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The Acting Chairman's Summing Up at the Conclusion of the
1992 Article IV Consultation with the United Kingdom - Hong Kong
Executive Board Meeting 93/17, February 3, 1993

Executive Directors commended the authorities for the strong performance of Hong Kong's economy in 1992. Directors noted that economic growth had gained further momentum, underpinned by buoyant private demand and accommodative financial conditions. Exports also had accelerated, reflecting the strong demand in China, as well as a further expansion in re-exports of goods produced in China. While there had been some relief on the inflation front, strong upward pressures on prices had persisted, and there remained a risk that inflationary expectations would become embedded given the tightness in the labor market, the prospect for continued strong growth, and the current stance of policies.

On the sources of inflation in Hong Kong, Directors noted that an important part of the current problem stemmed from the ongoing structural changes relating to a shift in manufacturing activities to China, and the surge in demand for services offered by Hong Kong in support of China's growing external trade. While there were structural factors behind the rise in inflation, Directors emphasized in addition that strong private demand could push aggregate demand beyond the economy's supply capacity.

Directors commented extensively on the appropriate mix of monetary, fiscal, and other policies to deal with the inflation problem. Looking at the budgetary prospects for the fiscal year and beyond, Directors expressed concern that fiscal policy was once again turning expansionary. The construction of the airport core projects, while desirable from the viewpoint of Hong Kong's long-term growth potential, would place heavy calls on economic resources over the period of its implementation. As a result, a significant decline in the net public savings balance appeared likely, implying an expansion of aggregate demand and a potential heightening of inflationary pressures already in the system. In order to prevent a significant positive impulse to aggregate demand while inflation remained strong and the economy was at full employment, Directors urged the authorities to find ways to economize on current expenditures, to adjust, if possible, capital expenditures, and to consider raising additional revenues as part of an effort to strengthen the budget position.

Directors noted that monetary policy remained oriented toward maintaining the linked exchange rate vis-à-vis the U.S. dollar. They generally agreed that, since its introduction in 1983, the linked exchange rate system had been an important element in preserving financial confidence and stability in the economy. However, Directors also observed that the exchange

rate link ruled out the effective use of monetary policy in containing inflation, and they noted with concern the persistence of negative real interest rates. A greater burden was therefore being imposed on other policy instruments--in particular, on fiscal policy--to contain demand pressures.

While most Directors agreed that the exchange rate link, on balance, continued to serve Hong Kong well, a few Directors believed that, given the overall stance of other policies, an upward adjustment of the exchange rate in the current circumstances could be an appropriate policy response in order to ease inflationary pressures. Directors also observed that supply-side measures--such as a further expansion of labor imports and increased sales of public lands--could help alleviate the inflation problem.

Directors observed that Hong Kong's long-term economic prospects appeared to be highly favorable. In particular, China's reaffirmation of its commitment to continued economic reform would underpin the further integration of the Hong Kong and southern Chinese economies, and enhance the investment climate and growth potential of Hong Kong.

Directors noted that Hong Kong's economic dynamism owed much to the authorities' strong and sustained commitment to a free internal and external trade regime. In that context, the hope was expressed that tensions in the international trading system, including trade restrictions imposed by other industrial countries, would not undermine Hong Kong's growth prospects in the period ahead. In addition, it was noted that the prospects for Hong Kong, given the openness of its economy, would be enhanced by a successful conclusion of the Uruguay Round.

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