International Monetary and Financial Committee

Thirty-First Meeting
April 18, 2015

IMFC Statement by ZHOU Xiaochuan
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On behalf of the People's Republic of China

Statement by the Honorable Zhou Xiaochuan

Governor of the IMF for China to the

Thirty-First Meeting of the International Monetary and Financial Committee

Washington, D.C., April 18, 2015

In 2015, the global economy continues to face significant challenges as recovery remains uneven. In the meantime, the IMF will undertake the quinquennial SDR review. In this context, this statement focuses on how China views the economic and financial developments in China and at the global level, as well as the role of the Fund. It also provides an update on China's plans to make the RMB more freely usable.

1. Global economy and financial markets

Global economic growth remains stranded in low gear, with the economic recovery process remaining uneven and brittle among advanced economies, while emerging market economies are stymied by strong domestic and external headwinds. Going forward, the global economy is also subject to a myriad of challenges. In particular, asynchronous monetary policy in major advanced economies, abrupt changes in oil prices, and renewed geopolitical tensions may trigger another round of turbulence in the global financial market, while demographic pressures and insufficient economic risk-taking—notably inadequate investments—may continue to drag global growth over the longer term. Thus, comprehensive and powerful policy actions by all sides are needed to strengthen the global economic recovery.

In advanced economies, the policy stance should stay largely supportive, with due regard to the adverse spillovers to the global economy. In the U.S., the monetary policy stance should always be effectively communicated—taking into account the side effects from a prolonged accommodation—while domestic coordination is needed to safeguard the soundness of the fiscal system and bolster growth potential. In Japan, to boost growth prospects and fiscal sustainability, the pace of structural reforms must accelerate to avoid overburdening the monetary policy. In the euro area, the effectiveness of the latest monetary policy actions must be monitored closely, and crisis legacies must be resolved in order to facilitate the economic recovery. Structural reforms should continue to proceed, while fiscal policy stance must strike a good balance between supporting growth and maintaining fiscal sustainability.

Being the major driver of global growth, emerging market economies are in the process of consolidating or enhancing their economic recovery. Any remaining macrofinancial vulnerability should be addressed promptly through adjustments in macroprudential policies. Taking the opportunity offered by lower oil prices, the design of the fiscal system should be improved in an environmental-friendly and growth-enhancing way. Meanwhile, structural reform and transformation efforts must persevere to boost the business climate, enhance inclusiveness, counter demographic pressure, and promote trade and financial integration.

To safeguard the robustness and sustainability of global growth, multilateral efforts— in addition to national efforts—are also needed. In particular, the multilateral trade system should be reignited, while efforts on completing the financial regulatory reform agenda must be sustained, with due regard to the consistency of implementation in different economies. Meanwhile, the role of women in the economy should continue to be strengthened, while efforts should be made to address climate change and income inequality. Finally, multilateral organizations should strengthen their representations in the changing global economic landscape, and cooperate with the international community closely in promoting sustainable development of the global economy.

2. The Chinese economy and policies

The Chinese economy is transiting toward its new normal. Amidst continued structural adjustments and absorption of the post-crisis stimulus effects, the real GDP growth rate edged down from 7.7 percent in 2013 to more sustainable rates of 7.4 percent in 2014 and 7.0 percent in the first quarter of 2015. However, thanks to the ongoing urbanization, increasing consumption, and the growing tertiary sector, job creation remains firm, while the current account surplus stays subdued, with the renminbi registering increasing two-way movements. Meanwhile, inflationary pressure remains contained—with the CPI inflation rate dropping from 2.6 percent in 2013 to 2.0 percent in 2014 and 1.2 percent in the first quarter of this year—due to the moderation in food and oil prices. The banking sector remains in good shape, despite some pickup in nonperforming loans.

While China's macrofinancial condition remains stable, the economy is facing some downward pressure. Thus, the Chinese government will maintain the continuity and stability of the monetary policy to ensure reasonable credit growth and liquidity, while at the same time facilitating the economic transition currently under way. Meanwhile, fiscal policy will continue to be proactive in supporting the economy—including through tax cuts, provisions of public goods and services, and infrastructure investment—with the sustainability of local government debt being safeguarded by better regulations in local government finance. On the other hand, the Chinese government will stay vigilant on nonbank financing, which will be supported by continued efforts to enhance the regulatory framework, and deploy macroprudential measures, as appropriate, so as to guard against systemic financial risks. The Chinese government will also continue to implement a differentiated housing mortgage policy to support the healthy housing demand, alongside other efforts to boost household consumption.

At the same time, the Chinese government will continue to deepen reforms and expedite structural adjustments, with due regard to the need to advance the rule of law. In particular, financial and exchange rate reforms will continue to proceed, including through: (1) speeding up interest rate liberalization; (2) further increasing the flexibility of the renminbi exchange rate; (3) further promoting capital account convertibility and making the renminbi more freely usable, as well as relaxing foreign exchange regulations, and; (4) sustaining efforts on establishing a multi-layered capital market. Meanwhile, the development of the New Silk Road Economic Belt and the 21st Century Maritime Silk Road will be pushed forward to further open up and integrate China with the global economy, while urbanization, hukou, and fiscal reform will continue to be undertaken. Environmental protection will also continue to be strengthened, while SOE and land reform will be implemented.

The Hong Kong SAR economy grew modestly by 2.3 percent year-on-year in 2014, as the slow global economic recovery weighed on exports of goods, tourist spending slackened, and domestic demand also weakened. The labor market remained in a state of full employment, with the unemployment rate staying low at 3.3 percent in the fourth quarter. Underlying consumer price inflation trended lower to 3.5 percent, thanks to the mild global inflation and receding local cost pressure. Looking ahead, the Hong Kong SAR economy is forecast to grow by 1-3 percent in 2015. Meanwhile, consumer price pressures should remain tame and the underlying composite CPI is expected to increase by an average of 3 percent.

The Macao SAR economy shrank 10.2 percent in the second half of 2014, following a 10.5 percent growth in the first half, attributable to a sharp decline in the export of tourism services. For the whole of 2014, the Macao SAR economy contracted slightly by 0.4 percent. The unemployment rate stabilized at a low level of 1.7 percent, while the inflation rate stayed at a relatively high level of 6.0 percent. In 2015, the Macao SAR economy would continue to undergo an adjustment process with slow output growth.

3. The role of the IMF

To uphold multilateralism and safeguard international monetary stability, the Fund—as a quota-based institution—needs to be representative and have adequate resources. To avoid further undermining the legitimacy of the Fund, we urge the U.S. to ratify the 2010 quota and governance reform at its earliest opportunity, and any interim step should represent a meaningful advance to the goals of the 2010 reform without substituting for the reform itself. We also call for all stakeholders to endeavor to complete the 15th General Review of Quotas and the quota formula review by the new deadline of December 15, 2015. Meanwhile, we look forward to the upcoming quinquennial SDR review, given its pivotal role in strengthening the SDR’s representation of the multilateral global economy, and in contributing to the reform of not only the international monetary system but also the individual member’s financial system.

To sustain its hard-earned gain in popularity in recent years, we encourage the Fund to continue to sharpen its surveillance toolkits. In particular, we view that the spillover of reserve currency-issuing countries’ monetary policies to the foreign exchange market should receive greater attention in the Fund’s work, while any proposal on assessing reserve adequacy and foreign exchange interventions should only be implemented if there is consensus. While we welcome the Fund to further deepen its analysis of the macroeconomic implications of financial sector development, environmental sustainability, and macrocritical trade issues, we agree that, given its resource constraint, the Fund should stick to its areas of comparative advantage—including on analyzing macroeconomic and financial policy, mobilizing domestic resources, and catalyzing international financing support—and continue to collaborate closely with other institutions, including the World Trade Organization, the World Bank, and the Bank for International Settlements.

To safeguard the inclusiveness of global growth, we encourage the Fund to continue to provide full-fledged support to low-income countries (LICs) and contribute to global poverty reduction. We are pleased to see the two-year extension of the interest waiver on Poverty Reduction and Growth Trust (PRGT) loans, and the consistency of the waiver with the self-sustainability of the Trust. We also welcome the provision of a second round of concessional loans to Ebola-hit countries, and the establishment of a new Catastrophe Containment and Relief (CCR) Trust. While the reform of the policy on public debt limits in Fund-supported programs will provide the LICs with more flexibility in using concessional and nonconcessional loans, it should be implemented in a transparent and even-handed manner, with due regard to country-specific circumstances.

4. China's plan to make the RMB more freely usable

This year, the Fund will conduct its quinquennial SDR review. One important issue in the review will be whether the RMB will be included in the SDR currency basket.

One of the criteria for an SDR currency is that the currency must be "freely usable," which requires a certain degree of capital account convertibility. The goal of achieving capital account convertibility was first put forward in the early 1990s by China, and was reiterated in the 12th Five-Year Plan and at the Third Plenum of the 18th CPC Central Committee. Over the last two decades, China has been making steady progress toward achieving this goal, despite the adverse impact of the Asian financial crisis and the global financial crisis. 2015 is the year of the SDR review, as well as the last year of the 12th Five-Year Plan. China is prepared to take a series of targeted reforms to further increase RMB capital account convertibility.

RMB capital account convertibility: An overview of history

At the Third Plenum of 14th CPC Central Committee in 1993, China set the goal of "gradually making the RMB a convertible currency." In 1996, China achieved current account convertibility, and announced it would seek to achieve capital account convertibility. However, this process was delayed by the Asian financial crisis that erupted soon after. At the Third Plenum of the 16th CPC Central Committee in October 2003, China once again made it clear that it would "gradually achieve RMB capital account convertibility."

From then on, much progress has been made in streamlining foreign exchange management and promoting capital account convertibility: the RMB has largely become convertible for foreign direct investment (FDI) and outward direct investment (ODI); registration-based management has been adopted for trade credit and trade-related claims on nonresidents, and only external debt remains subject to quota management; Qualified Foreign Institutional Investors (QFII) and Qualified Domestic Institutional Investors (QDII) programs have been introduced and improved.

The process of RMB capital account convertibility was interrupted again by the global financial crisis in 2008. At the same time, due to the shortage of hard currencies and increased volatility among major currencies, the demand for the RMB in many countries has increased. In response, China began to facilitate the use of the RMB in cross-border trade and direct investment; expanded RMB cross-border financial investment in a sound and orderly manner, including by allowing foreign institutions to invest in the domestic interbank market and launching the RMB Qualified Foreign Institutional Investor (RQFII) program; continuously deepened bilateral monetary cooperation, with 28 bilateral local currency swap agreements signed; promoted the steady development of offshore RMB markets, and established RMB clearing banks in 14 countries/regions. These steps have not only supported the fast development of RMB internationalization, but also further strengthened RMB capital account convertibility.

In 2011, the goal of "gradually achieving RMB capital account convertibility" was reiterated in the 12th Five-Year Plan. At the Third Plenum of 18th CPC Central Committee in 2013, it was announced that China would seek to "speed up the process toward RMB capital account convertibility." The China (Shanghai) Pilot Free Trade Zone was established in 2013. In the second half of 2014, the Shanghai-Hong Kong Stock Connect was successfully launched, representing an important step in the liberalization of the capital market.

At present, there are only a few capital account items that are completely inconvertible. According to the IMF's classification of capital account transactions, 35 out of the 40 items are fully or partly convertible in China, and only five items remain inconvertible. These five items mainly involve individual cross-border investment and the issuance of shares and other financial instruments by nonresidents on domestic markets. Therefore, China is not far from achieving its goal of RMB capital account convertibility.

China's plan to make the RMB a more freely usable currency

In 2015, China plans to launch a series of reforms that target currently inconvertible items under the capital account, with the aim of further promoting capital account liberalization and making the RMB a more freely usable currency.

First, China will create channels for cross-border investments by individual investors, including by launching the pilot Qualified Domestic Individual Investor (QDII2) program. Second, China will introduce the Shenzhen-Hong Kong Stock Connect program, and nonresidents will be allowed to issue financial products on the domestic markets with the exception of derivatives. Third, foreign exchange regulations will be revised to remove requirements for ex ante approvals in most cases, and an effective system for ex post monitoring and macroprudential management will be built. Fourth, measures will be taken to further facilitate access to the Chinese capital markets by overseas institutional investors. Fifth, efforts will be made to further facilitate the international use of the RMB by removing unnecessary policy barriers and providing the necessary infrastructure. Sixth, steps will be taken to ensure sound risk prevention.

It is worth noting that the concept of capital account convertibility has changed since the global financial crisis. The capital account convertibility China is seeking to achieve is not based on the traditional concept of being fully or freely convertible. Instead, drawing lessons from the global financial crisis, China will adopt a concept of managed convertibility. After achieving RMB capital account convertibility, China will continue to manage capital account transactions, but in a largely transformed manner, including by using macroprudential measures to limit risks from cross-border capital flows and to maintain the stable value of the currency and a safe financial environment. China will retain capital account management in the following four cases:

> First, cross-border financial transactions that involve money laundering, financing of terrorism, as well as those that overly exploit tax havens will be subject to monitoring and analysis. This is a practice widely adopted by most countries.
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> Second, macroprudential management of external debt remains necessary in emerging market economies. Excessive foreign debt in the private sector and significant currency mismatches were the origins of the Asian financial crisis. Countries need to learn the lesson from the crisis, and macroprudential measures could be used to manage their external debt when necessary.
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> Third, China will manage short-term speculative capital flows when appropriate, while lifting controls on the medium- and long-term capital flows that support the real economy. This is also a recommendation by the Fund.
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> Fourth, balance of payments statistics and monitoring will be strengthened. As suggested by the Fund after the global financial crisis, countries may adopt temporary capital control measures when there are abnormal fluctuations in the international markets, or there are balance of payments problems.