

Press release

IMF reaffirms support for Linked Exchange Rate System, praises HK's economic, financial policies **Wednesday, December 12, 2012**

An International Monetary Fund (IMF) Staff Mission to Hong Kong reaffirmed the long-standing support for the Linked Exchange Rate System and commended the Government's proactive policies to support growth and preserve financial stability.

The assessment was made in the Preliminary Conclusions of the International Monetary Fund Staff Mission published today (December 12), following the 2012 Article IV Consultation discussions.

The Mission reiterated that the Linked Exchange Rate System is a transparent, credible and effective exchange rate regime and warrants continued support as the best arrangement for Hong Kong. The preconditions to sustain such a system including a strong fiscal position, robust and proactive financial oversight, and flexible labour, product and asset markets are in place. The Mission continued to find the current level of the Hong Kong dollar to be broadly in line with economic fundamentals.

The IMF has seen that the global economic weakness is impacting Hong Kong but domestic demand is resilient owing to a supportive fiscal stance and continued strength in the labour market. With the drag from net exports abating next year, the Mission projected that Hong Kong's economic growth would increase from 1.25 per cent in 2012 to around 3 per cent in 2013. The key risks of potential global shocks will include a renewed intensification of the euro area crisis and the US fiscal cliff. In the event that any of these shocks materialises, the IMF suggested the Government consider launching a fiscal stimulus package and providing liquidity to the banking system through an array of tools if and when necessary.

The Mission is of the view that Hong Kong's fiscal policy has been effectively deployed to reduce economic volatility. While suggesting that temporary measures could be targeted at lower-income households in the near term, the IMF also noted that it is critical to ensure that fiscal policies are applied symmetrically through the business cycle to prevent an erosion of fiscal discipline, recognising that Hong Kong's history of fiscal prudence has been providing an important backbone to the economy.

The Mission considers that the property sector is the main source of domestic economic risk of Hong Kong though the probability of a correction large enough to generate major macroeconomic and financial consequences is fairly low in the near term. In this regard, the Mission commended the Government's various macro-prudential measures to help safeguard the banking system, while noting that the recently adopted Buyer's Stamp Duty and extension of the Special Stamp Duty should help dampen housing demand. The IMF also welcomed the Government's efforts to ensure a steady and adequate supply of property units going forward, as any improvement in the affordability of housing prices ultimately hinges on the supply of housing.

The Mission noted that Hong Kong is benefiting from the ongoing financial integration with the Mainland and should continue to build on its comparative advantage. In particular, the authorities should continue to develop the RMB financial infrastructure to capture the opportunities provided by the opening of the Mainland's capital account and the expanded international use of RMB. Meanwhile, the Mission recommended the authorities to continue to stress test and closely monitor banks' exposure to the Mainland, and to ensure that banks maintain prudent underwriting standards and hold adequate buffers against the potential risks in this regard.

The Financial Secretary, Mr John C Tsang, said, "We are glad that the IMF Mission supports our economic and financial policies in addressing potential global shocks and the considerable uncertainties in the external environment. The Government will continue to adopt proactive and suitable measures, including through the provision of counter-cyclical fiscal support to the economy as warranted. We also welcome the IMF's continued support for the Linked Exchange Rate System. The Government is fully committed to the maintenance of the system. We firmly believe that it remains the most appropriate exchange rate regime for Hong Kong, being a small and open

economy and an international financial centre."

The Chief Executive of the Hong Kong Monetary Authority, Mr Norman Chan, said, "I also welcome the Mission's continued support for the Linked Exchange Rate System, which remains a pillar of Hong Kong's monetary and financial systems. We are pleased to note the IMF's endorsement of our counter-cyclical prudential measures on mortgage lending. These measures have strengthened banks' risk management and ability to withstand a possible shock of a significant correction in the property market."

The Mission visited Hong Kong from November 7 to 16 this year for the 2012 Article IV Consultation with the Hong Kong Special Administrative Region. It held discussions with government officials and private sector representatives.

The Preliminary Conclusions of the Mission are attached at the Annex. The full report of the Article IV consultation will be endorsed by the IMF Executive Board in January 2013.

Ends