

Su Ning: Continue to strengthen macroeconomic management and push forward balanced economic growth

Speech by Mr Su Ning, Deputy Governor of the People's Bank of China, at the Forum on Balanced Growth, Beijing, 23 November 2006.

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Ladies and gentlemen:

It is a pleasure for me to attend the Forum on Balanced Growth. In China's economic development, it is an important objective to push forward balanced economic growth and advance building of a harmonious society.

In recent years, under the leadership of the State Council, the PBC has implemented a sound monetary policy by adopting market-based measures to conduct macroeconomic management in coordination with other policies and has successfully restrained deflation and a new round of inflation, significantly improved the stability of economic and financial performance and contributed to a sustained, rapid, healthy and balanced development of national economy.

First, more importance has been attached to the forward-looking and scientific nature of monetary policy. To address emerging problems in economic performance, policy stance and strength was adjusted in a timely manner, and sound monetary policy was adopted to effectively prevent inflation and economic fluctuations.

Second, a market-based indirect management system has been gradually built. The framework under which the central bank adjusts base money to manage money and credit aggregate has been increasingly improved. The coordinated use of open market operations and other monetary policy instruments such as reserve requirement ratio hike, central bank lending withdrawal and rediscount has been increasingly strengthened. Market-based interest rate reform has steadily advanced, resulting in an increasingly important role of interest rate in monetary policy transmission and resources allocation. A managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies was adopted. The RMB exchange rate flexibility was strengthened, and market supply and demand played a role in exchange rate formation. Financial market expanded at a stable pace. The fundamental role of market in financial resources allocation was enhanced and monetary policy transmission mechanism was evidently improved in which monetary policy is transmitted from central bank to financial market, then to financial institutions, and finally has an impact on the real economy.

Third, greater emphasis has been laid on the coordination and cooperation between monetary policy and other economic policies. To deal with overheating in certain investment sectors and rising inflationary pressures since 2003, a combination of sound monetary policy and sound fiscal policy has effectively contained aggregate demand expansion. Meanwhile, cooperation with regulatory policy and industrial policy has been enhanced to encourage banks to build long-term risk management mechanism, and to increase the soundness of financial system, with a view to further improving industrial structure, controlling credit risks, supporting consumption expansion and increasing employment.

Since the beginning of 2006, the PBC has continued to implement a sound monetary policy by intensifying liquidity management in banking system and policy coordination between local and foreign currencies. A mix of monetary policy instruments was employed to optimize credit structure, appropriately adjust money and credit aggregate, producing an evident effect in macroeconomic management. At present, outstanding problems and imbalances in economic performance have eased, as featured in the slowdown of slightly fast momentum of economic development, decelerated growth of investment and industrial production. Excessive expansion of money and credit has been initially contained. The broad money M2 decelerated gradually after May. At end-September, M2 grew by 16.8 percent year on year, down 1.6 percentage points and 0.9 percentage points from that at end-2005 and the same period last year respectively, reaching the bottom of the year. The RMB exchange rate experienced both upward and downward movements, its flexibility still gradually strengthened. At end-September, the RMB against US dollar exchange rate closed at 7.9041 yuan, representing a cumulative appreciation of 4.65 percent after the exchange rate regime reform. In the third quarter, GDP increased by 10.4 percent year on year, decelerated by 0.9 percentage points from the growth

rate of 11.3 percent in the second quarter. The price level remained basically stable in the second quarter, and the Consumer Price Index (CPI) generally rose by 1.3 percent.

At present, the national economy is developing in the direction anticipated by macroeconomic management. However, problems in economic performance can not be neglected, especially long-standing structural imbalances such as excess savings rate, lower-than-desired consumption rate, which are unlikely to be solved overnight.

First, economic growth is overly depended on investment and export, and domestic consumption demand is relatively inadequate. The share of final consumption in GDP dropped from 62 percent in the 1980s to 52.1 percent in 2005, and household consumption rate declined from 48.8 percent in 1991 to 38.2 percent in 2005, both hitting a record low. The savings rate climbed from 38.9 percent in 2001 to 47.9 percent in 2005, gaining 9 percentage points over the past five years. A relatively high savings rate as a product of the lower-than-desired consumption rate is transformed into high investment rate, which has resulted in an investment-driven economic growth, and made extensive economic growth pattern hard to change. Correspondingly, widening BOP imbalances give rise to excess domestic liquidity and stimulate excess investment and surging asset prices. Potential pressure on price stability has become a big challenge for macroeconomic management.

The balanced development of national economy is the prerequisite for rapid development of national economy, and the main content of sustainable and healthy economic growth as well as objective requirement for harmonious social and economic development. In the period ahead, the PBC will continue to implement a sound monetary policy, focusing on both short-term liquidity management and medium and long-term objectives to further intensify economic structural adjustment and promote balanced growth of economy.

First, the relationship between domestic and external demand will be appropriately dealt with by further expanding domestic consumption demand and reducing reliance on external demand. The coordination among the macroeconomic policies such as fiscal policy, monetary policy, foreign trade policy, industrial policy and investment policy will be improved by means of expanding consumption and domestic demand, lowering savings rate, boosting import and opening up market, as so to advance economic structural adjustment and promote BOP equilibrium.

Second, monetary policy transmission mechanism and environment will be improved to enhance the effectiveness of monetary policy. Efforts will be made to promote the evolution and improvement of financial market, deepen the reform of financial enterprises and state-owned enterprises. Government function in economic management should be further transformed. Indirect macroeconomic management mechanism should be improved to safeguard and promote sound performance of financial system.

Third, market-based interest rate reform will be progressed steadily. Efforts will be made to improve an interest rate formation mechanism based on market supply and demand and adjusted by central bank through monetary policy instruments. Market expectation shall be effectively utilized to enhance transparency and credibility of monetary policy.

Fourth, the coordination and cooperation between monetary policy and other economic policies should be strengthened. In line with division of labor, monetary policy and financial supervision authorities will enhance their coordination in line with the long-term development plan for financial market system construction to promote an all-round, balanced and sustainable development of financial industry. The coordination and cooperation between monetary policy and industrial policy will also be improved. According to national economic development plan, financial institutions should be guided to earnestly implement the requirement of national industrial policy by further improving credit structure and upgrading financial service.

Fifth, the share of direct financing will be further increased. Bond market will be vigorously expanded by encouraging bond products innovation and encouraging institutional investor development. Cultivation of transaction entities and intermediary institutions will be intensified, and fundamental institutional building of bond market will be expedited to further push forward the balanced development of financial market.

Ladies and gentlemen, on December 11, 2006, the transitional period under China's WTO commitment will expire, and China's economic reform and development will definitely enter into a new historical era. As the central bank, the PBC will further strengthen and improve macroeconomic management, actively promote financial reform and opening up, in an effort to create a favorable macroeconomic environment for sustained, stable and healthy development of national economy.

Thank you.