

## Monetary and Financial Stability Review\*

Research and Statistics Department

### 1. Macroeconomic Backgrounds

The economic uptrend since the year 2000 sustained throughout the period under review. The strong inbound tourism and the investment boom kindled by the liberalisation of the gaming industry continued to be the major propelling factors for the economic growth.

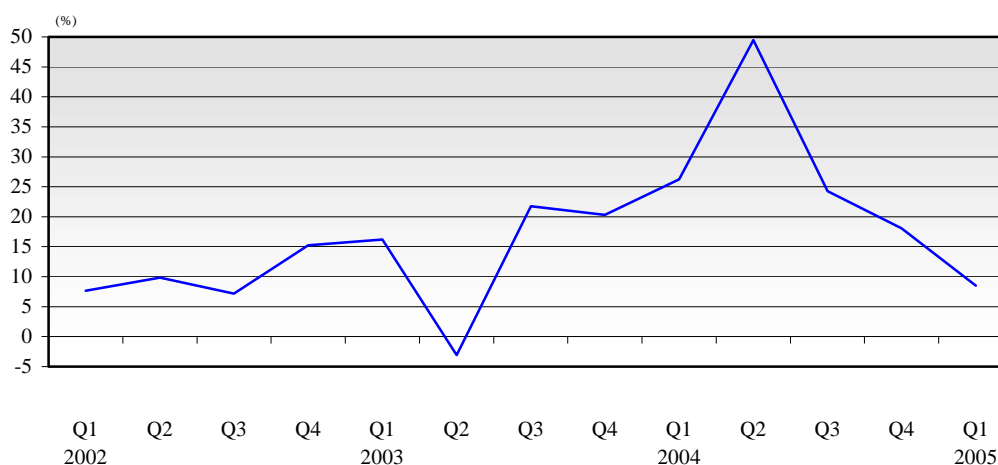
Partly due to the low basis of comparison induced by the outbreak of Severe Acute Respiratory Syndrome (SARS) in the year before, the real *gross domestic product* (GDP) growth peaked at an amazing 49.4% in the second quarter of 2004. The economy had upheld a two-digit growth until the first quarter of 2005, when the growth decelerated to 8.5% (Chart 1).

All expenditure components of GDP witnessed positive growth. Service exports and investment, in particular, grew at a markedly fast pace. Improvement in consumer sentiments brought about by the optimistic economic outlook also boosted the domestic consumption. The private consumption expenditure soared by 8.6% for the year 2004 as a whole, and went up 8.3% in the first quarter of 2005. In a small open economy like Macao, the revived domestic and external demand correspondingly boosted imports, which played a role in checking GDP growth.

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\* This review applies statistics and information available as at 8 July 2005.

**Chart 1: Real GDP Growth, 2002-2005**



Source: *Quarterly Gross Domestic Product*, Statistics and Census Service (DSEC).

Service exports, in which over 90% was related to visitors' gaming, accommodation and other non-gaming expenditures in the Special Administrative Region (SAR), continued to be an important driving force to underpin the prominent growth of the Macao economy. Approximates of contribution individual GDP expenditure components to overall GDP growth, as stated in Table 1, are derived from the changes in the expenditure components divided by GDP for the preceding year. The service trade sector, or net exports of services, contributed 28.1 percentage points to the territory's GDP growth in the year 2004. Its contribution to the 8.5% growth in the first quarter of 2005 was 6.6 percentage points.

Although investment was minor in comparison with service exports, it has become the second most important contributor to Macao's GDP growth since 2003. Meanwhile, the visible trade balance was in red as usual. Hence, the contribution of net export of goods was negative though it improved from minus 8.4 percentage points in 2004 to minus 5.6 percentage points in the first quarter of 2005 in line with slower growth in the global demand.

**Table 1: Main Expenditure Components' Contributions to Real GDP Growth, 2002-2005**

(%)

Year	Quarter	GDP	Private Consumption Expenditure	Gross Fixed Capital Formation	Government Final Consumption Expenditure	Net Exports of Goods	Net Exports of Services
		(1)=(2)+(3)+(4)+(5)+(6)	(2)	(3)	(4)	(5)	(6)
2002	1	7.7	1.4	0.6	0.3	-0.8	6.2
	2	9.9	1.8	2.0	-0.5	-5.1	11.7
	3	7.2	1.9	1.1	0.7	-2.0	5.5
	4	15.2	1.8	2.0	0.8	-2.0	12.7
2003	1	16.2	1.5	0.9	1.2	-3.3	15.9
	2	-3.1	-0.1	2.5	1.1	4.0	-10.6
	3	21.8	1.9	7.4	0.0	-5.1	17.6
	4	20.3	1.8	8.0	0.9	-7.0	16.6
2004	1*	26.2	2.3	4.5	0.3	-6.7	25.8
	2*	49.4	4.9	5.1	0.7	-14.0	52.7
	3*	24.2	2.6	3.8	-0.1	-8.3	26.2
	4*	18.1	2.2	6.5	0.4	-5.9	14.9
2004	1-4*	28.0	2.9	5.0	0.3	-8.4	28.1
2005	1*	8.5	2.6	4.5	0.4	-5.6	6.6

Notes: 1. The contribution of individual expenditure components to GDP growth is equal to the change in the expenditure component divided by GDP for the preceding year.

2. \*Figures are subject to revisions.

Source: Underlying data from *Quarterly Gross Domestic Product, Statistics and Census Service (DSEC)*.

Tourism continued to dominate services trade, and hence its development was apparently crucial to Macao's overall economic performance. In 2004, visitor arrivals reached a historical high of 16.7 million, representing a year-on-year growth of 40.2%. Mainland Chinese visitors, which represented 57.2% of the total arrivals in 2004, have emerged to be the driving force behind the strong growth, especially after the implementation of the "Individual Traveller Scheme" by the Central Government in July 2003.

The number of Mainland Chinese visitors grew at an impressive, year-on-year rate of 66.0% in 2004 as against 35.4% in 2003. The uptrend in visitor arrivals sustained in the first five months of 2005, with the total number of visitor arrivals rising 16.4% to approximately 7.5 million. Visitors from other major origins also witnessed increases in different degrees. Visitors from Hong Kong SAR and Chinese Taiwan continued to grow at double-digit paces while the increases in visitors from Southeast Asia, Americas and Europe were particularly marked, indicating a broad-based improvement in the tourism business environment.

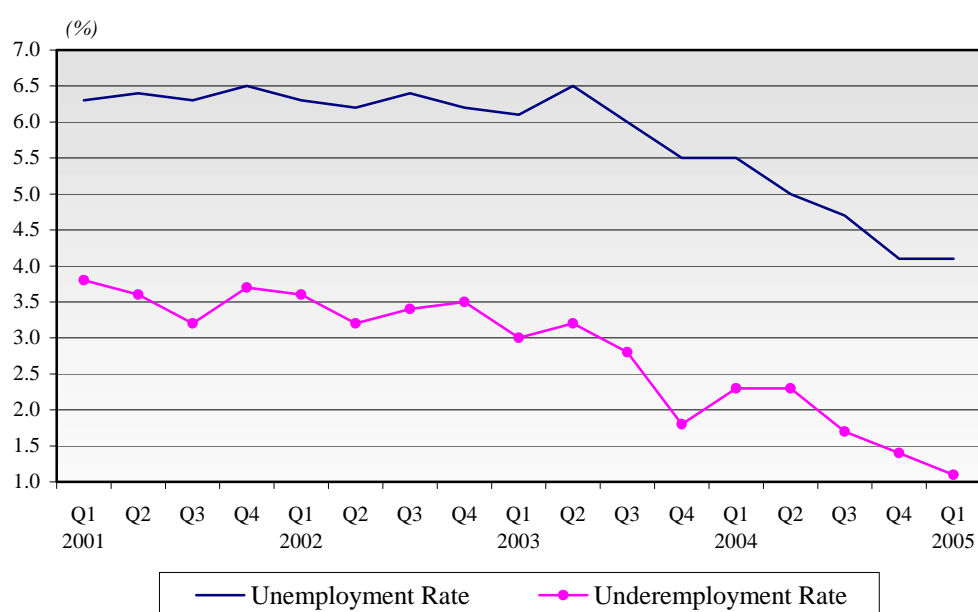
It is estimated that gaming accounts for more than 65% of tourist spending in Macao's service exports. In 2004, the value of gaming revenues from nonresidents reached MOP43.0 billion, representing an increase of 43.9% after discounting the effect of price changes. However, the pace of growth in gaming revenues (+11.6%) obviously slowed in the first quarter of 2005, partly due to the high year-earlier basis of comparison. Similarly, per capita spending (excluding gaming) of visitors in 2004 increased by 7.5% to MOP1,633, but remained flat in the first quarter of 2005 when compared with the corresponding period of 2004.

The *labour-market* condition continued to improve as the labour demand strengthened in line with the hefty output growth (Chart 2). In the first quarter of 2005, the unemployment rate remained unchanged from the previous quarter at 4.1%, but was 1.4 percentage points lower over one year earlier with jobs added in both services and construction sectors. The growing labour demand gradually raised local wage rates across most economic sectors. As a result, the median monthly employment earnings were pushed up by 16.3% to MOP5,680.

Since *deflation* ceased in the middle of 2004, consumer prices have continued to pick up at a relatively fast pace. The strong growth in domestic demand was one of the key driving forces behind the general price uplift. Meanwhile, the impacts of surging oil prices, weak USD and higher prices in major import sources of Macao also inten-

sified inflation pressure. The composite consumer price index (CPI) increased by a mild 0.98% for the whole year of 2004, but its growth pace accelerated in 2005 when the 12-month average change in CPI soared more than one percentage point to 2.53% in May 2005. Imported inflation, as measured by the year-on-year growth of unit value index of imports, rebounded from -0.7% in 2003 to 2.6% in 2004 (Table 2). This index rose 2.3% in the first quarter of 2005.

**Chart 2: Unemployment Rate and Underemployment Rate, 2001-2005**



Source: *Employment Survey*, DSEC.

**Table 2: Composite CPI-based and Unit Value Index-based Inflation, 2002-2005**  
(%)

Year	Quarter	Composite CPI (year-on-year growth)	Import Unit Value Index (year-on-year growth)
2002	1	-2.83	-3.61
	2	-3.17	-6.19
	3	-2.74	-3.10
	4	-1.79	0.85
2003	1	-1.60	-1.66
	2	-1.25	-0.43
	3	-1.99	0.64
	4	-1.40	-1.47
2004	1	-0.57	1.27
	2	0.07	3.80
	3	1.96	1.91
	4	2.49	3.30
2005	1	3.22	2.30

Sources: *Consumer Price Index*, *External Trade Index*, DSEC, various issues.

Significant rises in major asset prices appeared to be a concern in the period under review. In particular, the *property market* apparently gathered momentum with rising transactions and prices in line with the impressive economic growth and continued improvement in business confidence. As per the Finance Services Bureau's stamp duty records, the volume of transactions in the first quarter of 2005 substantially increased by 56.8%, outpacing the growth registered in the same period of 2004.

In addition to the significant rise in transaction volume, the growing pace of residential housing prices obviously sped up during the period. Buildings completed after 1999 continued to power the overall growth in prices while those completed before 2000 also witnessed price increases. The average transaction price of residential properties concurrently rose 25.2% after climbing 30.1% in the last quarter of 2004. Foreign investments in Macao's real estate market have been an important factor of the lively performance. However, in view of the revision on the requirements for investor immigrants in April, the activity in the property market slowed, though a correction in prices was not apparent.

**Table 3: Residential Property Transaction Volume and Prices, 2002-2005**

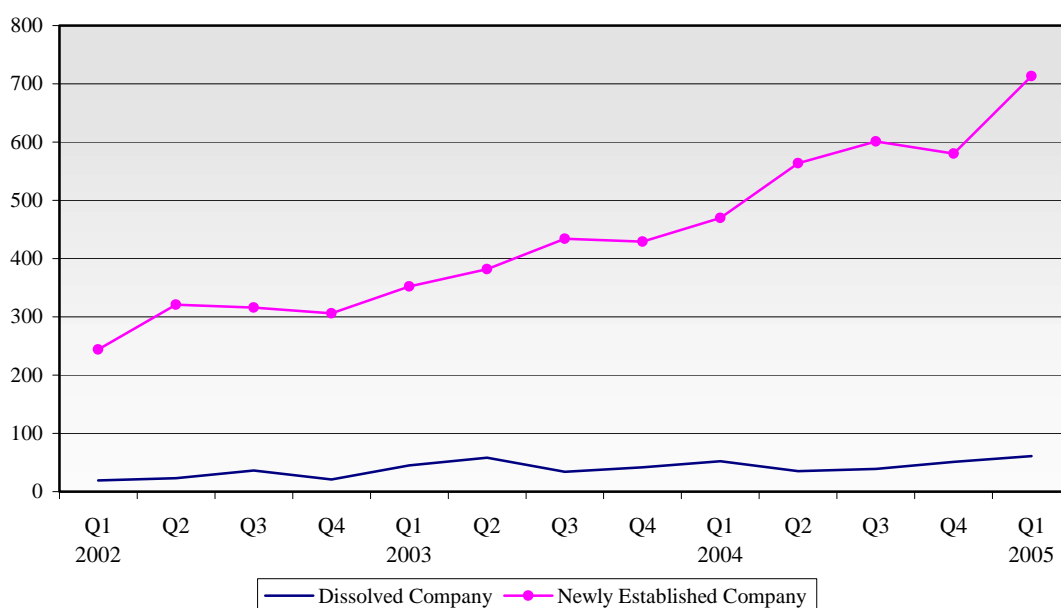
		Number of Units Transacted	Value of Units Transacted (10 <sup>6</sup> patacas)	Transaction Price* (Patacas)
Year	Quarter			
2002	1	2,590	1,195	6,123
	2	3,170	1,677	6,196
	3	2,277	1,061	6,233
	4	2,347	1,135	6,483
2003	1	2,133	975	6,154
	2	2,643	1,380	6,343
	3	2,803	1,496	6,305
	4	2,819	1,516	6,636
2004	1	3,114	1,913	7,343
	2	3,888	2,374	7,669
	3	4,196	2,896	8,016
	4	4,410	3,347	8,635
2005	1	4,882	3,744	9,190

Note: \*Figures indicate the average transaction price of residential units per square metre of usable area.

Source: *Private Sector Construction Statistics*, DSEC.

**Local corporate environments** have generally improved along with the economic upturn. To reflect the strength of the corporate sector and the business sentiment, the number of newly incorporated companies, after deduction for dissolved companies, rose 43.7% and 56.0% in the whole year of 2004 and the first quarter of 2005 respectively. In addition, improving signs of corporate earnings in 2004 were witnessed when the complementary (profit) tax revenue grew year-on-year by 31.0% to MOP651.3 million. The accumulated profit tax revenue in the first five months of 2005 declined 19.2% year-on-year to MOP42.0 million as an exceptionally high entry in a single month last year drove up the base for comparison.

**Chart 3: The Numbers of Dissolved and Newly Established Companies, 2002-2005**



Source: *Company Statistics*, DSEC.

## 2. Assessment of Monetary Stability

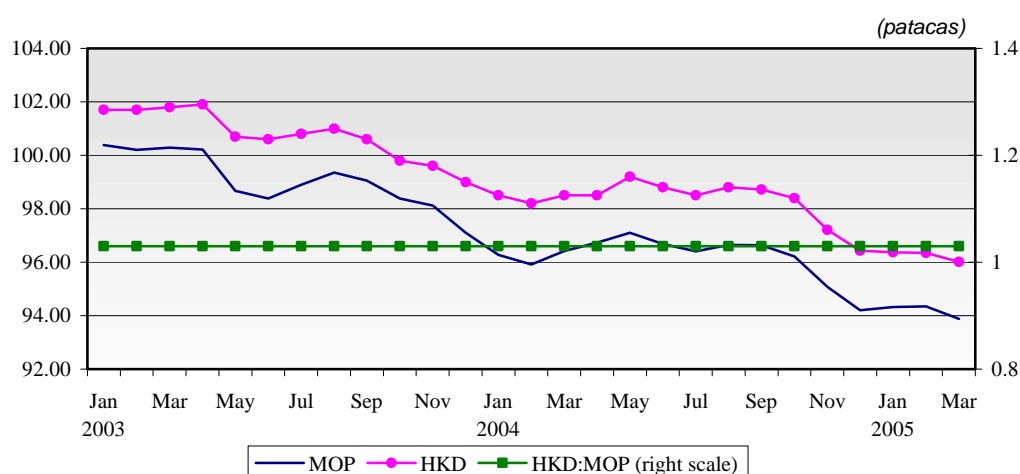
Macao adopts a rule-based, externally oriented monetary regime, under which the legal tender, pataca (MOP), is linked to the Hong Kong dollar (HKD) at a middle rate of HKD1:MOP1.03. The Currency Board Arrangements, which ensure full backing of monetary liabilities, are the underlying monetary mechanism to support the linked rate. As a result, the state of monetary stability in Macao directly reflects in the exchange rate of the MOP against the HKD, or ultimately, the adequacy of backing assets held by the Monetary Authority of Macao (AMCM) to ensure the convertibility of MOP monetary liabilities into foreign currencies on demand at all times.

Throughout the year 2004 and the first quarter of 2005, the MOP/HKD exchange rate did not deviate from the linked rate of HKD1:MOP1.03. On the other hand, in a world of generalised floating, the MOP's exchange rates against other currencies may fluctuate as determined by the exchange rates of its anchor currency, i.e. the HKD,

against other currencies. Since the HKD is linked to the US dollar, the exchange value of MOP is in turn affected by the exchange value of the US dollar.

As the greenback continued to weaken against other major currencies, the MOP in effective terms witnessed a depreciation of 4.8% in 2004, and a further 2.1% in the first three months of 2005 (Chart 4). The effective exchange rate indices for MOP and HKD were largely synchronised, indicating the stabilities of the linked rate as well as the monetary system during the review period.

**Chart 4: Bilateral Exchange Rate between the MOP and HKD, and Effective Exchange Rate Indices of the MOP and the HKD\*, 2003-2005**



Note: \* Base period = January 2000.

Sources: *Monthly Statistical Bulletin*, Hong Kong Monetary Authority (HKMA).

*Monthly Monetary Statistics Bulletin*, Monetary Authority of Macao (AMCM).

The *convertibility capacity* of the AMCM remained intact as the primary cover ratio, a ratio of foreign exchange reserves net of short-term foreign currency liabilities to current MOP liabilities, stayed at levels above 100%. The foreign exchange reserves at the end of March 2005 was estimated at MOP44.6 billion, which was equivalent to 108.9% of the sum of the monetary base (i.e. currency in circulation and banks' deposits with the AMCM), monetary bills outstanding, and government deposits with the AMCM.

*Fiscal discipline* plays a major role in maintaining the credibility and hence the stability of the linked rate system. The SAR government accounts have remained in surplus since the year 2000. In 2004, the overall fiscal surplus substantially increased by 131.8% over one year earlier to MOP6.2 billion, which was equivalent to 7.5% of Macao's nominal GDP or 46.7% of the government expenditure (excluding expenditure of public autonomous agencies). At the end of the year, the sum of retained surplus and the SAR Reserve Fund was estimated at MOP24.6 billion, an amount sufficient to finance government spending for over one year and equivalent to 29.8% of Macao's GDP. In the first quarter of 2005, the overall surplus increased 30.6% compared with the same period last year, indicating that fiscal conditions remained conducive to monetary stability. Meanwhile, the SAR Government continues to be debt-free.

The growth of *money supply* in Macao SAR is ultimately determined by the external balance, which is the balance of payments (BOP), under the linked exchange rate system. The BOP surplus, stemmed primarily from a growing trade or current account surplus, was evidenced by a two-digit growth of foreign exchange reserves, and underpinned the continued growth of monetary aggregates. During 2004, the trade surplus marked at MOP39.1 billion, equivalent to 47.3% of the nominal GDP. For the first quarter this year, trade surplus reached MOP9.1 billion, which was approximately 45% of the nominal GDP during the period.

Narrow money supply (M1) and board money supply (M2) rose year-on-year by 52.9% and 8.9% respectively at the end of 2004, and continued to climb in the first three months of 2005. The M1 reached MOP13.6 billion while the M2 increased to MOP122.5 billion at the end of March 2005. The larger increase of M1 over M2 would be attributed to the shift in depositors' preference in favour of current account deposits under a low interest-rate environment. Meanwhile, the growth of broad money supply continued to lag behind the growth of nominal GDP although the generally loose monetary stance prevailed. Basically, the slow growth of M2 was due to the shrinking domestic credit brought about by the persistent negative growth of the net credit to the public sector. As a result, the extra money creation was solely

balanced by an accumulation in investment abroad, rather than domestic credit expansion, on the asset side of the balance sheets of monetary institutions (Table 4).

Renminbi (RMB) deposits have become part of Macao's money supply since November 2004, when Macao banks started the RMB business. It is observed that the share of RMB deposits in total resident deposits has continued to grow in the past few months, though their absolute value remains small. Nevertheless, it would take time to observe the corresponding monetary impact of RMB in the SAR.

**Table 4: Monetary Survey, 2001-2005**

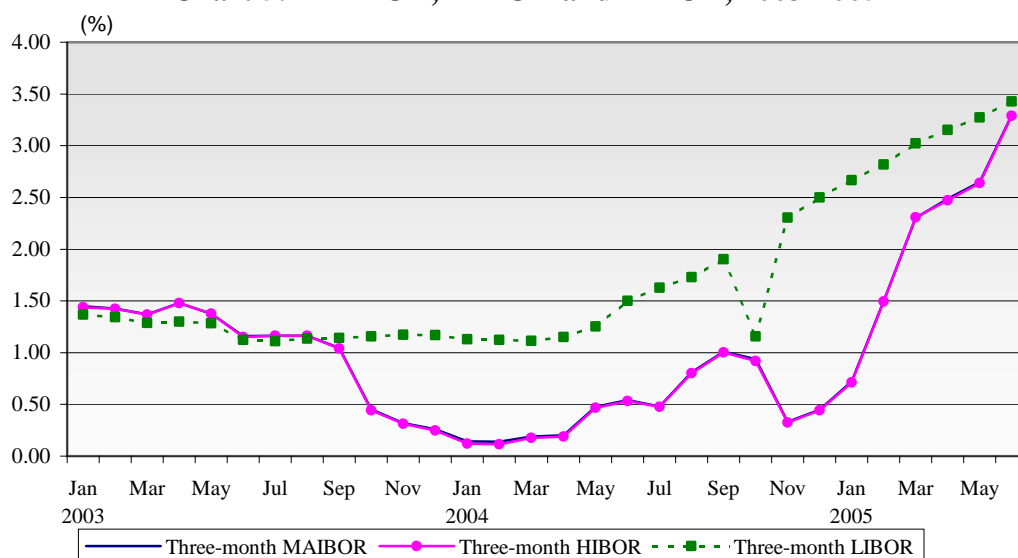
*(Annual change in value, 10<sup>6</sup> patacas)*

Year	Quarter	M2	Net Foreign Asset	Domestic Credit	Other Items (Net)
2001	1	-1,137.5	15,527.4	-5,242.6	-11,422.3
	2	7,029.0	13,469.9	-5,118.2	-1,322.7
	3	6,270.5	12,657.7	-5,325.0	-1,062.2
	4	6,632.1	10,246.8	-3,446.2	-168.5
2002	1	8,284.4	12,737.4	-4,451.9	-1.0
	2	7,893.2	12,454.9	-4,080.4	-481.3
	3	6,131.5	10,572.4	-5,088.9	648.1
	4	7,409.3	12,737.9	-4,443.1	-885.5
2003	1	7,251.8	12,281.0	-4,135.8	-893.4
	2	6,000.4	11,442.8	-4,876.9	-565.5
	3	12,412.2	17,312.2	-3,505.6	-1,394.4
	4	12,130.7	16,756.9	-3,564.3	-1,061.9
2004	1	10,014.0	14,577.2	-3,416.3	-1,146.9
	2	10,024.8	14,820.5	-3,227.1	-1,568.7
	3	7,191.4	13,531.4	-5,642.5	-697.5
	4	9,857.0	15,890.9	-5,057.4	-976.6
2005	1	11,586.8	16,514.4	-3,530.4	1,397.2

Source: Monetary Authority of Macao (AMCM).

To safeguard the monetary stability as defined by the pataca's fixed exchange rate relationship with the Hong Kong dollar, *short-term interest rates* in Macao cannot deviate much from their Hong Kong counterparts under a free capital account setting. As HKD interest rates started to enter its up-cycle, MOP interest rates moved up in line with those of HKD. At the end of June 2005, the three-month MAIBOR was 3.38%, which was virtually identical to its Hong Kong counterpart. The MAIBOR has moved up by about 300 basis points since the beginning of the year (Chart 5). On policy interest rates, the yield of 3-month monetary bill and the Base Rate of the discount window were fixed by the AMCM at 2.55% and 4.50% respectively at the end of June 2005. The latter in particular was kept at the exact level of Hong Kong's Base Rate quoted by the Hong Kong Monetary Authority, which was adjusted upwardly by 75 basis points from the beginning of 2005. To a certain extent, speculations on a possible revaluation of the RMB, which encouraged capital inflows into the Hong Kong market, had played a role in easing the upward pressure on Hong Kong interest rates, and hence Macao interest rates, especially before the Hong Kong Monetary Authority introduced "three refinements to the operation of the linked exchange rate system" on 18 May 2005.

**Chart 5: MAIBOR, HIBOR and LIBOR, 2003-2005**



Note: Rates are monthly averages.

Sources: British Bankers' Association.

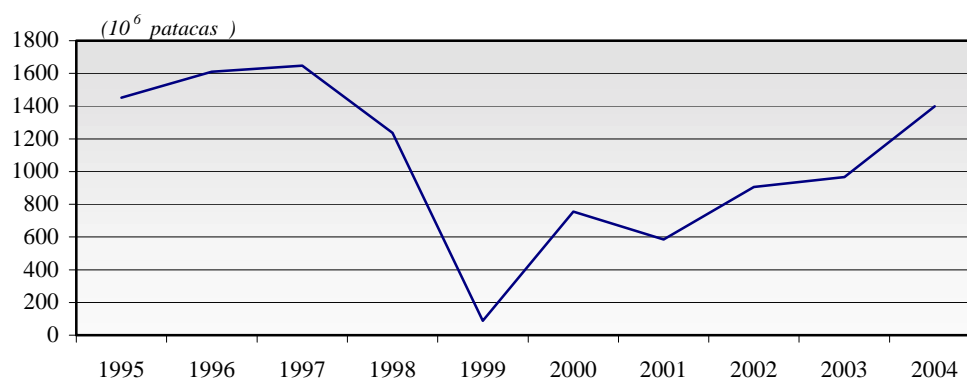
*Monthly Statistical Bulletin*, HKMA.

*Monthly Monetary Statistics Bulletin*, AMCM.

### 3. Assessment of Financial Stability

Further improvements in the *profitability* of the local banking sector were witnessed under the backdrop of a favourable macroeconomic environment. In the year 2004, operating profits of all 24 banks in Macao (including one postal savings bank and one offshore banking unit) rose strongly by 44.7% to MOP1,398.2 million, despite the further decline in interest income. At the end of March 2005, operating profits reached MOP624.8 million, compared with MOP244.5 million in the same period of 2004. Return on equity - the ratio of net profit/operating results to paid-up capital plus reserves - for locally incorporated banks rose from 10.0% in 2003 to 12.6% in 2004.

**Chart 6: Operating Profits\* of Banks, 1995-2004**



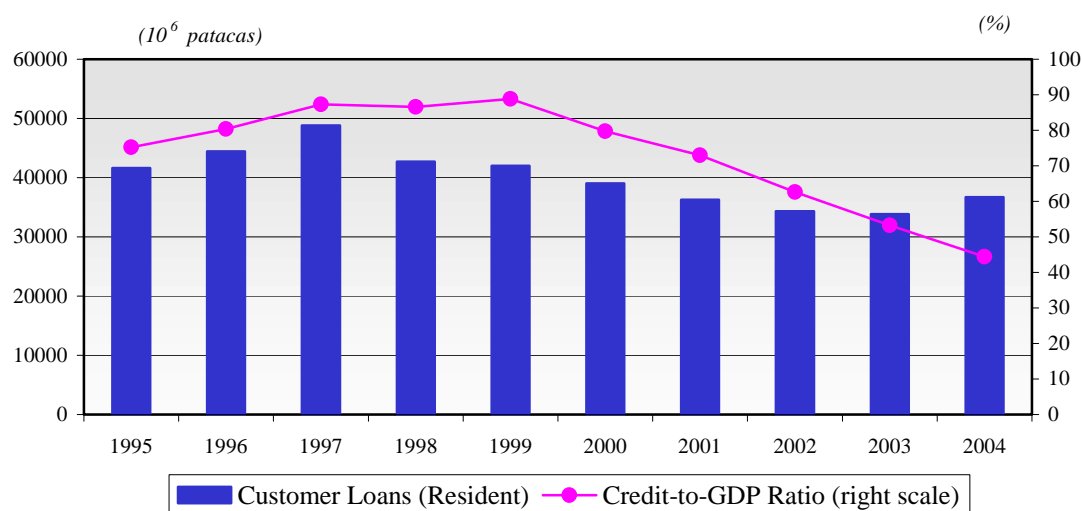
Note: \* Excludes profit/loss related to previous years, exceptional profit/loss, utilisation of provision and profit tax provision.

Source: AMCM.

Banks have devoted their effort to diversifying income sources, but net interest income or interest margin remains the largest income component. The trimmed size of loan portfolio, largely due to significant write-offs on bad debts, has dampened interest income from credit operations in the past few years. Yet, in line with the improved business environment, the value of consumer loans (including both resident and non-resident sectors) witnessed a rebound. It rose 8.1% to MOP52.7 billion at the end of 2004 and 10.7% to MOP53.5 billion at the end of March 2005. The pick-up in loans, if sustained, would eventually raise the profitability of banks. Meanwhile,

the domestic credit-to-GDP ratio kept moving south, indicating a reduced leverage or overall indebtedness of the economy. Such phenomenon is considered conducive to financial stability against a backdrop that interest rates are trending up.

**Chart 7: Customer Loans (Resident) and Credit-to-GDP Ratio, 1995-2004**



Source: AMCM.

Fee-based services, securities investment and foreign exchange operations have generated the healthy profit growth of the banking sector. During 2004, the non-interest income advanced 21.6%, whereas the net interest income contracted by 6.4%. In the first quarter of 2005, the former kept growing at a similar pace of 21.5%, while the latter gained over 30%, partly attributed to the increase in the credit to the private sector. Nevertheless, the ratio of interest margin to gross income (i.e. interest margin plus non-interest income) reduced to 53.0% for the whole of 2004 and further dropped to 52.8% in the first quarter this year.

The continual reduction in doubtful debt provision has reduced operating costs. In the first quarter of 2005, the ratio of non-interest expenses (net of taxation and provision allowance) to gross income, which is an important indicator of the operating condition, was marked at 45.7%, compared to 50.5% recorded in the first quarter of

2004 and 47.8% for the whole year of 2004. Meanwhile, “income from banking services” soared 36.3% in 2004 and went up by 20.0% in the first quarter of 2005. The expansion of fee-based incomes would continue to contribute to the growth of bank earnings, while the reduced reliance on interest income would help contain credit risk.

**Table 5: Ratios of Interest Margin to Gross Income and Non-interest Expenses to Gross Income, 2002-2005**

(%)			
Year	Quarter	Interest Margin to Gross Income	Non-interest Expenses to Gross Income
2002		68.0	44.1
2003		59.4	46.3
2004		53.0	47.8
2002	1	74.1	43.4
	2	68.2	39.5
	3	66.3	44.1
	4	63.3	49.6
2003	1	59.7	48.0
	2	57.2	45.4
	3	55.3	45.1
	4	65.8	47.0
2004	1	50.5	50.5
	2	56.5	39.9
	3	51.5	42.9
	4	53.3	56.3
2005	1	52.8	45.7

Source: AMCM.

In line with the surge in bank profits, the *quality of assets* witnessed improvements as reflected in the downtrend of non-performing loans or loans overdue for more than three months. After a plunge of 69.7% in 2004, the value of non-performing loans (resident and non-resident sector) dropped another 68.1% in the first quarter of 2005.

Downtrend was also observed in the non-performing loan ratio for both resident and non-resident sectors, which dropped to 3.3% in 2004 and 3.2% in the first quarter of 2005 (Chart 8).

**Chart 8: Non-performing Loan\* Ratio, 2001-2005**



Note: \* Total loans and advances extended to nonresidents and residents.

Source: AMCM.

Property-related items continue to be the largest credit exposure to firms and individuals in banks' assets. In view of the property market boom, their dominant position further strengthened. The ratio of property-related loans to total private sector credit for the resident sector rose from 37.6% in 2004 to 38.1% in the first quarter of 2005.

The strong performance of the real estate sector has stimulated individual house-purchase loan demand. In the course of 2004, the value of new credit extended to individuals for house purchases increased substantially by 77.9% year-on-year to MOP4.1 billion (Table 6). The sharp increase in the new credit to individuals for house purchases merit attention with regard to financial stability, especially when the property prices are growing at a markedly fast pace. Nevertheless, loans for construction and public works continued to contract, and hence would help limit the banks' exposure to the property sector.

**Table 6: Total Personal Housing Loans, 2003-2004**

Year	Quarter	Outstanding Balance at period end (10 <sup>6</sup> patacas)	Number of Contracts at period end	Value of New Credit (10 <sup>6</sup> patacas)	Number of New Contracts
2003		10,920	43,730	2,296	5,339
2004		12,121	42,921	4,085	6,863
2003	1	10,783	43,650	397	985
	2	10,605	43,476	457	1,134
	3	10,809	43,759	735	1,731
	4	10,920	43,730	707	1,489
2004	1	11,018	43,454	741	1,465
	2	11,480	43,415	1,045	1,734
	3	11,739	43,235	996	1,739
	4	12,121	42,921	1,303	1,925

Source: AMCM.

Credit to individuals unrelated to house purchase, which was dominantly unsecured with higher interest margins and would pose higher credit risk to credit institutions, registered a double-digit growth in the year 2004 and the first three months of 2005. Notwithstanding its hefty increase, this category of loans only accounted for 10.1% of the total credit to the private sector and 23.7% of the credit to resident non-corporate individuals as at end-March 2005.

*External exposures* remained large in banks' balance sheets though their share slightly subsided. The ratio of external assets to total assets dropped from 43.1% at the end of December 2004 to 41.6% at the end of March 2005. The share of non-resident credit in total loans and advances also edged down from 30.7% in 2004 to 29.9% at the end of March 2005. Hong Kong continued to be the largest destination

for fund placements by Macao banks. Its share in external assets of Macao banks reached 60.3% at end-March (Table 7). In addition, low risk of currency mismatch was reflected in the ratio of assets denominated in foreign currencies to foreign currency liabilities, which stayed close to one at 1.07 at the end of March 2005.

**Table 7: Geographical Distribution of Banks' External Assets, 2001-2005**

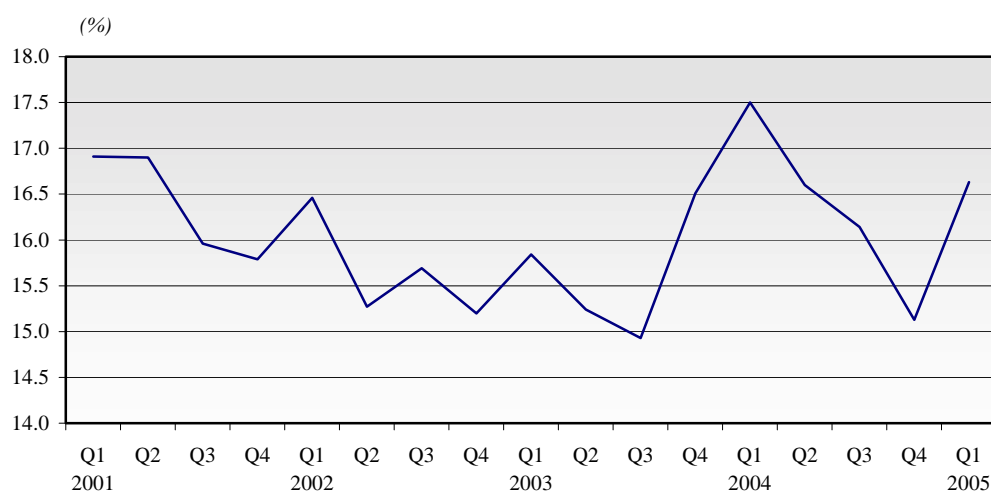
(% Share)

Year	Quarter	Hong Kong	China	Others
2001	1	64.3	3.1	32.7
	2	63.5	3.9	32.7
	3	61.9	3.9	34.2
	4	59.2	3.2	37.6
2002	1	59.8	2.8	37.4
	2	59.6	2.9	37.5
	3	63.0	3.0	33.9
	4	59.9	1.8	38.3
2003	1	61.4	2.2	36.4
	2	61.2	2.1	36.7
	3	58.5	3.1	38.4
	4	61.5	4.1	34.4
2004	1	51.8	4.6	43.6
	2	63.3	4.3	32.4
	3	60.5	3.3	36.2
	4	61.6	4.9	33.4
2005	1	60.3	4.9	34.8

Source: AMCM.

All of the 10 locally incorporated, non-government banks meet the 8% minimum requirement of capital adequacy set by the Basel Committee on Banking Supervision of the Bank for International Settlements on an individual basis. Their consolidated capital adequacy ratio reached 16.6% at the end of March 2005, indicating a strong *solvency* position.

**Chart 9: Consolidated Capital Adequacy Ratio of Locally Incorporated Banks, 2001-2005**

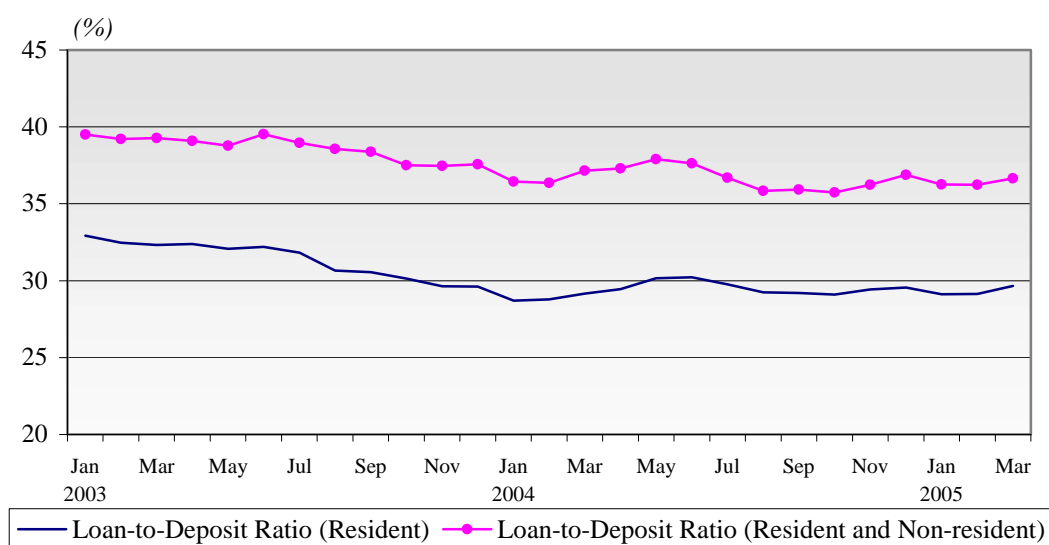


*Source: AMCM.*

The Macao banking sector is persistently liquidity-abundant. Liquid assets acquired by Macao banks are primarily composed of cash, short-term interbank assets and high-rated securities, which play a central role in accommodating the financial commitments of banks. At the end of 2004, the liquid asset to total asset ratio increased 1.1 percentage points from a year earlier to 61.8%. At the end of the first quarter of 2005, the ratio was 61.1%, about two percentage points higher than the 59.2% recorded one year earlier.

The loan-to-deposit ratio of the resident sector continued to stay at low levels. It reached 29.5% at end-2004, and 29.7% at the end of the first quarter of 2005. The ratio for both resident and non-resident sectors, however, edged down from 36.9% at end-2004 to 36.7% at the end of the first quarter this year (Chart 10). The reserve to total liabilities ratio hovered between 2.35% and 2.55% for the year 2004. For the first three months this year, the ratio moved in a narrow range of 2.51-2.57%.

**Chart 10: Loan-to-Deposit Ratios, 2003-2005**



*Note: Including both private sector and public sector deposits.  
Source: AMCM.*

#### 4. Conclusion

Following an analysis of relevant economic and financial statistics, it can be concluded that the monetary and financial system in Macao remained stable during the period under review. Strong economic fundamentals contained the risks in the system. Monetary operations under the CBA remained smooth, while latest financial data of the banking system pointed to a low level of risk against systemic stability.

Macao's economic outlook is largely favourable though the pace of growth is expected to slow. Tourist spending and investment will continue to power the GDP growth in the foreseeable future. However, the increasing demand for labour and infrastructure facilities would probably underscore the concern for resource bottlenecks at the top of the SAR Government's economic agenda. Sharp increases in output and property prices, as well as the gradual hike in import prices, have apparently intensified the inflation pressure.

Under the linked exchange rate system, the BOP plays a dominant role in determining the SAR's monetary conditions. Macao's major trading partners are forecast to maintain their economic growth, supporting their demand for exports of the SAR (Table 8). Mainland China would continue to be a major source of visitor arrivals to Macao. The gradual completion of various tourism facilities and casinos would further solidify Macao's position as a major tourist attraction in the region. A considerable expansion in service exports would therefore fully compensate a possible downside of merchandise exports after the complete elimination of the quota system for textile and garment products. In addition, textile exports of Macao are likely to recoup some loss in the early part of the year following the imposition of quantitative restrictions on China imports by the US and EU.

**Table 8: Economic Growth of Macao's Major Export Markets, 2004-2006**

*(Annual change in %)*

	2004	2005	2006
<u>Major Markets of Exported Goods</u>			
United States	4.4	3.6 (3.5)	3.6 (3.2)
United Kingdom	3.1	2.6 (2.4)	2.6 (2.2)
Germany	1.7	0.8 (0.9)	1.9 (1.5)
<u>Major Markets of Exported Services</u>			
Mainland China	9.5	8.5 (8.7)	8.0 (8.0)
Hong Kong SAR	8.1	4.0 (4.6)	4.0 (4.6)
Taiwan, China	5.7	4.0 (4.1)	4.3 (4.2)

*Note: Data are sourced from World Economic Outlook, April 2005, International Monetary Fund; data in brackets are consensus private-sector forecasts reported in the Economist, 21 May 2005 issue and 4 June 2005 issue.*

Local interest rates basically follow the interest-rate uptrend in Hong Kong and the US. The three refinements to the operation of the linked exchange rate system in Hong Kong, which are aimed at removing uncertainty about the HKD:USD exchange rate, would lessen the usage of the HKD as a vehicle for speculations on a revaluation of the RMB. Hong Kong interest rates would catch up with their comparatively higher US counterparts while Macao interest rates would correspondingly edge up in line with those of Hong Kong.

According to the *Consensus Forecast*, observers continue to mull over whether a pause in the tightening cycle will be forthcoming while relevant indicators are still in favour of a continued rise in US short-term interest rates. The upward adjustment of local interest rates, coupled with the waxed exposure of banks to the hot property sector, would, to a certain degree, raise concern for financial stability. Nevertheless, major financial statistics of the banking sector still comfortably rule out the possibility of immediate threat to the overall solid position.

Under the proviso that the exchange value of the USD will stabilise in 2005, the effective exchange rate of the pataca is anticipated to experience slight appreciation. Deficit in the capital and financial account is expected to prevail as residents continue to acquire foreign assets. The overall BOP, however, would be in surplus thanks to a large current account surplus.

The fiscal accounts will continue to register surpluses, given the positive trend for gaming tax receipts. The large surplus of the public sector will limit the expansion of the banking sector via curbing the growth of domestic credit, but will enhance the credibility of the linked exchange rate system, which is the core stabiliser of the local monetary system.

**Table 9: Major Economic and Financial Indicators of Macao, 2003-2005**

	2003	2004	2005 Q1
<b>A. Gross domestic product<sup>f</sup></b>			
GDP at current market prices (10 <sup>6</sup> Patacas)	63,564.3	82,685.5	20,315.8 <sup>P</sup>
Major components of GDP at current market prices (10 <sup>6</sup> Patacas)			
-Private consumption expenditure	20,670.5	22,735.0	6,096.8 <sup>P</sup>
-Government final consumption expenditure	6,828.3	7,095.3	1,435.2 <sup>P</sup>
-Gross fixed capital formation	8,981.9	13,392.0	3,609.7 <sup>P</sup>
-Private	6,671.7	10,075.8	3,553.2 <sup>P</sup>
-Public	2,310.3	3,316.2	56.6 <sup>P</sup>
-Export	65,691.5	87,549.9	20,221.6 <sup>P</sup>
-Import	38,925.8	48,461.7	11,117.2 <sup>P</sup>
GDP per capita at current market prices (USD)	17,804.9	22,556.9	n/a
<b>B. External trade: goods &amp; services (10<sup>6</sup> Patacas)</b>			
Goods			
-Exports	20,700.1	22,561.1	3,496.2
-Domestic exports	16,261.0	17,322.8	2,407.9
-Re-exports	4,439.1	5,238.3	1,088.3
-Imports	29,164.7	36,982.9	8,214.9 <sup>P</sup>
-Balance	-8,464.6	-14,421.8	-4,718.7 <sup>P</sup>
-Terms of trade index (1996=100)	100.9	99.0	96.1 <sup>P</sup>
Services			
-Exports	44,991.3	64,988.8	16,725.4 <sup>P</sup>
-Tourism receipts	41,133.2	59,779.3	15,381.7 <sup>P</sup>
-Gaming	29,893.4	43,002.9	11,066.1 <sup>P</sup>
-Non-gaming	11,239.8	16,776.4	4,315.5 <sup>P</sup>
-Imports	9,761.1	11,478.9	2,902.3 <sup>P</sup>
-Balance	35,230.2	53,509.9	13,823.1 <sup>P</sup>
<b>C. Tourism</b>			
Visitor arrivals (10 <sup>3</sup> )	11,887.9	16,672.6	4,457.0
Visitor per-capita spending (Patacas)	1,518.0	1,633.0	1,490.0
Hotel occupancy rate (annual average, %)	64.3	75.6	65.7
<b>D. Public finance<sup>1</sup> (10<sup>6</sup> Patacas)</b>			
Revenue	14,120.2	19,344.9	4,879.5 <sup>P</sup>
Expenditure	11,462.6	13,184.4	2,686.6 <sup>P</sup>
Surplus/deficit for the year	2,657.7	6,160.5	2,192.9 <sup>P</sup>
Macao SAR Reserve Fund as at end of the year	10,902.3	10,889.1	10,933.1 <sup>P</sup>
<b>E. Property market</b>			
Credit to individuals			
for house purchases (10 <sup>6</sup> Patacas)	10,631.4	11,663.1	12,219.2
Units transacted <sup>2</sup>	18,556.0	27,823.0	8,350.0
Value transacted <sup>2</sup> (10 <sup>6</sup> Patacas)	8,980.1	16,286.1	5,521.9

**Table 9: Major Economic and Financial Indicators of Macao, 2003-2005 (cont'd)**

	2003	2004	2005 Q1
<b>F. Prices</b>			
Composite consumer price index (Oct 1999-Sep 2000=100)	93.5	94.4	96.6
Tourist price index (Jul 1999-Jun 2000=100)	101.9	106.3	110.21
Trade unit value indices (1996=100)			
-Exports	94.6	95.1	94.1
-Imports	93.7	96.1	97.9
<b>G. Labour</b>			
Labour force (10 <sup>3</sup> )	215.5	229.1	239.6
Unemployment rate (annual average, %)	6.0	4.8	4.1
Underemployment rate (annual average, %)	2.7	1.9	1.1
<b>H. Money supply (as at end of the year, 10<sup>6</sup> Patacas)</b>			
M1	8,789.5	13,440.7	13,583.6
M2	111,090.0	120,947.0	122,484.4
<b>I. Interest rates (annual average, %)</b>			
Three-month interbank rate	1.05	0.48	1.51
Three-month time deposits <sup>3</sup>	0.26	0.08	0.37
Bills' discounted rate <sup>3</sup>	6.00	6.01	6.03
<b>J. Exchange rates (annual average)</b>			
Pataca/Hong Kong Dollar	1.03	1.03	1.03
Nominal trade-weighted effective exchange rate Index (Base period=January 2000)	101.0	96.2	94.2
<b>K. Foreign exchange reserves (as at end of the year, 10<sup>6</sup> Patacas)</b>			
	34,733.5	43,540.4	44,641.2 <sup>P</sup>
<b>L. Banking sector</b>			
Assets/Liabilities as at end of the year (10 <sup>6</sup> Patacas)	155,834.7	171,193.2 <sup>P</sup>	174,899.5
Operating results (10 <sup>6</sup> Patacas)	966.3	1,398.2 <sup>P</sup>	624.8 <sup>P</sup>
Capital Adequacy Ratio (as at end of the year, %)	16.5	15.1	16.6
<b>M. Insurance sector</b>			
Assets/Liabilities as at end of the year (10 <sup>6</sup> Patacas)	5,253.2	6,759.5 <sup>P</sup>	6,338.5 <sup>P</sup>
-Life insurers	4,449.6	5,921.7 <sup>P</sup>	5,454.4 <sup>P</sup>
-Non-life insurers	803.6	837.8 <sup>P</sup>	884.0 <sup>P</sup>
Financial results (10 <sup>6</sup> Patacas)	9.6	67.7 <sup>P</sup>	46.1 <sup>P</sup>

**Notes:***r* Revised figures.*p* Preliminary figures.<sup>1</sup> Excluding government autonomous agencies; revenue does not include balance from previous fiscal years.<sup>2</sup> Since August 2001, the figures have been based on the record of stamp duty.<sup>3</sup> Average rate of major banks.