

BUFF/ED/99/47

March 24, 1999

**Statement by Mr. Faini on Portugal—Macau
Executive Board Meeting 99/32
March 25, 1999**

I would like to begin by stating my authorities' appreciation for management's and staff's prompt response to the request for Macau to join the Fund's consultation process. It is my authorities' conviction that, as long as its economic autonomy will warrant it, the participation of Macau in the Article IV process will provide a much useful framework for an exchange of views on economic policies and prospects. In this respect, the timing of the first Article IV mission to Macau, in the aftermath of a major financial crisis in neighboring economies and about one year before the transfer of sovereignty to China, was particularly fortunate.

Despite its strong fundamentals and the prospects of a smooth transition to Chinese sovereignty, the economy of Macau was hit hard by the financial crisis in the region, as evidenced by a sharp slowdown in economic activity and an increase in unemployment. The negative effect in the real economy was also magnified by the unavailability of the exchange rate as a buffer to the external shock. Yet, despite the difficult economic environment, the authorities view the exchange rate link as a key ingredient of financial stability, hence the priority given to maintaining adequate supporting monetary and fiscal policies.

In addition to sound public finances it is worth noting the priority attached to maintaining a lean government, where revenues and expenditures account for a relatively low percentage of GDP, considering the level of per capita income in Macau. More importantly, however, the goal of a low tax environment has been achieved while safeguarding an adequate provision of public services, particularly in social sectors. Indeed, sufficient funds have been made available to education, which is now free, and health, which is highly subsidized. This policy is consistent with the authorities' goal of upgrading skills, which should be instrumental in improving labor productivity and promoting economic diversification.

Looking ahead, we share staff's cautious optimism with regard to economic prospects in Macau. Most importantly, we believe that the flexible nature of markets, well reflected in a remarkable deceleration in prices and wages during the past year, should help the economy's ability to adjust to changing circumstances and offset somewhat the unavailability of the exchange rate as a buffer to exogenous shocks. Moreover, a number of factors should come into play and contribute to minimizing the output cost of adjustment in Macau. The unwinding of the devaluation in other regional currencies, coupled with the above-mentioned wage and

price flexibility, should be instrumental in strengthening the competitive position of the economy. Also, external demand for exports should be stronger, reflecting the improved growth outlook in neighboring economies.

Yet, there is a considerable downside risk to a recovery in 1999, mostly related with the uncertainty still surrounding the growth outlook in the region, including in Hong Kong SAR. In particular, if a devaluation of the Renminbi materializes, it should have significant consequences for the growth and financial stability of the Macanese economy.

With regard to the policy discussions, my authorities agree with the thrust of the staff's advice, namely with the need to improve productivity and diversify the economy and with the desirability of including any fiscal stimulus in the context of a budgetary framework that incorporates the medium-term goal of fiscal balance. However, while the challenges of the current situation are obvious, it is equally clear that the handover of sovereignty to China in a short period of time constrains the authorities' leeway to address those challenges. On fiscal policy, for instance, while the comfortable fiscal position would normally provide some scope to implement countercyclical fiscal policy, the authorities do not want to initiate any projects that cannot be completed before the future administration takes over.

In view of the exchange rate arrangement in place, another priority is to increase factor productivity and diversify domestic production and exports, including tourism, in order to safeguard the competitiveness of the Macanese economy. For that purpose, in addition to measures aiming at upgrading labor force skills, the authorities have concentrated efforts towards strengthening tourism and promoting foreign direct investment. They believe these efforts will be instrumental in achieving a higher growth of exports and output.

Finally, my authorities would like to express their appreciation for the Fund's consideration of their request for technical assistance in the area of balance of payments statistics. In their view this is an area where data is particularly weak and that needs to be addressed promptly if Fund surveillance is to be effective.