

Yi Gang: Global economic developments, the outlook for China and the need for IMF reform

Statement by Mr Yi Gang, Governor of the People's Bank of China, at the Ministerial Meeting of the 38th Meeting of the International Monetary and Financial Committee (IMFC), Bali, Indonesia, 14 October 2018.

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I. Global Economic and Financial Development

The global economy has continued to recover but the pace has become less synchronized, and growth momentum has weakened. Growth and inflation dynamics in major advanced economies have diverged recently. In the United States, growth has been strong. In the Euro Area, Japan, and the United Kingdom growth has slowed down. In the Euro Area and Japan, inflation is lower than expected, while in the United States and the United Kingdom, inflation is close to or above targets. Emerging markets and developing countries have generally registered rapid growth, but performance has continued to vary across different groups of economies. In energy exporting countries, growth has strengthened due to rising oil prices. Tighter financial conditions, increased risk aversion, certain domestic factors, and geopolitical uncertainties have resulted in slower growth and mounting pressures in the foreign exchange and financial markets in some emerging economies.

Downside risks to global growth warrant close attention, with trade protectionism and rising trade tensions being major risks facing the global economy. As countries become increasingly integrated and interconnected against the backdrop of economic globalization, their industrial and financial systems have closely linked to each other. The rising trade protectionism, friction and policy uncertainties have begun to dampen global business confidence and resulted in increased financial market volatility. Investment and trade as well as economic growth have also been dragged. In the medium and long term, trade protectionism could also disrupt global production chain, supply chain and value chain, hampering technological innovation, and ultimately suppress growth potential. Therefore, continued efforts are needed to strengthen macroeconomic policy coordination, oppose all forms of trade and investment protectionism, and jointly promote global investment and trade liberalization.

Abrupt tightening of global financial conditions could have a negative impact on financial markets. With relatively ample global liquidity, asset prices have been at record high. Should financial conditions tighten, asset prices may fall abruptly, triggering disorder portfolio realignment as well as more volatile exchange rate movement and capital flows. Countries should continue to push forward financial sector reforms, enhance global safety net, and improve the stability and resilience of the international monetary system in a coordinated manner.

While the global economy has continued to recover, the window of opportunity to push forward reforms has been narrowing. Countries should take advantage of the still favorable environment to press ahead with monetary, fiscal, and structural reforms, so as to maintain the recovery momentum, enhance growth potential, and make their economies more resilient and inclusive. Fiscal policy should focus on rebuilding buffers while accommodating growth needs. Monetary policy normalization in major advanced economies should be data-dependent and well communicated. The IMF should stand ready to provide necessary liquidity support. At the same time, efforts should be made to strengthen financial resilience, reduce leverage, and mitigate financial risks, so as to safeguard financial stability. Emerging market and developing countries should take steps to control contingent liabilities and balance sheet mismatches, curb financial market risks, monitor foreign currency debt exposures, and enhance resilience to financial tightening, capital outflows and commodity price volatility.

II. Economic and Financial Development in China

The Chinese economy has continued to grow steadily in 2018, with progress achieved in structural upgrading and efficiency improvement. In the first half of the year, GDP grew by 6.8 percent, and consumption and investment grew steadily. In August, total retail sales of consumer goods increased by 9.0 percent year-on-year; the manufacturing PMI registered 51.3; the nationwide survey-based urban unemployment rate stood at 5.0 percent, and CPI rose by 2.3 percent year-on-year. In the first eight months of this year, import and export maintained steady growth, and the total value of import and export of goods increased by 9.1 percent year-on-year, of which imports increased by 13.7 percent and exports increased by 5.4 percent. From January to August, China's trade surplus had narrowed by 33.4 percent. As of end-August, broad money M2 increased by 8.2 percent, and RMB loans grew by 13.2 percent. The authorities have focused more on the quality of economic growth, and growth has become more balanced. In the first half of the year, consumption contributed 78.5 percent to GDP growth, an increase of 14.2 percentage points over the same period of the previous year; contribution of the service sector to growth increased further to 60.5 percent, 1.4 percentage points higher than that in the same period of last year. At the same time, the use of clean energy has increased, and energy consumption per unit of GDP has been further reduced.

The financial sector as a whole is sound, and overall risks are in control. China has continuously taken measures to strengthen financial supervision and regulation. In the second half of this year, the State Council's Financial Stability and Development Committee has focused on the prevention and resolution of financial risks. The regulatory authorities have strengthened coordination to ensure orderly deleveraging. At the same time, the regulation of wealth management product, shadow banking, and internet finance has been significantly enhanced. As a result, risks are well contained and risk awareness and market discipline have been strengthened.

In 2018, China has continued to pursue prudent monetary policy stance, kept liquidity appropriate and ample, further improved the dual-pillar framework with focus on both monetary policy and macro-prudential policy, and actively pushed forward with financial reform and opening up. Since the beginning of this year, China has announced a series of important opening-up measures in the financial sector, including relaxing foreign equity caps on banks, securities firms, and insurance companies, easing restrictions on the establishment of foreign financial institutions in China with expanded scope of business. Most of the measures have been implemented, and the remaining ones are expected to take effect by the end of this year. Compared with efforts in the past, these measures are more intensive and broad-based. Foreign financial institutions will have greater presence in China, and China's financial industry is expected to be more competitive. In line with the principle of pre-entry national treatment with a negative list, China will take further steps to open up the financial sector in a proactive and orderly manner, and create a fair, friendly, and predictable business environment.

Looking ahead, China's monetary policy is expected to remain neutral with more focus on guiding expectations. Proactive adjustment and fine-tuning are needed to ensure that the monetary stance will remain appropriate in a changing economic and financial environment, both domestically and externally. It is expected that a well designed and implemented monetary policy will create a conducive financial environment for the supply-side structural reforms and high-quality economic growth. At the same time, China will continue to push ahead with the market-based reforms of interest rate and exchange rate regimes, and keep the RMB exchange rate broadly stable at an adaptive equilibrium level. China will continue to let the market play a decisive role in the formation of the RMB exchange rate. We will not engage in competitive devaluation, and will not use the exchange rate as a tool to deal with trade frictions. Since the beginning of this year, China has continued to implement proactive fiscal policies, and has adopted a series of measures to ease the burden on market participants. Fiscal policies have

been playing a greater role in expanding domestic demand and promoting structural adjustment.

Supported by robust external and domestic demand, the Hong Kong SAR economy sustained strong momentum with real GDP expanding by 3.5% year-on-year in the second quarter of 2018, marking the seventh quarter of above-trend growth. The labor market tightened further with unemployment rate edging down to 2.8%, the lowest level in more than 20 years. Overall inflation pressure remained moderate, and underlying consumer price inflation remained unchanged at 2.4% in Q2 2018. Notwithstanding the increased uncertainties in the external environment, domestic demand is expected to remain largely resilient and the Hong Kong SAR economic growth is forecasted to maintain at 3-4% for 2018 as a whole. Supported by service exports and private consumption, the Macao SAR economy grew by 7.6 percent in the first half of 2018. Private consumption increased by 5.1 percent and the unemployment rate fell to 1.9 percent while inflation rebounded to 2.7 percent. The fiscal account continued to record surplus. The Macao SAR economy is expected to maintain its positive growth trend in 2018 and 2019.

III. Reform of the IMF

The IMF should continue to support an open, inclusive, rules-based multilateral trade system. The recent rise of global protectionism highlights the importance of maintaining a strong multilateral trade system. Having in place a system of well-designed international rules is in the interest of all countries. China stands ready to enhance cooperation with all parties to support the liberalization and facilitation of trade and investment. Countries should jointly take measures against trade protectionism and strive to make economic globalization more open, inclusive, balanced and beneficial to all.

Continued efforts should be made to promote multilateral cooperation and strengthen policy coordination. Trade tensions need to be resolved in a rules-based multilateral trade system and in a constructive approach, promoting global trade and investment integration. Unilateralism and protectionism will in fact only exacerbate domestic imbalances and undermine the necessary structural adjustments, which will not only have a negative impact on the countries concerned, but also weigh on global growth. At the current juncture, multilateral mechanisms are particularly needed to play an active role in promoting global growth and safeguarding financial stability. With its near-universal membership of 189 countries, the IMF is well positioned to make unique contributions to this process. We expect the IMF to play a greater role.

The IMF should continue to push ahead with quota and governance reforms to ensure that the institution remains strong, quota-based, and adequately funded to preserve its central role in the global financial safety net (GFSN). Quotas are the building blocks of the IMF's financial and governance structure. They not only form the basis of the institution's lending capacity, but are also closely related to the institution's representativeness, governance, and legitimacy. If quota reviews fail to achieve the above objectives, the IMF's credibility will be compromised, and its ability to help member countries will be weakened. China is open to any constructive approach to complete the 15th General Review of Quotas in time, including general, selective, or ad hoc quota increases to reduce misalignment. The quota formula serves only as a tool to achieve our goal. It is important to set a goal that is less controversial and can garner broad political support to reach consensus. In addition, countries need to make continuous efforts to implement the agreed financial sector reforms in a coordinated manner, so as to improve the stability and resilience of the international monetary system.

The IMF should continue to help low-income countries improve their debt management. The past decade after the global financial crisis has actually been a period of relatively strong economic performance in low-income countries, especially in sub-Saharan Africa. China stands ready to strengthen coordination with the international community on debt issues. We will support the IMF's efforts to help low-income countries strengthen their debt management capability and improve institutional frameworks and governance structure. There is still room for

improvement in the IMF's Debt Sustainability Analysis (DSA) framework. Debt issues related to infrastructure should be properly addressed, as this type of debt could generate future economic returns. Therefore, it is advisable to take a balance-sheet approach, to analyze net debt, rather than gross debt, in order to provide better analysis on whether and how this type of debt should be restructured.

We welcome the IMF's work in the area of fintech, the Bali Fintech Agenda jointly developed by the IMF and the World Bank in particular, and support the IMF in using this Agenda as a framework for its work on fintech. To maximize the benefits brought by fintech while minimizing the associated risks, due consideration should be given to specific situations and needs of individual countries. We welcome the IMF's review of the AML/CFT Strategy to strengthen AML/CFT more effectively while ensuring the financial sector operating effectively. We support the IMF's efforts in strengthening its work on big data, cyber risks, and tax systems. Steps should be taken to promote international taxation cooperation and to jointly address the challenges of cybersecurity and climate change, promoting a more open, inclusive, balanced, and win-win global economy.

In recent years, the IMF has made significant progress in capacity building and continued efforts should be made in this regard. We support the IMF's work on capacity building to broaden its influence, including through the upcoming review. Capacity building should be better aligned with surveillance and lending activities, strategic partnerships with member countries should be strengthened. China will continue to deepen its cooperation with the IMF in capacity development.