the major policies on the statistical production; (b) reviewing the plans and programmes prepared by the respective statistical production units; and (c) overseeing the adoption of international nomenclatures that are applicable to the Territory. The CCE is headed by the Director of the **Census and Statistics Department of Macau (DSEC)**.

The DSEC and the Monetary and Foreign Exchange Authority of Macau (AMCM) are the two main **production units** of statistics in Macau. The former is the main producer that coordinates all the statistical activities and is responsible for recording, verifying, processing, analyzing and disseminating the statistical information on demography, economy, and the environment, while the latter is responsible for statistics on finance, monetary, foreign exchange and insurance. Dissemination of any statistical information is subject to prior approval of DSEC.

B. Statistical Issues

Real sector, prices, labor, and social indicators

GDP estimates are made by DSEC through the analysis of a variety of sector-by-sector sources of economic, social, and public finance statistics. However, GDP estimates are only published broken down by the major categories of expenditure, as value added information on the *production side is not readily available* except for some sectors (such as manufacturing). DSEC collects and publishes data on key economic activities in Macau, namely: tourism, distributive trades, and construction. Data are also published covering prices and employment. Price series include the consumer price index (monthly), wholesale and retail price indices (annual), and a wage index (quarterly). The weights in the CPI basket were revised to take account of the 1993/94 household budget survey; *however about a quarter of the basket relating to residential rentals is not updated because of rent controls*.

Social and demographic statistics are mainly collected from the administrative records. In addition, DSEC's important statistical operations include the Population and Housing Census and the Bycensus which are conducted every 10 years; the Household Expenditure Survey, every 5 years; and the Construction Survey and Industry Survey, conducted annually.

Accordingly DSEC publishes a number of statistical indicators, for example: Demographic Indicators, estimates of resident population, and Labor Statistics.

External sector

There are extensive data on exports and imports of goods, direction of trade. Data on trade in services are also readily available, although with less detail. However, there have been recent revisions to the trade data and *the definitions making the distinction between trade with Macau and transit trade are not clear*. The services balance shows a large surplus that is heavily influenced by transfers of nonresidents for tourism and gambling. *Macau however does not produce balance of payments statistics, and no information on capital account transactions is available*. There is only sketchy information on *external debt* published by the authorities, although the public and publicly guaranteed debt is negligible.

Monetary accounts

The AMCM compiles detailed data on banks and other financial institutions. A significant portion of M2 is composed of non-pataca deposits, as currency cocirculation of the Hong Kong dollar is widespread; which makes the weakness in applying the *residency* criteria used for bank reporting of particular significance. Furthermore no effort is made to estimate non-pataca currency in circulation, which affects the measurement of reserve money and broad money supply. The *Land Fund* (which is a blocked account for use by Government after the transition) is not included in monetary statistics. No information on bank soundness is published. Interest rate data and credit distribution by sector are readily available.

Government finance

The budget estimates are produced annually (fiscal year is the same as the calendar year). The *budget classification does not follow the standard government financial statistics (GFS) methodology*. On the revenue side the surplus funds carried forward are classified as a source of current year revenues. On the expenditure side tax expenditures due to discretionary exemptions, particularly to investors, are not accounted for in the budget; neither are quasi-fiscal activities arising from interest rate subsidies. Budgetary data include the consolidated accounts of autonomous bodies, but they are not readily consistent with monetary statistics and other macroeconomic accounts.

Macau: Core Statistical Indicators
as of end-February 1999

| | Exchange rates | International reserves | Central Bank balance sheet | Reserve/base money | Broad money | Interest rates | Consumer price index | Exports/imports | Current account balance ^{1/} | Overall government balance | GDP/ GNP | External debt ^{2/} |
|----------------------------|----------------------|------------------------|----------------------------|----------------------|----------------------|----------------------|----------------------|----------------------|---------------------------------------|----------------------------|----------------------|-----------------------------|
| Date of latest observation | Jan. 28 1999 | Nov. 30 1998 | Nov. 30 1998 | Nov. 30 1998 | Nov. 30 1998 | Jan. 28 1999 | Dec. 1998 | Nov. 1998 | Nov. 1998 | Nov. 1998 | 1997 | ... |
| Date received | end-Feb. 1999 | end-Feb. 1999 | end-Feb. 1999 | end-Feb. 1999 | end-Feb. 1999 | end-Feb. 1999 | Feb. 1999 | Jan. 1999 | Jan. 1999 | Jan. 1999 | June 1998 | ... |
| Frequency of data | Daily | Monthly | Monthly | Monthly | Monthly | Daily | Monthly | Monthly | Monthly | Monthly | Annually | ... |
| Frequency of reporting | Bi-weekly | Monthly | Monthly | Monthly | Monthly | Bi-weekly | Monthly | Monthly | Monthly | Monthly | Annually | ... |
| Source of update | Officially published | Officially published | Officially published | Officially published | Officially published | Officially published | Officially published | Officially published | Officially published | Officially published | Officially published | ... |
| Mode of reporting | News brief | Electronic | Electronic | Electronic | Electronic | News brief | News brief | News brief | News brief | News brief | Statistical yearbook | ... |
| Confidentiality | No | No | No | No | No | No | No | No | No | No | No | ... |
| Frequency of publication | Bi-weekly | Monthly | Monthly | Monthly | Monthly | Bi-weekly | Monthly | Monthly | Monthly | Monthly | Annually | ... |

1/ Merchandise trade balance. Balance on goods and nonfactor services are reported annually, with the same lag as GDP data.

2/ Macau has no direct public external debt, but has guaranteed some of the external debt of the company that constructed and operates the airport.

Portugal (Macau): Social and Demographic Indicators

| | | Comparator 1/ |
|---|------------|---------------|
| Population (1997) | 422,000 | 6,311,000 |
| <i>Of which:</i> | | |
| Male (in percent) | 48.1 | 50.1 |
| Female (in percent) | 51.9 | 49.9 |
| Population growth rate (in percent, 1997) | 1.5 | 2.5 |
| GDP per capita (1997) | US\$17,500 | US\$24,500 |
| Life expectancy at birth (years, 1995-96) | | |
| Male | 75.1 | 76.3 |
| Female | 80.0 | 81.8 |
| Crude birth rate (per 1,000, 1995-97) | 13.2 | 10.1 |
| Crude death rate (per 1,000, 1995-97) | 3.2 | 5.1 |
| Infant mortality rate (per 1,000 live births, 1995-97) | 5.3 | 4.1 |
| Population per doctor (1997) | 1,270 | 590 |
| Adult literacy rate (in percent, 1995) | | |
| Male | 91.8 | 96.0 |
| Female | 79.7 | 88.2 |
| Primary and secondary enrollment (persons, 1996/97) | 71,400 | 879,000 |
| Population between 5 years old and 14 years old (persons, 1996/97) | 75,100 | 816,400 |

Sources: Census and Statistics Department, Macau Government, *Yearbook of Statistics, 1994*; Census and Statistics Department, Hong Kong SAR, *Hong Kong Annual Digest of Statistics, 1997 Edition*; and United Nations Educational, Scientific and Cultural Organization, *Social Indicators Home Page* (<http://www.un.org/depts/unsd/social/literacy.htm>)

1/ Hong Kong SAR for 1996.