Anselmo L S Teng: Update of the economic development in Macao

Opening remarks by Mr Anselmo L S Teng, Chairman of the Monetary Authority of Macao, at the BIS – advanced reserve management workshop, Macao, 22-25 May 2007.

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Honoured Guests, Dear Delegates, Ladies and Gentlemen,

Good morning,

First of all, I would like to thank the BIS for choosing the Macao Special Administrative Region (MSAR) as the venue for this workshop, and for inviting me to deliver this opening remark. I would also like to wish the participants a great stay in this enclave which is a combination of nostalgia and excitement, as well as a good blend of eastern and western culture.

Let me also take this opportunity to provide you an update of the economic development of Macao. As you are aware, Macao is a highly open economy. In 2006, Macao registered another year of two-digit economic growth, at 16.6%. Its GDP per capita reached USD28.4 thousand, representing one of the highest among Asian economies. Tourism-dominated service exports, investment and private consumption all witnessed strong growth. As the leading industry, tourism showed splendid performance, with visitor arrivals reaching an all-time high of 22 million last year.

The economy continued to fare well in the first few months of 2007 as the growth of the tourism sector hardly showed any moderating signs. Visitor arrivals increased by 21.4% in the first quarter. After years of strong growth, however, the resource constraint and inflationary pressure have become apparent. While unemployment rate further shrank to 3.2% in the first quarter of this year from 3.5% in the last quarter of 2006, inflation was 4.57% in the first quarter after easing from 5.15% last year.

In the past few years, the economic prosperity has been largely built on the thriving tourism services sector. Specialising in a few economic activities, however, is widely believed to be risk prone and unfavorable to macroeconomic stability. Diversifying the structure of our economy is therefore closely related to the sustainability of Macao's development, employment environment and the stability of the community. For a very small economy like Macao that easily faces tight resource constraints and possesses a competitive tourism services sector, any diversification initiative naturally opts for a gradual approach with a long-term perspective in order not to incur a high cost of disrupting the development of the leading industry. The SAR Government has therefore been determined to promote vertical diversification of the tourism services industry, putting emphasis on non-gaming tourism with new elements of culture, leisure, sport, convention and meeting. Besides, the continuous effort by the government to optimize business environment, as well as the gradual deepening of CEPA; the role as platform of trade and services; and the scheme of cross border industrial zone will be part of the driving force in diversifying the economy of Macao over the longer term.

Now, let's talk about reserves. Also benefiting from the robust tourism sector, Macao's external account remains favorable. In 2006, the trade account surplus was equivalent to one-third of nominal GDP, pushing our foreign exchange reserves up by 36.8% to USD 9.1 billion by the end of 2006. This amount of foreign exchange reserves represented an ideal level of 15 months of total imports in 2006. As at the end of March 2007, foreign exchange reserves further rose to USD 10.3 billion. It is considered substantial for a small city with a population of 500 000.

The management of the reserves of the Macao SAR is in the good hands of my colleagues in the Monetary Authority. By adopting a prudent strategy, they managed a reasonable return in a turbulent market environment. However, through out the process, like everybody else who is in charge of managing a reserve, they may feel like walking on a tight rope – they have to strike a balance between return and risk, which is becoming more so as rapid development in the financial market opened up new opportunities to invest in different asset classes beyond traditional ones and, as a result, risk management challenges also mount.

When I look around the global financial market, I always ask myself a question: if a correction is bound to happen what will trigger its fall? It will certainly arise from an implosion of one or more instruments. Everything appears to be frothy these days. The suspect can be debts, stocks, commodities, hedge funds, private equity firms, carry trades, derivatives, just to name a few. The market value of any one of the above categories is measured in terms of billions of US dollars. Indeed, we witnessed last year the fall of two substantial hedge funds. In February this year, the unwinding of Yen carry trades sent worldwide stock markets tumbling down. Recently, global financial markets fret about the possible collapse of U.S. real estates market which may interact with the default of subprime loans to form a vicious cycle. Fortunately, the global financial system appears to be more resilient than what we expect. But there is no ground for complacency. We should stay vigilant in the turbulent financial markets. These events may be ominous.

Universal asset inflation has in fact been caused by excess liquidity which is flooding the financial world and prompts the cash owners/managers to acquire riskier assets in order to secure a return which is in line with the norm of investment world. There are many explanations why there is so much money moving around the global village. Some of them are:

- After the Asian crisis, most of the Asian nations have recovered and prospered again with much better fiscal conditions and stronger economic structure;
- Unlike pre-Asian crisis, Asian countries have accumulated, since then, substantial foreign exchange reserves;
- Although part of the exchange reserves have to be maintained to ensure the stability of national currencies, excess exchange reserves are building up quickly in this region;
- To alleviate the economy from plummeting into a tailspin after the dotcom bubble of 2000 and 911 incident of 2001, the FED eased money supply and allowed FED fund rate to fall to as low as 1% in mid 2003.
- The near zero interest rate policy in Japan and the comparatively weaker Yen has given rise to carry trades.
- Oil exporters have reaped a windfall in the wake of a sharp rise in oil prices in the past few years, the huge surplus has joined the river of excess liquidity.

The recent financial market dilemma has posed a big problem to managers of all kinds of reserves. On one hand, they have to take bigger risks in order to earn a return which ranks pari passu with those of their peers. On the other, they are well aware of the business cycle and the consequence of froth. When will the party end and how it will end is everybody's guess. What we really worry about is what we cannot predict and therefore we have difficulty in taking the necessary measures to maintain our portfolios.

Today, I am very pleased that the BIS has invited experts in this field to shed some light on this pressing issue. After this meeting, I believe that the participants will be able to obtain sufficient enlightenment to formulate a policy conducive to the purposes of setting up that particular reserve which he or she manages. I would again like to thank the BIS for the arrangement and choosing Macao to hold such a practical and meaningful workshop.

Thank you very much. Enjoy your workshop and the rest of your stay in Macao.