

**EXECUTIVE  
BOARD  
MEETING**

SM/19/73

Correction 2

April 23, 2019

To: Members of the Executive Board

From: The Acting Secretary

Subject: **People's Republic of China—Macao Special Administrative Region—Staff  
Report for the 2019 Article IV Consultation Discussions**

Board Action: The attached corrections to SM/19/73 (4/9/19) have been provided by the staff:

**Mischaracterizations  
of the Views of the  
Authorities**

**Page 8**

**Evident Ambiguity**

**Pages 10 and 21**

Questions:

Ms. Colacelli, APD (ext. 36090)



spending (with official projections showing a tripling in the number of old-age pensioners between 2021 and 2056).

**8. A MLTFF will help increase efficiency in the use of fiscal reserves while helping ensure long-term fiscal sustainability and intergenerational equity in an aging society.** Key pillars of the framework are a medium/long-term fiscal strategy and medium/long-term orientation within the annual budget process. This approach would entail developing (i) a medium/long-term macroeconomic framework, which would provide realistic multiyear projections of key economic variables; (ii) a MLTFF that would provide clear multiyear targets on aggregate fiscal variables; and (iii) a medium/long-term budget or expenditure framework, which would translate the overall budget envelope into a set of multiyear expenditure ceilings for main spending ministries. In the context of recent rapid accumulation of fiscal reserves with no public debt, the fiscal reserve-to-GDP ratio could be used as one possible fiscal anchor—though a view on optimal reserves would need to be formed—while any chosen anchor should be consistent with the MLTFF. The MLTFF should incorporate a counter-cyclical framework (discussed below) that can be layered over the fiscal targets from the MLTFF to account for needed cyclical adjustments. The authorities should start with producing a long-term fiscal sustainability report—Australia and New Zealand's can serve as a model.

**9. The authorities should ensure that their planned Sovereign Wealth Fund (SWF) is integrated into the MLTFF** (Annex II). The authorities plan to establish a SWF in 2019 with the objectives of furthering Macao SAR's development and enhancing its stability and fiscal buffers. Key considerations should include: integration of SWF within the MLTFF and annual budget including through clear but flexible inflow/outflow rules, and clear management guidelines and accountability following best practice as outlined in the "Santiago Principles" (designed by the International Working Group of Sovereign Wealth Funds).

**10. Authorities' Views.** The authorities are not using an explicit medium/long-term fiscal framework to ground fiscal budget decisions. However, they may consider the cross-country cases and best-practice examples provided by staff. Regarding the planned [Macao Investment and Development Fund \(MIDF\) SWF](#), the authorities took note of staff's recommendation that ~~the fund~~ is integrated within a MLTFF and stated that a new independent public company is to lead the [MIDF SWF](#) following the Santiago principles.

## B. Near-Term Fiscal Policy

**11. An explicit counter-cyclical fiscal framework would also improve near-term budget preparation.** Given the large output volatility due to external conditions affecting gaming, and given the substantial fiscal space, the economy can benefit from a more formal framework for counter-cyclical fiscal policy to smooth sharp private demand fluctuations. In recent years fiscal policy tended to be counter-cyclical, but an explicit counter-cyclical framework within budget preparation, including macro projections and improved estimates for fiscal outcomes, will help improve the calibration of the desirable discretionary fiscal response. Importantly, the counter-cyclical framework should be integrated with the MLTFF discussed above.

**12. The projected 2019 fiscal policy stance is appropriate and could be made more**

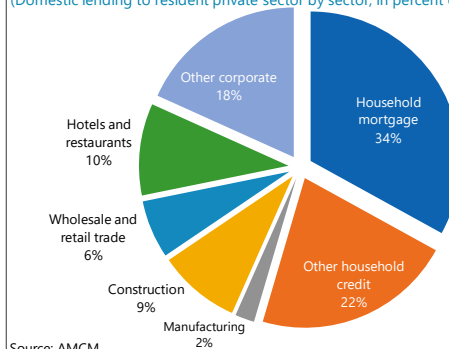
**14. Authorities' Views.** The authorities took note of staff's proposal for a more formal counter-cyclical fiscal policy framework. They stated that the completion of large capital projects is driving the decline of the 2019 capital expenditure budget, while current expenditure is expected to grow based on the 2019 budget. The authorities shared the view that additional targeted spending to support diversification and social inclusion should be calibrated. Nevertheless, the authorities believed that the principle of keeping expenditure within its means to avoid deficits as stipulated by the Macao SAR Basic Law has served as an important policy anchor to safeguard Macao's fiscal sustainability. To foster inclusion, the authorities noted that they are considering expanding the minimum wage to more sectors.

## FINANCIAL SECTOR POLICIES AND HOUSING

**15. Balance sheets of the banking system continue to suggest that the sector remains sound, but ongoing attention to large short-term foreign liabilities and to the quality and liquidity of foreign assets is needed.** Foreign banks are the bulk of the financial system—with 24 foreign branches and subsidiaries, and 4 local banks. The large scale of the banking system (about 400 percent of GDP in total assets) calls for continued supervisory caution. However, several factors moderate risks on the domestic and external side of the balance sheet.

- *Domestic* operations remain strong regarding liquidity and asset quality, helped by moderate private sector leverage. Exposures to gaming remain large, though balance sheets of gaming operators remain strong.
- The *external* side of the banking sector balance sheet shows large foreign liabilities, over 65 percent short-term, increasing funding risks (Annex IV). Moderating this risk, banks' foreign assets far exceed liabilities, which increases banks' ability to fund potential withdrawals—as long as the quality and liquidity of assets allow it. In addition, about 30 percent of the foreign liabilities of Macao SAR's banks are due to related foreign banks—and the foreign banks provide some backing to the local branches. Regarding risks to foreign assets, given the significant bank exposure to the Mainland (about 30 percent of external assets), recent efforts by the Monetary Authority of Macao (AMCM) and People's Bank of China (PBOC) to strengthen financial supervisory and regulatory cooperation, with plans to set up an information exchange framework-system, are welcome.

**Domestic real estate is over 40 percent of domestic lending to residents and over 10 percent of bank's assets**  
(Domestic lending to resident private sector by sector, in percent of total, 2018Q4)



**Balance Sheet of the Banking Sector**

(In USD billions)	2018
<b>Total Assets</b>	222
Domestic Assets	82
o/w credit to private sector	63
Foreign assets	139
Claims on banks 1/	61
Claims on nonbanks	78
<b>Total Liabilities</b>	222
Domestic Liabilities	136
Private sector deposits	79
Public sector deposits	30
Interbank liabilities	5
Capital accounts, other non-monetary liabilities, sundry, and notes	22
Foreign Liabilities	86
Liabilities to banks 2/	38
Short term	31
Medium to long term	7
Liabilities to nonbanks	30
Unallocated items	18

**Memo:**

1/ Related parties' share is 53 percent in 2018.  
2/ Related parties' share is 71 percent in 2018.

Source: AMCM.

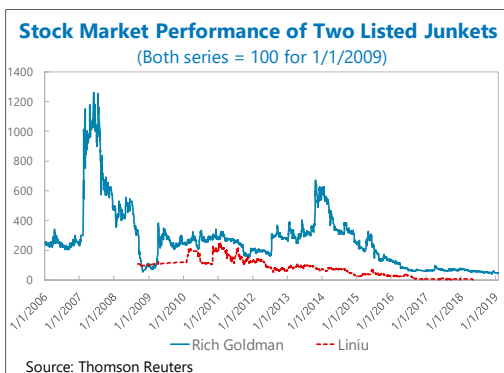
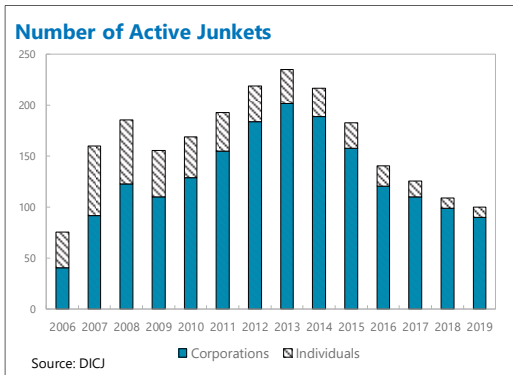
### Box 1. Junket Finance in Macao SAR<sup>1</sup>

**VIP gaming plays a big role in Macao SAR's economy.** For example, in 2017, the value added from gaming and junket activities was close to 50 percent of GDP, and the game of VIP Baccarat alone accounted for around 55 percent of all gross gaming revenue.

**VIP gaming activities are mostly facilitated by junket promoters ("junkets").** Junkets provide complementary facilities to VIP patrons including transportation, accommodation, meals, entertainment, and financing. In exchange for attracting VIP patrons to Macao SAR's casinos, junkets are remunerated by casinos. Junkets are locally incorporated companies or local legal persons, and need an annually-renewed license from the Gaming Inspection and Coordination Bureau (DICJ).

**A key service provided by junkets is the extension of credit to VIP patrons.** The extension of credit to VIP patrons is mainly to facilitate patrons to gamble without bringing large amounts of cash to Macao SAR. By law, junket gaming credit is extended in the form of unconvertible casino chips. When VIP patrons gamble and win, they collect chips that are convertible to cash, and when they lose, the junket credit becomes collectible debt.

**Junkets have been subject to anti-money laundering and combating financing of terrorism (AML/CFT) obligations since 2006.** Under the regulations, casinos are liable to ensure compliance with AML/CFT obligations of their associated junkets. Requirements were strengthened in 2016 to align the framework with the revised international standard. In recent years there have been more instances of revocation of junket licenses by DICJ. However effective implementation of existing measures remains a challenge.



**Following changes in business environment and strengthened regulation, the junket industry has consolidated over the last six years.** Peaking in 2013 with 235 approved licenses, the number of junkets has declined to 100 in 2019.<sup>2</sup> In parallel, several junkets have shown poor performance in the stock market. In line with the consolidation in the sector, the market share of the top five junkets has increased from 65 percent in 2014 to 80 percent in 2018.<sup>3</sup>

**As the economy diversifies away from VIP gaming, the junket segment is expected to contract further.** ~~Staff projects the~~The observed decline in the number of junkets ~~is expected~~ to continue under the government diversification plans where economic activity is expected to move towards mass-market gaming and non-gaming tourism, and away from VIP gaming.

<sup>1</sup> Prepared by Sakai Ando (STA).

<sup>2</sup> End-January figures for each year as published in "Approved Licensed Junket Promoter List."

<sup>3</sup> "Equities Hotels Restaurants & Leisure, Macau Gaming," HSBC Global Research, October 2018.