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**Statement by Mr. Jin, Mr. Sun, and Ms. Lok on People's Republic of China - Hong Kong
Special Administrative Region
Executive Board Meeting
January 10, 2018**

On behalf of the Hong Kong SAR authorities, we would like to thank staff for the comprehensive report, and the constructive dialogue during the mission. We broadly agree with staff's assessment of the economic outlook, which faces both challenges and opportunities, and welcome staff's recognition of the strong buffers in place in our economy to help weather challenges ahead.

Latest economic developments and outlook

The Hong Kong SAR economy continued to expand. For the first three quarters of 2017 combined, real GDP grew by 3.9 percent year-on-year. This has been driven by both domestic and external factors. Domestically, demand has attained solid growth on the back of expanding private consumption. More recently, retail sales volume has grown, supported by positive consumer sentiment and revival in inbound tourism. Business sentiment also remained broadly positive. On the external front, demand for goods and services exports has strengthened, thanks to a broad-based global economic upturn. Given the economy is poised to attain solid growth in the rest of the year, the authorities expect the full-year real GDP growth rate to be 3.7 percent for 2017, which is in line with staff's projection.

With muted external price pressures and moderate local cost increases, inflation in the Hong Kong SAR economy stayed fairly modest, with the underlying consumer price inflation rate at 1.6 percent year-on-year as of November 2017, which was lower than the 2.3 percent recorded in 2016. The authorities forecast underlying consumer price inflation at 1.7 percent for 2017 as a whole.

In terms of outlook, the authorities agree with staff's assessment that the balance of risks has improved since last year, and expect solid growth in the economy to continue in the near term. Hong Kong SAR will also continue to benefit from an improving external environment,

as well as a steady transition in Mainland China, which is supported by the Chinese government's dedication to deepening structural reforms. Nevertheless, the authorities note the possible downside risks identified by staff, including disorderly adjustments in our housing market, bumps in Mainland China's transition, tighter-than-expected global financial conditions, and reduction in cross-border integration. As staff point out, strong policy frameworks and ample buffers are in place in the Hong Kong SAR economy to help navigate through these challenges. The authorities will also stay vigilant and be prepared to take appropriate actions in a timely manner to safeguard the macroeconomic and financial stability of Hong Kong SAR.

Fiscal Policy

Underpinned by prudent fiscal management, Hong Kong SAR's fiscal position is strong, with fiscal balance expected to be in surplus for a 14th straight year, and fiscal reserves to stand at 37 percent of GDP for FY2017/18. We agree with staff that supportive fiscal policy helps the economy tide over difficulties amid a challenging global economic environment. While being mindful of our constitutional responsibility to uphold fiscal prudence, the authorities strive to spend wisely and flexibly with regard to the overall fiscal position. For example, the counter-cyclical measures introduced after the Global Financial Crisis have been effective in supporting Hong Kong SAR's economy, which has been able to maintain an average growth of 3.4 percent per annum over the past 7 years from 2010-2016.

The authorities note staff's assessment that Hong Kong SAR's long-term fiscal sustainability will face challenges from population aging. In our view, raising the economic growth capacity will be key to meeting the increasing demands on public expenditure. To this end, active efforts are being made to boost this capacity. While staff suggest revenue mobilization as a way to preserve Hong Kong SAR's sound fiscal position over the longer term, it should be noted that as an international financial center, Hong Kong SAR's simple and efficient tax system with low tax rates is one of our key competitive edges. Due regard is therefore needed for maintaining competitiveness when formulating policy response in tax reform.

Property Market

Strong capital inflows following the Global Financial Crisis, an ultra-low interest rate environment, and housing supply-demand imbalance, have contributed to growing exuberance in the property market in Hong Kong SAR. The authorities agree with staff's assessment that disorderly adjustment to house prices could pose systemic risks. On the supply side, efforts have been stepped up through a multi-pronged approach to increase housing land supply in the short, medium, and long term. A Task Force on Land Supply was also established in September 2017 to conduct a comprehensive review of the options and

ways to increase land supply, as well as evaluate alternative options and their priorities. Existing efforts to speed up and increase housing land supply (e.g. land use review and rezoning, increasing development intensity, etc.) will also be continued.

It will take time for the effects of supply-side efforts to show. In the meantime, since 2009, the authorities have rolled out successive demand-side management and counter-cyclical macro-prudential measures to safeguard the stability of the banking and financial system, and ensure the healthy development of the property market. We appreciate staff's support for continuing our efforts in this regard.

The various measures implemented by the authorities have had some success in dampening the growing exuberance in the property market and the risks entailed. Nevertheless, driven by the factors mentioned above, property prices continued to face upward pressures. In particular, the authorities observed that the volume of home purchase by non-residents had surged since 2010 and stayed at elevated levels through the better part of 2012. With non-resident home purchases being a key driver to the exuberance in the property market, the Buyer's Stamp Duty (BSD) was introduced in October 2012 as part and parcel of a basket of earlier measures to holistically address the supply-side and demand-side factors underlying the heated property market. In February 2013, a Doubled Ad Valorem Stamp Duty (DSD) which applied to both residential and non-residential properties, except those residential properties acquired by buyers who are Hong Kong SAR Permanent Residents without existing properties at the time of acquisition, was also introduced. In November 2016, the ad valorem stamp duty rate for residential properties was increased to a flat rate of 15 percent (also known as the New Residential Stamp Duty (NRSD)). The authorities agree with staff's assessment that the stamp duties, which are intended to address the overheated property market and safeguard against systemic risks, are appropriate.

Linked Exchange Rate System

The Linked Exchange Rate System (LERS) has been the anchor of Hong Kong SAR's monetary and financial stability for more than 30 years and has proved highly resilient in a series of regional and global financial crises during this period. The authorities welcome staff's positive assessment on the suitability of the LERS, and are fully committed to safeguarding the system. We also appreciate staff's balanced assessment of the external position of Hong Kong SAR.

Financial Sector

As assessed by staff, the regulatory and supervisory frameworks of our financial system are robust, and substantial progress has been made on implementing the 2014 FSAP recommendations. The authorities will continue to implement agreed international regulatory reforms to further strengthen the safety and soundness of our banking system and remain vigilant to risks that may undermine financial stability. The authorities appreciate staff's support for our efforts in enhancing the competitiveness of Hong Kong SAR as an international financial center, and shall continue to strive to capture new opportunities, especially those arising from further financial development in Mainland China. We will also continue to facilitate healthy development of fintech in Hong Kong SAR, without compromising effective regulation and supervision.

Growth in Mainland China-related lending of the Hong Kong SAR banking sector is a natural consequence of the growth of the Mainland China economy and development of Mainland corporates. As staff point out, the authorities have maintained strong guidance and close monitoring of banks' lending activities. Asset quality associated with Mainland-related lending remains healthy, supported by high credit quality of borrowers, prudent underwriting standards, and a significant portion of the lending being backed by collateral or guarantee. Stress test results also show that the banking system can withstand severe adverse shocks. To this end, the authorities take positive note that staff also assess vulnerabilities arising from Mainland China-related exposure to appear manageable under stressed scenarios.

Ensuring sustainable and inclusive growth

Finally, the authorities recognize the importance of ensuring sustainable and inclusive growth. We have been paying close attention to income disparity and striving to enable society to share the fruits of social and economic development. Our social security system provides a safety net for persons who cannot support themselves financially for reasons such as old age, disability, unemployment, single parenthood, etc., and at the same time, encourages and supports people capable of working to achieve self-reliance through job training and counselling. The authorities have also recently announced a series of improvements to the Low-Income Working Family Allowance Scheme, which is a scheme aimed at encouraging self-reliance through employment and easing intergenerational poverty.

The authorities share staff's view that multiple considerations are involved in working hours policy, including implications for labor market flexibility and competitiveness. Having regard to the recommendations of the Standard Working Hours Committee, the authorities will carefully consider the views of the community and explore possible ways to improve the working hours policy of Hong Kong SAR. Abolishing the "offsetting" arrangement in the Mandatory Provident Fund (MPF) system is a priority of the authorities, and a proposal

taking into account the interests of both the business and labor sectors is expected to be drawn up in the coming months.