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IMF Executive Board Concludes 2019 Article IV Consultation Discussions with People's Republic of China—Hong Kong Special Administrative Region

On December 13, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation discussions¹ with the People's Republic of China—Hong Kong Special Administrative Region (SAR).

Economic activity in Hong Kong SAR weakened significantly in 2019 as rising trade tensions between the U.S. and China and heightened uncertainty took a toll on exports and investment while private consumption and visitor arrivals have declined due to the social unrest that started over the summer. As the cyclical downturn continues, GDP is expected to contract by 1.9 percent in 2019. Growth is projected to rise to 0.2 percent in 2020, led by private consumption, but the pace of recovery over the medium term is expected to be slower than in previous recoveries as increased trade barriers and disruptions to global supply chains would be a drag on trade-related activities.

Despite external and domestic headwinds, financial markets continue to function smoothly and the HK dollar has traded within the convertibility undertaking range since the last FX operations conducted by the Hong Kong Monetary Authority in March 2019. The interbank rates have remained stable, net capital outflows have been limited, and market expectations of the HKD/USD exchange rate have remained well anchored. However, with the slowdown in growth in Hong Kong SAR and Mainland China, credit growth has moderated to 6.3 percent in September 2019, from a peak of 21.4 percent in October 2017. Housing prices, which rose for

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

the first five months of 2019 amid expectations of monetary easing in the U.S, also declined by about 4 percent between May and September.

Risks to outlook are tilted to the downside. On the external side, further escalation of trade tensions between the U.S. and China and a significant slowdown of Mainland China as well as additional barriers, including potential restrictions by the U.S. against China in technology and the financial sectors, could negatively affect growth in Hong Kong SAR. On the domestic side, a deterioration of the sociopolitical situation and delays in addressing structural challenges of insufficient housing supply and high income inequality could further weaken economic activity and negatively affect the city's competitiveness in the long term. A significant slowdown of the economy could trigger an adverse feedback loop between house prices, the real economy and the financial sector.

Executive Board Assessment²

Executive Directors noted that economic activity in Hong Kong SAR has deteriorated significantly on account of the global growth slowdown, U.S.-China trade tensions, and ongoing social unrest. While the balance of risks is tilted to the downside going forward, Directors agreed that Hong Kong SAR's robust policy frameworks and ample buffers will help the economy weather the challenges ahead. They welcomed the authorities' readiness to use these buffers as and when necessary.

Amid the growth slowdown and strong headwinds, Directors agreed that countercyclical fiscal support would continue to be essential. They welcomed the recently announced stimulus targeted at the most vulnerable households and small- and medium-sized enterprises. Directors recommended a comprehensive medium-term fiscal package to cope with the cyclical downturn and address longer-term structural challenges associated with housing market imbalances, population aging, and income inequality, while preserving fiscal sustainability. In light of the envisaged spending pressures, Directors encouraged the authorities to consider tax reform over the medium to long term to boost revenues and foster equity. On the expenditure side, they saw scope for improving budget planning and execution, as well as developing a long-term healthcare spending strategy.

² At the conclusion of the discussion, the Managing Director, as Chairman of the Board, Summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

Directors supported the authorities' three-pronged approach to contain housing market risks and improve housing affordability, with priority given to increasing land allocation for residential housing. Noting the effectiveness of macroprudential measures, Directors concurred that any adjustment should be based on evolving financial stability risks. They encouraged the authorities to phase out the new residential stamp duty and replace it with alternative non-discriminatory macroprudential measures once systemic risks from nonresident inflows dissipate.

Directors underscored the importance of safeguarding financial stability amid rising global volatility. They commended the authorities for the progress in implementing the 2014 FSAP recommendations. Continued efforts would be needed to monitor vulnerabilities in the corporate sector, further strengthen the regulatory and supervisory framework, and facilitate innovation while managing risks. Directors noted that further development of green finance and the Greater Bay Area would help maintain Hong Kong SAR's competitiveness.

Directors observed that Hong Kong SAR's external position is broadly in line with medium-term fundamentals and desirable policies. They agreed that the Linked Exchange Rate System remains an appropriate anchor of stability. They stressed that preserving a track record of public communication would be key to the credibility of the currency board arrangement.

Hong Kong SAR: Selected Economic and Financial Indicators, 2015–24

	2015	2016	2017	2018	Proj.					
					2019	2020	2021	2022	2023	2024
NATIONAL ACCOUNTS										
Real GDP (percent change)	2.4	2.2	3.8	3.0	-1.9	0.2	4.7	2.8	2.6	2.5
Private consumption	4.8	2.0	5.6	5.5	-2.3	-0.7	4.3	2.3	2.3	2.3
Government consumption	3.4	3.4	2.8	4.2	5.2	5.8	4.1	3.5	3.2	3.2
Gross fixed capital formation	-3.2	-0.1	2.9	2.0	-10.2	-1.0	7.6	5.8	4.2	4.2
Inventories (contribution to growth)	-1.2	0.9	0.5	-0.1	-0.5	0.2	0.0	0.0	0.0	0.0
Net exports (contribution to growth)	0.8	-0.3	-1.2	-1.4	1.9	0.0	-0.1	-0.3	-0.2	-0.3
Output gap (in percent of potential)	-0.1	-0.7	0.2	0.3	-3.1	-4.6	-2.1	-1.6	-1.5	-1.5
Saving and investment (percent of GDP)										
Gross national saving	24.9	25.5	26.7	26.0	25.2	25.1	25.3	25.5	25.6	25.7
Gross domestic investment	21.5	21.5	22.0	21.7	19.7	20.0	20.6	21.1	21.4	21.7
Saving-investment balance	3.3	4.0	4.7	4.3	5.5	5.2	4.7	4.4	4.2	4.0
LABOR MARKET										
Employment (percent change)	0.9	0.2	0.9	1.4	0.5	0.5	1.1	0.8	0.8	0.7
Unemployment rate (percent, period average)	3.3	3.4	3.1	2.8	3.1	3.4	3.1	3.0	2.9	2.9
Real wages (percent change)	0.5	1.2	2.3	1.1	1.3	0.0	1.2	1.3	1.3	1.3
PRICES										
Inflation (percent change)										
Consumer prices	3.0	2.4	1.5	2.4	3.0	1.8	2.6	2.5	2.4	2.4
GDP deflator	3.6	1.6	3.0	3.6	1.4	1.1	2.2	2.0	2.0	2.0
GENERAL GOVERNMENT (percent of GDP)										
Consolidated budget balance	0.6	4.5	5.6	2.4	0.0	0.3	0.6	0.7	0.9	0.9
Revenue	18.8	23.0	23.3	21.1	20.7	20.8	21.0	21.0	21.0	21.0
Expenditure	18.2	18.6	17.7	18.7	20.7	20.6	20.4	20.3	20.2	20.2
Fiscal reserves (as of March 31)	35.1	38.3	41.4	41.2	41.4	41.1	39.0	37.9	37.1	36.1
FINANCIAL										
Interest rates (percent, period-average)										
Best lending rate	5.0	5.0	5.0	5.0	...	...	...	...	...	...
Three-month HIBOR	0.4	0.6	0.9	1.8	...	...	...	...	...	...
10-year Treasury bond yield	1.6	1.2	1.6	2.1	...	...	...	...	...	...
MACRO-FINANCIAL										
Loans for use in Hong Kong SAR (excl. trade financing)	6.3	8.0	16.1	6.5	5.0	5.5	8.5	7.5	7.4	7.2
House prices (end of period, percent change)	2.4	7.9	14.7	1.9	1.0	3.6	9.9	8.1	7.8	7.6
Credit-to-GDP gap 1/	15.3	11.5	19.3	9.8	10.6	9.4	8.1	6.2	4.8	2.8
Hang Seng stock index (percent change)	-7.2	0.4	36.0	-13.6	...	...	...	...	...	...
EXTERNAL SECTOR										
Merchandise trade (percent change)										
Export value	-1.8	-0.5	8.0	7.4	-3.9	2.8	3.8	3.5	3.4	3.4
Import value	-4.1	-1.0	8.7	8.4	-5.6	1.6	3.9	3.7	3.6	3.6
Current account balance (percent of GDP) 2/	3.3	4.0	4.7	4.3	5.5	5.2	4.7	4.4	4.2	4.0
Foreign exchange reserves 2/										
In billions of U.S. dollars (end-of-period)	358.8	386.3	431.4	424.7	425.3	425.9	427.0	428.5	429.9	430.5
In percent of GDP	116.0	120.4	126.2	117.1	117.7	116.4	109.2	104.5	100.2	96.0
Net international investment position (percent of GDP)	324.2	359.2	417.0	356.7	363.8	364.4	345.3	333.7	323.1	313.1
Exchange rate										
Market rate (HK\$/US\$, period average)	7.752	7.762	7.793	7.838	...	...	...	...	...	...
Real effective rate (period average, 2010=100)	110.4	115.2	115.3	113.1	...	...	...	...	...	...

Sources: BIS, CEIC; HKSAR Census and Statistics Department; and IMF staff estimates.

1/ Based on loans for use in Hong Kong SAR, including trade financing.

2/ Data published using the Balance of Payments Statistics Manual 6 (BPM6) format.