Press release

IMF supports Government's policy to maintain Linked Exchange Rate and promote Hong Kong as an international financial centre

Tuesday, February 5, 2008

In its Staff Report on Hong Kong released today (February 5), the International Monetary Fund (IMF) reiterates its support for the authorities' commitment to the Linked Exchange Rate System (LERS) and recognises the Government's efforts in furthering Hong Kong's role as an international financial centre.

The IMF projects Hong Kong's real GDP growth in 2007 to be 6%, which is in line with the latest Government forecast. Inflation is expected to have been 2.2% in 2007. This compares with the actual outturn of 2.0%. The strong economic growth in recent years reflects the flexibility of Hong Kong's markets and its successful transformation into a services-based economy. Growth is expected to moderate to below 5% in 2008 and average around 5% in the medium term if financial integration with the Mainland and the competitive pressures from other regional financial centres are managed well.

The IMF expects the budget surplus for 2007-08 to outperform the original estimate. The current fiscal stance is appropriate, although Hong Kong continues to face the challenges of volatile revenue and prospective ageing-related healthcare spending. The IMF welcomes the Government's new investment income sharing arrangement with the Exchange Fund to limit revenue volatility, but the need to broaden the tax base remains. While the IMF has long supported the introduction of a goods and services tax to smooth tax revenue, it suggests the Government may also explore other options, such as expanding the base of the salaries tax. The IMF also supports the Government's efforts in seeking ways to address ageing-related spending pressures through reforms to healthcare services including financing.

On the future of Hong Kong's status as a financial centre, the IMF shares the authorities' view that it is intimately linked with Hong Kong's expanding role in Mainland financial intermediation. The IMF recognises the authorities' proactive efforts in seeking ways for Hong Kong's developed financial platform to benefit the Mainland, and the increased cross-boundary co-ordination with Mainland regulators. To safeguard Hong Kong's first-mover advantage and diversify its business base, expanding the range and type of products to investors will also be important.

The IMF considers that ensuring continued financial stability would be essential to the competitiveness of Hong Kong's financial sector, and notes that the smooth implementation of Basel II, enhanced framework of anti-money laundering and counter-terrorist financing, and the establishment of the Financial Reporting Council have further improved Hong Kong's already strong governance and supervisory regimes.

Welcoming the IMF's latest report on Hong Kong's economic developments and policies, the Financial Secretary, Mr John C Tsang, said, "We are glad to note the IMF's positive assessment of the Hong Kong economy and the broad support for the Government’s policy framework. We will continue our efforts in promoting deeper financial integration with the Mainland and diversifying our product and market mix to further enhance Hong Kong’s status as an international financial centre."

The IMF maintains its long-standing support for the authorities' commitment to the LERS, agreeing with the authorities that the peg to the US dollar remains appropriate. Fortified by the Three Refinements introduced in 2005, the LERS has been able to cope well with periodic stresses, underscoring the system's strength. Both quantitative and qualitative analyses by the IMF suggest that the real value of the Hong Kong dollar is in line with fundamentals.

The Chief Executive of the Hong Kong Monetary Authority, Mr Joseph Yam, said, "We welcome the IMF's continued support of the Linked Exchange Rate system. The system has served Hong Kong well since its establishment. Given our externally oriented economy and our role as an international trade and financial centre, the link provides currency stability, particularly in times of turbulence, which is crucial to the long-term development of Hong Kong."

Noting the importance of Hong Kong's traditional strength in market flexibility to its ongoing success, the IMF supports the Government's planned implementation of a general competition law, which should strengthen market flexibility. With labour market flexibility playing a pivotal role in the economic adjustment of Hong Kong, the IMF suggests that the Government could consider alternative measures such as expanding in-work benefits rather than legislating a minimum wage to balance wage flexibility and worker protection.

The IMF mission visited Hong Kong from October 29 to November 7, 2007, to conduct the Article IV consultation discussions.

The IMF's Public Information Notice is attached in the annex. The Staff Report can be obtained from the website of the Financial Services and the Treasury Bureau (www.fstb.gov.hk) or the IMF website (www.imf.org).