

CHINA 2019 ARTICLE IV CONSULTATION

ECONOMIC DEVELOPMENTS AND POLICY ISSUES

Kenneth Kang



International Monetary Fund
November 2019

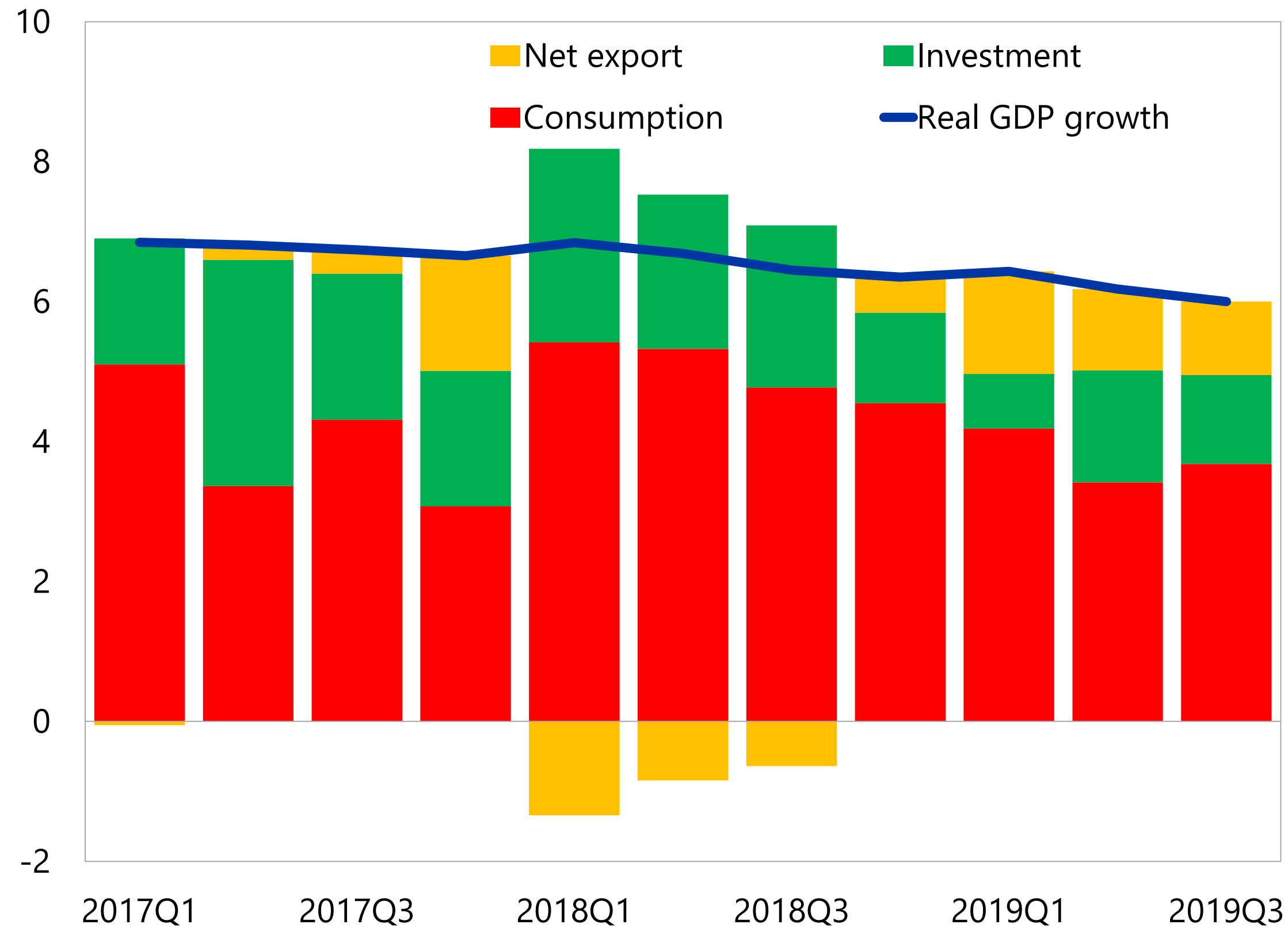
Main takeaways

- **Growth has slowed amid domestic regulatory tightening and rising trade tensions. The outlook remains uncertain with risks tilted to the downside.**
- **Progress in reforms continues, in particular for financial deleveraging and opening up, while SOE reform has been slow.**
- **To navigate the highly uncertain global environment, policy priorities are:**
 - *Adjust macro policies to trade shocks and allow for a more flexible exchange rate*
 - *Work with trading partners to strengthen the international trading system*
 - *Stay the course on deleveraging*
 - *Contain external imbalances and further boost consumption*
 - *Accelerate non-strategic sectors opening-up, intensify SOE reforms, and modernize policy frameworks*

Growth was slowing even before the trade tensions...

Contribution share to real GDP: demand side

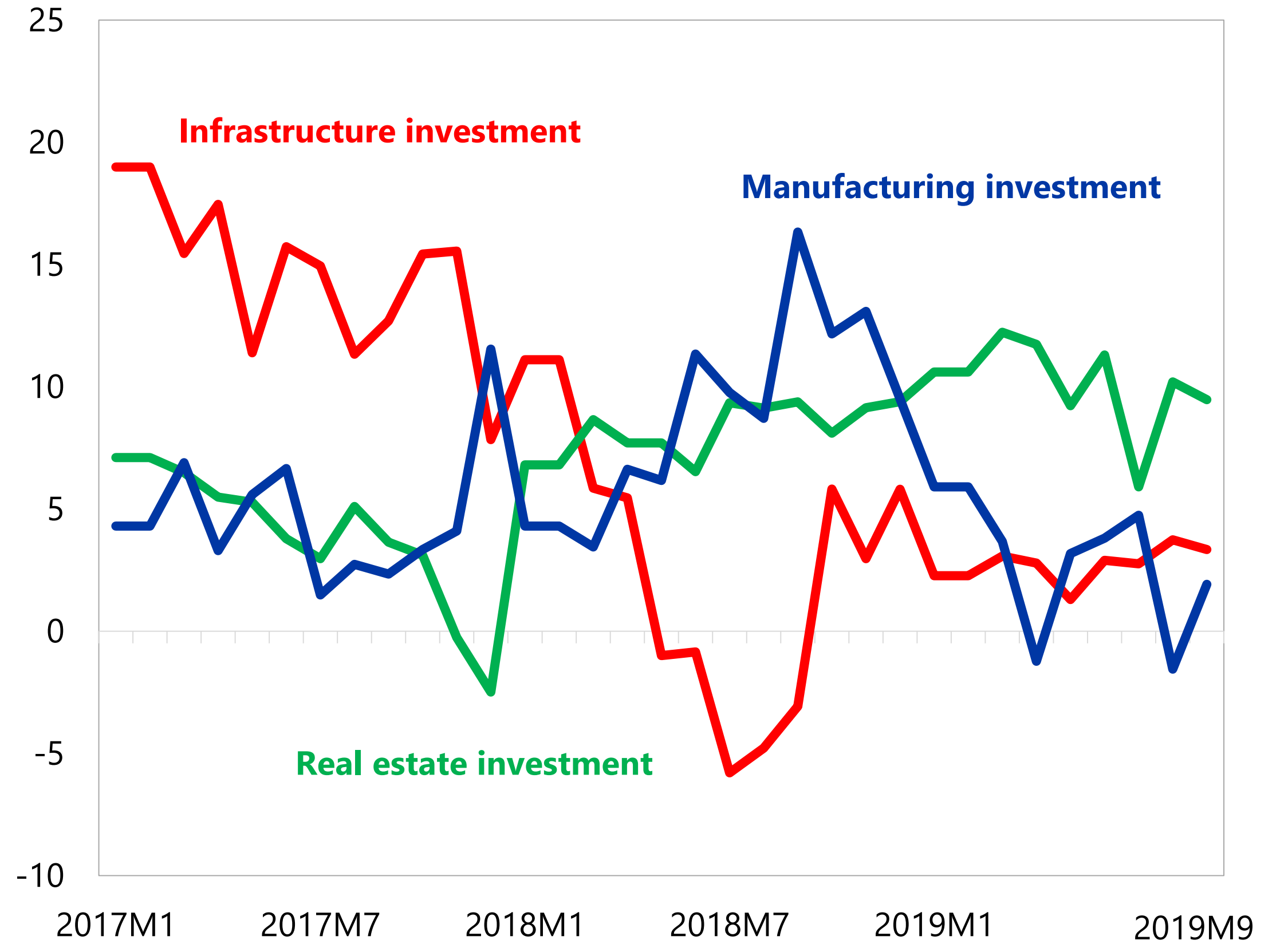
(In percent)



Source: CEIC.

Investment growth

(In percent, yoy)

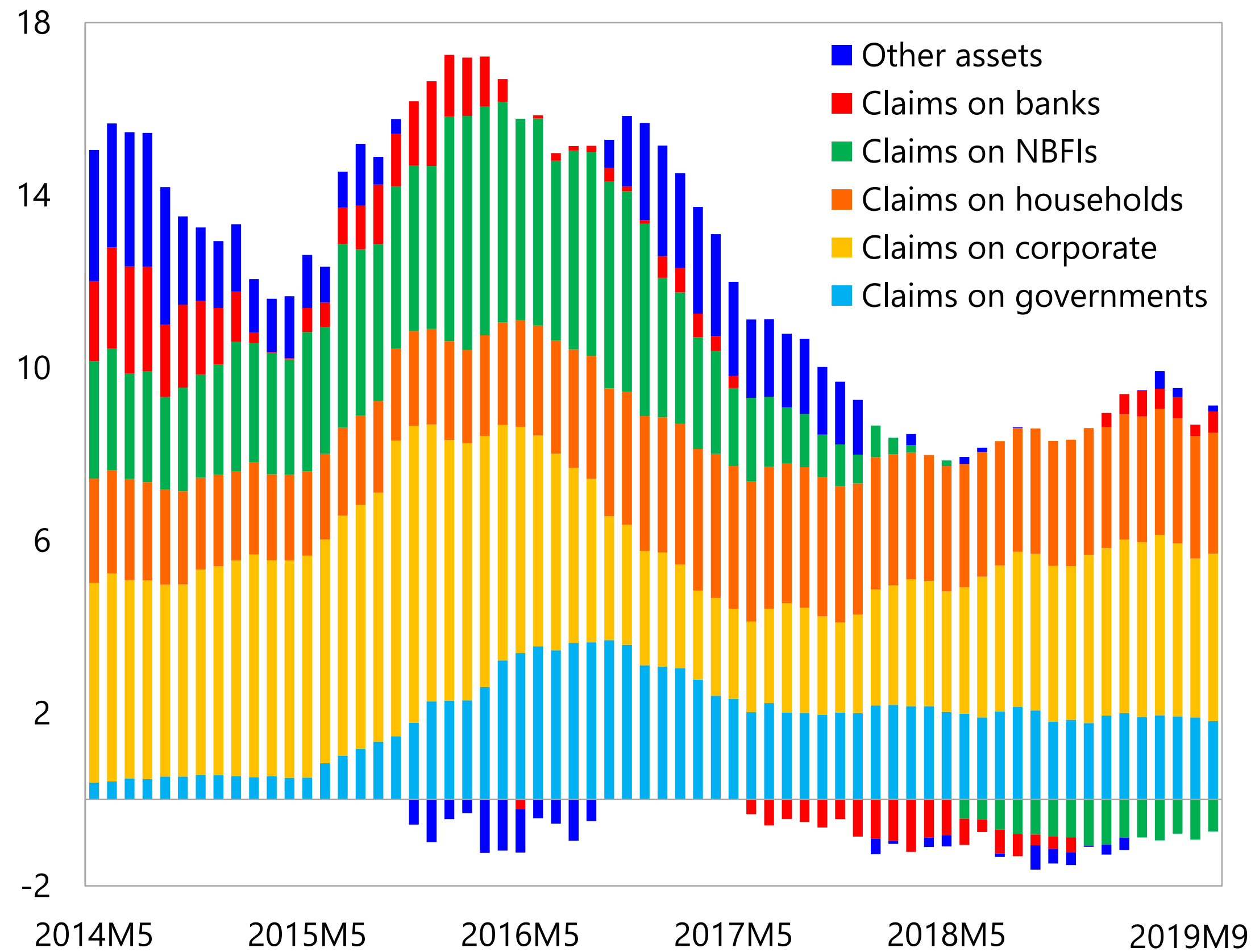


Source: CEIC.

...led by financial regulatory tightening which hit hard lending to private and smaller firms

Contribution to bank asset growth

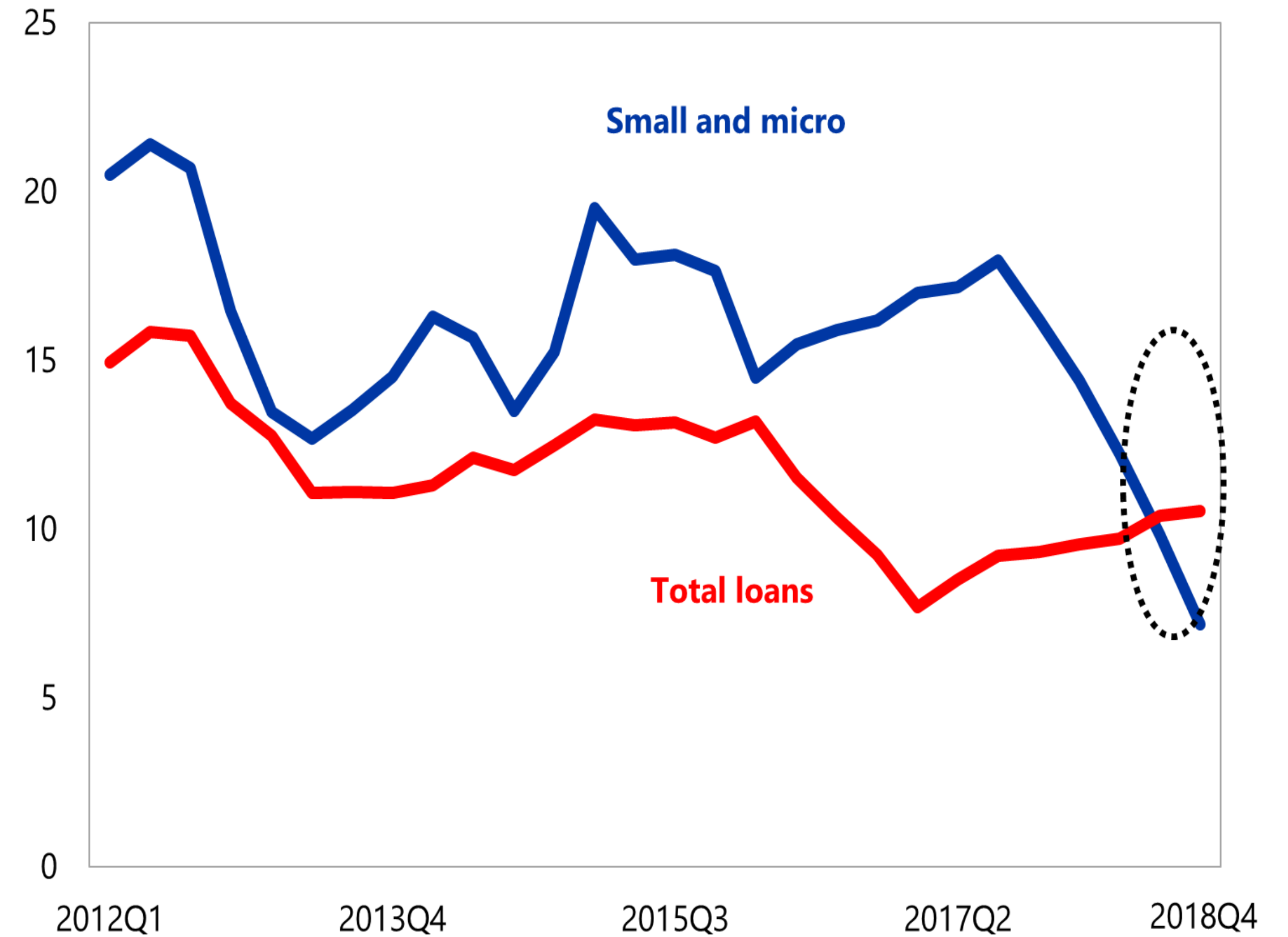
(In percent, year-on-year)



Source: Haver Analytics.

Loans to enterprises by size

(In percent, year-on-year)

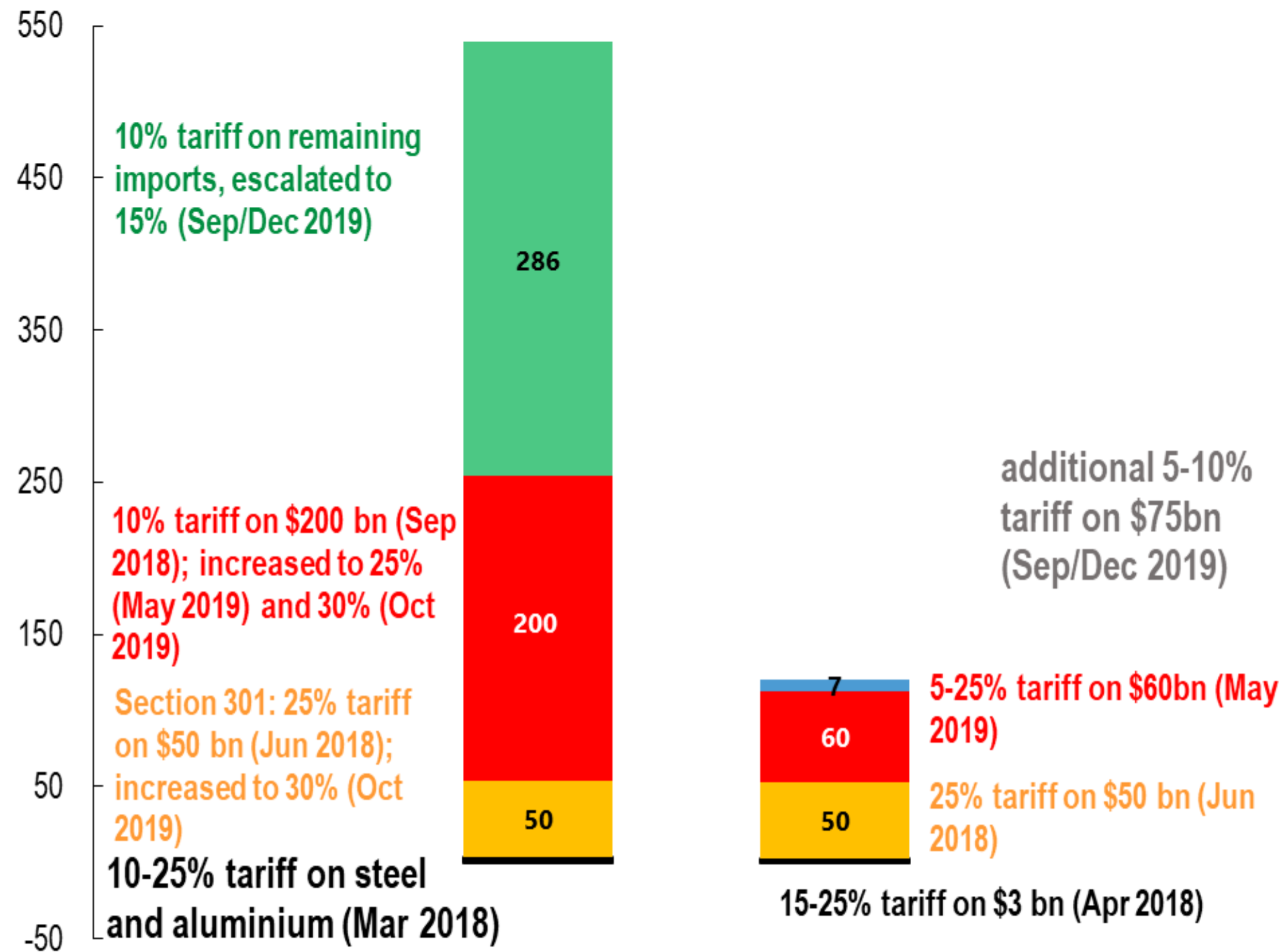


Sources: CEIC and IMF staff estimates.

Trade tensions with the U.S. have slowed markedly merchandise trade

Tariff announcements

(Goods trade 2018, in USD billions)

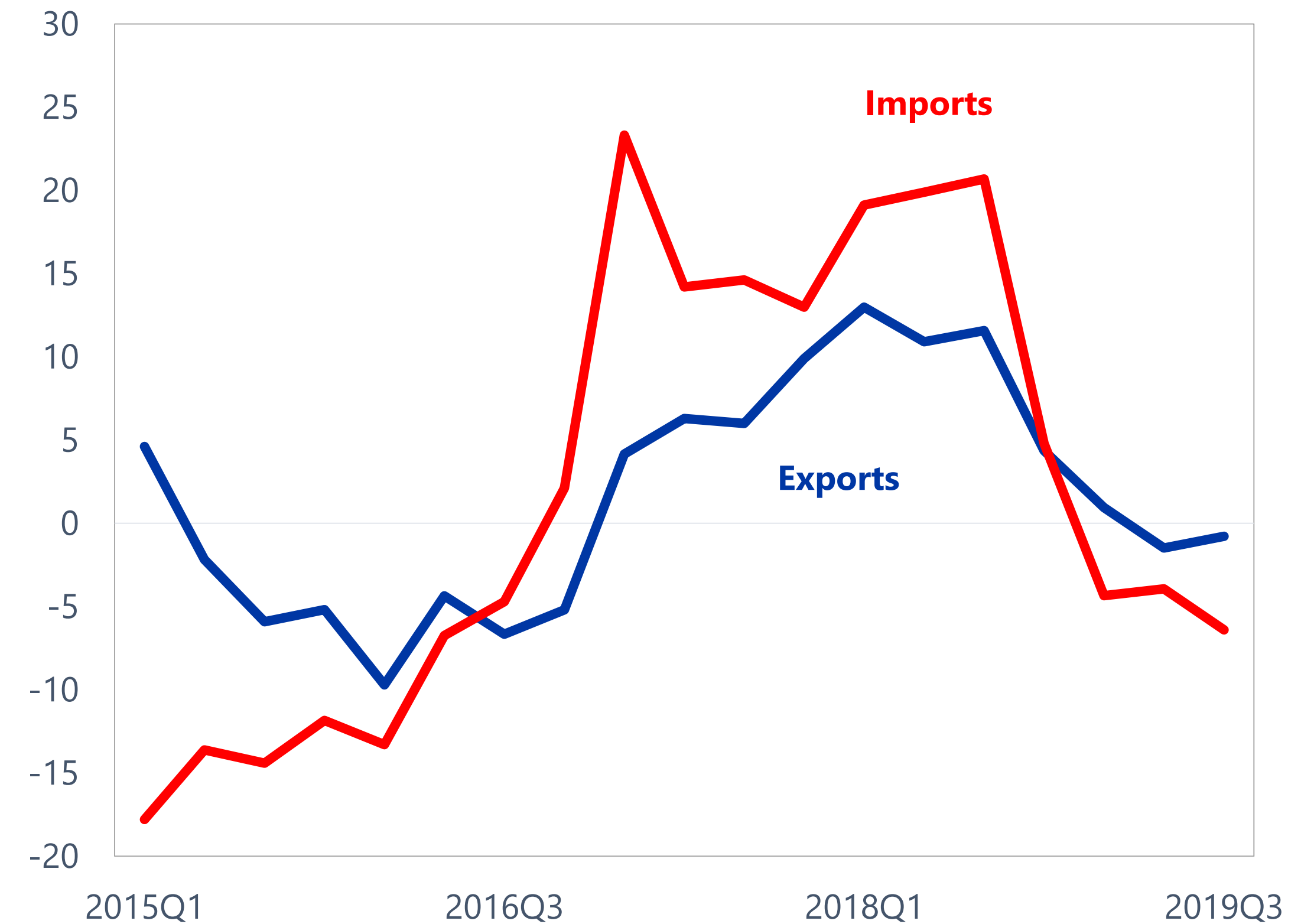


China exports to US

US exports to China

Nominal export and import growth

(Measured in USD, In percent, year-on-year)

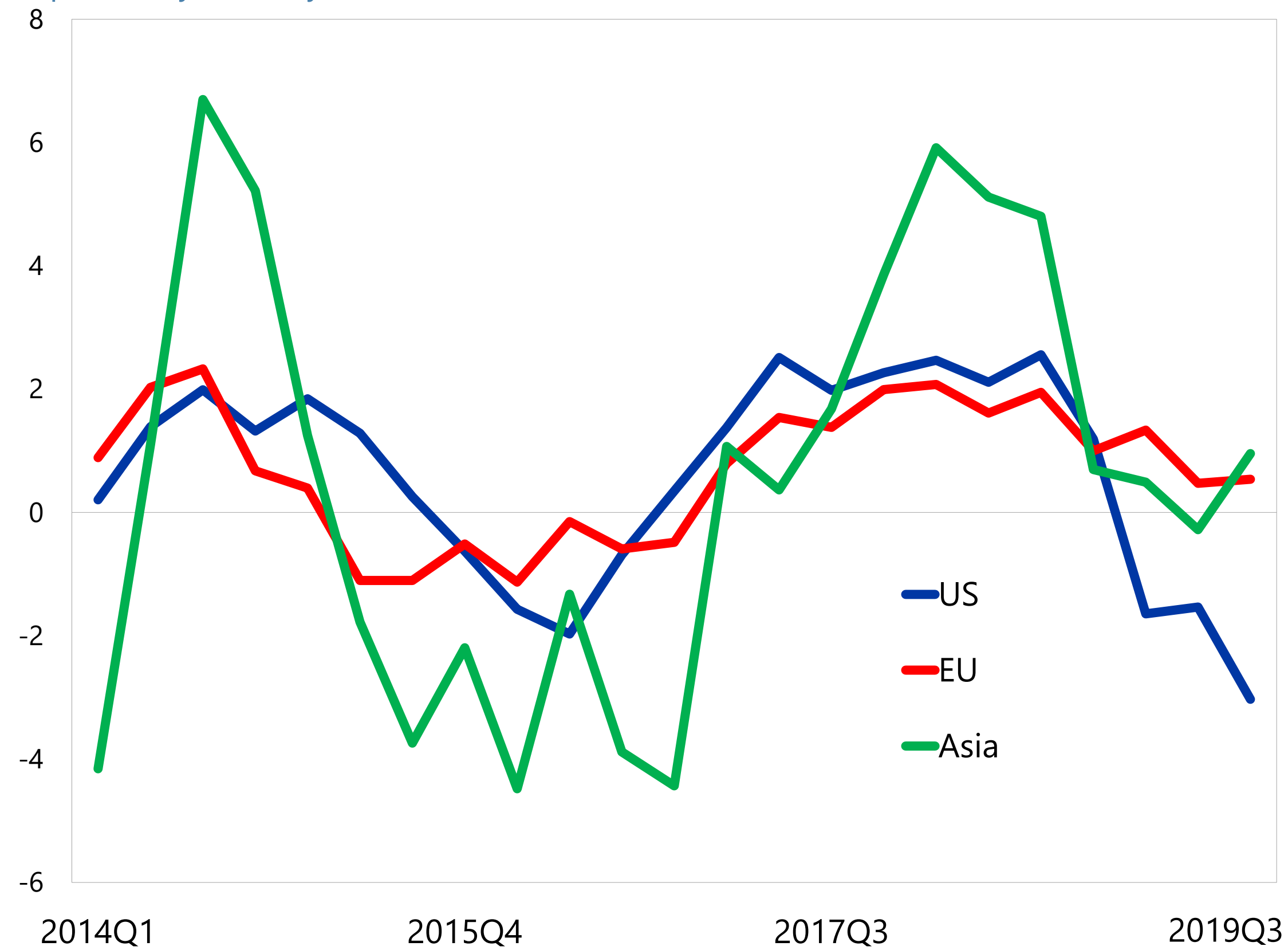


Source: CEIC and IMF staff estimates

China trade slowdown is broad-based, led by the U.S.

Export value growth, by destination

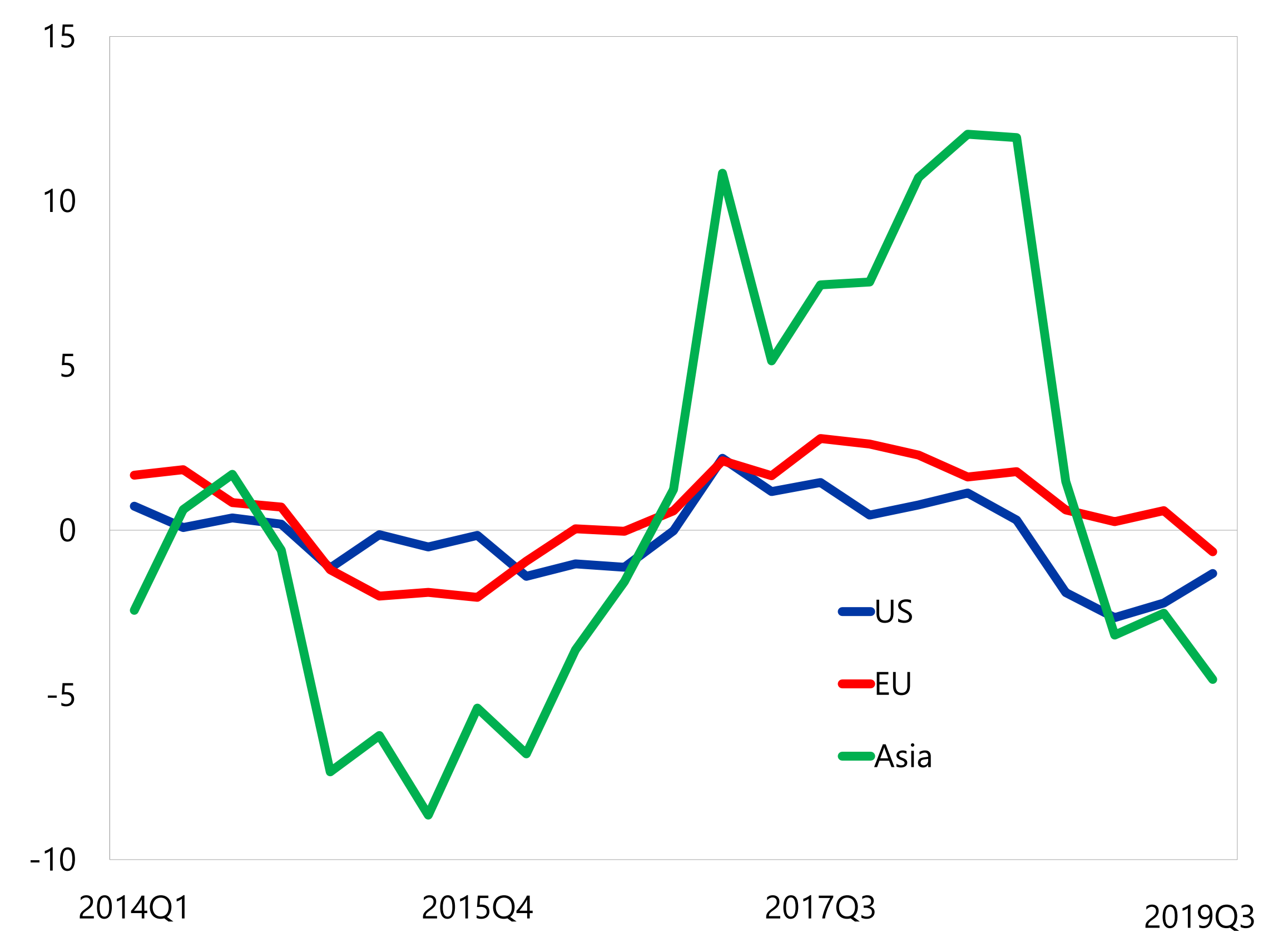
(In percent, year-on-year)



Source: CEIC and IMF staff estimates.

Import value growth, by destination

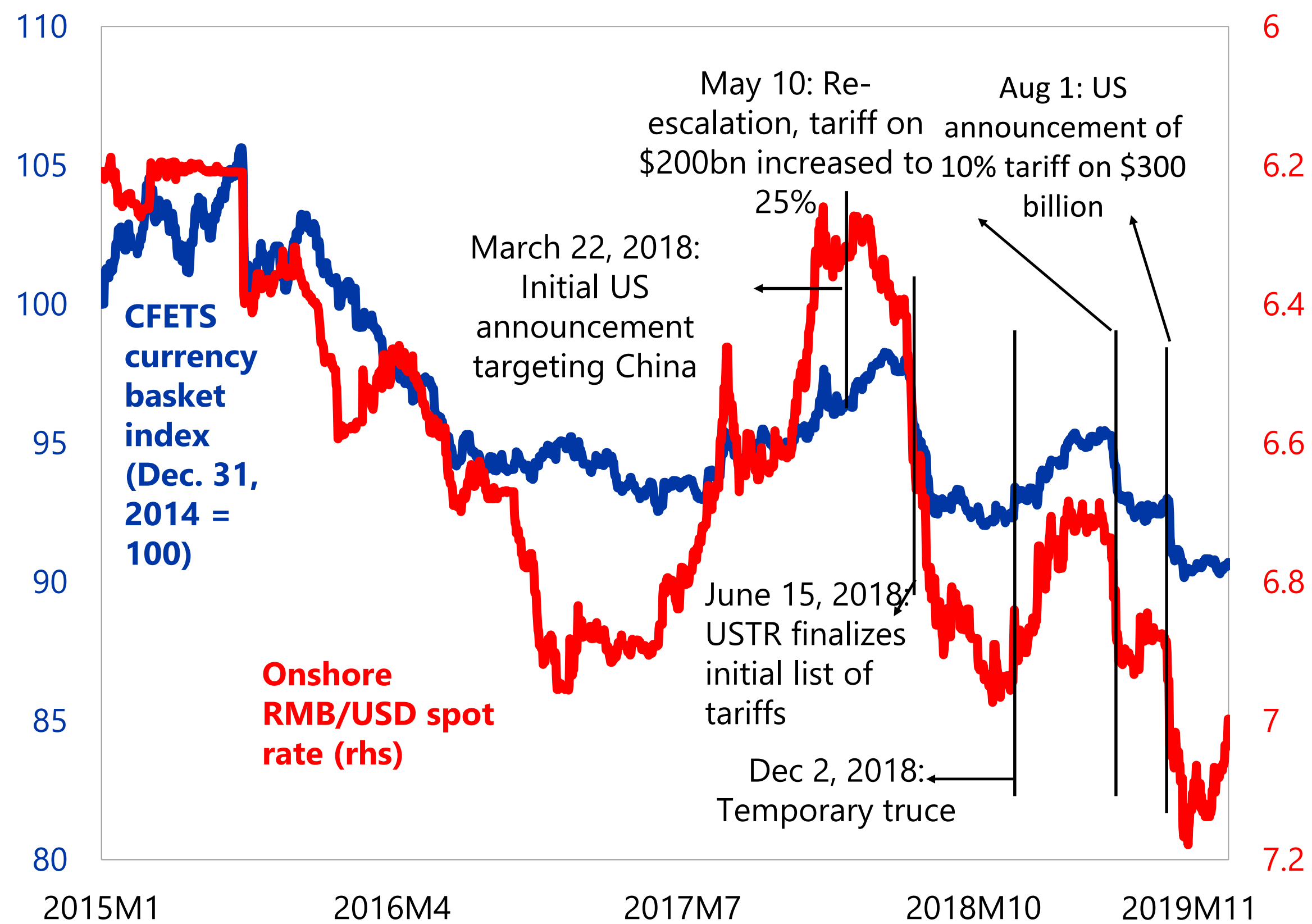
(In percent, year-on-year)



Source: CEIC and IMF staff estimates.

External tensions have put the exchange rate under pressure, but reserves remain adequate with few indications of large scale FXI

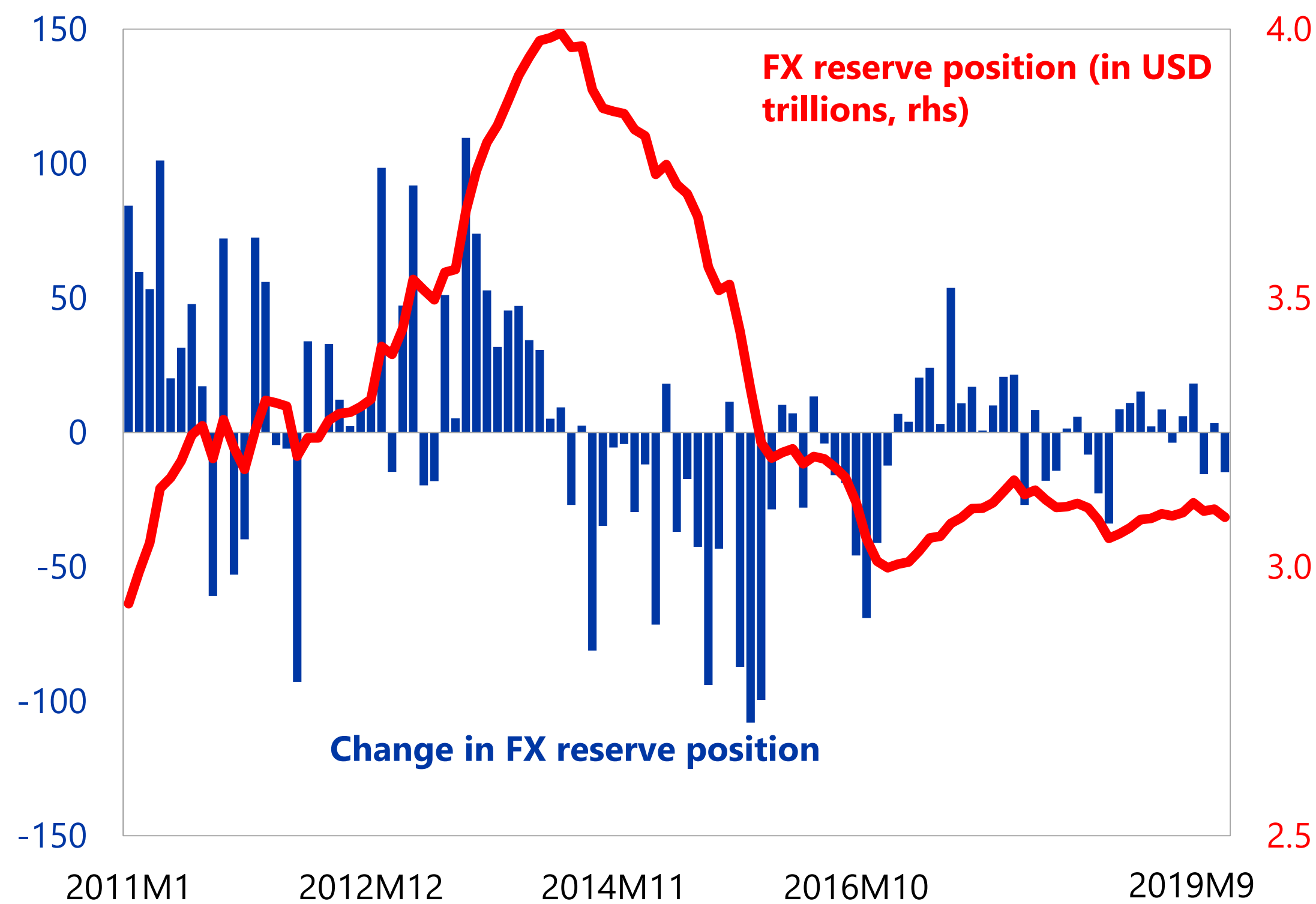
RMB exchange rates vs. the US dollar and CFETS index



Source: Bloomberg, IMF staff estimates.

Foreign exchange reserves

(In USD billions)

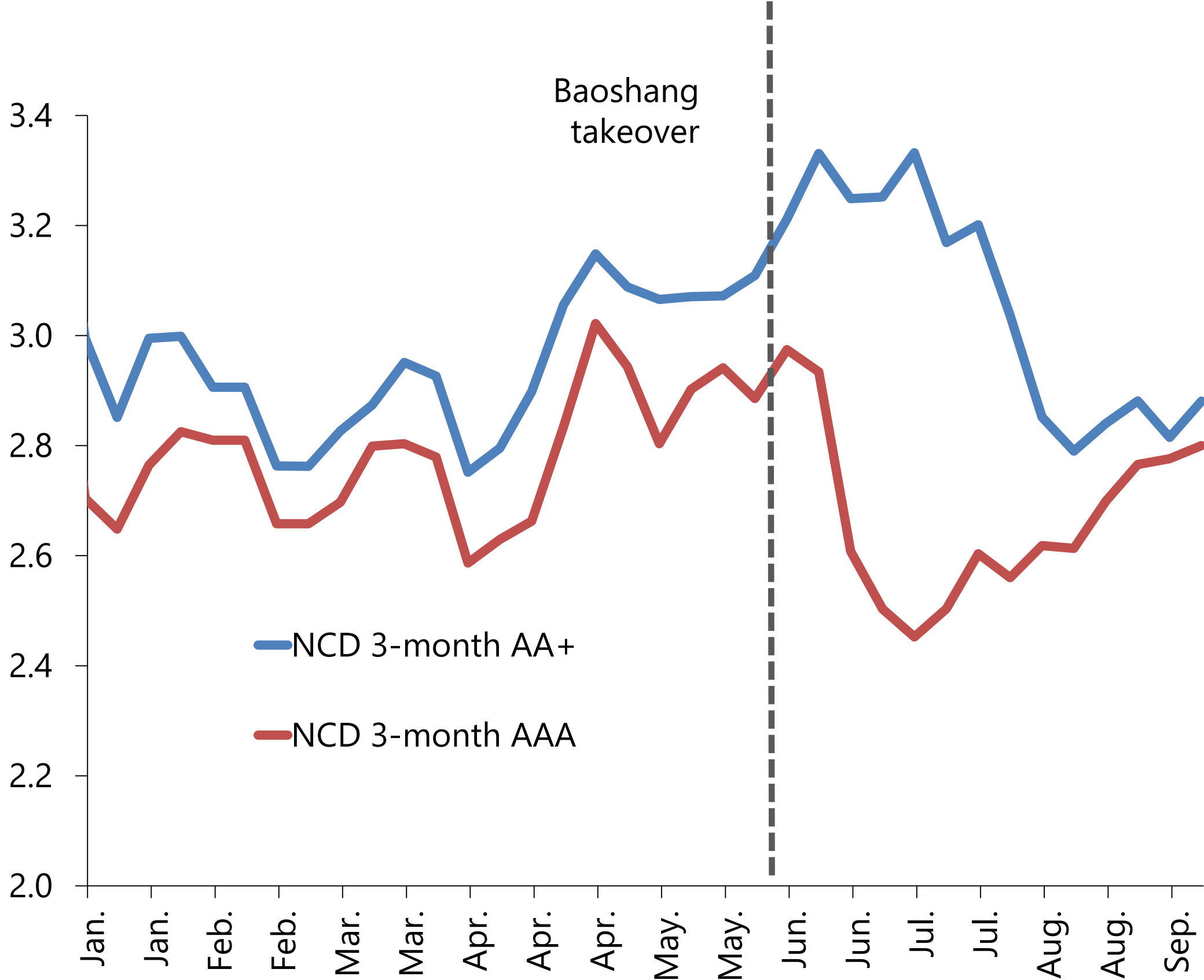


Source: Haver Analytics

Vulnerabilities in the financial sector remain elevated amid takeover of small banks

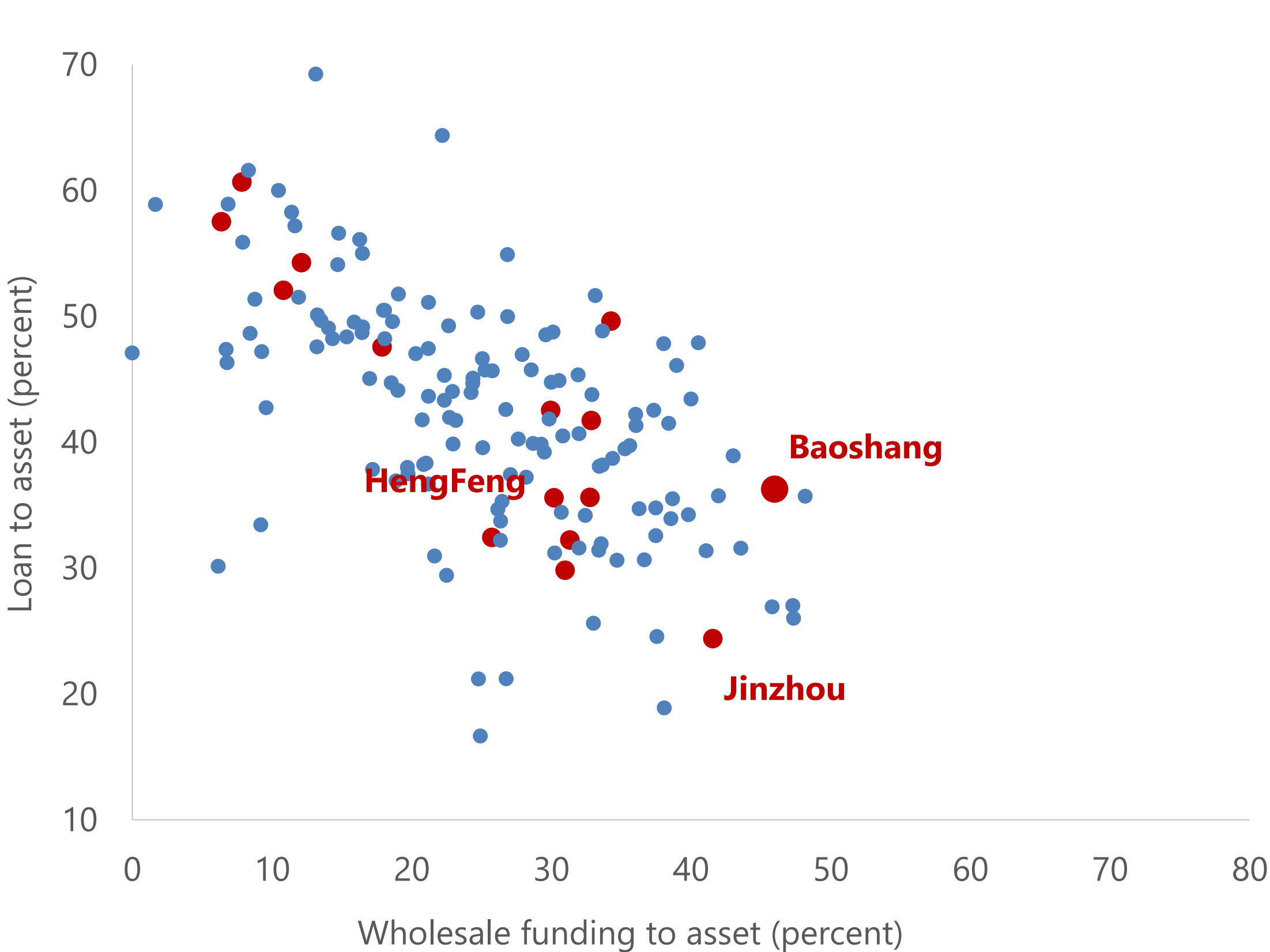
NCD Funding Costs, 2019

(Percent)



Source: WIND database

Many banks have similar risk profiles as Baoshang

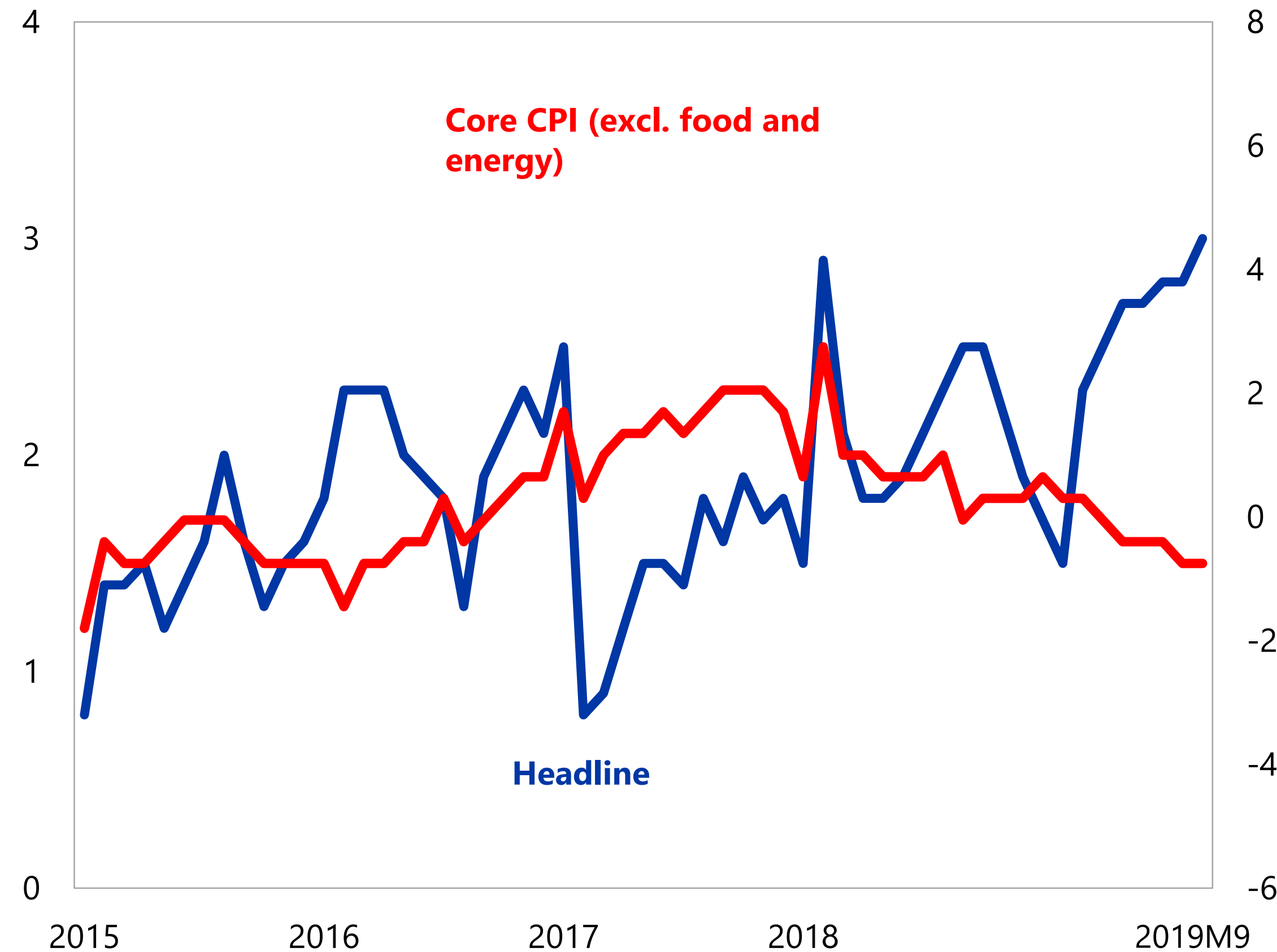


Source: SNL; data as of 2016 when data were released for banks in sample
 Note: Red dots = multiple delays in annual report publication or still unpublished reports

Inflation pressures remain contained, reflecting slowing growth

CPI Inflation

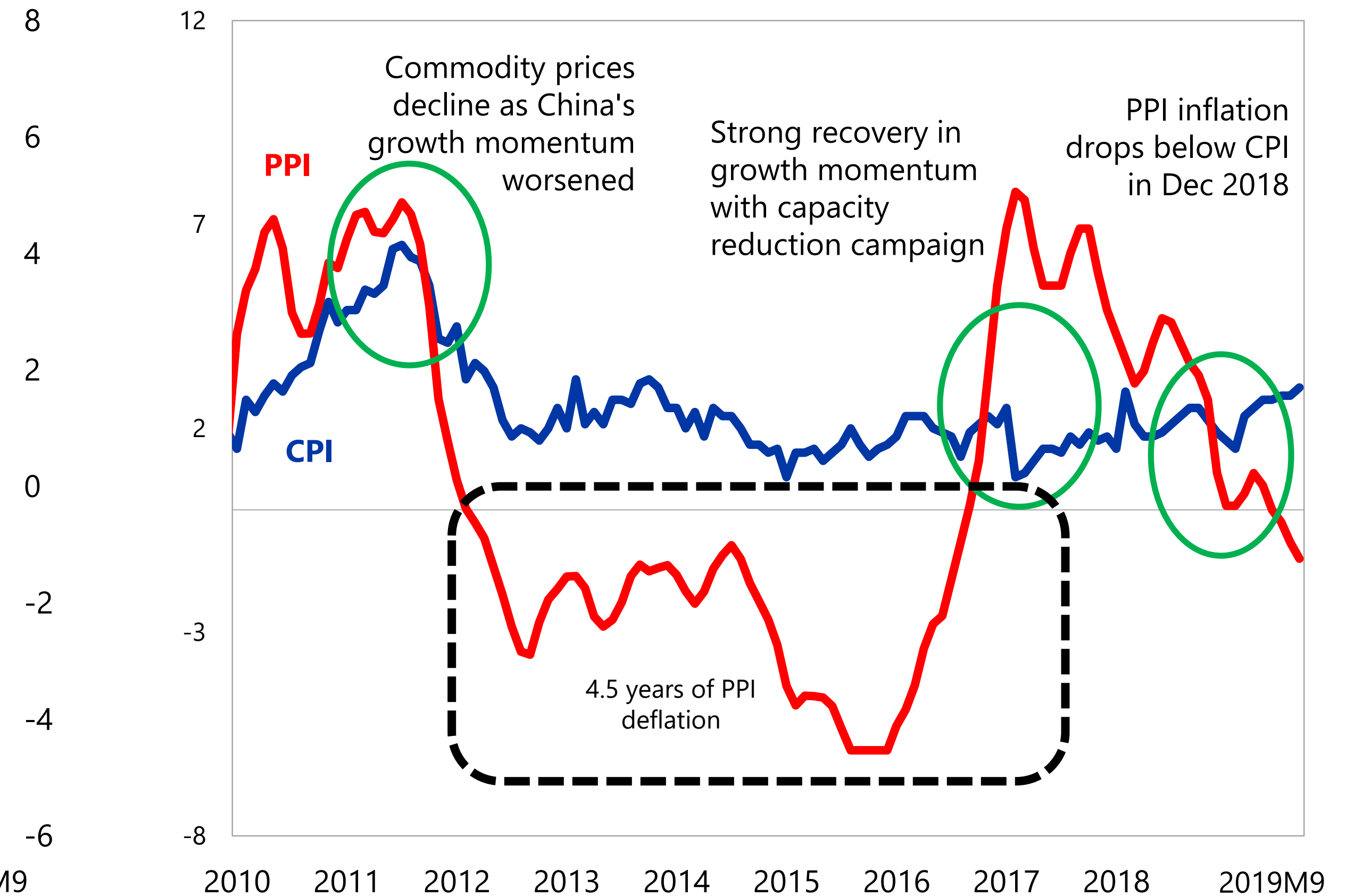
(In percent, year-on-year)



Source: CEIC.

Headwinds from another potential round of PPI deflation

(In percent, year-on-year)

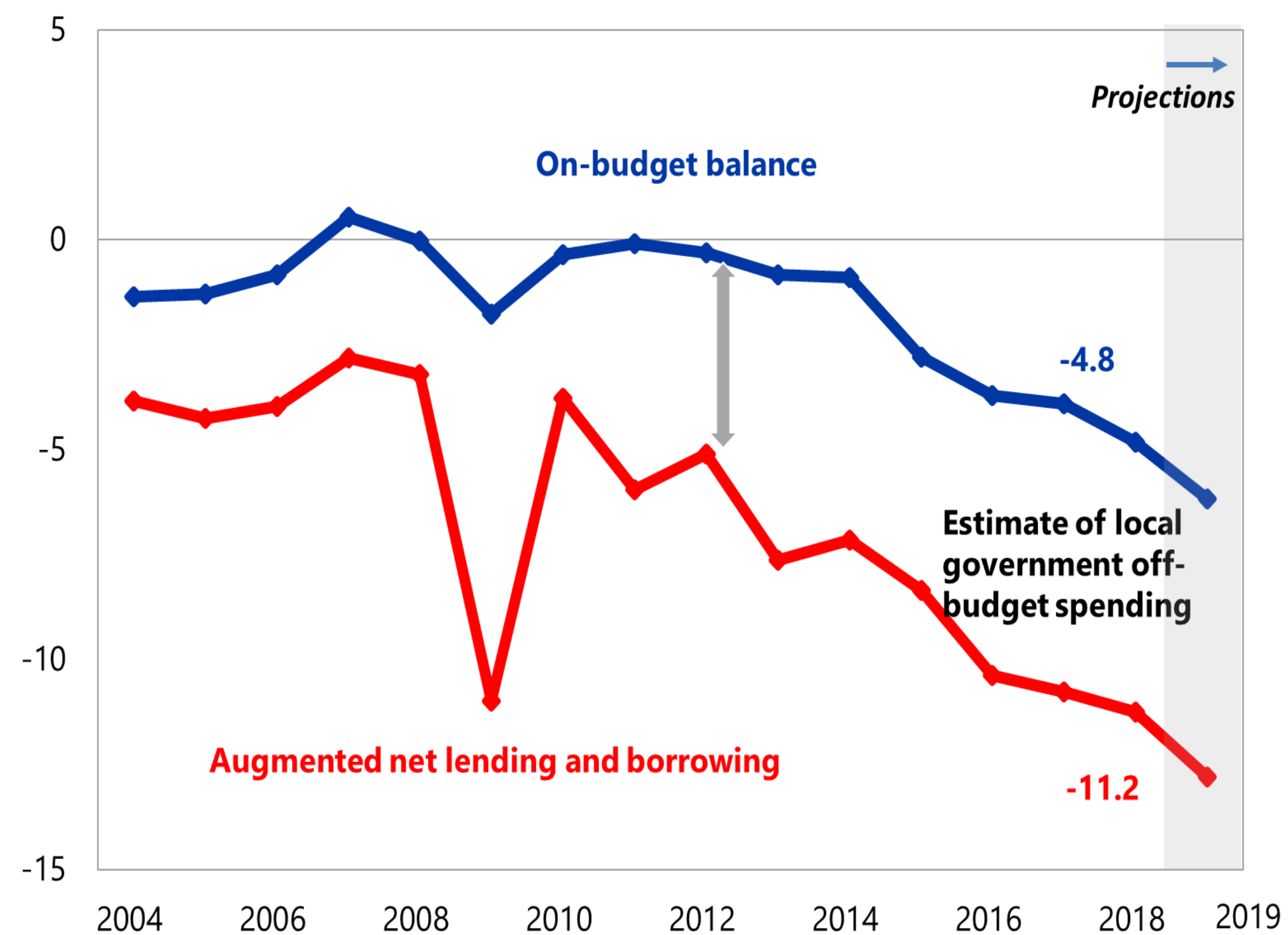


Source: CEIC.

In response, fiscal and monetary policies have eased...

Government balance under different definitions

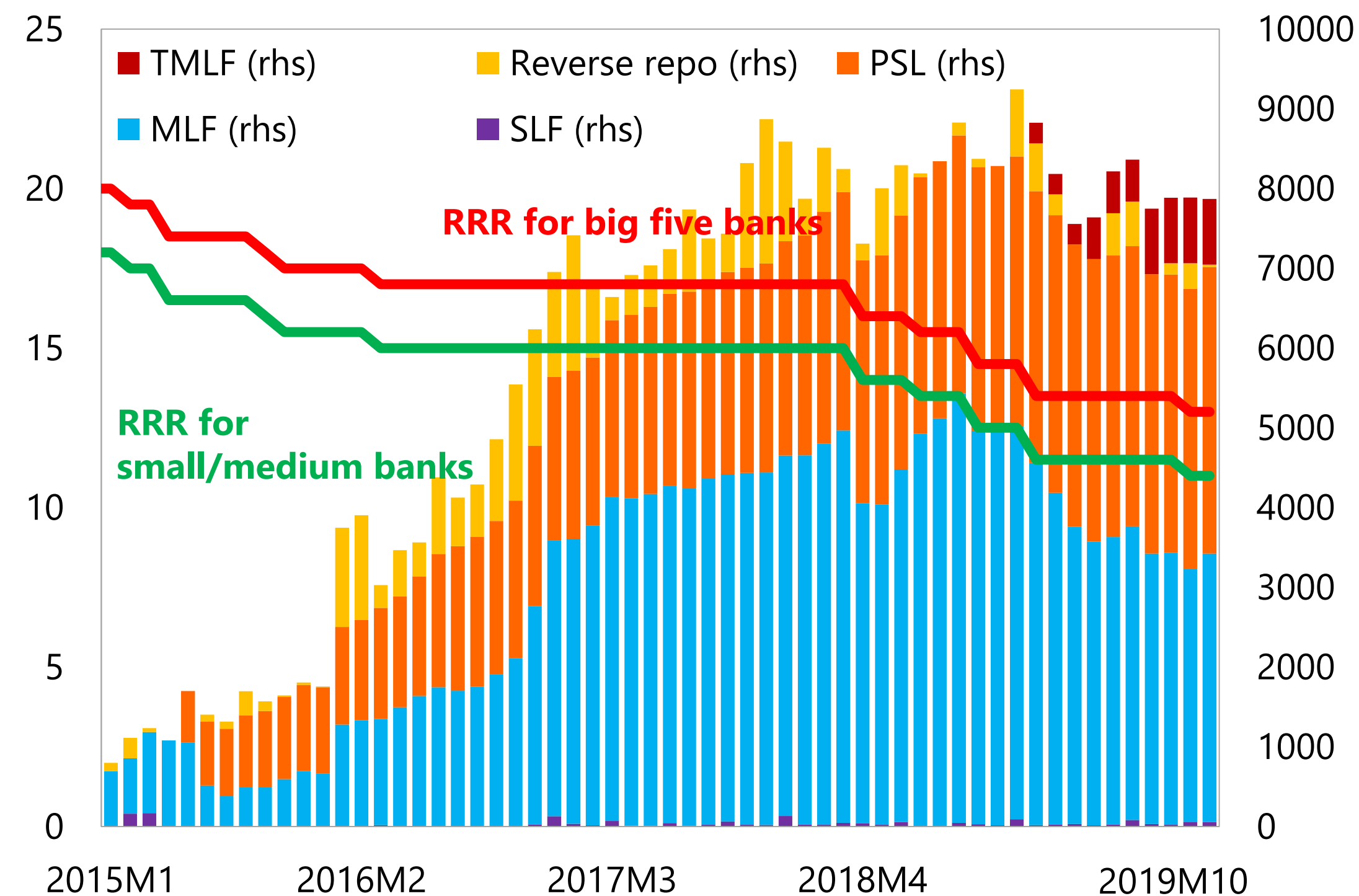
(In percent of GDP)



Source: CEIC and IMF staff estimates.

China's RRR and balances under repo and lending facilities

(In percent; rhs in billions of RMB)



Note: "PSL" stands for pledged supplementary lending facility. "MLF" stands for medium-term lending facility. "SLF" stands for standing lending facility. "TMLF" stands for targeted medium-term lending facility.

Source: CEIC, Haver Analytics, PBOC.

...while financial policies remain tight and structural reforms continued

Major Reforms Targeted on the Domestic Economy		Major Reforms Targeted on Opening-Up	
Improvement in WB's Doing Business Indicators China's rank improved to 46 in 2018 from 78 in 2017.	2018*	Foreign investment law adopted	Mar 2019*
Target Medium-term lending facility to provide financing support for SMEs & private firms.	Dec 2018	Shanghai-London Stock Connect launched	June 2019*
Relaxation of Hukou restrictions for some cities.	April 2019	Multiple rounds of tariff cuts	Sep 2018-Jan 2019*
Lower SOE leverage by 2 percentage points by 2020 from the 2017 level.	Sep 2018	Foreign ownership cap in banking, securities, and insurance to be removed by 2020.	July 2019
Local government to define the first lists of zombie companies.	Dec 2018	Negative list for foreign investment entry streamlined.	July 2019
Approval of the fourth batch of pilots for SOE mixed-ownership reform.	May 2019	Improved foreign access to domestic bond rating and asset management	July 2019

Note: Dates refer to announcement date of the reform

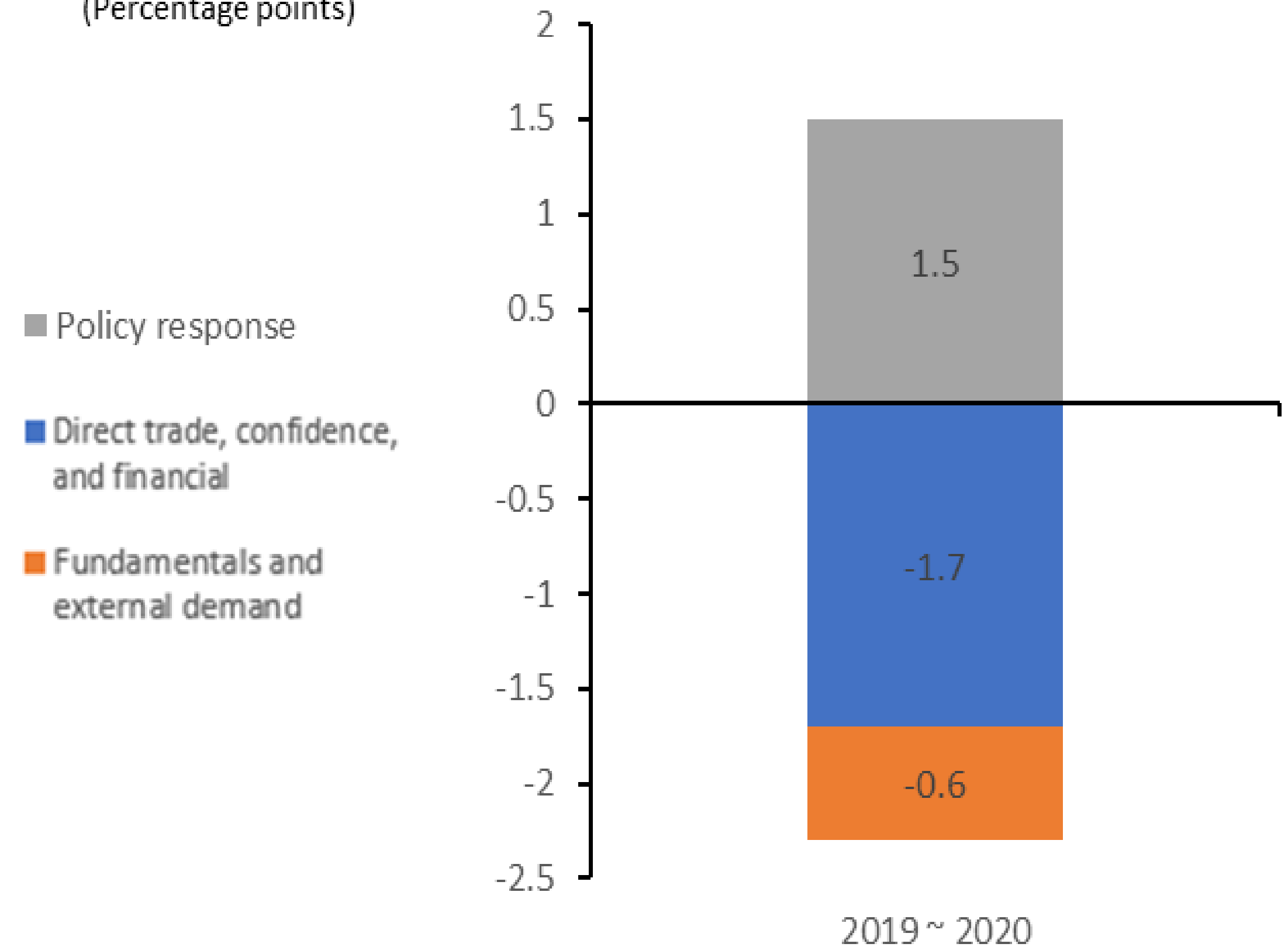
* Implemented date

Escalating trade tensions have dampened the near-term growth outlook...

Vintage	2019 Growth Forecast	2020 Growth Forecast
July 2018 WEO	6.4	6.3
April 2019 WEO	6.3	6.1
July 2019 WEO/ 2019 Article IV	6.2	6.0
October 2019 WEO	6.1	5.8

China's 2019-2020 Growth, Decomposition of Revisions relative to July 2018 WEO Vintage

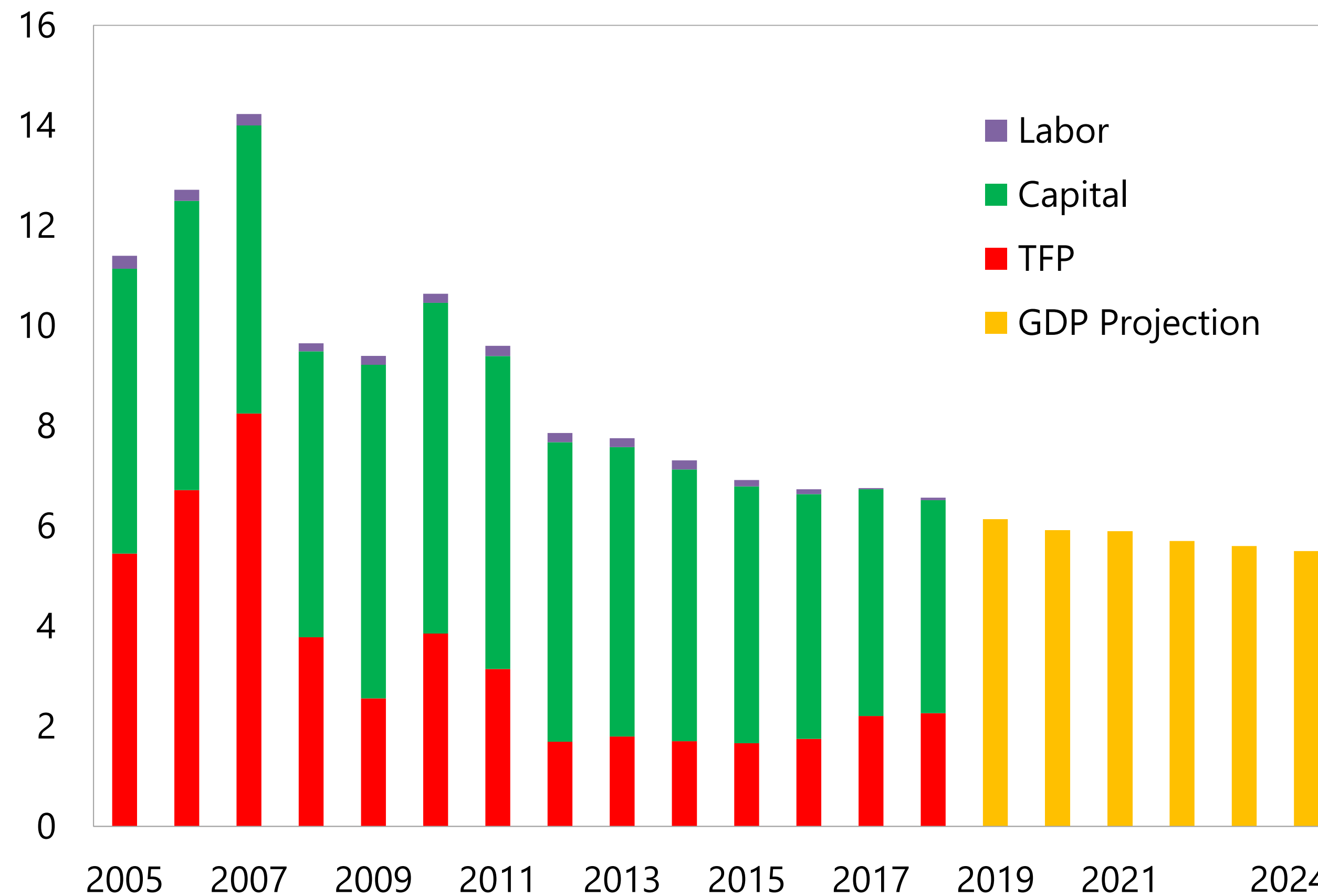
(Percentage points)



...as growth over the medium-term is expected to moderate

Declining contribution of TFP to real GDP Growth

(In percentage points)



Source: CEIC and IMF staff estimates.

Five key policy questions to navigate an uncertain environment



The Way Forward

V. Boosting productivity

IV. Deleveraging and de-risking

III. Containing external imbalances and further boosting consumption

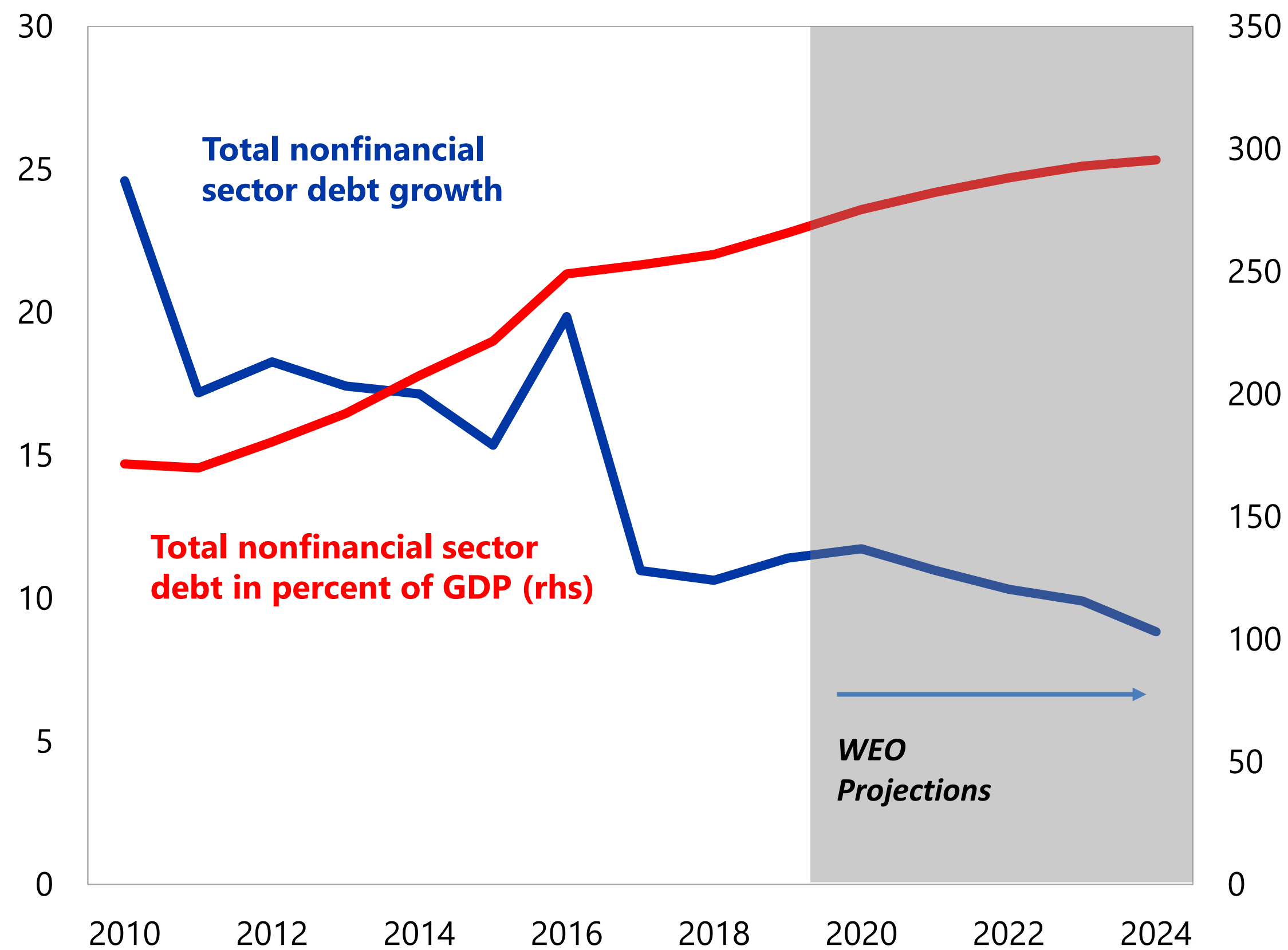
II. Evolving frameworks to modernize the international system

I. Responding to rising trade tensions and uncertainty

Q1: How should macro policies respond to rising trade tensions and uncertainty?

Nonfinancial sector debt to continue increasing in 2019

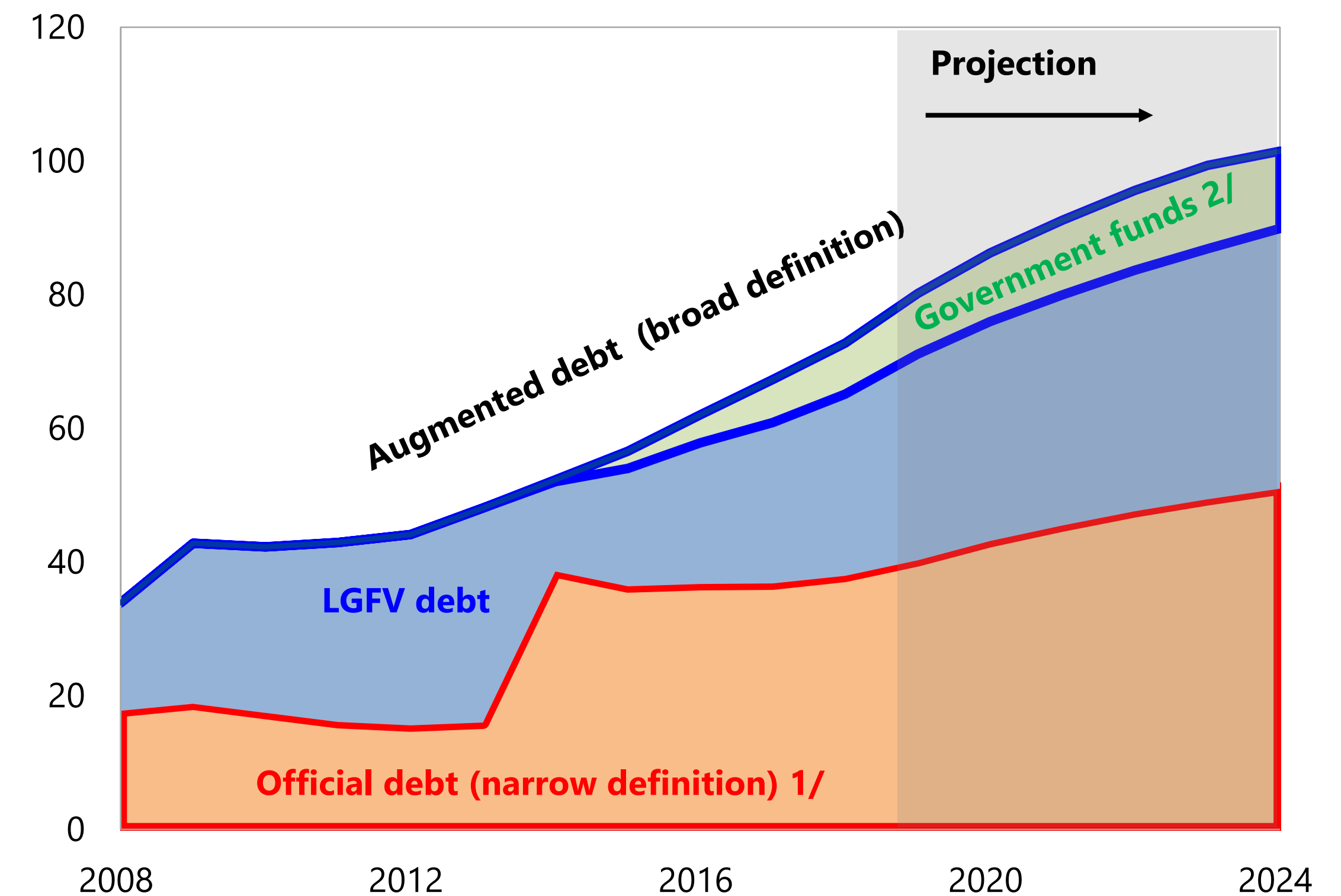
(In percent; in percent of GDP)



Source: Haver Analytics and IMF staff estimates.

Narrow and broad government debt

(In percent of GDP)



Source: IMF staff estimates.

1/ Data through 2015, 2016 estimated, 2017 projection. Large jump in 2014 reflects official recognition of 22 percent of GDP in LGFV debt.

2/ Government guided funds (GGF) and special construction funds (SCF). Social capital portion only.

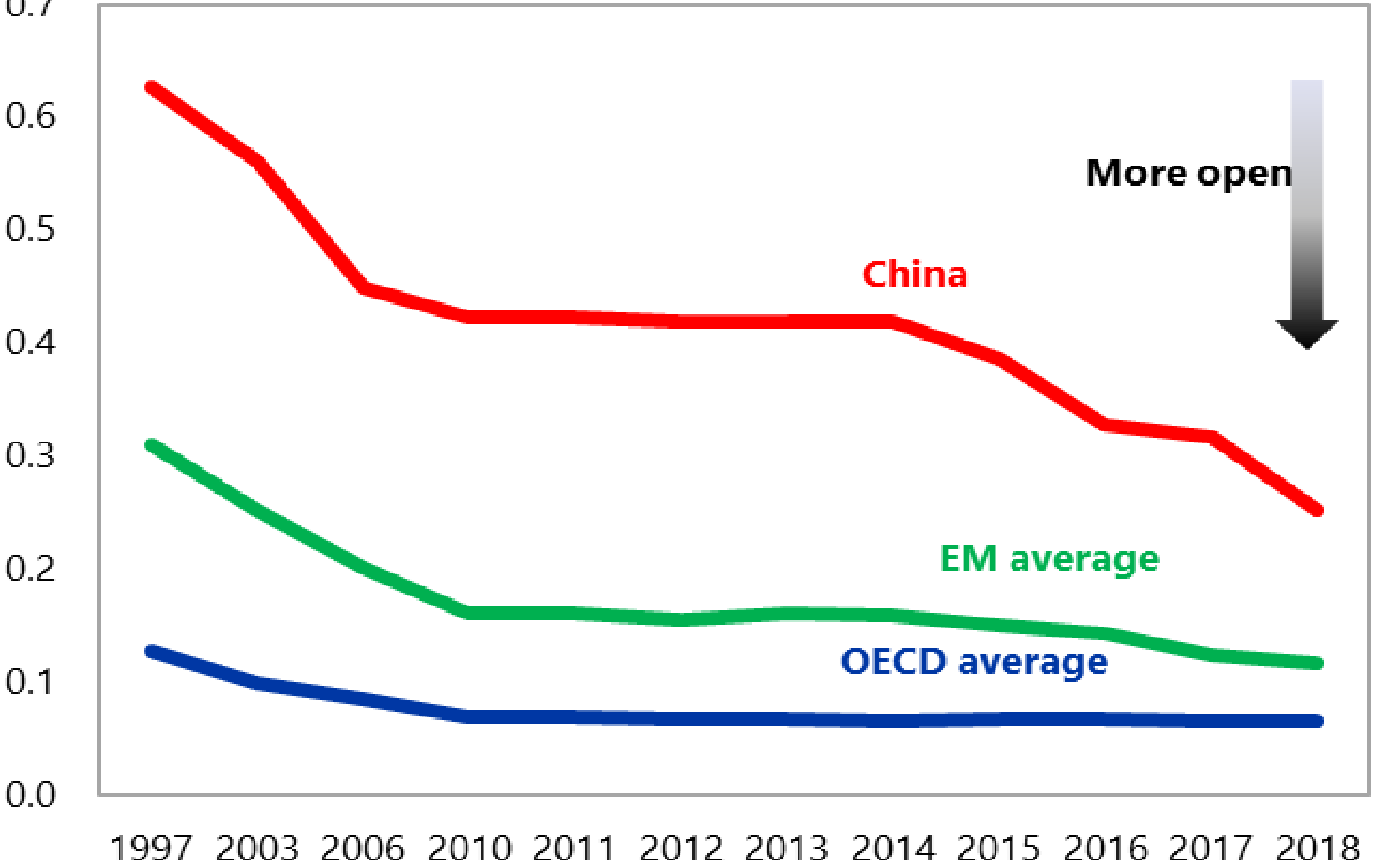
Staying the course under the baseline but a balanced policy mix, mainly fiscal stimulus and FX flexibility, if trade tensions escalate

	Baseline Continuation of all previously imposed up to tariffs prior to September 1 st , 2019.	Adverse A further escalation of the trade tensions, for example the U.S. raising tariffs to 25 percent on remaining imports from Chinese
Fiscal	<ul style="list-style-type: none"> No additional stimulus. Gradual medium-term fiscal consolidation. 	<ul style="list-style-type: none"> A fiscal expansion of about 0.8 percentage point of GDP. Expansion to be on-budget and centrally financed, pro-balancing, and targeted to low-income households.
Monetary and Credit	<ul style="list-style-type: none"> No further monetary policy. 	<ul style="list-style-type: none"> If core inflation falls along with growth, further monetary easing could be considered.
Exchange Rate	<ul style="list-style-type: none"> Increase flexibility of the exchange rate. Refrain from using the counter-cyclical adjustment factor. 	<ul style="list-style-type: none"> Remain flexible and market-determined. FX intervention could be used to counter disorderly market conditions.
Financial Regulation	<ul style="list-style-type: none"> No watering down of envisaged regulatory/supervisory reforms 	<ul style="list-style-type: none"> No watering down of envisaged regulatory/supervisory reforms

Q2: How should China's external policies and frameworks evolve?

FDI regulatory restrictiveness index has fallen in China

(Index; 1= closed)



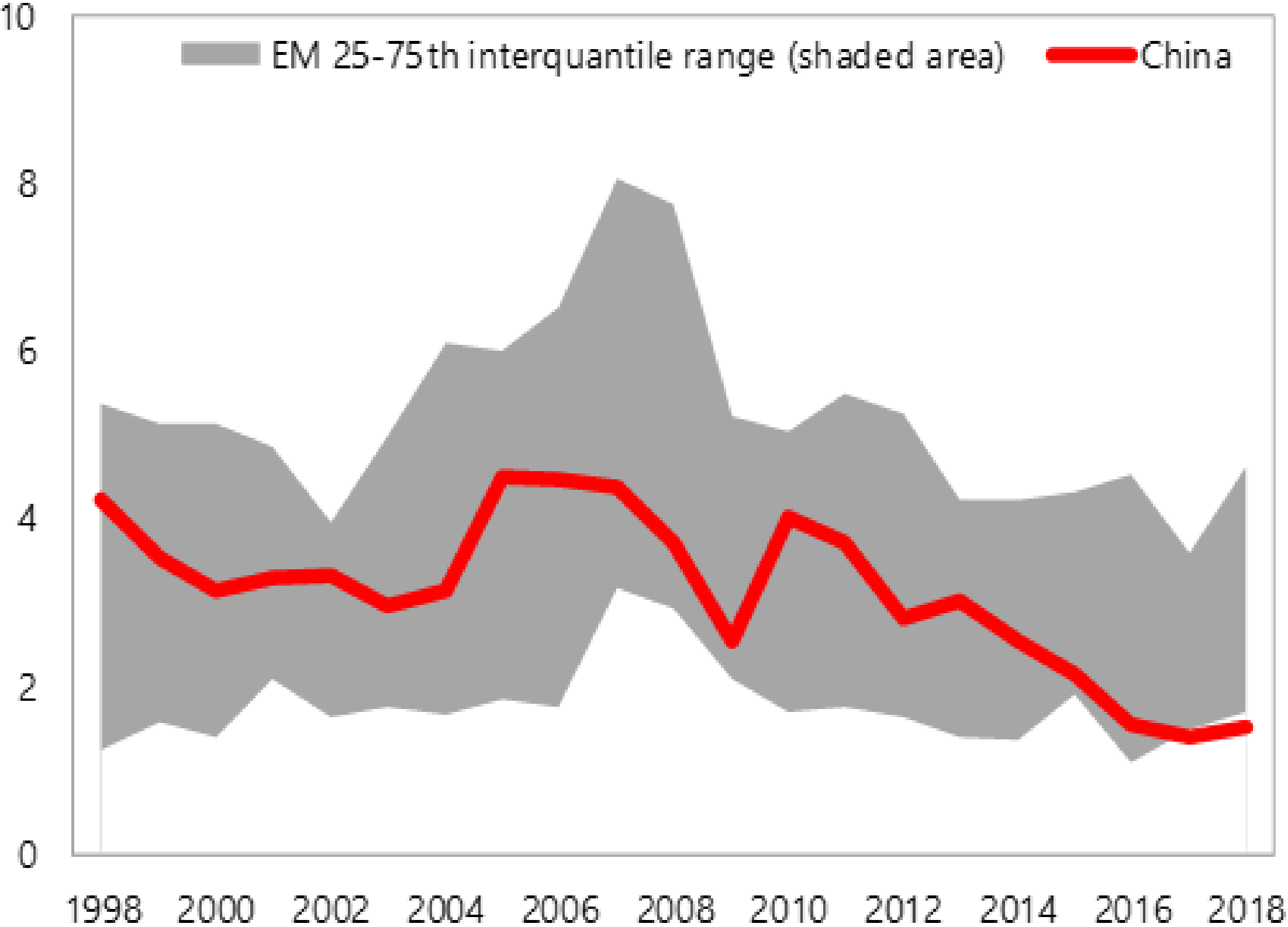
Note: The FDI Regulatory Restrictiveness Index (FDI Index) measures statutory restrictions on foreign direct investment in 68 countries, including all OECD and G20 countries, and covers 22 sectors.

See <http://www.oecd.org/investment/fdiindex.htm> for further information.

Source: OECD Stat.

China's FDI is trending down and below EM average

(In percent of GDP)

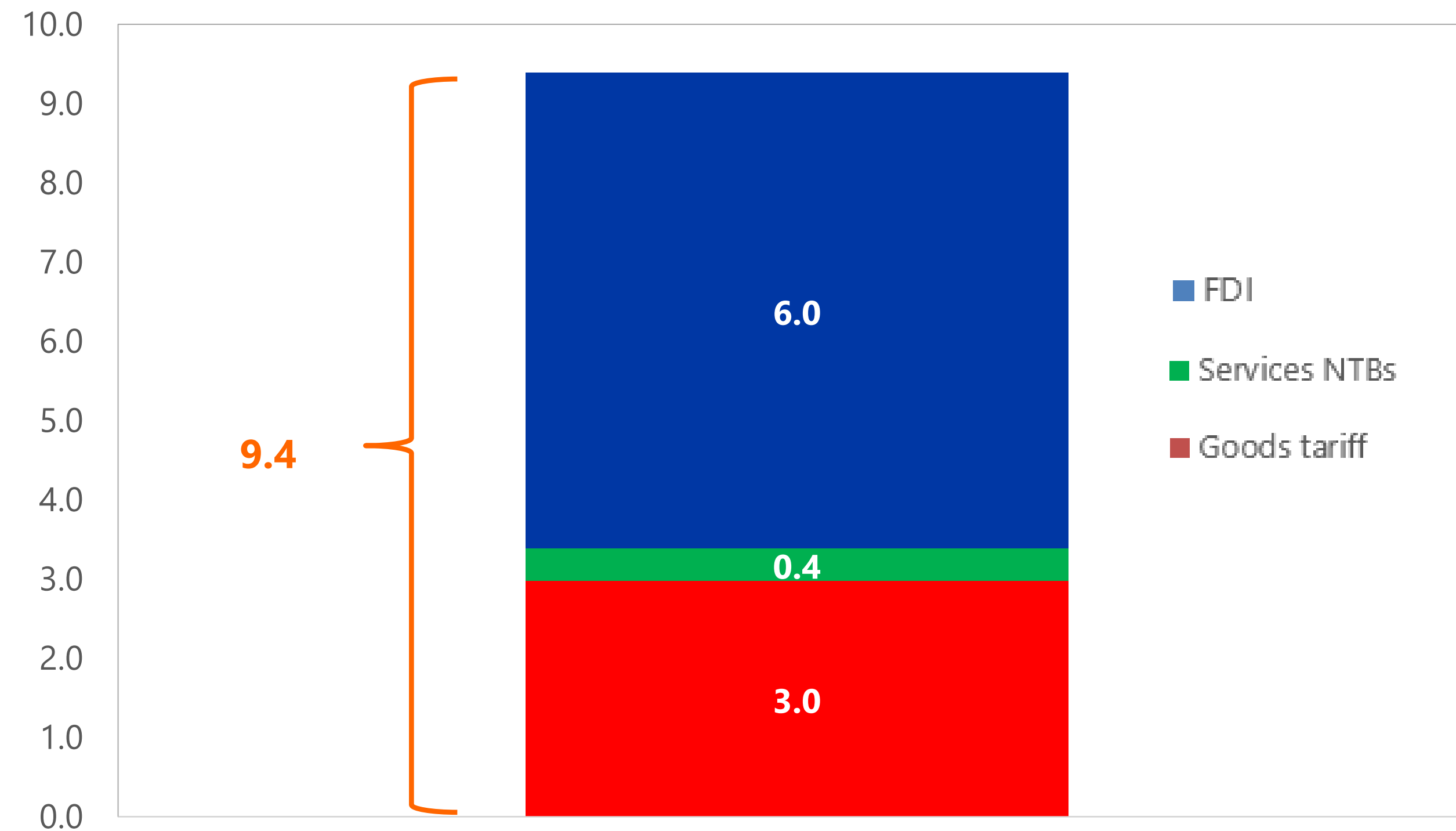


Source: IMF WEO database.

Accelerating opening-up will boost significantly China's GDP...

China would gain by unilaterally liberalizing

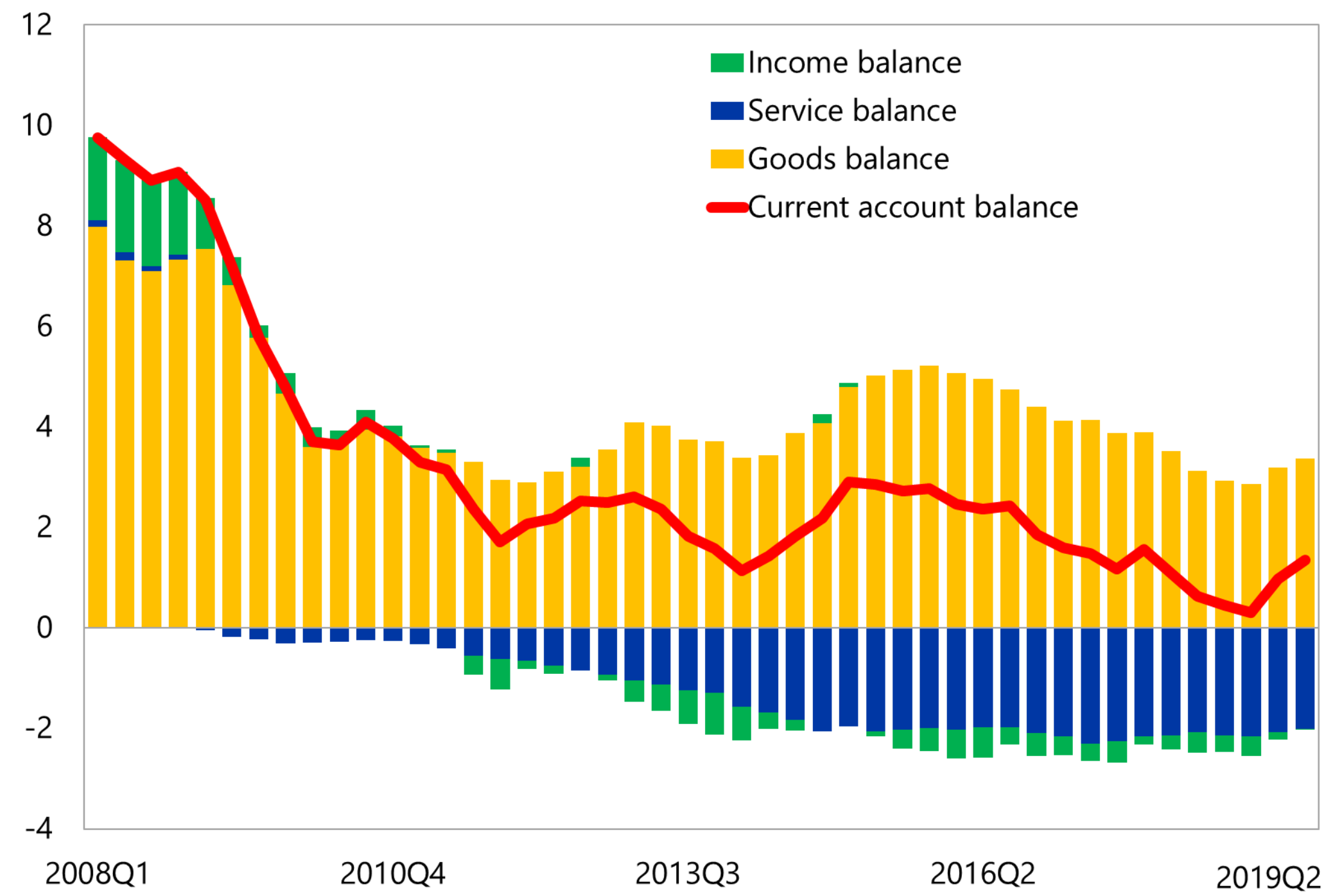
(Long-term Impact on GDP level, percent)



Source: IMF staff estimates.

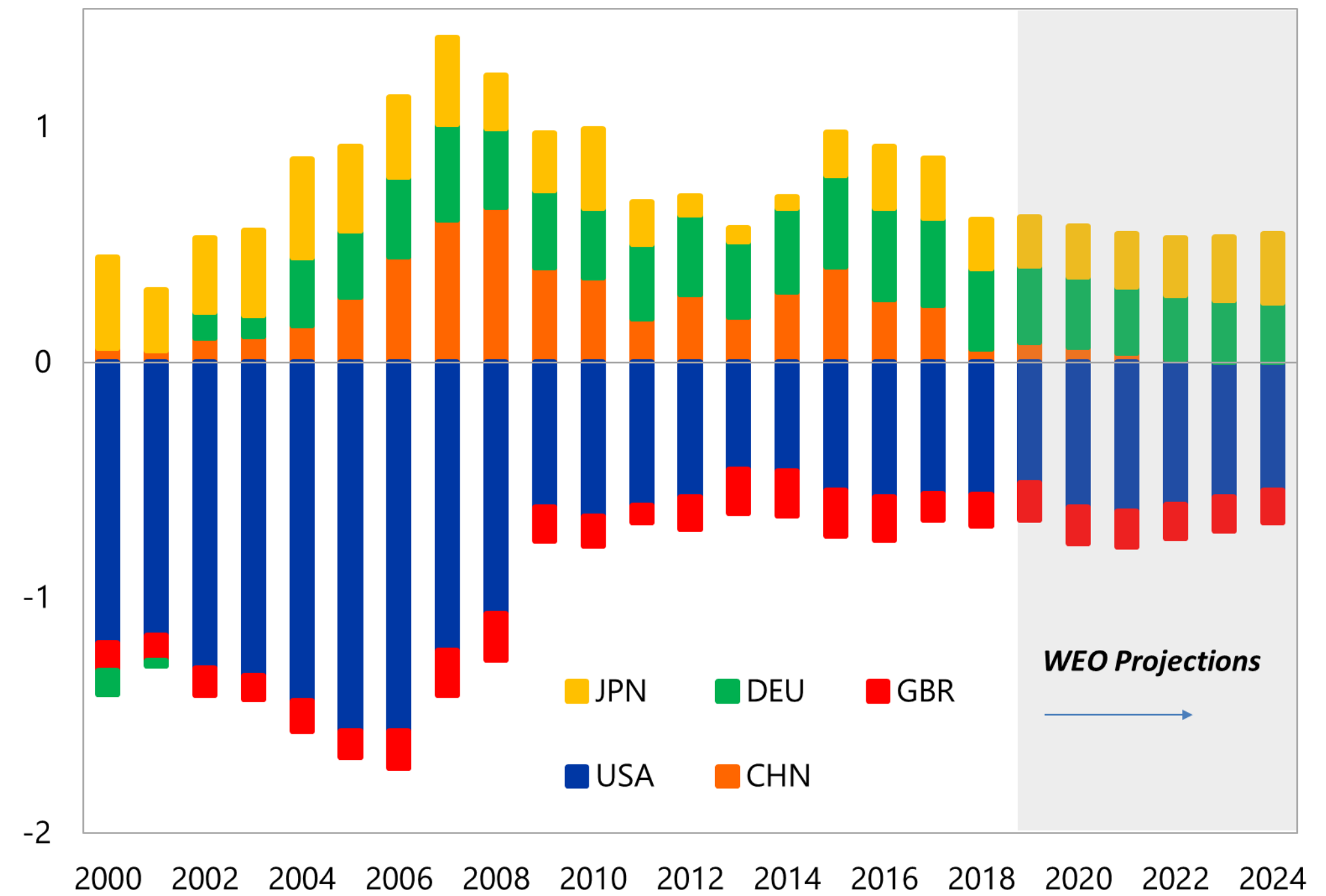
Q3: How to contain external imbalances and further boost consumption?

Current account
(In percent of GDP, 4qma)



Source: CEIC.

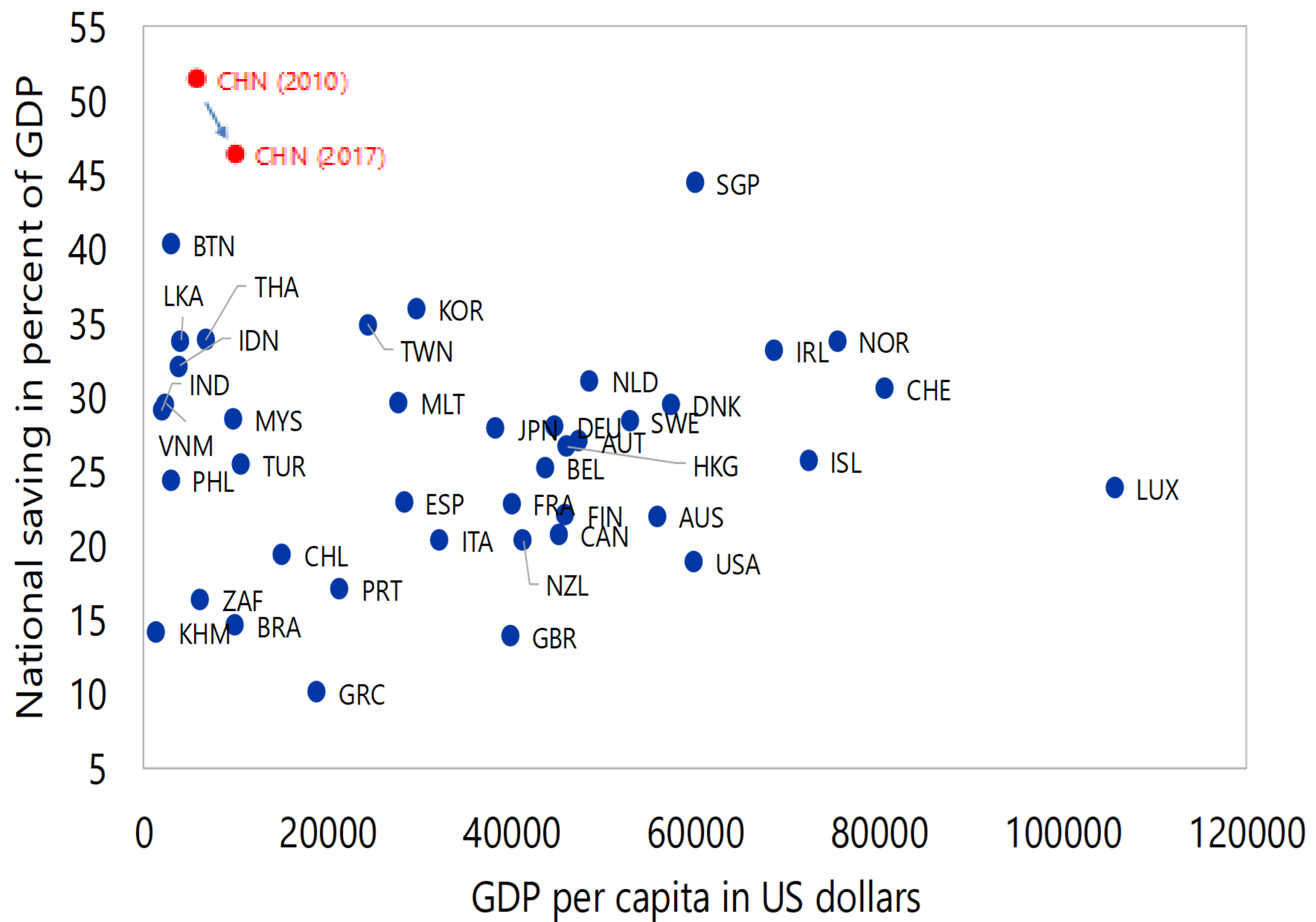
Current Account Balances, 2000-2024
(In percent of world GDP)



Source: IMF WEO database.

Rebalancing will require boosting consumption and lowering investment

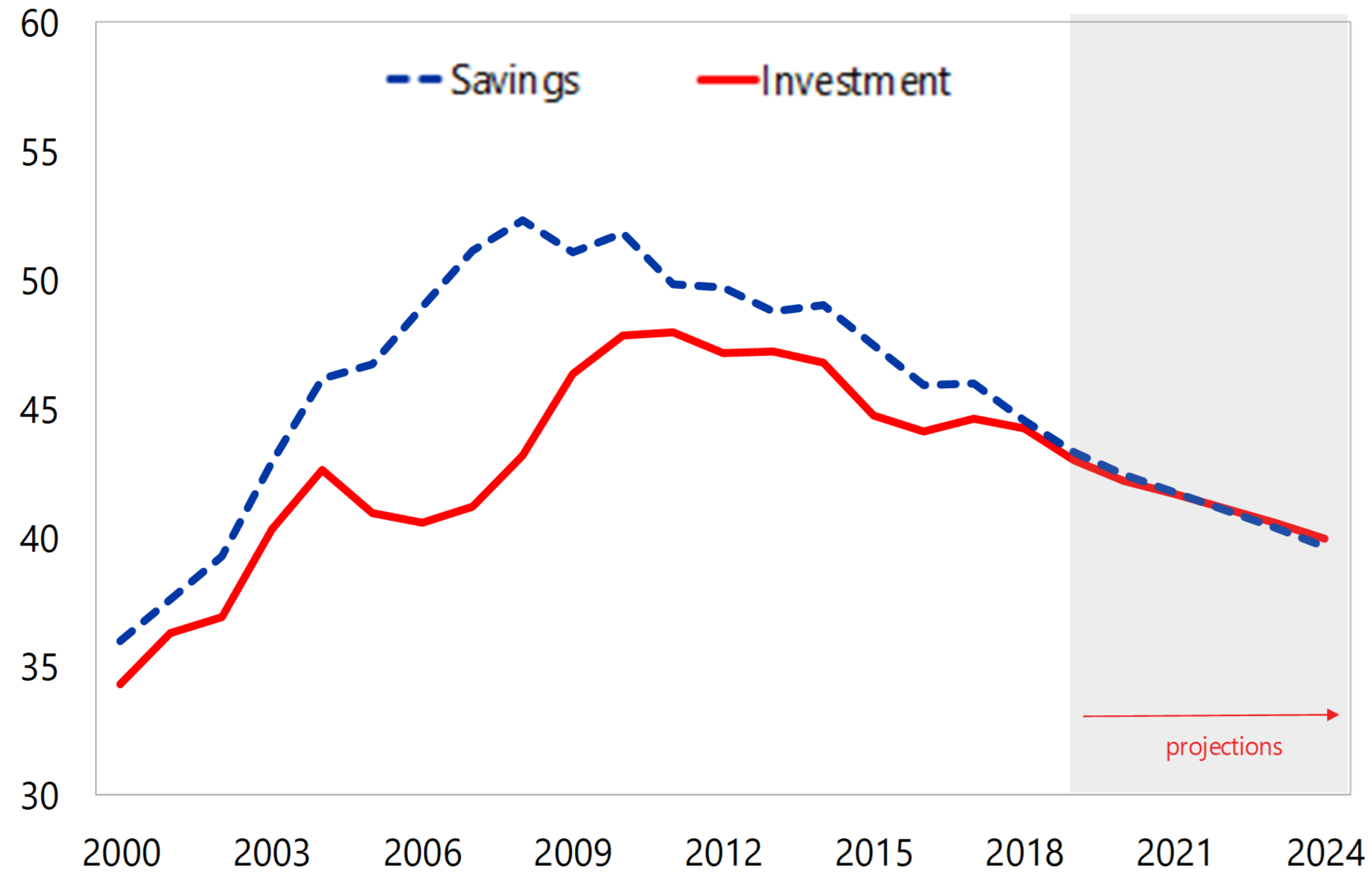
National Saving Rate



Sources: World Economic Outlook; and IMF staff calculations.

China's Gross Saving and Investment

(In percent of GDP)

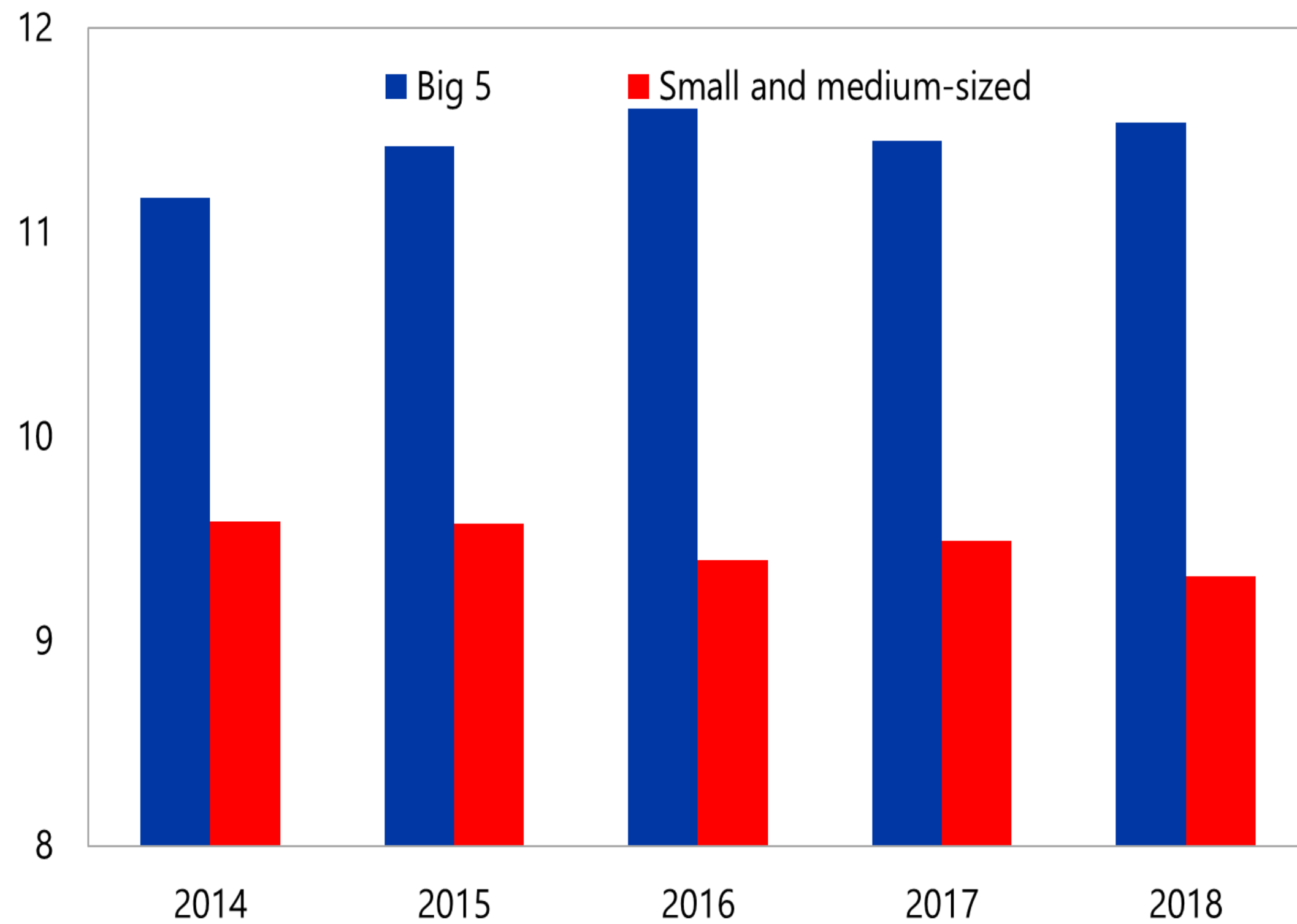


Sources: National authorities; and IMF World Economic Outlook.

Q4: How to continue deleveraging and de-risking amid tighter domestic financial conditions and slowing growth?

Lower tier 1 capital adequacy at small and medium-sized banks

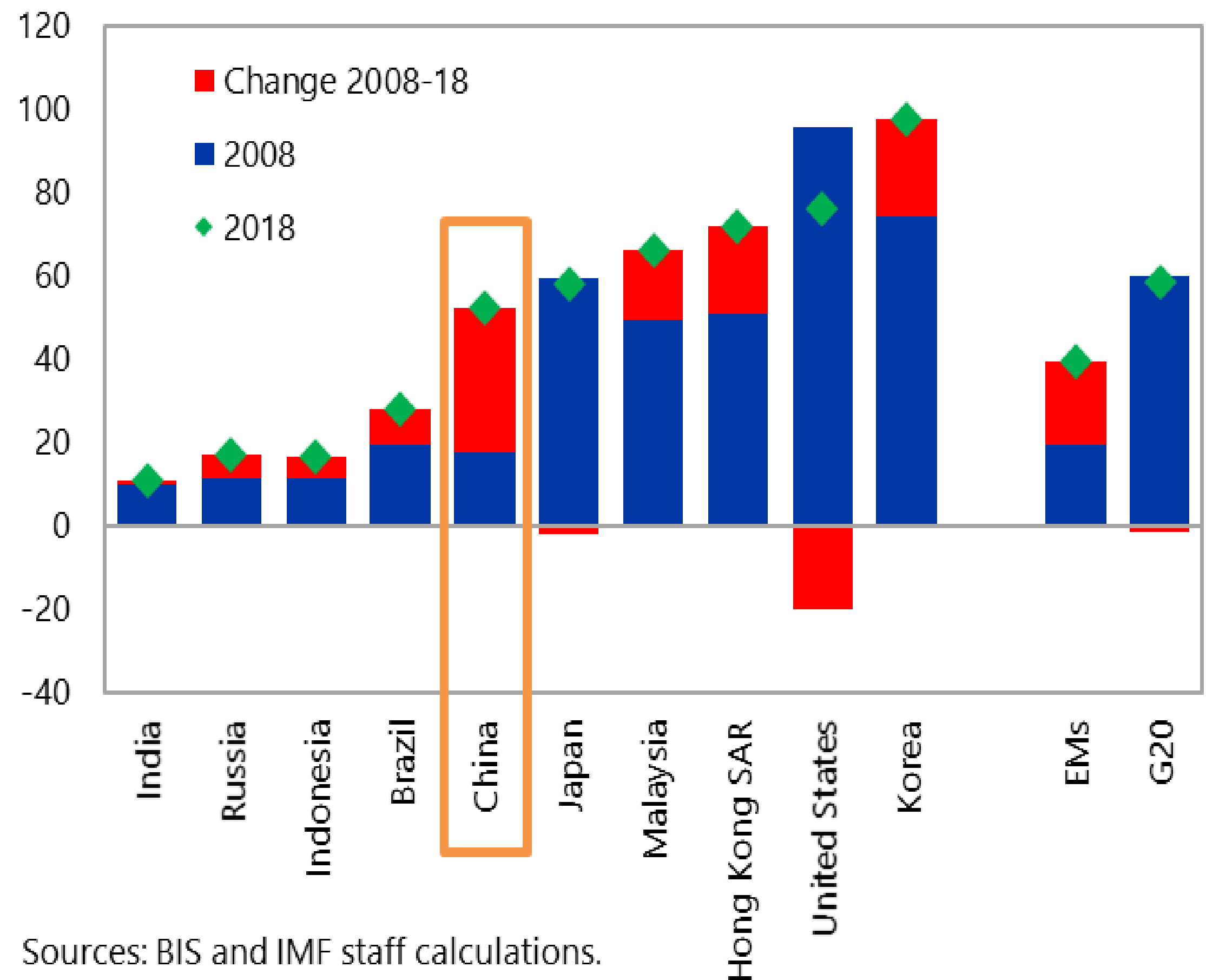
(In percent)



Source: SNL financial.

Large increase in China's household debt-to-GDP ratio

(In percent)

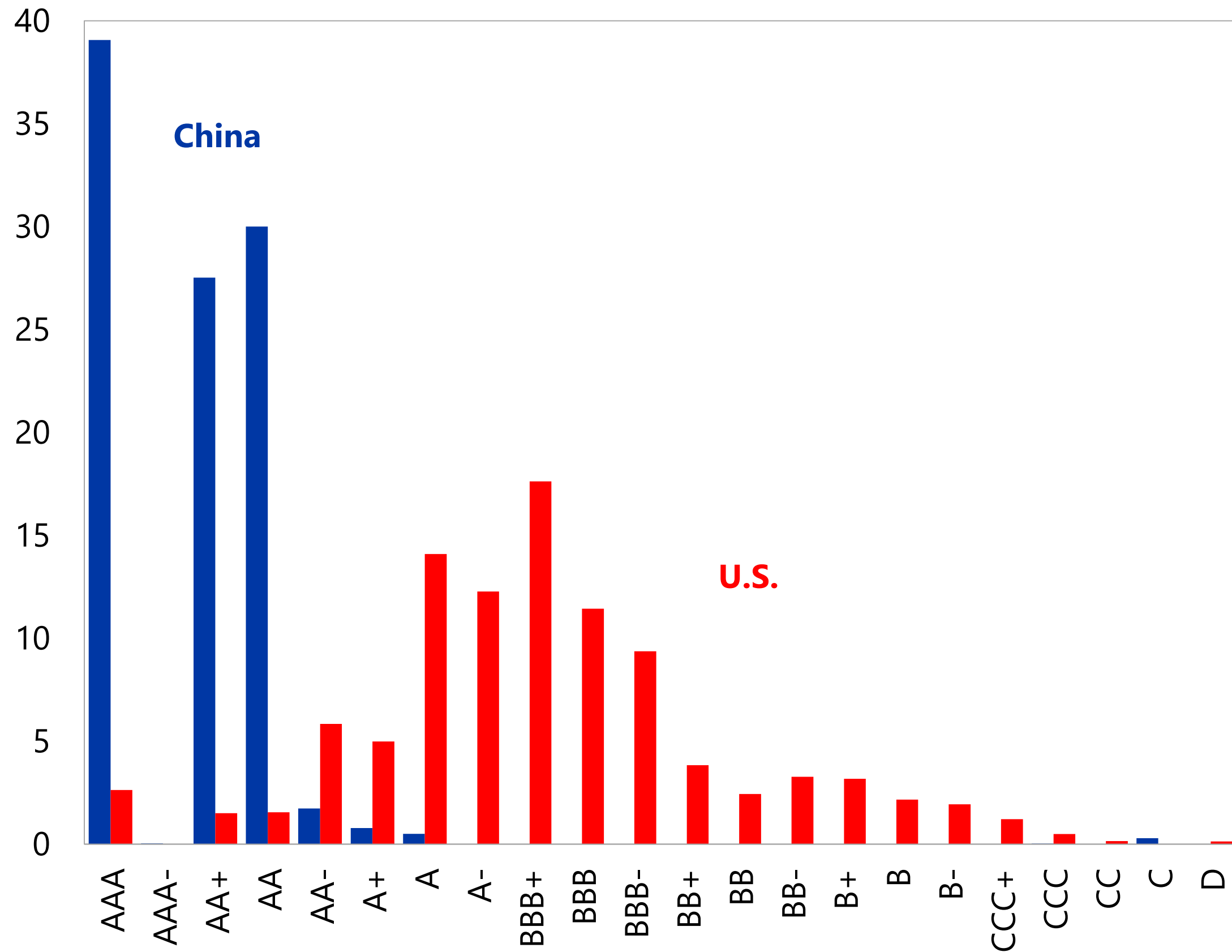


Sources: BIS and IMF staff calculations.

Strengthen role of financial markets to better allocate credit

Chinese bond ratings are high

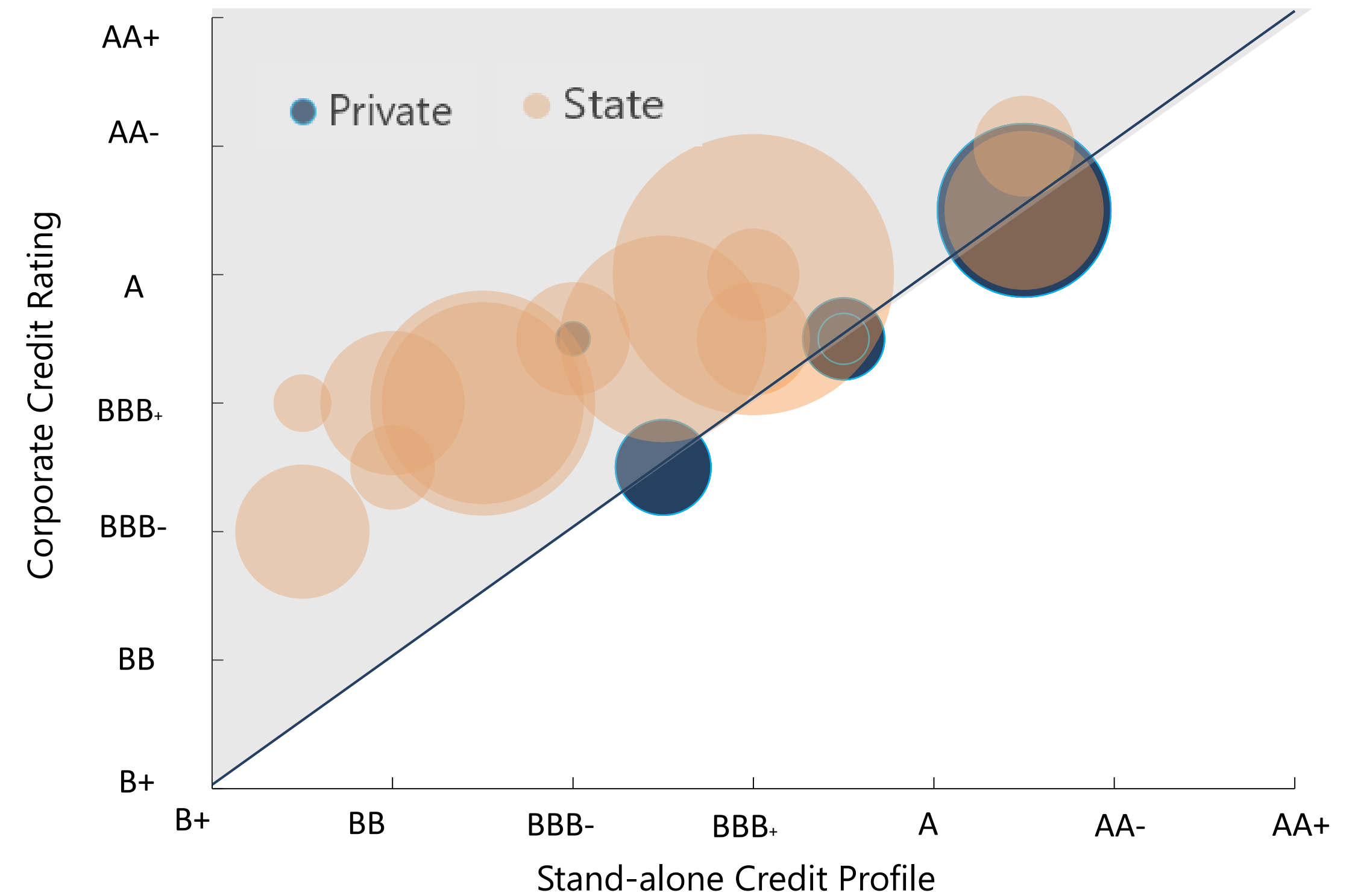
(In percent)



Source: Bloomberg.

SOEs higher credit rating reflect implicit guarantees

(Rating score)



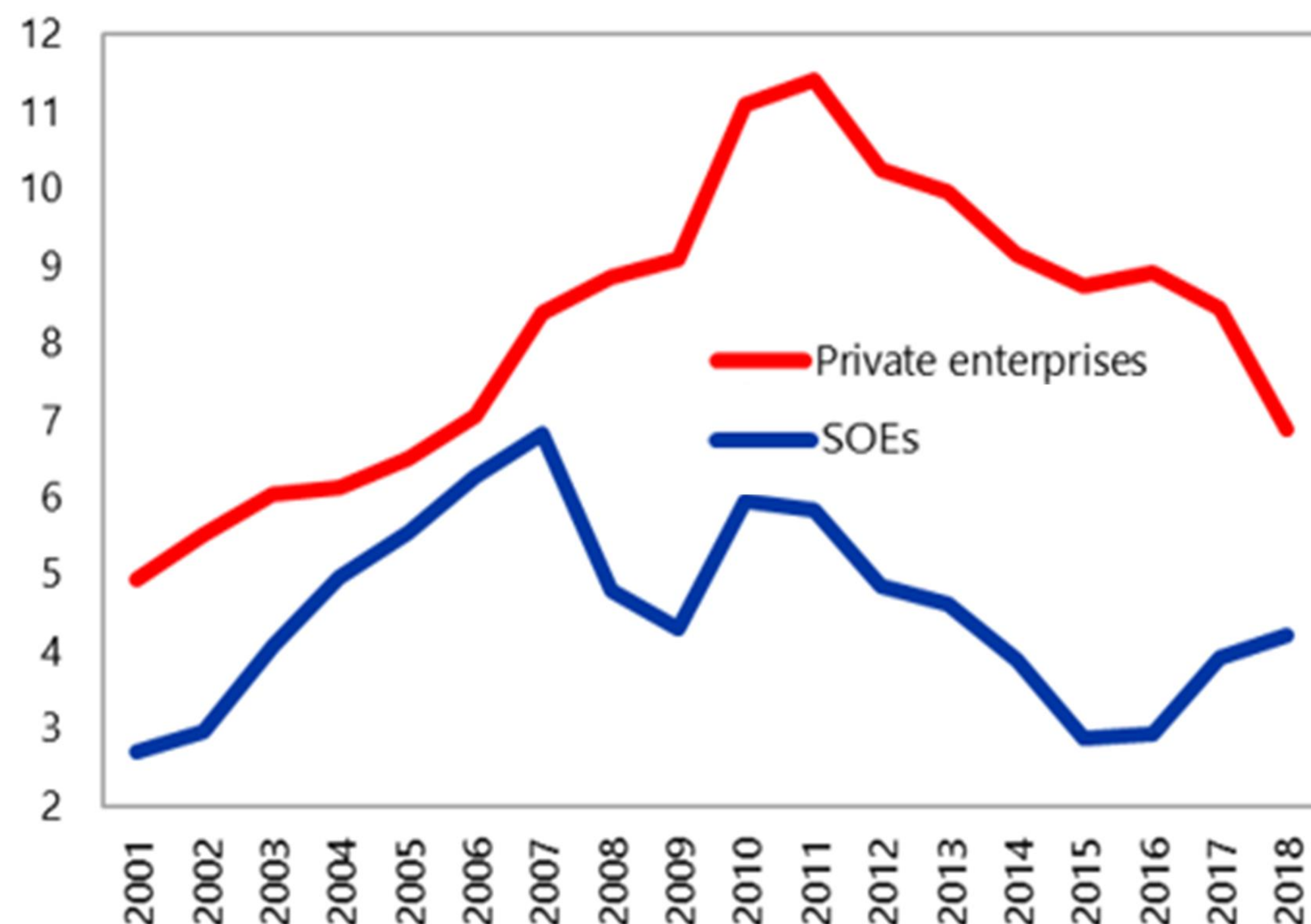
Sources: Standard & Poors; Bloomberg L.P.; and IMF staff calculations.

Note: Size of the bubble denotes the entity's total debt. Shaded area shows corporates that have a higher credit rating than their stand-alone credit profile.

Q5: How to boost productivity and longer-term development

Return on Assets Lower in SOEs

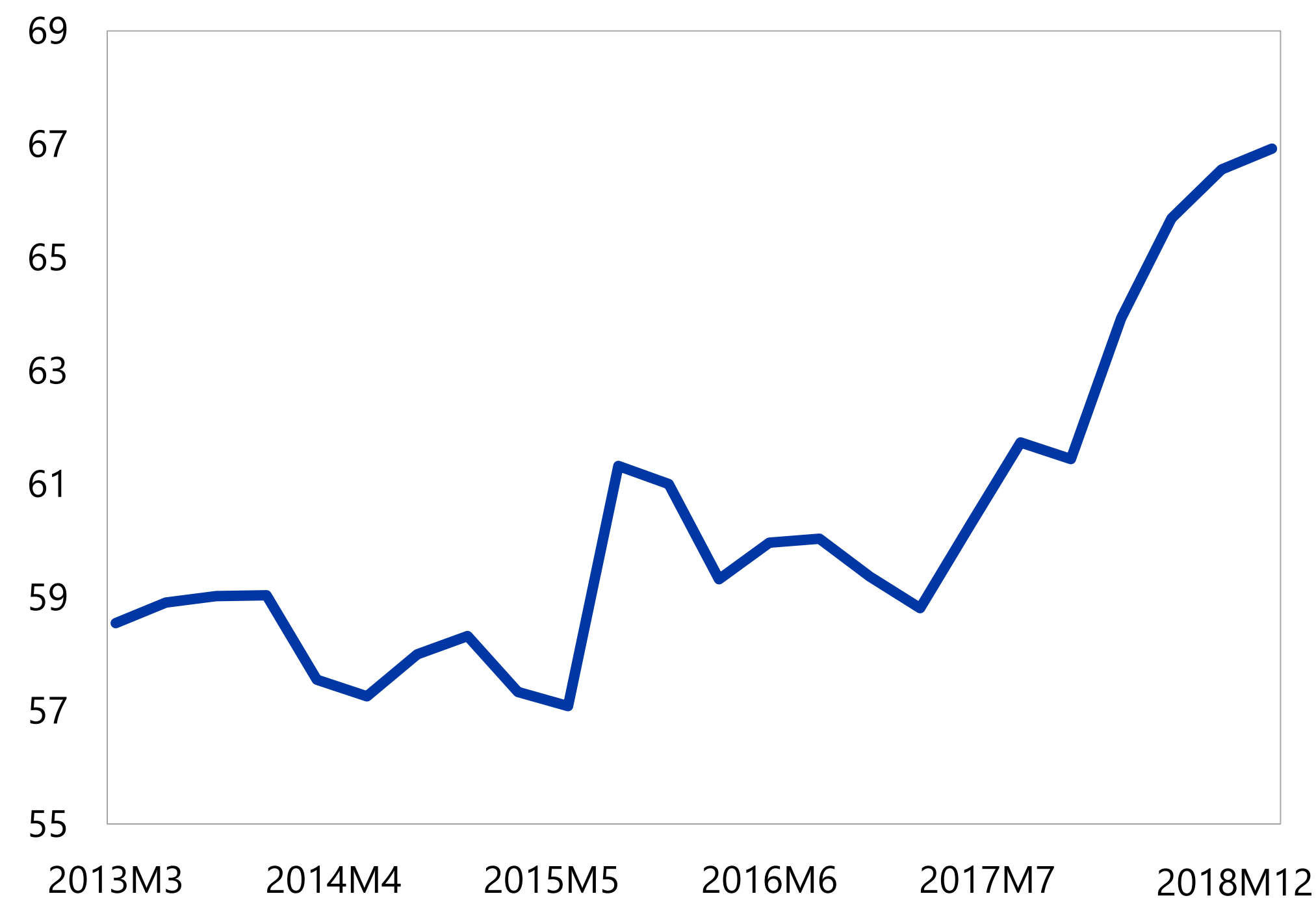
(in percent)



Source: National Bureau of Statistics and authors' calculation.

SOE liabilities as a share of total liabilities

(In percent)



Source: PBOC, MoF, Wind, CNBS and IMF staff estimates.

Apply the principles of “competitive neutrality” to promote SOE reforms



Harden budget constraints.

Enforce dividend payments to budget.

Set deleveraging goals in terms of SOE debt/GDP ratio.

Complete transfer of social responsibilities to the government.

Complete exit of zombie firms.

Move SOEs out of competitive sectors and open-up non-strategic sectors to POEs.

As China's economy matures, policy frameworks should be modernized

Monetary Policy

Phase Out
Benchmark Rates

Establish One Key
Policy Rate

Fiscal Policy

Strengthen fiscal
discipline

Ensure social security
sustainability

Enhance fiscal
governance

Financial Stability

Full macro-prudential
authority to the
Financial Stability and
Development
Committee

Data Issues

Improve
Transparency

Statistics in line with
international
standards

Close data gaps

Summary of key policies

- **Respond to rising trade tensions and uncertainty by adjusting macroeconomic policies and allowing exchange rate flexibility**
- **Work with trading partners to promote a more open, stable, transparent, and rules-based international trading system**
- **Stay the course on deleveraging and de-risking by strengthening the financial system, addressing weak banks and high household debt, and improving credit allocation**
- **Contain external imbalances and further boost consumption**
- **Boost productivity by accelerating opening-up non-strategic sectors, intensifying SOE reforms, and modernizing policy frameworks**

Check out the report

- [China 2019 Article IV Consultations –Staff Report](#)
- [China 2019 Article IV Consultations –Selected Issues Paper](#)
 - The Drivers, Implications, and Outlook for China’s Shrinking Current Account Surplus
 - Household Indebtedness in China
 - Improving the Allocation of Corporate Credit in China
 - The Spillover Effects of the U.S.—China Trade Policies
- IMF China page <http://www.imf.org/en/Countries/CHN>



Thank you!