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**SM/99/56
Supplement 1**

**CONTAINS CONFIDENTIAL
INFORMATION**

March 23, 1999

To: Members of the Executive Board

From: The Acting Secretary

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

The attached supplement to the staff report for the Article IV consultation discussions held in 1998 in respect of Macau (SM/99/56, 3/3/99) has been prepared on the basis of additional information. A draft Press Information Notice appears on pages 7–10. This subject is tentatively scheduled for discussion on Thursday, March 25, 1999.

Mr. Otani (ext. 37305) or Mr. Krellove (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 Discussions
Supplementary Information**

Prepared by the Asia and Pacific and
Policy Development and Review Departments

Approved by Wanda Tseng and Leslie J. Lipschitz

March 22, 1999

1. **This supplement contains information which has become available since the staff report (SM/99/56) was circulated to the Board on March 2, 1999.** The information does not alter the thrust of the staff appraisal.

Economic developments

2. **The Macau authorities now believe that the final estimate of 1998 real GDP could decline by more than their earlier projection of 3.3 percent;** however, no detailed information on the final estimate has been provided. The weakness in economic activity in 1998 was reflected in the real estate market that showed no signs of recovery: the number of units and total gross floor area completed in 1998 declined by about 9 percent and 16 percent over 1997, respectively, while the value of units transacted fell by about 40 percent.

3. **Nevertheless, there were some signs of recovery in the external sector.** Although exports and imports during the first half of 1998 were down by 3.5 percent and 8 percent (year over year), respectively, a pick up in both exports and imports in the second half meant that exports were unchanged over 1997, while imports were down by 6 percent (Table 1).

4. **Tourism also recovered somewhat during the second half of 1998.** For the year as a whole, the total number of arrivals was down by less than one percent from 1997 (Table 1). The hotel occupancy rate for 1998 increased by about one percentage point to 51.3 percent.

5. **The labor market and product prices continued to be soft.** The rate of unemployment edged up to 5.4 percent in the fourth quarter of 1998 from 5.3 percent in the third quarter. The 12-month rate of decline in the consumer price index increased to 1.8 percent in December 1998 and further to 2.5 percent in January, owing to the weakness in domestic demand and declines in import prices.

6. **Credit to the private sector declined by 1½ percent during the year.** However, the net foreign assets of the commercial banks increased sharply, while those of the Monetary and Foreign Exchange Authority of Macau (AMCM) remained virtually unchanged. Owing mainly to a significant increase in quasi-money, which in turn reflected increases in real interest rates on time and savings deposits, broad money increased by 10 percent during 1998.

7. **Interest rates in the money markets continued to decline.** Interest rates on the 3-month monetary bills of the AMCM have fluctuated in the range of 5–6½ percent since early November 1998. The spread between the rates on AMCM monetary bills and on US dollar denominated deposits, which largely reflects a risk premium, fluctuated in the range of 1–2.6 percentage points between end-September and early November (Table 2),¹ before declining gradually to a negligible level. In mid-January, the spread increased sharply to over 1 percentage point, mainly reflecting the announcement of the bankruptcy of the GITIC and the insolvency of the Nam Yue Group, the Guangdong Province Government's window company in Macau.

8. **The Macau authorities have confirmed that the banking sector's exposure to Chinese international trust and investment corporations and window companies in Macau is small.**² Despite the closure of the GITIC in the fall of 1998 and of the Nam Yue Group in mid-January 1999,³ there have been no signs of significant drop in the liquidity in

¹The interest rates on monetary bills is normally lower than the rate on Hong Kong dollar denominated deposits by 0.03 percentage points, reflecting a higher transaction cost for pataca denominated assets.

²Loans involved in the GITIC currently represent only 0.8 percent of Macau banks' total loan portfolio, while the exposure of Macau banks to the Nam Yue Group is estimated at around 3 percent of their total loan portfolio.

³In mid-January, the Guangdong Provincial Government called a creditors' meeting in Hong Kong SAR with a view to informing the creditors regarding a restructuring plan for its two investment arms—one in Hong Kong SAR and the other (Nam Yue Group) in Macau. There were 85 creditors present at the meeting, of which 28 were creditors of the Nam Yue Group. Of this, 12 are creditors from Macau. According to the Guangdong Provincial Government's representative, the Government will continue to pay interest on loans and guarantee the principal, and by end-April 1999, a restructuring plan will be revealed. A steering committee has been formed and seven banks from Macau are included. The committee has appointed a lawyer and an auditor to represent creditors' interests. In the meantime, the AMCM has recommended banks to increase provisions for loans to the Nam Yue Group. Also, the AMCM is currently reviewing the issue related to the banking sector's exposure to Chinese window companies in Macau.

the economy. In fact, the commercial banks have experienced excess liquidity due to lack of loan demand and rapid increases in deposits.

9. **On January 28, Macau ratified its acceptance of the WTO's Fifth Protocol to the General Agreement on Trade and Services regulating financial services**, thus ensuring the openness and transparency of the local financial system.

The 1999 budget

10. **The broad framework of the 1999 budget that was approved by the Legislative Assembly is virtually the same as the preliminary budget presented in SM/99/56 (Table 3)**; the budget envisages a small surplus (equivalent to 0.1 percent of GDP) in 1999, compared with a deficit equivalent to 1.5 percent of GDP in 1998.

11. **Total revenue is projected to increase by 7.5 percent to 16.6 percent of GDP**, primarily reflecting significant increases in revenue from gambling and land leases. The former anticipates a recovery in tourism, while the latter reflects an expected increase in the collection rate of arrears. Other revenues increase only moderately, compared with the outturn in 1998.

12. **Total expenditure is budgeted to decrease by 2.5 percent to 16.5 percent of GDP**, with the current expenditure increasing by nearly 3 percent and capital expenditure declining by 22 percent. The former reflects an increase in civil services wages, which had been frozen for 1998, higher spending on the social safety net, and a recovery in purchases of goods and services from the "austerity program" cuts in mid-1998. The sharp decline in capital expenditure is due to the government's desire not to initiate major investment projects that cannot be completed before the handover.

Table 1. Macau: Recent Economic Indicators, 1998

	1998						
	Jun	Jul	Aug	Sep	Oct	Nov	Dec
	(In percent)						
CPI inflation (Year-on-year change)	0.8	-0.7	-1.3	-1.3	-1.5	-1.5	-1.8
Unemployment rate (3-month moving average)	4.2	5.1	5.3	5.3	5.4	5.4	5.4
	(Year-on-year change, in percent)						
Broad money	5.7	6.6	6.3	7.4	8.7	10.0	10.0
Credit to private sector	3.8	3.3	1.7	0.5	0.0	-1.6	-1.6
	(End of month, percent per annum)						
Three month money market rate							
Monetary bills	9.8	10.8	13.1	7.8	7.2	5.5	5.2
Hong Kong dollar	10.0	10.9	13.7	7.8	7.2	5.6	5.3
U.S. dollar	4.6	5.6	5.1	5.3	5.2	5.0	5.1
	(In millions of US dollars)						
Exports (cumulative from Jan.) 1/ (Percentage change) 2/	943 -3.5	1,180 -2.3	1,403 -1.2	1,574 -0.1	1,752 -1.1	1,929 -0.4	2,140 -0.1
Imports (cumulative from Jan.) (Percentage change) 2/	959 -8.1	1,130 -8.1	1,228 -12.1	1,459 -6.1	1,622 -6.1	1,783 -5.8	1,955 -5.8
	(In percent)						
Hotel occupancy rate	45.5	52.9	58.9	47.0	49.1	51.6	52.9
	(1,000 persons)						
Number of tourist arrivals	469	605	710	517	552	556	605
Number of tourist arrivals from Jan. (Percentage change) 2/	3,404 -9.5	4,009 -6.8	4,718 -2.6	5,236 -2.0	5,797 -2.0	6,343 -1.4	6,949 -0.7

Source: The Macau Monetary and Foreign Exchange Authorities.

1/ Includes re-exports.

2/ Compared with the corresponding period of 1997.

Table 2. Macau: Three-month Money Market Interest Rates, September 1998-March 1999
(Percent per annum)

	AMCM's monetary bills (A)	Hong Kong dollar (B)	U.S. dollar (C)	(A) - (B)	(A) - (C)
1998					
30-Sep	7.84	7.81	5.25	0.03	2.59
8-Oct	7.03	7.06	5.31	-0.03	1.72
15-Oct	6.28	6.31	5.28	-0.03	1.00
22-Oct	6.23	6.23	5.12	0.00	1.11
29-Oct	7.19	7.22	5.16	-0.03	2.03
5-Nov	6.41	6.44	5.21	-0.03	1.20
12-Nov	6.16	6.19	5.31	-0.03	0.85
19-Nov	5.85	5.88	5.12	-0.03	0.73
26-Nov	5.53	5.56	4.97	-0.03	0.56
3-Dec	5.88	5.84	5.03	0.04	0.85
10-Dec	5.47	5.50	5.12	-0.03	0.35
17-Dec	5.18	5.53	5.50	-0.35	-0.32
31-Dec	5.22	5.25	5.12	-0.03	0.10
1999					
7-Jan	5.07	5.03	4.87	0.04	0.20
14-Jan	6.22	6.25	4.90	-0.03	1.32
21-Jan	6.09	6.12	4.94	-0.03	1.19
28-Jan	6.28	6.31	4.91	-0.03	1.37
4-Feb	5.75	5.78	4.89	-0.03	1.37
11-Feb	5.91	5.94	4.91	-0.03	0.86
25-Feb	6.03	6.06	4.90	-0.03	1.13
4-Mar	5.66	5.69	5.06	-0.03	0.60
14-Mar	5.53	5.56	5.00	-0.03	0.53
18-Mar	5.41	5.44	4.96	-0.03	0.45

Source: The Monetary and Foreign Exchange Authority of Macau.

Table 3. Macau: Government Finance, 1998-99

	1998 Outturn	1999	
	Preliminary 1/ SM/99/56	Budget SM/99/56	Approved
(In millions of patacas)			
Total revenue 2/	8,890	9,536	9,556
Current revenue	8,658	9,323	9,323
Direct taxes from gambling	4,886	5,400	5,266
Other direct taxes	1,470	1,768	1,504
Indirect taxes	494	513	513
Revenue from equity and property	990	1,219	1,219
Other revenue	818	424	821
Capital revenue and reimbursements	232	214	233
Total expenditure 2/	9,740	9,486	9,494
Current expenditure	7,615	7,836	7,839
Wages and benefits	3,000	...	3,156
Goods and services	570	...	678
Current transfers 3/	3,480	...	3,403
Other current expenditure	565	...	602
Capital expenditure	2,125	1,650	1,655
Public Investment Plan	1,650	1,200	1,092
Other capital expenditure and net lending	475	450	563
Balance	-850	50	62
(In percent of GDP)			
Total revenue	15.5	16.5	16.6
<i>Of which:</i>			
Direct taxes from gambling	8.5	9.2	9.1
Revenue from equity and property	1.7	2.1	2.1
Total expenditure	17.0	16.5	16.5
Current expenditure	13.3	13.6	13.6
Public Investment Plan	2.9	2.1	1.9
Other capital expenditure	0.8	0.8	1.0
Balance	-1.5	0.1	0.1

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

1/ Outturn for 1998 will not be finalized until April/May 1999.

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

3/ Excluding transfer to Land Fund.

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International Monetary Fund
Washington, D. C. 20431 USA

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 dependent 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 textiles into a more service-oriented economy focused on tourism (including gambling). In the

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.

early 1990s, the government began to develop 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 1993. 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 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 1 ½ 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 small.

Executive Board Assessment

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Public Information Notices (PINs) are issued, 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.

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.	1,988	1,988	2,138	2,088
Imports, f.o.b.	-2,050	-1,950	-2,025	-1,950
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 Fund staff estimates.