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INTERNATIONAL MONETARY FUND
Minutes of Executive Board Meeting 19/29-2
11:10 a.m., April 24, 2019

**2. People's Republic of China—Macao Special Administrative Region--2019
Article IV Consultation Discussions**

Documents: SM/19/73 and Correction 1, and Correction 2; and Supplement 1

Staff: Colacelli, APD; Gemayel, SPR

Length: 33 minutes

Executive Board Attendance

D. Lipton, Acting Chair

Executive Directors Alternate Executive Directors

D. Mahlinza (AE)

S. Bah (AF), Temporary

C. Moreno (AG), Temporary

P. Fachada (BR)

P. Sun (CC)

L. Villar (CE)

L. Levonian (CO)

S. Benk (EC)

A. Castets (FF)

K. Merk (GR)

M. Siriwardana (IN)

T. Persico (IT), Temporary

T. Ozaki (JA), Temporary

M. Daïri (MD)

F. Al-Kohlany (MI), Temporary

V. Rashkovan (NE)

J. Sigurgeirsson (NO)

A. Tolstikov (RU), Temporary

R. Alkhareif (SA)

C. Ong (ST), Temporary

P. Trabinski (SZ)

T. Hemingway (UK), Temporary

A. Grohovsky (US), Temporary

G. Tsibouris, Acting Secretary

E. Tsounta, Summing Up Officer

A. Lalor / J. Acheson, Board Operations Officers

M. McKenzie, Verbatim Reporting Officer

Also Present

Asia and Pacific Department: G. Alvim Balbino, M. Colacelli, J. Daniel, J. Zhang. N. Heo.
 Legal Department: K. Kwak. Strategy, Policy, and Review Department: M. Binici,
 E. Gemayel. Statistics Department: S. Ando. Senior Advisors to Executive Directors:
 W. Kuhles (GR), J. Shin (AP), M. Tolici (NE). Advisors to Executive Directors: K. Badsu
 (MD), E. Boukpepsi (AF), B. Jappah (AE), N. Komura (JA), M. Sylvester (CO), N. Vaikla
 (NO), A. Zaborovskiy (EC), K. Lok (CC), A. Sode (FF).

2. PEOPLE'S REPUBLIC OF CHINA—MACAO SPECIAL ADMINISTRATIVE REGION—2019 ARTICLE IV CONSULTATION DISCUSSIONS

Mr. Sun and Ms. Lok submitted the following statement:

On behalf of the Macao SAR authorities, we would like to thank staff of the Article IV team for the constructive discussions during the mission, as well as their professional and comprehensive assessment. The Macao SAR authorities appreciate this consultation with the Fund, which has been the third for Macao SAR since 2014. We broadly agree with staff's assessment of the economic outlook and welcome staff's recognition of the authorities' efforts in enhancing growth resilience of Macao SAR through diversification. We are pleased to confirm the authorities' intention to publish the staff report.

Economic Updates and Outlook

The Macao SAR economy has swiftly rebounded since mid-2016, following a two-year consolidation in 2014-16. Boosted by the strengthening of external demand, real GDP grew sturdily by 9.7 percent in 2017 and further by 7.6 percent in the first half of 2018. Nevertheless, the growth momentum decelerated to 2.0 percent in the second half of 2018, attributed to weaker investment and slowdown in service exports growth. For 2018 as a whole, the economy witnessed a growth rate of 4.7 percent. Nominal GDP per capita reached MOP666,893 or USD82,609.

Inflationary pressures picked up moderately as labor and rental costs fed into consumer prices. The average composite CPI increased by 3.0 percent in 2018, as against 1.2 percent in 2017. In the meantime, the unemployment rate fell to 1.8 percent in 2018 from 2.0 percent in 2017.

While the outlook of 2019 is clouded by uncertainties, external demand is expected to remain solid. This is underpinned by cross-border infrastructure upgrades, in particular, the commissioning of the Hong Kong-Zhuhai-Macao Bridge (HZMB) in October 2018, which would bolster the visitor base of Macao SAR. Furthermore, new integrated resorts to be opened in 2019 will lend support to external demand for tourism services.

Price pressure is likely to remain steady and the unemployment rate is expected to hover around levels of below 2.0 percent in 2019. Foreign workers, accounting for 47.8 percent of employment in February 2019, have been playing a major role in alleviating the issues of labor shortage and providing sufficient cushion for labor-market flexibility.

Economic Diversification

The authorities have attached great importance to the transition towards more stable sources of growth and strived to make progress in diversification. A roadmap towards economic diversification has been laid down in Macao SAR's first Five-Year Development Plan (2016-2020), where both intra- and inter-sectorial diversification plans were proposed. Policy priorities have been given to accelerate the development of the emerging industries, including MICE (meetings, incentives, conferences, and exhibitions), Chinese medicine, and featured financial services (FFB).

The authorities welcome staff's assessment that envisages a more stable growth path for Macao SAR as diversification progresses, with the economy forecast to grow steadily at about 4 percent over the medium term.

Macao SAR endeavors to bolster featured financial services as a core component of the commercial and trade service platform between China and Portuguese-speaking countries (PSCs). Staff's assessment concurs that the China-PSCs niche market is a natural area for expansion of the financial sector. To this end, the authorities have strived to improve the operating environment for providing the related financial services. For example, the "Leasing Companies Law" was enacted on 9 April 2019 to facilitate easier entry into Macao SAR's financial leasing market and raise the economy's overall competitiveness in this sector.

In December 2018, the "Arrangement between the National Development and Reform Commission and the Government of the Macao Special Administrative Region for Advancing Macao's Full Participation in and Contribution to the Belt and Road Initiative" was signed. This would support Macao SAR's provision of financing services for implementing the Belt and Road Initiative and help build Macao SAR into a financial service platform for commercial and trade cooperation between China and PSCs.

The "Outline Development Plan for Guangdong-Hong Kong-Macao Greater Bay Area" (GBA plan) was unveiled in mid-February 2019, which would offer huge opportunities for Macao SAR to broaden its development space and diversify its economy through regional cooperation. The authorities see large potential gains for Macao SAR as the GBA would expand the demand base for Macao SAR's economic diversification. In 2017, the 11 cities in the GBA had a total population approaching 70 million, contributing a total GDP of USD1.5 trillion.

Linked Exchange Rate System

The existing Linked Exchange Rate System (LERS) has been the anchor of Macao SAR's monetary stability for over three decades. The authorities welcome staff's affirmation that the LERS remains well-suited for Macao SAR and the credibility of currency board arrangement has been upheld by fiscal prudence, adequate reserve coverage, a liquid and well-capitalized banking sector, as well as a flexible labor market.

Fiscal Policy and Fiscal Reserve

The authorities have noted staff's proposal for a more formal counter-cyclical fiscal policy framework to smooth sharp private demand fluctuations. Even though fiscal space is ample, the authorities believe that the Macao SAR Basic Law mandate of balanced budgets has served as an important policy anchor to safeguard Macao SAR's fiscal sustainability.

To enhance efficiency in Macao SAR's reserve asset investment, in particular the Fiscal Reserve, the authorities have planned to establish the Macao Investment and Development Fund in 2019, which would be managed by a newly independent public company in accordance with the Santiago principles.

Property Market

The property market remained buoyant in the first quarter of 2018 but cooled off in the second half of 2018 after the authorities rolled out new macro-prudential measures in February 2018. The authorities welcome staff's assessment that the current housing macro-prudential stance and related fiscal measures to mitigate systemic risks associated with the property market are broadly appropriate. Property-related credit activities have remained as a significant portion of bank lending though they have moderated. The share of property-related loans (residential mortgage and commercial real estate loans) in total private-sector loans dropped to 39.9 percent at end-February 2019 from 41.7 percent a year ago. Moreover, the asset quality of these loans has held up well. The delinquency ratio of property-related lending edged down to 0.17 percent at end-February 2019 from 0.18 percent at end-February 2018. Nonetheless, the authorities will remain vigilant of developments in the property market and deploy appropriate measures based on evolving macroeconomic and financial stability risks facing Macao SAR.

Property prices continued to face upward pressures in 2018, rising by 7.5 percent. To alleviate the housing affordability issue for the youth, the maximum loan-to-value ratio of mortgages granted to Macao young first-time homebuyers was relaxed to assist young adults in purchasing their first homes in February 2018. Subsequently, the proportion of local first-time homebuyers rose notably to 82.1 percent in 2018, from 45.0 percent in 2017.

On the supply side, ongoing public housing projects are expected to satisfy public housing needs by 2026 when about 50,000 additional public housing units would become available.

Financial Sector

The authorities have exerted tremendous effort in safeguarding the financial system and welcome staff's assessment that Macao SAR's financial sector remains sound. Liquidity and asset quality remain healthy. Regarding rising banks' exposure to Mainland-related lending, the authorities have maintained close monitoring of banks and strengthened supervision to ensure that Macao banks adhere to prudent credit underwriting standards and risk management. Asset quality associated with Mainland-related lending remains healthy and a significant portion of such lending is backed by collateral or guarantee. Furthermore, the Monetary Authority of Macao continues to strengthen financial supervisory and regulatory cooperation with the People's Bank of China.

The authorities appreciate staff's support for their efforts in strengthening the anti-money laundering and combating the financing of terrorism (AML/CFT) framework. The assessment by the Asia/Pacific Group on Money Laundering (APG) in 2016 recognized Macao SAR's substantial progress in implementing international standards, including the filing of suspicious transaction reports (STR) and large sum transactions in the gaming sector. In 2017, the authorities introduced the "Control of Cross-Border Transportation of Cash and Bearer Negotiable Instruments" to further strengthen the AML/CFT framework.

Mr. Agung, Mr. Villar, Ms. Arevalo Arroyo and Ms. Ong submitted the joint following statement:

We thank staff for their informative reports and Mr. Sun and Ms. Lok for their insightful buff statement. We welcome that economic growth in Macao SAR has rebounded since 2016 and that sound economic stewardship has helped build strong fiscal and foreign reserve buffers. Given Macao's

small size, openness and heavy dependence on gaming revenues, the longer-term priority is to shape a robust growth model through diversification and prudent macroeconomic management. We concur with the thrust of the staff appraisal and offer the following comments for consideration.

The authorities should continue their track record of prudent fiscal policy. With monetary policy limited by the currency peg to the Hong Kong Dollar, fiscal policy is the primary lever for both near-term and long-term macroeconomic management. We therefore see merit in a well-articulated fiscal strategy to address long-term sustainability and equity concerns, while remaining responsive to short-term output fluctuations. That said, the Basic Law mandate of a balanced budget appears to have served as a credible fiscal anchor without necessarily constraining a counter-cyclical response. Further, staff's recommendation of a granular MLTFF appears predicated on accurate multi-year forecasts, which might be challenging in the Macanese context in which output and fiscal variables are volatile and heavily influenced by external factors. Staff's comments are welcome. Depending on its mandate, the planned Macao Investment and Development Fund could be a useful vehicle for intergenerational savings and stabilize fiscal revenues, and we encourage the authorities to manage it in line with international best practice, as affirmed in the buff statement.

We note staff's consideration that social spending is lower compared to peers, but we would have appreciated further analysis linked to outcomes, particularly related to education and health, that would have contributed to a clearer understanding of the recommendation to increase spending in these areas in a targeted fashion. Staff notes that the Wealth Partaking Scheme (WPS) is not targeted, but according to Box 2 a "remarkable feature of the WPS is that it is a universal basic income program (UBI)". Staff comments are welcome on the expected distributional benefits of boosting targeted spending vis-à-vis the results of the WPS as UBI to date.

We welcome that the financial sector remains sound. As financial sector development is a key part of the authorities' economic diversification strategy, we encourage continued vigilance to financial stability risks and efforts to enhance regulatory and supervisory capacity. Large short-term foreign liabilities in the banking system warrant ongoing attention, although we think that the intra-group nature of these liabilities helps attenuate the risks here. We take positive note of staff's assessment that systemic risks in the housing market appear contained. The prominence of both the gaming and financial sector elevates money laundering risks, and we encourage the

authorities to press on with their efforts to strengthen the AML/CFT framework and its enforcement.

Efforts to broaden the economy's growth engines should continue. Recent experience has highlighted potential concentration risks with regard to VIP gaming revenue. We welcome the progress to date in boosting the role of mass-market gaming, non-gaming tourism and MICE activities, and the financial sector. We support staff's recommendations to consider diversification incentives in the next round of gaming concessions and to address infrastructure and human capital bottlenecks.

Country idiosyncrasies and data limitations exacerbate uncertainties in the external sector assessment. The linked exchange rate system with Hong Kong SAR continues to serve Macao well. While the last Article IV consultation found Macao's current account balance to be broadly consistent with fundamentals and desirable medium-term policies, staff now assesses Macao's current account balance to be substantially stronger than warranted. Could staff elaborate on the change in assessment, including assumptions regarding the permanence of the gaming monopoly and the determination of optimal fiscal policy? More broadly, we underscore that Macao's small size, openness and large financial center (among other factors) makes any external balance assessment highly uncertain, and that these challenges are further compounded by data limitations.

Mr. Ozaki and Mr. Komura submitted the following statement:

We thank staff for the comprehensive report and Mr. Sun and Ms. Lok for the informative statement. Macao SAR is the largest casino center in the world. The economy highly relies on gaming and junkets activities amounting to almost half of GDP. Due to liberalization of gaming sector and liberalization of travel policies in China, the economy has expanded rapidly since early 2000s, making its GDP per capita one of the highest in the world. In addition, its prudent macroeconomic policies have contributed to build large fiscal and foreign reserve buffers over the expansive periods. Going forward, economic diversification, together with maintaining its position as a large casino center, and efficient use of revenues from gaming sector with adequate protections for vulnerable groups would be a key for sustainable and inclusive growth in Macao SAR. As we broadly concur with staff's assessments, we would like to offer following comments for emphasis:

Diversifying Sources of Growth

Economic diversification is challenging but essential agenda. We support that the authorities focus on diversifying sources of growth, from VIP gaming to mass-market gaming and from gaming tourism to non-gaming tourism. In this regard, the economy may benefit from increases in average earnings and development of infrastructure in Guangdong province, potentially by investment from Macao SAR, because they could be additional sources of revenues from mass-market gaming and non-gaming tourism. Does staff consider that the "Greater Bay Area" plans help to create such positive synergies and spillovers in the medium-term? In contrast, noting the staff's recommendation that economic diversification policies should be guided by careful study of Macao SAR's comparative advantage, we would like to better understand whether it is appropriate for the authorities to focus on fostering financial sector as a source of growth given its geographical proximity of one of the world financial center, Hong Kong SAR. Could staff elaborate more on this front?

Fiscal Policy

We agree with staff that a MLTFF would be helpful to deal with various needs in Macao SAR. Macao SAR has ample fiscal buffers due to strong growth and prudent fiscal policies under its Basic Law. Looking ahead, there would be several needs or challenges to which fiscal policies should respond. Amid expected moderation of growth, the authorities should make their fiscal policies more growth-friendly and accommodate higher social spending stemmed from population-aging, while ensuring fiscal sustainability. Furthermore, vulnerable groups should be adequately protected. In addition, more pro-cyclical fiscal policies are warranted to mitigate adverse effects from economic fluctuations. Against this backdrop, developing a MLTFF would help the authorities to comprehensively and efficiently deal with these needs or challenges. Given its significance, SWF should be integrated into the MLTFF. In this regard, we welcome staff's work on providing best practices set out in Annex II. They seem to well facilitate discussions with the authorities. On the SWF itself, transparent and sound governance structure based on clear management guidelines and accountability are imperative. We agree with staff that the SFW should follow the "Santiago Principles." On top of that, around ten years have passed since the establishment of the principle. Considering development of SWFs and lessons from implementations of the principle over the decade, could staff make more granular advice on what elements should the upcoming SWF incorporate, instead of simply recommending following the principle?

Financial Sector Policy

The banking sector remains sound. However, we are of the view that large short-term foreign liabilities call for continuous attention. In addition, banks have significant exposure to the Mainland and to BRI countries. Regarding the BRI participation, we agree with staff that careful analysis of comparative advantage of Macao SAR and high project quality and transparency would be critical.

Mr. Benk and Mr. Zaborovskiy submitted the following statement:

We thank staff for the well-written paper and Mr. Sun and Ms. Lok for their informative buff statement. Macao SAR's accumulated fiscal and foreign exchange buffers, reported at 121 and 40 percent of GDP respectively in 2017, shield its economy well against downside risks. We commend the Macao SAR authorities for their prudent policies and diversification efforts, and broadly agree with the thrust of staff's appraisal.

An integrated medium/long-term fiscal framework (MLTFF) that includes the reserve assets management and counter-cyclical fiscal rules could serve the authorities well to ensure long-term fiscal sustainability and intergenerational equity in an aging society. We note that staff consistently continues to advocate the MLTFF, including in the 2014 and 2016 Article IV reports on Macao SAR, however, traction seems to be limited. As stated in Mr. Sun and Ms. Lok's buff statement "the authorities believe that the Macao SAR Basic Law mandate of balanced budgets has served as an important policy anchor to safeguard Macao SAR's fiscal sustainability". Staff's further comments on how to improve traction of their advice are welcome. Going forward, it would be useful to have a more nuanced discussion in the Article IV paper about the design of the MLTFF, including calibration of the appropriate fiscal anchor and optimal reserves levels. We encourage the authorities to further integrate social and infrastructural spending considerations into the fiscal framework to achieve more sustainable and inclusive economic growth and to facilitate the external balance convergence to equilibrium (from the current account surplus of 35 percent of GDP in 2018).

The large banking system (about 400 percent of GDP in total assets) requires vigilant supervision and advanced regulatory cooperation with counterparts in other jurisdictions. We note staff's conclusion that the Macao SAR's financial sector remains sound, however, large short-term foreign liabilities of the banking sector warrant ongoing attention. We also call on the

authorities to advance the macroprudential regulation to mitigate housing market risks, replacing the residency-based differentiation with alternative measures. The ongoing review of the Financial System Act presents a good opportunity to implement key FSAP recommendations and we encourage the authorities to press ahead with this task.

The strengthening of the AML/CFT framework is a welcome development which should be sustained. We positively note the authorities' plans to intensify AML/CFT oversight and enhance the sanction regime for non-compliance with the existing regulation. We echo staff's call for strengthening the framework for sound Fintech adoption with an appropriate focus on preventing regulatory arbitrage and avoidance as well as preserving financial integrity. Comments on any differences between Macao SAR and the Mainland in the regulation of crypto-assets are welcome.

We note the concordance between staff and the authorities about the diversification policies. The authorities' plans to transform Macao SAR into a World Center of Tourism and Leisure as well as to boost its financial sector could be further complemented by well-designed structural measures, supporting competition and private sector led-growth. We are encouraged by the various ongoing economic diversification initiatives outlined in the buff statement. In this context, investments in human capital and development of well-targeted social safety nets remain critical to facilitate diversification, innovations, and inclusion.

Mr. Heo and Mr. Shin submitted the following statement:

We thank staff for their comprehensive report on Macao SAR and Mr. Sun and Ms. Lok for the informative buff statement. After struggling with negative growth the last few years, Macao's economy has reverted to expansion and is expected to grow moderately at around 4 percent over the medium term. However, risks still remain tilted to the downside given its high dependence on Mainland China and narrow concentration on the gaming industry. We broadly agree with the staff assessment and have the following comments for emphasis and clarification.

Even with a healthy fiscal position, spending efficiency and long-term sustainability need to be ensured. We applaud the authorities' prudent macroeconomic policies that helped build a large fiscal buffer (121 percent of GDP in 2017) with zero public debt. However, we believe that fiscal space is one thing; the decision to spend is another. While sharing staff's view that the fiscal stance this year could be more expansionary in light of growth

moderation, we underline that it should be focused on more selective areas such as education, health, and infrastructure to raise growth potential and promote diversification. We also support the planned establishment of sovereign wealth fund (MIDF) that could help build sustainable buffers to offset the impact of possible adverse shocks and accumulate funds for long-term need for future spending, if it is closely integrated into the MLTFF.

Despite the overall cooldown of the housing market, continued attention on the market movement would be warranted. The surging price of small properties following recent policy easing for young first-time homebuyers shows the fundamental excess demand for housing. We encourage the authorities to keep fine-tuning the macroprudential measures in tandem with the market condition. On the residency-based LTV, we suggest staff provide more specific advice to find an alternative measure that could achieve the same policy objective without differentiating between residents and non-residents. We would welcome staff's view on this issue. At the same time, we agree with staff that a broader set of policies should support the housing affordability including through an urban planning framework and urban renewal plan.

We welcome the emphasis on the diversification policy towards non-gaming services. While recognizing that diversification in a small economy is challenging, we note that Macao is well placed to meet Mainland China's growing demands for professional services and a various type of tourism. Infrastructure upgrades such as Hong Kong-Zhuhai-Macao Bridge (HZMB) would play a catalytic role in broadening networks and accommodating more diversified service industry model. We also agree with the staff that high project quality and transparency would be important regarding BRI participation, especially it is related to provision of financing services. Could staff elaborate further on how Macao has been involved in the BRI and it will be down the road, particularly as regard to financing services?

Mr. Rashkovan and Mr. Tolici submitted the following statement:

We thank staff for their report and Mr. Sun and Mr. Lok for their buff statement. Over the last decade, Macao's sound macroeconomic policies have led to robust growth, healthy public finances and a strong external position. While the high level of fiscal and external buffers, standing at 121 percent and 40 percent of GDP respectively in 2017, continues to strengthen the resilience of the economy, we note potential risks stemming mainly from external shocks and high vulnerability to economic, financial and policy developments in mainland China. We encourage the authorities to maintain their prudent and

proactive policies, while continuing to strengthen competitiveness, regional cooperation and diversification of the economy.

We broadly concur with staff's analysis and offer the following comments for emphasis.

A medium long-term fiscal framework (MLTFF) is needed to secure sustainability, promote transparency and ensure that spending is consistent with developmental and social objectives. We note that the authorities' adherence to key principles under the Basic Law of Macao SAR supported a continuous accumulation of fiscal reserves and debt-free status. Nevertheless, the heavy reliance of the public finances on revenues generated in the gaming sector require precaution. We encourage the authorities to develop a formal framework for counter-cyclical fiscal policy to mitigate any revenues volatility due to adverse shocks in the gaming sector. We concur with staff that the adoption of a MLTFF is warranted to increase the efficiency in the use of fiscal reserves while ensuring long-term sustainability and intergenerational equity in an ageing society. The establishment of a Sovereign Wealth Fund could create sustainable buffers for countercyclical action. We advise the authorities to ensure that the fund's risk tolerance, management guidelines and accountability follow the best practices as outlined in the "Santiago Principles".

Economic diversification is crucial for sustaining Macao's growth over the longer term. Diversifying the economy toward non-gaming services is required to reduce vulnerabilities to external disturbances and ensure future sustainable growth. Public investment in infrastructure and human capital, financial development and broader integration with Mainland China are key pillars to support Macao SAR's development into an economic and trade co-operation platform for China and Portuguese-speaking countries. In this respect, we positively note from the buff statement the recent advancement of Macao SAR on strengthening regional cooperation by signing the agreement for its full participation in the Belt and Road Initiative. At the same time, we concur with staff on the importance of increasing public investment in social sectors to reduce inequality and boost human capital to support the diversification agenda and foster inclusion.

Macao SAR's financial sector remained broadly strong and resilient. We note the significant progress with strengthening the supervisory framework by implementing most of the 2011 FSAP recommendations and urge the authorities to make steady progress in relation to operational independence to the Monetary Authority of Macao (AMCM) as well as

adopting the IFRS to enhance transparency and credibility of banks' financial reporting. Large short-term foreign liabilities and the concentration of foreign assets (70 percent) in Hong Kong SAR and the Mainland require, however, increased efforts to strengthen financial supervision and regulation cooperation across jurisdictions. The establishment of a Fintech team within the AMCM and coordinated work with People's Bank of China (PBOC) on Fintech and mobile payment regulation are welcome steps toward increasing cyber resilience in financial institutions and Fintech firms. More efforts are needed to prevent regulatory arbitrage by enhancing cross-border supervisory collaboration. We encourage the authorities to further strengthen the AML/CFT framework in accordance with the FATF principles, in particular by enhancing the oversight and sanctions regime in the gaming sector.

Mr. Sigurgeirsson and Mr. Vaikla submitted the following statement:

We thank staff for the comprehensive report and Mr. Sun and Ms. Lok for their informative buff statement. We commend the authorities for the strong performance of the economy in recent years. While the risks are considered to be skewed to the downside, the gradual strengthening of gaming and tourism growth coupled with regional diversification efforts should further support Macao SAR's medium-term economic outlook. We encourage the authorities to continue pursuing prudent macroeconomic policies and enhancing economic diversification plans. We agree with the thrust of the staff appraisal and would like to limit our comments to the following points.

The authorities' current near-term budget policy is appropriate. However, creating a medium-term fiscal framework would further strengthen fiscal sustainability. We agree with staff that the fiscal reforms, involving a long-term macroeconomic forecast, multi-year targets for fiscal variables and an expenditure framework, would be helpful in upgrading the current fiscal framework. The framework would also benefit from integration with the planned Sovereign Wealth Fund (SWF). However, we are not fully convinced that Macao SAR would currently need to develop an explicit counter-cyclical fiscal framework to cushion external volatility, as suggested by staff. While it would help to smooth domestic demand, the authorities' current near-term fiscal policy is in many respects suitable for a small and open economy with a pegged exchange-rate policy. The authorities near-term budget policy has served them well and we support the authorities view that the simple Basic Law mandate is appropriate to safeguard fiscal sustainability.

A large financial sector and rising property prices requires continuous monitoring. The Macao SAR financial system is considered sound and

characterized by ample liquidity and sound asset quality. We take note of the authorities' strong efforts in safeguarding the financial system through efforts of strengthening the AML/CFT framework. Given the large size of the financial sector, we encourage the authorities to monitor sizeable short-term foreign liabilities and to strengthen financial supervisory and regulatory cooperation with the People's Bank of China. We agree with staff that if residential property prices continue to appreciate and potentially affect financial stability, tighter macroprudential and/or fiscal measures should be considered.

Further economic diversification could stabilize economic growth over the long-term. We commend the authorities for their efforts to diversify the economy by enhancing mass-market gaming, non-gaming tourism and financial sector growth. The "Development Plan for Guangdong-Hong Kong-Macao Greater Bay Area" could further boost potential growth and diversify the economy through regional cooperation. In their diversification efforts, we encourage the authorities to follow the guiding principles for diversification policies suggested by staff.

Mr. Mahlinza, Mr. Jappah and Mr. Nakunyada submitted the following statement:

We thank staff for a comprehensive report and Mr. Sun and Ms. Lok for their helpful buff statement.

We commend the Macao authorities for prudent macroeconomic management that supported the strong growth rebound and the building of ample reserves. Nevertheless, growth prospects remain challenged by economic developments in Mainland China, US-China trade tensions, reliance on gaming tourism, an aging population, elevated housing prices, and income inequality. To tackle these challenges, the authorities should focus on diversifying growth sources, efficient use of fiscal resources, strengthening financial integrity, and increasing priority investment and social expenditures.

Comprehensive reforms are required to support prudent and efficient medium to long term fiscal policy. To this end, we concur with staff's view that the authorities need to shift from discretionary fiscal policy towards adoption of a medium to long term fiscal framework (MLTFF) to ensure efficient use of fiscal revenues. We view the MLTFF as important to help calibrate future expenditures required to meet development and social objectives including the long-term pension and healthcare obligations related to the aging population. Further, the budget preparation process would benefit from the adoption of an explicit counter-cyclical fiscal framework to smooth

domestic demand fluctuations. At the same time, we urge the authorities to prioritize well-targeted infrastructure and social expenditures including human capital development, to support diversification objectives, foster inclusion, and help reduce external imbalances.

Supervisory and regulatory vigilance is required to mitigate risks from large short-term foreign liability exposures, and fintech developments. In this connection, we are encouraged by the efforts to strengthen financial supervisory and regulatory cooperation across jurisdictions and plans to establish an information exchange system. That said, we emphasize the need to strengthen the framework for sound Fintech adoption through additional measures to enhance cyber resilience. In addition, closer cross-border supervisory collaboration would be essential to prevent regulatory arbitrage. Further, we commend the authorities for the progress made in strengthening the AML/CFT requirements in the gaming sector and encourage further strengthening of the regulatory framework for market entry in line with the 2017 assessment.

We welcome the current macroprudential policies that have contained systemic risks in the housing sector. This notwithstanding, we remain concerned with the effects of elevated housing prices on affordability. Accordingly, we urge the authorities to address supply side bottlenecks by promoting a coordinated private and public investment housing strategy. Could staff clarify the authorities' view that on-going projects will meet housing demand by 2026? The authorities should closely monitor housing market developments and related financial stability risks and stand ready to adjust macro-prudential measures as warranted. Moreover, the supervisory capacity of banks' mortgage lending should be strengthened in line with the last FSAP recommendations. Nevertheless, we support the authorities' plans to make public housing more targeted to the vulnerable.

The diversification of growth sources would be important to strengthen economic resilience. In this context, we welcome the authorities' broad range of policy plans aimed at enhancing growth by diversifying the economy. We, therefore, view progress made thus far in reducing the share of VIP gaming, growth in non-gaming tourism and various financial sector development initiatives, as important steps in the right direction. While we agree on the need for the diversification agenda to be guided by the country's comparative advantage, we wonder if there has been work on other sectors besides those currently being explored. Staff comments are welcome.

Mr. Gokarn and Mr. Siriwardana submitted the following statement:

We thank staff for the informative report, and Mr. Sun and Ms. Lok for their helpful buff statement. Macao SAR has shown remarkable macroeconomic performance over the years while raising per capita income to near a global high and maintaining zero public debt. Growth has recovered strongly after the recent set-back with the support of strengthened external demand, although it has decelerated more recently and is projected to remain around 4 percent in the medium-term. Inflationary pressures have picked up lately but are expected to remain steady. Unemployment has dropped to a historically low level. Fiscal and current accounts have continued to record surpluses. The authorities deserve credit for their effective macroeconomic management, which has also been supported by greater openness, and strong links with the Mainland and Hong Kong SAR.

However, the report indicates several key challenges. The dependence on tourism and gaming revenue has made the economy susceptible to associated shocks, requiring policies to safeguard macroeconomic and financial stability. Inequality remains higher than the OECD average. The transition towards more stable sources of growth and making progress in diversification towards non-gaming activities will also be critical to ensure future sustainable growth. In addition, high vulnerability to the spillovers from Mainland's rebalancing of growth, population ageing and social pressures also necessitate appropriate policies. Against this backdrop, we broadly concur with staff's assessment and wish to make following remarks for emphasis.

Macao SAR's healthy fiscal position and continued fiscal surpluses have resulted in a large accumulated fiscal reserve, providing cushion to any revenue fluctuations as well as external vulnerabilities. The budgetary surplus will be continued although it is estimated to decline gradually to around 12 percent of GDP by 2024. We see merits in staff's proposal to develop a medium/long-term budget framework to safeguard sustainability and ensure developmental and social objectives. The plans to establish the Macao Investment and Development Fund (MIDF) in 2019 will also be an important step to enhance efficiency in reserve asset investment and, very importantly, support economic diversification efforts.

The Linked Exchange Rate System (LERS) has been appropriate, providing a credible nominal anchor while being supportive for economic activity. It has also helped Macao SAR to weather shocks successfully. Staff has assessed the external position as substantially stronger than medium-term fundamentals and desirable policy settings.

The property market has cooled off in the latter part of 2018. This seems to have prevented any abrupt correction of the property market. In this respect, we note the new measures taken by the authorities, including the tightening of the LTV for non-first-time homebuyers and some fiscal measures. However, the decline in the housing affordability is a concern. The steps that are being taken to improve supply conditions are also important to promote a balance in the market. Could staff comment on the extent to boost the housing supply given the territory's space constraints?

The financial system of Macao SAR remains healthy and resilient. However, we urge continuous vigilance on the potential resumption of strong growth in residential property prices and the related financial stability concerns. Significant progress has been made in implementing FSAP recommendations. We welcome the steps taken to strengthen the AML/CFT framework and urge authorities to strengthen it further for sound Fintech adoption.

The authorities' commitment to diversify the economy into non-gaming services is reassuring. The efforts to enhance emerging industries, including MICE and the GBA Plan will play a catalytic role in diversifying Macao SAR's economy.

Despite the high per capita income, the persistent income inequality in Macao SAR is a concern. While we note the causes of inequality indicated in Annex III, staff's comments are welcome on the possible policy measures to address this structural issue going forward.

With these remarks, we wish the authorities all success in their future endeavors.

Mr. Trabinski and Mr. Makhammadiev submitted the following statement:

We thank staff for their comprehensive report and Mr. Sun and Ms. Lok for their informative buff statement. We commend the authorities for the prudent macroeconomic policy, especially the strong fiscal discipline, that has allowed to accumulate extensive fiscal and foreign reserves. The currency board arrangement has proven to be effective and has served Macao SAR well. While gaming, tourism and related activities remain the main drivers of growth in the medium-term, additional efforts to diversify the economy are warranted to sustain long-term growth and inclusiveness.

The dependence of Macao SAR's economy on Mainland China and the gaming industry calls for swift implementation of the government's diversification plans. Even though Macao SAR enjoys a gambling monopoly in China, its economy is very sensitive to the developments and policy changes in the Mainland that may affect tourists' ability to spend money abroad. In addition, growing competition in the South East Asia region's gaming industry may have an impact on Macao SAR in the short term and serves as a reminder of the benefits of diversifying the economy. Thus, we welcome the authorities' diversification plans and concur with staff's guiding principles for their implementation. Against the backdrop of high current account surpluses and increasing needs for expanding non-gaming tourism, the authorities could consider higher infrastructure spending.

Developing an explicit medium/long-term fiscal framework (MLTFF) will be key to linking fiscal revenues generated by the gaming industry to long-term objectives. The Macao SAR Basic Law has been instrumental in maintaining prudent fiscal policy. However, the lack of an explicit counter-cyclical framework has limited capacity to smooth volatility in private demand. In this context, we take positive note of the authorities' plan to establish a Sovereign Wealth Fund (SWF), which will play an important role in generating wealth for future generations. We agree with staff's advice to integrate the SWF into the MLTFF and to follow the Santiago principles of governance and accountability.

The financial sector is sound, and we commend the authorities for strengthening supervision. We welcome the recent efforts by the Monetary Authority of Macao (AMCM) and People's Bank of China (PBOC) to strengthen their financial supervisory and regulatory cooperation. While the overall AML/CFT framework has been solidified, the dominance of the gaming sector calls for heightened attention, with a focus on oversight of junket promoters.

Despite the very high income per capita, Macao SAR lags behind its peers on inequality metrics. We share staff's view to step up spending on health and education to improve inclusiveness. Besides strengthening inclusion, higher education spending will foster human capital, which will be crucial for the successful implementation of the diversification plans. Given the high reliance of Macao's SAR economy on the gaming industry, could staff elaborate on how the authorities are matching up development trends and labor market needs with vocational training? Moreover, to address housing affordability issues, we encourage the authorities to resolve supply bottlenecks.

Mr. Castets and Mr. Sode submitted the following statement:

We thank staff for the quality of their documents and Mr. Sun and Ms. Lok for their buff statement. Macao ongoing recovery is welcome but there are several downside risks to the growth outlook, most prominently due to the strong economic links with Mainland China's economy. While we agree with staff analysis and recommendations, we would like to emphasize the following remarks:

Given its ample fiscal space, Macao has room to increase public spending for social safety nets and physical infrastructures and in order to enhance the inclusion of the most vulnerable households, including migrant workers. We thank staff for their annex on the trends and drivers of inequality which shows that while Macao has the one of highest level of income per capita in the world, its levels of inequality and poverty remain relatively high. Housing affordability, education and health access and quality, as well as social insurance, notably for non-resident worker, could be significantly improved with the large revenues that come from the gaming and tourism industry. Could staff elaborate on the existing regulations protecting migrant workers as well as on the minimum wage, and discuss how these regulations could be further improved to foster inclusion?

We encourage the authorities to adopt the best international standards in term of AML/CFT framework and effective implementation. We fully share staff's recommendations to strengthen the standards applying to the gaming sector, to increase oversight of "junket" promoters and to enhance the sanctions regime, notably to make casinos more accountable. Regarding the financial sector, we encourage the authorities to remain vigilant regarding the accumulation of foreign-denominated short-term liabilities and commend the authorities for the macroprudential measures taken to limit risks in the housing sector.

Mr. Raghani and Mrs. Boukpassi submitted the following statement:

We thank staff for the well-balanced report and Mr. Sun and Ms. Lok for their informative buff statement on recent macro-economic developments in Macao -Special Administrative Region (SAR).

The Macao-SAR authorities should be commended for implementing prudent policies which have enabled economic recovery since mid-2016 with ample fiscal and external buffers. However, Macao's economy remains highly dependent on gaming and tourism and is sensitive to financial and economic

developments occurring in China which, together with international trade tensions, have impacted growth in the second half of 2018.

Looking ahead, Macao SAR is facing daunting challenges including economic diversification, increased competition in the region's gaming industry, and the weight of aging population. There is therefore a need to step up efforts and pursue the implementation of sound macroeconomic policies, as well as far reaching structural reforms. This would help the authorities harness the region's comparative advantages, unleash its potential growth while preserving macroeconomic stability and further improving social inclusion.

We broadly share staff policy recommendations and would like to provide the following comments for emphasis.

On the fiscal front, we welcome the authorities' sound policy in recent years which has led to sizeable fiscal buffers. Based on this satisfactory performance, we agree that it will be advisable to pursue a broad and strong reform agenda with a medium and long-term fiscal framework to efficiently address the increased infrastructure needs and social spending. This will ensure long-term fiscal sustainability and help preserve the Macao SAR Basic Law. Furthermore, we see merit in additional fiscal relaxing in 2019 to expand priority public investments and strengthen targeted social expenditures.

Regarding the financial sector, we commend the authorities for the strength of Macao's banking system, as evidenced by a high level of liquidity and asset quality. In view of the strong interconnexion with banks in Hong Kong SAR and Mainland China, there is a need to contain the funding risks related to this situation. In this regard, further efforts will be necessary to enhance banking supervision and promote cooperation between the three jurisdictions on the regulatory front.

While we welcome progress made in strengthening the AML/CFT framework as rightly highlighted by the 2016 assessment in compliance with international standards, we encourage the authorities to further enhance this framework based on the risks associated to gaming activities, including money laundering. These include inter alia, implementing required policy measures to enhance the regulatory framework for market entry, intensifying AML/CFT oversight and reinforcing the sanction regime. We see merit in the joint work between the Mainland's central bank (PBOC) and Macao's monetary authority (AMCM) on Fintech and mobile payment regulation which bodes well for further progress in these areas.

We take good note of the recent developments in the housing market and share the view that the macroprudential measures aiming at managing property prices are appropriate. However, the authorities should remain vigilant for further tightening of their policies should residential property prices start to increase.

On structural reforms, the rising competition in the region's gaming industry and related tourism activities calls for a wide diversification of the sources of growth and taking account Macao's comparative advantage. In this regard, we agree with the authorities that recent regional cooperation efforts including the Greater Bay Area (GBA) plans are steps in the right direction to further boost Macao SAR's attractiveness and help diversify the economy away from gaming services. With most of the gaming concessions coming to an end in 2022, we encourage the authorities to provide robust incentives for potential new businesses in order to help enhance non-VIP tourism. The region's infrastructure will need to be expanded to respond to the needs of a high number of tourists under a mass-market and non-gaming model. This will also require the provision of adequate financial services. To this end, it will be critical to implement policies aiming at increasing the highly educated workforce and facilitating the removal of structural bottlenecks to investment in the tourism and financial sectors.

With these remarks we wish the Macao SAR's authorities every success in their future endeavors.

Mr. Dairi and Mr. Badsı submitted the following statement:

We thank staff for the well-written set of reports and Mr. Sun and Ms. Lok for their informative buff statement. We commend the authorities for their outstanding economic performance. After a strong rebound from a recession in 2017 and early 2018, growth in the tourism and gaming-based economy of Macao SAR is expected to stabilize at a more sustainable 4 percent over the medium-term, reflecting progress in economic diversification toward less volatile sources of growth. Headline inflation is expected to remain subdued, and the fiscal and external current accounts in surplus. However, high income inequality remains a concern. Risks to the outlook are skewed to the downside, mainly driven by spillovers from developments in Mainland China and US-China trade tensions, and a sharp tightening of global financial conditions. We agree with the thrust of the staff appraisal.

Prudent fiscal policy has contributed to building ample domestic buffers. However, we agree with staff that the adoption of a medium to long-term fiscal framework will help ensure efficient use of fiscal resources for priority infrastructure and social spending, long-term fiscal sustainability and intergenerational equity in a rapidly aging society. We look forward to the establishment of the Sovereign Wealth Fund along with a more formal counter-cyclical fiscal framework. We are encouraged by the shared view between the authorities and staff on the need for calibrating additional targeted spending to support diversification and social inclusion.

The banking sector is healthy while largely based on foreign branches and subsidiaries. We welcome the recent efforts by the Monetary Authority of Macao SAR and the People's Bank of China to strengthen financial supervisory and regulatory cooperation, with plans to set up an information exchange system. We commend the authorities for the strides made to buttress the AML/CFT framework, including in the gaming sector, and encourage them to further strengthen the framework for sound Fintech adoption. We note with satisfaction that the housing macroprudential stance and related fiscal measures are broadly appropriate and have helped to alleviate potential systemic risks in this sector. The exchange rate peg remains appropriate. We welcome the authorities' recognition of the need to strengthen infrastructure and social spending to bring the current account surplus more in line with fundamentals, but we also take note of the bottlenecks they face in this area.

We welcome the authorities' plan to enhance growth resilience and their commitment to economic diversification as mentioned by Mr. Sun and Ms. Lok, including by gradually reducing reliance on high-end gaming and tourism. We are pleased to note the authorities' agreement with the guiding diversification principles proposed by staff, including incentives for new concessions, infrastructure upgrades, and financial sector policies.

We wish the authorities' further success in their endeavors.

Mr. Grohovsky made the following statement:

We did not issue a gray statement. There are just three points we would like to make about the Article IV consultation.

First, we would echo the staff's call on replacing the residency-based differentiation feature of the loan-to-value ratio (LTV), which is classified as both a macroprudential measure (MPM) and a capital flow management measure (CFM) under the Institutional View. We appreciate that the staff

provided alternative options, both in the report and then also in the written responses to the questions, that would attain the same policy objective while eliminating the differentiation between residents and non-residents. We want to thank the staff for the alternative options on that.

Second, we ask the staff to clarify some of the risks that were in the report. We understand Macao's geographic location; but for such a small place, we were wondering whether U.S.-China trade tensions are really a significant risk, as well as a sharp tightening of global financial conditions, with unexpected Fed rate hikes. We note in that same paragraph that the staff indicates that gaming revenue has been resilient to exchange rate movements. We can understand some of the logic that may have gone into some of these risks, but perhaps they could have been a bit more tailored.

Finally, we wanted to echo the calls made by Mr. Trabinski, Mr. Rashkovan, and some others regarding the planned sovereign wealth fund, particularly that it should follow best practices, as outlined in the Santiago Principles. We welcome the authorities' stated commitment to do exactly that.

Ms. Levonian made the following statement:

We thank the staff for the comprehensive report. We did not issue a gray statement, but I wanted to take the opportunity to indicate our broad support for the staff's appraisal and recommendations and to highlight three specific points.

First, we commend the Macao authorities for their prudent economic management in recent times, which has supported strong economic performance and the buildup of significant buffers. Looking ahead, the authorities are encouraged to maintain prudent policies, given the country's high susceptibility to external shock and its narrow economic base.

Second, like many other chairs, we stress the necessity for continued efforts and vigilance to mitigate financial stability risks that could stem from the large short-term foreign liabilities in the banking system and from potential regulatory and supervisory failure. Furthermore, we encourage the authorities to make additional progress on strengthening the Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework, including for sound fintech adoption.

Lastly, we welcome the efforts to diversify the economy to build economic resilience and support inclusive growth. We encourage further progress in this area, in line with the five-year development plan.

Mr. Ozaki made the following statement:

We thank the mission chief, Ms. Colacelli, and her team for the well-written report, with interesting boxes and annexes. We also thank Mr. Sun and Ms. Lok for their informative statement.

As we mentioned in our gray statement, we broadly concur with the staff's appraisal. We would like to provide two comments.

First, we note that the authorities promised to establish the sovereign wealth fund this year. As many other colleagues mentioned in their gray statements and Mr. Grohovsky mentioned at the Board, we agree with the staff's view that the promised sovereign wealth fund should be integrated into the medium/long-term fiscal framework (MLTFF). It will contribute to ensure efficient use of fiscal resources, long-term fiscal sustainability, and intergenerational equity in an aging society. In this regard, we appreciate Annex II in the staff paper for providing an insightful perspective.

Second, on economic diversification, we note that the authorities are focusing on financial sector development. When focusing on the financial sector, the authorities should also monitor the risk of financial markets and implement appropriate supervision to maintain a stable market.

In addition, regarding the Belt and Road Initiative (BRI) participation, we agree with the staff that high project quality and transparency are critical.

Mr. Trabinski made the following statement:

There is a Chinese proverb which says: He who can persuade someone not to gamble has earned money for him.

As we are discussing Macao SAR today, it is valid to ask whether we should encourage the Macanese authorities to move away from gambling, as in their case, it seems to be very profitable. On the other hand, by supporting the diversification of the economy, we might, indeed, earn money for them, especially as it does not mean departing from the gambling industry but, rather, developing other engines of growth, like non-gaming tourism or financial services. In this regard, the Chinese authorities' Greater Bay Area

development plans' focus on enhanced economic activity and innovation indicate additional potential benefits for the Macanese economy.

As we issued a gray statement, let me stress two additional points.

First, we concur with the staff and some other chairs who emphasized that the authorities should continue their prudent fiscal policies. In this regard, we find staff's recommendation for an MLTFF appropriate. This is specifically important in preparing long-term forecasts of fiscal needs, like infrastructure, education, and health care, all of which are crucial for diversifying the economy and raising its growth potential. Moreover, like Mr. Ozaki and Mr. Komura, we support integrating the sovereign wealth fund into the MLTFF.

Second, we note the overall good condition of the banking sector. However, we see scope for strengthening financial sector supervision and following closely housing market developments. This seems to be particularly important, given the authorities' plans to expand financial services, which are enclosed in their diversification strategy.

The staff representative from the Asia and Pacific Department (Ms. Colacelli), in response to questions and comments from Executive Directors, made the following statement:¹

I thank Directors for the comments and the questions and for the helpful gray statements.

To answer the questions that were just raised, the main one I hear is about the risks and how they apply to Macao specifically. When we talk about the U.S.-China trade tensions affecting Macao, we think about the exposure of Macao to Mainland China which is significant in so many ways. Even though the gaming spending per visitor has been somewhat resilient to exchange rate fluctuations—the renminbi versus the pataca—there is a huge exposure in terms of China's economic activity slowing and that affecting the amount of tourists that would come to Macao on vacation and to gamble. The trade tensions are affecting producers in Guangdong province, who are the main source of tourism for Macao within China. That is a region that is very exposed to the trade tensions. In addition, investment plans to serve additional tourists will be affected, depressing growth even more. Banking sector

¹ Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

exposure is another important issue for Macao, given that the banking sector is highly exposed to assets in Mainland China. Therefore, if there were to be issues with the quality of those assets in Mainland, vis-à-vis the escalation of trade tensions, there will be an impact on the financial sector in Macao.

We responded in writing to the detailed questions that were raised, but I wanted to mention two points and to answer one question on the external assessment change that we did not answer in the technical questions.

The first issue I wanted to mention was fiscal policy. The mission had productive and open discussions with the authorities on the staff's recommendations, including those to boost public investment and targeted social spending, such as health, education, and housing. As we state in the report and as agreed by many Directors, we believe that Macao can benefit from a comprehensive fiscal reform agenda that can support the efficient use of the sizable fiscal buffers, while maintaining fiscal sustainability and intergenerational equity.

We consider that the resulting medium-to-long-term fiscal framework, or MLTFF, can be helpful to complement the Basic Law in Macao that has served well as a policy anchor. Both concepts can work together. It does not have to be one or the other. An MLTFF can be built to deliver the fiscal policy that achieves balanced budgets.

Going forward, if the authorities find it useful, the staff will be happy to engage with them to help design the specifics of a Macao SAR MLTFF. The framework would incorporate ingredients that the authorities were to consider most appropriate, such as the Basic Law and their views of what would be the best and most useful fiscal anchor for Macao, perhaps one based on their view of the optimal level of the fiscal reserves. The planned Macao Investment and Development Fund should be included in the MLTFF.

While Macao SAR is one of the top economies in the world in terms of output per capita, inequality is higher than the OECD average. We consider that Macao SAR is in a position of strength that can allow for accommodating increased, targeted fiscal social spending. But an important question is, how much should they spend in social spending? This is a difficult question, and the MLTFF provides a framework to help deliver such answer.

Similarly, how much room does Macao SAR have to spend on the needed infrastructure to boost diversification efforts? Again, an MLTFF can be a helpful tool to answer this question. One can use the framework to

determine infrastructure spending, accounting in the forecasts for what is going to be the boosted returns and the boosted growth and fiscal revenue derived from priority infrastructure projects. That will allow one to deliver an answer with the realistic available fiscal space.

The issue of infrastructure bottlenecks and social spending brings us to the second issue that I wanted to discuss, which was the external sector assessment. As Directors noted, this year we changed the assessment of the current account from in line in the past to now substantially stronger than medium-term fundamentals and desirable policies. The real effective exchange rate assessment is maintained, and the exchange rate peg continues to serve Macao well and should be maintained.

Why did we change the current account assessment? There are two main reasons why the current account assessment was changed. The first is that the current account is higher now. The second is that we removed a previous staff adjustment. After careful consideration within the External Balance Assessment (EBA) modeling framework, we now view the structural distortions are associated with casino rents as part of the unexplained current account gap. In other words, we now consider that the structural distortions are largely explaining the external imbalance and that comes from two channels. The first structural distortion channel is the investment and infrastructure bottleneck that faces Macao that is preventing the domestic market from absorbing the gaming monopoly rents. The second one is that policies in place cause excessive savings, such as the low public social spending.

The reason why I bring up the external assessment is that the policy recommendations that come from the assessment reinforce what we say regarding fiscal policy earlier. In addition, they also support the diversification efforts that the authorities are working on. We recommend that infrastructure and social spending are boosted. These policies will help, at the same time, to reduce the external imbalance by lowering savings and increasing investment.

To mention an additional important issue affecting both the MLTFF and the external assessment, there is a question that was also mentioned in the gray statements: What is the time horizon for the gaming monopoly?

We have provided the recommendations under the assumption that the gaming monopoly is permanent, in line with the authorities' views. However, if we assume, instead, that the gaming monopoly is temporary, the external

assessment would likely change, and the MLTFF would also look quite different and it would likely show much less fiscal space.

Let me conclude by highlighting that Macao SAR is in a position of strength, as high reserves provide solid buffers against shocks, thanks to the prudent macroeconomic policy of the authorities and a period of rapid expansion. These are good times to plan for the future and to consider adopting an upgraded fiscal framework that can be efficient, sustainable, equitable, and inclusive.

Mr. Dairi made the following statement:

We thank the staff for the clarifications and responses.

I am a bit worried about this abrupt change in the external sector assessment. Going from in line to substantially high in one year or two years is a bit excessive. I would have preferred an adaptation of a more gradual transition—of course, we are not in the design of this idea.

But in some cases, it is better to be a bit cautious because the current account surplus increased in 2018 but not by much. It went up from 33 percent of GDP to 35 percent. This is not an amount that would make it easy to explain this reclassification. We have to be careful on the communication side to try to avoid getting overly alarmist in this area.

Mr. Sun made the following concluding statement:

On behalf of the Macao SAR authorities, I thank Ms. Colacelli and her team for their excellent work and constructive policy advice. I would also like to thank Directors for their useful comments, which I will convey to the authorities.

Following a two-year consolidation in 2014 to 2016, the Macao SAR economy has rebounded strongly. In the face of a weakening global environment, growth momentum has slowed in the second half of 2018, and the economic outlook is clouded by uncertainties. That said, prudent policy management has helped build strong buffers to bolster Macao SAR's resilience. Continued economic diversification and opportunities arising from greater regional integration will also lend support to the economy.

The Macao SAR authorities continue to exercise fiscal prudence, upholding the principle of fiscal balance, as mandated by the Basic Law. As a

number of Directors have pointed out, the Basic Law mandate has served Macao SAR well. Nevertheless, we take note of staff's suggestion to establish a medium/long-term fiscal framework, and we welcome further dialogue with staff in this regard. Meanwhile, the planned Macao Investment and Development Fund will help enhance the efficiency in fiscal reserve management.

The authorities share staff's view on the need for additional targeted spending to support diversification and social inclusion, while balancing against the need to spend within their means and safeguard fiscal sustainability. The authorities remain committed to protecting the vulnerable and improving people's livelihoods.

Efforts continue to be made in optimizing Macao SAR's social security system. In the 2019 Policy Address, the Chief Executive of Macao SAR announced further measures to enhance social protection for the vulnerable. These include raising subsidies and allowances to students and those with disabilities, introducing a rent waiver for social housing tenants, and disbursing temporary housing subsidies for eligible families on the waiting list for social housing. The authorities have also upgraded social programs aimed at enhancing self-reliance among the underprivileged through job matching and career services, as well as skills development. Meanwhile, continued efforts will be made in addressing housing affordability concerns.

Macao SAR's financial sector remains sound, supported by ample liquidity and sound asset quality. The authorities will stay vigilant and keep a close watch on potential risks and vulnerabilities, while strengthening supervision and regulation cooperation across jurisdictions. The authorities will continue to enhance the AML/CFT framework in line with international standards. Developments in the housing market will be monitored on an ongoing basis, and the authorities stand ready to take further action, as needed, to safeguard financial stability.

Going forward, the authorities recognize the importance of transitioning toward more stable sources of growth and are committed to making further progress in diversification under the Five-Year Development Plan. Efforts will also be devoted to promoting non-gaming tourism and nurturing emerging sectors. Staff's recommendation to guide diversification policies based on Macao SAR's comparative advantage is well noted.

The Guangdong-Macao Traditional Chinese Medicine Technology Industrial Park is an example of Macao SAR's efforts to create synergy by

integrating its own advantages of research capacity, talent, and tourism resources, with the expertise of the neighboring Guangdong province to develop Macao SAR into an international gateway for Chinese traditional medicine.

On the external front, the authorities will continue to uphold the Linked Exchange Rate System - which has served as an important anchor of Macao SAR's monetary stability - through continued prudent policy management.

Once again, on behalf of the authorities, I thank Ms. Colacelli and her team for their useful inputs and Directors for their insightful comments. We look forward to our next Article IV consultation discussion in two years' time.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended Macao SAR's macroeconomic performance over the years, which has resulted in one of the highest per capita incomes in the world with zero public debt levels. Directors indicated that prudent macroeconomic policies and high reserves provide strong buffers against shocks for Macao SAR, though they noted that growth risks are tilted to the downside. Looking ahead, Directors supported the authorities' efforts in enhancing growth resilience through diversification.

Directors saw the need for a comprehensive reform agenda to support fiscal policymaking. While acknowledging that the current balanced budget rule has been instrumental in maintaining prudent fiscal policy, they saw merit in an integrated medium/long-term fiscal framework that could include countercyclical fiscal policy, along with the planned Macao Investment and Development Fund (MIDF) that is managed and governed under international standards. Directors noted that such a framework will help increase efficiency in the use of fiscal reserves, ensure that priority spending supports the diversification agenda and fosters inclusion, and help ensure long-term fiscal sustainability and intergenerational equity in an aging society.

Directors concurred that the financial sector remains sound with healthy liquidity and asset quality. They welcomed the steps taken to strengthen supervision and regulatory cooperation across jurisdictions. Given the large size of the financial sector and the significant short-term foreign liabilities, Directors called for continued supervisory caution, including for sound Fintech adoption. They also welcomed the strengthening of the

AML/CFT framework and called for sustained efforts, particularly for the gaming sector.

Directors agreed that the current housing macroprudential stance and related fiscal measures appear broadly appropriate and that systemic risks in the housing market seem broadly contained. They stressed that housing affordability concerns should be addressed by a broad set of housing supply policies.

Directors agreed that diversification policies should be guided by a careful study of Macao SAR's comparative advantage. They commended the progress made by the authorities and agreed with the principle of diversification towards mass-gaming and non-gaming tourism and bolstering financial sector development. They noted the importance of supportive policies, including advancing infrastructure plans to ease supply-side bottlenecks and fostering a highly educated workforce.

Directors agreed that the exchange rate peg has provided monetary stability, continues to serve Macao SAR well and should be maintained. Directors also took note of the staff's assessment that Macao SAR's external position is substantially stronger than implied by medium-term fundamentals.

It is expected that the next Article IV consultation with Macao SAR will be held on the 24-month cycle.

APPROVAL: April 15, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Fiscal Policy

1. ***Further, staff's recommendation of a granular MLTFF appears predicated on accurate multi-year forecasts, which might be challenging in the Macanese context in which output and fiscal variables are volatile and heavily influenced by external factors. Staff's comments are welcome.***
 - Staff agree with the challenges that arise when forecasting volatile output and fiscal variables, particularly for revenue. While challenging, the usefulness of MLTFF, however, is not necessarily restricted by the accuracy of those forecasts. For example, long-term fiscal needs such as those coming from aging, infrastructure, education policy, healthcare etc. are not as volatile as output and fiscal revenue. Building forecasts for those relatively more predictable variables can provide helpful quantitative benchmarks for future expenditure and fiscal policy. In addition, historical volatility can provide an informative benchmark for the potential size of future shocks, which can be used to assess the appropriateness of the policy buffers within the MLTFF.
2. ***Staff comments are welcome on the expected distributional benefits of boosting targeted spending vis-à-vis the results of the WPS as UBI to date.***
 - The main objectives of the authorities from the Wealth Partaking Scheme (WPS) are to share the results of the region's economic development with its people and help mitigate the effects of inflation. Having been in place for ten years, the WPS is highly appreciated by Macao SAR's residents and the program appears to fulfill its objectives.
 - On the other hand, further targeted social spending can help further inclusion and decrease inequality. Country-specific considerations, including administrative capacity and social preferences, are important as the authorities determine their desirable allocation between targeted and non-targeted spending (Fiscal Monitor, Tackling Inequality, October 2017).
 - Staff note that social spending including education and healthcare is lower than in the OCED benchmark, indicating that there is room for Macao SAR to further boost it in a targeted manner (Macao SAR 2019 Staff Report, paragraph 13). IMF research has previously noted the positive role of education and health spending in addressing

inequality of income and opportunity (Fiscal Monitor, Tackling Inequality, October 2017).

- In terms of outcomes, further study and broader data coverage are needed to fully assess them. From available information and partial data, there is evidence that higher education could be further improved (with Macao SAR universities ranking below many of those in Hong Kong SAR, Singapore, and top universities in the Mainland). Regarding health outcomes, life expectancy is relatively high in Macao SAR, though Macao SAR residents reportedly often go to Hong Kong SAR for treatment suggesting that infrastructure and medical care may have room to improve.
3. ***We agree with staff that the SFW should follow the “Santiago Principles.” On top of that, around ten years have passed since the establishment of the principle. Considering development of SWFs and lessons from implementations of the principle over the decade, could staff make more granular advice on what elements should the upcoming SWF incorporate, instead of simply recommending following the principle?***
- While likely very useful, an assessment of lessons from the implementation of the Santiago principles over the last decade is beyond the scope of the Article IV consultation. At present, the Santiago principles continue to provide generally agreed principles and best practices that guide the establishment and operations of sovereign wealth funds. Based on known information about the planned MIDF, staff have made recommendations starting in 2014 regarding key considerations when setting up the fund. For example, paragraph 26 and Box 6 in the 2014 Staff Report from the Article IV Consultation Discussion provide international experience and recommendations including regarding governance and the Santiago Principles on best practice for ensuring full accountability and transparency.
4. ***As stated in Mr. Sun and Ms. Lok’s buff statement “the authorities believe that the Macao SAR Basic Law mandate of balanced budgets has served as an important policy anchor to safeguard Macao SAR’s fiscal sustainability”. Staff’s further comments on how to improve traction of their advice are welcome.***
- To further the discussions on this topic during this consultation, staff prepared an Annex (Macao SAR 2019 Staff Report, Annex II) with case studies on MLTFF and Sovereign Wealth Funds. While the authorities highlight the helpful role that has been played by Macao SAR’s Basic Law for fiscal policy, they also appreciated the case studies provided by staff and may consider them going forward. Staff agree that for the future work agenda, further work, in consultation with the authorities, on a possible fiscal anchor (and optimal reserves) for Macao SAR can be most helpful.

Financial Sector and Housing

5. *Comments on any differences between Macao SAR and the Mainland in the regulation of crypto-assets are welcome.*
- Macao SAR, as the Mainland, has explicitly required all banks and payment services institutions in Macao SAR not to participate in or provide, directly or indirectly, any financial services that involve the use of virtual currencies or virtual commodities as the means of payment (order issued by AMCM in September 2017). Similar to PBOC, AMCM has stated that virtual commodities like bitcoin is neither a legal tender nor a financial instrument subject to supervision, and has highlighted that any trading of these commodities involves considerable risks.
6. *On the residency-based LTV, we suggest staff provide more specific advice to find an alternative measure that could achieve the same policy objective without differentiating between residents and non-residents. We would welcome staff's view on this issue.*
- Staff see at least two avenues that could be explored to attain the policy objective (of protecting banks from higher default risks associated with lending to nonresidents) without discriminating against nonresidents:
 - (i) One is to examine whether the schedule of LTVs could be changed such that nonresidents are facing the same constraint as a suitably defined group of residents that also pose higher risk, such as more speculative resident borrowers, as indicated, for instance by buyers borrowing for a second or multiple properties.
 - (ii) The other alternative is to condition the LTVs on some other underlying information which is indicative of the risk of default. For instance, the banks could be required to ask for proof of income derived in Macao SAR before extending a mortgage loan for purchase of a residence in Macao SAR. The LTVs could then be tighter for those borrowers (resident or nonresident) who are unable to provide such proof of local income.
 - In addition to changes in the way the LTV framework is operating, the authorities should also examine whether there are ways to improve enforcement and collection on loans across borders or jurisdictions.
7. *Could staff clarify the authorities' view that on-going projects will meet housing demand by 2026?*

- The authorities conducted a study (“2017 Public Housing Demand Research Report” prepared by Macao Public Governance Research Center), with forecasts on public housing supply and demand (using population and income growth projections). The study finds that public housing will satisfy demand by 2026. However, the study notes that there will be excess demand in the short term (i.e. 2021).
- 8. *Could staff comment on the extent to boost the housing supply given the territory’s space constraints?***
- The authorities continue to advance land reclamation efforts. In parallel, on top of authorities’ efforts to boost public housing supply, staff recommend advancing regulatory policy within a transparent framework that supports private sector supply and boosts well-targeted public housing supply. Notably, since 2000, growth in private housing supply has been subdued in Macao SAR. The urban planning framework and urban renewal plan are to provide the government strategy on housing and can help boost supply—with the master urban plan planned to be completed in 2019 and the detail plan to follow afterwards.

External Sector

- 9. *While the last Article IV consultation found Macao’s current account balance to be broadly consistent with fundamentals and desirable medium-term policies, staff now assesses Macao’s current account balance to be substantially stronger than warranted. Could staff elaborate on the change in assessment, including assumptions regarding the permanence of the gaming monopoly and the determination of optimal fiscal policy?***
- Staff will respond to this question during the Board meeting.

Diversification

- 10. *Could staff elaborate further on how Macao has been involved in the BRI and it will be down the road, particularly as regard to financing services?***
- Leveraging Macao SAR’s languages and legal framework—that have Portuguese commonalities—the authorities plan to bolster financial sector growth including participation in BRI, with a focus on financial intermediation between China and Portuguese-speaking countries.
- 11. *Does staff consider that the "Greater Bay Area" plans help to create such positive synergies and spillovers in the medium-term?***

- According to the Greater Bay Area (GBA) plan released by China’s authorities on February 18, 2019, the GBA (comprising Hong Kong SAR, Macao SAR, and 9 cities in Guangdong province) is envisioned to elevate innovation, enhance connectivity via infrastructure, leverage respective cities' strength to broaden customer base, and promote RMB usage within the region and beyond. Plans include several regional goals, with specific plans still being finalized.
 - Without conducting a full assessment of the impact of the GBA plan on Macao SAR, staff considers that the regional strategy has important potential to help boost Macao SAR’s prospects. For example: (i) planned boosted innovation collaboration can further help Macao SAR benefit from Guangdong’s innovation in technology and R&D; (ii) plans to further increase GBA connectivity and infrastructure development can provide potential investment opportunities for Macao SAR and easier access to visitors from China and abroad; (iii) restrictions to cargo, labor, and capital mobility within the region may be reduced, potentially increasing business opportunities including for Macao SAR; and (iv) GBA plan includes support for Macao SAR as a RMB clearing center for PSCs which can contribute to its financial sector development.
- 12. *We would like to better understand whether it is appropriate for the authorities to focus on fostering financial sector as a source of growth given its geographical proximity of one of the world financial center, Hong Kong SAR. Could staff elaborate more on this front?***
- In assessing their diversification plans, the authorities have determined several specific areas within financial sector development where they assess to have potential comparative advantages. As they do not attempt to replicate business models or sectors established in Hong Kong SAR, staff concur with the authorities that their chosen specific areas within financial sector development have growth potential—including China-PSCs financial intermediation, with emphasis on financial partnerships with Mainland bond issuances, financial services (financial leasing and wealth management), and BRI participation.
- 13. *While we agree on the need for the diversification agenda to be guided by the country’s comparative advantage, we wonder if there has been work on other sectors besides those currently being explored. Staff comments are welcome.***
- Staff are not aware of work on additional sectors to help advance the diversification agenda.

Inequality and Labor Market

14. *While we note the causes of inequality indicated in Annex III, staff's comments are welcome on the possible policy measures to address this structural issue going forward.*

- The Staff Report makes a set of recommendations in light of the low social spending (Macao SAR 2019 Staff Report, paragraph 13) that can help lower inequality. Staff consider that boosting targeted social spending can alleviate distributional concerns, including spending on housing, and also health and education where there appears to be room to boost them.

15. *Given the high reliance of Macao's SAR economy on the gaming industry, could staff elaborate on how the authorities are matching up development trends and labor market needs with vocational training?*

- Macao SAR has multiple institutions engaged in providing vocational training courses, including public and private training institutions, and higher education institutions. Vocational training in Macao SAR served 66,500 participants in 2017. The most popular courses are on business and administration (about a third of course participants in 2017), followed by computing (at 12 percent) and languages (11 percent). Course participants in tourism, gaming, and MICE events courses more than doubled in 2017 (accounting for another 11 percent of participants). Without a full assessment, the above statistics suggest that vocational training covers sectors featured in diversification plans, however staff were told during mission that there is scope for increasing local skills for financial services provision.

16. *Could staff elaborate on the existing regulations protecting migrant workers as well as on the minimum wage, and discuss how these regulations could be further improved to foster inclusion?*

- The “law for the employment of non-resident workers” is effective as of 2010. The sectors that employ the most non-resident workers are hotels/restaurants, construction, domestic work, wholesale/retail, and real estate/business. Some highlights on existing regulations on employment of non-resident workers include: (i) contracts are up to 2 years, (ii) types of non-resident worker status include specialized workers (3 percent of workers), non-specialized workers (82 percent), and domestic workers (15 percent), (iii) employers are required to provide lodging or lodging allowances, and (iv) principle of remuneration equality and non-discrimination (with Labor Affairs Bureau regulating the salary on non-residents).

- Minimum wage regulation currently stipulates a certain minimum salary for workers in security and janitors/cleaning sectors. The authorities are considering expanding the minimum wage regulation to more sectors, which can contribute to foster inclusion.