

COUNTRY REVIEW

Macao, SAR



15 October 2009

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EULER HERMES COUNTRY RISK GRADE: A

Country Risk Grades are on a scale of AA, A, BB, B, C, D
where AA is the lowest and D the highest risk.

Strengths

- Stable relationship with Mainland China helps limit risk of systemic political instability from within
- Pro-market, pro-business stance protected by Basic Law
- Small population, mainly ethnic Chinese
- Attractions as a centre for gambling—frequently from Mainland Chinese
- Balanced fiscal and monetary policy
- Strong external balance

Weaknesses

- Not immune to negative political developments in Mainland China
- Few natural resources and heavy concentration on garment manufacturing limit growth potential outside of gambling and tourism
- Some data inadequacies.

Key Risks

- **Recession**

Country Risk Assessment

Ratings	Macao		Median Grade A	Taiwan	Peers	
	Latest	Previous			Hong Kong	Singapore
Systemic Political Risk:	P2+	P2+	P2+	P2+	P2+	P1
Systemic Economic Risk:	E2	E2	E2	E2	E2	E2
ME rating:	ME2	ME2	ME2	ME2	ME2	ME2
<i>Structure</i>	5.0	5.0	3.3	4.0	3.3	3.3
<i>Policy</i>	1.3	2.3	2.3	1.9	1.9	3.8
<i>Solvency</i>	2.3	1.3	1.3	1.0	1.0	1.3
<i>External Liquidity</i>	2.3	1.3	2.3	2.8	4.2	2.3
SBE rating:	SBE2	SBE2	SBE2	SBE2	SBE1	SBE1
COUNTRY GRADE:	A	A	A	A	A	A

Nomenclature:

Political Risk Ratings are on a scale of P1 (lowest risk), P2+, P2-, P3+, P3-, P4 (highest risk).

Economic Risk Ratings are on a scale of E1 (lowest risk), E2, E3, E4, E5, E6 (highest risk).

ME (Macro-Economic) ratings are on a scale of ME1 (lowest risk), ME2, ME3, ME4, ME5, ME6 (highest risk).

The constituent parts of the ME rating are on a scale of 1.0 (best) to 6.0 (worst).

SBE (Structural Business Environment) ratings are on a scale of SBE1 (best), SBE2, SBE3, SBE4, SBE5, SBE6 (worst).

Country Grades are on a scale of AA, A, BB, B, C, D where AA is the lowest and D the highest country risk.

Source: Euler Hermes Country Risk Unit

ECONOMIC STRUCTURE

Country Profile

Capital city:	Macao
Population:	0.54mn 2008
GDP:	USD 21430 mn (2008)
Currency:	Pataca (MOP)
Form of state:	Special Administrative Region of China
Head of government:	Chief Executive Chui Sai-on (from December 2009)
Next elections:	September 2013 (chief executive by election committee)

Major Industries (% of GDP at market prices, 2007)

Mining & manufacturing	2.7%
Utilities	1.1%
Construction	13.3%
Services	82.9%

Global Assumptions

	2009	2010
Real GDP grth (% yr/yr) *	-3.9	0.9
Inflation (% , av) *	-0.1	1.3
Dated Brent (USD/b)	61	72
* Major economies		

Main Exports (% of total, 2008)

Garments	52.5%
Machinery, apparatus & parts	7.5%
Other textiles	4.5%

Main Imports (% of total, 2008)

Consumer goods	45.9%
Raw materials & intermediate goods	21.5%
Fuels & lubricants	13.2%
Capital goods	19.3%

Lead Export Markets (% of total exports, 2007)

US	40.8%
Mainland China	14.8%
Hong Kong	13.1%
Germany	6.4%

Lead Import Markets (% of total imports, 2007)

Mainland China	42.6%
Hong Kong	10.1%
Japan	9.0%
US	5.6%

Basic indicators

Selected economic indicators	2006	2007	2008	2009f	2010f
Nominal GDP (USD mn)	14,212	18,605	21,430	19,306	19,982
Population (mn)	0.50	0.51	0.53	0.54	0.55
GDP per capita (USD)	28,424	36,480	40,434	35,752	36,331
Real GDP growth (% yr/yr)	16.5	25.3	13.2	-7.0	2.0
Inflation (% , eop)	4.6	7.1	6.2	0.5	1.5
Fiscal balance (% of GDP)	8.7	17.8	14.6	3.3	1.0
Current account balance (% of GDP)	20.6	31.5	34.9	36.1	34.4
Foreign exchange reserves (USD mn)	9,130	13,230	15,930	17,700	18,000
Import cover (months)	9.6	10.6	14.9	20.7	21.5
Exchange rate assumption, MOP:USD (av)	8.00	8.04	8.02	7.98	7.98
f: CRU central forecast					

Sources: National, IMF, World Bank, Euler Hermes Country Risk Unit

Political Stability

Formerly a Portuguese territory, Macao reverted to control by Mainland China at end-1999 and, like Hong Kong, was accorded Special Administrative Region status. As in Hong Kong, there is a Basic Law that enshrines Beijing's "one country, two systems" policy for fifty years. Mainland China is responsible for foreign affairs and defence but allows a "high degree of authority" in other areas. While it is likely that Mainland China will preserve a good degree of autonomy, it is unlikely that the development of political processes perceived as threatening by Beijing would be tolerated. Moreover, were there to be a breakdown in political stability in Mainland China or a radical policy shift it is hard to see how Macao would be left unscathed and it is unlikely that the international community would intervene forcibly. The political risk rating therefore reflects that of Mainland China. The World Bank Institute's latest Worldwide Governance Indicators put political stability and government effectiveness above average for both High income economies and the Asia region. The widening gap in wealth and income from concentration on gaming is a potential problem.

The head of government is the chief executive who is elected by a 300-member committee and may serve a maximum of two five-year terms. Incumbent, Edmund Ho Hau-wah, will complete his second in December 2009 when he will be replaced by Fernando Chui Sai-on who was elected uncontested in September. There is also a 27-member legislative council (ten members elected directly, ten indirectly and seven appointed). Macao has an independent judiciary and a legal system based largely on Portuguese law. There are no political parties, but important social and economic groups are represented through various formal organisations. Ethnically, Macao is predominantly Chinese.

Economic Stability

The economy is dominated by services, particularly gambling, revenues from which account for some 60% of GDP and 80% of fiscal revenues. Services account for more than 80% of GDP and more than 90% of all current account export earnings. Garments and other textiles, though in decline, account for almost 60% of goods exports, mainly destined for the US. Macao is a high income economy based on World Bank definitions with a population of half a million. Real GDP per capita GDP grew strongly over the past decade by an annual average of just under 6%.

Real GDP more than doubled in 2002-08, as the gambling sector was opened up, producing an explosion of foreign-led investment in casinos and associated infrastructure. In 2007 alone growth hit an estimated 26%. In 2008, however, growth began to slow and real GDP began to contract in Q4 yr/yr with a further 12.9% yr/yr decline in H1 2009, as the global downturn hit arrivals and investment. There have also been reports of restrictions on Mainland Chinese visas by Beijing which could have hit the number of arrivals. There are some positive signs, however, as the number of tourist arrivals has begun to pick up and other Asian economies are recovering. Overall, real GDP is likely to contract by 7-8% in 2009 before returning to modest growth in 2010. However, the pace of recovery and future growth depends largely on the speed with which investments in the casino sector are re-started—which points at least to a lag with the rest of Asia—and, longer term, on how non-gambling revenues are developed in the casino resorts, as well as the stance of Beijing.

The fiscal balance has been in surplus since 2000 and based on H1 data should remain so in 2009 though at a much reduced level (probably 3-4%). Assuming some recovery in gambling revenues balance or small surplus should be maintained in 2010 as well. Indeed, the public sector is in net surplus with a strong accumulation of banking sector deposits. Monetary policy is set to maintain the exchange rate peg (currency board) against the Hong Kong dollar, which is pegged to the USD. Inflation eased through 2008 to 6.2% yr/yr from 7.1% at end-2007 and in 2009 has fallen sharply to 0.4% yr/yr in August. Deflation is now the main risk, though food and energy costs should see low inflation continue through 2010. The exchange rate peg is appropriate and the exchange rate does not appear to be unduly misaligned. The banking sector does not pose a serious systemic threat.

The trade balance is in large structural deficit, but a large surplus on services takes the current account in strong surplus. Goods exports fell in 2008 and H1 2009. Services inflows (mainly associated with the gambling sector) grew by an annual average of 26% in 2004-08 but in H1 2009 were 15% down on a year earlier (GDP basis). Nonetheless, a current account surplus should be maintained in 2009-10. Net FDI flows are also set to remain positive. Foreign exchange (FX) reserves have increased steadily, even in 2009, and provide around 20 months import cover. M2 is less than 200% of FX reserves. Official external data are not available but based on World Bank/BIS/OECD data external debt seems to be moderate and easily manageable.

Structural Business Environment

The Structural Business Environment is generally strong, but falls short of the highest rating

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