INTERNATIONAL MONETARY FUND

IMF Country Report No. 19/266

PEOPLE'S REPUBLIC OF CHINA

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; STAFF STATEMENT AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR CHINA

August 2019

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with China, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its July 31, 2019 consideration of the staff report that concluded the Article IV consultation with China.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 31, 2019, following discussions that ended on June 5, 2019, with the officials of China on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 12, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.
- A **Statement by the Executive Director** for China.

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INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 19/314
FOR IMMEDIATE RELEASE
August 9, 2019

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2019 Article IV Consultation with the People's Republic of China

On July 31, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with China.

The Chinese economy is facing external headwinds and an uncertain environment. GDP growth slowed to 6.6 percent in 2018, driven by necessary financial regulatory reforms and softening external demand. Growth is projected to moderate to 6.2 percent in 2019 as the planned policy stimulus partially offsets the negative impact from the US tariff hike on US$ 200 billion of Chinese exports. Headline inflation rose due to rising food prices and is expected to remain around 2½ percent.

Reforms progressed in several key areas. The strengthening of financial regulations and control over off-budget local government investment has reduced the pace of debt accumulation, helping contain the build-up of risks in the financial sector. Opening up continued, with decreases in tariffs, passage of a new foreign investment law, and revisions to the negative list for foreign investment entry. Progress on SOE reforms, however, was mixed.

Credit growth slowed through 2018 but began to pick up in 2019. While the corporate deleveraging partially offset government and household debt accumulation, total nonfinancial sector debt still rose faster than nominal GDP growth. The deficit of the general government sector (including estimated off-budget investment spending) was estimated to be around 11 percent of GDP in 2018.

The current account surplus fell by around 1 percentage point, to 0.4 percent of GDP in 2018 and it is projected to remain contained at 0.5 percent of GDP in 2019. The external position in 2018 was assessed to be broadly in line with the level consistent with medium-term fundamentals and desirable policies. Net capital outflows declined sharply from around $650 billion in 2015 and 2016 to $30 billion in 2018.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment[2]

Executive Directors commended the authorities' recent reform progress, in particular, in reducing financial sector fragilities and continuing opening up of the economy. They noted the highly uncertain external environment and emphasized that successfully shifting from high-speed to high-quality growth requires continuing with deleveraging and strengthening rebalancing efforts while adjusting macroeconomic policies to respond to rising trade tensions.
Directors agreed that the announced policy measures are sufficient to stabilize growth in 2019 provided there are no further increases in tariffs, and that additional stimulus and excessive credit growth should be avoided. In this context, a few Directors reiterated the need to de-emphasize growth objectives. Directors agreed that if trade tensions escalate further, putting at risk economic and financial stability, additional stimulus, mainly fiscal, would be warranted and should be targeted.

Directors underscored the importance of structural fiscal reforms that can enhance medium-term growth.

Directors welcomed the authorities' commitment to multilateralism and a rules-based trading system. In this regard, they saw scope for China to work constructively with trading partners to better address shortcomings in the international trading system. Directors agreed that tensions between China and the United States should be quickly resolved through a comprehensive agreement that avoids undermining the international system. Directors also emphasized that China has an important role to play and would benefit from further opening up of the economy and other reforms that enhance competition.

Directors stressed the importance of staying the course on deleveraging and financial de-risking. They concurred that continuing financial regulatory reforms while strengthening bank capital, developing a clear resolution regime for banks, and containing vulnerabilities from rising household debt would help deliver a more sustainable growth path. To improve credit allocation, most Directors agreed that a plan to reduce implicit guarantees for state-owned enterprises would be important.

Directors welcomed the progress on reducing external imbalances over several years and noted staff's assessment that the external position in 2018 was broadly in line with fundamentals and desirable policies. They emphasized that achieving a durable balance in the external position requires continued progress in addressing distortions that encourage excessive household savings. In this regard, to help boost consumption and reduce inequality, Directors urged continued progress on reforms to enhance the social safety net and make the tax system more progressive. Directors concurred that greater exchange rate flexibility and deeper and better functioning FX markets would help the financial system prepare for greater capital flow volatility. Greater

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

exchange rate policy transparency would also be important. Some Directors also called for disclosure of FX interventions. Directors agreed that China should continue to upgrade its external lending framework to foster greater coordination and cooperation, and to ensure transparency and debt sustainability.

Directors underscored that a broad set of reforms are needed to boost productivity and longer-term income convergence. They stressed the need to increase the role of the market and reduce the dominance of the public sector in many industries by ensuring fair competition, accelerating opening up to the private sector, and intensifying reform of state-owned enterprises. They also highlighted the need to continue to modernize policy frameworks, including by moving to a more price-based monetary policy framework, and addressing the misalignment of center-local fiscal responsibilities. They stressed the urgent need to address China’s macroeconomic data gaps to further improve data credibility and policy making.

China: Selected Economic Indicators

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
								Projections			
	(Annual percentage change, unless otherwise indicated)										
NATIONAL ACCOUNTS											
Real GDP (base=2015)	7.3	6.9	6.7	6.8	6.6	6.2	6.0	6.0	5.7	5.6	5.5
Total domestic demand	7.2	7.2	7.6	6.3	7.4	6.1	6.2	6.2	6.0	5.8	5.6
Consumption	7.2	8.3	8.6	7.4	9.4	8.0	7.2	6.6	6.3	6.2	6.0
Investment	7.1	6.1	6.5	5.1	4.8	3.8	5.0	5.8	5.6	5.4	5.2
Fixed	6.8	6.7	6.8	4.4	4.8	3.8	5.2	6.0	5.8	5.6	5.4
Inventories (contribution)	0.2	-0.2	0.0	0.4	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net exports (contribution)	0.4	-0.1	-0.6	0.6	-0.6	0.2	0.0	-0.1	-0.1	-0.1	-0.1
Total capital formation (percent of GDP)	46.8	44.7	44.1	44.6	44.8	42.9	42.2	41.6	41.1	40.5	39.8
Gross national saving (percent of GDP) 1/	49.0	47.5	45.9	46.3	44.6	43.4	42.5	41.8	41.1	40.4	39.7
LABOR MARKET											
Unemployment rate (annual average) 2/	5.1	5.1	5.0	4.9	4.8	5.0	...	...	...	...	...
Employment	0.4	0.3	0.2	0.0	-0.1	-0.1	-0.1	-0.1	0.1	0.1	0.1
PRICES											
Consumer prices (average)	2.0	1.4	2.0	1.6	2.1	2.2	2.4	2.8	2.9	3.0	3.0
GDP Deflator	1.0	1.1	-0.1	2.4	2.1	1.4	1.8	2.1	2.2	2.4	2.3
FINANCIAL											
7-day repo rate (percent)	5.1	2.4	2.7	5.4	3.1	...	...	...	...	...	...
10 year government bond rate (percent)	3.7	2.9	3.1	3.9	3.3	...	...	...	...	...	...
Real effective exchange rate (average)	3.2	9.8	-4.9	-2.9	1.4	...	...	...	...	...	...
Nominal effective exchange rate (average)	3.6	9.7	-5.4	-2.5	1.5	...	...	...	...	...	...
MACRO-FINANCIAL											
Total social financing 3/	14.3	12.4	16.7	13.4	9.8	10.5	10.5	10.0	9.5	9.2	8.7
In percent of GDP	190	198	216	224	226	232	238	242	245	247	249
Total nonfinancial sector debt 4/	17.1	15.4	19.9	11.0	10.4	11.6	11.7	11.0	10.3	9.9	8.8
In percent of GDP	207	222	249	253	257	266	275	282	288	293	295
Domestic credit to the private sector	13.2	15.8	21.3	8.5	7.8	8.8	9.9	9.5	8.9	8.7	8.1
In percent of GDP	149	159	181	180	178	180	183	185	187	188	188
House price 5/	1.4	9.1	11.3	5.7	12.2	6.5	8.6	7.3	6.6	6.2	6.0
Household disposable income (percent of GDP)	60.4	60.5	61.0	60.4	60.0	60.0	59.8	59.4	58.9	58.1	58.1
Household savings (percent of disposable income)	38.0	37.1	35.5	35.4	33.0	31.5	30.3	28.9	27.3	25.4	25.0
Household debt (percent of GDP)	35.8	38.7	44.8	49.7	54.0	56.2	59.1	61.1	63.2	65.4	67.9
Non-financial corporate domestic debt (percent of GDP)	113	121	136	130	124	124	124	124	124	122	120
BIS credit-to-GDP gap (percent of GDP) 6/	21.1	20.8	18.2	10.5	0.4	...	...	...	...	...	...
GENERAL BUDGETARY GOVERNMENT (Percent of GDP)											
Net lending/borrowing 7/	-0.9	-2.8	-3.7	-3.9	-4.8	-6.1	-5.7	-5.6	-5.6	-5.5	-5.4
Revenue	28.1	28.5	28.2	28.3	29.2	28.8	29.1	28.8	28.5	28.2	28.0
Additional financing from land sales	2.7	1.9	2.0	2.6	2.9	2.8	1.7	1.4	1.1	1.0	0.9
Expenditure	31.6	33.2	33.9	34.7	36.9	37.7	36.5	35.7	35.2	34.7	34.3
Debt 8/	38.6	36.4	36.7	36.8	37.9	40.3	43.1	45.5	47.6	49.4	51.0
Structural balance	-0.5	-2.5	-3.6	-3.9	-4.8	-6.1	-5.6	-5.5	-5.5	-5.4	-5.3
BALANCE OF PAYMENTS (Percent of GDP)											
Current account balance	2.2	2.7	1.8	1.6	0.4	0.5	0.4	0.2	0.1	0.0	-0.1
Trade balance	4.1	5.1	4.4	3.9	2.9	3.1	2.9	2.7	2.5	2.5	2.4
Services balance	-2.0	-1.9	-2.1	-2.1	-2.2	-2.2	-2.2	-2.2	-2.1	-2.1	-2.1
Net international investment position	15.2	14.9	17.4	17.4	15.9	15.6	14.8	13.9	12.9	12.0	11.0
Gross official reserves (bn US$)	3,899	3,406	3,098	3,236	3,168	3,167	3,174	3,177	3,179	3,182	3,189
MEMORANDUM ITEMS											
Nominal GDP (bn RMB) 9/	64,718	69,911	74,563	81,526	88,702	95,539	103,084	111,560	120,546	130,318	140,613
Augmented debt (percent of GDP) 10/	52.3	56.6	62.0	67.3	72.7	80.2	86.2	91.1	95.6	99.3	101.5
Augmented net lending/borrowing (percent of GDP) 10/	-7.2	-8.4	-10.4	-10.8	-11.2	-12.7	-12.2	-11.9	-11.6	-11.5	-11.4

Sources: Bloomberg, CEIC, IMF International Financial Statistics database, and IMF staff estimates and projections.

1/ IMF staff estimates for 2017 and 2018.

2/ Surveyed unemployment rate.

3/ Not adjusted for local government debt swap.

4/ Includes government funds.

5/ Average selling prices estimated by IMF staff based on housing price data (Commodity Building Residential Price) of 70 large and mid-sized cities published by National Bureau of Statistics (NBS).

6/ Latest observation is for Q3 2017.

7/ Adjustments are made to the authorities' fiscal budgetary balances to reflect consolidated general budgetary government balance, including government-managed funds, state-administered SOE funds, adjustment to the stabilization fund, and social security fund.

8/ Official government debt. Estimates of debt levels before 2015 include central government debt and explicit local government debt (identified by MoF and NPC in Sep 2015). The large increase in general government debt in 2014 reflects the authorities' recognition of the off-budget local government debt borrowed previously. The estimation of debt levels after 2015 assumes zero off-budget borrowing from 2015 to 2021.

9/ Expenditure side nominal GDP.

10/ Augmented fiscal data expand the perimeter of government to include local government financing vehicles and other off-budget activity.

INTERNATIONAL MONETARY FUND

PEOPLE'S REPUBLIC OF CHINA

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

July 12, 2019

KEY ISSUES

Context. After the slowdown in 2018, reflecting financial regulatory strengthening and softening external demand, growth stabilized in early 2019. Financial deleveraging and reduced interconnectedness between banks and non-banks have helped contain the build-up of financial risks, but vulnerabilities remain elevated and progress on rebalancing is mixed. While a moderate slowdown is expected in 2019, uncertainty around trade tensions remains high and risks are tilted to the downside.

Policies. Successfully shifting from high-speed to high-quality growth in a highly uncertain environment requires stabilizing the economy amid rising trade tensions while continuing with deleveraging and strengthening rebalancing. The key elements are to:

- *Adjust macro policies and allow for a more flexible exchange rate*. The announced policy measures are sufficient to stabilize growth in 2019 provided there are no further increases in tariffs. If trade tensions escalate further, additional stimulus, mainly fiscal, would be warranted.
- *Improve external policies and frameworks* by working constructively with trading partners to better address shortcomings and enable a trading system that can more readily adapt to economic changes in the international environment. The global economy would benefit from a more open, stable, and transparent, rules-based international trade system. China can also benefit from further opening up and other structural reforms that enhance competition.
- *Continue strengthening the financial sector* by fully implementing the announced regulatory reforms, strengthening bank capital, especially for smaller banks, and enhancing macroprudential tools to address vulnerabilities from rising household debt. Developing a clear resolution regime would facilitate the exit of weak banks. Removing the implicit guarantees and hardening the budget constraints for state-owned enterprises (SOEs) would improve credit allocation and limit SOEs' advantage in accessing credit.
- *Boost competition by opening up* non-strategic sectors, particularly in services, to private and foreign enterprise, and unifying product markets across localities.
- *Modernize policy frameworks* by eventually moving to a single policy rate in the monetary policy framework, reducing the misalignment of center-local fiscal responsibilities, and further improving transparency and statistics.

Approved By
Kenneth Kang and Petya Koeva Brooks

Discussions took place in Guizhou and Beijing May 23–June 5, 2019. The team comprised K. Kang (head), J. Daniel, S. Das, F. Han, S. Jahan, E. Jurzyk, J. Kang (all APD), G. Li (FAD), M. Catalan (MCM), P. Deb (SPR), and A. Schipke, S. Chen and L. Zhang (Resident Representatives). FDMD D. Lipton held high-level meetings on June 3-4. Z. Jin, P. Sun and Y. Liu (all OED) joined the official meetings. T. Yan (COM) coordinated media activities, and J. Brondolo (FAD) provided governance assistance. G. Alvim, K. Chow, L. Tolentino, J. Zhang, Q. Shan, and J. Li supported the mission.

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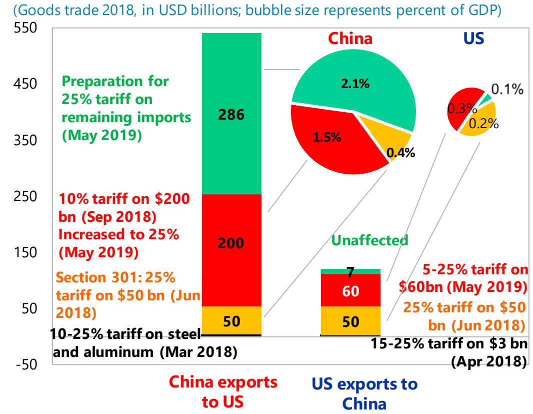
CONTEXT: NAVIGATING HEADWINDS AND UNCERTAINTY

1. **Reform agenda – a pause in deleveraging.** This is a critical year for the authorities' planned pivot from "high-speed" to "high-quality" growth. The authorities' made commendable progress on reducing financial sector fragilities and announced a lower growth target for 2019, a range from 6.0-6.5 percent. As economic activity slowed in the second half of 2018, however, the government shifted emphasis from deleveraging back to supporting growth. Structural reforms have continued in a number of areas but, while the principle of "competitive neutrality" has been put forward as a policy objective, its implementation remains at an early stage.

2. **External headwinds – trade tensions and weak global demand…** The trade conflict with the U.S. escalated since its start in spring 2018, and the outlook for the global economy in 2019 is weaker than previously expected. Two rounds of U.S. tariffs and counter-tariffs were implemented before a 'truce' and negotiations began in December 2018, which broke down in May and led to another round of tariff increases. At end-June, Presidents Xi and Trump agreed to temporarily keep tariffs at their current levels and to restart bilateral trade negotiations. The conflict goes beyond bilateral trade and extends to structural issues related to China's foreign investment regime, intellectual property (IP) protection, technology transfer policies, industrial policy, cyber security, and, more broadly, the large economic role of the state. Progress on some of these dimensions, opening up in particular, would be consistent with previous staff recommendations and boost medium-term prospects, while other aspects of a potential U.S.-China agreement, such as on managed trade, could negatively affect the multilateral trading system.

Tariff announcements

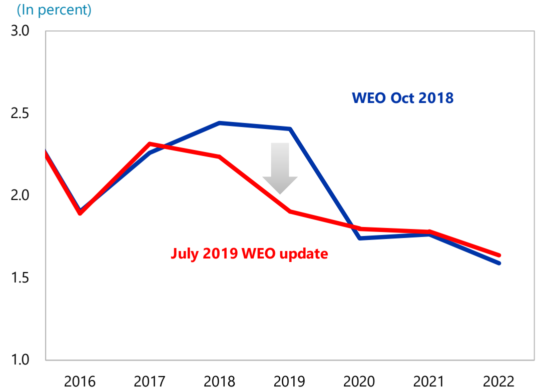
(Goods trade 2018, in USD billions; bubble size represents percent of GDP)



Source: CEIC.

Weaker domestic demand in advanced economies

(In percent)



Source: IMF WEO database.

3. **…leading to an uncertain and challenging environment**. In the event a comprehensive and durable agreement is not reached, uncertainty is likely to persist and weigh on both the near and longer-term outlook as China's access to foreign markets and technology may be significantly reduced.

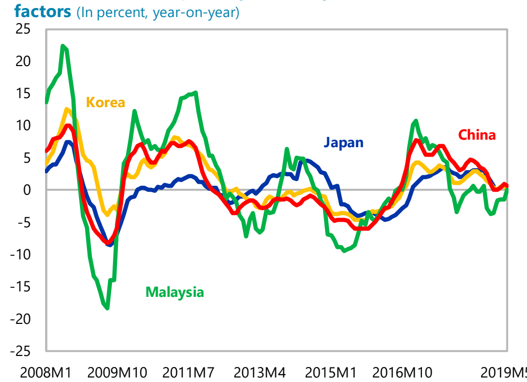
RECENT DEVELOPMENTS: WEAKER GROWTH AMID REGULATORY STRENGTHENING AND EXTERNAL HEADWINDS

4. Growth slowed in 2018… In line with staff projections, growth moderated from 6.8 percent in 2017 to 6.6 percent in 2018, as a result of necessary financial regulatory reforms and tighter conditions for local government (LG) infrastructure funding. Trade tensions with the U.S. have weakened sentiment and heightened stress in financial markets. The authorities have responded with a wide range of policy measures, including import tariff cuts, tax cuts, monetary easing, and a marginal relaxation of the pace of regulatory strengthening.

5. …but stabilized in 2019 Q1, before being hit by another trade shock. Real GDP growth was 6.4 percent (y/y) in Q1, unchanged from 2018 Q4. Domestic demand weakened further, however, to 4.9 percent in Q1 compared to 6.7 percent in 2018 Q4, as net exports contributed 1.5 percentage points to growth due to contracting imports. Nominal GDP growth also decelerated further, from 9.1 percent in 2018 Q4 to 7.8 percent in Q1, driven by sluggish producer prices. High-frequency indicators still point to sluggish domestic and external demand as renewed trade tensions continue to weigh on market and business sentiment.

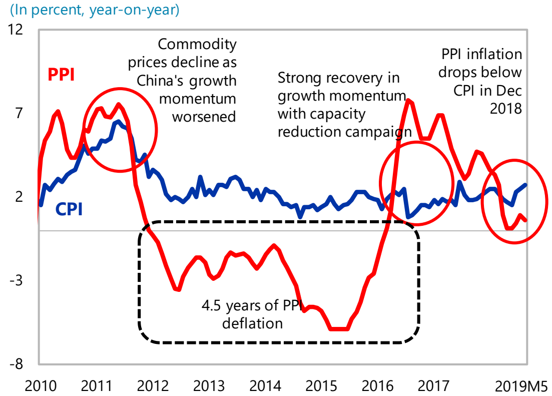
6. Core inflation moderated, while headline rose. Amid slowing activity, core CPI inflation fell just below 2 percent in mid-2018, and further to 1.6 percent in May. Headline CPI inflation rose to 2.7 percent in May, driven by rising food inflation. Driven by a global decline in commodity prices and weak infrastructure and construction, Industrial Producer Price Index (PPI) inflation fell sharply to below 1 percent in 2019, renewing pressure on corporate earnings and debt servicing capacity.

PPI Inflation trends partially driven by common external factors (In percent, year-on-year)



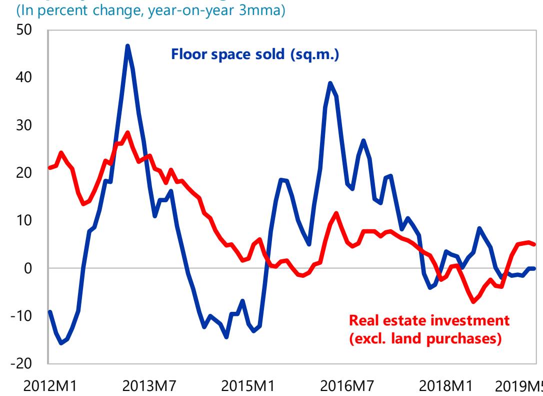
Source: Haver Analytics.

PPI inflation drops below CPI inflation
(In percent, year-on-year)



Source: CEIC.

Property market slowing since 2017
(In percent change, year-on-year 3mma)



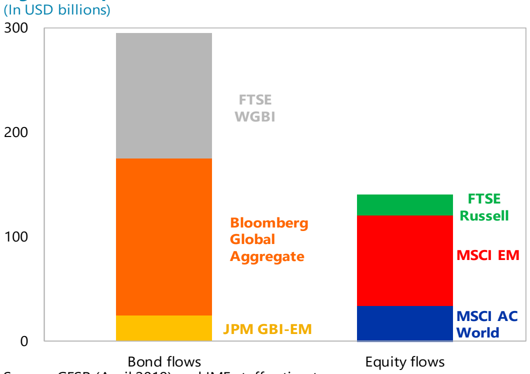
Source: CEIC and IMF staff estimates.

7. The property market trended down. Growth in real estate investment (excluding land purchases) was mostly negative in 2018, and both house price growth and sales growth slowed since late 2018. Housing inventories have started to build up in recent months, suggesting the housing cycle may still be in a downturn.

8. The current account (CA) continued to decline and capital flows moderated after strong inflows in early 2018.

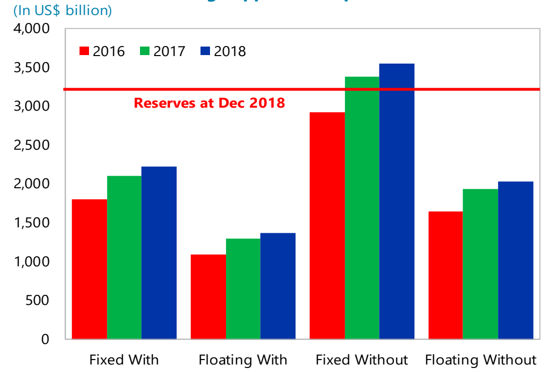
- *Current account*. The CA surplus has declined substantially relative to its peak of about 10 percent of GDP in 2007, reflecting strong investment growth, REER appreciation, weak demand in major advanced economies, technological upgrades in manufacturing, and a widening of the services deficit (see SIP). The CA surplus continued to decline in 2018, falling by about 1 percentage point, to 0.4 percent of GDP, driven by strong import growth. Export and import growth remained strong through most of 2018, partially due to frontloading of exports to the U.S. ahead of tariff imposition, before contracting from December. Driven by changing expectations about the outcome of U.S.-China trade negotiations, trade has been volatile so far in 2019, with nominal export growth near zero and imports contracting at 4 percent for the first six months of the year (y/y).
- *Exchange rate*. The bilateral RMB/USD rate depreciated relatively rapidly from mid-June to early August 2018, when measures to counter depreciation pressure – the 20 percent reserve requirement for FX derivatives (a capital flow management measure (CFM)) and the counter-cyclical adjustment factor (CCAF) in the daily trading band's central parity formation – were re-introduced. Despite the RMB/USD depreciation, the RMB was broadly stable against the basket and depreciated in real effective terms by about 2½ percent since the last Article IV. Estimates suggest little FX intervention by the PBC. At about US$3.2 trillion, China's foreign currency reserves remain more than adequate to allow a continued transition to a floating exchange rate.
- *Capital flows*. Capital inflows were strong in early 2018 and moderated through the year to small net outflows in 2018 Q4, but there were no significant outflow pressures. Capital inflows were supported by the inclusion of China A shares in MSCI equity indices and local currency government and policy bank bonds into the Bloomberg Barclays Global Aggregate Index. Staff estimates suggest these inclusions could result in sizeable additional inflows of around US$450 billion over the next 2-3 years.

Significant potential inflows from index inclusions
(In USD billions)



Source: GFSR (April 2019) and IMF staff estimates.

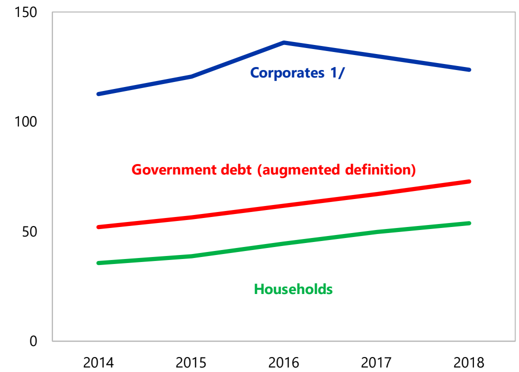
China's reserve coverage appears adequate
(In US$ billion)



Source: CEIC, IMF staff estimates.

9. After slowing last year, debt accumulation accelerated in 2019 Q1. Overall debt of the nonfinancial sector grew by an average of 3½ percentage points of GDP in 2017 and 2018, considerably more slowly than in the decade prior, as corporate deleveraging partially offset government and household debt accumulation – but still reached 257 percent of GDP in 2018. Recent policy easing measures have led to a sharp increase in the pace of debt accumulation in 2019 Q1, with household and corporate debt growing by 1 and 3 percentage points of GDP, respectively.

Household and government debt still rising
(In percent of GDP)

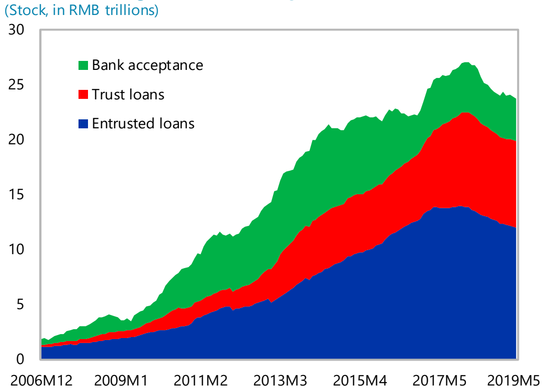


1/ Excludes LGFV.
Source: Haver Analytics and IMF staff estimates.

10. The build-up of risks in the financial sector has been contained, but vulnerabilities remain elevated and credit growth is picking up.

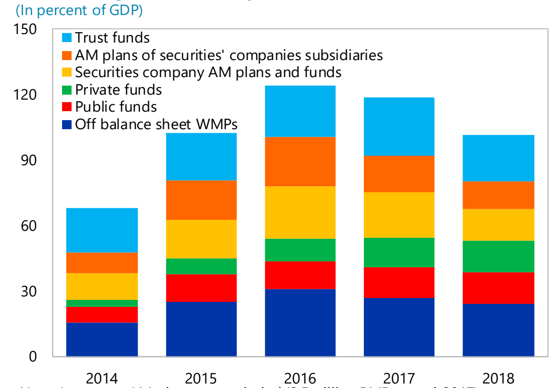
- *Financial deleveraging and reduced interconnectedness* between banks and non-banks, as well as somewhat improved risk-differentiation, resulted from regulatory and supervisory reforms. Bank asset growth fell from 15 percent (y/y) in mid-2016 to 7 percent (y/y) in mid-2018, driven by a fall in claims on other financial institutions. Banks' issuance of off-balance sheet investment vehicles, wealth management products in particular, was curtailed.

Shadow banking contracted through 2018
(Stock, in RMB trillions)



Sources: CEIC and IMF staff estimates.

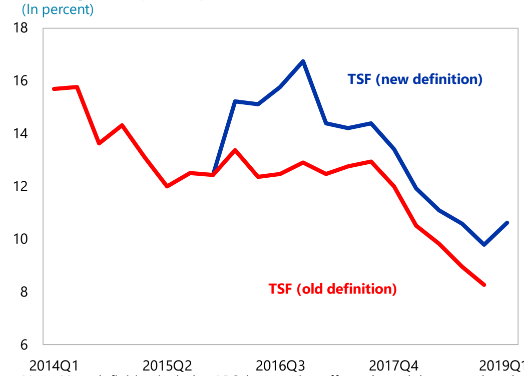
Asset management industry declined further in 2018
(In percent of GDP)



Note: Insurance AM plans are excluded (2.5 trillion RMB at end 2017).
Source: CEIC.

- *Credit growth slowed through 2018 but has begun to pick up in 2019*. As a result of the contraction in shadow banking, total social financing (TSF) growth slowed more sharply than expected, from 15 percent (y/y) in early 2017 to under 10 percent at end-2018. Bank lending to the corporate sector continued to expand strongly, but banks favored SOEs over private enterprises, and lending to small and medium-sized enterprises (SMEs) in particular was curtailed. Growth in household lending moderated, but remained high, and short-term

Credit growth picks up
(In percent)

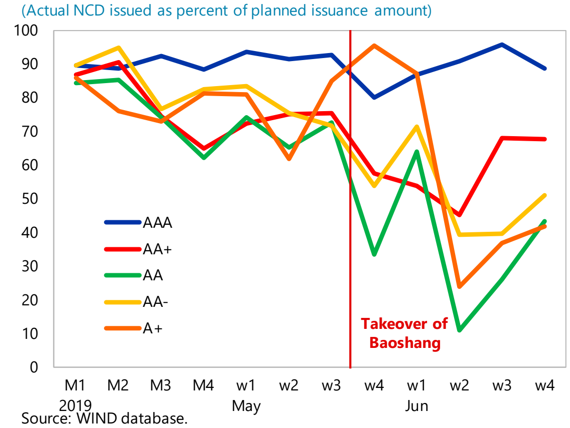


Note: New definition includes ABS, loans write-offs, and special purpose bonds.
Source: Haver analytics and IMF staff estimates.

credit continued to expand rapidly, in part to circumvent restrictions on mortgage lending. TSF growth accelerated in 2019 to 10.6 percent in May, due to policy stimulus.

- *A recent takeover of a non-systemic mid-size bank*. The government in May took over a medium-sized "zombie" bank with solvency and liquidity problems (Baoshang), the first public takeover in 20 years. The announcement that negotiated haircuts would be applied to large creditors' claims raised concerns about counterparty risks and highlighted balance sheet weaknesses facing many small and medium-sized banks (joint-stock commercial banks, city commercial, and rural banks make up about 45 percent of total banking assets), including more than a dozen that have yet to release 2018 financial statements. These banks are reliant on interbank funding and also provide funding to non-bank financial institutions (NBFIs). Interbank funding tightened for some small banks and NBFIs, as negotiable certificate of deposit (NCD) issuance (about a tenth of small bank funding), fell sharply while funding costs for many NBFIs rose significantly. The PBC took steps to stabilize funding conditions by injecting liquidity and introducing a new credit support scheme for banks' NCDs. Market sentiment has since stabilized, though borrowers with weaker balance sheets continue to face higher borrowing costs.

Drop in small banks and NBFI's NCD issuance
(Actual NCD issued as percent of planned issuance amount)

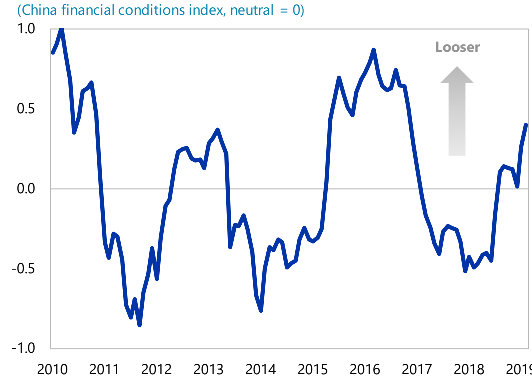


Source: WIND database.

11. Financial conditions, after tightening strongly in 2018, loosened in 2019.

- *Financial conditions tightened in the first half of 2018,* driven by more stringent regulatory standards for banks and non-banks. Corporate credit spreads widened, more so for lower-rated borrowers, and corporate bond defaults rose from a low base, mainly for private corporates. Notwithstanding strong foreign inflows, China's equity markets fell by 25 percent in 2018, more than other EMs, driven in part by margin calls and forced selling related to stock-pledged borrowings.

Financial conditions have loosened somewhat
(China financial conditions index, neutral = 0)

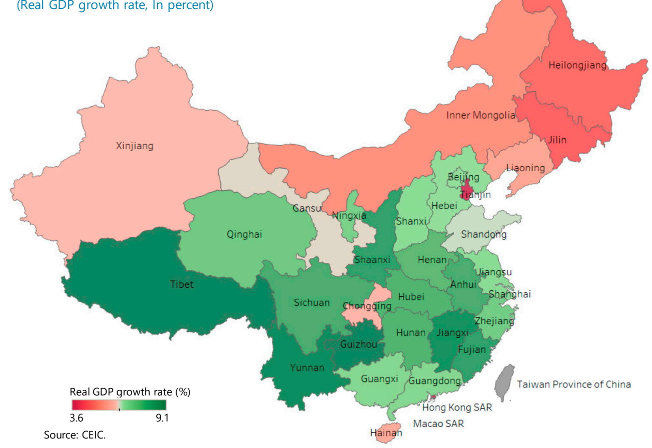


Source: S&P Global.

- *Financial conditions then eased somewhat after monetary policy loosened from summer 2018.* Monetary policy easing led to a decline in short-term interest rates, but access to credit for private, particularly smaller, firms remained difficult. The stock market has rebounded by 19 percent so far in 2019.

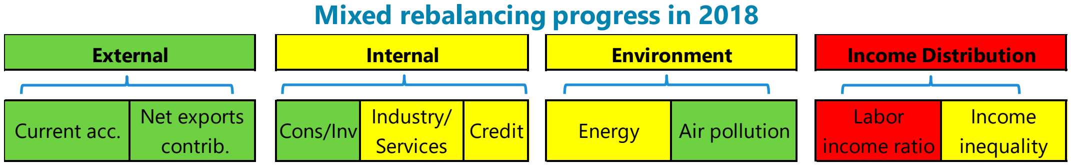
12. Progress on rebalancing was mixed in 2018. External rebalancing resumed with net exports contributing negatively to growth, while internal rebalancing towards consumption accelerated. Internal rebalancing towards services progressed more slowly and, after a big improvement in 2017, credit efficiency did not improve further. Environmental rebalancing continued but progress was more limited in reducing inequality. While absolute poverty has fallen to less than 3 percent of the population—close to the authorities' goal of eliminating it by 2020—still-high spatial and rural-urban inequality remains a challenge, as evidenced in the mission's visit to villages in Guizhou province.

Large variation in regional growth
(Real GDP growth rate, In percent)



Source: CEIC.

Mixed rebalancing progress in 2018

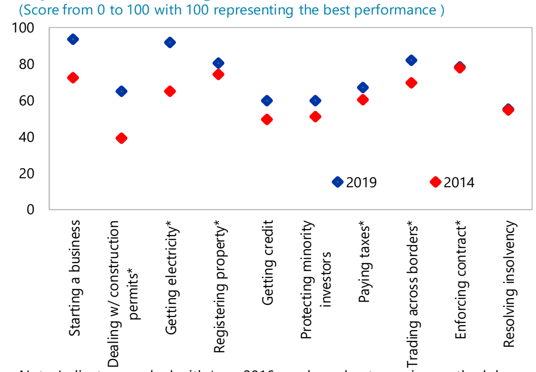


Note: Refer to Table 7 for details.

13. Progress on structural reforms continued.

- *Opening up*. The authorities cut tariffs twice, in line with staff advice, bringing the effective tariff rate down by over 2 percentage points to 7.5 percent in 2018. A new foreign investment law was passed, including provisions on equal treatment of foreign and domestic firms and prohibiting forced technology transfer, to take effect in January 2020, and the negative list for foreign investment was revised, relaxing restrictions primarily in agriculture, mining, and infrastructure sectors. Financial sector opening accelerated, including removal of the foreign ownership limit for Chinese banks and asset management companies, and restrictions on foreign ownership in futures, securities and life insurance companies to be fully lifted by 2020.

Improvements in doing business indices
(Score from 0 to 100 with 100 representing the best performance)

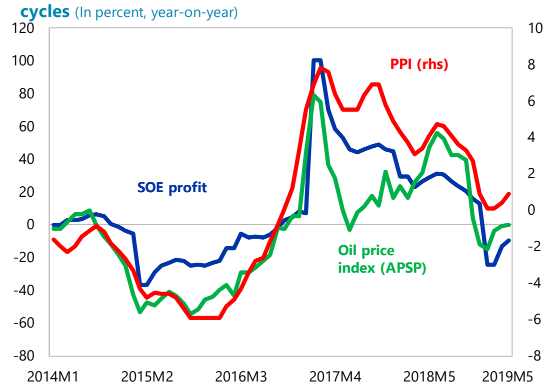


Note: Indicators marked with * are 2016 numbers due to scoring methodology revision.
Source: World Bank Doing Business database.

- *Role of market forces*. A Negative List for Market Access that clarified the sectoral restrictions and licensing requirements applying to both foreign and domestic firms was released. The authorities strengthened IP protection by establishing an IP tribunal in the supreme court, strengthening enforcement, and revising the patent law. A limited reform of the "hukou" (household residency registration system) was also taken. Measures taken in 2018 to improve the business environment resulted in China moving up 32 places to 46th in the World Bank's 2019 Doing Business Rankings.

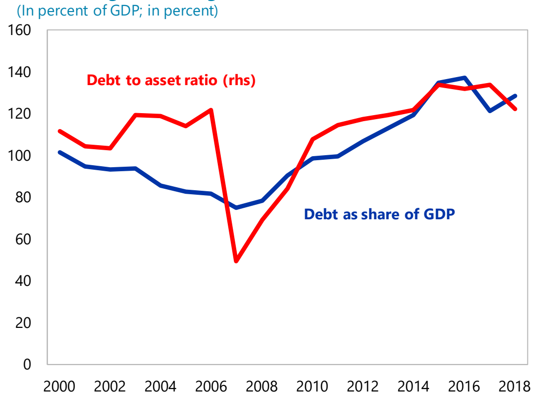
14. But some recent reforms have increased the dominance of SOEs and worsened the environment for private businesses. The treatment of zombie central SOEs is largely complete, but came mainly from mergers and acquisitions by other SOEs, rather than bankruptcy, resulting in fewer but larger SOEs. Overcapacity cuts improved profits in upstream, SOE dominated sectors and the profitability of industrial SOEs relative to private enterprise in downstream sectors. These two factors contributed to the decline in the SOE debt-to-assets ratio even as SOE debt as a share of GDP continued to rise. SOE debt as a share of total enterprise debt rose sharply, reflecting the shift in bank lending towards SOEs and away from private firms. Overall, SOE profitability remains weak and about a third of SOEs remain loss making.

Industrial SOE profit growth related to commodity price cycles (In percent, year-on-year)



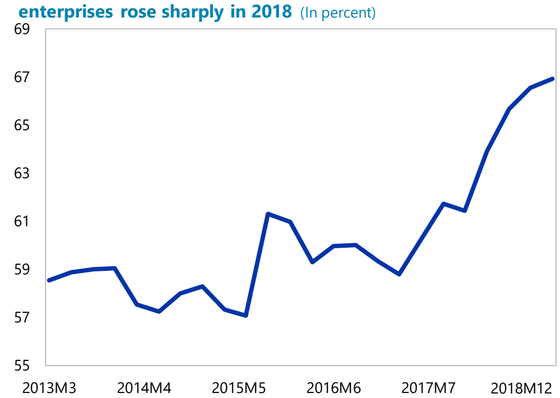
Note: "APSP" refers to Average Petroleum Spot Price and is calculated as simple average of U.K. Brent, Dubai Fateh, and West Texas intermediate.
Source: CEIC, IMF primary commodity prices database.

SOE leverage still rising as share of GDP
(In percent of GDP; in percent)



Source: CEIC and Ministry of Finance.

SOE liabilities as a share of total liabilities of nonfinancial enterprises rose sharply in 2018 (In percent)



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

15. The authorities responded to the slowdown with wide-ranging macro policies. Compared to the 2015/16 stimulus, the policy response this time is more focused on rebalancing, with fiscal policy more targeted and polices aimed at shadow banking and the property sector remaining restrictive so far. That said, not all measures are consistent with staff advice. In particular, the Personal Income Tax (PIT) reform decreased the progressivity of the tax system as a whole as it reduces the already small share of progressive tax revenues.

- *Fiscal – tax cuts and infrastructure spending expected to increase the "augmented" deficit by 1½ percent of GDP in 2019*. Under staff's economic-based ("augmented") definition of the general government sector (including estimated off-budget investment spending), the deficit widened by 0.4 percent of GDP in 2018, mainly due to higher expenditure. So far, the fiscal response has included reforming the PIT (higher exemption threshold and more deductions), lowering the higher VAT rates (from 16/10/6 percent to 13/9/6 percent), increasing the VAT refund for exports, cutting taxes for smaller firms, accelerating issuance of LG bonds, and, more recently, allowing some financing for LG infrastructure investment to be used as equity in infrastructure projects. In total, the augmented deficit is expected to widen to 12.7 percent of GDP in 2019.

Fiscal Measures in the Baseline

Measures	Details	Size (% of GDP)	Fiscal multiplier effect*	Overall impact on 2019 growth	Recommended/consistent with MT goals?
Personal income tax--threshold	Thresholds effective Oct 1, 2018, new law in place from Jan 1, 2019. Raises the threshold for tax exemption from RMB 3500 to 5000 per month; adds special deductible items; and shifts from taxing monthly to annual income.	0.3	Medium	0.15	No. Tax base is already narrow. PIT one of the few progressive taxes. Reducing regressive payments, such as those related to social security, would target inequality better.
Personal income tax--increase in allowable deductions	Additional deductions on six categories: expenditure on children's education, continuing education, critical illness treatment, mortgage interest payment, rental expenses, and elderly care. E.g. a typical family with one child and a 60-year-old parent can enjoy additional pre-tax deductions of RMB 2000 per capita, equivalent to raising the exemption further from RMB 5000 to RMB 7000.	Less clear	Medium	Small	No in general. Recommend the targeted tax credit for children. Do not recommend the mortgage interest deduction. Encourages debt finance and, along with the deduction for rental expenses, distorts consumption choices toward housing.
Increase of VAT refund on exports	Effective Sep 18, 2018, an increase in the VAT rebate for exports by 2 pp (weighted average). VAT refund on exports is RMB about 1600 billion (1.8% of GDP) as of 2018.	Less clear, -0.1	Medium	0.05	Yes. The increase of VAT refunds to exports is a welcome step, but we recommend moving towards a standard VAT system where exports are zero rated.
VAT cuts for manufacturing sectors	Effective April 1, 2019. Reduction of the standard and of one of the reduced VAT rates. Reducing the current rate of 16% in manufacturing and other industries to 13%; lowering the rate in transportation, construction and other industries from 10% to 9%; and, maintaining the 6% rate on all other items.	0.3	Medium	0.15	Yes. The resulting compression of VAT rates is welcome and will allow future consolidation into even fewer rates than the current three.
Tax support for MSEs	Micro and small businesses enjoy now half corporate income tax for taxable annual income exceeding 1 million but less than 3 million, and lower rates for the taxable income below 1 million.	Less clear	Small	Small	No in general. The measures support MSEs, but these types of preferential rates can cause threshold effects and prevent growth of MSEs.
Social security contribution cuts	Effective May 1, 2019. Lower the employers' contributions to 16%.	0.2	Medium	0.1	Yes. Other measures should be used to break the long-term social security contribution-benefit gap.
Infrastructure (financed by special purpose bonds)	Special purpose bonds quota increases from RMB 1350 billion in 2018 to RMB 2150 billion in 2019. Also, some rail and road construction announcements, but without detailed plans.	0.7	Medium	0.35	No.
Total Fiscal Impact		**1.5**		**0.8**	

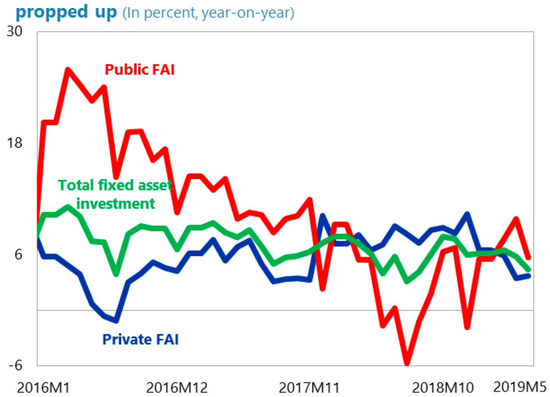
* When number not specified, large is about 0.8, medium is about 0.5, and small is about 0.3.

- *Monetary and credit – regular and targeted easing with partial transmission.* With a cut in each quarter of 2018Q2 – 2019Q1, the PBC lowered the reserve requirement ratio (RRR) for banks by a total of 350bps, increased liquidity through the medium-term lending facility (MLF), and created a new 'targeted' medium-term lending facility (TMLF). While the April RRR cut had limited impact as it was offset by a decline in other PBC-provided liquidity, the July RRR cut led to a decline in interbank interest rates, which only partially transmitted to medium and longer-term lending rates. To assist the private sector, the PBC 'targeted' some RRR cuts for lending to micro and small enterprises (MSEs). The government also announced a target of having the large state-owned banks increase lending to MSEs by 30 percent in the 2019 Government Work Report, and separately announced the objective of having private enterprises receive at least 50 percent of new loans within three years.

Authorities' Views

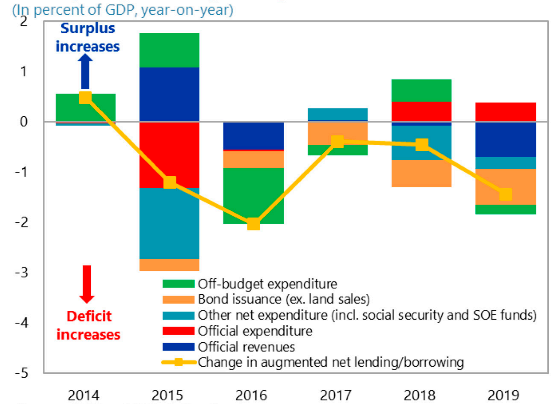
16. **The authorities noted that 2019 started well with strong real GDP growth in Q1, stable employment, and moderate inflation**. GDP growth remained solid at 6.4 percent in Q1, unemployment rate was stable at around 5 percent (less than the 5.5 percent target), and PPI inflation continued to rise. The national industrial capacity utilization rate in Q1 was the second highest Q1 rate since 2013, and industrial production had been steady, led by strong growth in high-tech industries. The growth rates of M2 and TSF also remained steady, basically matching the growth rate of nominal GDP. The authorities viewed the housing market as broadly stable and the recent rebound in house prices after the 2019 Spring Festival as temporary and mainly driven by seasonal factors. The reforms aimed at curbing shadow credit had been successful in reducing leverage in the financial market, particularly in the asset management businesses, and banks continued to bring off-balance sheet assets onto their balance sheets.

Investment growth stabilized as public investment was propped up (In percent, year-on-year)



Source: CEIC.

Decomposing the change in augmented balance
(In percent of GDP, year-on-year)



Source: CEIC and IMF staff estimates.

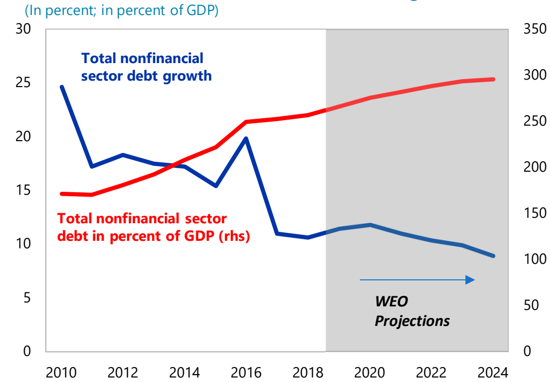
17. **The authorities are implementing policies focused on high-quality development and adhering to supply-side structural reforms, deepening market-oriented reform, and accelerating opening up.** Conditions for high-quality growth were positive in China, with its improving business environment, large domestic market, and high potential to upgrade and transform industry. Consumption remains a strong driver of growth, macro-control of the economy is improving, and the "active" fiscal policy undertaken would increase the competitiveness of the corporate sector and help stabilize exports. Credit growth was rebounding and supporting the real economy.

OUTLOOK AND RISKS: SLOWER GROWTH, RISING DEBT, HIGHER UNCERTAINTY

18. **The near-term outlook is particularly uncertain given the trade tensions.** Growth is expected to decline moderately to 6.2 and 6.0 percent in 2019 and 2020, respectively, given the authorities' policy response. Key assumptions underpinning the baseline forecast are that the current tariffs (25 percent on US$250 billion of U.S. imports from China, 5-25 percent on US$110 billion of Chinese imports from U.S.) stay in place, no new tariffs are imposed, and the policy

stimulus is not rolled back. Although renewed tensions are weighing on sentiment, domestic demand is expected to strengthen in the remainder of 2019 as a result of the stimulus, and export growth is expected to be positive, partially supported by 'frontloading', both leading to an increase in import growth. Headline inflation is projected to rise to 2.2 percent in 2019, due to higher food prices. Reflecting easing measures, nonfinancial sector debt as a share of GDP is expected to rise sharply in 2019, by 10 percentage points, and credit growth to pick up to 10.5 percent.

Nonfinancial sector debt to continue increasing in 2019
(In percent; in percent of GDP)



Source: Haver Analytics and IMF staff estimates.

19. **Over the medium term, growth is expected to gradually slow to 5½ percent as the economy moves towards a more sustainable growth path.** Reflecting China's early stage in productivity convergence, growth is expected to remain strong in the medium term, but slow gradually as the economy shifts further from the industrial sector to lower-productivity service sectors (Box 1). Credit efficiency is expected to improve, but not sufficiently to prevent debt-to-GDP from rising further. Augmented debt is on an upward trajectory and is not projected to stabilize over the medium term (Appendix I). The outlook is also constrained by factors such as petering gains from structural transformation and urbanization, and aging in the longer term.

Box 1. Productivity Convergence and Potential Growth[1]

China's convergence remains at an early stage and ample rooms exist for further catch-up and robust growth. Nonetheless, the shift from industry to services and shrinking distance to the frontier will likely put sustained downward pressure on GDP growth, which could slow to 4 percent by 2030.

Convergence – Where does China stand today?

China's labor productivity has converged from 15 percent of the frontier to 30 percent over the past two decades, reflecting both labor reallocation from low-productivity agriculture to high-productivity industry and services, and upgrading within each sector. Since the 1990s, the employment share of agriculture fell steadily from 60 percent to below 30 percent, while the share of industry and services rose to 28 and 46 percent respectively. Within each sector, there has also been fast catching up, though significant gaps remain.

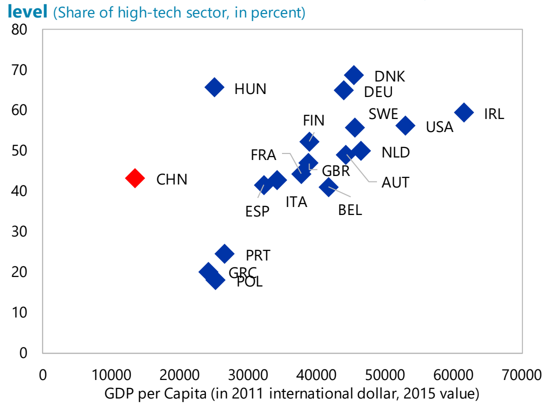
Industrial convergence has been rapid, and China has a highly advanced industrial structure today. Industrial productivity has converged from 15 percent of the frontier at the end of 1990s to about 35 percent, driven both by the upgrade from low-tech to high-tech sectors and productivity increase in each industry. Notably, China has a more advanced industrial structure than its income level would suggest. The share of high-tech in industrial value-added was 43 percent in 2015 based on 2011 international dollars, similar to the level in Belgium and Spain, where income levels are about three times higher.

[1] Prepared by L. Zhang based on a forthcoming working paper "China's potential growth: A stocktaking and reassessment" by M. Zhu, L. Zhang, and D. Peng

Box 1. Productivity Convergence and Potential Growth (Concluded)

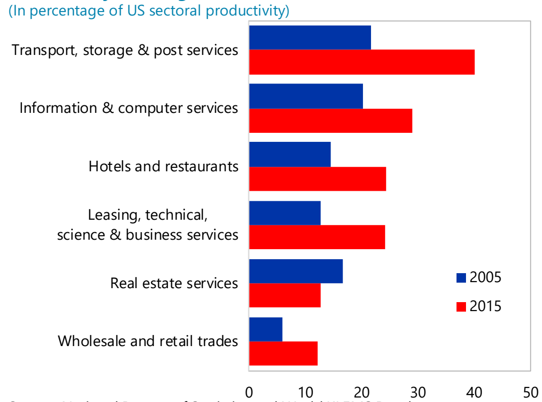
Service convergence has been slower. Service productivity has converged from 10 percent of the frontier in the end 1990s to 26 percent, lagging that of the industrial sector. This reflects both the non-tradable nature of certain services and less opening up of the service sector in China. The degree of convergence also varies, with transportation services most advanced at 40 percent, followed by ICT services at 28 percent benefiting from the high penetration of internet and rapid digitalization in China, but the productivity of wholesale and retail trade remains low at below 12 percent of the frontier, likely due to restrictive regulations.

China has a more advanced industrial structure given income level (Share of high-tech sector, in percent)



Source: World KLEMS Database, China's National Bureau of Statistics.

Productivity convergence within services
(In percentage of US sectoral productivity)



Source: National Bureau of Statistics and World KLEMS Database.

Convergence – Where is China heading?

Structural shifts are key to understanding China's future growth trend. While the previous shift from agriculture to industry and services has boosted aggregate growth, since 2012, China has entered the phase of "deindustrialization", with labor shifting from industry to services. Given industrial productivity is about 1.3 times high as services productivity, deindustrialization will likely put sustained downward pressure on aggregate growth.

Further productivity convergence is likely, though at a slower pace. Reflecting its early stage in sectoral convergence, China has the potential to maintain robust growth in the coming decade. Nonetheless, growth will be on a gradual downward trend as the sectors move closer to the frontier and the transition from industries to services continues. Applying convergence speed at sectoral levels based on cross-country experiences in Rodrik (2013) and Bourles et.al (2010), both industrial and service productivity growth are expected to slow to 3–4 percent by 2030, with the level of productivity reaching 57 and 44 percent of the frontier respectively. The shift from industry to services is projected to continue, with service share rising to 65 percent by 2030. Overall, this would imply GDP growth would slow from current 6½ percent to 4–4½ percent by 2030. Faster SOE reform and opening up of the service sector could moderate the pace of slowdown by boosting productivity growth.

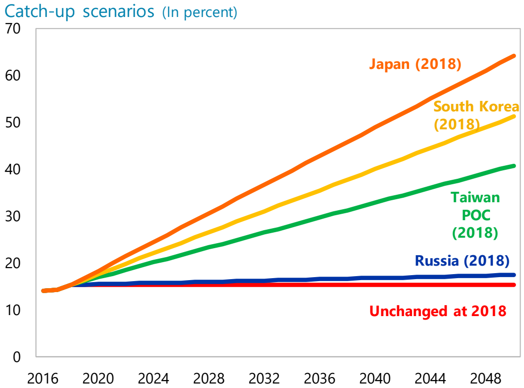
20. Risks are tilted to the downside (Appendix II).

- **Downside.** On the *external side*, a further escalation in tensions could result in higher tariffs, disrupting supply chains and depressing confidence and investment. Furthermore, the US and other countries' export ban to certain Chinese technology companies could exacerbate this trend. This could be combined, on the *domestic side*, a with a deterioration in asset quality of financial institutions, especially among small and mid-size banks, and funding stress facing banks and non-bank financial institutions amid greater concerns about counterparty risk, a sharp downturn in the property market, and a return to PPI deflation, which could generate a selfreinforcing downward cycle, affecting weaker private corporates in particular. Over the longer term, weaker external demand, or the potential reversal of globalization and resulting weaker trade outlook and reduced access to markets and technology could weigh on China's growth prospects. At the same time, the increasing role of the state could further worsen resource allocation, especially if combined with a reliance on debt to hit excessively high short-term growth targets.

- **Upside.** A reduction in trade tensions could spur confidence and investment. With reduced uncertainty, stimulus measures in the pipeline could have a larger impact, leading to an overshooting of near-term growth. Given the still-large differences in income per capita between China and advanced economies, there is ample room for convergence, though this will require significant reforms to boost productivity. A comprehensive domestic reform package to increase the role of markets, aided by greater openness, along with meaningful SOE reform, could significantly lift productivity and potential growth (see section E) over the medium term.

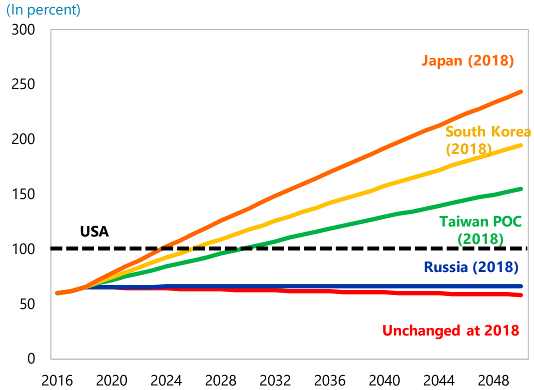
Still much potential to catch-up

China GDP per capita as share of U.S. GDP per capita in 2050 Catch-up scenarios (In percent)



Note: Graph shows China's GDP per capita as a share of US GDP per capita if it catches up to the 2018 GDP per capita level of the other countries. E.g. 'Japan 2018' shows the share if China achieves Japan's 2018 GDP per capita in 2050.
Source: Haver Analytics, IMF WEO database, UN and IMF staff estimates.

China GDP as a share of US GDP in Catch-up scenarios (In percent)



Note: Graph shows China's GDP as a share of US GDP if it catches up to the 2018 GDP per capita level of the other countries. E.g. 'Japan 2018' shows the share if China achieves Japan's 2018 GDP per capita in 2050.
Source: Haver Analytics, IMF WEO database, UN and IMF staff estimates.

Authorities' Views

21. The authorities broadly agreed on the outlook for growth and external risks, but were more sanguine on domestic risks. They were confident that real GDP growth would be within the 6.0-6.5 target range and expected CPI inflation to remain below 3 percent despite the pickup in the second half of the year. They expected the current account to remain in surplus in the medium term. House prices were expected to be broadly stable throughout the year as city governments are now held fully accountable and can use a variety of measures (e.g., administrative restrictions and macroprudential tools) to ensure their stability. They also viewed a large decline in nationwide house prices in the near term as very unlikely due to still-strong growth, strong income growth, and continued rapid and large-scale urbanization. They did not expect a significant increase in the debt ratio of the economy in 2019, despite an uptick in Q1, as credit growth would moderate in the remainder of the year and nominal GDP recovers. They were mostly concerned with external risks in the near- to medium-term, especially the risk of further escalation of the trade tensions with the U.S. with its negative impact on corporate investment and relocation of global supply chains, as well as the risk of decoupling triggering a more severe global slowdown.

POLICIES TO STRENGTHEN REBALANCING AMID HIGH UNCERTAINTY AND HEADWINDS: FIVE KEY QUESTIONS

Policymakers face the challenge of stabilizing the economy amid rising trade tensions while continuing progress towards balanced and sustainable growth. Under this uncertainty, shifting from high-speed to high-quality growth would call for addressing a number of policy questions:

A. How Should Macro Policies Respond to Rising Trade Tensions and Uncertainty?

22. Key issues. Financial deleveraging and improved control over LG off-budget infrastructure financing led to slower, but safer, growth in 2018. A sizeable policy package has been rolled out in 2019, geared toward supporting growth at a still-high level. Given the uncertainty, policy advice is tailored to different scenarios, corresponding to different outcomes from the trade talks with the U.S.

23. Policies under the baseline—"stay the course"; avoid additional stimulus and excessive credit growth.

- ***Fiscal* policy**.
  - No additional stimulus is needed as the planned stimulus is sufficient to stabilize growth in 2019 and 2020 despite the recent tariff increase. Nevertheless, given the risk of further escalation, consolidation should wait for greater clarity on trade and the external environment, but resume as tensions ease and the outlook becomes clearer. Policy space should be used to offset any negative impacts from needed structural reforms instead of geared towards achieving excessively-high growth targets.
  - Augmented debt is high (73 percent of GDP in 2018), rising rapidly, and is projected to exceed 100 percent of GDP in 2024. Given China has some fiscal space (large assets, low borrowing costs), consolidation can be gradual. Reducing the augmented deficit by about ¾ percent of GDP a year over ten years would stabilize debt while keeping the growth impact manageable.

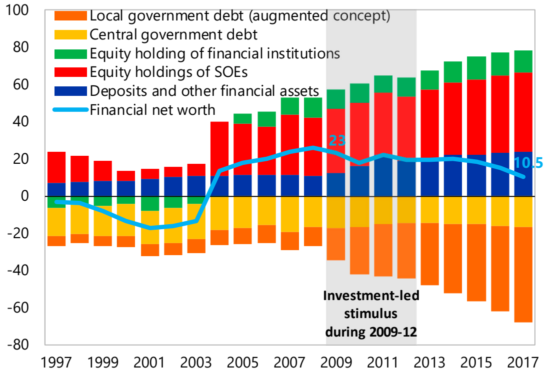
Debt Stabilization Scenarios

	Debt stabilizes in :			
	5 years		***10 years***	
	Augmented	Narrow	Augmented	Narrow
Annual average reduction in primary deficit	-1.3	-0.6	-0.7	-0.3
Debt at end of the period	93	46	107	52

Source: IMF staff estimates.

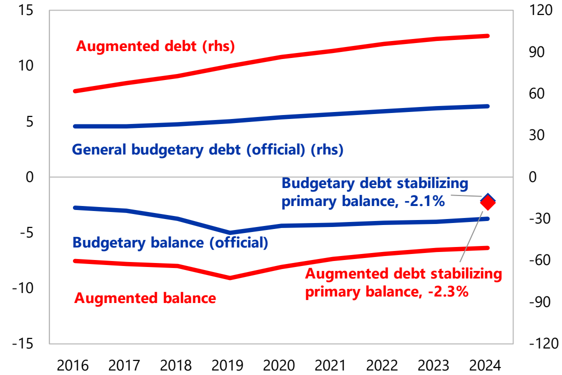
  - To increase the quality of medium-term adjustment, the focus should be on limiting infrastructure spending (especially off budget), boosting progressive and pro-rebalancing taxes (e.g. PIT, property, and carbon), while spending more on health, education, and transfers to poorer households and regions.

China's General Government Net Financial Worth has decreased since the Investment-Led Stimulus (In percent of GDP)



Source: April 2019 Fiscal Monitor.

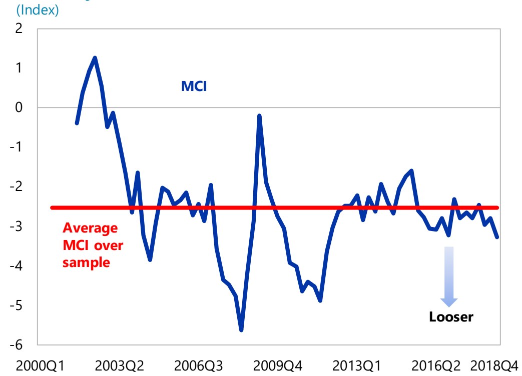
Government debt projected to rise, especially augmented
(In percent of GDP)



Source: IMF staff estimates.

- Further ***monetary policy*** easing is not recommended as actions already taken are sufficient, still being transmitted, and core inflation remains anchored. Further actions should be data dependent, including on the impact of fiscal loosening and credit growth.
- After progress on reducing ***credit growth*** in 2018, credit growth accelerated in 2019. Aggregate credit growth remains high and credit allocation has worsened. The recent credit acceleration should be curtailed to prevent an increase in credit growth in 2019, and further deceleration should occur in 2020. In the medium term, credit growth should moderate towards nominal GDP growth or lower and the efficiency of credit needs to improve, through a more market-based allocation of credit instead of targets on lending to private enterprises. Reforms to address the underlying causes of unsustainable and inefficient credit growth (see section C) should focus on reducing the pace of credit growth to SOEs (see section E) and pricing credit appropriately. Measures in the near term to boost bank capital would facilitate further downsizing of shadow banking and increase banks' resilience to shocks.

Monetary conditions loosen
(Index)



Note: MCI tailored to transitional monetary policy framework with both price and quantity targets. Weights are derived from a regression of real GDP growth on the excess reserve ratio, real ST interest rate, and change in REER.
Source: CEIC and IMF staff estimates.

- Flexibility of the ***exchange rate*** should increase to facilitate adjustment to the new external environment, with public communication and FX intervention used when needed to counter disorderly market conditions (e.g. exchange rate acting as shock amplifier, herd-like behavior). Greater flexibility will also better prepare the markets and the public for higher volatility in the future. In this regard, the authorities should refrain from using the CCAF in the daily trading band to control the exchange rate, while the reserve requirement on FX forwards should be phased out. CFMs should not be used to actively manage the capital flow cycle and substitute for warranted macroeconomic adjustment and exchange rate flexibility. Publishing information on FX intervention would improve the transparency and communication of the framework. Further capital account opening, while desirable over the medium term, should be carefully sequenced and targeted.

- **Policy mix.** Stronger planning and calibration of policies, and coordination among agencies, would enhance policy traction, reduce volatility and mitigate the risk of start-and-stop reforms.

24. Policies under an adverse scenario. A further escalation of the trade tensions, for example the U.S. raising tariffs to 25 percent on remaining imports from Chinese, could reduce growth by around 0.8 percentage points over the following 12 months, driven by a sharp fall in demand and tightening of financial conditions, with significant negative spillovers globally. Against this shock, further easing, primarily through fiscal measures, would be warranted.

- A ***fiscal*** expansion of 0.8 percentage points of GDP could be used to stabilize the economy. Such an expansion should be on-budget and centrally financed, pro-rebalancing, and targeted to low-income households to maximize the multiplier effect and contribute to lower poverty and inequality. Measures could include higher social transfers and spending on education and health, and lower social security contributions (see table).

Recommended Fiscal Measures Under an Adverse Scenario

Measures	Size (% of GDP)	Fiscal multiplier effect*	Targeted	Consistent with MT goals?
Expenditure				
Permanent increase in rural/urban pensions	0.1	Large	Yes	Yes
Increase in social transfers to provinces	0.1	Large	No	Yes
Education	0.1	Large	Yes	Yes
Health	0.1-0.2	Large	Yes	Yes
Unemployment benefits	0.1	Medium	Yes	Yes
Revenue				
Remove minimum social contribution contributions for low-income households	0.1	Large	Yes	Yes
Full VAT refund on exports	0.1-0.2	Medium	No	Yes
Total Size	**0.8**			

* When number not specified, large is about 0.8, and medium is about 0.5.

- As core inflation could fall along with growth, further ***monetary policy*** easing may be warranted but should be modest, data dependent, and factor in the impact of other easing measures on inflation. As RRRs are still high (13.5 percent for large banks), the most effective easing would take the form of further RRR cuts, followed by a cut in the PBC 7-day reverse repo rate.

- The ***exchange rate*** should remain flexible and market-determined to help absorb the tariff shock. Greater depreciation pressures and potential capital outflows will call for clear public communication and possible FX intervention to counter disorderly market conditions. In case FX market pressures persist and lead to herding and financial system stress, tightening existing CFMs in a transparent and temporary manner may be appropriate, as part of a broader policy package to stabilize the economy and markets.

- ***Financial sector reform*** and deleveraging should continue. Macroprudential policies should not be loosened in general. Distortionary administrative restrictions (e.g. on home purchases and sales) should be relaxed before relaxing any housing macroprudential policies. Government intervention to support the stock market should be avoided. If there are concerns about the systemic impact from forced selling by firms reliant on stock-collateralized borrowing, transparent direct support to the firms could be considered.

25. Policies under an upside scenario. If a comprehensive agreement with the U.S. on trade is reached, stimulus measures should be scaled back.

- The ***fiscal stimulus***, expected to increase the augmented deficit by 1½ percent of GDP, would be too large and should be reduced in 2019 with fiscal consolidation proceeding more rapidly. Options to withdraw stimulus include: (1) decreasing LG infrastructure spending, particularly off-budget spending; (2) accelerating implementation of a recurrent property tax; (3) raising pollution charges; and (4) tightening some of the PIT reform parameters.
- With the stronger output and inflation outlook, ***monetary policy*** may need to tighten moderately, through an increase in the PBC 7-day reverse repo rate. Credit growth should slow.
- The ***exchange rate*** could strengthen, creating room to more rapidly eliminate distortionary restrictions such as the reserve requirement on FX forwards and the counter-cyclical adjustment factor in the daily trading band.
- Efforts to build bank capital buffers via external injections or profit retention should be intensified.

Authorities' Views

26. The authorities broadly agreed with staff's growth forecasts and policy recommendations. They noted they have been following an "active" fiscal policy, focused on supporting domestic demand through tax and fee cuts, and that policies were frontloaded. The authorities expected the policy impacts would show gradually in the second quarter of 2019. They viewed their monetary and credit policies as prudent and appropriately calibrated to the current economic environment. They did not intend to loosen monetary policy in the baseline, but noted that some additional targeted measures to increase credit to the private sector and SMEs may be undertaken to ensure adequate financing of that sector.

27. The authorities reiterated their commitment to increasing FX flexibility and deepening market reforms. They noted that the exchange rate had become more flexible in recent years and the markets had adjusted well to the increased volatility. They confirmed that no new administrative measures or CFMs were put in place since the last Article IV other than the CCAF and the reintroduction of the 20 percent reserve requirement on FX forwards. The authorities saw these as macroprudential measures to prevent exchange rate overshooting and noted that, the conditions necessary to remove them were not yet satisfied. Going forward, PBC will closely monitor exchange rate movement, promote market-oriented exchange rate reform, maintain exchange rate flexibility, and dynamically assess and adjust macroprudential measures. The PBC is establishing a macroprudential management framework for managing cross-border capital flows, and actively managing the capital flow cycle is not a target of such macroprudential regulation. They also noted that China's disclosure of FX intervention data meets international standards since joining IMF's SDDS.

28. The authorities are pressing ahead with financial regulatory reform despite heightened external risks. With banking as the biggest sector of the economy, opening up and reforming financial services are an integral part of the authorities' structural supply-side reform. To strengthen the solvency of small banks, the authorities are encouraging profit retention and capital raising from outside sources. If these options fail to strengthen the weakest banks in the system, consolidation through acquisitions is viewed as another option to boost systemic resilience.

29. The authorities have prepared contingency plans in the case of an adverse scenario. Pipeline projects have been identified on both central and local government levels, to support public housing, farming, rural connectivity, regional development, and some basic public infrastructure, and to strengthen unemployment insurance and job training. They noted they have adequate monetary policy room to deal with a worse external environment, with RRRs still above 10 percent and nominal interest rates well above zero, and that increased exchange rate flexibility has expanded the room for monetary policy. They are increasingly focused on policy transmission, in particular targeted measures to improve the structure of credit, and would refrain from excessive credit growth to support the economy. They saw the measures already in place as sufficient to handle exchange rate volatility and did not see any need to introduce additional CFMs, but emphasized the need to closely monitor the scale, composition and nature of capital flows.

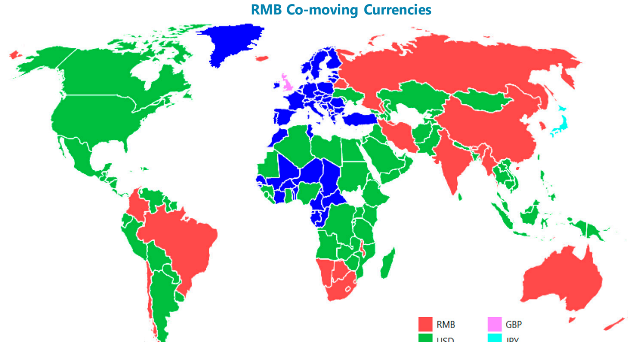
30. As the risks of protracted trade tensions had increased, the authorities also noted that policy implementation and increasing efficiency are key even in an upside scenario. The current budget aims to improve the quality of development and not simply pursue high-speed growth.

B. How Should China's External Policies and Frameworks Evolve to Modernize the International System?

31. Key issue. For China to continue to benefit from globalization and support the aspirations of developing countries, it will need to limit adverse spillovers from its own policies and work with partners to build a stronger multilateral system that promotes open and stable trade.

32. Spillovers from trade tensions. The ongoing tensions not only weigh on global trade and confidence, but how they are resolved may shape the global trading system – positively or negatively – for years to come. A preferential or "managed trade" deal among the two largest economies would divert trade and investment and could weaken the rules-based global trading system, adding a further medium-term risk for the global economy. Such a deal could also have *direct* spillovers that put at risk substantial EU and Asian exports. Global sectoral dislocations could ensue, with Vietnam and Australia, for example, seeing substantial declines in real exports of extractive industries, while electronics would be most affected in Korea and Malaysia in the longer term (Box 2 and SIP).

RMB Co-moving Currencies



Source: Tovar and Mohd Nor (2018).

Box 2. Spillovers from a Potential U.S.-China Managed Trade Agreement[1]

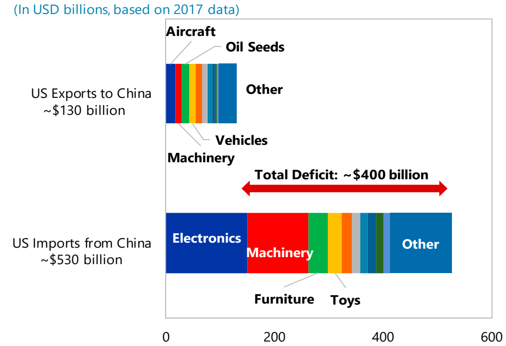
While there is much uncertainty about the likelihood and shape of a possible agreement, a managed trade deal could introduce new distortions. A deal promises to reduce policy uncertainty, lower tariffs, and promote new reforms. However, there might also be costs—for example, if the two sides ended up with a transactional deal whereby China were to purchase more U.S. goods and/or imposes voluntary export restrictions but with little progress in reducing underlying barriers to trade and investment.

Closing the US-China bilateral trade deficit through managed trade will be difficult. The U.S. exports about $130 billion of goods to China each year currently, while importing $530 billion, yielding a deficit of around $400 billion. U.S. exports to China of aircraft, machinery, and agricultural products such as soybeans account for close to $50 billion per year. Even if China cut the bilateral trade gap in half by importing an additional $200 billion per year of these products from the U.S., the current volume of these imports would need to increase by 400 percent, which seems unlikely in the near term.

In the short term, larger Chinese imports of a broader group of U.S. exports would likely cause trade diversion. Recent **IMF research** finds that bilateral trade balances are mostly determined by aggregate macroeconomic conditions. This suggests that, unless China significantly boosts demand, the increase in purchases from the U.S. will likely be offset by a decrease in imports from the rest of the world. China's import structure from the U.S. gives a preliminary indication of where trade diversion may take place, although its extent and direction will be contingent on the specific outcome of a China-US deal. For example, purchases of more U.S. aircraft would affect France and Germany the most. Goods in certain sectors, such as electronics, however, may be more difficult to substitute with U.S. imports at least in the short run.

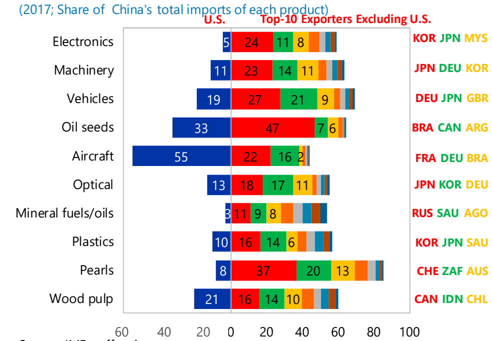
This scaling up of imports from the U.S. could have a particularly substantial effect on European and Asian gross exports. Depending on how the adjustment takes place, European Union exporters could see declines of about $84 billion due to exposure to items such as vehicles, machinery and electronics. Korea and Singapore could potentially lose exports amounting to about 2.1 and 3.8 percent of their GDP, respectively. Smaller countries may be more affected if the adjustment costs fall more on primary products and more easily substitutable homogenous commodities and less on sophisticated manufactured goods and electronics.

US-China trade of goods structure
(In USD billions, based on 2017 data)



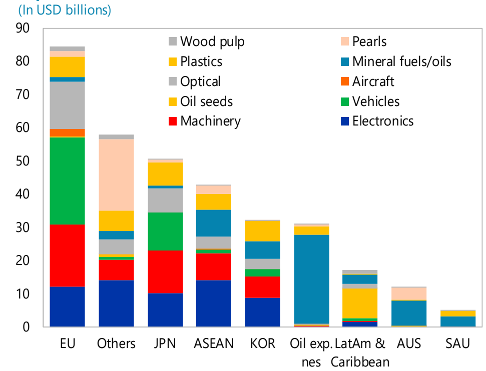
Source: Comtrade and IMF staff estiamtes.

China's import structure for top products imported from U.S.
(2017; Share of China's total imports of each product)



Source: IMF staff estimates.

Exports-at-Risk
(In USD billions)



Sources: UN Comtrade; and IMF staff calculations using HS-6 digit data and around 200 economies.

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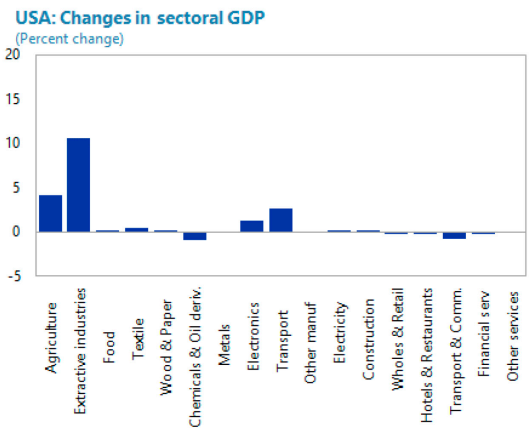
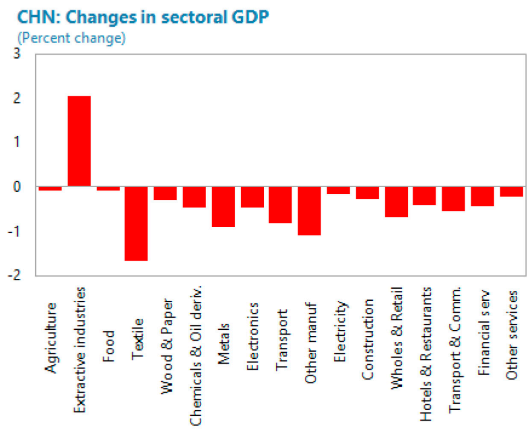
[1] Prepared by P. Deb, S. Hannan, and S. Jahan; also C. Caceres, D. Cerdeiro, and R. Mano ("Trade Wars and Trade Talks: Estimated Effects Using a Multi-Sector Model", IMF Working Paper, 2019), E. Cerutti, S. Chen, and A. Mohommad

Box 2. Spillovers from a Potential U.S.-China Managed Trade Agreement (Concluded)

In the longer term, a managed trade deal could generate significant sectoral dislocations globally. A general equilibrium sectoral trade model (see Caceres et al. 2019) illustrates the impact of a scenario of a 50 percent reduction in the bilateral U.S.-China trade deficit. When such a deal is implemented through increased purchases of U.S. goods (mainly primary sector products and vehicles/aircraft), some countries see large declines in sectoral GDP. For example, Vietnam and Australia, would see significant declines in extractive industries, while electronics would be most affected in Korea and Malaysia. Some U.S. sectors benefit from larger Chinese purchases, while those same sectors tend to struggle in China. As a rule, the long-run productivity effects of these reallocations are negative.

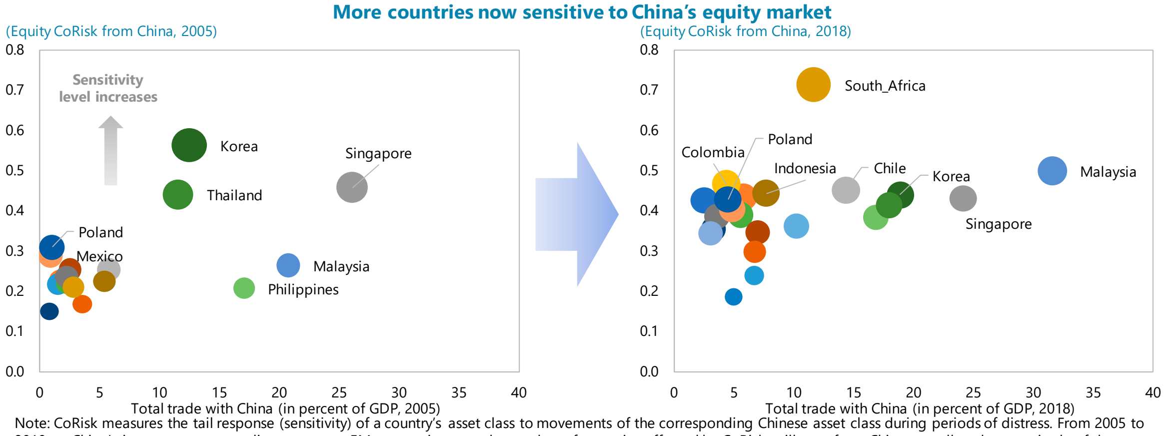




Losses could be amplified by factors outside the model. While the results discussed above focus on long-term productivity effects, aggregate losses could be larger on account of adjustment costs and the dynamic response of labor and capital accumulation to the new distortions a trade deal might introduce. For example, if the reduction of the bilateral trade deficit was brought about by guided Chinese purchases of U.S. goods, China could be expected to experience aggregate GDP losses due to higher import costs. While the U.S. would likely benefit, its aggregate output gain would likely be small, and the preferential treatment of U.S. imports in China would result in negative spillovers on third countries, with larger effects on countries for which China is a preponderant trading partner and which do not have a diversified economy. The impact on global GDP from the distortions introduced by a trade deal would likely be negative and weigh against the benefits from reduced policy uncertainty, the withdrawal of higher tariffs, and the introduction of new reforms.

33. The global economy would benefit from a more open, stable, and transparent, rules-based international trade system. China and its trading partners should work constructively to address shortcomings in the trading system and enable a system that can more readily adapt to economic changes in the international environment. Trade tensions between China and the U.S. should be quickly resolved through a comprehensive agreement that avoids undermining the international system and not through a managed trade deal that targets a compression in the U.S.-China trade deficit. It is important that an agreement between two large and systemically important trading partners serves to reinforce WTO rules, is non-discriminatory, and is based on market mechanisms and macroeconomic fundamentals.

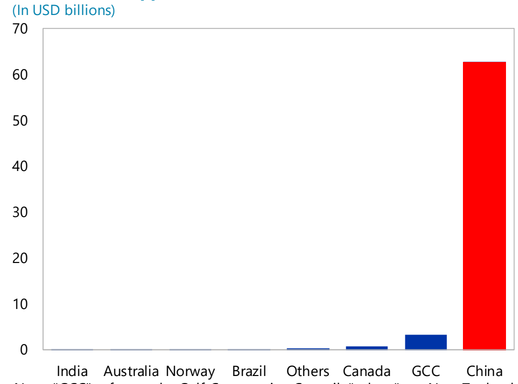
More countries now sensitive to China's equity market



Note: CoRisk measures the tail response (sensitivity) of a country's asset class to movements of the corresponding Chinese asset class during periods of distress. From 2005 to 2018, as China's importance as a trading partner to EM economies rose, the number of countries affected by CoRisk spillovers from China as well as the magnitude of the spillovers increased substantially.
Source: IMF staff estimates.

34. **China can also play an important role and benefit from modernizing the international trade system and further opening up.** China should work together with international partners to advance trade negotiations in areas such as e-commerce and services and ensure the continued enforceability of existing WTO commitments through a well-functioning, improved WTO dispute settlement system. China may also accept more open investment regimes, and transparency/reduction on industrial subsidies. As a global leader in e-commerce and fintech, China could collaborate with other countries to set global standards on industry regulation, digital standards, and cyber security. More generally, China can support the international system and benefit from further opening up and other structural reforms that enhance competition.

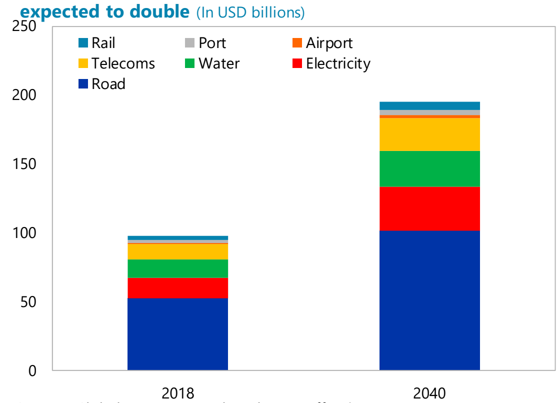
Government support for aluminum sector, 2013-2017
(In USD billions)



Note: "GCC" refers to the Gulf Cooperation Council; "others" are New Zealand, Russia, Spain, and the United States.
Source: OECD (2019) "Measuring distortions in international markets: the aluminum value chain", OECD Trade Policy Papers, No. 218.

35. **External lending frameworks should be strengthened to support its effectiveness for both partner countries and China.** China's external lending, such as through the Belt and Road Initiative (BRI), has the potential to bring significant benefits to partner countries by directing financing to much-needed infrastructure projects, strengthening bilateral trade, and deepening global value chains. A framework that promotes greater coordination, cooperation, and transparency would help maximize the benefits of China's external lending to partner countries by directing financing to most needed infrastructure projects. Enhanced debt sustainability monitoring, improved trade policies and customs procedures, and exchange rate and financial sector policies are

Annual infrastructure investment gaps in BRI countries expected to double (In USD billions)



Sources: Global Investment Hub and IMF staff estimates.

key. The authorities' new BRI-Debt Sustainability Framework (DSF) is a positive step to enhancing discipline in external lending and should be complemented by a coordinating body charged with monitoring debt sustainability and overseeing broader BRI issues. Competitive project selection with open procurement and private sector participation and sound project assessment would strengthen resource allocation while mitigating environmental, financial, and corruption risks. Such frameworks should adhere to global standards that promote transparent and sustainable lending practices by fostering cooperation among borrowers, creditors and international organizations and enhance capacity building. Environmental sustainability can be enhanced by ensuring investment projects are green, low-carbon, and climate resilient.

Authorities' Views

36. **The authorities noted that trade tensions are a major risk faced by the global economy and hoped that all parties would seek to maintain and strengthen the multilateral and rules-based trade system.** They emphasized that there are no winners in a trade war and China is committed to credible consultations based on equality and mutual benefit. They noted that China is well placed to navigate the increased uncertainties given its economic resilience—diversification of exports to non-US destinations and increasing role of domestic demand and policies—and still sufficient room for fiscal and monetary policy maneuvers. They explained that their three immediate WTO reform priorities include resolving the impasse on the selection of appellate body members, restricting the abusive use of national security exemptions, and curbing the increasing prevalence of unilateral trade actions. They noted ongoing work with other emerging markets and the OECD.

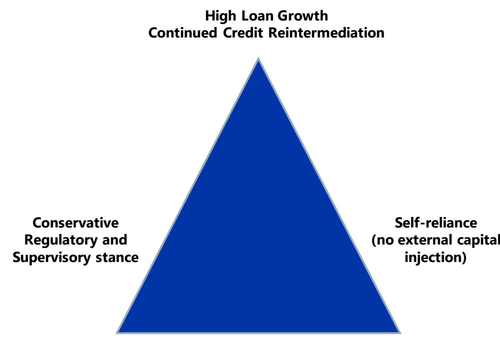
37. **The authorities underscored the broad scope of the Belt and Road Initiative, that encompasses not only infrastructure projects but also financial and trade connectivity, policy coordination, and cultural ties.** The authorities are actively working towards full implementation of their new BRI-DSF by gathering the necessary data and building up capacity among government agencies and financial institutions. They also underscored the recent commitment towards green investment under the initiative. They noted that at present there are no plans to change the oversight framework of the BRI.

C. How to Continue Deleveraging and De-risking Amid Tighter Domestic Financial Conditions and Slowing Growth?

38. **Key Issues**. On the *positive* side, concerted efforts to strengthen financial regulation, reduce regulatory arbitrage, and improve the institutional framework for financial supervision, led to a contraction of shadow banking and financial interconnectedness, resulting in a needed decline in credit growth and corporate debt. On the *negative* side, many banks' business models and profitability have come under pressure, system-wide capital remains comparatively low, particularly in small and medium sized banks, household debt rose rapidly, and credit allocation worsened as

private firms' access to credit was curtailed, reflecting balance-sheet strains in small and medium-sized banks, greater risk aversion, and less shadow financing.

The banking sector is facing an impossible trinity

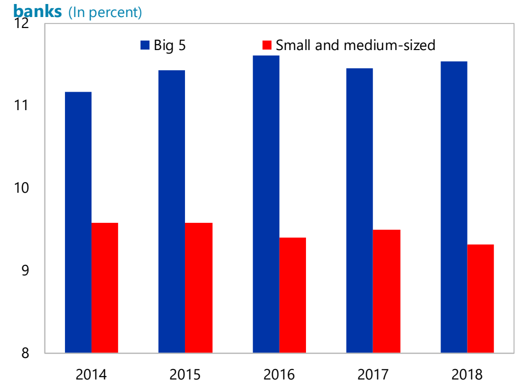


39. The priority should be to avoid regulatory backtracking and continue with structural regulatory reforms to reduce still-elevated vulnerabilities, while boosting bank capital. The heightened risk aversion and funding pressures on small banks following the first public bank takeover in twenty years underscore the need to move promptly on needed reforms, including those recommended by the FSAP (Appendix VI). Key recommendations include:

- *Fully implement announced regulatory reforms*. The asset management sector, which continues to see significant maturity and liquidity mismatches, should be uniformly regulated and supervised, with reforms for the sector introduced from late 2017 fully implemented without delays. Micro-prudential regulations should not be relaxed, even temporarily, for cyclical reasons or to offset tighter financial conditions.

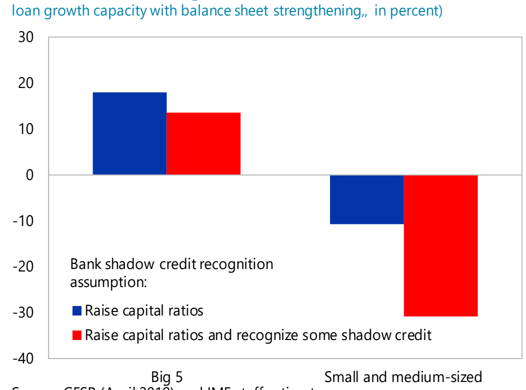
- *Strengthen bank capital* to facilitate the continued downsizing of shadow banking and encourage migration of these assets onto bank balance sheets, and improve the transmission of monetary policy. Finalize the DSIBs and SIFIs framework, including additional capital surcharges. Encouraging retention of profits and/or providing tax incentives to raise equity (such as an Allowance for Corporate Equity (ACE)) from non-bank sources would be preferable to increasing capital through cross-bank holdings of perpetual bonds which increases interconnectedness and may exacerbate systemic risk.

Lower tier 1 capital adequacy at small and medium-sized banks (In percent)



Source: SNL financial.

Banks outside the Big 5 face a trade-off between improving resilience or extending new credit (Estimated aggregate one-year loan growth capacity with balance sheet strengthening,, in percent)

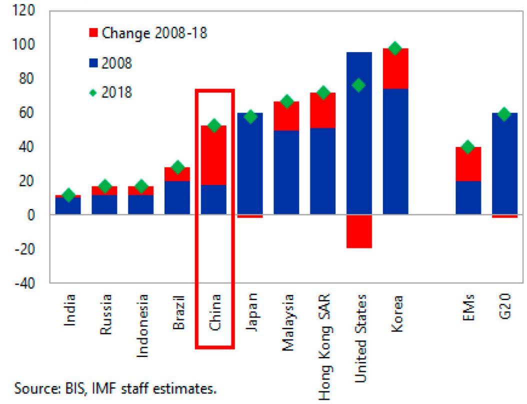


Source: GFSR (April 2019) and IMF staff estimates.

- *Further enhance the financial framework* by developing *resolution regimes for banks* that are applied consistently across banks (following up on FSAP recommendations) and strengthening the deposit insurance system to help facilitate the exit of weak institutions.

- *Contain vulnerabilities from rising household debt* by strengthening macroprudential tools and developing a personal bankruptcy regime (see SIP). The debt-service-to-income (DSTI) limit (currently 55 percent) should be tightened to international norms of 30-50 percent, applied to all debt obligations including those from nonbanks (e.g., P2P lending), and used more actively to enhance the effectiveness of loan-to-value limits, for example, by restricting the use of unsecured loans for mortgage down payments. The systemic risk assessment of the household sector should be extended beyond aggregate credit and housing market indicators, and the quality and scope of the credit registry be improved. Over time, the authorities should develop a personal bankruptcy regime which, together with strengthened institutional arrangements (e.g., asset and credit registries), can help address situations of extreme over-indebtedness while mitigating moral hazard. The recently introduced income tax deduction for interest on mortgages should be removed.

Large increase in China's household debt-to-GDP ratio
(In percent)



Source: BIS, IMF staff estimates.

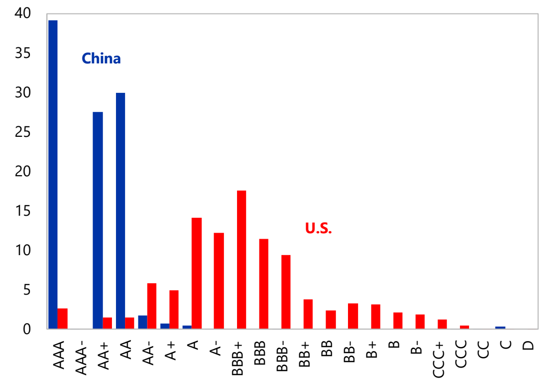
- *Fintech regulation* should press ahead with comprehensive fintech supervisory oversight, including the current, welcome "substance over form" approach (based on activity rather than type of entity). Current initiatives that strengthen data gathering and enhance "know your customer" requirements are welcome. Policies that support open networks and foster competition, while maintaining financial stability, would help address the presence of oligopoly in the digital industry. The PBC's announcement in March, outlining market entry requirements for foreign companies in the domestic digital payments market, is a welcome step. At the same time, efforts that leverage fintech to bolster greater financial inclusiveness, including greater internet penetration in rural areas, should be encouraged.
- China's *anti-money laundering and countering-financing of terrorism* (AML/CFT) system is relatively young, but the institutional framework is comprehensive, as is domestic coordination. The most recent assessment report of China's AML/CFT system was published on April 17, 2019 by FATF (Appendix III). The authorities should address the identified shortcomings, including measures to increase the transparency of beneficial owners of legal entities operating in China (also an anti-corruption measure), introduce a comprehensive legal framework to implement UN-based targeted financial sanctions requirements and improvements in financial sector supervision and preventive measures (e.g., customer due diligence and politically exposed persons).

40. To improve credit allocation and efficiency, policies to increase lending to the private sector should be complemented with policies that reduce the share of credit to SOEs (see SIP). Removing the pervasive implicit guarantees and other advantages (e.g. endowed land) enjoyed by SOEs would help foster debt and regulatory neutrality and promote higher-quality deleveraging.

- A comprehensive and well-sequenced plan to *remove implicit guarantees* in the medium-term is needed to improve corporate credit allocation. In the near-term, one way would be to require corporates that receive such implicit advantages to explicitly pay the cost to the budget; this would be in addition to the standard targeted transfer of SOE profits to the fiscal budget. Alternatively, SOEs that fail to meet the dividend payout target of 30 percent of profits could be penalized, such as by reducing their access to loans or increasing their credit spreads. Banks' risk weights on loans to corporates receiving such guarantees could also be increased to correct the underpricing risk to the banks.

- *Other financial regulatory* options to assist private firms include: (1) gradually tightening the caps on banks' exposure limits on SOE loans, with the goal of equalizing the application of large and related-party limits on lending to SOEs and private enterprises in the medium-term; (2) harmonizing regulation in the segmented bond market, to increase liquidity and price discovery; and (3) dropping the requirement that medium-term notes and commercial paper obtain an AA rating or higher, to encourage more issuance by smaller firms, while allowing investors to bear the risks and bonds to default.

Chinese bond ratings are high
(In percent)



Source: Bloomberg.

- To *improve SMEs' access to financing*, expediting payments to SMEs (especially from SOEs) and increasing use of alternative forms of collateral, such as moveable assets and accounts receivable, would be preferable to lowering risks weights for SMEs or expanding public credit guarantees.
- Increasing *transparency* on SOE/private enterprise credit would also help, for example, by publishing the share of bank credit to each group.
- More *equity financing* could be encouraged, for example, through an Allowance for Corporate Equity that provides an income tax deduction for the normal rate of return on equity. However, implementation of an ACE should be monitored for its impact on tax collection.
- Strengthening the overall *credit culture* will also improve lending decisions and enhance financial resilience. This would include developing a more comprehensive credit registry and encouraging operation of more foreign ratings' agencies to improve bond ratings.

Authorities' Views

41. The authorities agreed that bank capital needs to be strengthened, particularly for small banks, and recognized the rapid rise in household debt. The authorities viewed Baoshang Bank as an isolated case and considered the risk of contagion to be low and manageable, as the PBC is ready to provide sufficient liquidity to mitigate funding problems that could affect other banks. They also agreed with the need to establish a well-functioning resolution regime. On the rise in household debt, the authorities acknowledged that DSTI limits have not been changed in the past decade and are currently used mainly as a microprudential tool. They plan to enhance the role of DSTI limits as a macroprudential tool going forward but emphasized the need to improve the information of all household debt obligations. The authorities saw the merits of having a unified credit registry, but favored having credit information collected and shared by different registries, including market-based ones. They agreed on the need to promote the establishment of a personal bankruptcy regime, to improve the existing enterprise bankruptcy law, and to strengthen institutional arrangements, including establishing a universal property registration and reporting system, further developing the social security framework, and addressing the moral hazard concern that some debtors may abuse a personal insolvency regime.

42. On fintech, the authorities recognized that the dominance of a few market leaders – and the use of particular technologies – could amplify risks to the financial system. Accordingly, the authorities are formulating rules for fintech regulation which will establish basic principles for innovative fintech products, create rules for new financial services channels, including administrative and safety rules for banks' application programming interfaces, data protection, as well as regulation of key technologies such as cloud computing. A comprehensive oversight plan of fintech firms is expected to be rolled out in the future.

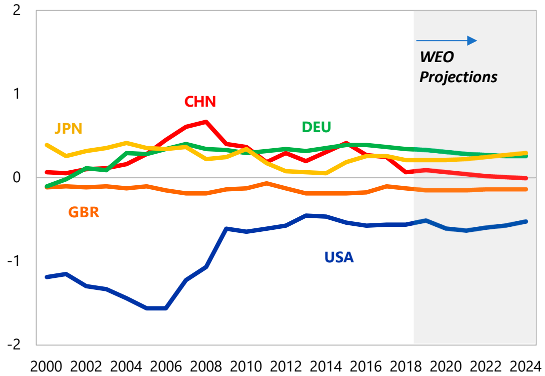
43. On AML/CFT, the authorities are preparing a plan to address shortcomings identified in the FATF report, which will outline division of responsibilities among relevant departments. They aim to submit it to the State Council as soon as possible. The authorities have already adopted regulations that require financial institutions to obtain beneficial ownership information for new clients, and imposed timetables for the existing clients. They have also adopted new standards to identify financial institutions not complying with the AML regulations and impose sanctions

44. The authorities highlighted their success in deleveraging. They noted that the requirement that SOEs decrease their leverage (liability-to-asset ratio) by 2 percentage points by 2020 has yielded positive results. In addition, they have implemented a pilot program requiring banks to jointly decide on whether they should lend to highly indebted SOEs. They viewed the lower cost of capital for SOEs as reflecting market perceptions of SOEs being less risky. They were committed to further deleveraging of SOEs but stressed that the process would need to be gradual. They noted the need to properly balance deleveraging, risk prevention, and economic stability, while encouraging financial institutions to lend to the private sector, particularly SMEs, following market principles They also agreed that credit allocation to SMEs could be improved by finding alternatives to collateral, including through using fintech to determine their creditworthiness.

D. How to Contain External Imbalances and Further Boost Consumption?

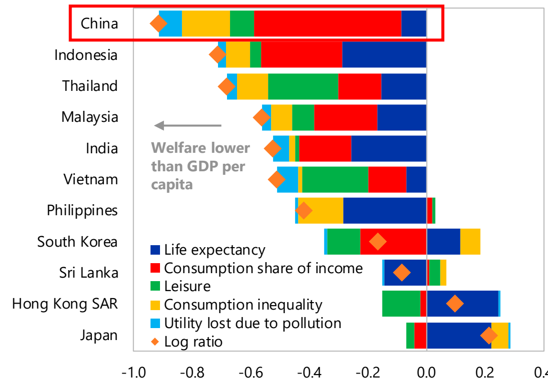
45. Key issues. China has made welcome progress in reducing external imbalances over several years. The external position in 2018 was broadly in line with medium-term fundamentals and desirable policies (Appendix IV) The CA is projected to remain close to balance over the medium-term, but there are risks that an excessive surplus reemerges should consumption fail to rise as quickly (e.g. due to high household debt) or investment fall faster than expected (e.g. due to further credit tightening). Achieving a durable balance in the external position requires continued progress in addressing distortions that encourage excessive household savings and further boosting consumption. This will also increase the welfare of Chinese citizens, who spend less on consumption than those in other similar income-level countries.

China no longer a contributor to global imbalances
Current Account Balances (In percent of world GDP)



Source: IMF WEO database.

China's low consumption negatively affects welfare
(Decomposition of log ratio of welfare to per capita GDP, 2012)



Source: Bannister and Mourmouras (2017).
Note: Welfare estimated using Jones and Klenow (2016) methodology, which incorporates data on consumption, leisure, inequality and mortality to calculate expected lifetime utility across countries, and extend it to include environmental externalities. For each country, the components of the log ratio of estimated welfare to GDP per capita are displayed relative to the US log ratio, to show the factors that contribute most to the gap between welfare and income.

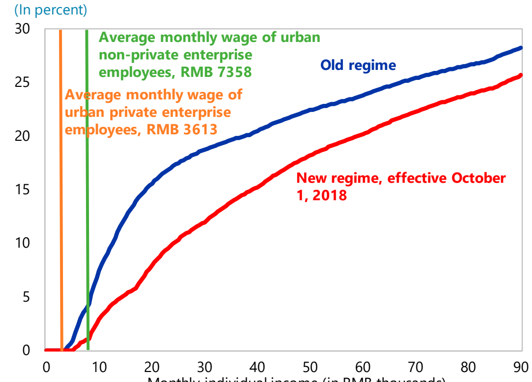
46. Continued progress in addressing distortions that encourage excessive household savings and boosting consumption would help achieve a durable external balance. China's savings rate is projected to fall over time due to demographic changes, but targeted fiscal reforms can also help boost consumption and reduce inequality. The structural reform priorities are to:

- *Enhance the social safety net to lower precautionary savings*. Policies should seek to increase spending on social welfare including healthcare, education, and pensions, and to improve access to social services by accelerating *hukou* reform. A shift in certain spending responsibilities, e.g. health and education, to the central government would ensure a minimum level of service and reduce the large disparity between urban and rural public service provision.

- *Make the tax system more progressive*, by:

  - *Reducing the personal income tax threshold and widening the tax base*. This would be in contrast to the recent PIT reform which raised the taxable income threshold sharply and introduced a wide range of deductions which have the effect of further lifting the exemption threshold, with the better-off benefitting most, and narrowing the tax base.

PIT reform reduces effective rates further
(In percent)



Source: China Ministry of Finance.

  - Remove minimum *social security contributions for low income households*, which result in prohibitively high effective tax rates for the lowest earners.

  - Accelerate the introduction of a nationwide recurrent *property tax*, which would also provide an important source of LG revenue and contribute to curbing property speculation.

  - Impose a substantial *carbon or coal tax* to tackle air pollution and climate change would also help generate revenue to offset higher social spending, as well as save almost four million lives by 2030.

47. The financial system and policy framework should prepare for greater capital flow volatility. To handle a more open capital account and volatile capital flows, the financial system needs to be strengthened through continued de-risking and improved FX risk management. Greater exchange rate flexibility should be complemented by further steps to deepen the FX market and improve transparency. In light of the growing importance of benchmark-driven foreign portfolio flows, it is important to develop markets and tools for risk management (e.g. bond futures). Regulatory reforms should adhere to international standards to encourage investment by institutional and long-term investors and deepen RMB internationalization. Over the medium term, the CFMs should be gradually phased out in a sequence consistent with greater exchange rate flexibility and other supporting reforms.

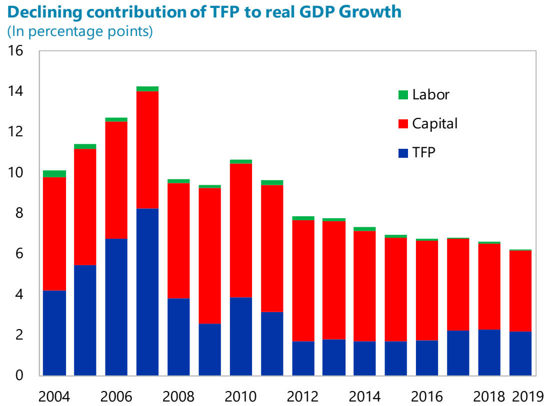
Authorities' Views

48. The authorities agreed on the importance of strengthening rebalancing and addressing socio-economic gaps. The authorities have implemented policies to reduce poverty for the least-developed regions, with the goal of eliminating absolute poverty before 2020, focusing on supporting those regions' education and infrastructure. Resolutions to improve the unemployment insurance system were announced at the 19th National Congress of the Communist Party of China. Although staff pointed out that the recent PIT reform might reduce the progressivity of the overall tax system, the authorities noted that the reform to replace the classified income tax with some integration of comprehensive income tax would reasonably increase the tax for higher income earners and reduce inequality. Property tax legislation is also in steady progress.

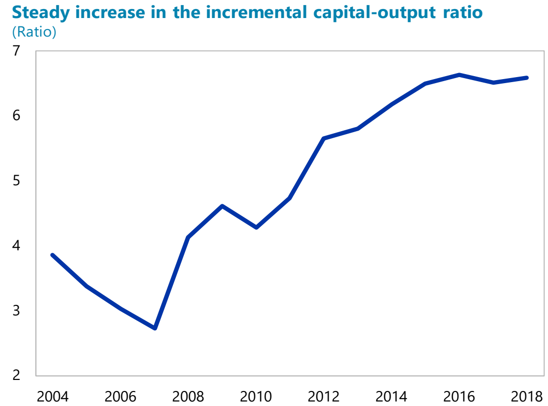
49. They concurred with the assessment that the external position was consistent with medium term fundamentals and highlighted continued efforts to open up and reform. The authorities expected that the current account to remain in surplus over the medium term and reaffirmed their commitment to opening up the securities market, expanding the range of financial instruments and channels through which foreigners can invest, on facilitating the operation of foreign investors, and supporting the overseas issuance of Chinese securities. Although capital flows in 2019 may be affected by changes in market sentiment, the inclusion of Chinese domestic debt and stock markets in international indices would provide a stable source of inflows. Over the medium term the authorities expect the current account to remain in surplus and the income deficit to narrow. China's foreign investment structure has also improved, with the proportion of ODI increasing, leading to higher return on overseas earnings and hence a narrowed deficit in investment returns.

E. How to Boost Productivity and Longer-term Income Convergence?

50. Key issues. China's productivity growth has declined steadily since the GFC, driven by declining returns on infrastructure investment and worsening resource misallocation related to the increasing role of the state. The incremental capital-output ratio has been rising and TFP growth since the GFC, at 2¼ percent, is about half of its average in the decade before the GFC, with the decline in TFP explaining most of the fall in GDP growth between the two periods. The slowdown in growth also partly reflects convergence to a more sustainable growth path. Reforms to enhance productivity and policy frameworks would support strong and sustainable growth through this transition.



Source: CEIC and IMF staff estimates.



Source: IMF WEO database and staff estimates.

51. Priorities. To boost long-term productivity growth and income convergence, a broad set of reforms are needed to strengthen the role of the market, increase competition, foster greater openness, and reverse the growing dominance of SOEs. As the economy develops, China's policy frameworks and governance also need to evolve. These reforms would be mutually reinforcing, and proper sequencing can increase their impact, while limiting short-term adverse effects (Box 3).

Box 3. Reform Complementarities and Sequencing[1]

The above reforms would be mutually reinforcing, and proper sequencing can help deliver the biggest bang for the buck. Examples of complementarities and sequencing between reforms include:

Business environment and internal barriers. Expediting reforms with negligible upfront costs, such as reducing business regulations, and removing internal product market barriers will increase firm entry, increasing the benefits of higher labor market flexibility achieved through hukou reform. This would be facilitated by increasing transfers to under-resourced regions in the short run.

Barriers to foreign competition. Accelerating opening up, in particular for the service sector, can help absorb employment losses from SOE reform. SOE reform in turn will both reduce trade tensions and increase the competitiveness of the tradeable sector.

Fiscal structural and rebalancing. Expediting introduction of the long-discussed nationwide property tax increase LG revenue will help in reducing the imbalance in local-center fiscal responsibilities and can help compensate regions that bear the upfront costs of SOE and hukou reforms. LGs can also be encouraged to reign in investment expenditure while boosting social spending.

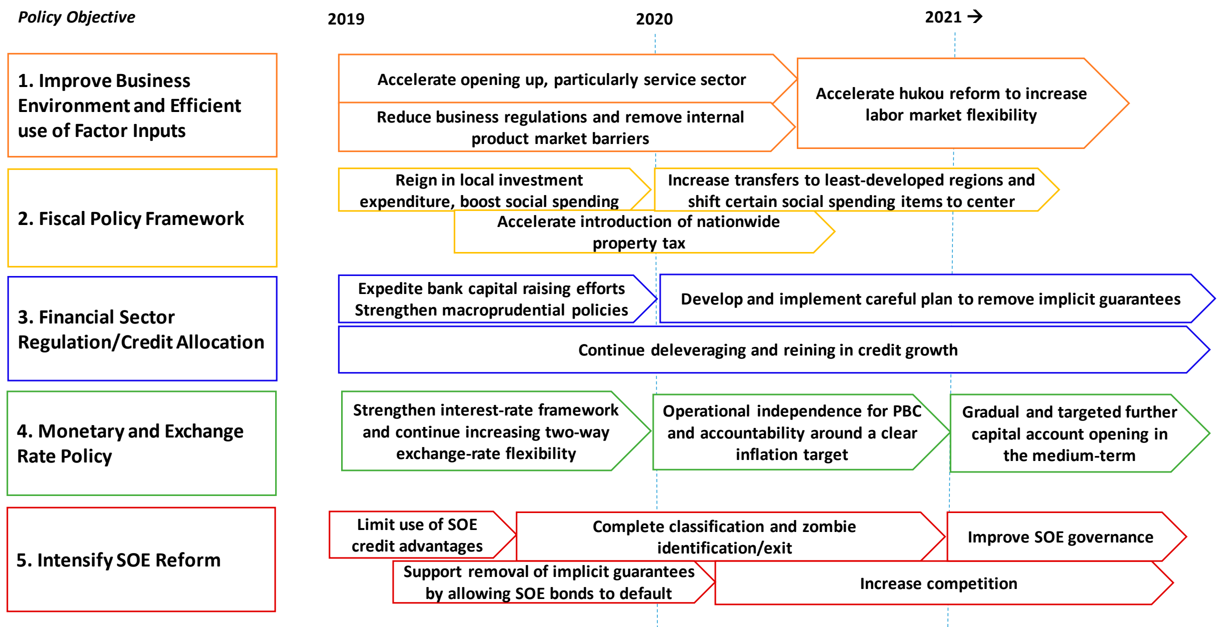
Financial regulation and credit. Expediting capital raising by banks will help support lending to the private sector and improve monetary policy transmission, while SOE and other reforms geared at competitive neutrality will decrease SOE and zombie firm credit demand and increase private sector credit demand. Macroprudential policies should be strengthened now to contain vulnerabilities from rising household debt.

Monetary and exchange rate policy. Continuing with monetary and exchange rate reforms will set the stage for gradual and carefully sequenced capital account liberalization in the medium term.

[1] Prepared by S. Das

Box 3. Reform Complementarities and Sequencing (Concluded)

China has the policy space to provide targeted, upfront fiscal support to counter short-term impacts of structural reforms and compensate those shouldering the burden of adjustment, such as providing support to workers displaced by SOE reforms.



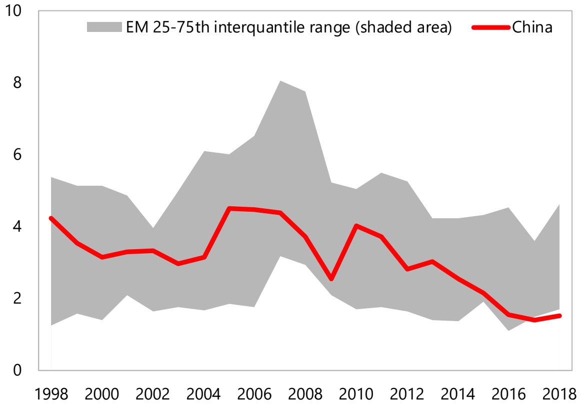
52. Increase the role of the market by unifying product markets, which will increase firm entry across sectors and regions, and increasing labor market flexibility.

- *Further liberalize markets*, particularly in services which are dominated by the public sector.
- Product markets are also fragmented regionally by barriers favoring local businesses. Measures should be taken to *remove various forms of local protectionism* (e.g. requirements to use designated service providers, local registration requirements), following on the government's Work Plan for Dismantling Barriers to Competition.
- *Amend the bankruptcy law* to improve the quality of exits and restrain LG intervention and expand the use of specialized bankruptcy courts and administrators.

  Increase labor market flexibility, through accelerating *hukou* reform, enhancing access to social services, and increasing the portability of pensions.

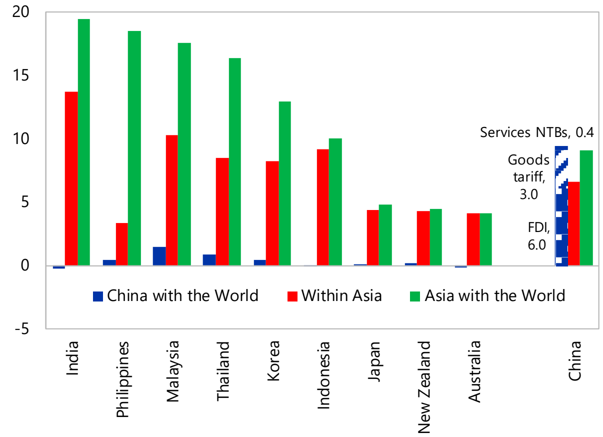
53. Accelerate opening up. Despite gradual opening to foreign trade and investment, China remains less open than other G20 emerging market economies in services and FDI and would benefit from further opening up its service sector and simplifying approval of inward investments. The recent changes to the negative list and the new foreign investment law are welcome further steps towards equal market access and treatment of public procurement, and should be implemented consistently across localities. This should be complemented by progress towards high-quality free trade agreements, covering services, investment, and e-commerce—for example, China's unilaterally eliminating tariffs on goods imports could increase China's real GDP level by about 3 percent in the long term, while liberalizing FDI could increase GDP by a further 6 percent (see IMF Asia and Pacific Regional Economic Outlook, Oct 2018).

China's FDI is trending down and below EM average
(In percent of GDP)



Source: IMF WEO database.

China would gain by unilaterally liberalizing
(Impact on GDP, percent)

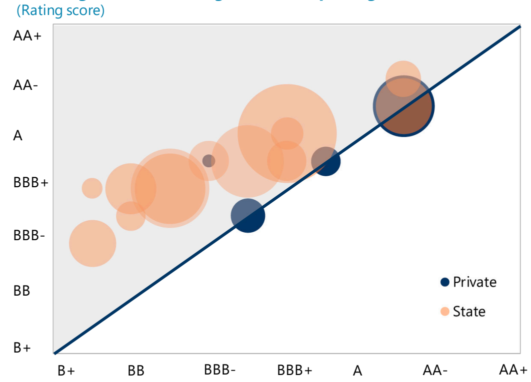


Note: Charts shows the estimated increase in real GDP from three scenarios, where China: (1) eliminates goods tariffs, (2) lowers non-tariff barriers (NTB) on services, (3) further liberalizes FDI.
Source: IMF Asia and Pacific Regional Economic Outlook (Oct 2018).

54. **Accelerate and intensify SOE reform**. In addition to removing implicit guarantees (see section C), further reforms are needed to achieve competitive neutrality and improve the performance of SOEs.

- *Limit SOE use of credit advantages*. The flow of SOE borrowing should be constrained by hardening budget constraints. Dividend payments to the budget should be increased, while completing transfer of social responsibilities to the government. Deleveraging goals should be set in terms of SOE debt/GDP ratio.
- Support the *removal of implicit guarantees* to SOEs by allowing SOE and LGFV bonds to default.
- *Complete classification/identification/zombie exit.* Classification of SOEs into categories (competitive, social, strategic) should be published, along with a timetable for moving SOEs out of competitive sectors. Progress on "zombie" local SOEs should move forward with the publication and exit of local zombies, facilitated by a comprehensive amendment of the Enterprise Bankruptcy Law. Exits should not reduce competition through top-down mergers with other SOEs, but rather release resources to the private sector. Zombie exits should be facilitated by strengthening the social safety net.

SOEs higher credit ratings reflect implicit guarantees
(Rating score)

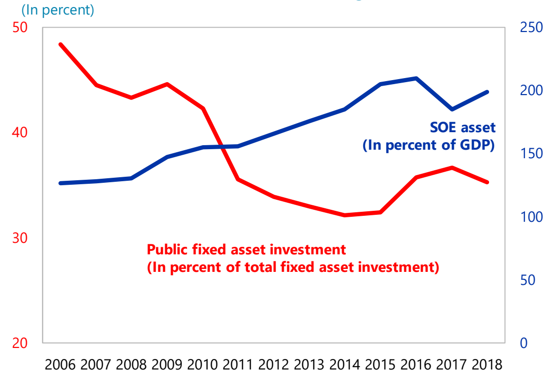


Sources: Standard & Poors; Bloomberg L.P.; and IMF staff calculations.
Note: Size of the bubble denotes the entity's total debt. Shaded area shows corporates that have a higher credit rating than their stand-alone credit profile.

- *Increase competition* by opening up non-strategic sectors to private and foreign enterprise, strengthening the role of the State Administration for Market Regulation and independent arbitration in dealing with SOE monopolies, and submitting a high-quality revised offer to join the WTO Agreement on Government Procurement.

- *Improve SOE governance*. The authorities should increase transparency of governance at the group level, by increasing information disclosure on group-level board meetings, and promote the appointment of managers with international and private sector experience (e.g. by following the 2015 OECD guidelines on corporate governance of SOEs).

SOE assets and share of investment rising trend
(In percent)

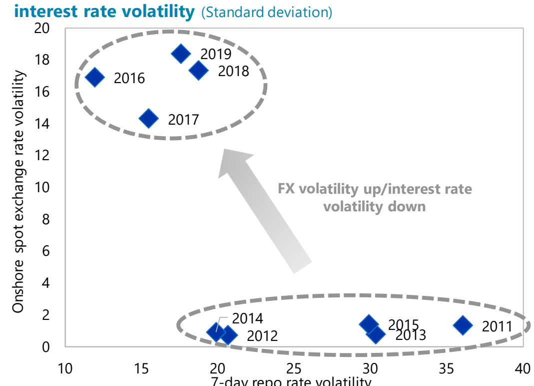


Source: CEIC, Ministry of Finance and IMF staff estimates.

55. Managing the increasingly systemic and complex economy requires modernizing policy frameworks and improving governance. The overarching goal should be to continue moving to more market-based and transparent frameworks, relying less on administrative measures. This would also help reduce vulnerabilities to corruption, including as a result of reforms to strengthen SOE governance, fiscal transparency, and land sales, as detailed below.

- ***Monetary policy***. Progress has been made on strengthening the interest rate-based framework by gradually reducing the distortionary high reserve requirements and improving monetary policy communication. Further efforts are needed to: (1) phase out benchmark deposit and lending rates while developing a market-based loan pricing mechanism; (2) clarify that there is one key policy rate (the PBC's reverse repo rate), while moving corridor ceiling and floor rates in tandem with the policy rate, and (3) base pricing and access to the PBC's lending facilities on clearly defined collateral rules and not supervisory criteria. While new facilities (e.g. TMLF) and central bank lending (re-lending/discounting) have been used to respond to the slowdown, gradually phasing them out and simplifying the operating framework would improve its effectiveness. These steps should be complemented by giving the PBC greater accountability and operational independence around a clear inflation objective.

Increased exchange rate volatility accompanied by lower interest rate volatility (Standard deviation)



Source: Bloomberg and CEIC.

- ***Financial regulation and supervision***. The Financial Stability and Development Committee (FSDC) should be given full macro-prudential authority, with a clearly defined policy process and toolkit including the counter-cyclical capital buffer, to effectively assess vulnerabilities and map risks to policy action. The division of responsibility across agencies, decision making process, roles and coordination mechanisms should be clearly communicated to the public.

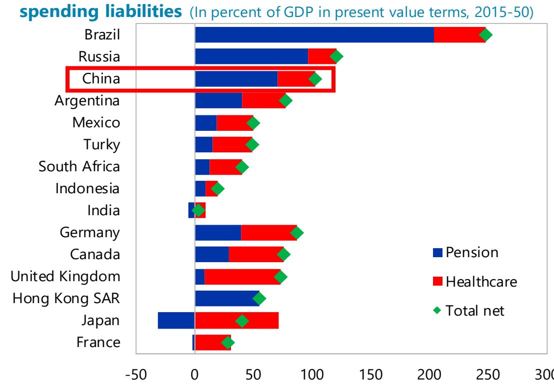
- ***Fiscal reforms.***
  - The establishment of a *macro-fiscal unit* in the Ministry of Finance, with the role of estimating China's fiscal policy stance and macro impact, would help macro management, especially with fiscal policy now taking the lead in adjusting to the trade shock.

- While reforms to *strengthen fiscal discipline* have progressed, with the tightening of off-budget LG borrowing and introduction of special purpose bonds as an infrastructure financing tool to replace LGFV borrowing, off-budget debt remains large and rising. Implicit guarantees on remaining off-budget investment should be carefully dismantled with non-commercial debt recognized. Estimates of the general government deficit and debt should be improved, by following international standards and including off-budget borrowing.

- Reducing the misalignment of *center-local fiscal responsibilities* is critical, as the gap between LG revenues and expenditures leads to several market distortions (e.g. local protectionism) and affects the quality of rebalancing (e.g. weaker public service provision in rural areas). Key reforms include accelerating the introduction of a nationwide recurrent property tax and having the central government take over certain expenditure responsibilities (pensions, employment insurance, health, and education, some of which is already planned). The size of equalization grants should be increased to support the least-developed and vulnerable regions.

- With a rapidly aging population, the shortfall in the pension system has been growing over time, despite relatively high social security contributions compared to other major economies. *Social security sustainability* should be improved through parametric reforms such as gradually increasing the retirement age, indexing benefits to prices, and modifying benefit formulas.

China has relatively high implicit pension and healthcare spending liabilities (In percent of GDP in present value terms, 2015-50)



Source: April 2019 Fiscal Monitor and IMF staff estimates.

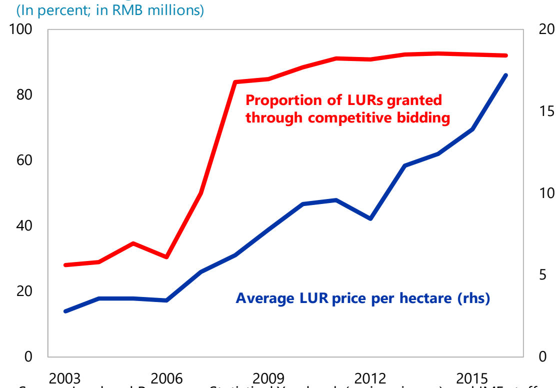
- *Fiscal governance* should be enhanced by further increasing transparency. This includes publishing general government accounts and balance sheets and the Executive's budget proposal in line with international best practice, providing information on quasi-fiscal operations of the SOEs and extrabudgetary funds, and work towards producing a fiscal risk statement and improving the framework for non-tax revenues (e.g. land sales, Box 4).

- ***Improving transparency and statistics.*** Monetary policy and financial stability communication have improved, including through a new PBC website in English, regular press conferences, expanded Q&As, and publishing results of stress tests in its annual financial stability report. Fiscal accounts should be made more transparent and the data brought more in line with international standards. Addressing longstanding data gaps in national accounts data and sparse labor market data would improve policymaking and credibility, IMF surveillance, and G20 commitments.

Box 4. Improving Governance in Administering Land Transfer Fees[1]

Context. China mobilizes substantial amounts of government revenue by selling land user rights (LURs) to entities and individuals. In 2017, land transfer fees from LUR sales accounted for around 7 percent of GDP and 39 percent of LG revenue. Land transfers have also been a critical factor in China's economic growth and urban development. Thus, proper governance of land transfer fees is key to ensuring sufficient funding for LGs as well as promoting economic efficiency and fairness in land allocation.

Land User Right Prices, 2003-16
(In percent; in RMB millions)



Source: Land and Resources Statistical Yearbook (various issues) and IMF staff estimates..

Current practices. Urban land is owned by the state and rural land is owned by collective organizations. Individuals and entities can use land by acquiring LURs, either for free (or at low cost) if used for public purposes, or for a fee if used for private (profit) purposes. Since 2007, for profit LURs have been granted through a bidding process instead of direct negotiation and land transfer fees have been turned over to LG treasuries and reported in their budgets.

Existing vulnerabilities and recent improvements. A 2014 National Audit Office report found that about 20 percent of the RMB13 trillion (3 percent of GDP) in audited land transfer fees were either under-collected, inappropriately spent, or improperly accounted. Recently, the authorities initiated some reforms: an online Public Resources Transactions Platform has been deployed on which all land auctions and tenders are now executed. The MOF has issued new procedural guidelines for collecting and using land transfer fees.

Good international practices. To further improve the administration of land transfer fees, the authorities could consider benchmarking their current practices against international good practices.

Collection of land transfer fees:

- **The Land Administration Law, which is currently undergoing revision, could be amended to include a section on land transfer fee administration.** This section could include the most crucial provisions governing land auctions/tenders and collection of land transfer fees while still providing flexibility to LGs on other, less critical features of fee administration. Regulations—which are currently scattered across various decrees and instructions--could be consolidated.
- **An appropriate division of collection responsibilities across agencies is needed to provide checks and balances.** The responsibilities for key collection functions (e.g., preparing auction and tender documents, establishing reserve prices, evaluating the tenders and selecting the winning bids, handling payments) should be split across government agencies to avoid undue concentration of authority.
- **Competitive bidding processes should include features that ensure fairness and transparency.** This could be promoted by requiring tenders and reserve prices to be submitted in sealed envelopes, secured in a locked tender box, and opened in the presence of and evaluated by officers from multiple agencies. There is also evidence that single-stage auctions are less vulnerable to manipulation than two-stage auctions. Auctions and tenders could be conducted on-line using an electronic bid submission system with a secure log book. Both winning and losing bids should be published.
- **Internal controls need to be designed to promote integrity in administration.** The Ministry of Finance and Ministry of Natural Resources could issue internal control guidelines on segregation of duties within agencies, establish multiple levels of review for key decisions, and require reconciliation of

[1] Prepared by J. Brondolo, F. Gonguet, and S. Saxena

Box 4. Improving Governance in Administering Land Transfer Fees (Concluded)

accounting information (e.g., to ensure the agreed contract price matches the amount actually paid). Information systems should grant access rights to authorized officials in line with their responsibilities and include activity logs and exception reports for identifying unusual system usage for follow up.

- **External supervision and investigation should be guided by modern risk management methods.** Those categories of land transfer fee administration that are perceived to have the highest risk of violations should be assigned a national risk manager who is responsible for overseeing a national strategy for mitigating the risk. The National Audit Office could conduct a *targeted* land administration audit to follow-up on its 2014 comprehensive audit.
- **Land administration officials should be bound by a public service code of conduct.** The standard code of conduct could be extended for land officials by requiring them to file a financial disclosure declaration each year and a confidentiality of information form for each auction/tender. A comprehensive and continual awareness program should be implemented to ensure that land officials understand the code of conduct, how to comply with it, and the consequences of violations.

Use of land transfer fees:

- **There are clear benefits in bringing all land expenditures (and revenues) under a unified budget and subjecting them to legislative scrutiny.** Mechanisms that earmark revenue and expenditures to specific purposes limit policy flexibility to allocate resources to higher priorities. They also impede the legislature's fiscal oversight. Good practice is to include all land sales revenues and expenditures in the annual general budget of the concerned local government.
- **If a separation cannot be avoided, then the planned uses of the fees (and expected collections) should be fully disclosed as part of budget documentation for information purposes**, under the same classification standards and granularity as the general budget. Existing regulations may need strengthening to ensure the resources are efficiently managed and are carried out in accordance with acceptable standards of accounting and reporting, internal control, internal and external audit, and meets basic transparency requirements. The regulations may also need clarity on the accountability for the use of these resources.
- **Central oversight of the use (and collection) of land transfer fees should be supported by well-designed IT systems.** Local accounting IT systems should ideally be harmonized across local governments and follow similar timelines to ensure the rapid and timely consolidation of information at the central level. At least, IT systems should be designed to allow for some degree of dialogue between one another, so that the information can be easily translated and exploited for consolidation purposes.

Authorities' Views

The authorities pointed out several initiatives implemented in recent years to improve land transfer fee administration. An online Public Resources Transactions Platform has been deployed on which all land auctions, tenders, and listings are now executed. New guidelines have been issued on the collection and uses of land transfer fees. Investigations of land administration violations were increased, resulting in more prosecutions. The authorities are of the view that these and other initiatives have had a significant impact on improving land transfer fee administration and reducing corruption, but saw value-added in considering further some of the good international practices identified by the mission.

Authorities' Views

56. The authorities agree that further labor market unification is needed, in particular via *hukou* reform. They have recently announced measures to relax *hukou* restrictions for medium-sized cities and will continue hukou reform for mega cities in the future. The anti-trust authorities committed to creating a fair, open, and transparent market environment for market participants, by removing market barriers, streamlining administration, promoting fair and just regulation, and effectively preventing inappropriate government intervention in market competition. The authorities reiterated their commitment to further open up despite the escalating trade tensions, and allowing for foreign ownership or sole proprietorship in more areas. They have also published a streamlined negative list for foreign investment entry and will ensure the pre-establishment national treatment of foreign investors by enforcing the foreign investment law.

57. The authorities agree that SOE reforms are needed to reduce leverage and boost productivity. Rather than setting deleveraging targets defined as SOE debt to GDP ratio, they preferred measures to reduce SOE leverage through setting specific alert thresholds on industrial and non-industrial SOE's liabilities-to-assets ratios beyond which they would be more strictly supervised, attracting strategic investors, exiting zombies, and reforming governance. The authorities do not see SOEs' credit advantage via implicit guarantees. The government is committed to further reform in classifying SOEs into commercial ones and those for public welfare, and improving SOE governance via mixed-ownership reform and establishing state capital investment and operation companies. They pointed out that laws such as the Anti-Monopoly Law apply equally to SOEs and private enterprises, while the Foreign Investment Law will lower market barriers for foreign companies. They agreed to carefully review any new amendments, for example, to the Company Law Act to ensure that laws ensure equal treatment. They stressed that the way forward for better allocation of resources would be to build on the success of mixed-ownership reform which saw an increase in profitability and a reduction in leverage for restructured SOEs.

58. The authorities are focused on improving monetary policy transmission, both in terms of the speed of transmission and the structure of credit, and are studying how to promote interest rate reform. There was clear evidence that changes in the short-term interest rate "DR007" transmits effectively to bond markets, but with only limited transmission to bank lending rates with a lag. Targeted RRR cuts and the TMLF are also useful to improve the structure of credit. Eliminating benchmark lending rates will take time, as many loans are still priced off of them.

59. The authorities clarified that the FSDC is mainly responsible for coordinating financial development and regulation, coordinating financial regulation, monetary, fiscal, and industrial policies related to financial stability, analyzing the international and domestic financial environment, and responding to international financial risks. The PBC recently created a Macroprudential Policy Bureau whose responsibilities include taking the lead in establishing a macroprudential policy framework and basic principles, drafting rules for monitoring and regulating financial holding companies and systemically important financial institutions, and conducting macroprudential regulation for FX markets. In the case of borrower-based instruments, the PBC will receive inputs from other agencies, including local governments—these instruments are differentiated across cities and provinces to match local housing market conditions.

60. The authorities continued their efforts to modernize the fiscal framework. To foster balanced regional development, they are establishing a standardized and transparent budget system and implementing budget performance management. Reforms of central-local fiscal relationship are underway through further sharing of central-local government expenditure responsibilities (i.e. modestly giving central government more fiscal and expenditure responsibilities) and improving inter-government transfers. The authorities noted that the social security system does not face sustainability issues in the short run.

61. **While agreeing with the need to continue strengthen local government budget constraints, the authorities continued to disagree with staff's definition of the general government perimeter.** They continued to disagree with staff's augmented concept, noting that under the 2014 Budget Law, local governments did not bear any responsibility for the financial obligations of Local Government Financing Vehicles, government-guided funds, or special construction funds.

62. **The authorities agreed with the need to further improve data, while noting recent progress.** Full implementation of the System of National Accounts (SNA) 2008 was progressing. They noted that many countries use the single deflation method and that double deflation was not necessarily superior given measurement error in input price indexes. Although they were expanding the content of published data each year, quarterly expenditure-side GDP being under improvement and the analysis and testing of CPI weights made publishing details impractical in the near future.

STAFF APPRAISAL

63. **Growth stabilized in early 2019 after slowing in 2018**. The slowdown in 2018 reflected financial regulatory strengthening and softening external demand, while policy support contributed to stabilizing growth in 2019. Headline CPI inflation increased but core inflation moderated and unemployment was stable. Renewed trade tensions, however, are weighing heavily on sentiment. Financial deleveraging and reduced interconnectedness between banks and non-banks have helped contain the build-up of financial risks, but vulnerabilities remain elevated.

64. **Reforms continued in several areas and rebalancing progress was mixed.** Regulatory and supervisory reforms led to a decline in bank asset growth and reduced interconnectedness between banks and non-banks, and credit growth slowed in 2018 before picking up again in 2019. Opening up continued and China moved up 34 places to 46th in the World Bank's 2019 Doing Business Rankings. The current account surplus continued to fall and growth was driven by consumption, but rebalancing towards services progressed more slowly and credit expansion remains excessive. China has made welcome progress in reducing external imbalances over several years and the external position in 2018 was broadly in line with medium-term fundamentals and desirable policies. Achieving a lasting balance in the external position will require the gradual reining in of expansionary macroeconomic policies and implementation of structural reforms.

65. **Uncertainty around trade tensions remains high and risks are tilted to the downside.** On the negative side, a further escalation in tensions could result in higher tariffs, disrupting supply chains and depressing confidence and investment. Financial vulnerabilities could also amplify the

effects of a trade shock, or other domestic risks including a sharp downturn in the property market, and a return to PPI deflation. Over the longer term, the potential reversal of globalization, weaker trade outlook, and reduced access to markets and technology could weigh on China's growth prospects, while the increasing role of the state could further worsen resource allocation, especially if combined with a reliance on debt to hit excessively high short-term growth targets. On the positive side, a reduction in trade tensions could spur confidence, investment, and trade and lead to higher growth. A comprehensive domestic reform package to increase the role of markets, aided by greater openness, along with meaningful SOE reform, could also significantly boost productivity and potential growth over the medium-term.

66. No additional policy easing is needed as the announced measures are sufficient to stabilize growth in 2019. However, if trade tensions escalate further, putting at risk economic and financial stability, additional stimulus, mainly fiscal, would be warranted, while allowing for a more flexible exchange rate.

67. China and its trading partners should work constructively to better address shortcomings in the trading system. China can also play an important role and benefit from further opening up and other structural reforms that enhance competition. Trade tensions between the U.S. and China should be quickly resolved through a comprehensive agreement that avoids undermining the international system and not through a managed trade deal that targets a compression in the U.S.-China trade deficit.

68. The authorities should continue efforts to strengthen financial regulation, reduce regulatory arbitrage, and improve the framework for financial supervision. The problem among smaller banks has highlighted the urgency of implementing needed reforms, including those recommended by the FSAP. The announced regulatory reforms should be fully implemented, and bank capital strengthened without relaxing micro-prudential measures. Developing a clear resolution regime would facilitate the exit of weak banks. Macroprudential tools should be strengthened to address vulnerabilities from rising household debt and a personal bankruptcy regime should be developed to help address extreme over-indebtedness while mitigating moral hazard. A comprehensive and well-sequenced plan to remove the implicit guarantee for state-owned enterprises would improve credit allocation.

69. Targeted structural fiscal reforms can help boost consumption and contain external imbalances, and reduce inequality. These include increasing spending on healthcare, education, and pensions, and making the tax system more progressive, by (i) reducing the personal income tax threshold and widening the tax base; (ii) removing imputed minimum earnings for social security contributions for low income households; (iii) accelerating the introduction of a recurrent property tax, and (iv) imposing a substantial carbon or coal tax.

70. Further progress on reforms to open up the economy and increase the role for market forces are needed. This means reducing the dominance of the public sector in many industries, opening up more markets to the private sector, and ensuring fair competition. SOE reform to limit their advantages in accessing credit by hardening budget constraints is needed, as is allowing exit of zombie SOEs to release resources to the private sector. Opening up of non-strategic sectors, particularly in services, to private and foreign enterprise and unifying product markets across localities would boost competition.

71. Managing the increasingly systemic and complex economy requires modernizing policy frameworks. Monetary policy should continue to become more price- rather than quantity-based, including by eventually moving to a single policy rate. Greater exchange rate flexibility and better-functioning FX markets would help the financial system prepare for larger capital flow volatility. The misalignment of center-local fiscal responsibilities could be reduced by accelerating the introduction of a recurrent property tax, shifting certain expenditure responsibilities to the central government, and increasing inter-government transfers. Enhancing the social safety net with a more progressive tax system would discourage excessive household savings and boost consumption. China should continue upgrading its external lending framework to foster greater coordination and cooperation, ensure transparency and debt sustainability.

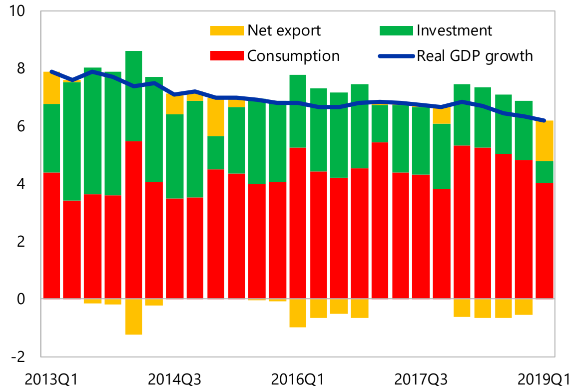
72. China should urgently address macroeconomic data gaps to further improve data credibility and policy making.

73. It is proposed that the next Article IV consultation with China take place on the standard 12-month cycle.

Figure 1. Recent Developments: Weaker Growth Momentum

Growth moderated in 2018, particularly in the second half of the year.

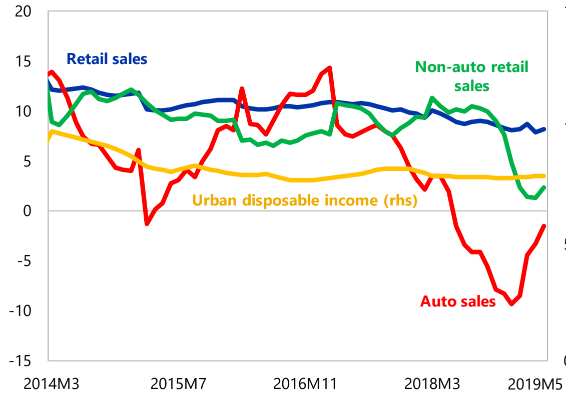
Contribution share to real GDP: demand side
(In percent)



Source: CEIC.

On the demand side, consumer spending remained relatively robust (excluding tax-affected auto sales)

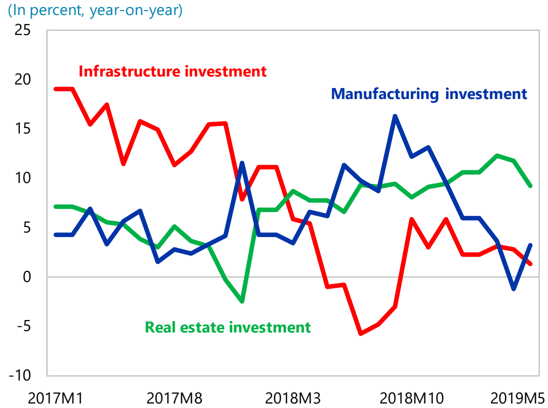
Retail sales, auto sales and urban disposable income
(In percent, year-on-year, 3mma)



Source: CEIC and IMF staff estimates.

...while infrastructure investment fell in mid-2018 before recovering in the fall.

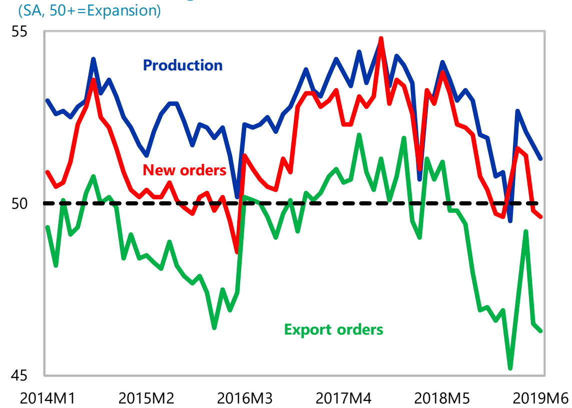
Growth of investment and total social financing
(In percent, year-on-year)



Source: CEIC.

On the supply side, survey indicators weakened significantly, especially for export orders.

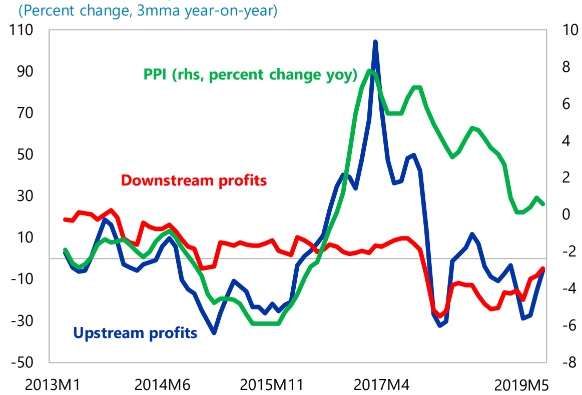
PMI: Manufacturing
(SA, 50+=Expansion)



Source: Haver Analytics.

Profitability has fallen as PPI inflation moderates…

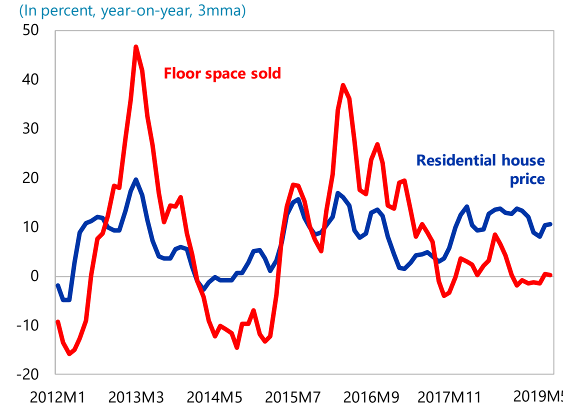
Industrial profit growth
(Percent change, 3mma year-on-year)



Source: CEIC, IMF staff estimates.

…and property sales have weakened.

Residential House Price and Floor Space Sold
(In percent, year-on-year, 3mma)

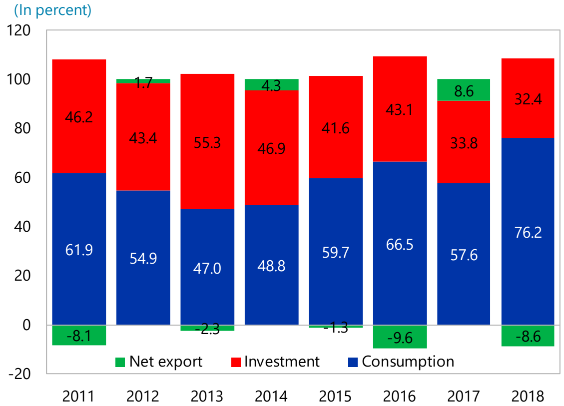


Source: CEIC and IMF staff estimates.

Figure 2. Rebalancing: Continued but Uneven Progress

Internal rebalancing towards consumption in real terms accelerated.

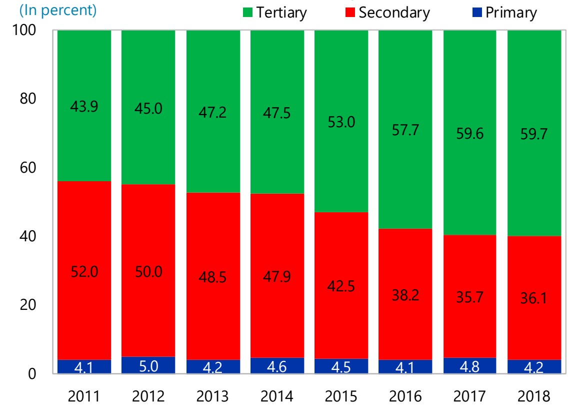
Contribution share to real GDP: demand side
(In percent)



Source: CEIC.

Internal rebalancing towards services stalled as a share of GDP…

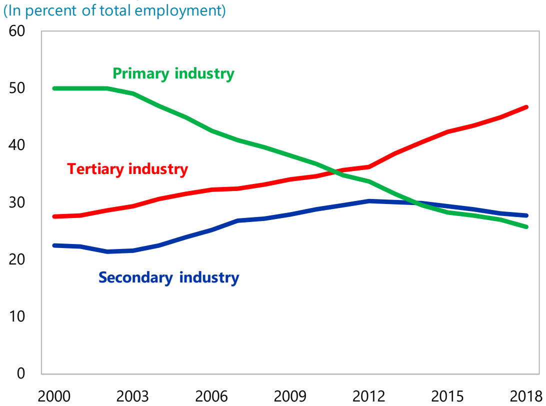
Contribution share to real GDP: supply side
(In percent)



Source: CEIC and IMF staff estimates.

…but labor reallocation from agriculture and industry to services continued.

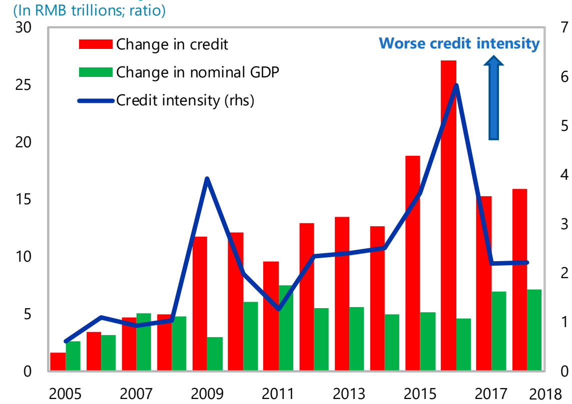
Sectoral employment
(In percent of total employment)



Source: CEIC and IMF staff estimates.

After improving in 2017, credit intensity stabilized in 2018.

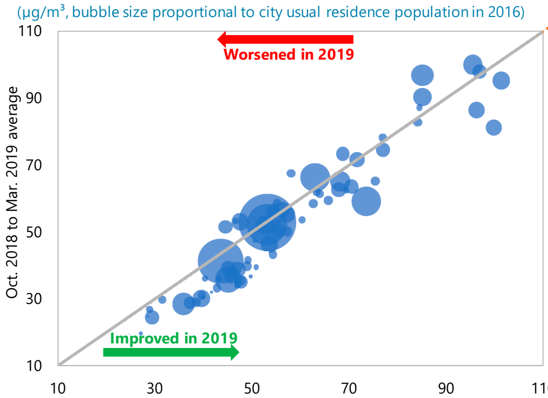
Credit intensity
(In RMB trillions; ratio)



Note: Credit intensity defined as credit to economy divided by nominal GDP.
Source: CEIC and IMF staff estimates.

Most cities saw continued declines in air pollution.

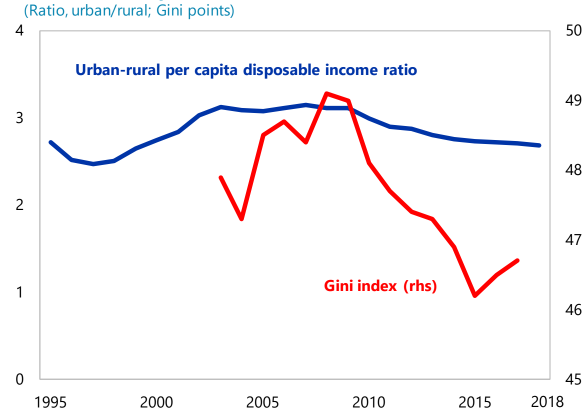
Winter PM 2.5 in 74 cities
($\mu g/m^3$, bubble size proportional to city usual residence population in 2016)



Note: December excluded due to data availability.
Source: CEIC and IMF staff estimates.

The rural-urban aspect of inequality improved somewhat in 2018 but remains high.

Urban-rural disposable income ratio and Gini index
(Ratio, urban/rural; Gini points)

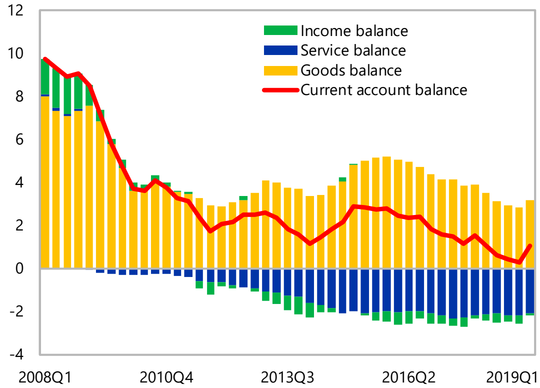


Sources: China National Bureau of Statistics, Haver Analytics.

Figure 3. External: Shrinking Current Account Surplus

China's CA surplus declined by 1 percentage point in 2018, driven by structural factors...

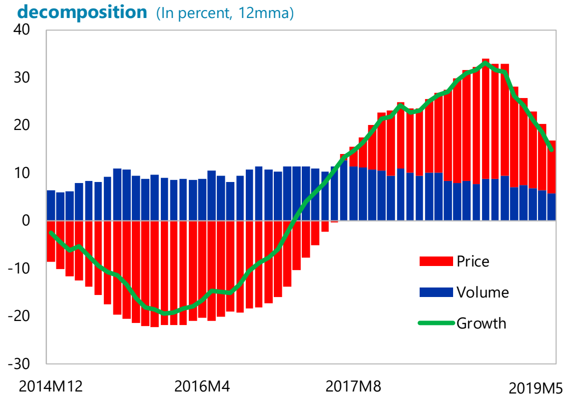
Current account
(In percent of GDP, 4qma)



Source: CEIC.

...and a jump in oil and semiconductor prices.

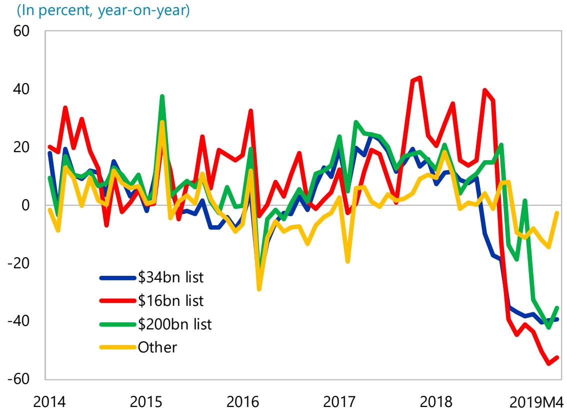
China petroleum and integrated circuits import growth decomposition (In percent, 12mma)



Source: Haver Analytics and IMF staff estimates.

While trade tensions introduced volatility in the export of targeted commodities, they only affect 10 percent of china's exports so far…

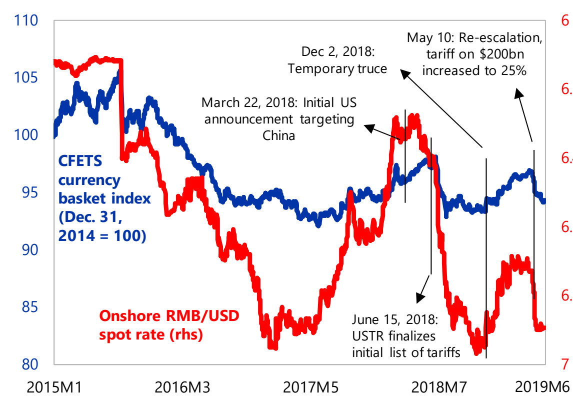
U.S. imports from China
(In percent, year-on-year)



Source: IMF staff estimates.

...but played a role in reversing the RMB's appreciating trend against the USD, although it remained stable against the basket.

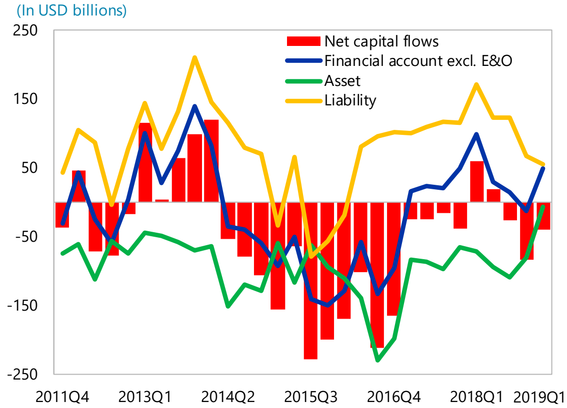
RMB exchange rates vs. the US dollar and CFETS index



Source: Bloomberg, IMF staff estimates.

Although capital inflows moderated during the year, and turned into outflows in Q4, there were no significant outflow pressures.

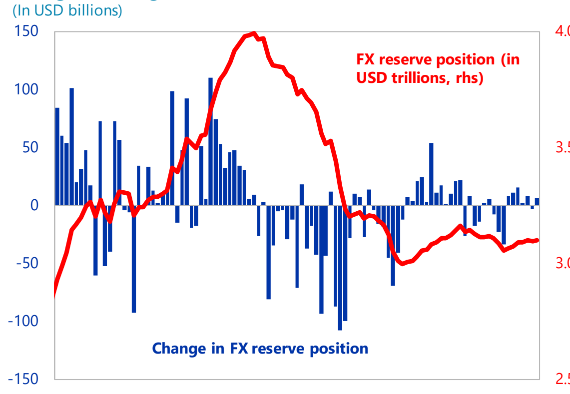
Financial account
(In USD billions)



Source: CEIC.

Reserves remain adequate and there were no indications of large scale FXI despite RMB depreciation against the USD.

Foreign exchange reserves
(In USD billions)

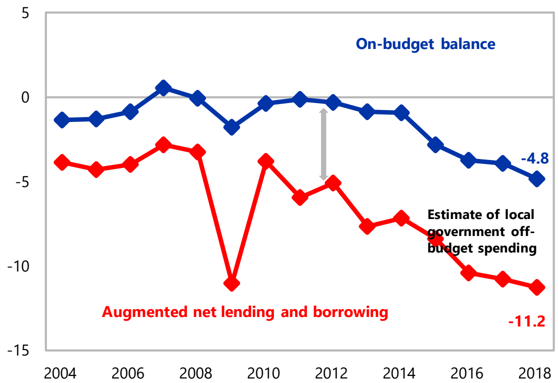


Source: Haver Analytics.

Figure 4. Fiscal: Continued Loosening

The augmented deficit expanded further in 2018…

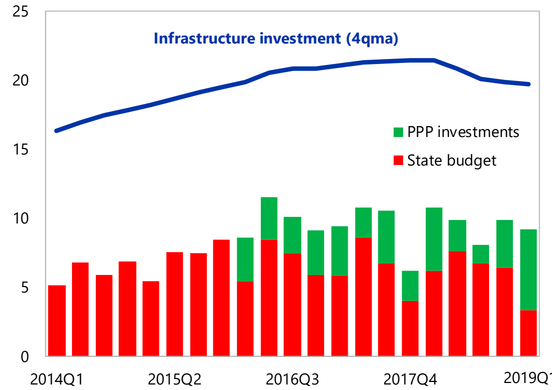
Government balance under different definitions
(In percent of GDP)



Source: CEIC and IMF staff estimates.

… though infrastructure investment stabilized.

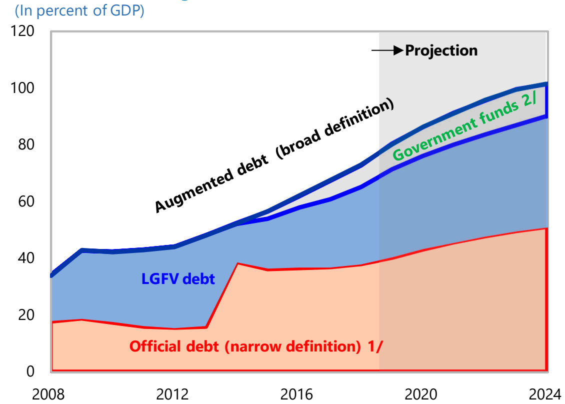
Financing gap for infrastructure investment
(In percent of GDP)



Source: CEIC.

Official and especially augmented debt is projected to rise further.

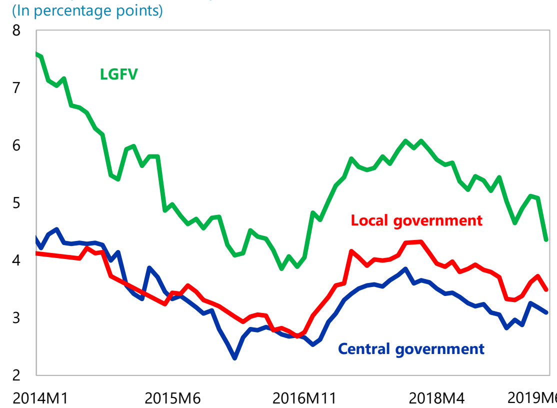
Narrow and broad government debt
(In percent of GDP)



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.

Government bond yields have moderated somewhat from recent highs.

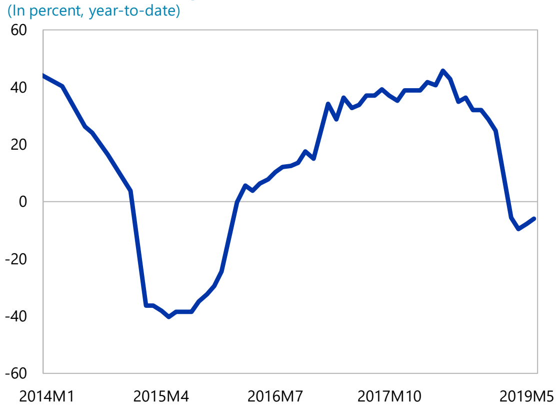
Primary market bond yields
(In percentage points)



Source: WIND and IMF staff estimates.

Land sale revenues contracted in recent months…

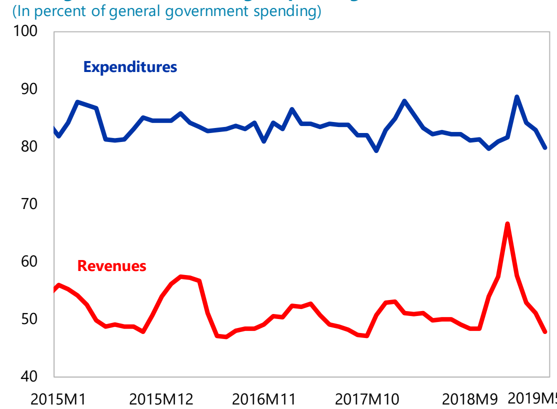
Land sales revenues growth
(In percent, year-to-date)



Source: CEIC.

…and the local government revenue-expenditure gap remains wide.

Local government on-budget spending and revenues
(In percent of general government spending)

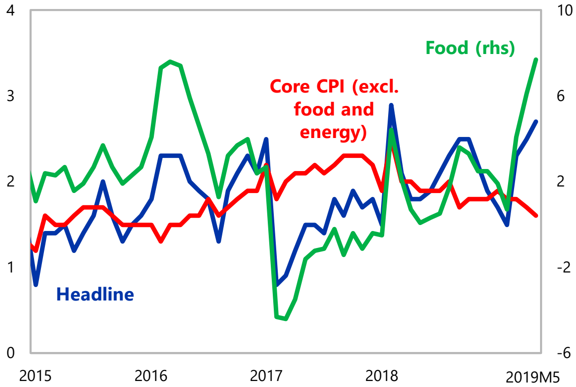


Source: CEIC.

Figure 5. Monetary: Inflation Contained Amid Policy Easing

Core CPI inflation fell in the second half of 2018, while changes in headline inflation were driven by food prices.

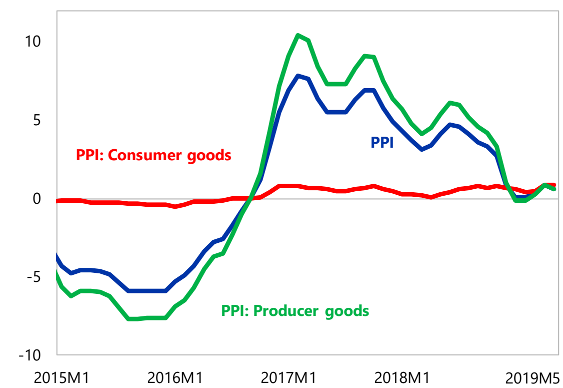
CPI inflation
(In percent, year-on-year)



Source: CEIC.

PPI inflation moderated through 2018, falling sharply at the end of the year.

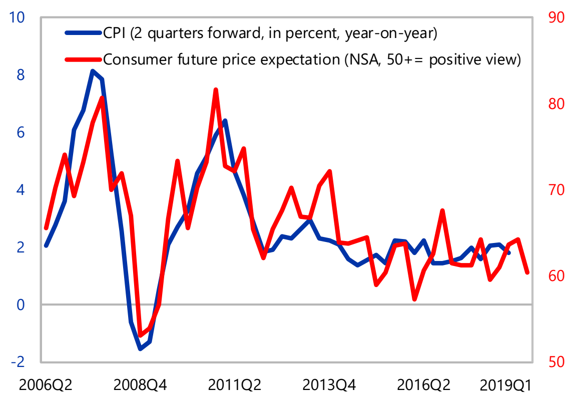
Producer price index
(In percent, year-on-year)



Source: CEIC.

Inflation expectations remained anchored.

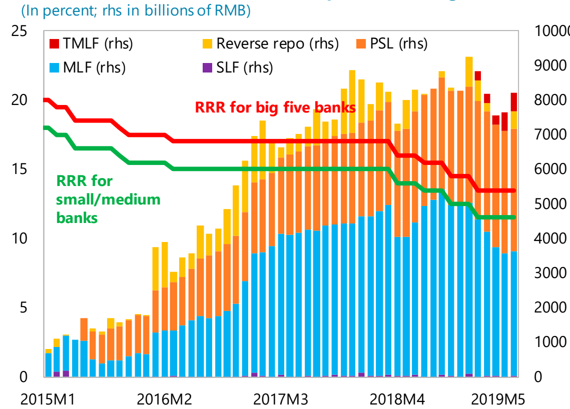
Inflation and future price expectations



Source: CEIC, Haver Analytics.

The PBC cut the RRR in each of quarter from 2018Q2-2019Q1 and increased medium term liquidity.

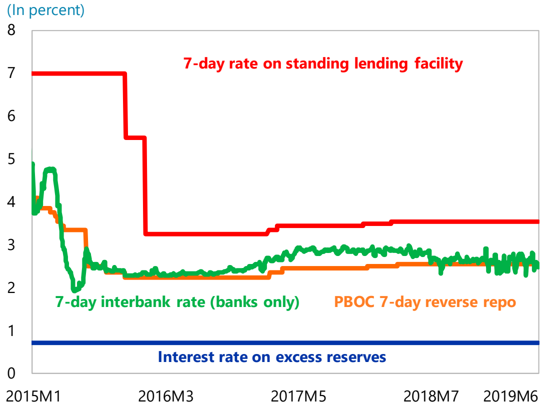
China's RRR and balances under repo and lending facilities
(In percent; rhs in billions of RMB)



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.

The 7-day reverse repo rate for deposit institutions fell by about 25 basis points following the July RRR cut and has hovered near the bottom of the corridor…

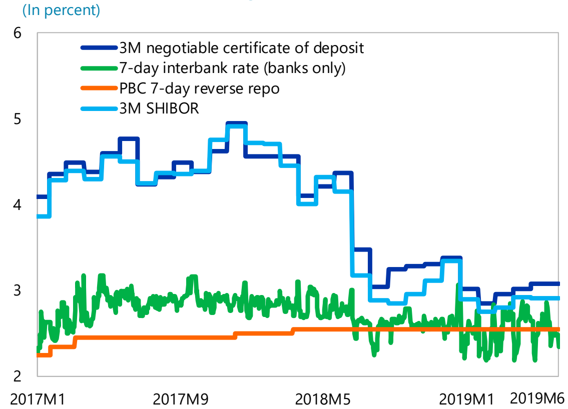
Interest rate corridor
(In percent)



Source: Bloomberg, CEIC.

…while other interbank interest rates fell by more and have stayed low.

Wholesale market funding costs
(In percent)



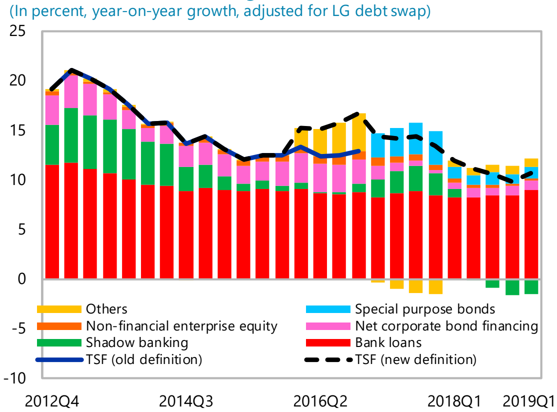
Source: CEIC.

Figure 6. Credit Growth Slows but is Still Rising as a Share of GDP

Credit growth stabilized at the end of 2018 but recently picked up…

Contribution to TSF stock growth

(In percent, year-on-year growth, adjusted for LG debt swap)

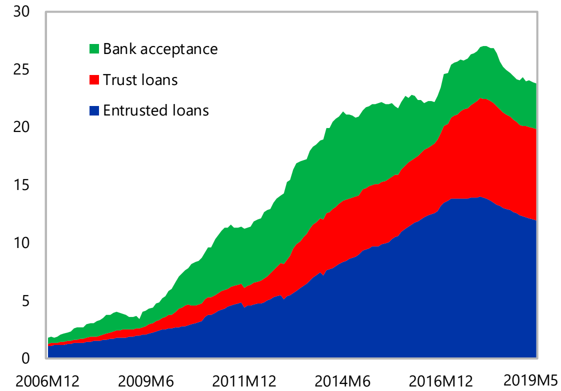


Note: Since January 2017, ABS, loan write-offs, and special purpose bonds are included. TSF stands for total social financing.
Source: Haver Analytics and IMF staff estimates.

…but shadow banking continues to contract.

Shadow banking by component

(Stock, in RMB trillions)

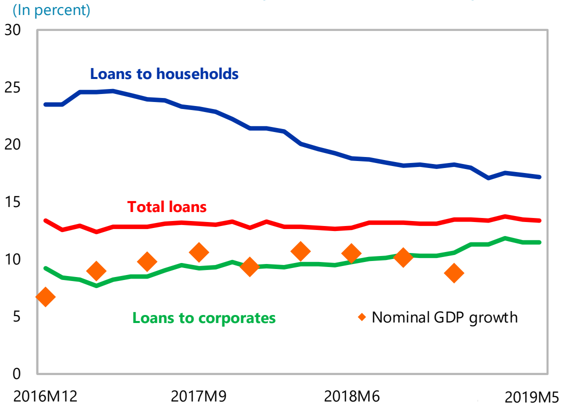


Sources: CEIC and IMF staff estimates.

Banks continued to expand loans strongly, with momentum shifting from household to corporate lending…

Growth rate of bank loans by borrower and maturity

(In percent)

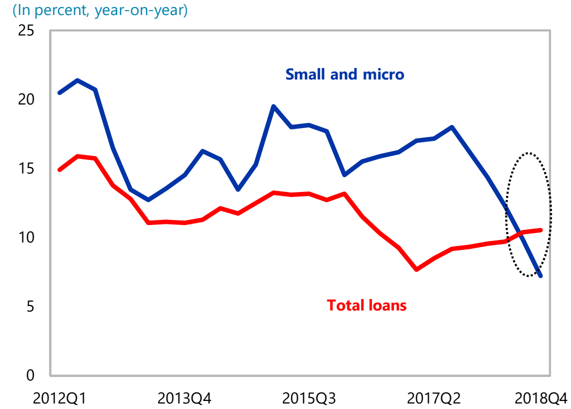


Source: Haver Analytics and IMF staff estimates.

…though lending to small firms decelerated sharply.

Loans to enterprises by size

(In percent, year-on-year)

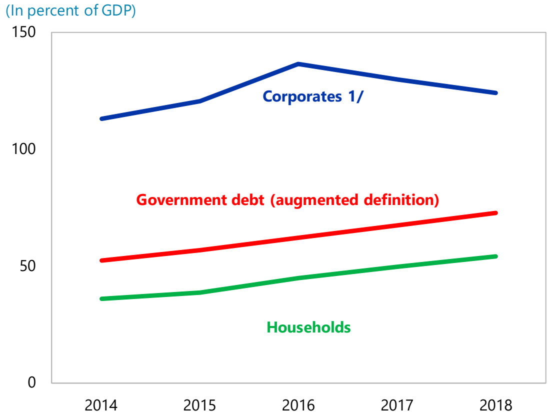


Sources: CEIC and IMF staff estimates.

Debt levels remain high as corporate deleveraging was more than offset by rising public and household debt…

Domestic non-financial sector debt

(In percent of GDP)

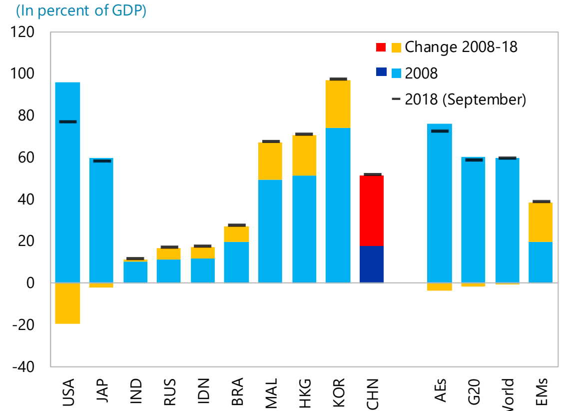


1/ Excludes LGFV.
Source: Haver Analytics and IMF staff estimates.

…and household debt levels now exceed the EM average.

Household debt to GDP

(In percent of GDP)

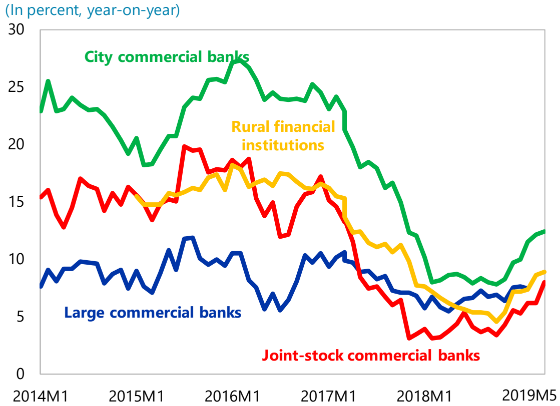


Source: BIS.

Figure 7. Banking Asset Growth Has Bottomed Out, but Capital Constraints Could Hamper Recovery

Bank asset growth has stabilized in recent months, except for rural financial institutions, where the decline continues.

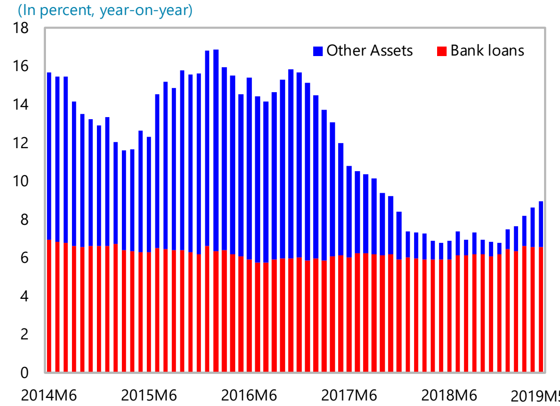
Growth rate of bank assets
(In percent, year-on-year)



Source: CEIC.

Direct bank lending to the real economy remained strong.

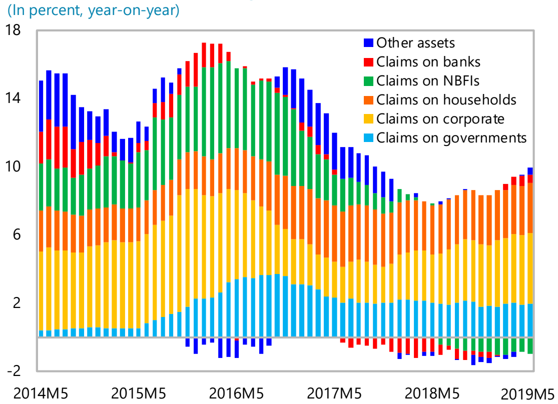
Contribution to bank assets growth
(In percent, year-on-year)



Source: Haver Analytics.

Bank claims on NBFIs contracted while claims on corporates expanded, reflecting ongoing reintermediation.

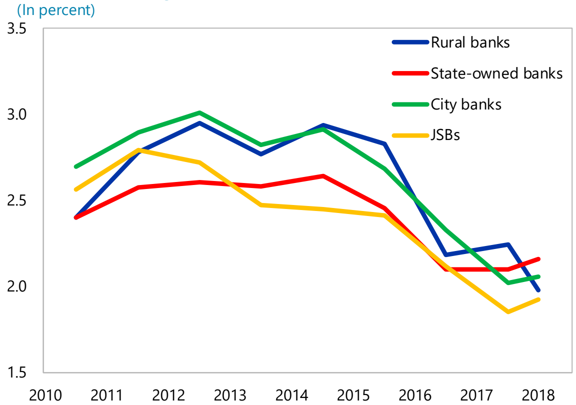
Contribution to bank asset growth
(In percent, year-on-year)



Source: Haver Analytics.

Further downsizing of shadow activity and bank reintermediation could be hampered by declining profitability...

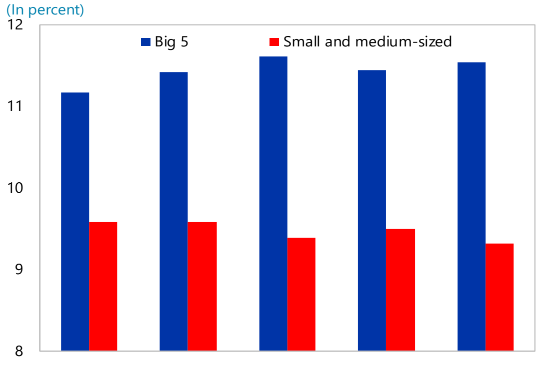
Net interest margin
(In percent)



Source: WIND database.

...tighter capital constraints, particularly in small and medium-sized banks, ...

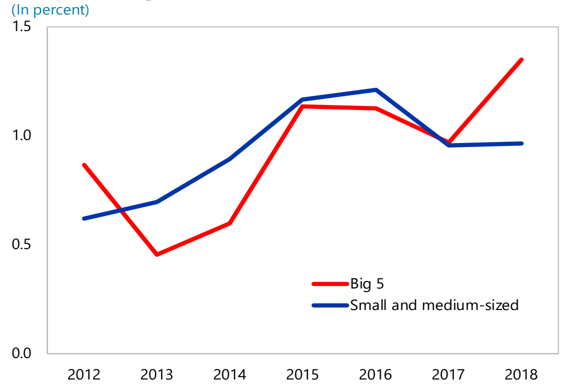
Tier 1 capital ratio
(In percent)



Source: SNL financial.

...and rising NPL ratios.

Non-performing loan ratio
(In percent)

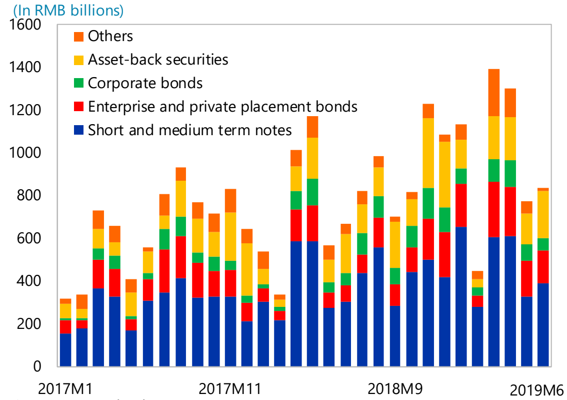


Source: WIND database and IMF staff estimates.

Figure 8. Financial Market Funding Conditions Tight Despite Policy Easing

Increased liquidity boosted bond financing particularly for short to medium-term notes issuers…

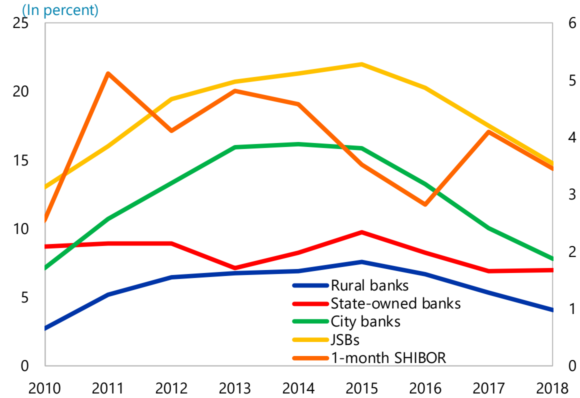
Corporate bond gross issue by type
(In RMB billions)



Source: WIND database.

…but banks' reduced reliance on interbank borrowing limits the benefits of lower interbank rates.

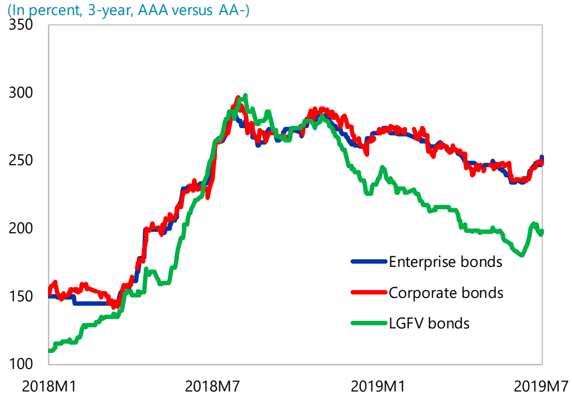
Interbank borrowing to total liabilities of banks
(In percent)



Source: WIND database.

Credit spreads remained mostly elevated despite lower rates…

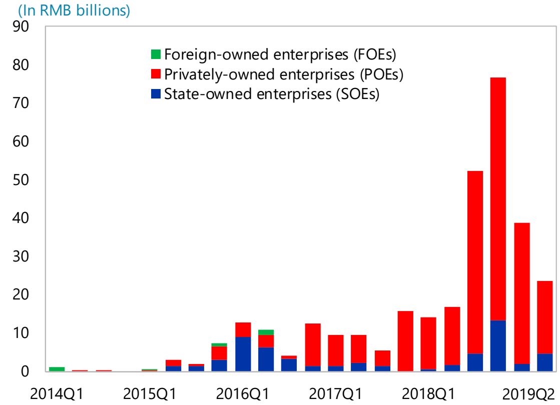
Credit spread of corporate and LGFV bond issuers
(In percent, 3-year, AAA versus AA-)



Source: WIND database.

…and credit events have been rising, mainly for privately-owned enterprises.

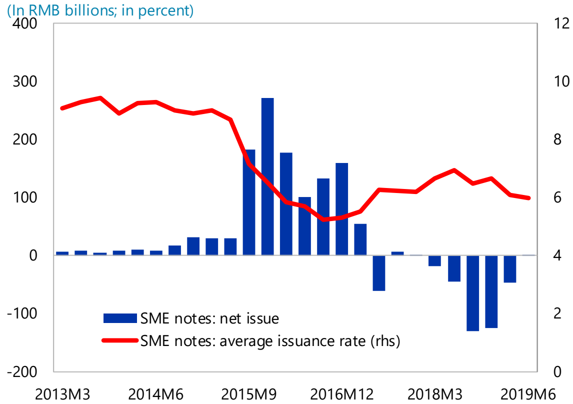
Credit events by bond issuer
(In RMB billions)



Source: WIND database.

Small enterprises still face high borrowing costs and reduced their issuance.

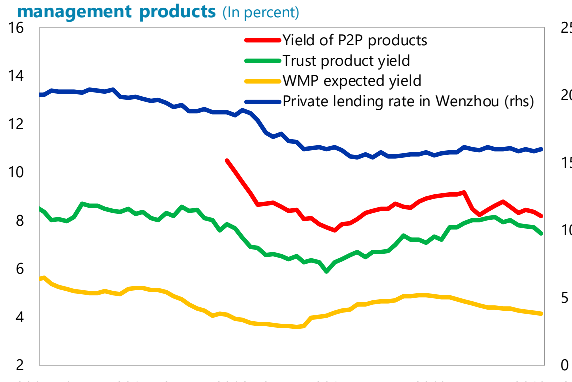
Private placement notes by small and medium sized enterprises
(In RMB billions; in percent)



Source: CEIC, WIND database.

Informal, private sector lending rates – Wenzhou and P2P – remain high.

Private lending rates and yields of trust and wealth management products (In percent)



Source: WIND database.

Table 1. China: Selected Economic Indicators

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
						Projections					
	(Annual percentage change, unless otherwise indicated)										
NATIONAL ACCOUNTS											
Real GDP (base=2015)	7.3	6.9	6.7	6.8	6.6	6.2	6.0	6.0	5.7	5.6	5.5
Total domestic demand	7.2	7.2	7.6	6.3	7.4	6.1	6.2	6.2	6.0	5.8	5.6
Consumption	7.2	8.3	8.6	7.4	9.4	8.0	7.2	6.6	6.3	6.2	6.0
Investment	7.1	6.1	6.5	5.1	4.8	3.8	5.0	5.8	5.6	5.4	5.2
Fixed	6.8	6.7	6.8	4.4	4.8	3.8	5.2	6.0	5.8	5.6	5.4
Inventories (contribution)	0.2	-0.2	0.0	0.4	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net exports (contribution)	0.4	-0.1	-0.6	0.6	-0.6	0.2	0.0	-0.1	-0.1	-0.1	-0.1
Total capital formation (percent of GDP)	46.8	44.7	44.1	44.6	44.8	42.9	42.2	41.6	41.1	40.5	39.8
Gross national saving (percent of GDP) 1/	49.0	47.5	45.9	46.3	44.6	43.4	42.5	41.8	41.1	40.4	39.7
LABOR MARKET											
Unemployment rate (annual average) 2/	5.1	5.1	5.0	4.9	4.8	5.0	...	...	...	...	...
Employment	0.4	0.3	0.2	0.0	-0.1	-0.1	-0.1	-0.1	0.1	0.1	0.1
PRICES											
Consumer prices (average)	2.0	1.4	2.0	1.6	2.1	2.2	2.4	2.8	2.9	3.0	3.0
GDP Deflator	1.0	1.1	-0.1	2.4	2.1	1.4	1.8	2.1	2.2	2.4	2.3
FINANCIAL											
7-day repo rate (percent)	5.1	2.4	2.7	5.4	3.1	...	...	...	...	...	...
10 year government bond rate (percent)	3.7	2.9	3.1	3.9	3.3	...	...	...	...	...	...
Real effective exchange rate (average)	3.2	9.8	-4.9	-2.9	1.4	...	...	...	...	...	...
Nominal effective exchange rate (average)	3.6	9.7	-5.4	-2.5	1.5	...	...	...	...	...	...
MACRO-FINANCIAL											
Total social financing 3/	14.3	12.4	16.7	13.4	9.8	10.5	10.5	10.0	9.5	9.2	8.7
In percent of GDP	190	198	216	224	226	232	238	242	245	247	249
Total nonfinancial sector debt 4/	17.1	15.4	19.9	11.0	10.4	11.6	11.7	11.0	10.3	9.9	8.8
In percent of GDP	207	222	249	253	257	266	275	282	288	293	295
Domestic credit to the private sector	13.2	15.8	21.3	8.5	7.8	8.8	9.9	9.5	8.9	8.7	8.1
In percent of GDP	149	159	181	180	178	180	183	185	187	188	188
House price 5/	1.4	9.1	11.3	5.7	12.2	6.5	8.6	7.3	6.6	6.2	6.0
Household disposable income (percent of GDP)	60.4	60.5	61.0	60.4	60.0	60.0	59.8	59.4	58.9	58.1	58.1
Household savings (percent of disposable income)	38.0	37.1	35.5	35.4	33.0	31.5	30.3	28.9	27.3	25.4	25.0
Household debt (percent of GDP)	35.8	38.7	44.8	49.7	54.0	56.2	59.1	61.1	63.2	65.4	67.9
Non-financial corporate domestic debt (percent of GDP)	113	121	136	130	124	124	124	124	124	122	120
BIS credit-to-GDP gap (percent of GDP) 6/	21.1	20.8	18.2	10.5	0.4	...	...	...	...	...	...
GENERAL BUDGETARY GOVERNMENT (Percent of GDP)											
Net lending/borrowing 7/	-0.9	-2.8	-3.7	-3.9	-4.8	-6.1	-5.7	-5.6	-5.6	-5.5	-5.4
Revenue	28.1	28.5	28.2	28.3	29.2	28.8	29.1	28.8	28.5	28.2	28.0
Additional financing from land sales	2.7	1.9	2.0	2.6	2.9	2.8	1.7	1.4	1.1	1.0	0.9
Expenditure	31.6	33.2	33.9	34.7	36.9	37.7	36.5	35.7	35.2	34.7	34.3
Debt 8/	38.6	36.4	36.7	36.8	37.9	40.3	43.1	45.5	47.6	49.4	51.0
Structural balance	-0.5	-2.5	-3.6	-3.9	-4.8	-6.1	-5.6	-5.5	-5.5	-5.4	-5.3
BALANCE OF PAYMENTS (Percent of GDP)											
Current account balance	2.2	2.7	1.8	1.6	0.4	0.5	0.4	0.2	0.1	0.0	-0.1
Trade balance	4.1	5.1	4.4	3.9	2.9	3.1	2.9	2.7	2.5	2.5	2.4
Services balance	-2.0	-1.9	-2.1	-2.1	-2.2	-2.2	-2.2	-2.2	-2.1	-2.1	-2.1
Net international investment position	15.2	14.9	17.4	17.4	15.9	15.6	14.8	13.9	12.9	12.0	11.0
Gross official reserves (bn US$)	3,899	3,406	3,098	3,236	3,168	3,167	3,174	3,177	3,179	3,182	3,189
MEMORANDUM ITEMS											
Nominal GDP (bn RMB) 9/	64,718	69,911	74,563	81,526	88,702	95,539	103,084	111,560	120,546	130,318	140,613
Augmented debt (percent of GDP) 10/	52.3	56.6	62.0	67.3	72.7	80.2	86.2	91.1	95.6	99.3	101.5
Augmented net lending/borrowing (percent of GDP) 10/	-7.2	-8.4	-10.4	-10.8	-11.2	-12.7	-12.2	-11.9	-11.6	-11.5	-11.4

Sources: Bloomberg, CEIC, IMF International Financial Statistics database, and IMF staff estimates and projections.

1/ IMF staff estimates for 2017 and 2018.

2/ Surveyed unemployment rate.

3/ Not adjusted for local government debt swap.

4/ Includes government funds.

5/ Average selling prices estimated by IMF staff based on housing price data (Commodity Building Residential Price) of 70 large and mid-sized cities published by National Bureau of Statistics (NBS).

6/ Latest observation is for Q3 2017.

7/ Adjustments are made to the authorities' fiscal budgetary balances to reflect consolidated general budgetary government balance, including government-managed funds, state-administered SOE funds, adjustment to the stabilization fund, and social security fund.

8/ Official government debt. Estimates of debt levels before 2015 include central government debt and explicit local government debt (identified by MoF and NPC in Sep 2015). The large increase in general government debt in 2014 reflects the authorities' recognition of the off-budget local government debt borrowed previously. The estimation of debt levels after 2015 assumes zero off-budget borrowing from 2015 to 2021.

9/ Expenditure side nominal GDP.

10/ Augmented fiscal data expand the perimeter of government to include local government financing vehicles and other off-budget activity.

Table 2. China: Balance of Payments

(In percent of GDP, unless otherwise noted)

	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
						Projections					
Current account balance	2.2	2.7	1.8	1.6	0.4	0.5	0.4	0.2	0.1	0.0	-0.1
Trade balance	4.1	5.1	4.4	3.9	2.9	3.1	2.9	2.7	2.5	2.5	2.4
Exports	21.3	19.1	17.7	18.4	18.0	17.6	16.9	16.2	15.5	15.0	14.5
Imports	17.2	14.0	13.4	14.4	15.1	14.5	14.0	13.5	13.0	12.5	12.1
Services balance	-2.0	-1.9	-2.1	-2.1	-2.2	-2.2	-2.2	-2.2	-2.1	-2.1	-2.1
Income balance	0.1	-0.4	-0.4	-0.1	-0.4	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Current transfers	0.0	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Capital and financial account balance	-0.5	-3.8	-3.7	0.9	1.0	-0.5	-0.4	-0.2	-0.1	0.0	0.1
Capital account	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial account	-0.5	-3.9	-3.7	0.9	1.0	-0.6	-0.4	-0.2	-0.1	0.0	0.1
Net foreign direct investment	1.4	0.6	-0.4	0.2	0.8	0.7	0.6	0.6	0.6	0.5	0.4
Foreign Direct investment	2.5	2.2	1.6	1.4	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Overseas Direct Investment	-1.2	-1.6	-1.9	-1.1	-0.7	-0.8	-0.8	-0.9	-1.0	-1.0	-1.1
Portfolio investment	0.8	-0.6	-0.5	0.2	0.8	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Other investment	-2.6	-3.9	-2.8	0.4	-0.6	-1.2	-0.9	-0.7	-0.5	-0.4	-0.2
Errors and omissions 1/	-0.6	-1.9	-2.0	-1.8	-1.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	1.1	-3.1	-4.0	0.8	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Reserve assets	-1.1	3.1	4.0	-0.8	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
International investment position:											
Asset	61.1	54.8	58.0	59.3	54.6	54.9	53.8	52.5	51.2	50.0	48.8
Direct investment	8.4	9.8	12.1	15.0	14.2	14.2	14.0	13.8	13.7	13.7	13.8
Securities investment	2.5	2.3	3.3	4.1	3.7	4.5	5.2	5.9	6.6	7.3	7.8
Other investment	13.2	12.4	15.0	13.3	13.1	13.8	13.9	13.7	13.3	12.8	12.1
Reserve assets	37.0	30.3	27.6	26.8	23.6	22.4	20.7	19.1	17.6	16.3	15.1
Liability	45.9	39.9	40.6	41.9	38.7	39.3	39.0	38.6	38.3	38.0	37.8
Direct investment	24.7	24.0	24.6	22.6	20.6	21.0	20.9	20.7	20.7	20.6	20.6
Securities investment	7.6	7.3	7.2	9.1	8.2	8.7	9.0	9.3	9.6	9.8	10.1
Other investment	13.7	8.6	8.8	10.1	9.9	9.6	9.1	8.5	8.0	7.6	7.1
Net international investment position	15.2	14.9	17.4	17.4	15.9	15.6	14.8	13.9	12.9	12.0	11.0
Memorandum items:											
Export growth (value terms, percentage change)	4.4	-4.5	-7.2	11.4	9.1	3.2	3.8	3.9	3.9	4.8	4.7
Import growth (value terms, percentage change)	1.1	-13.4	-4.2	16.0	16.2	1.7	4.2	4.6	4.5	4.6	4.5
FDI (inward, billion of US$)	268	242	175	166	203	206	229	252	276	300	324
External debt (billion of US$)	1,788	1,383	1,416	1,758	1,987	2,113	2,245	2,388	2,542	2,707	2,882
As a percent of GDP	17.0	12.3	12.6	14.6	14.8	14.9	14.7	14.4	14.1	13.9	13.7
Short-term external debt (remaining maturity, billion of US$)	1,311	887	871	1,099	1,234	1,308	1,382	1,463	1,549	1,641	1,739
Gross reserves (billion of US$) 2/	3,899	3,406	3,098	3,236	3,168	3,167	3,174	3,177	3,179	3,182	3,189
As a percent of ST debt by remaining maturity	297	384	356	294	257	242	230	217	205	194	183
Terms of trade (percentage change)	1.7	7.6	7.7	5.1	3.9	0.5	0.3	0.3	0.3	1.2	0.7
Real effective exchange rate (2010 = 100)	119	131	124	121	122	…	…	…	…	…	…
Nominal GDP (billion of US$)	10,535	11,226	11,222	12,062	13,407	14,146	15,310	16,639	18,032	19,532	21,113

Sources: CEIC; IMF, Information Notice System; and IMF staff estimates and projections.

1/ Includes counterpart transaction to valuation changes.

2/ Includes foreign currency reserves and other reserve assets such as SDRs and gold.

Table 3. China: External Vulnerability Indicators

	2014	2015	2016	2017	2018
Monetary and financial					
General government debt (in percent of GDP, narrow definition) 1/	38.6	36.4	36.7	36.8	37.9
Broad money (M2: annual percentage change)	11.0	13.3	11.3	9.0	8.1
Foreign currency deposits to broad money (percent)	2.9	2.9	3.2	3.1	2.7
Local currency loans to the economy (annual percentage change)	13.6	14.3	13.5	12.7	13.5
Foreign currency loans to bank domestic credit (in percent)	4.7	4.0	3.4	3.1	2.8
Stock exchange index (end-of-period, December 19, 1990 = 100) 2/	3,389	3,704	3,250	3,463	2,611
Stock exchange capitalization (percent of GDP) 3/	58.1	77.5	68.6	69.1	48.3
Number of listed companies (A-share)	2,592	2,808	3,034	3,467	3,567
Balance of payments					
Exports (annual percentage change, U.S. dollars)	4.4	-4.5	-7.2	11.4	9.1
Imports (annual percentage change, U.S. dollars)	1.1	-13.4	-4.2	16.0	16.2
Current account balance (percent of GDP)	2.2	2.7	1.8	1.6	0.4
Capital and financial account balance (percent of GDP)	-0.5	-3.8	-3.7	0.9	1.0
Of which : gross foreign direct investment inflows	2.5	2.2	1.6	1.4	1.5
Foreign Exchange Reserve					
In Billions of U.S. Dollars 4/	3,899	3,406	3,098	3,236	3,168
Coverage in terms of:					
Imports (in months)	22.1	18.2	18.6	20.0	17.2
Broad money (percent)	19.5	15.2	13.3	12.9	11.5
Short-term external debt by remaining maturity (percent)	297	384	356	294	257
Assessing reserve adequacy (range) 5/	137-331	119-316	106-284	96-253	92-240
External debt and balance sheet indicators					
Total external debt (percent of GDP)	17.0	12.3	12.6	14.6	14.8
Total external debt (billions of U.S. dollars)	1,788	1,383	1,416	1,758	1,987
Short-term external debt by original maturity (billions of U.S. dollars)	1,311	887	871	1,099	1,234
Net foreign assets of banking sector (billions of U.S. dollars)	189	444	540	500	570
Total debt to exports of goods & services (percent)	72.6	58.6	64.4	72.4	74.9
Total debt service to exports of goods & services (percent)	52.9	37.8	39.9	45.5	48.2
Of which : Interest payments to exports of goods & services (percent)	0.2	0.2	0.2	0.2	0.2
Foreign-currency long-term sovereign bond ratings (eop)					
Moody's	Aa3	Aa3	Aa3	A1	A1
Standard and Poor's	AA-	AA-	AA-	AA-	A+

Sources: CEIC; Bloomberg; IMF, Information Notice System; and IMF staff estimates.

1/ Estimates of debt levels before 2015 include central government debt and explicit local government debt (identified by MoF and NPC in Sep 2015). The large increase in general government debt in 2014 reflects the authorities' recognition of the off-budget local government debt borrowed previously.

2/ Shanghai Stock Exchange, A-share.

3/ Shanghai Stock Exchange, A-share and B-share, and Shenzen Stock Exchange.

4/ Includes foreign currency reserves and other reserve assets such as SDRs and gold.

5/ Range for the ARA metric under different assumptions of exchange rate regime and capital controls.

Table 4. China: Monetary and Credit Developments

	2014	2015	2016	2017	2018
MONETARY SURVEY					
			(Annual percentage change)		
Net foreign assets	2.6	-2.7	-5.9	-4.0	1.0
Monetary authority (contribution)	2.4	-8.6	-9.1	-2.4	-1.5
Depository institutions (contribution)	0.3	5.9	3.1	-1.6	2.5
Domestic credit	16.2	23.7	20.1	11.3	10.4
Claims on government, net (contribution)	0.6	4.0	4.8	2.7	2.6
Claims on nonfinanical sectors (contribution)	11.4	13.8	8.6	7.7	9.1
Claims on other financial sectors (contribution)	4.1	5.9	6.6	0.9	-1.3
Broad money (M2)	11.0	13.3	11.3	9.0	8.1
M1 (contribution)	1.0	4.3	6.1	3.7	0.5
Quasi-money (contribution)	10.0	9.0	5.2	5.4	7.6
Reserve money	8.5	-6.0	11.8	4.2	2.8
TOTAL SOCIAL FINANCING					
			(In percent)		
TSF 1/	14.3	15.0	19.8	14.4	10.2
Bank loans (contribution)	9.2	8.8	8.5	8.1	7.9
Shadow banking (contribution)	2.3	0.6	0.9	2.1	-1.5
Net corporate bond financing (contribution)	2.2	2.4	2.3	0.3	0.9
Non-financial enterprise equity (contribution)	0.4	0.6	0.9	0.5	0.2
Others (contribution)	0.2	0.0	3.7	-3.0	-0.1
			(In percent of GDP)		
TSF 1/	189.8	202.2	227.1	227.6	227.5
Bank loans	131.2	137.0	144.6	149.0	154.3
Shadow banking	33.1	31.7	31.4	33.0	27.1
Net corporate bond financing	18.1	20.9	24.0	22.5	22.7
Non-financial enterprise equity	5.9	6.5	7.7	8.2	7.9
Others	1.6	1.5	8.5	1.5	1.3
MEMORANDUM ITEMS					
			(In percent)		
Nonperforming loans ratio	1.3	1.7	1.7	1.7	1.8
Provision coverage ratio (provisions/NPLs)	232	181	176	181	186
Liquidity ratio (liquid assets/liquid liabilities)	46.4	48.0	47.6	50.0	55.3
Loan to deposit ratio	65.1	67.2	67.6	70.6	74.3
Return on assets	1.2	1.1	1.0	0.9	0.9
Return on equity	17.6	15.0	13.4	12.6	11.7
Capital adequacy ratio	13.2	13.5	13.3	13.7	14.2
Tier 1 capital adequacy ratio	10.8	11.3	11.3	11.4	11.6
Core tier 1 capital adequacy ratio	10.6	10.9	10.8	10.8	11.0
Net open FX position (in percent of capital)	3.5	3.7	3.5	2.5	2.4

Sources: Haver Analytics; and IMF staff estimates.

1/ After adjusting for the local government debt swap.

Table 5. China: General Government Fiscal Data

		2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
							Projections					
						(In RMB billions)						
Balance: General Budgetary (official)												
(1)	**Revenue (incl. adjustments) (1a)+(1b)**	14137	16032	16688	18273	19812	20764	21654	23295	25145	27096	29154
(1a)	Headline revenue	14037	15227	15960	17259	18335	19250	21309	22915	24727	26637	28648
(1b)	Adjustments 1/	100	806	727	1014	1477	1514	345	380	418	459	505
(2)	**Expenditure (incl. adjustments) (2a)+(2b)**	15497	17658	18854	20626	22192	23524	25494	27413	29560	31722	34004
(2a)	Headline expenditure	15179	17588	18776	20309	22091	23524	25494	27413	29560	31722	34004
(2b)	Adjustments 2/	319	70	78	318	102	0	0	0	0	0	0
(3)	**Fiscal balance (official) (1)-(2)**	-1360	-1626	-2166	-2353	-2380	-2760	-3840	-4118	-4415	-4626	-4850
Balance: General Budgetary (Fund definition)												
(4)	**Revenue (1a)+(4a)+(4b)**	18158	19949	21048	23055	25890	27554	30046	32107	34399	36814	39359
(4a)	Social security revenue	3919	4466	4827	5538	7265	7968	8366	8784	9224	9685	10169
(4b)	SOE fund revenues 3/	202	256	260	258	290	337	370	407	448	493	542
(5)	**Expenditure (2a)+(5a)+(5b)+(5c)**	20463	23199	25308	28317	32758	36059	37640	39811	42480	45240	48193
(5a)	Social security expenses	3367	3936	4392	4895	6459	7425	7871	8343	8844	9374	9937
(5b)	SOE fund expenditures 3/	200	208	217	201	216	240	264	291	320	352	387
(5c)	Managed funds' expenditure financed by land sales, bond issuance or carryover 4/	1717	1467	1923	2912	3992	4869	4011	3764	3757	3793	3865
(5d)	of which: net expenditure financed by land sales	1717	1302	1498	2082	2604	2683	1753	1507	1387	1304	1252
(6)	**Net borrowing/lending (Fund definition) (4)-(5)+(5d)**	-587	-1948	-2762	-3179	-4264	-5821	-5841	-6197	-6695	-7122	-7581
Balance: Augmented (staff estimates of general government)												
(7a)	Additional infrastructure spending financed by LGFV debt	4072	3421	3417	3783	3885	4340	4548	4697	4945	5215	5627
(7b)	Additional spending of special construction (SCF) and gov't guided funds (GGF)	-29	469	1566	1825	1813	1981	2176	2359	2390	2589	2784
(8)	**Augmented net lending/borrowing (6)-(7a)-(7b) 5/**	-4630	-5838	-7744	-8787	-9962	-12142	-12565	-13252	-14029	-14926	-15993
Debt: General government												
(9)	**General budgetary debt (official) (10)+(11)**	24966	25417	27362	29987	33643	38457	44448	50707	57364	64337	71646
(10)	Central government debt 6/	9566	10660	12007	13477	15233	18146	22238	26597	31354	36427	41835
(11)	Explicit local government debt 7/	15400	14757	15356	16510	18410	20310	22210	24110	26010	27910	29810
(11a)	Non-swap LG bonds	1162	1624	2550	3704	5604	7504	9404	11304	13204	15104	17004
(11b)	Other recognized LG debt	14238	13133	12806	12806	12806	12806	12806	12806	12806	12806	12806
(12)	Additional LGFV debt likely/possible to be recognized 8/	8698	12331	15755	19622	24114	29462	33860	38495	43477	48840	54740
(13)	Additional debt tied to SCF and GGFs 9/	174	1806	3118	5247	6767	8667	10567	12467	14367	16267	16267
(14)	**Augmented debt (9)+(12)+(13)**	33837	39554	46236	54856	64525	76586	88875	101669	115208	129445	142653
Memorandum items:												
(15)	Augmented excluding "possible to be recognized" 10/	25835	28710	32940	38143	44796	53176	62101	71451	81432	91982	103226
							(In percent of GDP) 11/					
Balance: General Budgetary (official)												
(1)	**Revenue (incl. adjustments) (1a)+(1b)**	21.8	22.9	22.4	22.4	22.3	21.7	21.0	20.9	20.8	20.8	20.7
(1a)	Headline revenue	21.7	21.8	21.4	21.2	20.7	20.1	20.7	20.5	20.5	20.4	20.4
(1b)	Adjustments 1/	0.2	1.2	1.0	1.2	1.7	1.6	0.3	0.3	0.3	0.4	0.4
(2)	**Expenditure (incl. adjustments) (2a)+(2b)**	23.9	25.3	25.3	25.3	25.0	24.6	24.7	24.6	24.5	24.3	24.2
(2a)	Headline expenditure	23.5	25.2	25.2	24.9	24.9	24.6	24.7	24.6	24.5	24.3	24.2
(2b)	Adjustments 2/	0.5	0.1	0.1	0.4	0.1	0.0	0.0	0.0	0.0	0.0	0.0
(3)	**Fiscal balance (official) (1)-(2)**	-2.1	-2.3	-2.9	-2.9	-2.7	-2.9	-3.7	-3.7	-3.7	-3.5	-3.4
Balance: General Budgetary (fund definition)												
(4)	**Revenue (1a)+(4a)+(4b)**	28.1	28.5	28.2	28.3	29.2	28.8	29.1	28.8	28.5	28.2	28.0
(4a)	Social security revenue	6.1	6.4	6.5	6.8	8.2	8.3	8.1	7.9	7.6	7.4	7.2
(4b)	SOE fund revenues 3/	0.3	0.4	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4
(5)	**Expenditure (2a)+(5a)+(5b)+(5c)**	31.6	33.2	33.9	34.7	36.9	37.7	36.5	35.7	35.2	34.7	34.3
(5a)	Social security expenses	5.2	5.6	5.9	6.0	7.3	7.8	7.6	7.5	7.3	7.2	7.1
(5b)	SOE fund expenditures 3/	0.3	0.3	0.3	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3
(5c)	Managed funds' expenditure financed by land sales, bond issuance or carryover 4/	2.7	2.1	2.6	3.6	4.5	5.1	3.9	3.4	3.1	2.9	2.7
(5d)	of which: net expenditure financed by land sales	2.7	1.9	2.0	2.6	2.9	2.8	1.7	1.4	1.2	1.0	0.9
(6)	**Net borrowing/lending (Fund definition) (4)-(5)+(5d)**	-0.9	-2.8	-3.7	-3.9	-4.8	-6.1	-5.7	-5.6	-5.6	-5.5	-5.4
Balance: Augmented (staff estimates of general government)												
(7a)	Additional infrastructure spending financed by LGFV debt	6.3	4.9	4.6	4.6	4.4	4.5	4.4	4.2	4.1	4.0	4.0
(7b)	Additional spending of special construction (SCF) and gov't guided funds (GGF)	0.0	0.7	2.1	2.2	2.0	2.1	2.1	2.1	2.0	2.0	2.0
(8)	**Augmented net lending/borrowing (6)-(7a)-(7b) 5/**	-7.2	-8.4	-10.4	-10.8	-11.2	-12.7	-12.2	-11.9	-11.6	-11.4	-11.4
Debt: General government												
(9)	**General budgetary debt (official) (10)+(11)**	38.6	36.4	36.7	36.8	37.9	40.2	43.1	45.4	47.6	49.3	50.9
(10)	Central government debt 6/	14.8	15.2	16.1	16.5	17.2	19.0	21.6	23.8	26.0	27.9	29.7
(11)	Explicit local government debt 7/	23.8	21.1	20.6	20.3	20.8	21.2	21.5	21.6	21.6	21.4	21.2
(11a)	Non-swap LG bonds	1.8	2.3	3.4	4.5	6.3	7.9	9.1	10.1	10.9	11.6	12.1
(11b)	Other recognized LG debt	22.0	18.8	17.2	15.7	14.4	13.4	12.4	11.5	10.6	9.8	9.1
(12)	Additional LGFV debt likely/possible to be recognized 8/	13.4	17.6	21.1	24.1	27.2	30.8	32.8	34.5	36.1	37.5	38.9
(13)	Additional debt tied to SCF and GGFs 9/	0.3	2.6	4.2	6.4	7.6	9.1	10.2	11.2	11.9	12.5	11.6
(14)	**Augmented debt (9)+(12)+(13)**	52.3	56.6	62.0	67.3	72.7	80.1	86.2	91.1	95.5	99.3	101.4
Memorandum items:												
(15)	Augmented excluding "possible to be recognized" 10/	39.9	41.1	44.2	46.8	50.5	55.6	60.2	64.0	67.5	70.6	73.4

Sources: CEIC, Data Co. Ltd.; China Ministry of Finance; NAO; and IMF staff estimates and projections.

1/ Includes central and local governments' transfers to general budget from various funds, carry-over.

2/ Includes adjustments for local government balance carried forward, redemption of local government bonds prior to 2014 and government bond issued under government managed funds.

3/ Including only revenues/expenditures for the year, and excluding transfers to general budget and carry over.

4/ Includes carry over counted as revenue, adjustments to local government spending, proceeding from issuing special purpose bonds, and net expenditure financed by land sales estimated by subtracting the acquisition cost, compensation to farmers, and land development from the gross land sale proceeds.

5/ The overall net lending/borrowing includes net land sale proceeds as a decrease in nonfinancial assets recorded above the line.

6/ Ministry of Finance debt only, excludes bonds issued for bank recapitalization and asset management companies.

7/ Includes local government bonds and explicit debt.

8/ 10% of government contingent debt in 2014. Contingent debt in 2014 is estimated using LGFV total debt minus explicit LG debt of 15.4 Tr. Thereafter, 2/3 of new contingent debt are assumed likely to be recognized as general government

9/ Total social capital constribution to SCF and GGFs.

10/ Includes only 2/3 of LGFV debt, being categoried as government explicit debt according to NAO report (2013), and excludes the rest 1/3, being categorized as government guaranteed debt or "possible to be recognized" debt.

11/ GDP in this table refers to expenditure side nominal GDP.

Table 6. China: Nonfinancial Sector Debt

	(In RMB trillions)			(In percent of GDP)			Coverage	
	2016	2017	2018	2016	2017	2018		
Total non-financial sector debt	186	206	228	249	253	256		
Central government	12	13	15	16	17	17	Official Government Debt	Staff Estimate of General Government Debt ("Augmented")
Local government 1/	15	17	18	21	20	21		
Local government financing vehicles (LGFV)	16	20	24	21	24	27		
"Likely" to be recognized								
As per the 2014 audit	1	1	1	1	1	1		
New borrowing in 2015-17 (staff estimate) 2/ 3/	5	7	10	6	9	12		
Additional debt possible to be recognized								
As per the 2014 audit	8	8	8	10	10	9		
New borrowing in 2015-17 (staff estimate) 2/ 3/	2	4	5	3	4	6		
Government funds 3/	3	5	7	4	6	8		
Households	33	41	48	45	50	54		Private Sector Debt
Corporates (excluding LGFV)	106	111	115	142	136	130		
Domestic	102	106	110	136	130	124		
External	4	5	5	6	6	6		
Memo items:								
Total domestic non-financial sector debt	181	201	222	243	247	251		
Corporates (including LGFVs)	122	130	139	163	160	157		
of which LGFVs	16	20	24	21	24	27		
Households	33	41	48	45	50	54		
General government (Official definition)	27	30	34	37	37	38		
Government funds 3/	3	5	7	4	6	8		
Nominal GDP	75	82	89					

Sources: CEIC Data Co., Ltd.; Ministry of Finance; and IMF staff estimates.
1/ Including LGFV debt recognized as LG debt as of 2014 (by the 2014 audit).
2/ New LGFV borrowing estimate for 2015-18 is based on infrastructure fixed asset investment data.
3/ Government guided funds (GGF) and special construction funds (SCF). Social capital portion only. Assumed to be included in corporate debt.

Table 7. China: Rebalancing Scorecard

External		Internal			Environment		Income Distribution	
Current acc.	Net exports contrib.	Cons/Inv	Industry/ Services	Credit	Energy	Air pollution	Labor income ratio	Income inequality

Rebalancing Score Card Summary Indicators

	Unit	2014	2015	2016	2017	2018
1. External rebalancing						
Contribution of net exports to GDP growth	%	0.4	-0.1	-0.6	0.6	-0.6
Current account balance	% of GDP	2.2	2.7	1.8	1.4	0.4
FX reserve coverage	months of imports	22.1	18.2	18.6	20.0	17.6
National saving rate	% of GDP	49.0	47.5	45.9	46.0	44.6
2. Internal rebalancing						
Demand side						
Growth contribution of consumption vs investment	%	1.0	1.4	1.5	1.7	2.4
Share of private consumption (Nominal)	% of GDP	37.5	38.0	39.4	39.0	40.0
Share of investment (Nominal)	% of GDP	46.8	44.7	44.1	44.6	44.2
Supply side						
Growth contribution of Tertiary vs Secondary sector	%	1.0	1.3	1.5	1.7	1.2
Share of Tertiary sector (Nominal)	% of GDP	48.0	50.5	51.8	51.9	51.9
Share of Tertiary sector in total employment	%	40.6	42.4	43.5	45.2	46.8
Credit Side						
Private credit	% of GDP	149	159	181	180	178
Credit intensity		3.3	4.0	6.4	3.1	3.0
Return on asset: SOE - private	%	-7.1	-7.7	-7.7	-5.6	-2.9
3. Environmental rebalancing						
Energy intensity of output	per unit of output	86.2	83.0	82.1	79.9	79.8
PM 2.5 (Weighted by usual residence)	mcg per cubic metre	…	55.9	49.8	48.0	44.6
4. Income distribution						
Gini	index number	0.469	0.462	0.465	0.467	…
Labor income	% of GDP	60.4	60.5	61.0	60.4	60.0
Urban/rural income gap	income ratio	2.75	2.73	2.72	2.71	2.69
Real disposable income growth: Median – Mean	%	4.4	2.3	2.0	0.0	2.1

Note: The color coding is based on the change in each indicator from 2017 to 2018. Color coding: red if the changes go in the opposite direction of rebalancing; yellow if some progress was observed; and green if there was substantial progress in rebalancing. For indicators that are ratios, changes are measured in simple differences and are considered substantial if larger than 0.5 percentage points. For indicators that are indices and for the credit indicators, changes are measured in annual percent change and are considered substantial if larger than 5 percent. See Zhang, L. (2016), "Rebalancing in China—Progress and Prospects," IMF Working Paper No. 16/183 for the framework.

Sources: CEIC and IMF staff estimates and projections.

Table 8. China: SOE Performance

Dimention	Indicator	2014	2015	2016	2017	2018
		(In percent unless otherwise indicated)				
Profitability	Return on assets SOEs	2.2	1.8	1.6	1.9	1.9
	Return on assets industrial SOEs	3.9	2.9	3.0	3.9	4.2
	Return on assets industrial private	9.2	8.7	8.9	8.5	6.9
Efficiency	Cost per unit of income -SOE	95.4	97.3	94.8	97.1	97.1
Leverage	Debt to equity SOEs	183	192	190	192	183
	-Central	192	213	217	213	210
	-Local	176	175	171	174	165
	Debt to asset SOE	64.7	65.7	65.5	65.7	64.7
	-Central	65.7	68.1	68.4	68.0	67.7
	-Local	63.8	63.7	63.1	63.5	62.2
	Debt to Asset -Industrial	57.2	56.6	55.9	56.0	56.5
	Debt to asset industrial SOEs	62.0	61.9	61.6	60.5	58.7
	Debt to asset industrial private	54.1	53.2	52.3	53.0	55.2
	Number of zombies 1/			2041	841	141
	Number of Bankruptcies	2031	3568	5665	9542	18823
Corporate governance	Central SOEs with board of directors	74.0	85.0	85.0	87.0	94.0
	Number of Central SOEs 2/	112.0	106.0	102.0	98.0	96.0
	Dividend payments to budget	10.3	11.9	10.1	7.6	7.4
SOEs share in the economy	Employment	16.1	15.4	14.9	14.3	
	Industrial Sales	23.7	21.8	20.6	23.4	26.8
	Asset(industrial SOEs/total industrial)	38.8	38.8	38.5	39.2	38.8
	Liability(industrial SOEs/total industrial)	42.1	42.5	42.4	42.4	40.3

Sources: CEIC, NBS, Ministry of Finance.

1/ Number of zombies refers to legal entities of central SOEs.

2/ There are 96 central SOEs and 39000 legal entities affilicated to these SOEs by 2018.

Appendix I. Debt Sustainability Analysis[1]

The debt sustainability analysis (DSA) assesses government debt under both official "budgetary" and staff's estimated general government "augmented" definitions. Comprehensive fiscal measures have been used to mitigate the economic slowdown from both revenues and expenditure side during 2018-19 and the DSA results thus reflect worsening debt dynamics compared to last year. While official budgetary government debt remains low, "augmented" debt and associated gross financing needs are high and debt under both definitions is on an upward trajectory. Accordingly, it is important for the authorities to make continued efforts to reduce off-budget investment spending of local governments.

China's public debt sustainability analysis (DSA) is based on the following assumptions:

- **Public debt coverage**. Two definitions of debt are used. The main difference is the coverage of local government debt.
    - The *"budgetary"* coverage scenario includes central government debt and "on-budget" local government debt identified by the authorities. For 2004–13, general government debt includes central government debt and local government bonds (issued by the central government). From 2014, general government debt includes central government debt and explicit local government debt (which consists of local government bonds and other recognized off-budget liabilities incurred by end-2014). The change of definition in 2014 is mainly a result of the change of official data coverage when 2/3 of LGFV debt was explicitly recognized as government liability.
    - *"Augmented"* debt is used in the broad coverage scenario. It adds other types of local government borrowing, including off-budget liabilities borrowed by Local Government Financing Vehicles (LGFVs) via bank loans, bonds, trust loans and other funding sources, estimated by staff. It also covers debt of government-guided funds and special construction funds, whose activities are considered quasi-fiscal. The augmented deficit is the flow counterpart of augmented debt. Augmented data are staff's best estimate of general government data. Data limitations mean some nongovernment activity is likely included, and some LGFV and funds may end up having substantial revenues. It is also possible that some general government activity takes place outside of staff's augmented definition (e.g. PPPs).
- **Macroeconomic assumptions**:

The projection reflects a gradual slowdown of real GDP growth to 5.5 percent y/y by 2024 and GDP deflator growth of about 2.3 percent. The fiscal assumptions differ in the scenarios with budgetary government debt or augmented debt.

- *Fiscal balance in the budgetary coverage scenario.* This scenario assumes all spending is done within the confines of the budget, and thus off-budget public investment is sharply reduced. Under this scenario, the primary fiscal deficit is assumed to rise from 3.8 percent of GDP in 2018 to 5.0 percent of GDP in 2019, driven mainly by fiscal measures implemented to mitigate the slowdown (increased tax cuts and higher special purpose bonds quota), before

[1] Prepared by G. Li.

gradually declining back to 4.0 percent of GDP in 2024. The special purpose bond quota increases from RMB 1350 billion RMB in 2018 to RMB 2150 billion RMB in 2019, which is about additional 0.7 percent of GDP.

- *Fiscal balance in the augmented scenario*. Off-budget local government spending is assumed to decline marginally. The augmented primary deficit, which includes the on-budget fiscal deficit and off-budget spending financed by LGFV debt and government funds, is projected to rise from around 8.0 percent of GDP in 2018 to around 9.0 percent of GDP in 2019, and gradually decrease in the medium term to 6.4 percent of GDP in 2024.

- *Local government financing*. While many local governments relied on net revenue from land sales and LGFV borrowing to finance their investment in the past, the DSA assumes that future financing needs will be increasingly met by bond issuance.

- *Interest rates and amortization*. The interest rates for central government and local government bonds are assumed to be about 3–4 percent (in line with historical average). The interest rates of off-budget borrowing (only in the augmented scenario) are assumed to be about 6-7 percent (based on the yield differential between sovereign bond and LGFV bank loans and other short-term instruments). Staff assume all maturing debt will be rolled over.

In the narrow coverage scenario, budgetary government debt is on an increasing path.

- Government debt under narrow coverage at 38 percent of GDP in end-2018 is on an increasing path to 51 percent of GDP in 2024, to which a favorable growth-interest rate differential contributed. Slightly different from before, as fiscal stimulus relies more on-budget items, the budgetary government debt now is increasing faster than in last year's DSA.

In the broad coverage scenario, augmented debt continues to rise rapidly and consolidation in the medium-term would be necessary to prevent it hitting a very high levels in the long run.

- Augmented debt rises to 101 percent of GDP in 2024 from 73 percent of GDP in 2018. The debt-stabilizing primary balance is estimated to be -2.3 percent of GDP in the medium term, almost 7 percentage points of GDP stronger than the projected 2019 level.

Although China faces relatively low risks to debt sustainability for the budgetary government, the worsening debt dynamics of augmented debt pose large risks to debt sustainability.

- In the narrow coverage scenario, budgetary government debt remains relatively low at a still reasonable level in all standard stress tests except for the scenario with contingent liability shocks. A contingent liability shock in 2020 will result in a sharp increase from about 38 percent of GDP in 2018 to about 67 percent of GDP in 2020.[2] While the budgetary debt level is still

[2] Mechanically, the standard contingent liability shock in the IMF's DSA toolkit assumes that 10 percent of non-government banking system assets would turn into government liabilities. Non-government banking system assets were about 220 percent of GDP in 2016. It also assumes that the real GDP growth in 2019 and 2020 would be 2–2.5 percent lower (a one standard deviation shock).

manageable, the authorities would potentially have to deal with an increase in gross financing needs that could be sensitive to market financing conditions and may entail rollover risks.

- In the broad coverage scenario, the augmented debt level is also sensitive to macro-fiscal shocks. Combined macro-fiscal shocks would push debt to above 110 percent of GDP in 2024.

China's debt profile will largely depend on the implementation of fiscal measures and, more fundamentally, on the willingness to reduce public investment and support macroeconomic rebalancing.

- Based on the projected debt dynamics under the narrow coverage, China's debt profile is still manageable, especially given that it is mostly domestically financed.
- However, the debt dynamics crucially depends on public investment, especially off-budget. The extent to which off-budget investment is strictly implemented, especially that off-budget investment is on a strictly commercial basis, will determine whether debt dynamics will be closer to the narrow-coverage scenario or the broad-coverage scenario. If local governments continue to incur off-budget liabilities, the debt profile will move closer to that in the broad-coverage scenario and the debt-to-GDP ratio will continue to rise at very high levels in the medium term. Fiscal risks may also arise from new borrowing avenues that have emerged, such as less supervised PPP and government-guided funds. As overall SOE profitability remains weak and about a third of SOEs remain loss making, the medium-term debt profile should also be cautious about fiscal risks from SOE debt especially given SOE assets may not be liquid and SOE debt (in terms of GDP) is on the rise.

Figure 1. China: Public Sector Debt Sustainability Analysis (Augmented Debt: Broad Coverage)

(In percent of GDP unless otherwise indicated)

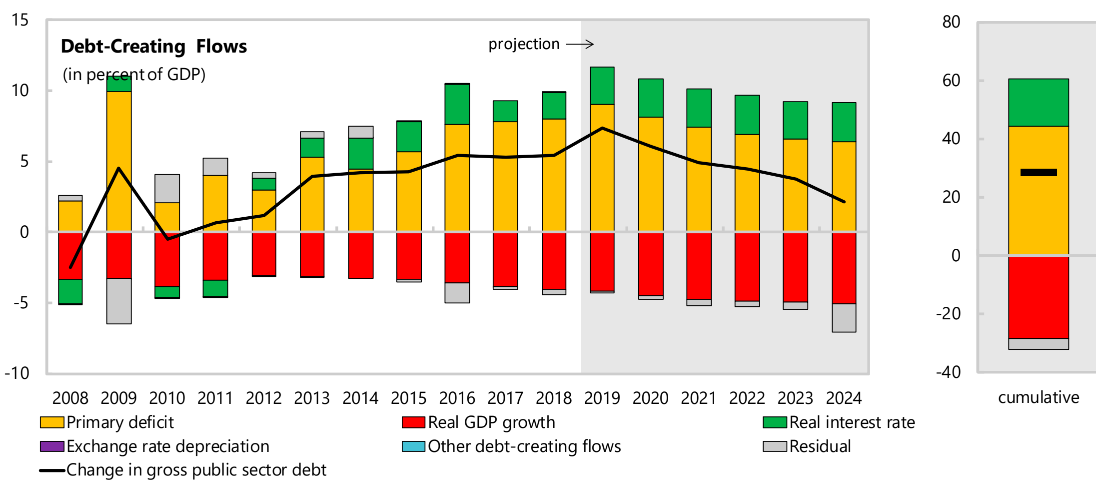
Debt, Economic and Market Indicators [1/]

	Actual			Projections						
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	47.7	67.3	72.7	80.1	86.2	91.1	95.5	99.3	101.4
Public gross financing needs	20.2	22.3	22.2	22.7	23.7	25.4	24.7	25.2	25.7
Real GDP growth (in percent)	8.4	6.8	6.6	6.2	6.0	6.0	5.7	5.6	5.5
Inflation (GDP deflator, in percent)	3.2	2.4	2.1	1.5	1.8	2.1	2.2	2.4	2.3
Nominal GDP growth (in percent)	12.0	9.3	8.8	7.8	7.9	8.2	8.1	8.1	7.9
Effective interest rate (in percent) [4/]	5.0	5.2	5.2	5.4	5.5	5.6	5.6	5.5	5.4

As of June 06, 2019		
Sovereign Spreads		
EMBIG (bp) 3/		77
5Y CDS (bp)		43
Ratings	Foreign	Local
Moody's	A1	A1
S&Ps	A+	A+
Fitch	A+	A+

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	2.4	5.3	5.5	7.4	6.1	4.9	4.4	3.8	2.1	28.7	-2.3
Identified debt-creating flows	2.3	5.5	5.8	7.5	6.3	5.3	4.8	4.3	4.1	32.4	
Primary deficit	4.9	7.8	8.0	9.0	8.1	7.4	6.9	6.6	6.4	44.4	
Primary (noninterest) revenue and gra	26.4	28.3	29.2	28.8	29.1	28.8	28.5	28.2	28.0	171.4	
Primary (noninterest) expenditure	31.3	36.1	37.2	37.9	37.3	36.2	35.4	34.8	34.4	215.9	
Automatic debt dynamics [5/]	-2.6	-2.4	-2.2	-1.6	-1.8	-2.1	-2.0	-2.3	-2.3	-12.1	
Interest rate/growth differential [6/]	-2.6	-2.4	-2.2	-1.6	-1.8	-2.1	-2.0	-2.3	-2.3	-12.1	
Of which: real interest rate	0.7	1.5	1.9	2.6	2.7	2.7	2.8	2.7	2.8	16.2	
Of which: real GDP growth	-3.4	-3.8	-4.1	-4.2	-4.5	-4.8	-4.8	-4.9	-5.1	-28.3	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Fiscal: General Government: Revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Expansion of the swap beyond initial	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	0.1	-0.2	-0.3	-0.1	-0.3	-0.4	-0.4	-0.5	-2.0	-3.7	



Source: IMF staff.

1/ Public sector is defined as the Augmented public sector.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

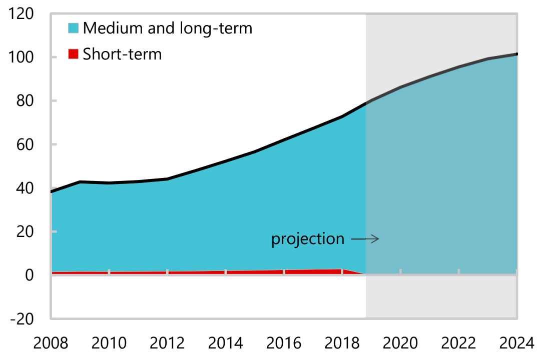
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 2. China: Public DSA — Composition of Augmented Debt (Broad Coverage) and Alternative Scenarios

Composition of Public Debt

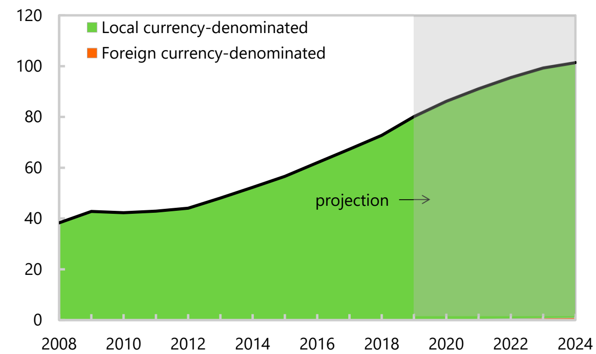
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

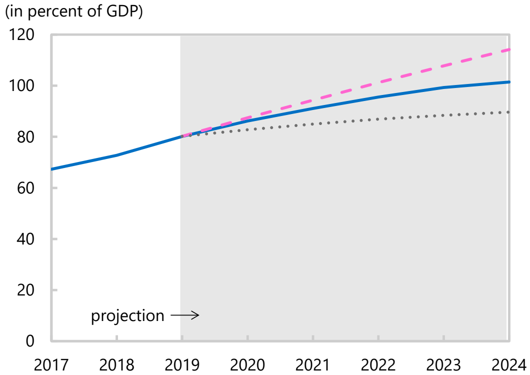


Alternative Scenarios

Baseline Historical Constant Primary Balance

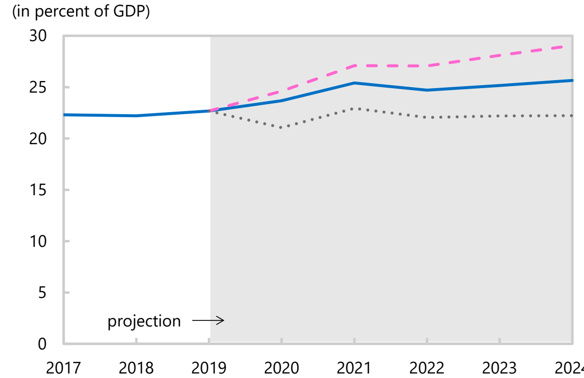
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	6.2	6.0	6.0	5.7	5.6	5.5
Inflation	1.5	1.8	2.1	2.2	2.4	2.3
Primary Balance	-9.0	-8.1	-7.4	-6.9	-6.6	-6.4
Effective interest rate	5.4	5.5	5.6	5.6	5.5	5.4
Constant Primary Balance Scenario						
Real GDP growth	6.2	6.0	6.0	5.7	5.6	5.5
Inflation	1.5	1.8	2.1	2.2	2.4	2.3
Primary Balance	-9.0	-9.0	-9.0	-9.0	-9.0	-9.0
Effective interest rate	5.4	5.5	5.6	5.5	5.4	5.2

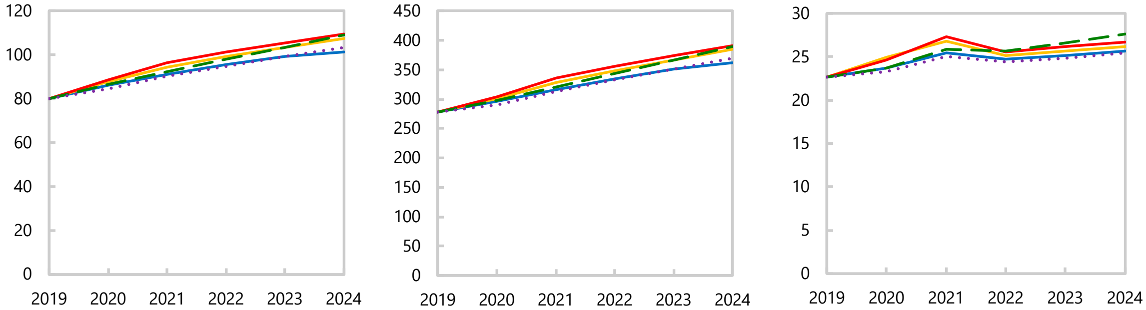
Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	6.2	7.9	7.9	7.9	7.9	7.9
Inflation	1.5	1.8	2.1	2.2	2.4	2.3
Primary Balance	-9.0	-5.8	-5.8	-5.8	-5.8	-5.8
Effective interest rate	5.4	5.5	5.4	5.3	5.0	4.8

Figure 3. China: Public DSA (Augmented Debt: Broad Coverage) – Stress Tests

Macro-Fiscal Stress Tests

Baseline
Real GDP Growth Shock
Primary Balance Shock
Real Exchange Rate Shock
Real Interest Rate Shock

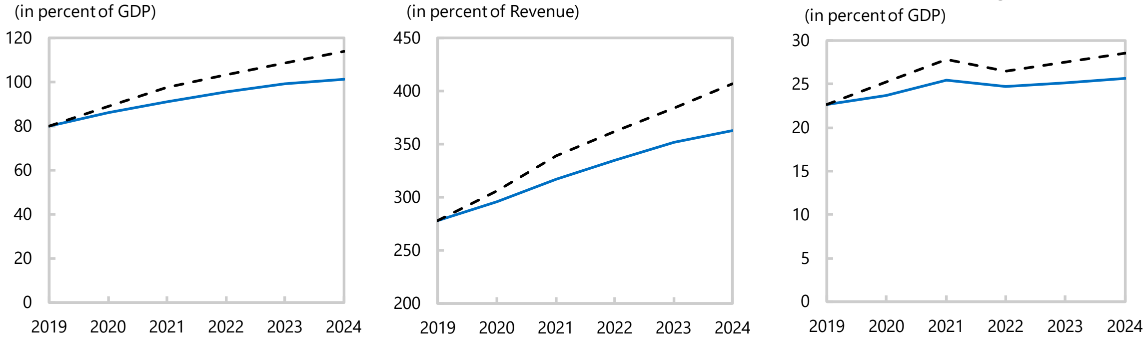
Gross Nominal Public Debt (in percent of GDP) | **Gross Nominal Public Debt** (in percent of Revenue) | **Public Gross Financing Needs** (in percent of GDP)



Additional Stress Tests

Baseline
Combined Macro-Fiscal Shock

Gross Nominal Public Debt (in percent of GDP) | **Gross Nominal Public Debt** (in percent of Revenue) | **Public Gross Financing Needs** (in percent of GDP)



Underlying Assumptions
(in percent)

Primary Balance Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	6.2	6.0	6.0	5.7	5.6	5.5
Inflation	1.5	1.8	2.1	2.2	2.4	2.3
Primary balance	-9.0	-9.4	-8.7	-6.9	-6.6	-6.4
Effective interest rate	5.4	5.5	5.7	5.7	5.6	5.4
Real Interest Rate Shock						
Real GDP growth	6.2	6.0	6.0	5.7	5.6	5.5
Inflation	1.5	1.8	2.1	2.2	2.4	2.3
Primary balance	-9.0	-8.1	-7.4	-6.9	-6.6	-6.4
Effective interest rate	5.4	5.5	6.2	6.6	6.9	7.0
Combined Shock						
Real GDP growth	6.2	4.6	4.6	5.7	5.6	5.5
Inflation	1.5	1.4	1.7	2.2	2.4	2.3
Primary balance	-9.0	-9.4	-8.7	-6.9	-6.6	-6.4
Effective interest rate	5.4	5.5	6.1	6.6	6.8	6.9

Real GDP Growth Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	6.2	4.6	4.6	5.7	5.6	5.5
Inflation	1.5	1.4	1.7	2.2	2.4	2.3
Primary balance	-9.0	-8.8	-8.6	-6.9	-6.6	-6.4
Effective interest rate	5.4	5.5	5.6	5.7	5.6	5.4
Real Exchange Rate Shock						
Real GDP growth	6.2	6.0	6.0	5.7	5.6	5.5
Inflation	1.5	4.2	2.1	2.2	2.4	2.3
Primary balance	-9.0	-8.1	-7.4	-6.9	-6.6	-6.4
Effective interest rate	5.4	5.5	5.6	5.6	5.5	5.3

Source: IMF staff.

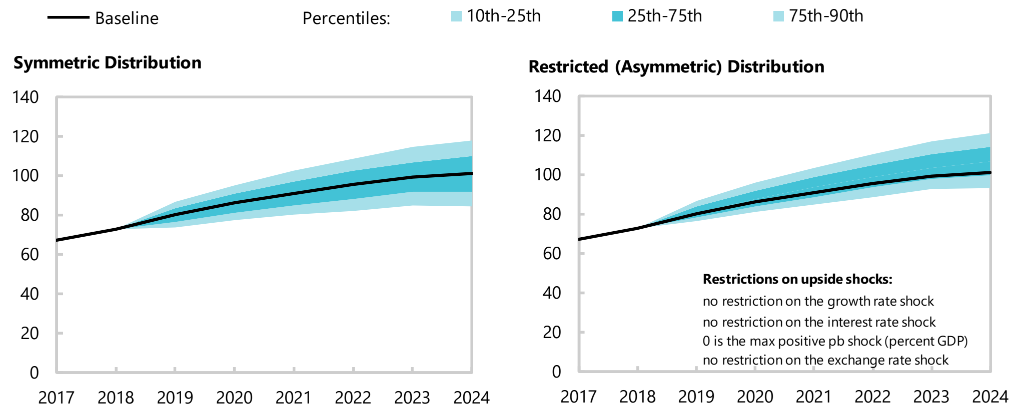
Figure 4. China: Public DSA (Augmented Debt: Broad Coverage) – Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

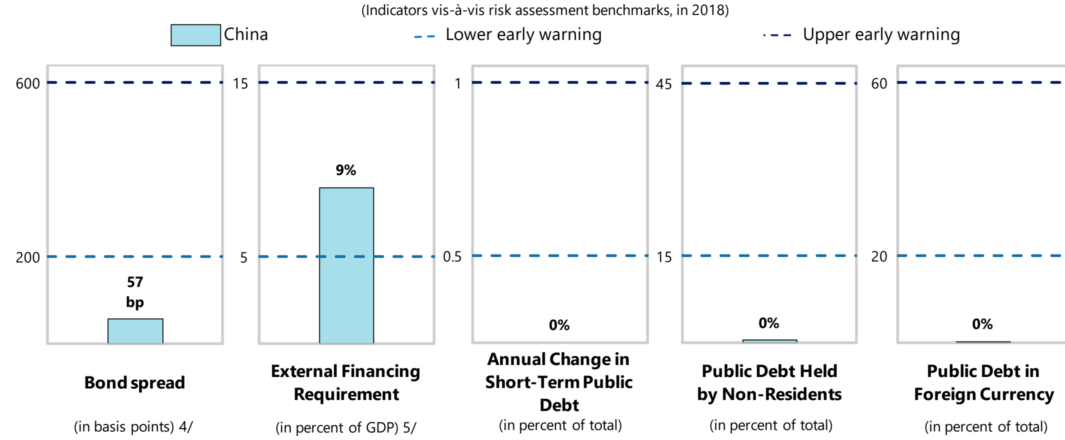
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2018)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 08-Mar-19 through 06-Jun-19.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Figure 5. China: Public Sector Debt Sustainability Analysis (Budgetary Government Debt)

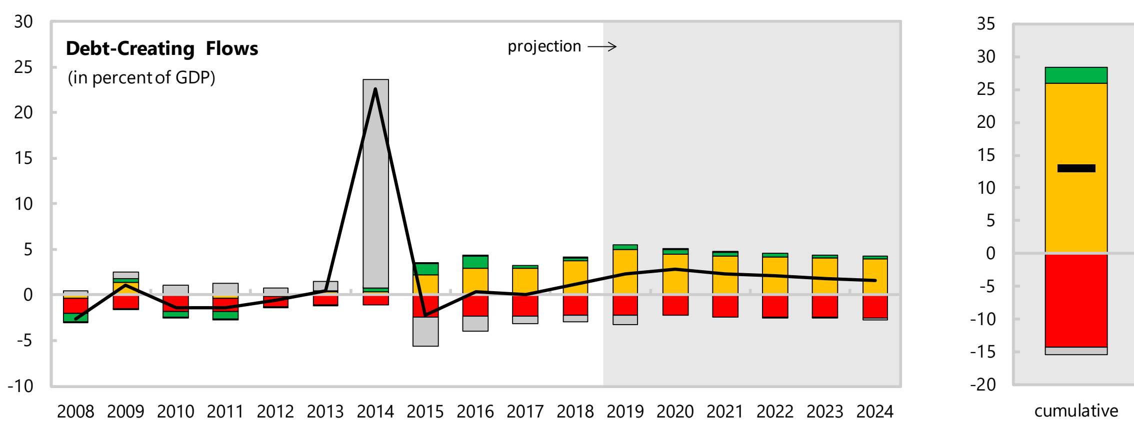
(In percent of GDP, unless otherwise indicated)

Debt, Economic and Market Indicators [1]

	Actual			Projections						As of June 06, 2019		
	2008-2016 [2]	2017	2018	2019	2020	2021	2022	2023	2024	Sovereign Spreads		
Nominal gross public debt	23.7	36.8	37.9	40.2	43.1	45.4	47.6	49.4	50.9	EMBIG (bp) 3/		77
Public gross financing needs	11.7	11.0	10.2	9.6	9.8	11.1	10.2	10.3	10.4	5Y CDS (bp)		43
Real GDP growth (in percent)	8.4	6.8	6.6	6.2	6.0	6.0	5.7	5.6	5.5	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	3.2	2.4	2.1	1.5	1.8	2.1	2.2	2.4	2.3	Moody's	A1	A1
Nominal GDP growth (in percent)	12.0	9.3	8.8	7.8	7.9	8.2	8.1	8.1	7.9	S&Ps	A+	A+
Effective interest rate (in percent) [4]	3.4	3.5	3.3	3.2	3.2	3.2	3.2	3.1	3.1	Fitch	A+	A+

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9]
Change in gross public sector debt	1.8	0.1	1.1	2.3	2.9	2.3	2.1	1.8	1.6	13.0	
Identified debt-creating flows	-0.8	1.0	1.9	3.4	2.7	2.3	2.2	1.9	1.8	14.2	
Primary deficit	0.7	3.0	3.8	5.0	4.5	4.3	4.2	4.1	4.0	26.0	-2.2
Primary (noninterest) revenue and gra	26.4	28.3	29.2	28.8	29.1	28.8	28.5	28.2	28.0	171.4	
Primary (noninterest) expenditure	27.1	31.2	33.0	33.8	33.6	33.0	32.7	32.3	31.9	197.4	
Automatic debt dynamics [5]	-1.5	-2.0	-1.9	-1.6	-1.8	-2.0	-2.1	-2.2	-2.2	-11.8	
Interest rate/growth differential [6]	-1.5	-2.0	-1.9	-1.6	-1.8	-2.0	-2.1	-2.2	-2.2	-11.8	
Of which: real interest rate	0.1	0.3	0.3	0.6	0.5	0.4	0.4	0.3	0.3	2.4	
Of which: real GDP growth	-1.6	-2.3	-2.2	-2.2	-2.3	-2.4	-2.4	-2.5	-2.5	-14.2	
Exchange rate depreciation [7]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Fiscal: General Government: Revenue	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Expansion of the swap beyond initial	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8]	2.6	-0.9	-0.8	-1.0	0.2	0.1	0.0	-0.1	-0.2	-1.1	



Source: IMF staff.

1/ Public sector is defined as general government as per authorities definition.

2/ Based on available data.

3/ Long-term bond spread over U.S. bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi (1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

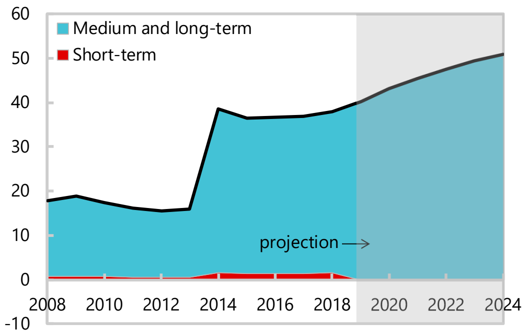
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

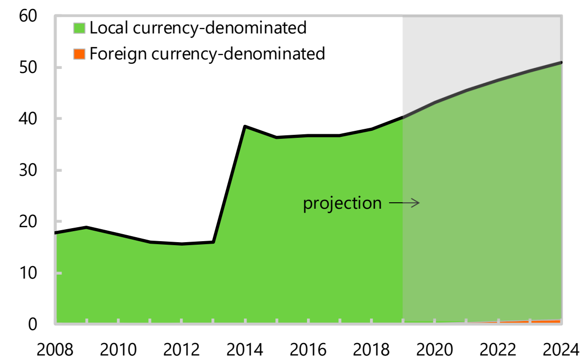
Figure 6. China: Public DSA—Composition of Budgetary Government Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



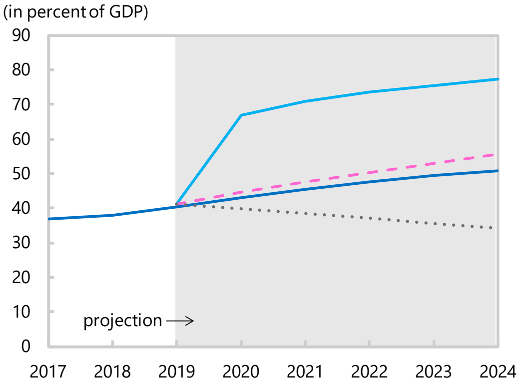
By Currency
(in percent of GDP)



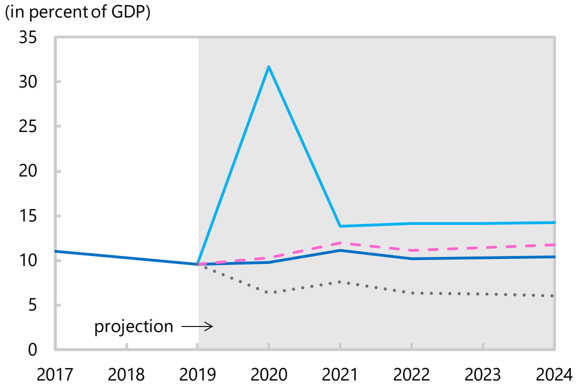
Alternative Scenarios

Baseline
Contingent Liability 1/
Historical
Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



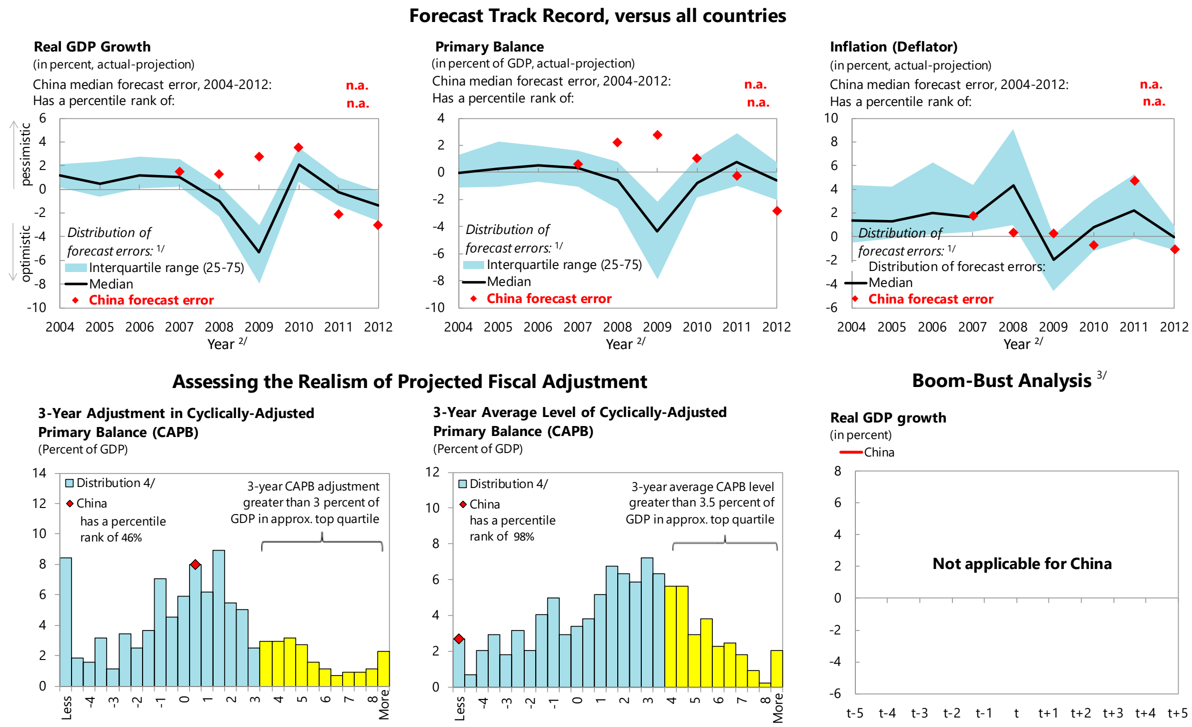
Underlying Assumptions
(in percent)

Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	6.2	6.0	6.0	5.7	5.6	5.5
Inflation	1.5	1.8	2.1	2.2	2.4	2.3
Primary Balance	-5.0	-4.5	-4.3	-4.2	-4.1	-4.0
Effective interest rate	3.2	3.2	3.2	3.2	3.1	3.1
Constant Primary Balance Scenario						
Real GDP growth	6.2	6.0	6.0	5.7	5.6	5.5
Inflation	1.5	1.8	2.1	2.2	2.4	2.3
Primary Balance	-5.0	-5.0	-5.0	-5.0	-5.0	-5.0
Effective interest rate	3.2	3.2	3.2	3.2	3.2	3.2

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	6.2	7.9	7.9	7.9	7.9	7.9
Inflation	1.5	1.8	2.1	2.2	2.4	2.3
Primary Balance	-5.0	-1.1	-1.1	-1.1	-1.1	-1.1
Effective interest rate	3.2	3.2	3.1	3.0	3.0	2.9

1/ The contingent liability shock scenario also assumes that 10 percent of banking assets would turn into government liabilities.

Figure 7. China: Public DSA (Budgetary Government) – Realism of Baseline Assumptions



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

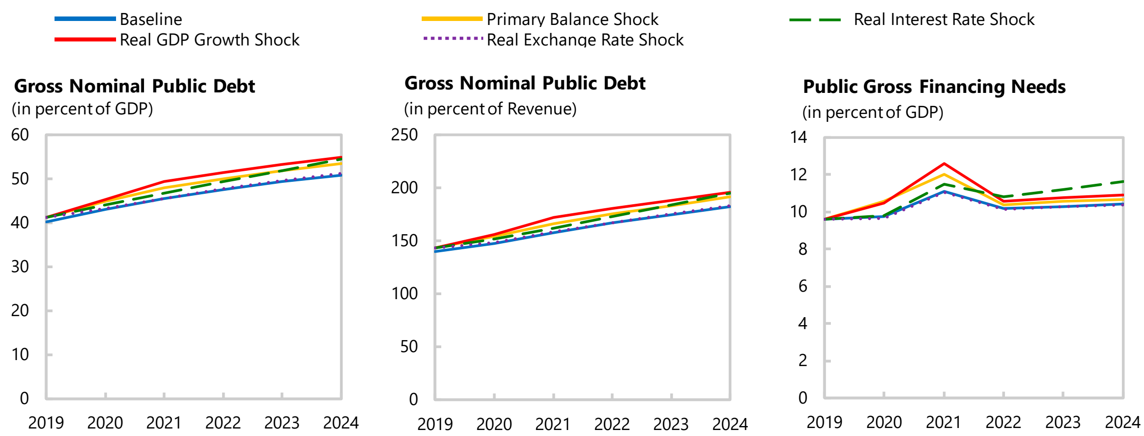
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for China, as it meets neither the positive output gap criterion nor the private credit growth criterion.

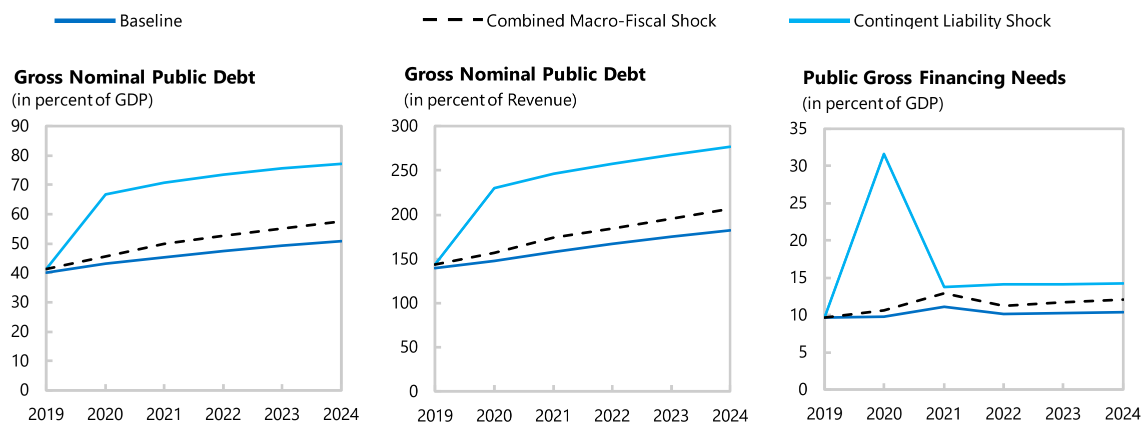
4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Figure 8. China: Public DSA (Budgetary Government) – Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	6.2	6.0	6.0	5.7	5.6	5.5
Inflation	1.5	1.8	2.1	2.2	2.4	2.3
Primary balance	-5.0	-5.2	-5.0	-4.2	-4.1	-4.0
Effective interest rate	3.2	3.2	3.2	3.3	3.2	3.2
Real Interest Rate Shock						
Real GDP growth	6.2	6.0	6.0	5.7	5.6	5.5
Inflation	1.5	1.8	2.1	2.2	2.4	2.3
Primary balance	-5.0	-4.5	-4.3	-4.2	-4.1	-4.0
Effective interest rate	3.2	3.2	3.8	4.5	4.9	5.2
Combined Shock						
Real GDP growth	6.2	4.6	4.6	5.7	5.6	5.5
Inflation	1.5	1.4	1.7	2.2	2.4	2.3
Primary balance	-5.0	-5.2	-5.4	-4.2	-4.1	-4.0
Effective interest rate	3.2	3.2	3.9	4.5	4.9	5.2

Real GDP Growth Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	6.2	4.6	4.6	5.7	5.6	5.5
Inflation	1.5	1.4	1.7	2.2	2.4	2.3
Primary balance	-5.0	-5.0	-5.4	-4.2	-4.1	-4.0
Effective interest rate	3.2	3.2	3.2	3.3	3.2	3.2
Real Exchange Rate Shock						
Real GDP growth	6.2	6.0	6.0	5.7	5.6	5.5
Inflation	1.5	4.2	2.1	2.2	2.4	2.3
Primary balance	-5.0	-4.5	-4.3	-4.2	-4.1	-4.0
Effective interest rate	3.2	3.2	3.2	3.2	3.2	3.1
Contingent Liability Shock						
Real GDP growth	6.2	4.6	4.6	5.7	5.6	5.5
Inflation	1.5	1.4	1.7	2.2	2.4	2.3
Primary balance	-5.0	-26.1	-4.3	-4.2	-4.1	-4.0
Effective interest rate	3.2	3.6	5.9	5.6	5.1	4.8

Source: IMF staff.

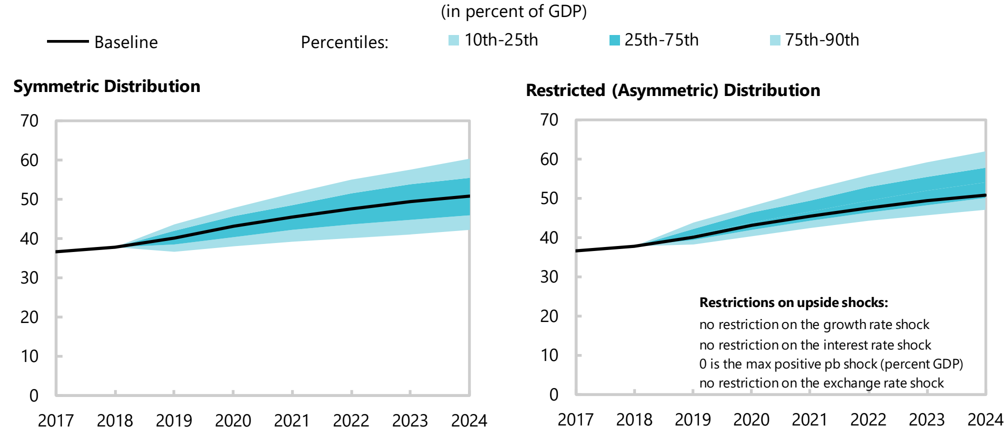
Figure 9. China: Public DSA (Budgetary Government) – Risk Assessment

Heat Map

Debt level [1/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs [2/]	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile [3/]	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

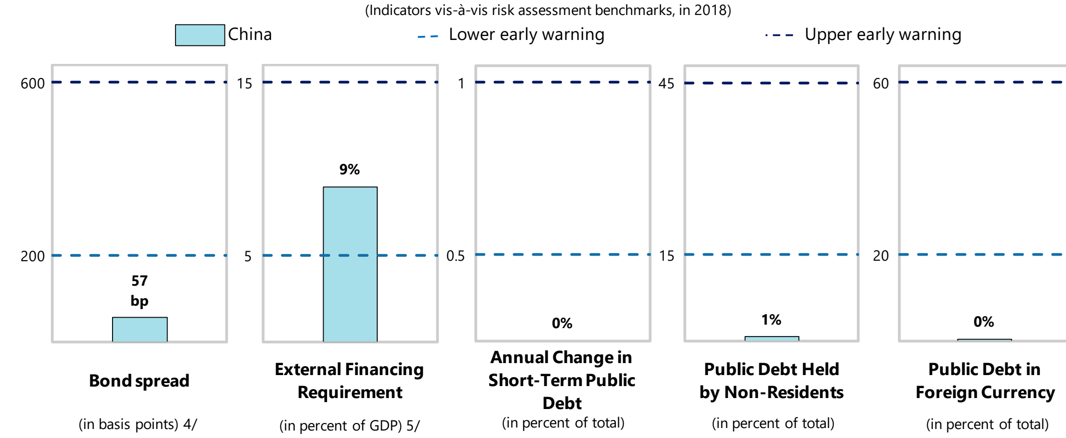
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2018)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over U.S. bonds, an average over the last 3 months, 08-Mar-19 through 06-Jun-19.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

Appendix II. Risk Assessment Matrix[1,2]

Likelihood	Time Horizon and Identification of Risks	Impact and Policy Response
	Short-term	
High ↓	**1. Rising Protectionism.** A re-escalation in tensions could result in higher tariffs, disruptions in supply chains, and weaker confidence and investment.	**High.** Mitigate trade tensions by seeking a durable settlement and continue to support multilateralism and the global trading system.
Medium ↓	**2. A downturn in the property market.** A sudden correction in property prices could have significant adverse impact on financial sector stability and the real economy.	**High.** Macroprudential policies for the property market can curb excessive risk taking and be eased in the event of a sharp downturn.
Low ↓	**3. Sharp tightening of global financial conditions.** The tightening could be a result of market expectation of tighter U.S. monetary policy triggered by strong wage growth and higher-than-expected inflation. Pressure on the exchange rate could resume because of capital account pressures. Higher debt service and refinancing risks could put stress on leveraged firms.	**Medium.** Move toward effectively floating exchange rate, and limit intervention to mitigate disorderly market conditions.
Medium ↓	**4. Cyber-attacks.** Financial, transport or communication infrastructure could be affected triggering systemic financial instability or widespread disruptions in socio-economic activities.	**High**. Put in place adequate firewalls and security measures. Enhance crisis preparedness for cyber-attacks.
Medium/High ↓	**5. Weaker-than-expected global growth.** The global growth slowdown could be synchronized as weakening outlooks in the U.S. (medium), Europe (high) and China (medium) feed off each other and impact on earnings, asset prices and credit performance. In China, in the short term, intensification of trade tensions and/or a housing market downturn could prompt a slowdown, which is not fully offset by policy easing. Deleveraging may be delayed, and financial stresses could emerge including capital outflow and exchange rate pressures.	**Medium.** Engage partners to sustain and build a stronger rules-based multilateral trading system. Make sufficient progress in rebalancing and ensure that credit flows to the productive private sector.
	Medium-term	
Medium ↑	**1. A comprehensive reform package.** Reforms that increase the role of markets, aided by greater openness could significantly boost productivity and potential growth.	**High.** Implement a high-quality comprehensive reform package based on market-oriented policies.
Medium ↑	**2. A more dynamic private sector.** China's booming fintech sector and digital economy could present an upside potential to growth as commercialization of digital business models could proceed rapidly.	**High.** Support the development of fintech while ensuring financial stability through proper regulation and supervision.
High ↓	**3. Rising protectionism and retreat from multilateralism.** Geopolitical competition and fraying consensus about the benefits of globalization lead to economic fragmentation with adverse effects on growth and stability.	**Medium.** Adopt competitive neutrality policies that will help mitigate tensions with foreign firms.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

2/ Green upward and red downward arrows denote upside and downside risks respectively.

Medium	**4. Increasing role of the state.** With a slowdown in growth, the role of the state has been increasing which could weigh on potential growth especially if combined with a reliance on debt to hit short-term growth targets.	**Medium.** Stay the course on rebalancing and deleveraging. Improve credit allocation to the private sector while maintaining credit quality.
Medium/High	**5. Weaker-than-expected global growth.** The global growth slowdown could be synchronized as weakening outlooks in the U.S. (medium), Europe (high) and China (medium) feed off each other and impact on earnings, asset prices and credit performance. In China, over the medium term, insufficient progress in deleveraging and rebalancing could reduce growth and raises the probability of a larger disruptive adjustment. There would be negative spillovers on the global economy through trade volumes, commodity prices, and financial markets.	**Medium.** Engage partners to sustain and build a stronger rules-based multilateral trading system. Make sufficient progress in rebalancing and ensure that credit flows to the productive private sector.

Appendix III. AML/CFT Assessment[1]

Fund staff recently concluded a detailed assessment of China's AML/CFT system. China's AML/CFT system is relatively young (China only joined FATF in 2007), and although there is still a lot of room for improvement, over the years, the authorities have been making progress towards improving the legal system and the effectiveness of the measures taken.

The assessment report measures the effectiveness of China's AML/CFT framework (i.e., the extent to which the country achieves a series of 11 predetermined outcomes in light of its ML/TF risks) and China's technical compliance (i.e., the country's legal and regulatory framework against the FATF 40 Recommendations).

Regarding effectiveness, China substantially meets 3 of the 11 immediate outcomes; however, the other 8 outcomes are assessed as insufficiently effective. Technical compliance is somewhat better; China is compliant or largely compliant with 22 Recommendations, while 18 Recommendations were rated partially or non-compliant.

- Domestic AML/CFT cooperation and coordination is well established and could be a good starting point to develop an improved risk understanding, and subsequently, take appropriate risk mitigation measures. The main proceeds-generating predicate crimes in China are illegal fundraising, fraud, trafficking in illicit drugs, corruption and bribery, tax crimes, counterfeiting of products, and illegal gambling.
- China's Financial Intelligence Unit, consisting of two separate units at the national level and 36 separate regional branches, has the potential to produce financial intelligence that supports the operational needs of competent authorities. But the current incomplete access of all parts of the FIU to all data, leads to a fragmented analysis and disseminations.
- Law enforcement authorities have access to and actively use a wide range of financial information to identify and trace proceeds. However, their focus is mainly on proving predicate offences and on confiscating assets, and to a lesser extent on financial investigations related to money laundering and terrorist financing.
- The implementation of UN-mandated targeted financial sanctions related to terrorist financing and proliferation financing related to Iran and the DPRK, is suffering from fundamental shortcomings in legislation and in implementation by banks. This exposes Chinese banks and other financial institutions and businesses to enhanced regulatory domestic and foreign risks.
- Hiding the persons who ultimately own or control a legal entity, is made exceedingly easy through a lack of an understanding of the risks of legal entities (including of state-owned companies), a lack of legal requirements, and a lack of implementation, including by banks and other financial institutions. This also notably affects efforts to address corruption.
- While FIs have a satisfactory understanding of their AML/CFT obligations, they have not developed a sufficient understanding of risks, and measures implemented to mitigate risk are generally not commensurate with different risk situations. Fundamental improvements of FIs

[1] Prepared by R. Berkhout.

implementation of preventive measures are needed, including requirements for domestic politically-exposed-persons. The supervision of FIs is not sufficiently risk-focused and sanctions applied by supervisors are not effective, proportionate and dissuasive.

- Implementation of measures for designated non-financial businesses and professions is for most sectors still pending.

Ratings Key	
Sufficient ratings	Insufficient ratings
11 Immediate outcomes	
High level of effectiveness	Moderate level of effectiveness
Substantial level of effectiveness	Low level of effectiveness
40 Technical Recommendations	
Compliant	Partially compliant
Largely compliant	Non-compliant

11 Immediate outcomes

IO.1	Risk, policy and coordination	Substantial	IO.2	International cooperation	Moderate
IO.3	Supervision	Moderate	IO.4	Preventive measures	Low
IO.5	Legal persons and arrangements	Low	IO.6	Financial intelligence	Moderate
IO.7	Money laundering investigations & prosecution	Moderate	IO.8	Confiscation	Substantial
IO.9	Terrorist financing investigations & prosecution	Substantial	IO.10	Terrorist financing preventive measures & financial sanctions	Low
IO.11	Proliferation financing financial sanctions	Low			

40 Technical Recommendations

R.1	Assessing risk & applying risk-based approach	LC	R.2	National cooperation and coordination	C
R.3	Money laundering offence	PC	R.4	Confiscation & provisional measures	C
R.5	Terrorist financing offence	LC	R.6	Targeted financial sanctions for terrorism	PC
R.7	Targeted financial sanctions for proliferation	NC	R.8	Non-profit organizations	PC
R.9	Financial institution secrecy laws	C	R.10	Customer due diligence	LC
R.11	Record keeping	C	R.12	Politically exposed persons	PC
R.13	Correspondent banking relationships	LC	R.14	Money or value transfer services	LC
R.15	New technologies	PC	R.16	Wire transfers	PC
R.17	Reliance on third parties	LC	R.18	Internal controls and foreign branches and subsidiaries	PC
R.19	Higher risk countries	C	R.20	Reporting of suspicious transactions	LC
R.21	Tipping off and confidentiality	LC	R.22	DNFBPs: Customer due diligence	NC
R.23	DNFBPs: Other measures	NC	R.24	Transparency & BO of legal persons	NC
R.25	Transparency & BO of legal arrangements	NC	R.26	Regulation and supervision of financial institutions	PC
R.27	Powers of supervisors	LC	R.28	Regulation and supervision of DNFBPs	NC
R.29	Financial Intelligence Unit	PC	R.30	Responsibilities of law enforcement and investigative authorities	C
R.31	Powers of law enforcement and investigative authorities	C	R.32	Cash couriers	LC
R.33	Statistics	LC	R.34	Guidance and feedback	PC
R.35	Sanctions	PC	R.36	International instruments	LC
R.37	Mutual legal assistance	LC	R.38	Mutual legal assistance: freezing and confiscation	PC
R.39	Extradition	LC	R.40	Other forms of international cooperation	LC

China

Foreign Asset and Liability Position and Trajectory

Background. The NIIP remains positive but declined to 15.9 percent of GDP by end-2018 after peaking at 30.2 percent of GDP in 2008. This deterioration is driven by a reduction in the CA surplus, valuation changes, and sustained high GDP growth. Gross foreign assets (55 percent of GDP by end-2018) are dominated by foreign reserves, whereas gross liabilities (40 percent of GDP) mainly reflect inward FDI. Reserve assets were stable and stood at US$3.1 trillion by end-2018 (about 24 percent of GDP).

Assessment. The NIIP-to-GDP ratio is expected to remain strong, with a modest decline over the medium term, in line with the projected CA. The NIIP is not a major source of risk at this point, as assets remain high—reflecting large foreign reserves—and liabilities are mostly FDI related. Capital outflow pressures have remained subdued, despite pressures on the US dollar–renminbi bilateral exchange rate during the second half of 2018. There are currently no substantial net outflow pressures, although such pressures may resurface as the private sector seeks to accumulate foreign assets faster than nonresidents accumulate Chinese assets.

2018 (% GDP)										
	NIIP	15.9	Gross Assets	54.6	Res. Assets	23.6	Gross Liab.	38.7	Debt Liab.	13.0

Current Account

Background. The CA surplus declined further in 2018, reaching 0.4 percent of GDP in 2018, about 1 percentage point lower than in 2017. This mainly reflects a shrinking trade balance (driven by high import volume growth) and a continued increase in the services deficit (mostly driven by tourism), as well as higher commodity and semiconductor prices. Viewed from a longer perspective, the CA surplus has declined substantially relative to the peak of about 10 percent of GDP in 2007, reflecting strong investment growth, REER appreciation, weak demand in major advanced economies, technological upgrades in manufacturing, and a widening of the services deficit. In line with continued rebalancing, the CA surplus is expected to gradually decline further over the next few years.

Assessment. Consistent with the EBA CA methodology, which estimates that the cyclically adjusted CA exceeds the norm by 0.8 percent of GDP, staff assesses the CA to be broadly in line with fundamentals and desired policies with a CA gap range of –0.7 to +2.3 percent.[1] The EBA-identified policy gaps are small on net (–0.3 percent), reflecting largely mutually offsetting forces: loose fiscal policy and excessive credit growth on the one hand and inadequate health spending on the other hand. The overall gap is mostly accounted for by the residual, which reflects other factors, including distortions that encourage excessive savings.

2018 (% GDP)												
	Actual CA	0.4	Cycl. Adj. CA	0.3	EBA CA Norm	–0.4	EBA CA Gap	0.8	Staff Adj.	0.0	Staff CA Gap	0.8

Real Exchange Rate

Background. In 2018, the average REER appreciated by about 1.4 percent relative to 2017, driven by the appreciation in the NEER (1.5 percent). Estimates through May 2019 show that the REER has depreciated by about 0.2 percent relative to the 2018 average.

Assessment. The 2018 EBA REER index regression estimates China's REER to be at the same level as warranted by fundamentals and desirable policies—compared with 5.3 percent lower in 2017.[2] However, this assessment is subject to large uncertainties related to the outlook and shifts in portfolio allocation preferences.[3] Overall, staff assesses the REER gap to be in the range of –11.5 to 8.5 percent.*

Overall Assessment:

The external position in 2018 was broadly in line with the level consistent with medium-term fundamentals and desirable policies. This represents a change from earlier assessments when the external position was judged to be moderately stronger. While the trend decline in CA surplus since the 2007 peak is largely structural, reflecting progress in rebalancing, the sharp decline in 2018 was partly supported by higher commodity and semiconductor prices. It remains important to ensure that rebalancing in China continues in order to avoid a return of excessive CA surpluses.

Potential Policy Responses:

Achieving a lasting balance in the external position will require the gradual closing of domestic policy gaps in fiscal and credit areas to be accompanied by reforms that address distortions to ensure that the economy remains on a more sustainable growth path, with higher consumption and lower overall saving. This can be achieved through successful implementation of the

Capital and Financial Accounts: Flows and Policy Measures	**Background.** After witnessing capital inflows in the first half, there were some modest outflows in latter part of 2018. Overall, China registered a small net capital inflow of US$30 billion in 2018, compared with net capital outflows of US$103 billion in 2017, and down significantly from the record outflows of US$647 billion in 2015 and US$646 billion in 2016. China's capital account remains relatively closed in a de jure sense. More recently, a 20 percent reserve requirement on FX forwards, a CFM, was reintroduced, and the authorities reimposed administrative measures to control the exchange rate in August 2018. **Assessment.** Over the medium term, the sequence of capital control loosening that is consistent with exchange rate flexibility should carefully consider domestic financial stability. Specifically, the further opening of the capital account is likely to create substantially larger two-way gross flows. Hence, the associated balance sheet adjustments and the shifts in market sentiment call for prioritizing the shift to an effective float (while using FX intervention to counter disorderly market conditions) and strengthening domestic financial stability prior to a substantial further liberalization of the capital account. Efforts should be stepped up to encourage inward FDI, which would generate positive growth spillovers and improve corporate governance standards.		authorities' reform agenda. Priorities include improving the social safety net; SOE reform and opening markets to more competition; creating a more market-based and robust financial system; taking steps to attract more inward FDI, including by ensuring equal treatment of foreign and domestic investors; and moving more to a flexible, market-based exchange rate. This will require a more market-based and transparent monetary policy framework and communications.
FX Intervention and Reserves Level	**Background.** FX reserves declined modestly by US$67 billion in 2018, after rising by US$129 billion in 2017. Staff estimates suggest that, after adjusting for estimated valuation changes and return on reserves, this change reflected minor net FX sales during episodes of market pressures; these estimates are subject to a margin of error, which could include no intervention. **Assessment.** Reserves stood at 90 percent of the IMF's composite metric unadjusted for capital controls at end-2018 (down from 106 percent and 97 percent in 2016 and 2017, respectively); relative to the metric adjusted for capital controls, reserves stood at 145 percent (down from 156 percent in 2017). The decline of the ratio is driven by higher broad money (M2) growth, external debt, and other liabilities that are driving up the metric. Given that the capital account is considered only partially open, reserves would be considered adequate in the range indicated by the adjusted and unadjusted metrics. Overall, staff assesses the current level of reserves to be adequate. As the transition to greater flexibility advances, intervention should be limited to smooth excessive volatility.		
Technical Background Notes	**The staff assessed REER gap of –1.5 percent is within the (± 5 percent) interval generally described as broadly in line with fundamentals.* → **The staff assessed REER gap of –1.5 percent is within the (± 5 percent) interval generally described as broadly in line with fundamentals.* 1 The CA norm for 2018 (–0.4 percent) is broadly similar to the one in 2017 (–0.3 percent), with a range of ± 1.5 percent of GDP. 2 The EBA REER level model estimates a total REER gap of 12.6 percent, with identified policy gaps of –2.5 percent. However, the model fit of the EBA REER level model is very poor for China. 3 Shifting expectations about trade tensions, monetary and exchange rate policy, reassessments of the government's reform agenda, or a desire by residents to diversify into foreign assets could trigger large changes in capital flows and exchange rate pressures, even in the absence of significant changes in fundamentals as captured by the EBA.		

Appendix V. Implementation of Main Recommendations of the 2018 Article IV Consultation

Announced Reform Measures since June 2018	Date
Continue to rein in credit growth	
De-emphasize growth target	
• The 2019 growth target was lowered from 6.5 percent in 2018 to 6-6.5 percent	Mar 2019
Corporate deleveraging	
• The government aims to lower SOE leverage by 2 percentage points by 2020 from the 2017 level. A dynamic leverage management system is set: 5 percent above the average leverage ratio of enterprises above designated size in a certain industry is a warning line; 10 percent above would lead to strict supervision.	Sep 2018
Tackling local government debt	
• MOF tightened control on PPPs. If a government's fee payment to PPP project exceeds 5 percent of fiscal spending, it cannot launch any new fee-paid-by-government project; 2) if more than 7 percent, the central government will warn the local government on the risk; 3) if more than 10 percent, no new project will be accepted into MOF's database.	Sep 2018
A more holistic approach towards financial regulation	
• CBIRC released administrative measures on asset management for commercial banks.	Dec 2018
• CBIRC released administrative measures on asset management for commercial banks subsidiaries.	Oct 2018
• PBC, CBIRC and CSRC jointly released a guideline to improve supervision of Systematic Important Financial Institutions.	Nov 2018
Overcapacity cut/Zombie exit	
• The government reaffirmed that no new production capacity would be allowed in the cement and the sheet glass industry. Government agencies shall conduct rigorous review for capacity replacement proposals.	Sep 2018
• NDRC and other agencies urged local governments and State-owned asset management departments to define the first lists of zombie companies. With the disposal of zombie companies set to be completed by 2020.	Dec 2018

Accelerating rebalancing efforts	
Promoting lending to small and private firms	
• PBC launched Target Medium-term lending facility (TMLF) to provide financing support for small and micro enterprises and private firms.	Dec 2018
• PBC and CSRC introduced credit risk mitigation (CRM) tools to allow investors to hedge default risks associated with private corporate bonds.	Oct 2018
Promoting consumption	
• The State Council published a comprehensive strategy to boost consumption.	Oct 2018
• NDRC released plans for consumption upgrading, mainly targeting cars, home appliances and electronic products. Key measures include lifting purchase and driving restrictions on new energy cars.	Jun 2019
Poverty reduction	
• The State Council issued guidelines on the Three-Year "Action to Win the Strong Battle against Poverty", setting a goal of eliminating absolute poverty in rural areas by 2020.	Jun 2018
Reducing urban-rural gap	
• China released a new guideline on rural digitalization, which aims to expand the 4G coverage, modernize agriculture and public services in rural area, and close the urban-rural digital gap.	May 2019
Tackling pollution	
• Target to reduce the level of PM 2.5 pollution by around 3 percent in the cities around the Beijing-Tianjin-Hebei region between October 2018 and March 2019; remove industrial production controls and grant localities more autonomy in deciding the scale of production suspensions.	Jun 2018

Fostering greater openness	
Opening-up measures	
• The National People's Congress adopted the foreign investment law, which grants foreign investors pre-establishment national treatment and negative list management. The law also forbids local government from forced technology transfer and codifies equal treatment of foreign companies in public procurement.	Mar 2019
• CSRC announced to allow majority shareholding by foreign investors in futures companies.	Aug 2018
• CBIRC announced to allow foreign investors to operate insurance appraisal and agency business in China.	Mar 2019
• MOF granted a three-year tax exemption on interest income on bond investment by foreign institutions.	Nov 2018

Capital account liberalization	
• The quota for Qualified Foreign Institutional Investors (QFII) was doubled from $150 bn to $300bn.	Jan 2019
• PBC and SAFE issued guidelines on funds involved in stock incentives for foreign employees of listed companies. Once registered at SAFE, relevant fund transfer will not require prior approval.	Feb 2019
• The Shanghai-London Stock Connect was officially launched, which will allow listed companies to issue global depository receipts (GDR) on the other exchange based on local rules and regulations. At the initial stage, the quota is set at 300 bn RMB for Shanghai Stock Exchange listed companies' issuance on the London Stock Exchange, and 250 bn RMB for London Stock Exchange listed companies' issuance in Shanghai.	Jun 2019
Tariff reductions	
• China announced to raise export tax rebates for products such as mechanical and electrical goods as well as cultural products, effective September 15th.	Sep 2018
• The State Council cut tariffs on a wide range of industrial products and raw materials beginning in November 1. The move targets 1585 tariff code categories, including textiles, metals, electromechanical equipment and other raw materials and products, about 19 percent of the total number of Chinese tax items.	Nov 2018
• The State Council announced to cut the MFN tariff rate of 298 IT products from July 1st, 2019 and adjust the provisional tax rate of some IT products accordingly.	Dec 2018
• The State Council eliminated export tariff on 94 commodities and set provisional tariff on more than 700 import items, effective January 1st.	Jan 2019
Increasing the role of market forces	
SOE reform	
• More than 2000 hospitals affiliated to SOEs will be separated from parent entities, ready for group management or restructuring.	Jun 2018
• SASAC issued guidelines on the accountability of SOE managers and employees. Loss of more than 5 million RMB will be regarded as Large Loss (loss above 50 million RMB as Major Loss), which will lead to demotion or deposition of SOE managers.	Jul 2018
• The government approved the fourth batch of pilots for SOE mixed-ownership reform, including 107 central SOE subsidiaries and 53 local SOEs or subsidiaries.	May 2019
• NDRC released a guideline to strengthen information disclosure of local SOEs' external bond issuance and ban local governments from providing implicit guarantees.	Jun 2019

Business environment	
• China's ranking in the World Bank's doing business index advanced from 78 in 2017 to 46 to 2018, reflecting progress in business registration, building permit, property registration, getting electricity, tax payment and cross-border trading etc.	2017-2018
Modernizing policy frameworks	
• CSRC published revised governance rules to standardize the operation of listed firms.	Sep 2018
• MOF published guidelines on promoting the third-party performance evaluation of government procurement service.	Aug 2018
• MOF started to implement a unified government accounting standard since Jan. 2019, a step towards a modern fiscal system and more efficient performance budgeting and management.	Jan 2019
• The State Council issued a new guideline on the division of responsibility between the central and local governments on education. For compulsory education, the central government will shoulder 50-80 percent of cost, depending on the regional income level.	Jun 2019
Enhancing data transparency and communication	
• The People's Bank of China set up a new working group to translate policy statements and news releases into English to better provide information to international investors.	End 2018
• The National Statistical Bureau increased the publication frequency of the survey-based unemployment rate from quarterly to monthly.	Jan 2019
• The State council announced the revised version of "Regulations on the Openness of Government Information of the People's Republic of China", which would take effect on May 15, 2019.	Apr 2019
• The government intensified its efforts in cracking down data falsification at local level.	2018-2019

Appendix VI. Implementation of Main Recommendations from China's 2017 FSAP[1]

Recommendation	Priority	Time-frame	Measures Adopted
Macroeconomic recommendations			
De-emphasize relatively high GDP growth projections in national plans; these higher projections motivate the setting of high growth targets at the local level.	H	NT	China's GDP growth target is an indicative target determined based on comprehensive consideration of domestic and foreign economic situations rather than a binding target. **The indicative target for GDP growth in 2019 was set at 6-6.5 percent. Primary considerations: First,** the factors of instability and uncertainty in economic operation were adequately estimated to adjust the economic growth forecast target in accordance with the principle of a realistic view based on facts. At the same time, in consideration of seasonal volatility in the economic growth rate, interval indicative targets were used to increase elasticity. **Second,** the purpose in maintaining a reasonable economic growth rate is to satisfy demand for new employment, and to provide the necessary macro environment to promote high-quality development, deepen supply-side reforms, and successfully fight the three tough battles, which will aid in stabilizing market expectations. **Third,** this indicative target conforms to China's current economic growth potential and matches the indicative growth targets for primary, secondary, and tertiary industries, and stable growth of tertiary industries can provide powerful support to maintain medium to high economic growth rates.
Systemic risk, macroprudential policy, and strengthening supervision			
Create a new financial stability sub-committee with the sole function of maintaining financial stability.	H	NT	**First, since the establishment of the new Financial Stability and Development Committee (FSDC), periodic special meetings have been held on the subject of preventing and defusing financial risk,** engaging in specialized study and making specialized arrangements for key risks in the financial field. Since 2018, more than ten special meetings on the prevention and defusing of financial risk have been convened. **Second, based on the latest plans for adjustments to party and state institutions, the office of the FSDC has been installed at the People's Bank of China,** and is charged with "proposing major policy recommendations to prevent and defuse financial risk and maintain financial stability." To effectively fulfill its responsibilities, the PBC has specifically established an internal secretariat of the office of the FSDC, responsible for handling the daily concerns of the office of the FSDC. The primary responsibilities of the secretariat include: promoting enhanced coordination of supervision, sharing of information, and linking of policies among financial regulatory agencies; successfully organizing and coordinating work to draft major financial reform and development plans, proposing policy recommendations for major monetary policy, financial supervision and financial reform and development matters requiring centralized planning and coordination, and promoting coordination and implementation thereof; organizing and coordinating the relevant agencies to study and propose major policy recommendations to prevent and defuse systemic financial risk and maintain financial stability; and coordinating the establishment of central and local cooperation mechanisms for financial supervision, risk resolution, information sharing, and consumer protections.
Establish robust mechanisms for cooperation, coordination, and exchange of information—including granular financial data—with domestic and foreign safety-net participants.	H	NT	**At the institutional level,** the State Council Financial Stability and Development Committee was established in November 2017, with the purpose of strengthening the coordination of financial supervision and making up for supervisory shortcomings, to ensure financial security and stable development. Under this framework, a variety of interdepartmental coordination mechanisms have been established to maintain the stability and healthy development of financial markets. **At the specific operational level,** the People's Bank of China (PBC) and the China Banking and Insurance Regulatory Commission (CBIRC) have established a mechanism for more regular and comprehensive sharing of information. **First,** this information sharing mechanism is used to obtain more off-site supervision information, including major banking industry indicators, major financing operation indicators, data related to loan and asset quality, and key supervisory reporting data; **second,** the PBC regularly shares central bank rating

[1] Information as reported by the authorities, with IMF staff providing translation.

			results with the CBIRC; **third,** the PBC promptly notifies the CBIRC of problems identified in onsite deposit insurance inspections and risk monitoring. Mechanisms for the sharing of data and information have taken shape among ministries and committees including the China Securities Regulatory Commission (CSRC) and the PBC, the CBIRC, the State Administration of Foreign Exchange, the National Bureau of Statistics, and the State Administration for Market Regulation, to share various types of statistical data concerning the securities and futures markets. **Regarding mechanisms for the exchange of information with foreign financial safety-net participants.** In 2018, the CBIRC held a joint meeting of the core regulators of four global systemically-important banks (G-SIBs), and engaged in bilateral consultations with the relevant domestic supervision departments and the relevant foreign supervision authorities. During the meeting, information was fully shared about the business operations, corporate governance, risk management, and supervisory concerns of the four G-SIBs.
Trigger the countercyclical capital buffer, and review banks' capital requirements with a view to a targeted—and in some cases substantial—increase in capital.	H	MT	The macroprudential capital adequacy ratio indicator in the macroprudential assessment (MPA) is one of the core indicators in the assessment, and is primarily influenced by the growth rate of broad credit, and targeted increases in GDP and the CPI. This indicator reflects the concept of countercyclical capital buffer in the Basel III capital framework, and guides financial institutions in aligning the growth rate of broad credit with macroprudential capital requirements. **The relevant departments are in the process of studying and formulating countercyclical capital supervision standards, and have begun continuous supervision of bank capital adequacy ratios.**
Amend primary laws to strengthen the operational and budgetary autonomy of the People's Bank of China (PBC) and the regulatory agencies, and increase their resources.	H	MT	**First, existing laws and regulations in China already contain clear provisions regarding the relevant budgetary authorities, and are continually being improved.** Pursuant to the provisions of the *Budget Law*, the National People's Congress examines central and local draft budgets and budget implementation reports, and approves central budgets and central budget implementation reports; financial departments of the State Council specifically prepare draft central budgets and final accounts and specifically organize the implementation of central and local budgets, and each department separately prepares drafts of its own departmental budget and final accounts. From the historical perspective, the implementation of departmental budgetary management has been a powerful support and protection for the PBC's performance needs. In the next stage, the PBC will actively promote amendment of the *Law of the People's Republic of China on the People's Bank of China*, with the intention of improving the finance and accounting systems of the PBC, to enhance budgetary autonomy, and will consider expanding the types of monetary policy tools to further enhance monetary policy flexibility and autonomy. **Second, in terms of the actual budget approval process, to a certain extent, regulatory agency expense budgets have continued to rise in recent years.** For example, the 2018 CBIRC budget approved by the Ministry of Finance increased by 49.3 billion yuan over 2017, a year-on-year increase of 7.13 percent. Operations related to monetary policy are settled based on actual expenditure, are not included in departmental budgets, and do not affect monetary policy operations. **Third, regulatory agencies have taken a variety of measures to strengthen team-building and increase regulatory resources.** In July 2017, the Fifth National Financial Work Conference proposed the need to optimize the allocation of regulatory resources and enrich professional regulatory agencies, particularly supervision forces at the grassroots level, and strengthen supervision enforcement capabilities. In accordance with the spirit of the conference, the CBIRC and the CSRC have actively strengthened communication and coordination with the relevant departments to promote and implement the central government's requirement to strengthen grassroots regulatory agency forces. At the same time, these efforts have been combined with system integration work to promote regulatory units at all levels to tilt resources in the direction of the front lines of supervision and energetically introduce outstanding professional supervision talent. Educational training and practical training have been intensified, with a focus on improving the professional supervision capabilities of the team of cadres.

Address data gaps that impede systemic risk monitoring and effective financial regulation and supervision.	H	MT	**The PBC is actively pressing ahead with comprehensive financial industry integrated statistics work. First,** in March 2018, the General Office of the State Council published the *Opinion Concerning Comprehensive Promotion of Integrated Statistics for the Financial Industry*, which became the policy basis and basic specification for the comprehensive promotion of integrated statistics for the financial industry, for the present as well as for a period of time going forward. **Second,** with the approval of the State Council, the PBC, together with the "two commissions and one administration" (CBIRC, CSRC, and SAFE), jointly published and distributed the *Statistical System* and *Statistical Templates* for the asset management products of financial institutions, structuring a full-life cycle, full-funding chain statistical system according to product for the asset management products of financial institutions in the banking, securities, and insurance industries, achieving uniform standards and full data collection coverage for asset management products. **The CBIRC continues to improve the framework and content of offsite supervisory reporting.** The relevant business report forms for on-balance sheet investments, interbank operations, and wealth management operations have recently been refined and updated to facilitate more enhanced monitoring. **The CSRC has made steady progress in the development of the securities market statistical system. First,** nearly 500 securities industry core indicators have taken shape, and benchmark definitions, reporting instructions, and an explanation of the corresponding relationships of accounting indicators for the various industries have been completed. **Second,** the CSRC's central database has been built, amassing basic data for all entities in the CSRC system, covering account opening, entrustment, and trading data from the stock, bond, and futures markets, as well as basic information of publicly listed companies, securities and futures fund institutions and their employees, investor profits and losses, and domestic and international historical economic and other data. **Third,** a central monitoring system has been built, with responsibility for monitoring abnormal trading, particularly cross-border, cross-exchange, and cross-account trades, monitoring trends in market operations, and analyzing macroeconomic trends and their impact on capital markets.
Assess the purposes and structure of the PBC's macroprudential assessment (MPA) with a view to simplifying it, and use it solely as an input to the deliberations of the FSS-C and the monitoring mechanisms established under its jurisdiction.	M		**Attaching great importance to strengthening and perfecting the macroprudential policy framework, China has proposed strengthening the regulatory framework of the dual pillars of monetary policy and macroprudential policy,** and the Fifth National Financial Work Conference put forward the need to strengthen the macroprudential management and systemic risk prevention responsibilities of the People's Bank of China. At present, as the leading department of macroprudential policy, the People's Bank of China has formed a consensus among the various regulatory agencies. The MPA is an important exploration and practice of the People's Bank of China in the area of macroprudential policy, and plays an important role in preventing systemic financial risk and maintaining financial stability. At the same time, considering the important role the banking system plays in China's monetary policy transmission mechanisms, the MPA is also an important tool for realizing such monetary policy regulatory objectives as M2 and aggregate financing to the real economy.
Bank regulation and supervision			
Enhance the supervision of financial holding group risk and increase the ability to supervise banks and their affiliated financial groups, as well as their ownership structures, including the identification of ultimate beneficial owners.	H	MT	**First, the supervision of controlling shareholders of financial institutions has been enhanced.** In 2018, the relevant departments continually improved supervision rules and systems, enhanced the qualification requirements for controlling shareholders of financial institution, and emphasized the review and identification of ultimate beneficial owners. The PBC, together with the CBIRC and the CSRC, jointly published the *Guiding Opinion on Strengthening the Supervision of Non-Financial Enterprise Investment in Financial Institutions*, and the *Provisional Measures on the Administration of Commercial Bank Equity* and *Measures on the Administration of Insurance Company Equity* were also successively introduced. These supervision regulations further established a system of look-through supervision for the major shareholders of financial institutions and their controlling shareholders, actual controlling parties, related parties, persons acting in concert, and ultimate beneficial owners, clarifying and refining the supervision responsibilities and supervision measures of supervision agencies with respect to major shareholders and their controlling shareholders,

			actual controlling parties, related parties, persons acting in concert, and ultimate beneficial owners. **Second, a simulated supervision pilot program for financial holding companies was organized and launched.** Since 2018, concurrent with the formulation of provisional measures, the PBC launched a financial holding company simulated supervision pilot for five typical enterprises: China Merchants Group, Shanghai International Group, Beijing Financial Holdings Group, Ant Financial, and Suning Holdings. Through the pilot, supervision experience has been accumulated and is reflected in the regulatory measures, to increase the targeted nature and operability of the measures. **Third, close attention has been paid to studying and formulating the *Provisional Measures for the Supervision of Financial Holding Companies*.** The PBC, in concert with the relevant departments, is currently focused on studying and formulating the *Provisional Measures for the Supervision of Financial Holding Companies*, and, after multiple rounds of soliciting comments and repeatedly amending the measures by integrating supervision information from the pilot program, once they have been submitted to the State Council for approval, they will be made available to the public for comment. The provisional measures emphasize adherence to the principle of "substance over form," conducting comprehensive, ongoing, look-through supervision of financial holding groups on a consolidated reporting basis. First, supervision of shareholder qualifications is strict, requiring simple, clear, and transparent equity structures. Second, supervision of the authenticity of sources of capital and compliance in the use of funds has been strengthened, requiring investing of legitimate equity, and implementing look-through supervision of the capital compliance of financial holding companies. Third, a complete system for the supervision of capital adequacy ratios has been established, strengthening related-party transaction and overall risk management and controls, and perfecting risk "firewall" systems.
Discontinue consideration of collateral in loan classification, constrain banks' ability to roll over credit to non-small and medium enterprise corporate borrowers, and classify all loans overdue by more than 90 days as nonperforming.	H	MT	**On April 30, 2019, the CBIRC made the *Provisional Measures for the Risk Classification of Commercial Bank Financial Assets (Public Comment Draft)* available to the public for comment.** The Provisional Measures (Public Comment Draft) require that financial asset risk classification by commercial banks should focus on an assessment of the performance capacity of debtors; rollovers of financial assets of enterprises that have encountered financial difficulties, or other contractual adjustments that are advantageous to the debtor, shall be regarded as restructured assets, and provisions are made for the classification requirements and observation periods of restructured assets; and the measures clearly require that principal, interest or income payments that are past due in excess of 90 days (including after rollovers) shall be classified as nonperforming, even when collateral is sufficient.
Strengthen enforcement of the "look-through" principle.	M		**On April 27, 2018, the *Guiding Opinion on Standardizing the Asset Management Operations of Financial Institutions* (hereinafter, *New Asset Management Rules*) were formally published.** The *New Asset Management Rules* establish uniform supervision standards for asset management products of the same category, and contain relevant provisions in such areas as the implementation of "look-through" management, strengthening of risk isolation, smashing of rigid redemption, full disclosure of information, and disclosure of risks. Regarding "look-through" supervision, the rules require that look-through supervision of asset management operations be put into practice, with upward identification of final investors and downward identification of underlying assets. **Currently, the relevant supervision agencies are strictly enforcing the "look-through" principle in their onsite inspections.** In special corporate governance inspections, the emphasis is on "look-through" supervision with respect to shareholders; in special shadow banking and cross-market financial production operation inspections, the emphases are on looking upward to qualified investors and downward to underlying assets; and in inspections of such areas as risk management and the effectiveness of internal controls, when operations involving interbank wealth and asset management are involved, the emphasis is on looking downward to the underlying assets.

Increase liquidity coverage ratio (LCR) requirements for interbank products and off-balance-sheet wealth management products (WMPs).	M		The requirements in China's liquidity coverage ratio concerning interbank products are consistent with the Basel international standard. **On May 23, 2017, the CBIRC formally published the *Administrative Measures on Commercial Bank Liquidity Risk*, increasing the erosion rate for off-balance sheet wealth management products from 2.5 percent to 5 percent.**
Enhance regulatory reporting requirements, collect more granular supervisory data, including bank investment information and the corresponding provisioning.	M		**The CBIRC continues to optimize and revise the relevant offsite supervision report forms.** Pursuant to new regulatory documents, routine monitoring of large risk exposures, banking book interest rate risk, related party transactions, liquidity, and trading counterparty credit risk have been strengthened. Regarding the monitoring of asset quality, asset classifications for past-due loans and credit risk have been refined, and items have been added to reflect impairment allowances, delinquency information, and restructuring and upward adjustment information for various types of credit risk assets (including assets under the terms of investments). Collection of investment operation information has been further improved.
The China Banking Regulatory Commission (CBRC) should enhance forward-looking integrated risk analysis to identify vulnerabilities, challenge banks, and facilitate ex ante intervention.	M		**The CBIRC continues to promote the development of risk identification and early warning systems in the banking industry.** First, multiple information platforms, including the offsite supervision information system, the onsite inspection analysis system, REASS, the customer risk early warning system, and the EAST system, are being used to collect comprehensive bank supervision indicators and business management data, and compare and contrast the data vertically from a chronological perspective time and horizontally against peers, focusing on unusual data changes to identify the various types of potential risks at the banks from multiple angles, including conventional analysis and advanced capital measurement methods; at the same time, risk information revealed in onsite inspections, local bureau supervision reports, and news media and opinion pieces collected through multiple channels continues to improve the forward-looking nature of risk analysis, and supervision assessments are performed to continually increase the forward-looking nature of risk analysis and achieve "early discovery, early warnings, and early resolution." **Second,** the information in the bank Risk Early-warning Analysis Support System (REASS) is continually updated, and we are in the process of comprehensively upgrading the system, adding more indicators that reflect changes in the banking industry and risks and optimizing page displays to fully reflect bank risks and vulnerabilities. **Offsite supervision of the banking industry has been enhanced. First,** monthly and quarterly bank operational analyses are compiled regularly; regular (quarterly) situation analysis meetings, supervision interviews, prudential conversations, and triparty conversations are used to accurately and clearly transmit supervision intentions and risk warnings to banks, to intensify intervention in potential risks. **Second,** utilizing the four major offsite supervision tools (risk assessment reports, supervision ratings, supervision enhancement standards, and the supervision discovered issue rectification and tracking assessment system), onsite and offsite supervision interactions have been enhanced, and five supervision transmission mechanisms, including supervision logs, supervision conversations, and supervision circulars, have been established to form a complete closed supervision loop. **Third,** stress testing and internal capital adequacy assessments (ICAAP) are held on a regular basis, enhancing the identification of vulnerable banks, and annual supervision ratings are used to thoroughly assess the risk situation at each bank; supervision and guidance of banks with relatively pronounced vulnerabilities are strengthened through such means as the convening of regional meetings, formulating differential risk prevention and elimination plans that clarify the timetable and roadmap for the defusing of risks, and implementing detailed "customized" plans and gradually moving forward. **We continue to urge local supervision agencies to conscientiously carry out supervision responsibilities, and to promptly take supervision measures with respect to institutions with risk problems.** In 2018, more than 150 supervision interviews, risk bulletins, and special risk guidance projects were initiated. The means of technical supervision improved, internal bank data marts were upgraded, and risk identification, monitoring, and early warning capabilities were optimized.

			Banks have been urged to improve the quality and efficiency of rectification and reform efforts, focusing on "catching things early while they are small," to prevent related issues from evolving into larger risk cases. A compliance issue ledger has been established, to enhance rectification and reform tracking and assessment for issues discovered during routine supervision, and promptly exert supervision pressure on banks that are irresolute or ineffectual in their rectification and reform efforts or are repeat offenders, and urge the relevant banks to draw inferences about other cases from single instances, to increase the quality of rectification and reform at the institutional level and close system loopholes, in order to prevent the recurrence of similar problems going forward. **Product innovation has been followed closely, and supervision of compliance has been enhanced.** Focused research has been conducted with respect to new products and new operations reported by banks, approached with a view to intensify compliance supervision and prevent "false innovation" for the sake of regulatory arbitrage, using ex ante intervention to promptly halt noncompliant or "borderline" products. **Market analysis and research have been strengthened,** with close tracking of domestic and foreign situations and bank risk trends, to study potential risks, successfully issue risk warnings, promptly propose effective response measures, and urge institutions to operate prudently.
Stress testing			
Substantially enhance and systematize data and information sharing across the three regulatory agencies and the PBC to improve stress testing and systemic risk assessment. Use more granular supervisory data in stress tests.	H	MT	T**he State Council Financial Stability and Development Committee was established in July 2017, enhancing the overall planning and coordination of the PBC and financial regulatory agencies; the scope of overall planning and coordination includes information sharing.** Currently, each of the financial regulatory agencies has fully shared aggregate financing to the real economy, monetary credit, banking industry operations and risks, and statistical data for the securities and futures markets; the breadth and depth of data sharing are being continually enhanced. In the course of initiating supervisory stress testing, all regulatory agencies engage in close communications and exchanges of key information, such as the scope of the test, scenario design, key methodologies, and test results, to maintain full cooperation. **In 2019, the PBC will continue to launch stress testing,** to examine the ability of banks to withstand risk under such stress scenarios as a macroeconomic downturn, deterioration of risk conditions in key fields, increased liquidity stress, and interbank transaction counterparty defaults. In the course of initiating stress testing, close communications will be maintained with the CBIRC regarding scenario design, test methodology, and key assumptions, and the stress testing framework and methods will be gradually spread to branches and sub-branches by such means as regular exchanges and remote training sessions, to develop the early risk warning role of stress testing. Internal data submitted by banks and supervisory data will be used in the tests, and data granularity will be increased gradually in the areas of historical trends in non-performing assets, classification of interest-bearing assets and liabilities, and bond investment types. **THE CBIRC has already begun to use more detailed, look-through data in bank stress testing.** For example, when analyzing the impact of investment items, detailed data that penetrates down to the underlying assets and invested industry are used, including such granular data as overall size and non-performing assets; in bond valuation stress testing, detailed raw data are used to test the principal, duration, and type of each bond invested in by the banks. In uniform scenario risk stress testing **of securities fund trading institutions, the CSRC** has begun using more detailed operational data by industry and institution. **In the futures field: first,** the CSRC amended and published the *Measures on the Administration of Risk Supervision Indicators for Futures Companies*, clarifying that futures companies should promptly perform stress testing of risk supervision indicators according to regulatory requirements, changes in the market, and business development conditions. At the same time, the CSRC directed the China Futures Association to formulate and publish the *Futures Company Stress Testing Guide (Provisional)*, which made specific requirements for the stress-testing-related systems, stress testing methods and processes, and stress testing reports and corresponding measures for futures

			companies. In April 2018, the CSRC instructed the China Futures Association to complete a comprehensive industry-wide annual stress test according to the relevant regulations. **Second,** the CSRC and the PBC further enhanced supervisory cooperation, facilitating the sharing of data and information, and the China Financial Futures Exchange will regularly provide trading and clearing statistical data for all types of participants in the treasury futures market and related breakdowns of data. **Third,** the CSRC has actively strengthened interdepartmental coordination, directed the China Futures Market Monitoring Center to submit customer account opening, transaction, position, and funding data to the China Securities Capital Market Operation Statistics Monitoring Center, to achieve the amassing of big data across markets, and increase the analytical abilities of the stress testing teams.
Significantly expand coverage of nonbanks and correlations in systemic risk assessments, developing and integrating stress testing of collective investment schemes (CIS).	M		**In the bank stress testing launched by the PBC in 2019, a network analysis model is being used to assess business correlations and risk contagion between banks, and between banks and nonbanks.** Macro scenario stress testing and sensitivity stress testing consider the effects of non-standard credit investments and off-balance sheet operations on bank capital adequacy levels, and liquidity risk stress testing considers the effects of wealth management product redemptions on bank liquidity levels. **As to the CBIRC, first,** when designing the stress testing plan, based on systemic risk analysis, ample consideration was given to the effects of non-banks, asset management products, and off-balance sheet operations on bank solvency and liquidity risk. For example, in the solvency stress testing, the effects of asset management product losses on bank profitability and capital adequacy levels are calculated; in the liquidity stress testing, the effects of wealth management product redemptions (differentiated as open and closed wealth management products) on liquidity levels are calculated. **Second,** in accordance with the content of the *Guiding Opinion on Standardizing the Asset Management Operations of Financial Institutions* published on April 27, 2018, banks are required to establish and improve wealth management product stress testing systems; the *Guiding Opinion* also clarifies that such testing must occur a minimum of once quarterly for publicly-offered wealth management products, and makes specific requirements regarding the stress scenarios, testing frequency, ex post inspections, and contingency plans. **Third,** stress testing of trust company liquidity risk and the credit risk of real estate-related operations began at the end of 2017, and stress testing of the credit risk of trust company real estate-related operations was launched again in mid-2018, continually improving key contents of the stress tests, including the scenario settings, assumptions, and parameter indicators, to calculate the risk exposures of trust companies under different stress scenarios, identify weak links in risk management, and urge trust companies to integrate stress testing results into their formulation of risk response plans, adjust business development plans, increase their ability to identify, issue warnings, and resolve risks early. **Fourth,** the study and formulation of *Administrative Measures for Trust Company Capital (Provisional)* have been accelerated, with a view to use stress testing as an important means of assessing the capital adequacy of trust companies, and guide trust companies to continually strengthen capital replacement capabilities and risk management standards. **Fifth,** regular financial asset management company stress testing is conducted annually, with test content including, but not limited to, credit risk, market risk, liquidity risk, operational risk, and capital adequacy levels. Through the stress testing, related risk information and decision-making bases are obtained to aid the companies in increasing their risk resilience in response to extreme events. At the same time, asset companies are urged to strengthen their utilization of the test results, and further enhance daily supervision work based on the test results. The CSRC continues to improve the uniform scenario assumptions and indicators for securities fund industry stress testing; the scope of participation in this stress testing includes securities companies, fund companies and their subsidiaries, and the stress testing of collective investment schemes (CIS) is already covered.
Enhance inter-agency coordination and analytical capacity of the stress testing teams.	M		**In the course of stress testing, the PBC and the CBIRC maintain close communications regarding the scope, scenario design, and technical methodology of stress testing.** At the same time, communication and cooperation among the various internal departments of the PBC have been strengthened; for example, the macroeconomic measurement model developed by the Research Bureau of the PBC was referred to during the design of the macro stress scenarios. Stress testing teams consisting of core business personnel from

			the headquarters, branches, and sub-branches of the PBC and the commercial banks have been established to create work synergy, and they hold regular discussions and exchanges regarding stress testing techniques, to increase the technical level and analytical capacity of the stress testing. The CBIRC actively leads all financial regulatory agencies to select core business personnel to participate in banking industry stress testing training courses arranged by the IMF, to draw on advanced international experience, continually improve stress testing methods, and further increase the risk sensitivity of the tests. **In the course of supervising the stress testing, the CBIRC** coordinates the various institutional regulatory agencies and banking and insurance regulatory bureaus to participate in key links including plan design and regulatory review and approval work, to strengthen communication and cooperation within the commission. Personnel are dispatched to participate in the Basel Committee Working Group on Stress Testing, to fully absorb and draw on advanced international experience, and upgrade and update bank stress testing methodology. Staff training has been strengthened. **The CSRC uses regular discussions to explore the structuring of a stress testing model case database,** to study and improve the relevant stress testing scenario indicators, promptly determine such assumption conditions as the decline in major equity market stock indexes and the decline in transaction amounts based on market conditions, establish mechanisms for tying stress testing into routine supervision, increase the targeted nature and effectiveness of the testing, and publish stress testing work manuals, to form a multidimensional industry and institutional stress testing system consisting of uniform stress testing for the industry and institutions, autonomous stress testing, and comprehensive stress testing for important institutions. In addition, the CSRC continues to deepen data sharing with the PBC and the CBIRC.
Shadow banking and implicit guarantees			
Amend the provisions of laws or regulations to ensure the bankruptcy remoteness of CIS (including WMPs) in the event of bankruptcy of the manager or the custodian.	H	MT	**The *Guiding Opinion on Standardizing the Asset Management Operations of Financial Institutions* published on April 27, 2018 requires** that financial institutions engaged in asset management operations should ensure that asset management operations are kept separate from their other operations, and that operations on behalf of customers are kept separate from operations on their own behalf. **In September 2018, the CBIRC published the *Administrative Measures for the Supervision of Commercial Bank Wealth Management Operations*,** clarifying that wealth management product assets are independent from the proprietary assets of the manager and the custodian, and that, in the event of liquidation of a manager or custodian as the result of disbandment according to law, cancellation according to law, or bankruptcy declaration according to law, the assets of wealth management products are not liquidated property, and cannot undergo creditor rights offsetting. **In 2018, the CBIRC published the *Notice Concerning Trust Supervision Work During the Transition Period for Strengthening the Standardization of Asset Management Operations* (Trust Letter (2018) No. 37),** requiring that trust operations initiated during the transition period should strictly implement all requirements of the New Asset Management Rules, i.e., relevant requirements including the requirement that trust companies maintain independent custodians, to ensure isolation of the assets; that funds for each asset management product are to be managed separately, with separate books and separate accounting; and that trust companies must not initiate or participate in fund pooling operations that have the characteristics of rolling issuance, collective operations, or separate pricing. **In the next stage, the CBIRC will promote formulation of *Provisional Measures on the Administration of Funding Trusts of Trust Companies*, which will clearly stipulate as follows: First,** funding trust property is independent from the inherent property of trust companies, and is independent from other trust property under the trust company's management; **second,** in the event of liquidation of a trust company as the result of disbandment according to law, cancellation according to law, or bankruptcy declaration according to law, the funding trust property is not liquidated property; **third,** the opening of independent custody accounts for funding trusts is required, and funding trust custodians should ensure that substantively independent custody is achieved; **fourth,** each funding trust is required to be managed separately, with separate books and separate accounting, and must not engage in fund pooling operations.

			Additionally, the CBIRC is in the process of actively promoting the Supreme People's Court's judicial interpretation work related to the *Trust Law of the People's Republic of China*, recommending further clarification of the principle of mutual independence of trust property and inherent property, to avoid situations such as sealing of trust property as the result of a trust company's own liabilities, or the sealing of a trust company's inherent property as the result of handling trust matters. **Regarding the issue of bankruptcy remoteness of asset management products in the field of securities investment funds, pursuant to the provisions of Article 5 of the *Securities Investment Fund Law*, fund property is independent from the inherent property of fund managers and fund custodians.** In the event of liquidation of fund managers or fund custodians as the result of disbandment according to law, cancellation according to law, or bankruptcy declaration according to law, fund property is not liquidated property. **Pursuant to the provisions of Article 6 of the *Administrative Measures for the Privately-offered Asset Management Operations of Securities and Futures Dealers*,** the debts of asset management plans are to be assumed by the property of the asset management plans themselves, and the liability assumed by investors for the debts of asset management plans is limited to the amount of their investments. However, if asset management contracts contain other provisions in accordance with the *Securities Investment Fund Law*, such provisions shall prevail. Asset management plan property is independent from the inherent property of securities and futures dealers and custodians, and independent from other property under the management or custody of securities and futures dealers and custodians. Property and income gained by securities and futures dealers and custodians arising from the management or utilization of asset management plan property or other situations shall be subsumed under the property of the asset management plan. In the event of liquidation of securities and futures dealers or custodians as the result of disbandment according to law, cancellation according to law, or bankruptcy declaration according to law, asset management plan property is not liquidated property. In the case of debts or other situations provided by law that are not the result of the asset management plan itself, asset management plan property must not be sealed, frozen, confiscated, or forcibly executed.
Move towards eliminating limits on lending to specific sectors, conditional on eliminating implicit guarantees.	M		**The PBC has actively guided financial institutions to adhere to the principles of differentiated treatment and combining support with control, and to satisfy the reasonable financing demand of enterprises,** to achieve orderly withdrawal from industries for which there is no hope of turning around losses. Financial institutions are encouraged to accelerate innovation of credit products to support the transformation and upgrading of the steel and coal industries. **The CBIRC has guided banks to implement differential credit policies in accordance with the principles of "differentiated treatment and combining guarantees with control."** Banks should proactively satisfy the reasonable financing demands of enterprises with advanced technical equipment, competitive products, and market prospects according to their own risk preferences, risk mitigation capacities, and strategic orientations. However, credit support for projects that expand production capacity without having gone through legal formalities, or enterprises that fail to meet environmental protection and safe production requirements, should be strictly controlled. **Additionally, financial regulatory agencies have actively cooperated with the Ministry of Finance and other relevant agencies in the adoption of a variety of measures to promote stripping local government financing platforms from the financing functions of local governments to make them more market-oriented.** By law, local governments are no longer permitted to use financing platforms for the raising of debt, and are no longer permitted to provide any form of guarantee. In 2018, the General Office of the State Council printed and distributed the *Guiding Opinion Concerning Maintaining the Intensity of Correcting Infrastructure Shortcomings* (Guo-Fa-Ban (2019) No. 101), requiring that lending to financing platforms that have "exited to become ordinary companies" be reviewed and approved according to the standards used for ordinary enterprises.
Interventions in asset markets,	M		**The CBIRC attaches great importance to preventing and controlling real estate risk.** Banking financial institutions have been urged to strengthen

including the real estate market and the equity market, should be limited to episodes of systemic risk.			compliance management and risk prevention and control, to undertake related onsite inspection work at the appropriate times, and to enhance monitoring, early warnings, and risk resolution, in order to firmly hold the bottom line of not allowing systemic risk to occur. **As to the CSRC, first, it has attached high importance to the risks that could appear in the course of implementing the New Asset Management Rules,** integrating the implementation of comprehensive statistics for the financial industry to strengthen monitoring of the progress asset management product standardization; together with the PBC and the CBIRC, it has established monitoring mechanisms for the asset management product standardization transition period, and urged and directed the Shanghai and Shenzhen exchanges to make the stocks and bonds of listed companies that are involved with debt risk key monitoring targets, arranging for real-time monitoring by dedicated personnel, to monitor the pledging situation for market stocks on a daily basis, and direct the relevant institutions to alleviate stock pledging risk in an orderly manner, handling and reporting abnormalities as soon as they are discovered, and using market and rule-of-law means to resolutely prevent and defuse the relevant risks.
Securities market regulation and supervision			
Improve disclosure of CIS; prohibit specifying expected returns in the prospectuses of WMPs.	H	NT	**In September 2018, the CBIRC published the *Administrative Provisions for Supervision of the Wealth Management Operations of Commercial Banks*,** making further distinctions in regard to information disclosures for publicly-offered and privately-offered wealth management products, requiring disclosure of daily net values for each date that publicly-offered open products are open, disclosure of net values at least once a week for publicly-offered closed products, and the provision of monthly statements to investors for publicly-offered products; privately-offered products must disclose net values and other important information a minimum of once a quarter; banks must publicly disclose the overall situation of their wealth management operations twice a year; and banks that issue wealth management products are not permitted to publicize expected returns. **At present, the CBIRC requires all banks to adhere strictly to the requirements described above in the current stage, integrating their own realities to formulate wealth management operation rectification and reform plans autonomously and in an orderly manner, to advance the standardization of wealth management operations, and promote orderly linkages between and a smooth transition from the old rules to the new rules.** **As to the CSRC, first, in 2018, it published the *Administrative Measures for the Privately-Offered Asset Management Operations of Securities and Futures Dealers*, Article 51 of which requires that disclosures of asset management plan information** must not contain forecasts of investment performance or publicize expected returns, promise returns, promise no loss of principal or limit the amount or percentage of principal losses, exaggerate or publicize lopsided views of the past performance of the plan manager, investment manager, or the asset management plans under their management. **Second, in November 2018, it published the *Operations Manual for the Application of the* Guiding Opinion on Standardizing the Asset Management Operations of Financial Institutions *for Large Collective Asset Management Operations of Securities Companies*,** which requires that the existing large collective asset management operations of securities companies should be managed to target the standards for publicly-offered funds by the end of 2020, including, but not limited to, product sales; share transactions, subscriptions, and redemptions; share registration; investment operations; valuation accounting; information disclosure, and risk reserve recognition.
Introduce functional supervision, to ensure that similar products issued by different financial institutions are supervised and regulated similarly.	H	MT	**First,** since the publication of the New Asset Management Rules in April 2018, the PBC has continued to pay close attention to developments in the financial markets, closely monitoring marginal changes in financial institution behavior, and evaluating the rectification and reform and development status of asset management operations. On July 20, it published the *Notice Concerning Further Clarification of Matters Related to Standardization of the Asset Management Operations of Financial Institutions*, clarifying related operational issues during the transition period, and instructing financial institutions to rectify and reform operations in an orderly manner, to stabilize market expectations.

			Second, in the course of promoting the introduction of detailed industry rules for such areas as bank wealth management, wealth management subsidiaries, securities funds, and futures, the PBC has maintained close communication with the CBIRC and the CSRC, to ensure that the industry rules and the functional supervision concept clarified in the New Asset Management Rules are put in place, and to realize equal access and uniform regulation of asset management operations undertaken by all types of financial institutions. **Third,** the CBIRC studied and formulated the *Administrative Provisions for the Supervision of Bank Wealth Management Operations* (hereinafter, the "New Wealth Management Rules"), which were officially published and implemented on September 28, 2018 as supporting rules for the "New Asset Management Rules." The "New Wealth Management Rules" put forward supervision requirements in the areas of controlling maturity mismatching, limiting multi-layer nesting of investments, controlling leverage and risk concentrations, strengthening investor suitability management, and enhancing sales compliance. The "New Wealth Management Rules" and the "New Asset Management Rules" are fully linked, and together they form the supervision requirements that banks must comply with to undertake wealth management operations. **Fourth,** the CSRC published the *Administrative Measures for the Privately-Offered Asset Management Operations of Securities and Futures Dealers* and the *Administrative Measures for the Operation of Privately-Offered Asset Management Plans by Securities and Futures Dealers* on October 22, 2018, unifying the supervision rules for the privately-offered asset management operations of all types of securities and futures dealers, and eliminating regulatory arbitrage.
Tighten eligibility and enhance haircut methodology for repo collateral.	M		**First, the PBC published a notice in October 2018 formally introducing triparty repo transactions on the interbank market.** Third-party institutions, trading platforms, and central counterparties are required to introduce operational rules related to the scope of qualified collateral and haircut standards. **Second, the CSRC has instructed China Securities Depository & Clearing Corporation Ltd. (hereinafter, CSDC) to continue to strengthen monitoring of bond collateral risk and development of dynamic management mechanisms,** and strengthen the development of internal rating systems for bond credit and market-implied rating mechanisms, to achieve dynamic adjustment of risk bond collateral repo eligibility and discount coefficients, promptly and dynamically adjusting discount coefficients or revoking repo eligibility based on conditions such as bond collateral credit risk and liquidity risk, effectively preventing credit risks for individual bonds at the micro level, and continually improving the overall eligibility standards for bond collateral at the macro level. **Third, CSDC has continued to perfect the standard bond haircut methodology,** establishing an autonomous valuation system and applying the results to the calculation of standard bond haircuts, studying a risk-adjusted valuation scheme that meets the risk management needs of central counterparties, and promoting development and implementation thereof.
Strengthen systemic risk monitoring mechanisms to ensure a holistic view of the interconnectedness between securities markets and between them and other financial sectors.	M		Measures adopted by the **PBC** include: **First, uniform supervision of the credit rating industry has been strengthened, to promote the interconnectedness of the bond markets.** In September 2018, the PBC and the CSRC jointly published 2018 Notice Number 14 (hereinafter, the *Notice*), which centers on the gradual unification of the qualifications of rating agencies for the interbank bond market and the exchange bond market, strengthening supervision of credit rating agencies and the sharing of supervisory information, pushing credit rating agencies to perfect internal systems, and standardizing uniform rating standards and increasing ratings quality. **Second, a uniform bond market enforcement mechanism has been established.** The PBC, the CSRC, and the National Development and Reform Commission (NDRC) jointly published the *Opinion on Further Strengthening Bond Market Enforcement Work* in October 2018, which realized the division of supervision responsibilities and unifying enforcement. **The CSRC continues to push forward the development of risk monitoring mechanisms for capital markets, primarily by undertaking the following tasks: First,** resolutely following the overall planning and leadership of the Financial Stability and Development Committee of the State Council, spearheading the establishment of comprehensive working mechanisms to maintain capital market stability, strengthening interagency information sharing

			and policy coordination, perfecting cross-market risk monitoring systems for the stock, bond, futures, money, and foreign exchange markets, and preventing the transmission of risk across markets, across industries, and across borders. **Second,** resolutely implementing the quarterly meeting system for the Leading Group on Stock Market Risk and Response, to analyze and assess risk conditions in the securities markets as a whole, and plan and coordinate risk monitoring and response work. **Third,** conscientiously strengthening supervision of the front lines of the exchanges, and strengthening monitoring and regulation of investor trading conduct and supervision of the information disclosures of listed companies. **Fourth,** essentially completing the development of the central supervisory information platform for the securities and futures industries, continually perfecting risk monitoring and early warning systems, promoting the development of phase II of the centralized capital market monitoring system, and increasing the information technology and intelligence levels of risk monitoring and early warnings.
Insurance regulation and supervision			
Develop plans for risk-based supervision, bringing together all issues and actions of each insurer, including market conduct.	M		**First,** solvency supervision is carried out under the "Solvency 2" supervisory framework, with comprehensive risk ratings conducted quarterly. **Second,** an assessment of the life insurance liability supervision system was initiated, advances were made in the development of the policy registration management information platform, the actuarial supervision system was strengthened, efforts continued to push ahead with revision of reporting rules for the *Actuaries Report*, and market analysis and monitoring were perfected with the establishment of mechanisms to monitor high risks and key companies. **Third,** in early 2019, a system to further strengthen the business management of insurance company intermediary channels was formulated, emphasizing that insurance companies should establish systems with clear authorities and responsibilities to strengthen management of cooperating entities and perfect compliance monitoring, and forbidding the use of intermediary channel entities to engage in illegal activities.
Formulate plans to gradually valuation methods that are more market-oriented.	M		The GAAP+ valuation system currently used in China's Solvency 2 conforms to the realities of the Chinese market and one of the solvency valuation methods permitted by ICP.
Supervision of financial market infrastructure			
Adopt full delivery-versus-payment in the China Securities Depository and Clearing Corporation (CSDC).	H	NT	The standard delivery-versus-payment (DVP) model refers to simultaneous delivery of cash and securities at the same time (typically meaning on the same day). **Currently, CSDC uses a non-standard DVP model of "T+0 securities delivery and T+1 transfer of funds," i.e., the securities are transferred on the transaction date, and funds are transferred the next day. The primary reason for adopting this model is,** securities in China are paperless, so that delivery and receipt can be realized on the same day, but transfers of funds are affected by the payment system and can only be accomplished the next day. Under real-life conditions, this is the most favorable arrangement for market principals. In order to effectively control the principal risk and spread risk that could be triggered by the time difference between securities delivery and the transfer of funds, on one hand, the *Securities Law* and the *Measures for the Administration of Securities Registration and Clearing* stipulate that when a buyer fails to perform the fund delivery obligation within the deadline, CSDC is entitled to seize the relevant securities immediately, in order to minimize losses to the central counterparty. On the other, CSDC has established an entire array of risk control arrangements, including a full margin system and a system of third-party custody of margins, which have generated noticeable effects. **Judging from the practical results, in the decade and a half since the founding of CSDC, securities and fund settlement have run smoothly and normally, and have withstood the severe tests of the global financial crisis in 2008 and abnormal stock market volatility in 2015.** In the *Financial Market Infrastructure Principles* (FMI Principles) self-assessment and the FSAP assessment, evaluators have said that CSDC should improve its DVP arrangement, and recommended that the modernization of risk management be further improved and realized. Attaching great importance to the recommendation to perfect the DVP arrangement, the CSRC has already included "improving the registration and clearing system, and launching reform of the A-share DVP clearing model" among its key tasks. At present, the CSRC is in the process of arranging for CSDC to

			formulate a reform plan based on the FMI Principles, and is pressing ahead with the related tasks as quickly as possible.
Strengthen resilience of financial market infrastructures (FMIs) through: full implementation of the CPSS-IOSCO Principles; and strengthening of the legal framework.	H	MT	**First,** the PBC is pushing forward amendment of the *People's Bank of China Law*, to improve the provisions on payment, clearing, and settlement. **Second,** the PBC has promoted bringing phase II of the renminbi cross-border interbank payment system (CIPS) fully online, and the development of fund settlement models for financial market transactions based on the fund settlement needs of different financial markets, such as delivery-versus-payment (DVP) settlement and synchronous settlement of renminbi-foreign currency transactions (PVP), to prevent and defuse financial market infrastructure principal risk. **Third,** the PBC has published the *Notice on Strengthening Administration of Cross-Border Financial Network and Information Services*, clarifying compliance obligations and industry self-regulation requirements for offshore providers and domestic users of cross-border financial network and information services, promoted the establishment of a wholly-owned subsidiary of SWIFT in China, and realized the supervision expectations made in the PFMI with respect to key service providers. **Fourth,** in compliance with the PFMI and other internationally recognized rules, the PBC, in concert with the relevant agencies, is in the process of formulating specialized measures on the supervision of financial infrastructure. CSDC and the futures exchanges, under the supervision of the CSRC, have adopted a series of improvement measures to strengthen the legal framework and further implement the FMI Principles: **Targeting CSDC: First,** a front-end funds control system has been established, to prevent major settlement risks that could result from excessively large purchases that have not undergone funding verification. **Second,** the CSRC has continued to push forward the amendment of the *Measures on the Administration of Securities Clearing Risk Funds*, to improve the matching of financial resources to market risks, and fully develop the risk prevention role of securities clearing risk funds. **Third,** commercial bank credit support mechanisms have been established and improved. The CSDC has already officially signed the *Agreement on Liquidity Support for Clearing Banks* with the five largest state-owned commercial banks. **Fourth,** the development of a uniform risk monitoring system has been enhanced. There has been further sorting of the orientations of the risk monitoring system's functional modules, increasing functionality in the areas of risk measurement, daily mark-to-market, and stress testing. **Fifth,** routine risk monitoring work continues. Performance of routine risk control tasks, including risk monitoring and stress testing, continues, with an emphasis on successfully completing tasks to support repo risk management. **Targeting futures exchanges: First,** the CSRC has actively cooperated with the National People's Congress to advance legislation of the *Futures Law,* to further improve the regulatory framework for the futures market. the *Futures Law (Draft)* standardizes the legal nature, organizational form, scope of duties and other aspects of futures exchanges. The draft has been reviewed and adopted by a plenary meeting of the Finance and Economics Committee of the Twelfth National People's Congress, and has now been listed in the legislation agenda for Standing Committee of the Thirteenth National People's Congress. In accordance with related legislation work arrangements, the CSRC is actively coordinating and pushing forward related tasks in an effort to publish and implement the law as quickly as possible. **Second,** the CSRC is pressing ahead with futures exchange central counterparty (QCCP) identification work. The CSRC organized self-assessments by all futures exchanges in accordance with the *Financial Market Infrastructure Principles*, and improved the supervision framework, governance structure and related institutional arrangements. It also organized an expert review meeting to review the QCCP qualifications of futures exchanges. In January 2019, the CSRC formally affirmed all futures exchanges as qualified central counterparties.
Expand provision of central bank services to all systemically-important central counterparties (CCPs).	M		**The PBC is currently in the process of studying improvements to the central bank account settlement service scheme,** with a view to establishing a functionally agile "settlement account management system" to support 24/7 use of central bank currency settlement by payment and market infrastructures. **In addition, the PBC currently only offers settlement services to China Central Depository & Clearing Corporation and Shanghai Settlement House, but is considering expanding central settlement services to CSDC and four futures exchanges.** Using central currency settlement will reduce the credit risk for these institutions, and

			the high value payment system can provide them with convenient, efficient fund settlement services. However, the potential problems that could result from giving these five central counterparties direct access to the High Value Payment System need to be centrally planned and considered: **First,** this means that these institutions would have access to the central bank's liquidity arrangements, which could cause these institutions and corresponding participants to overlook market risks, which could then give rise to ethical risk and even systemic financial market risk. Therefore, a prudential management remit needs to be implemented for the PBC with respect to these institutions. At the same time, these institutions must be urged to conscientiously enhance risk management. **Second,** these institutions would need to complete the relevant system modifications and adjust system operating logic, requiring a certain work period.
Anti-money laundering and countering the financing of terrorists			
Mandate enhanced customer due diligence (CDD) for domestic political public figures on a risk-sensitive basis.	M		In January 2013, the PBC printed and distributed the *Guidelines for Financial Institutions on Money Laundering and Terrorist Financing Risk Assessment and Customer Classification Management*, guiding financial institutions to adopt reasonable measures to assess customer risk, and requiring financial institutions to assign risk ratings based on such factors as customer characteristics, occupations, and regions, with domestic political dignitaries being identified as high-risk customers based on their characteristics and occupation factors. At the same time, enhanced CDD and other risk control measures are to be adopted for high-risk customers, including: (1) Obtaining senior management approval or authorization prior to establishing (or maintaining existing) business relationships; (2) further deepening knowledge of the customer's assets and sources of funds; (3) increasing the frequency and intensity of transaction monitoring throughout the duration of the business relationship. Financial institutions should promptly verify high-risk customers, including the information of domestic political dignitaries, through the purchase of databases or other means; or by obtaining photographs and other identifying information of officials from official government websites, in order to determine whether the customer or beneficial owner is a domestic political dignitary.
Ensure that self-laundering is more effectively investigated and prosecuted as a standalone offense.	M		In China, self-laundering by upstream offenders is not prosecuted as a standalone offense, because this would be contrary to basic Chinese legal principles. According to the crime constitution theory and judicial tradition in Chinese criminal law, money laundering is an "unpunishable act after the fact," a natural extension of the upstream offense, i.e., an inclusive offense. Based on the principle that lesser offenses are absorbed into graver offenses, offenders are generally prosecuted for the upstream (graver) offense. Pursuant to the provisions of Article 61 of the *Criminal Law*, Chinese courts consider self-laundering together with other sentencing considerations, and may impose heavier criminal penalties on self-laundering offenders, in keeping with the basic principle of "commensurateness of the crime, responsibility, and punishment" set forth in Article 5 of the *Criminal Law*. In judicial practice in China, there are cases of self-laundering that have been adjudicated. For example, in the case of "Participation in Organized Crime and Money Laundering by Wei in Qingdao, Shandong" (2015), Wei participated in an organized crime group and laundered the proceeds from the criminal activities of this organized crime group, and was ultimately convicted for the offenses of participating in organized crime and money-laundering.
Crisis management			
Triggers for activating a government-led crisis response should be more clearly defined, and limited to systemic events that require the utilization of public resources.	H	NT	In order to proactively implement the requirements of the Financial Stability Committee's *Core Elements for Effective Risk Resolution Mechanisms*, China has actively promoted the building of an effective risk resolution framework. **To further increase the effectiveness of risk resolution, together with the relevant agencies, the PBC has promoted the revision of the legislation work for the *Regulations on the Resolution of Commercial Bank Bankruptcy Risk*.** **In the securities markets, the CSRC attaches great importance to the regulating role played by market mechanisms, and does not directly intervene in stock indexes as long as there is no systemic risk of collapse.** Because the causes of crises are intricate and complex and they require different responses, it is very difficult to accurately define the trigger conditions for a crisis response. In practice, countries or regions around the world typically only define some conditions in principle, such as the emergence of large-scale liquidity crises among financial institutions, concentrated eruption of large numbers of debt default risks, or the rapid spread of risks across markets or industries. The CSRC

			will define crisis response triggers as clearly as possible based on market developments and specific circumstances in China, and formulate corresponding risk response mechanisms.
Formulate special resolution mechanisms for banks and systemically-important insurance companies.	H	MT	**On November 27, 2018, the PBC, CBIRC, and CSRC jointly published the *Guiding Opinion on Improving Supervision of Systemically-Important Financial Institutions*,** which requires the PBC to take the lead in establishing a crisis management group, charged with establishing special resolution mechanisms for domestic systemically-important financial institutions, regularly formulating recovery and resolution plans, and initiating resolvability assessments, to ensure that when major risks occur, they are resolved safely, quickly, and effectively, and guarantee that key operations and services are not interrupted. **A separate 2018 meeting was held in Beijing for the cross-border crisis management working groups of ICBC, ABC, BOC, and CCB on December 4, 2018.** The meeting reviewed 2018 updates to the recovery and resolution plans of the four banks and discussed the effectiveness of each bank's recovery options and the feasibility of their resolution tools, and required the banks to promptly and accurately update recovery and resolution plans to adapt to the banks' business models, management structures, risk conditions, and the most recent changes in the external environment. **The PBC is studying the formulation of administrative measures for early correction and risk resolution for deposit insurance;** and, together with the relevant departments of the CBIRC, has established a working mechanism of "joint consultations and investigations" into risk resolution measures, with both parties promptly circulating key risk information and work progress to defuse risks.
Develop a formal framework for emergency liquidity assistance by the PBC.	H	MT	**The PBC, working together with the relevant agencies, has formulated and is continually improving liquidity risk emergency response plans,** and has systematically sorted and arranged such areas as risk identification, risk prevention, risk response, and division of responsibilities.
Improve the system design of all kinds of protection funds to limit moral hazard.	MT		**Regarding deposit insurance funds,** continue to successfully perform basic tasks such as premium collection and fund management work, and improve risk-differentiated premium mechanisms. Monitor the risk conditions of insured institutions on a quarterly basis, intensify verification work, develop the role of risk warnings, explore the early risk correction function of deposit insurance, and promote early resolution of risks. **Regarding securities investor protection funds (hereinafter, the Funds),** the CSRC, the Ministry of Finance, and the PBC jointly published the *Administrative Measures for Securities Investor Protection Funds* (hereinafter, the *Measures*) on June 30, 2005, and amended them on April 19, 2016. Systemic arrangements that include restricting the purposes of such Funds, clarifying the review and approval process to utilize funds, restricting the scope of use of funds, and clarifying the punishments for illegal acts including misappropriation of the funds were made to limit and prevent ethical risk. **Regarding trust protection funds,** first, ex post assessment of the trust protection fund system has deepened, integrating the realities of China's trust industry to recommend that prevention of ethical risk be included in the institutional framework of trust protection funds. Second, through continued offsite analysis, supervisory recommendations have been proposed, including letting investors assume responsibility for risks and compacting the responsibilities of trust companies and their shareholders, conditioned on the orderly advancement of trustee due diligence work. Third, risk alerts are being issued to trust protection fund companies, requiring these companies to attach great importance to the prevention of ethical risk, to avoid triggering ethical risk as the result of lax control over the use of protection funds.
Financial inclusion			
Enhance the legal, regulatory, and supervisory frameworks for fintech.	M		First, basic supervision rules for artificial intelligence, blockchain, and biometric recognition have been formulated, the system of supervision rules for financial technology has been improved, and reasonable use of information technology in the financial field is being promoted.

			Second, in recent years, the PBC, working together with the relevant agencies, has actively studied the structuring of long-term mechanisms for supervision that is adapted to the development characteristics of internet finance, to promote healthy, sustainable development of internet finance. **First,** the establishment of supervision systems in all fields of internet finance has accelerated. The relevant financial regulatory agencies have now established a basic system for the supervision of internet lending and a system for the centralized deposit of non-bank payment reserves, clarified supervisory red lines for such fields as internet asset management, Bitcoin and other virtual currency exchanges, and initial coin offerings, and clarified supervisory policy standards in such fields as equity crowdfunding and internet insurance. **Second,** a supervisory framework has been preliminarily structured for combined operating and innovation activities in the internet finance field. The relevant financial regulatory agencies have further standardized internet sales of money market funds, implemented macroprudential supervision of systemically-important money market funds, and identified, evaluated, and prevented innovation deviations for such new business models as "Blockchain + finance." **Third,** the infrastructure for the internet finance industry has been further improved. The PBC pushed forward and accomplished the migration of processing for all payment operations between payment institutions and commercial banks to the NetsUnion and UnionPay clearing platforms, and has achieved centralized deposit of 100 percent of customer reserve deposits with the central bank. The National Internet Finance Association of China has continually improved industry infrastructures, including registration disclosures and statistical monitoring. At the same time, Baihang Credit has been formally established and has brought its personal credit information system online, offering credit information services to the fields of non-traditional finance and internet finance. **Fourth,** the CBIRC has launched efforts to amend the *Provisional Measures for the Supervision of Internet Insurance Operations*, to further perfect the system of supervision rules regarding new situations and new problems that have arisen during the rapid development of internet insurance operations. **Third,** the CSRC attaches great importance to financial technology supervision work in the securities and futures industry, has studied and drafted the *Guiding Opinion on Promoting Healthy Development of Financial Technology in the Securities and Futures Industry,* and has further amended and improved the opinion, in an effort to publish and implement it as soon as possible, to promote and standardize the healthy, orderly development of financial technology.

PEOPLE'S REPUBLIC OF CHINA

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 12, 2019

Prepared By
Asia and Pacific Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of June 30th, 2019)

Membership Status: Joined 12/27/45; Article VIII (December 1, 1996)

General Resources Account:

	SDR Million	% Quota
Quota	30,482.90	100.00
Fund holdings of currency	25,664.31	84.19
Reserve position in Fund	4,818.64	15.81
Lending to the Fund		
New Arrangements to Borrow	1,103.66	

SDR Department:

	SDR Million	% Allocation
Net cumulative allocation	6,989.67	100.00
Holdings	7,776.75	111.26

Outstanding Purchases and Loans: None

Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-by	11/12/86	11/11/87	597.73	597.73
Stand-by	03/02/81	12/31/81	450.00	450.00

Projected Payments to Fund (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2019	2020	2021	2022	2023
Principal		0.00	0.00	0.00	0.00
Charges/interest		0.11	0.11	0.11	0.11
Total		0.11	0.11	0.11	0.11

Exchange Arrangements:

China's de facto exchange rate regime has been classified as other managed arrangement, effective June 22, 2018. The previous classification was crawl-like against the basket of currencies in the CFETS index since June 1, 2017. The de jure exchange rate arrangement is managed floating with a view to keeping the RMB exchange rate stable at an adaptive and equilibrium level based on market supply and demand with reference to a basket of currencies to preserve the stability of the Chinese economy and financial markets. The floating band of the RMB's trading prices is 2% against the U.S. dollar in the interbank foreign exchange market: on each business day, the trading prices of the RMB against the U.S. dollar in the market may fluctuate within a band of ±2% around the midrate released that day by China's Foreign Exchange Trading System (CFETS). The People's Bank of China (PBC) indicated that the RMB's floating range would be changed in an orderly manner, based on the developments of the foreign exchange market and economic and financial situation. Within the trading band, banks may determine their RMB exchange rates to the U.S. dollar with their clients without any limit on the spread, based on market supply and demand (PBC No. 2014/188). On August 11, 2015, the PBC decided to further increase the flexibility of the RMB-to-USD exchange rate midrate quoting mechanism, thereby enhancing the market determination of RMB exchange rates, and giving market supply and demand an even greater role in exchange rate formation.

The CFETS publishes its exchange rate index (composed of 24 currencies since January 1, 2017, previously, 13 currencies), and other RMB indices based on the Bank for International Settlements (BIS) currency basket and the SDR currency basket.

China accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement on December 1, 1996. China maintains an exchange system free of multiple currency practices and restrictions on payments and transfers for current international transactions. However, China has notified measures to the Fund, pursuant to procedures under the Executive Board Decision 144 (52/51), which apply to measures imposed solely for national or international security reasons.

While exchange controls continue to apply to most capital transactions, the use of renminbi in international transactions has expanded over time. Effective October 1, 2016, the RMB was determined to be a freely usable currency and was included in the SDR basket as a fifth currency, along with the U.S. dollar, the euro, Japanese yen, and the British pound.

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

World Bank: https://www.worldbank.org/en/country/china

Asian Development Bank: https://www.adb.org/countries/prc/main

STATISTICAL ISSUES

(As of June 1, 2019)

I. Assessment of Data Adequacy for Surveillance
General: While data are broadly adequate for surveillance, they are only barely so. Efforts at strengthening the statistical system and enhancing data transparency led to China's subscription to the SDDS in October 2015. Nevertheless, China's statistics continue to have gaps that hamper surveillance. The areas of concern relate mainly to national accounts data and government finance statistics. China has endorsed and is in the process of implementing the recommendations of the Data Gaps Initiative of the G-20.
National Accounts: The National Bureau of Statistics (NBS) compiles and disseminates annual GDP by activity and by expenditure in current prices, by activity at constant prices (2015), and quarterly estimates of GDP by activity at current and constant prices. The NBS is in a transition period from 1993 SNA to 2008 SNA. The 2008 SNA has been implemented in the calculation of financial intermediation services indirectly measured and in the capitalization of research and development. The techniques for deriving volume measures of some GDP components are not sound and need to be improved. Annual and quarterly GDP by expenditure is compiled at constant prices but is not published. Limited expenditure components' contributions to GDP are available on a quarterly basis. The NBS has made several improvements to the range and quality of national accounts data, the most important being improving the exhaustiveness of the GDP estimates by activity. Further improvements are intended for both the annual and quarterly accounts; however, no target dates have been set. As in other countries, rapid economic change, including the expansion of the private sector, presents new problems for data collection and compilation. The ability to change the data collection systems is restricted by the decentralized nature of the statistical system. Monthly index of services production, and fixed investment indices are disseminated as ratios with respect to the corresponding month of the previous year, but no chain-linked indices are produced. Data revisions tend to be made without publishing the entire revised series.
Price Statistics: The CPI covers approximately 500 areas throughout the country, including around 200 counties and around 300 cities. The current CPI is a chained Laspeyres price index, which is compiled and disseminated since 2001**.** The index is compiled using weights derived from 2015 household expenditures However, the weights are not published. The PPI is aggregated according to the structure of the economy in 2015 but would benefit from expansion of coverage to include services activities. The NBS publishes residential property price indices (RPPIs) for selected cities. The indices are compiled following a basic mix-adjustment methodology (by size). A national composite index covering new and second-hand properties is not compiled.
Government Finance Statistics: Serious data shortcomings continue to hamper fiscal analysis. Data on the social security and extra budgetary funds are only provided annually and with a long lag. China currently reports GFS for general government with no breakdown of expenditure by economic type except interest, but including data under the Classification of Functions of Government for the GFS yearbook. Expenditure classification remains in need of improvement, mainly because expenditures by economic type are not published. The authorities have indicated an intention to begin collecting these data and to develop accrual based measures of fiscal performance over the medium term while also strengthening the compilation of cash based GFS. China has made a commitment under the G20 Data

Gaps Initiative to develop quarterly general government data, although no specific timeframe has been communicated. General Government coverage excludes the operations of the local government financing vehicles (LGFVs) which are substantial.

Monetary and Financial Statistics:
In recent years, improvements have been made in monetary and financial statistics. However, the monetary and banking surveys lack sufficient detail with regard to bank claims on the government, hampering the estimation of the fiscal deficit from the financing side. The reported net foreign assets position of PBC does not include exchange rate valuation effects and interest earnings on foreign reserves. The PBC has also ceased to report separate data on central government deposits in its balance sheet since April 2005 because the MOF no longer distinguishes between central and other government deposit accounts. This change has led to breaks in data series of monetary base and monetary aggregates.
The monetary and financial statistics missions in March 2015 made several recommendations for improvements in monetary data compilation with a view to accelerating PBC's implementation of the standardized report forms (SRFs). The PBC is currently technically capable of compiling and

Financial sector surveillance: China reports financial soundness indicators (FSIs) to the Fund for dissemination on the IMF's website. In addition to the 12 core FSIs, the authorities included in early 2015 two encouraged FSIs for deposit takers in their regular reporting to the Fund. The periodicity of data was also improved in May 2015 from annual to semi-annual frequency, and from semi-annual to quarterly frequency from the first quarter of 2019.

External sector statistics: The historic data series (balance of payments starting with data for 2005:Q1 and international investment position (IIP) starting with data for 2011:Q1) are compiled (in U.S. dollars) largely in accordance with the sixth edition of the *Balance of Payments and International Investment Position Manual* (*BPM6*) and are disseminated in the IFS. The authorities continue their efforts to improve the coverage of balance of payments (BOP) and IIP statistics, and progress is being made in developing these statistics. However, with the transition to BPM6, data gaps have appeared in the BOP pertaining to the series of workers remittances, merchanting, and primary income data (portfolio investment income). Since the International Transactions Reporting System is the major data source for BOP statistics, to ensure its smooth operation, regular training programs for staff in the provincial offices of SAFE have been recommended, aiming at reducing data gaps
China made considerable efforts to improve the coverage of external sector statistics, including by (i) commencing participation in the Coordinated Direct Investment Survey (CDIS) in 2011, although only inward direct investment positions are currently recorded and no breakdown is available between equity and debt instruments; (ii) initiating reporting data for the Coordinated Portfolio Investment Survey (CPIS) at the end of 2015; (iii) reporting data to the Currency Composition of Foreign Exchange Reserves (COFER) since 2015; and (iv) compiling and disseminating the International Reserves and Foreign Currency Liquidity Template starting September 2015. The latter does not include the coverage on currency composition of reserves by groups of currencies at least once a year.
Despite an ostensibly modest level of external vulnerability, there remains a need to strengthen external debt monitoring and compilation. In 2010, China started submitting total and public external debt data for the Quarterly External Debt Statistics (QEDS) database, a notable step forward.

II. Data Standards and Quality	
China began subscription to the Special Data Dissemination Standard in October 2015.	No data ROSC has been conducted.

China: Table of Common Indicators Required for Surveillance
(As of June 2019)

	Date of Latest Observation	Date Received	Frequency of Data[9]	Frequency of Reporting[9]	Frequency of Publication[9]
Exchange rates	05/19	06/19	M	M	M
International reserve assets and reserve liabilities of the monetary authorities[1]	04/19	05/19	M	M	M
Reserve/base money	04/19	05/19	Q, M	Q, M	Q, M
Broad money	04/19	06/19	M	M	M
Central bank balance sheet	04/19	05/19	M	M	M
Consolidated balance sheet of the banking system	04/19	06/19	M	M	M
Interest rates[2]	04/19	06/19	[10]	[10]	[10]
Consumer price index[3]	04/19	06/19	M	M	M
Revenue, expenditure, balance and composition of financing[4]—general government[5]	2016	07/17	A	A	A
Revenue, expenditure, balance and composition of financing[4]—central government	04/18	05/18	M	M	M
Stocks of central government and central government-guaranteed debt[6]	Q4/17	03/18	Q	Q	Q
External current account balance	Q4/18	03/19	Q	A, Q	A, Q
Exports and imports of goods and services[7]	Q4/18	03/19	Q	Q	Q
GDP/GNP[8]	Q4/18	03/19	A, Q (cumulative)	A, Q (cumulative)	A, Q (cumulative)
Gross external debt	Q4/17	03/18	A, Q	A, Q	A, Q
International investment position	2018	03/19	A, Q	A, Q	A, Q

[1] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Only 12-month growth rates are reported (price indices are not available).
[4] Data on financing (foreign, domestic bank and domestic nonbank financing) is not available.
[5] The general government consists of the central (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[6] Including currency and maturity composition.
[7] Goods trade data are provided monthly. Services trade data are released with the current account statistics.
[8] For real GDP, level data are available only on an annual basis (growth rates are available on a quarterly, cumulative basis).
[9] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA).
[10] Interest rates change only infrequently; these changes are publicly announced.

CAPACITY DEVELOPMENT AND TECHNICAL ASSISTANCE

China: Summary of Capacity Development and Technical Assistance, 2011–19 1/

Department	Purpose	Date
Tax System Reform		
FAD	Mission on Tax Gap Analysis	September 2011
FAD	Micro-Simulation Models	December 2013
FAD	Analysis of the Macroeconomic Impact of Tax Policy	March 2015
FAD	Reforming the Personal Income Tax	October 2015
FAD	The Future Design of Value-added Tax	September 2016
FAD	Tax Policy for promoting entrepreneurship and employment	September 2017
FAD	Social security contributions	March 2018
FAD	VAT policy	September 2018
Tax Administration Reform		
FAD	Tax Policy And Administration	September 2011
FAD	Tax Administration (Peripatetic Expert Visit 4 Of 5)	October 2011
FAD	Tax Administration (Peripatetic Expert Visit 5 Of 5)	October 2011
FAD	Large Taxpayer Compliance	October 2011
FAD	Workshop on Practical Tax Analysis For Tax Officials	December 2012
FAD	Large Taxpayer Administration	January 2013
FAD	Tax Administration Follow-Up	April 2014
FAD	Tax Collection Law Revision	May 2014
FAD	Tax Collection Law Revision	July 2015
LEG	Mission on Reforming Tax Collection Law	July 2015
FAD	Reforming the Personal Income Tax	October 2015
FAD	Improving Tax Compliance on ODI by Chinese Enterprises	October 2016
FAD	Tax administration—outbound investment and Taxpayer services	October 2017
FAD	Evaluate implementation of multi-year tax administration modernization	Janurary 2018
FAD	Tax administration—performance measurement	March 2018
FAD	Tax administration--PIT	November 2018
FAD	Workshop and rept on tax modeling and analysis	April 2019
Public Financial Management		
FAD	High-level Dialogue on PFM Institutions	June 2011
FAD	Medium-Term Expenditure Framework Seminar	November 2011
FAD	Medium-Term Revenue Administration Program And Policies Discussion	June 2012
FAD	High-Level Dialogue on PFM Institutions	November 2012
FAD	Mission on Introducing Advanced Treasury Reforms	February 2013
FAD	High-level Seminar on Fiscal Reforms	January 2014
FAD	Mission on Modernization of Government Accounting	April 2014
FAD	Mission on Medium Term Expenditure Frameworks	July 2014
FAD	Expert visit on Treasury management (accounting)	September 2014

China: Summary of Capacity Development and Technical Assistance, 2011–19 (continued)

FAD	Expert visit on Chart of Accounts Improvements	March 2015
FAD	Expert visit on Treasury Management (cash management)	March 2015
FAD	Mission on Strengthening Local Government Borrowing Reform	April 2015
FAD	Mission on Accounting Modernization	November 2015
FAD	Workshop on Medium-Term Expenditure Frameworks	April 2016
FAD	Seminar and Case Study on Local Government Borrowing and Bond Market Development	April 2016
FAD	Expert visit on Treasury – Central Bank Coordination	June 2016
FAD	Workshop on Medium-term Expenditure Frameworks	April 2017
FAD	Government accounting and financial reporting	April 2018
FAD	Performance Budgeting	April 2019
FAD		
Statistics		
STA	Workshop On Special Data Dissemination Standard	April 2011
STA	Government Finance Statistics	May 2011
STA	Data Work: SRFS Data Development for OFCs/ FSI Data Reporting	April 2012
STA	Quarterly National Accounts	November 2013
STA	Total Social Financing(TSF) Indicators/Monetary and Financial Statistics	March 2014
STA	SDDS Assessment	August 2014
STA	Data Work: Monetary Data Reported in SRF	September 2014
STA	SDDS Assessment	December 2014
STA	TSF/Monetary Data Reported in SRFs	March 2015
STA	Multi-sector Mission: SDDS Metadata Development and Topical TA	June 2015
STA	Quarterly National Accounts	March 2019
Monetary Policy, Bank and financial Supervision, and AML/CFT		
LEG	AML/CFT Legislative Drafting	March 2011
LEG	Bank Resolution	May 2012
MCM	Seminar on Article VIII of IMF's Articles of Agreement	July 2017
MCM	Securities Markets Supervision Workshop	September 2017
MCM	Mission on Securities Market Supervision	March 2018
MCM	Regulatory and Prudential Framework	August 2018
MCM	Financial Sector Technical Assistance	September 2018
MCM	Financial Sector Technical Assistance	November 2018
MCM	Monetary Policy Implementation and Operations	Janurary 2019
MCM	Financial Sector Technical Assistance	Janurary 2019
MCM	Financial Sector Technical Assistance	April 2019
MCM	Workshop on Sovereign Bond Futures Market	April 2019
MCM	Indicator-based Framework for Systemic Risks Monitoring	May 2019
Training		
LEG	AML/CFT Legislative Drafting Mission	March 2011
INS	Course on Macroeconomic Management and Financial Sector Issues	March 2011
INS	Course on Macroeconomic Forecasting	April 2011
INS	Government Finance Statistics Course at CTP	May 2011
STA	Course on Government Finance Statistics	May 2011

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STA	Course on Government Finance Statistics	June 2011
INS	BOP and IIP Course at CTP	June 2011
STA	Course on Balance of Payments Statistics	October 2011
INS	Monetary and Financial Statistics Course at CTP	November 2011
STA	Participate in OECD-NBS Workshop on National Accounts	March 2012
INS	FSI Course at CTP	September 2012
MCM	Medium Term Debt Management Workshop	November 2012
INS	BOP/IIP Course at CTP	April 2013
MCM	Workshop on Capital Account Convertibility and Exchange Rate Policy	June 2013
STA	SDDS Seminar	July 2013
INS	Introductory Course on Monetary and Financial Statistics in CTP	September 2013
STA	Quarterly National Accounts Seminar organized by NBS	November 2013
ICD	Macroeconomic Management & Financial Sector Issues	January 2014
MCM	Financial Statistics	March 2014
MCM	Workshop on Financial Regulation and Supervision	March 2014
ICD	Macroeconomic Management & Financial Sector Issues	March 2014
MCM	Course on External and Systematic Financial Risks	July 2017
ICD	Macroeconomic Diagnostics	September 2014
INS	Financial Soundness Indications in CTP	September 2014
STA	Seminar at Fund HQ for SAFE Officials on Experiences and Challenges in the Implementation of BPM6	September 2014
ICD	Macroeconomic Forecasting	October 2014
STA	OECD/NBS Workshop on Sectoral Accounts (with STA participation)	December 2014
ICD	Macroeconomic Management and Financial Sector Issues	March 2015
MCM/STA	Total Social Financing Indicator	March 2015
STA	Meeting: ECB Meeting with Delegation from China on Debt Securities & Data Issues	April 2015
STA	Meeting: BIS Meeting with Delegation from China on Debt Securities & Data Issues	April 2015
MCM	SDR Review/Operational Issues	June 2015
ICD	Macroeconomic Forecasting	June/July 2015
INS	Advanced Course on Monetary and Financial Statistics in CTP	August 2015
STA	SAFE-Course on Compilation of Balance of Payments Statistics	September 2015
ICD	Macroeconomic Diagnostics	September 2015
STA	Balance of Payments Statistics	September 2015
ICD/FAD	Fiscal Analysis and Forecasting	November 2015
FAD/ICD	Course on Fiscal Analysis and Forecasting	December 2015
STA	Debt Securities Statistics	March 2016
STA	OECD/NBS China Workshop on National Accounts (with STA participation)	March 2016
MCM	Sub-national Debt Market Development	April 2016
MCM	Workshop on Securities Supervision	April 2016
STA	Seminar on Cross-border Position Statistics and Challenges in the Implementation of New Data Initiatives	June 2016
ICD	Macroeconomic Forecasting	June/July 2016
ICD	Macroeconomic Forecasting – Advanced	July 2016
ICD	Financial Sector Surveillance	June/July 2016
MCM	Workshop on Enforcement and Market Surveillance	September 2016
ICD	Dynamic Stochastic General Equilibrium Modeling	November 2016
ICD	Dynamic Stochastic General Equilibrium Modeling - China	November 2016

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ICD	Financial Sector Surveillance	June 2017
ICD	Macroeconomic Forecasting –advanced course	June 2017
ICD	Monetary and Fiscal Policy Analysis with DSGE Models	August - September 2017
ICD	Dynamic Stochastic General Equilibrium Modeling – China	September 2017
STA	Cross-border Position Statistics	September 2017
ICD	Managing capital flows	March 2018
ICD	Macro-Econometric Forecasting and Analysis	May-June 2018
ICD	Fiscal Policy Analysis	June 2018
ICD	Financial Sector Surveillance	June 2018
ICD	Financial Development and Financial Inclusion	June-July 2018
ICD	Monetary and Fiscal Policy Analysis with DSGE models	August 2018
ICD	Monetary and Fiscal Policy Analysis with DSGE models(advanced)	August 2018
MCM	Stress Testing and Systemic Risks I	October 2018
ICD	Financial Programming and Policies	October 2018
ICD	Inclusive Growth	December 2018
MCM/ICD	Adapting Financial Supervision to New Financial Technologies	Janurary 2019
SPR	Debt Sustainability Framework in Low-Income Countries and Fund Policies	Feburary-March 2019
MCM	Stress Testing and Systemic Risk II	March 2019
ICD/MCM	Financial Markets and Instruments	April 2019
ICD	Financial Sector Policies	April 2019
ICD	Macroeconomic Diagnostics	May 2019
MCM/ICD/LE	Managing Capital Flows	May 2019
ICD	Financial Sector Surveilliance	June 2019
STA	Debt Securities Statistics	June 2019

1/ The new Institute for Capacity Development (ICD) was formed from the merger of the former IMF Institute (INS) and Office of Technical Assistance Management (OTM) on May 1, 2012.

Statement by the IMF Staff Representative
July 24, 2019

1. This statement contains information that has become available since the staff report was circulated. This information does not alter the thrust of the staff appraisal.

2. Recent data releases are broadly in line with staff projections:

- Q2 GDP growth was 6.2 percent (y/y), in line with staff projections and marginally lower than 6.4 percent in Q1. Growth was driven by rebalancing: services contributed more to growth than industry (3.6 percentage points vs industry's 2.3), and consumption more than investment (3.4 percentage points vs investment's 1.6); net exports remained a positive contributor to growth, at 1.2 percentage points, due to weak import growth. Nominal GDP growth accelerated to 8.2 percent (y/y) in Q2 from 7.8 percent in Q1.

- High-frequency indicators suggest some strengthening in activity in June. Industrial value-added recovered to 6.3 percent (y/y) in June from 5.0 percent in May. Fixed asset investment growth picked up to 6.3 percent (y/y) in June from 4.3 percent in May. Total social financing growth increased to 10.9 percent (y/y) in June from 10.6 percent in May, driven by a slower contraction in shadow banking.

- Headline CPI inflation remained at 2.7 percent (y/y) in June, with core CPI also steady at 1.6 percent (y/y); PPI inflation slowed to 0.0 percent (y/y).

3. Following the announcement in early July to accelerate financial sector opening, the Financial Stability and Development Committee announced eleven opening up measures. These improve foreign access to the bond market, asset management, insurance, securities, and ratings industries. Specifically, the measures will allow foreign financial institutions to: (1) rate domestic bonds; (2) establish and invest in wealth management subsidiaries of commercial banks; (3) establish controlling stakes in wealth management companies; (4) invest in pension management companies; (5) establish and participate in currency brokerage companies; (6) increase ownership in life insurance companies from 51 to 100 percent as of 2020 (advanced from 2021); (7) own more than 25 percent of the total shares of insurance asset management companies; (8) no longer be required to operate for over 30 years (for foreign-funded insurance companies); (9) own 100 percent of securities companies, fund management companies, and futures companies by 2020 (advanced from 2021); (10) obtain Class-A primary underwriting licenses in the interbank bond market; and (11) invest more easily in the interbank bond market.

4. Since the Staff Report was finalized on July 12th the RMB has been broadly stable, appreciating by 0.4 percent against the CFETS basket and depreciating by 0.1 percent against the US dollar; the equity market fell by ¼ percent; the 3-month central government bond yield rose by 15bps to 2.2 percent and the 5-year yield was essentially unchanged at 3.0 percent.

Statement by Executive Director for People's Republic of China, Jin Zhongxia
July 31, 2019

Our authorities would like to thank staff and management for the candid and constructive discussions during the Article IV consultation. The authorities value the Fund's analysis and advice, which are helpful for the authorities' policy deliberation. Given China's solid fundamentals and great potential, we are confident that the economy will overcome negative impacts of possible external shocks and will adapt to sustainable and quality growth.

Recent Developments

The Chinese economy has maintained stable growth, contributing substantially to the global economy. In the face of a more complex environment both internally and externally, GDP growth slowed down from 6.4 percent in the first quarter to 6.2 percent in the second quarter this year. Nevertheless, the economy remains resilient, with major economic indicators within a reasonable range. Inflation has remained stable, with CPI increasing by 2.2 percent in the first half. Despite pressures stemming from trade tensions, imports and exports have increased moderately, and the trade structure continued to improve. Employment has been stable with the surveyed urban unemployment rate at 5.1 percent in June.

As a large economy, domestic demand has always been the dominant driving force for China's growth. Thanks to years of efforts, China's economic structural adjustment has already started to bear fruit. The contribution of consumption expenditure to GDP growth has been raised to more than 60 percent. The service sector's share has expanded steadily to 52.2 percent and became larger than the manufacturing sector's share of 40.7 percent.

Economic Outlook

We are confident that the economy has the potential to achieve sustainable growth within an expected range of 6 to 6.5 percent in 2019. We concur with staff that, in the medium to long term, China has the potential to maintain robust growth, given the still sizeable gap between China's labor productivity and that of advanced economies, as well as China's early stage in productivity convergence. In recent years, the urbanization ratio has risen steadily. The once high housing inventory has declined to a new low. Despite high infrastructure investments in the past decades, China still has a large gap in density or per capita terms and has substantial potential for catching up with developed countries.

Despite shrinking global FDI and the diversion effect on trade tensions between China and the U.S., according to the latest UNCTAD World Investment Report 2019, China has remained the second largest FDI recipient in the world, with new FDI inflow increasing by 4 percent in 2018. In 2018, China also experienced a record level of portfolio inflows. On the one hand, some foreign investors are leaving China either to avoid higher tariffs imposed by the U.S. on Chinese exports, or to move their production to more cost-effective locations based on evolving comparative advantages. On the other hand, more foreign investments are entering into China to avoid retaliatory tariffs placed by China on U.S. exports and to take advantage of opportunities in the Chinese market. Recently, after comprehensive assessment, some firms that have previously moved out of China and experienced hardships have also moved back. This is very much associated with China's availability of a qualified labor force, comprehensive supply chain, convenient infrastructural network, and a stable and effective government. Although labor costs have risen significantly, China now has the largest pool of reasonably priced professional labor force such as engineers and technicians. The number of college graduates in 2018 reached a record high of 8.2 million, with science, technology, engineering, and mathematics majors (STEM) accounting for more than 50 percent of total graduates. China's R&D expenditure accounts for 2.18 percent of GDP, which is higher than EMs' average and close to OECD's average of 2.37 percent. Moreover, with significant improvements in transportation and communication infrastructure, the supply of effective working time has been multiplied, and these infrastructures integrated the economy into a more accessible and more liquid single country market.

Fiscal Policy

China has continued with a proactive fiscal policy with greater intensity and enhanced performance, focusing on large cuts in taxes and fees, totaling nearly 2 trillion yuan (equivalent to US$280 billion), and more efficient fiscal resource allocation between the central and local governments. Major beneficiaries of the tax cuts are small- and medium-sized companies, those in the middle- and low-income brackets, and R&D in the corporate sector. It is expected that the positive impact of the fiscal stimulus will be further felt in the latter half of 2019. We concur with staff's suggestion that there is no need for a further large-scale fiscal stimulus at this moment since the effects of trade tensions have already been factored into this year's budget.

As mentioned in staff's Debt Sustainability Analysis (DSA) in Appendix I, China's debt dynamics have worsened compared to that of last year, posing risks to debt sustainability. In our view, the recent rise in the debt ratio is a short-term response rather than a long-term trend, and the authorities are committed to stabilizing the overall leverage. China's debt dynamics should be examined in the context of the high savings rate in China. The high savings rate indicates the level of domestic resource mobilization that has enabled China's intertemporal resource allocation and made capital formation more independent of external financing. Overall, the large-scale financing based on high savings rate is also consistent with the need to maintain external balance.

There are limits to staff's analysis that is based on the debt to GDP ratio, as the approach has mismatched the concept of stock (debt) and flow (GDP) and can hardly provide a more relevant measurement of debt sustainability in China. We believe that a more accurate analysis of debt sustainability can be made based on the Debt Service/GDP ratio and Debt/National Wealth ratio.

Monetary Policy

China continues to conduct prudent monetary policy. Policy adjustments have been more data dependent, relying mainly on both domestic and international economic developments as well as changes in price levels. A combination of monetary policy instruments has been used to keep liquidity at an appropriate level, and money supply has been reasonably sufficient. The People's Bank of China (PBC) will further deepen the market-based interest rate liberalization reform and enable its policy rates to better guide market rates. At the same time, the PBC will further shift from a quantity-oriented monetary policy framework to a price-oriented one by improving the formation and transmission mechanism of the market-based policy rate. As staff noted in the report, the PBC has had little FX interventions in recent years.

Financial Stability

The authorities have attached great importance to safeguarding financial stability, and various measures have been taken to prevent and mitigate financial risks in the banking, securities, and insurance sectors. The financial sector has generally performed well as reflected by various indicators. The regulatory authorities have required small- and medium-sized banks to raise more capital from markets.

The recent takeover of Baoshang Bank and the participation of strategic investors in Jinzhou Bank have reflected the continuation of the authorities' efforts to clean up, consolidate, and strengthen some of the small and medium banks. In the past few years, the majority of small and medium banks have been strengthened by aggressive efforts to raise capital, dispose of non-performing loans, and a sharp increase in provisioning, which is consistent with FSAP recommendations.

SOE and SMEs

China has been resolutely deepening the supply-side structural reform. Ninety-five percent of central zombie firms have already been disposed, and the authorities will strive to tackle the remaining firms by the end of this year. Of the total disposed zombie firms, more than one-third have been disposed through bankruptcy, and the rest have been mainly disposed through mergers and acquisitions as well as internal restructuring. Not long ago, the National Development and Reform Commission (NDRC) and 12 other ministries have jointly released a new policy to facilitate zombie SOEs to declare bankruptcy and exit the market. For those SOEs that can satisfy the criteria for bankruptcy, no parties should impede their exit from the market. Both central and local governments are prohibited from providing subsidies or loans to prop up the operation of non-viable SOEs.

Domestic private owned firms currently account for over 60 percent of GDP and over 80 percent of employment in China. Domestic private owned firms and foreign invested firms account for more than 90 percent of China's exports. The authorities are committed to maintaining a level playing field for all types of companies, be it public or private, domestic or foreign, and implementing the principle of Competitive Neutrality in practice.

We welcome staff's Selected Issues Paper on "Improving the Allocation of Corporate Credit in China" and appreciate staff's reference to some countries' experiences in offsetting SOEs' low borrowing cost associated with explicit guarantee. That said, these country experiences are in eliminating "explicit guarantees," not "implicit guarantees." Caution should be exercised when defining and quantifying "implicit guarantees," as this is usually based on conjecture and not fact. China clearly prohibits any kind of unauthorized guarantees to companies. As recognized in the staff report, quite a lot of SOE bonds in China have defaulted in recent years, and in certain periods the number of defaults in SOE bonds is higher than that of privately-owned enterprises. This contradicts staff's assumption that implicit guarantee widely exists. Staff's view that the lower financing cost of SOE is evidence of implicit guarantee presents a risk of over-simplification and arbitrary judgment. Does the fact that some big financial institutions and auto makers in developed countries were bailed out by their government during financial crisis or partially owned by their government reflect implicit guarantees? We encourage staff to more comprehensively analyze these issues, and conduct cross-country comparisons, to test the robustness of the concept of "implicit guarantee" and apply it to member countries in an even-handed approach.

Trade

The intensification of trade tensions has inevitably affected the Chinese economy to an extent, but the impact is manageable. In terms of total retail sales, China has become the world's largest market. As China continues to open its markets, improve its investment environment, and strengthen the protection of intellectual property rights, no multinational company would risk giving up the Chinese market to third parties.

In addition, some technology transfer barriers and embargoes could weigh on China's technological development and innovation in the short term. But the suppliers could also be affected, sometimes fatally affected. Moreover, China could be forced to make large-scale investment to develop substitutes for imports, which will help offset the decline in external demand and boost economic growth.

That said, we concur with staff that China and its trading partners should work cooperatively and constructively to settle their disputes in a rules-based multilateral framework and make joint efforts to reform the WTO in a good faith and win-win approach. That is not only good for China and the U.S., but also for the international community as a whole.

We fully understand the concerns associated with a hypothetical "managed trade" that is characterized by discrimination and distortion. We share the view of the Fund that trade balance should be examined from a multilateral, rather than bilateral, perspective. In fact, the "managed trade" described by staff is proposed by negotiators of China's counterparty. It is more appropriate for the Fund to discuss the negative impact of "managed trade" with those who proposed it. China would like to resolve economic and trade divergences with its trade partners based on mutual respect, mutual benefit, and mutual trust. Any trade agreement that China could reach with its trade partners will both promote bilateral trade and be WTO consistent. It will be implemented on decisions made by independent market players based on market conditions. In the past year, China has already cut its effective tariff rate, liberalized market entry for foreign investors in many sectors, and further strengthened intellectual property protection. The progress achieved is a result of China's own opening of its markets, not as a condition to any specific bilateral agreement.

Overseas Lending

The authorities have made great efforts to improve monitoring, coordination, and transparency of its overseas lending. The Debt Sustainability Framework for Participating Countries of the Belt and Road Initiative has borrowed a lot from the Fund's methodology and benefited from staff's consultation and advice. Based on staff's monitoring and IMF Executive Board discussions, we have issued early warnings to creditors in China on their potential risks, and these efforts have yielded concrete positive results.

Finally, I would like to thank Acting Managing Director Lipton for his leadership and thank the mission chief Mr. Kenneth Kang, for his first candid and successful policy dialogue with the authorities. We would also like to thank the entire IMF China team for their arduous and professional work, and Director Rhee and Assistant Director Daniel of the Asia & Pacific Department for their advice and guidance.