



MRI FORUM 15

Macau: An Economy in Transition

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To start this talk by telling you that Macau is going through a period of rapid change is, you will agree with me, stating the obvious. However, what may not be so obvious is where these changes are leading us, what are the main challenges raised by it, how deeply will our lives be affected, and how long will we enjoy (some might say, endure) such a rate of change.

These are tough questions and I'm bound to start with two disclaimers, which may, I'm sorry to say that, disappoint you. First, I don't claim to tell you today "all" you might want to know about the Macau economy transformation or, namely, about its gaming industry. The reason is simple: even if I was willing and our hosts would grant us all the required time, the fact is that I would not know. I claim no special expertise or insider knowledge on the subject. I can only claim being a concerned citizen of this city and, being an economist by training, I feel compelled to look at it with the tools of my trade. Secondly, please do not expect me to make bold forecasts - specially, as an old story goes, not about the future. If - and fellow economists who may be in the audience will forgive me for saying this - we really, I mean, really, could see the future, we would not spend so much time delving and trying to make sense of doubtful statistics, unreliable figures and fuzzy trends. We could, for sure be making a comfortable living as fortune-tellers.

So, you may ask, what is the purpose of this talk? A modest one but, I hope, not an altogether useless one. In the midst of intense periods of change, it is easy to get lost in the succession of facts and details that almost every day brings forth. It is then necessary to try to identify the main characteristics or patterns of what's going on, to single out what is important from what does not appear to be so important, and to create, so to speak, a frame of reference that allows us to navigate through what will, possibly, be turbulent waters. I

will therefore, attempt to spell out a broad overview of the recent dynamics of the Macau economy and some of the main trends that, to my opinion, will frame the medium term development of this city. My comments are aimed at helping non-specialists to make sense of the on-going process, so I will avoid drowning you in technicalities or figures. If that objective is achieved today, if what I will have to say will be of any use you to, if it helps – as I would hope – to set off future reflections by others, more qualified than me (maybe our hosts we'll get this as a hint), I will have achieved my objectives.

What is changing?

So, to start with, what is changing? Why do we get this feeling that things are getting different, and getting different fast?

For most of the second half of the 1990s and up to, roughly speaking, 2002, the Macau economy was either contracting or growing slowly, unemployment rates were becoming worrying, prices were deflating and, to make things worse, we got the SARS scare (with effects that were felt well into 2003). Since then, most of the relevant economic indicators point only in one direction: up. Rates of growth unseen for along time, decreasing unemployment, increased investment, a tourism explosion, rising prices, a real estate boom... we could go on with the list. We are well beyond what one could expect from a 'normal' rebound of an economy after a 'normal' period of contraction. Before we look a bit more into detail at those changes and their dimension, let's state from the outset which are, to my view, the most important causes of this abrupt change.

The period of rebound coincides broadly with what I could call two major displacements in the general framework of the Macau economy. The first one was obviously the ending of the gaming monopoly, materialized in the three concession contracts signed in 2002. The second one, almost as obviously, was (and is) the policy of granting of individual visas to mainland Chinese to visit Macau, in operation since mid-2003, coupled with a progressive enlargement of the geographic scope of that policy. These two changes could obviously be expected to impact positively in the performance of the Macau economy, setting in motion the current growth process. Not so obvious was the speed and intensity of change, that appears to have caught many by surprise.

Recent evolution of select statistical indicators

Just a few indicators will give us the flavor of the changes talking place and the trends that are taking shape. I'll use as a reference mainly the evolution registered in the last 5 years, that is, the period from the resumption of Chinese sovereignty until the end of 2004 or, in a few cases the latest available data, from the first trimester of the current year.

1. Demography - Population dynamics has been characterized by a slow natural growth; the flow of immigrant workers has started to accelerate recently;
2. Gross Domestic Product (GDP) - After a period of slow growth, a clear increase in growth rates, with an outstanding figures of 14 and 28%, in real terms, for the last two fiscal years; as a result, the per capita income rose to levels on par with some developed countries; this economic expansion has been led by the gaming and tourism sectors, which represent an ever growing share of the GDP; there is by apparent deepening of the income distribution asymmetries;
3. Employment - Reversal of the recent trend, with a reduction in unemployment rates (currently at around 4%, the lowest for the period); an upward pressure on salaries (a median growth of 10% in the last two years), driven mainly by competition among the new casino operators and the construction boom (both with growth rates close to 20%, in the same period);
4. Investment - Investment has been stable for most of the period, based on a high level of public investment in public infrastructure (e.g., new Sai Wan bridge; East Asia games infrastructure; new border crossing); more recently, we can register an upward trend supported by growth of private investment, including Foreign Direct Investment (FDI);
5. Construction - A booming sector: suffice to say that the new buildings started in the last two years, represent a gross construction area that is roughly equivalent to that of all the buildings finished in the last five years; the trend is confirmed by an outstanding growth of cement apparent consumption (the value for the last two years and the first trimester of 2005 is of the same order as the cumulative value for the years from 1997 to 2002); high internal and external demand pressure on real estate, underpinning significant price increases, both for residential and commercial uses;
6. Tourism - An explosion in the number of visitors (over 16 million, last year), characterized by a remarkable growth of mainland visitors (representing 57% of the total); the mainland visitors are also the biggest spenders, with expenditures estimated at about to 3,000 MOP per capita;
7. Commerce - Another booming sector, with overall growth over 20% in the last year, especially remarkable in the areas of cars, clothing and supermarkets;
8. Money and prices - After a period of deflation, the data shows a significant growth of the monetary aggregates (especially M1) and growing levels of

credit (though still not too high when compared with recent standards); inflationary pressures are building up (prices started picking up by the second half of 2004, after a long deflation period, and appear to be increasing their momentum), and pressure is mounting on interest rates (base AMCM rate increasing from 2.5 to 4.5, between mid-2003 and May 2005);

Main growth drivers

The overall picture is then one of a booming economy whose main drivers are gambling, tourism and construction. Let's note that these are strongly correlated activities, that is, there are strong links between the performances of each of them. It is time, therefore, to look into what are the broad expectations concerning these sectors.

1 - Gambling

Following the assignment of the three concessions, but with a special stress in the last half year or so, there is hardly a month when one does not hear about new plans or commitments concerning the number of casinos, gambling tables and slot machines. From roughly 400 tables and 1,000 slots in 2003, numbers have been increasing steadily – over 1,000 tables and 2300 slots by the end of 2004 - and forecasts about the future figures keep being revised. According to some sector analysts, one should reach around 6,000 tables and over 11,000 slot machines by 2010. As far as the associated hotel premises are concerned, one can look for more than doubling of the number of rooms in five years, with some pointing to a six-fold increase in 10 years. The number of casinos is also more than doubling in this period, and is expected to be around 30 by 2010.

2 - Tourism

The number of visitors keeps increasing, with some foreseeing a doubling, to more than 30 million, within the next five years, and continuous growth beyond that. If we weigh in the average stay of visitors in Macau, and supposing it stays relatively constant – a conservative assumption, that will translate in an average of some 100,000 visitors per day in Macau. The more dynamic segment will keep being the mainland visitors, which are also those whose average spending is higher.

3 - Construction

The construction sector can look forward to a sustained pace. The level of planned construction, both private and public, will keep them busy for most of the decade. As examples, let's list briefly just some of the most visible projects, as gathered from the news: on the private side, besides the

construction of the new casinos and directly related facilities in COTAI and NAPE, new big developments are also expected in the areas of the Outer Harbor, the Nam Van lakes and the Pier nº 16; on the public side, we can mention the HK-Macau Bridge, the Tap Seac area development, the Light rail construction, again just to mention a few.

It is beyond the aim of this paper to estimate the amounts involved, but it is certain that they will run into big figures.

So we have identified so far the shocks that got the process running, the main features of the recent evolution and the expectations concerning the main growth drivers. It is time, therefore, to try to frame the questions that bring us here. What lies ahead? Within the next five years or so, where are we heading to, what are the likely consequences of this process, which challenges will Macau and its people be facing?

Main trends

It appears to me that four main trends will frame the development of this city development in the next few years.

Trend nº 1 – A deeper economic specialization

In 1999, in an interview to an American journal, when asked about the opportunities for diversification of the local economy, Mr. Stanley Ho was quoted as declaring plainly: “there’s only one business in town, and I run it”. I would say, even more so today, at least in what concerns the first part of that statement. Macau will rely increasingly on the gambling sector and related activities as, in parallel, its manufacturing industries appear in retreat. This is a high potential, high-risk development. The other dynamic sectors – tourism and construction – are highly correlated with the gaming activities and they all depend strongly on external factors, hardly influenced or controlled by the local agents. That means greater vulnerability to those external factors: should a crisis or an economic slow down strike this area of the world and the growth expectations would have to be seriously reviewed, without any obvious sector in a position to act as a shock absorber.

Trend nº 2 – Rapid increase in population

The needs of the ongoing casino related projects and those that will shortly start (most of the casinos are expected to be operating by 2009, at latest) will require, directly and indirectly, a level of workforce that is not available in Macau: not in quantity, not with the appropriate qualifications. For the new casinos to be built and to operate, to cater for the increasing number of visitors, a significant increase in the labor force will have to take place – in a

short time span. The few estimates, which have been heard so far, vary from 80,000 to 200,000, within the next five to ten years. If the timing of the planned investment is kept on track, a rough calculation, taking into account the construction needs and the increasing number of rooms, visitors and gambling facilities, can easily lead us to expect the population to increase by 20 to 30% in the next five to seven years.

Trend nº 3 – An urban space under stress

Multiplication of areas with ongoing construction works; growing population and growing numbers of visitors; increasing traffic; progressive encroaching of the “new developments’ on the traditional areas of the city: all these factors will put tough demands on the city’s infrastructure and services. They raise questions concerning the necessary infrastructure development and their timing and, are likely to impact negatively on the living conditions. There is an urgent need to plan and implement ways to minimize the effects of increasing air pollution; to ensure the maintenance of water quality and sanitary conditions; to improve the management of traffic; and to solve the problems generated by growing waste generation. There are no visible signs, or at least that I am aware of, that these problems and the means to prevent and/or mitigate them are being addressed in an integrated way, both for the city and the new development areas.

Trend nº 4 – A more volatile financial market

Macau appears to be in the process of becoming a three-currency area and the prices of some assets are starting to display what has, in similar contexts, politely been called “exuberance”. Given the openness of our economy and the monetary and inflation pressures that appear to be building up, the control and stability of our financial sector will become harder. Besides, the possibility of a financial bubble, starting in the real estate sector, and spreading to other sectors, cannot be dismissed (especially if the total levels of debt and the pressure on interest rates start to grow).

Future challenges - some pointers for further discussion

What challenges do these trends raise concerning our future? I think there are five main challenges that will have to be dealt with in the next few years, if the overall development of the city and the conditions for wealth creation are not to be disrupted. My concerns relate to:

1) The diversification of the economy, that is, what can be done to diversify the economic structure and render this region less vulnerable to economic fluctuations or external economic or political cycles?

- 2) The integration of a rising population: that is, how to accommodate, both socially and physically, a fast growing workforce, without transforming Macau in a markedly “dual society”?
- 3) The maintenance of monetary stability: namely, what must be done to the control of inflation pressure and to avoid a harmful property bubble?
- 4) The setting up of an integrated urban planning: how to ensure the provision and quality of basic public services (water, power, sanitation, road maintenance and the like) and to deal traffic congestion, pollution prevention and/or mitigation, no to mention the organization of the urban space itself?
- 5) The maintenance of the social infrastructure: I refer here, in the context of rapid and profound changes to the social fabric, to the need to maintain or improve: the quality and efficiency of the general public administration; the education, training and qualification of the workforce; the general health and social services; the enforcement of the law and the preservation of public security.

Dealing with all these challenges, I reckon, requires further and deeper analysis, and broader expertise must be called in. Dealing with and reflecting on these challenges (none of them a simple task), is not, I think, an exclusive task of the public authorities. None of the challenges is beyond our collective capacity to cope with, but I would not be true to you if I did not finish this talk mentioning what I call here the three great unknowns. What do I mean by that? If any of these three critical issues, which I will identify in a short while, gets “out of control”, if I’m allowed the expression, there will be serious consequences for all (or most) of us. The prospects for harmonious development of the city will be disrupted and some of the potential for wealth creation that exists in the current context, at least, partially destroyed.

The big unknowns

So what are these unknowns? I’m referring here to three specific issues that, for their complexity and broad impact, are critical to a smooth evolution of the Macau economy and society. Why do I call them unknowns? Because how we cope or manage these issues hinges on so many factors, events and agents’ behavior that to tackle them successfully requires not only wisdom and expertise, but also luck. Each has, also, its own timing and urgency. I’m talking about:

- 1) On the very short-term, the need to guarantee some measure of monetary control, so as to counter a rising inflation and to keep interest rates at reasonable levels;

- 2) On the short-term, the need to prepare for the demographic pressure, so as to prevent the further degradation, physical and social, of the urban environment;
- 3) On the medium term, the need to ensure the economic sustainability or viability of Macau's development.

What I mean by the first two and their degree of significance and urgency should be clear by now, if one takes into account the comments made previously. I will not, therefore, develop those subjects further. The third one requires, however, some additional comments. The apparently ever increasing number of operators, casinos, and tables raises some difficult questions concerning the viability of the already announced investments in the sector, not to mention those yet to be announced. On the face of the explosive growth (I hope this is not too literal) of gaming tables and slot-machines, are we to assume that such growth has no impact on the return on investment, and that no matter how many more tables are set, the global revenue will grow in parallel and the return per table will always be sufficient to recover the investments, not to mention to obtain a reasonable profit? Is the success of Macau assured no matter what existing and potential regional competitors do? What if the operators soon reach the point where the main avenue for growth is not finding new customers, but to fight for shares of a market whose growth, for one reason or another, levels off? I certainly am not in a position to answer, and the detailed investment plans and forecasts of the operators are not, obviously, available to me. I know I run here against the boundless optimism that appears to permeate all and every new announcement of yet another project (but maybe that's because I am not paid to announce them!). However, I cannot but feel puzzled when I listen to successive declarations of guaranteed and fast returns (it appears that everybody will recover the investment in 18 months).

Conclusion

Among so much optimism, and so early in the process, it may appear too soon to raise these somewhat awkward questions. But, with most of the new casinos expected to be operating in less than three years, we may have to start finding answers sooner rather later. Hopefully, my questions may then look irrelevant. But I cannot avoid the feeling that, as we enter these uncharted waters, increased awareness, deeper analysis and more strategic thinking are required. And more diversified expertise, well beyond the realm of economics alone, needs to be called into the debate. I am aware I cannot provide you with answers: I hope, nonetheless, that I've been able to ask some of the right questions.

