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Statement by Mr. Wei Benhua on United Kingdom - Hong Kong
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The experience of the first Article IV consultation with respect to Hong Kong has proved rewarding to all parties concerned, and my authorities would like to reiterate their continued support for this form of surveillance. They are in broad agreement with the staff appraisal and recommendations.

Since the conclusion of the 1990 Article IV consultation discussion in January last year, a significant turnaround has been observed in Hong Kong's economic performance. Real GDP grew by more than 4 percent in 1991; real domestic demand has returned to normal and, moreover, the external sector has been operating satisfactorily in spite of sluggish external demand and the ongoing recession in the major industrial economies. Exports, especially re-exports which are the fundamental pillars for securing a smooth economic operation in Hong Kong, have resumed their growth momentum.

Looking at such an encouraging recovery in the context of a persistently unfavorable external environment in 1991, two exceptionally favorable factors merit special attention from the viewpoint of the ever increasingly close economic and trade ties between China's mainland and Hong Kong.

First, my authorities fully endorse the staff's view that the signing of the Memorandum of Understanding between the Chinese and the British Governments in September 1991 with regard to the construction of a sizable, new airport project has greatly strengthened confidence in Hong Kong's future. The satisfactory solution to this once pending issue is conducive to the maintenance of stability in Hong Kong and, in turn, has certainly helped Hong Kong's economy to rebound.

Second, my authorities can concur with the staff assessment on page 2 of the Staff Report on the interlinkage between the two economies and, in particular, between southern China and Hong Kong. Economic reform and stabilization in China's mainland over the past three years has culminated in fruitful results in 1991. The sustained growth in China's mainland, together with its continuous opening, has benefitted Hong Kong. This again demonstrates the growing complementarity and interdependence between the two economies.

Nonetheless, Hong Kong's impressive economic recovery is not without weaknesses and risks. First, it is unfortunate that the economy recorded an even higher level of inflation in 1991 than in the previous year. Even though, as pointed out by the staff, special and nonrecurrent factors did contribute to a higher headline rate of consumer price inflation, the carry-

over effect from the recent expansionary fiscal policy should not be underestimated. Without a complete reversal of the recent running-up of public spending, the risk of higher inflation is still a possibility. Moreover, with the start this year of the airport construction, domestic investment and consumption are expected to be further stimulated, which would most likely keep the recovery lively. However, it would then probably be even harder to hold down inflation. In this context, inflation still constitutes a serious threat to Hong Kong's long-term sustainable growth and the Hong Kong authorities, therefore, are encouraged to mitigate inflationary pressures on the economy.

Second, Hong Kong's labor market remains tight, where even the smallest added tension could easily give rise to significant spillover effects. Therefore, we welcome the Hong Kong authorities' efforts over the past year to ease labor market tensions, as well as to reduce wage-cost pressures on inflation with appropriate policy measures. Over the past couple of years the above-mentioned two principal economic difficulties, as well as the urgent need for industrial transformation in Hong Kong, have caused Hong Kong's entrepreneurs to increasingly relocate their businesses to China's coastal areas. In fact, this tendency has enhanced the Hong Kong authorities' maneuverability in dealing with its labor market tensions over the longer term.

In addition, because Hong Kong's economy needs to accelerate its industrial transformation, it is equally important to emphasize retraining the domestic labor force and to obtain a higher level in the education of human resources for domestic employment while transferring the labor-intensive industries. The Hong Kong authorities are encouraged to put into place more specific measures in this respect in order to meet the increasing demand in the future for a qualified labor force.

Third, although marked improvement has been seen in the fiscal position, fiscal policy has not yet returned to the same soundness and prudence for which the Hong Kong authorities were well known in the past. It should be recognized that the growth rate of expenditures is still faster than that of revenue. As a matter of fact, expenditures as a proportion of GDP increased in 1991. It is imperative, therefore, that the Hong Kong authorities continue to pursue definite fiscal consolidation and, in particular, that they guard against any possible overruns during the construction of the airport project which would otherwise have critical repercussions on the budget and on the reserve position. In this regard, I am heartened to learn that the Hong Kong authorities will take a number of important precautionary measures in order to keep construction costs within the agreed budget.

Fourth, with regard to current monetary policy which is still oriented toward maintaining the linked exchange rate mechanism, my authorities continue to be supportive of such a policy because they believe the benefit still outstrips the cost and that it is the best choice for Hong Kong with regard to its need to maintain confidence and stability. However, it should be recognized that much more needs to be done to make up for the loss of

monetary autonomy in the battle against inflation in this tiny open economy. The Hong Kong authorities are facing challenges on this worldwide difficult issue of an open economy, and we stand to learn more from Hong Kong's ongoing successful experience in meeting these challenges.

I also note with concern that real interest rates in Hong Kong have become substantially negative because of the rise in inflation and the fall of external interest rates, which is said to have partly accounted for the overinvestment of resources in the property sector. Higher demand for housing has greatly pushed up property prices, which is not conducive to controlling inflation. For this reason, we welcome those relevant measures that have reportedly been taken to stop unhealthy developments in the property market.

In conclusion, my authorities would like to reiterate that they will ensure the long-term prosperity and stability of Hong Kong with the policy of "one country, two systems". For this purpose, we wish to stress two points. First, efforts should be made by both sides to strengthen the close cooperation between the Sino-British governments on the issue of Hong Kong during the later phase of Hong Kong's transitional period. Second, much needs to be done to promote the existing complementarity and interdependence between the two economies. The latter point is certainly a topic that merits further research, and staff efforts in this area would be much appreciated.

