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Statement by the Honorable YI Gang,

Alternate Governor, International Monetary Fund for China

On behalf of People's Republic of China

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Alternate Governor of the International Monetary Fund for China
to the Thirty-Second Meeting of the
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Lima, October 9, 2015

1. Recent Developments in the Global Economy and China

Global economic growth remains moderate, with rising uncertainties on the global economic prospects. Economic recovery in advanced economies has gained some momentum, particularly reflected by steady economic growth in the U.S. and signs of continued recovery in the Euro area. However, indicators are mixed in some other advanced economies and inflation pressures remain subdued. The growth of emerging market economies has slowed down. Some emerging economies are experiencing headwinds to growth due to low commodity prices and the reversal of capital flows. Financial market volatility in these economies has been elevated and uncertainties to the outlook have risen.

Regarding China's economic and financial conditions:

1.1 Stock market

China's stock market has undergone several corrections since June, and the adjustment has largely run its course.

The Chinese government has adopted a range of policy measures to prevent systemic risks. The People's Bank of China (PBC) cut interest rates and the required reserve ratio, and injected liquidity into the market, including by allowing securities companies to borrow from the interbank market. These measures helped stabilize the market and prevent systemic risks. As a result, no securities firms or fund management companies went bankrupt. Leveraging was also significantly reduced and financial risks abated in the following months.

The stock market volatility appears to have limited impact on China's real economy. The impact of market corrections on the operation of China's financial system is minimal because financial institutions are generally well-capitalized. In addition, equity financing has not been a significant source of funding for China's corporate sector which is mainly financed by bank credit and bond issuance. Several researches have also shown that the wealth effect of market corrections on consumption seems muted in China.

Nevertheless, this episode of market volatility revealed important issues in China's capital market. To address these problems, China will review and improve the regulatory framework of the market, strengthen supervision, and take measures to restore the functioning of the equity market, when appropriate. Furthermore, China will resolutely push through market-oriented reforms and stay the course of further opening the capital markets.

1.2 Reform of the renminbi (RMB) exchange rate

The reform of the RMB central parity on August 11, 2015 was to make the RMB exchange rate more market-based. After the reform, the central parity of the RMB exchange rate is largely determined by the closing price of the previous trading day, while also reflecting the overnight movements of major currencies, and foreign exchange supply and demand conditions. This reform was intended to enhance transparency of the RMB exchange rate and to prevent the central parity from persistently deviating from the market exchange rate.

The depreciation of the RMB after the reform made the exchange rate more aligned with market conditions. Before the reform, the RMB had appreciated substantially in effective terms as the U.S. dollar strengthened and many emerging market currencies depreciated, while the cyclical position of the Chinese economy and exports pointed to a weaker exchange rate. For an extended period of time, the RMB was traded at rates that were weaker than the central parity. Additional downward pressures were put on the RMB exchange rate after liquidity injection, in response to the stock market correction. The RMB exchange rate depreciated about 3 percent following the reform, and the PBC communicated and explained the reform to the public. Recognizing that an overshooting of the exchange rate was not in the interest of either China or the rest of the world, the PBC took measures to ensure the transition to a more flexible exchange rate regime is progressed in an orderly manner.

Persistent RMB depreciation would be inconsistent with China’s economic fundamentals. The Chinese economy continues to grow at a robust pace and the economic fundamentals remain strong. As wide-ranging structural reforms are being carried out, the Chinese economy will become more balanced and sustainable. Besides, the still-large trade surplus serves as an important support of the RMB exchange rate.

Going forward, the market-based RMB exchange rate reform will continue to proceed, and the RMB exchange rate will become more flexible, floating around the equilibrium level in both directions.

1.3 Capital flows

China has recently experienced some capital outflows. Several factors have contributed to such outflows. First, companies and individuals adjusted the currency composition of their assets and liabilities as the expectation of the RMB exchange rate changed. Second, companies reduced their foreign financing and repaid foreign debts, which helped lower leverages and address currency mismatch. Third, domestic companies increased their hedging against exchange rate risks, which translated into more demand for foreign exchanges. Fourth, outbound investment also expanded rapidly.

Meanwhile, China remains a major destination of long-term foreign investment. With medium-high economic growth in the medium and long term, China will remain attractive to foreign investors.

1.4 China's economy and macroeconomic policies

The Chinese economy has entered a "new normal." Amidst economic transformation and reforms, China's economy has transited away from two-digit or near-two-digit high growth to medium-high growth with better quality and structure. In the first half of 2015, although economic growth further slowed to 7 percent, it still remained within a reasonable range.

The Chinese economy faced some downward pressure but also showed a number of positive signs. Although the economy is facing headwinds from the traditional sectors—including the heavy industry—with a few leading indicators experiencing volatility that points to downward pressure, there are also some positive signs. First, labor market conditions remained healthy, with 8.41 million new jobs being created in China's urban areas during January and July, which accomplished 84.1 percent of the annual target. Second, consumption continued to grow steadily. Retail sales grew by a year-on-year rate of 10.8 percent in August, up 0.3 percentage points over July. Third, the real estate market has stabilized, with prices and sales of residential housing seeing a rebound in big cities. Fourth, emerging industries maintained fast growth. During January and August, nationwide online retail sales posted a cumulative year-on-year increase of 35.6 percent. Besides, earlier fiscal and monetary policy adjustments are expected to show the effects in the second half of this year, given the lag in effects.

Meanwhile, China's economic restructuring has continued to make progress. In the first half of 2015, the contribution of final consumption expenditure to growth hit 60 percent—5.7 percentage points higher than the corresponding period of last year—and continued to outperform that of investment. The share of value added by the tertiary industry in GDP climbed 2.1 percentage points over the same period of last year to 49.5 percent, 5.8 percentage points higher than that of the secondary industry, while energy consumption per unit of GDP dropped 5.9 percent on a year-on-year basis. The current account surplus was 3.14 percent of GDP in the first half of this year, mainly due to temporary factors such as lower commodity prices. However, China's commodity imports remained stable and increased in volume terms, despite the decline in value terms caused by the slump in commodity prices. In volume terms, China's grain imports surged 24.4 percent on a year-on-year basis over the period of January to August, while imports of copper ores and concentrates and crude oil increased respectively by 12.1 percent and 9.8 percent.

The Chinese government will maintain sound monetary policy and proactive fiscal policy to address the potential downward pressure on economic growth.

On the **monetary side,** we will continue to implement a sound monetary policy which should be neither too tight nor too loose, while making flexible use of various monetary policy tools to provide adequate liquidity to the market to ensure a reasonable growth in money and credit, as well as total social financing. The PBC has cut benchmark deposit and lending rates four times and the reserve requirement ratio (RRR) for all depository financial institutions three times since 2015, with additional RRR cuts targeting institutions qualifying certain criteria and a new policy of reserve averaging effective September 15, 2015. At the same time, new liquidity management tools have been developed. Moreover, we have actively promoted interest rate liberalization by further widening the floating range of deposit rates. By now, the ceiling of all deposit rates has already been removed, except that of demand deposit and time deposit with a maturity of less than one year.

On the **fiscal side,** the Chinese government will maintain proactive fiscal policy by further scaling up infrastructure investment, strongly promoting public-private partnerships (PPP), accelerating fiscal and tax system reforms, introducing structural tax cuts and fees reduction, and conducting a comprehensive clean-up of fees charged on firms so as to lower their burden. Fiscal spending by the central government is projected to grow by around 10 percent this year, higher than the target of fiscal revenue growth of around 7 percent set in the budget earlier this year.

The Chinese government will continue to firmly promote structural reforms and opening-up, and strengthen communications. First, more work will be done to streamline administration, delegate powers, and transform government functions so that the market can play a decisive role in resource allocation. Second, major reforms are to be implemented in fiscal and tax, the financial sector, judiciary, and areas bearing on people's livelihood, and environmental protection to promote sustainable economic growth. Third, the opening up of the Chinese economy will be further deepened to facilitate integration into the global economy.

The Hong Kong economy expanded by 2.8 percent in the second quarter of 2015, up from 2.4 percent in the preceding quarter. The domestic sector held remarkably resilient, thereby cushioning the overall economy against the lull in external trade. The labor market remained in a state of full employment. The unemployment rate edged down to 3.2 percent in the second quarter. The underlying consumer price inflation continued its easing trend, down further to 2.5 percent in the second quarter from 2.7 percent in the preceding quarter. Looking ahead, the real GDP growth forecast for 2015 as a whole is 2-3 percent. With the actual inflation outturn so far this year somewhat lower than expected, the forecast rate of underlying consumer price inflation for 2015 is 2.6 percent.

In the first half of 2015, Macao SAR's GDP shrank by 25.4 percent in real terms with contraction in service exports, but experienced consistent growth in private consumption and investment. On the other hand, the unemployment rate stabilized at the low level of below 2.0 percent, the public finance remained healthy with lingering surpluses, while the inflation rate eased to around 5.0 percent. With the continued adjustment of service exports, the Macao SAR economy is expected to record double-digit contraction for the whole of 2015.

2. SDR Review

China welcomes the IMF Executive Board's discussion of the *Review of the Method of Valuation of the SDR—Initial Considerations* in July. As noted in the report, the RMB is the only currency that has met the gateway export criterion but not included in the SDR basket. China fully recognizes that data transparency and operational issues are to be addressed before the RMB can become an SDR basket currency. In addition to actively preparing for reforms that we pledged during the Spring Meetings in April, China has implemented or will soon introduce the following reforms:

2.1 Enhance data transparency. China has officially subscribed to the SDDS, participated in the IMF's COFER survey, and is committed to participating in the IMF's Coordinated Portfolio Investment Survey and the BIS's International Banking Statistics by this year.

2.2 Develop representative RMB interest and exchange rates. For interest rates, the Ministry of Finance will issue three-month treasury bills on a weekly basis starting from October to improve market liquidity in this tenor. The three-month rate for treasury bills could serve as a representative RMB interest rate for calculation of the SDR interest rate basket. With regard to exchange rates, the China Foreign Exchange Trade System (CFETS) has published market-based benchmark RMB/USD exchange rates five times each trading day starting from August, one of which could be used as the RMB representative exchange rate for Fund operations and transactions.

2.3 Make China's interbank bond and foreign exchange markets accessible to foreign central banks. China announced to open interbank bond and foreign exchange markets to foreign institutional investors like central banks respectively in July and September this year. After the reform, reserve managers from the IMF's member countries are able to access freely China's interbank bond and foreign exchange markets, choose agents, and conduct hedging operations according to their needs without being subject to investment or currency exchange quota, and have more access to market data.

We believe that with the completion of these reforms, the RMB can meet the operational requirements for inclusion in the SDR basket. More efforts will likewise be made to continuously facilitate the international use of the RMB. We will fully respect the IMF's procedures and process in the SDR review with the hope that the RMB will be included as an

SDR basket currency in line with existing criteria during the Executive Board meeting later this year.

3. The Role of the IMF

As a quota-based institution, the IMF needs adequate representativeness and sufficient resources to safeguard global financial stability. We are deeply disappointed that the 2010 quota and governance reforms were not ratified by the extended deadline of September 15, 2015, which further undermines the credibility, legitimacy, and effectiveness of the Fund. Besides, the gap between calculated and existing quota shares for emerging market and developing economies has been widening. Thus, we call for all members to endeavor to complete the work on interim solutions that represent meaningful progress toward the objectives of the 2010 reforms by mid-December 2015. With that said, any interim solution should not substitute for the reform itself, and the 2010 reforms should remain the top priority. We also call for all stakeholders to expedite the work on the 15th General Review of Quotas and the quota formula review.

To safeguard traction of its policy advice, the IMF needs to continue to upgrade its crisis prevention capacity. We welcome the progress made in implementing the recommendations of the 2014 Triennial Surveillance Review (TSR), which has further strengthened the IMF's surveillance on macrofinancial linkages and macrocritical structural issues. With prolonged monetary accommodation in major advanced economies brewing financial imbalance in many countries, we support the Fund to continue to undertake research on the role of monetary policy in maintaining financial stability. Given the risk of secular stagnation in the global economy and the limited fiscal space in many countries, we particularly welcome the IMF's analysis on making public investment more efficient, and call for the IMF to maintain close cooperation with multilateral development banks in addressing the infrastructure gap in member countries.

To safeguard an inclusive and environmentally-sustainable growth, the IMF needs to further deepen its analysis on social and financial inclusions, while leveraging other multilateral institutions' expertise on other issues of importance. Moreover, we welcome the IMF's efforts to increase developing countries' access to all of the IMF's concessional facilities, improve its engagement with post-conflict and fragile countries, enhance the eligibility framework for Poverty Reduction and Growth Trust (PRGT), and support more flexible access to concessional and nonconcessional resources to better meet their financing needs.