INTERNATIONAL MONETARY FUND

IMF Country Report No. 24/258

PEOPLE'S REPUBLIC OF CHINA

August 2024

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE PEOPLE'S REPUBLIC OF CHINA

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 2024 Article IV consultation with the People's Republic of 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 19, 2024, consideration of the staff report that concluded the Article IV consultation with the People's Republic of China.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 19, 2024, following discussions that ended on May 29, 2024, with the officials of the People's Republic of China on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 3, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for the People's Republic of China.

The documents listed below have been or will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR24/295

IMF Executive Board Concludes 2024 Article IV Consultation with the People's Republic of China

FOR IMMEDIATE RELEASE

Washington, DC – August 2, 2024: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the People's Republic of China on July 19, 2024.

China's economy has remained resilient despite the continued weakness in the property sector, with GDP growing by 5.2 percent in 2023, and 5 percent y/y in the first half of 2024. Growth has been primarily driven by strong public investment and the post-COVID recovery in private consumption, with net exports also providing a boost more recently. However, inflation has been low in recent quarters amid continued economic slack.

Looking ahead, growth is projected to be broadly in line with the government's target in 2024, and inflation is expected to pick up gradually as the output gap closes and the impact of lower commodity prices wanes. Over the medium term, growth is projected to gradually decline to about 3.3 percent in 2029 amid headwinds from weak productivity and an aging population.

Uncertainty surrounding the outlook is high. Deeper-than-expected contraction in the property sector, combined with high debt levels, could result in sustained disinflationary pressures and adverse macro-financial feedback loops. External risks include greater-than-expected weakening of external demand, and an escalation of fragmentation pressures. On the upside, decisive policy action to facilitate adjustment in the property sector or market-oriented structural reforms could boost confidence and lead to a better-than-expected economic outcomes.

Executive Board Assessment[2]

Executive Directors welcomed China's resilient growth and the post-pandemic recovery in private consumption. Nonetheless, Directors emphasized downside risks from the ongoing adjustment in the property market and the drag from local government debt. In that context, they concurred that macroeconomic policies should support domestic demand in the short term. Directors also noted that a balanced policy approach and pro-market structural reforms would be necessary to foster high-quality, green growth in the medium term.

Directors welcomed the authorities' ongoing efforts to facilitate the property sector adjustment and boost homebuyers' confidence. They generally underscored the need for a comprehensive policy package to facilitate a more efficient and less costly transition for the sector. In that respect, Directors called for the timely exit of nonviable property developers and greater house price flexibility. Most Directors also saw scope in the deployment of central

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[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.

[2] At the conclusion of the discussion, the Managing Director, as Chair 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 summing up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

government financing to protect homebuyers of unfinished housing, while some noted the associated fiscal costs and the moral hazard implications.

Directors agreed that a neutral structural fiscal stance in 2024 would help restore consumer confidence and support domestic demand while mitigating downside risks. The positive effects would be stronger with a reorientation of expenditure away from investment and toward households through an expanded social protection system, including greater transfers to vulnerable segments, and a more progressive tax regime. A gradual decline in the structural fiscal deficit can begin in 2025, with a pace dependent on the strength of the recovery, inflation developments, and property market outlook.

Directors emphasized that stabilizing public debt will require sustained fiscal consolidation in the longer term, achieved through a reduction of off-budget investment and wide-ranging tax and social security reforms. They highlighted the need for fiscal framework reforms, including improving monitoring of local government finances, reducing their structural expenditure-revenue gaps, and establishing subnational fiscal rules. Directors noted that reducing the debt stock of local government financing vehicles would require greater use of insolvency tools.

Directors welcomed the People’s Bank of China’s monetary policy response and encouraged additional monetary easing via interest rates to boost domestic demand and further mitigate deflation risks. Greater exchange rate flexibility would also help absorb external shocks.

Directors positively noted the significant changes to China’s financial regulatory and supervisory architecture to enhance risk mitigation. They observed that financial stability risks remain elevated and called for reducing asset quality risks by phasing out forbearance measures and strictly applying prudential policies. They underscored the importance of reforms to tackle legacy vulnerabilities in the financial system, including the need to devise a comprehensive strategy to strengthen small and medium banks, upgrade crisis management and bank resolution frameworks, and enhance systemic risk oversight. Continuing to strengthen the AML/CFT framework is also important.

Directors emphasized the need for greener and more balanced growth. They underscored the importance of continued efforts to rebalance demand toward consumption together with reforms that boost the potential of the service sector as a growth driver, including by reducing regulatory barriers. Other key reform priorities include implementing SOE reforms, gradually increasing the retirement age, and strengthening labor market policies. Directors welcomed China’s decarbonization efforts and its success in deploying renewable energy. They urged accelerating power sector reforms, including reforms to the emission trading system.

Directors positively noted that China is a key player in addressing global challenges and welcomed its constructive role in supporting sovereign debt restructuring in low-income and vulnerable countries and tackling the global climate crisis. They also emphasized China’s important role in strengthening the multilateral trading system in close collaboration with international partners. In that context, Directors generally agreed that scaling back China’s industrial policies, which should only be used in the presence of well-defined market failures, and improving transparency around government support could help reduce domestic resource misallocation, lessen fragmentation pressures, and mitigate international spillovers.

Directors agreed that addressing remaining data gaps would help enhance data transparency and strengthen policy making.

China: Selected Economic Indicators 2019–2029

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
						Est.	Projections				
	(Annual percentage change, unless otherwise indicated)										
NATIONAL ACCOUNTS											
Real GDP (base=2015)	6.0	2.2	8.4	3.0	5.2	5.0	4.5	4.1	3.6	3.4	3.3
Total domestic demand	5.3	1.7	6.8	2.8	6.1	4.8	4.6	4.3	3.7	3.5	3.4
Consumption	6.3	-0.3	9.0	2.3	8.0	5.6	4.7	4.2	3.8	3.7	3.6
Fixed investment	5.3	3.4	3.2	3.2	4.9	5.2	4.3	4.4	3.4	3.1	3.1
Net exports (contribution)	0.7	0.6	1.8	0.3	-0.6	0.4	0.0	0.0	0.0	0.0	0.0
Total capital formation (percent of GDP)	43.1	42.9	43.3	43.2	41.6	41.8	41.7	41.8	41.7	41.7	41.6
Gross national saving (percent of GDP) 1/	43.8	44.5	45.3	45.7	43.0	43.4	43.2	43.2	43.1	42.9	42.7
Output gap estimate	-1.0	-4.0	-1.1	-2.8	-2.0	-1.2	-0.5	0.0	0.0	0.0	0.0
LABOR MARKET											
Unemployment rate (year-end) 2/	5.2	5.2	5.1	5.5	5.1	...	...	...	...	...	...
PRICES											
Consumer prices (average)	2.9	2.5	0.9	2.0	0.2	0.7	1.9	2.0	2.0	2.0	2.0
Consumer prices (end of period)	4.5	0.2	1.5	1.8	-0.3	1.5	2.0	2.0	2.0	2.0	2.0
GDP Deflator	2.1	1.3	3.0	2.0	-0.6	0.1	1.8	2.0	2.0	2.0	2.0
FINANCIAL											
7-day repo rate (percent)	3.0	2.7	2.2	2.3	1.9	...	...	...	...	...	...
10 year government bond rate (percent)	3.7	3.2	3.0	3.1	2.8	...	...	...	...	...	...
MACRO-FINANCIAL											
Total social financing	10.7	13.3	10.3	9.6	9.8	8.6	8.5	7.5	7.5	7.5	7.5
In percent of GDP	254	278	274	286	301	310	317	320	326	333	339
Total nonfinancial sector debt 3/	10.8	13.2	10.4	9.7	10.1	8.6	8.7	7.6	7.6	7.6	7.5
In percent of GDP	254	278	275	287	302	312	319	324	330	337	344
Domestic credit to the private sector	8.7	10.8	8.4	8.3	8.4	6.8	7.5	6.0	6.3	6.5	6.6
In percent of GDP	162	173	168	174	180	183	185	185	186	188	190
Household debt (percent of GDP)	55.8	61.6	62.1	62.3	63.7	64.0	63.0	62.7	62.6	62.5	62.4
Non-financial corporate domestic debt (percent of GDP)	106	112	106	112	116	119	122	122	123	125	127
GENERAL BUDGETARY GOVERNMENT (Percent of GDP)											
Net lending/borrowing 4/	-6.1	-9.7	-6.0	-7.5	-7.0	-7.4	-7.6	-7.8	-7.9	-8.1	-8.2
Revenue	28.1	25.7	26.6	26.0	26.6	26.3	26.4	26.6	26.8	27.0	27.0
Additional financing from land sales	2.9	2.5	2.3	1.1	0.9	0.8	0.8	0.8	0.8	0.8	0.8
Expenditure	34.2	35.4	32.7	33.5	33.7	33.7	34.0	34.4	34.7	35.0	35.3
Debt	38.5	45.4	46.9	50.7	56.3	60.5	63.7	67.1	70.9	74.9	79.1
Structural balance	-5.8	-8.6	-5.7	-6.8	-6.5	-7.1	-7.4	-7.8	-7.9	-8.1	-8.2
BALANCE OF PAYMENTS (Percent of GDP)											
Current account balance	0.7	1.7	2.0	2.5	1.4	1.5	1.5	1.4	1.4	1.3	1.2
Trade balance	2.7	3.4	3.2	3.7	3.3	3.5	3.5	3.5	3.5	3.4	3.4
Services balance	-1.8	-1.0	-0.6	-0.5	-1.2	-1.3	-1.4	-1.5	-1.5	-1.6	-1.7
Net international investment position	16.0	15.4	12.3	13.6	16.4	17.2	17.5	17.8	18.1	18.3	18.5
Gross official reserves (billions of U.S. dollars)	3,223	3,357	3,427	3,307	3,450	3,817	4,151	4,259	4,377	4,497	4,619
MEMORANDUM ITEMS											
Nominal GDP (billions of RMB) 5/	99,071	102,563	114,528	120,247	125,798	132,273	140,670	149,413	157,829	166,426	175,317
Augmented debt (percent of GDP) 6/	86.3	98.8	100.8	107.9	116.9	124.0	128.9	133.7	138.7	143.6	148.2
Augmented net lending/borrowing (percent of GDP) 6/	-12.5	-17.0	-12.1	-13.4	-13.0	-13.2	-13.1	-12.9	-12.7	-12.5	-12.2
Change in Augmented Cyclically-Adjusted Primary Balance 7/	-3.1	-2.4	3.6	-0.6	0.1	-0.2	0.1	0.2	0.5	0.6	0.5

Sources: Bloomberg; CEIC Data Company Limited; IMF International Financial Statistics database; and IMF staff estimates and projections.

1/ 2023 GDP will be revised to match official revisions, once full official data are released.

2/ Surveyed unemployment rate.

3/ Includes government funds.

4/ 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.

5/ Expenditure side nominal GDP.

6/ The augmented balance expands the perimeter of government to include government-guided funds and the activity of local government financing vehicles (LGFVs).

7/ In percent of potential GDP.

INTERNATIONAL MONETARY FUND

PEOPLE'S REPUBLIC OF CHINA

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

July 1, 2024

KEY ISSUES

Context. After four decades of high growth and remarkable socioeconomic achievements, China's growth has decelerated in recent years, reflecting the pandemic, a large but needed property market correction, and structural headwinds such as weakening productivity and labor force growth. The transition to lower growth is consistent with the authorities' goal to pursue high-quality growth and reduce the imbalances and vulnerabilities that have emerged, most notably with the significant build-up of debt. The authorities have taken incremental policy steps to achieve these objectives, but a comprehensive and balanced policy approach is needed to manage the challenges facing the economy.

Outlook. GDP growth is expected to remain resilient at 5 percent in 2024 despite the continued property sector adjustment, supported by strong public investment and the ongoing recovery in private consumption. Inflation has been low in recent quarters amid considerable economic slack and is expected to pick up gradually as the output gap closes and the impact of lower commodity prices wanes. Growth is expected to slow in the medium term amid declining productivity growth and aging.

Risks. Risks are tilted to the downside. The key domestic risk is a deeper- or longer-than-expected contraction in the property sector, which, combined with high debt levels, could result in a sustained period of disinflationary pressures, adverse macro-financial feedback loops, and risks of deflation. External risks include greater-than-expected weakening of external demand, and an escalation of fragmentation pressures.

Near-term policies to support domestic demand and mitigate risks. The immediate priorities are to facilitate a more efficient and less costly property sector adjustment and to provide adequate macroeconomic policy support amid continued slack and elevated downside risks.

- **Property sector:** The ongoing correction is welcome and needed to reduce the sector to a sustainable size after significant overbuilding and accumulation of excess leverage by property developers. The policy priority should now be the timely resolution of unviable developers and the deployment of central government (CG) financing to accelerate completion of unfinished, presold housing, which would help restore homebuyer confidence. Greater housing price flexibility, especially in the primary market, would also support housing demand and the clearing of the inventory overhang.
- **Macro and financial policies:** Fiscal policy should accommodate one-off CG fiscal support for the real estate sector to complete unfinished housing and protect homebuyers, which implies an expansion of the primary deficit in 2024 and 2025. Aside

from such support, a neutral structural fiscal stance in 2024 and a gradual decline in the structural deficit in 2025 would balance the tradeoffs between supporting domestic demand, reducing deflation risks, and containing government debt which remains elevated. Additional monetary easing via interest rates would support domestic demand, while allowing for greater exchange rate flexibility would help absorb external shocks and reduce disinflationary pressures and deflation risks. Financial sector policies should aim to mitigate financial stability risks and preserve financial institutions' capacity for credit intermediation.

Structural policies: Tackling the debt overhang, preventing the build-up of new risks, and fostering high-quality and sustainable growth requires comprehensive structural reforms, including to economic frameworks:

- **Fiscal:** Sustained general government (GG) fiscal consolidation over the medium term will help stabilize debt, while restructuring the debt of unsustainable local government financing vehicles (LGFV) through greater use of insolvency frameworks will reduce LG fiscal strains. GG fiscal consolidation should be based on a reduction of off-budget investment of LGs, together with tax and social security reforms. Fiscal framework reforms will be essential to sustain the needed consolidation. Priorities include public financial management reforms to strengthen CG monitoring of LG finances, increased transfers from the CG to LGs to close LG financing gaps, and the establishment and enforcement of fiscal rules to ensure fiscal discipline among LGs.
- **Financial:** Financial stability risks remain elevated amid significant credit risks from property sector and LGFV debt, declining bank profitability, and heightened vulnerability of small banks. Reform priorities include strengthening the crisis management and bank resolution frameworks, adopting a comprehensive strategy to address weak banks, and enhancing systemic risk oversight.
- **Structural:** Achieving high-quality, sustainable growth will require reforms that address both demand imbalances (specifically to increase reliance on consumption) and supply-side distortions. The service sector can become a driver of growth and a creator of jobs if measures that promote a rebalancing of demand towards consumption, such as structurally boosting the social safety net, are combined with reforms that reduce entry barriers and other regulatory restrictions. Other priorities include steps to (i) ensure competitive neutrality between state- and privately-owned firms; (ii) reduce regulatory uncertainty; (iii) strengthen human capital; (iv) improve job matching and labor mobility across sectors and regions; and (v) increase the retirement age to slow the decline in the labor force.
- **Industrial policies (IP) and trade distortions:** China should scale back its extensive use of IP to reduce domestic resource misallocation and mitigate international spillovers. This, together with greater transparency around such policies and avoidance of trade and investment restrictions, would reinforce China's efforts to strengthen the WTO and the multilateral trading system.
- **Climate:** China has made rapid progress towards meeting its climate goals thanks to concerted policy effort. Expanding the coverage of the emissions trading scheme (ETS) would help achieve emissions goals more efficiently while auctioning permits would raise revenue to compensate for adverse distributional effects.

Approved By APD
Thomas Helbling (APD) and Kenneth Kang (SPR)

Discussions took place in Beijing May 16-29, 2024. The team comprised S. Jain-Chandra (head), N. Klein, S. Kothari, E. Liu, N. Novta, Y. Xu (all APD), D. Garcia-Macia (FAD), Y. Chen (MCM), F. Zhang (RES), D. Plotnikov, E. Van Heuvelen (SPR), J. Ishikawa (STA) and S. Barnett, P. Jeasakul, and X. Li (Resident Representatives). T. Helbling (APD) joined key meetings. FDMD G. Gopinath held high-level meetings on May 27-29, 2024. Z. Zhang, X. Bai (both OED) joined the official meetings. T. Yan (COM) coordinated media activities. A. Balestieri and D. Hua (RA) supported the mission.

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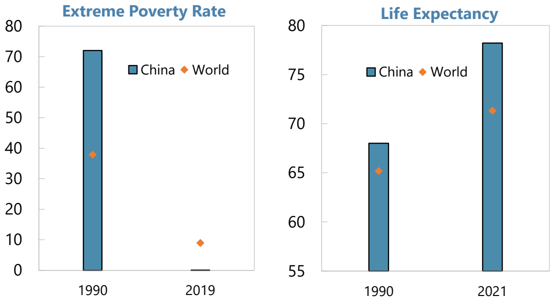
CONTEXT

1. **China's economic development over the past few decades has been remarkable.** Since the 1990s, China registered impressive growth, facilitated by market-oriented reforms, trade liberalization, and greater integration into global supply chains. By tapping its potential, the Chinese economy has outperformed peers, becoming the second largest economy in the world. High growth has translated into impressive gains on various social metrics, including the eradication of extreme poverty.

Social Indicators: China and World

(LHS, in percent; RHS, years)

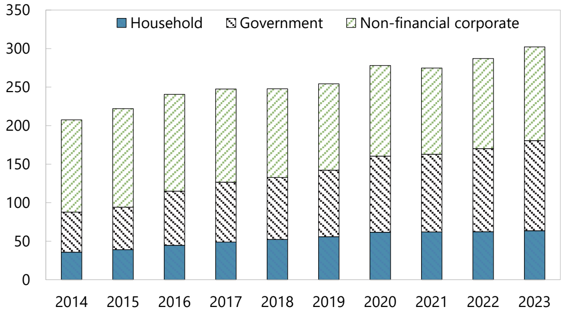


Sources: The World Bank Group; and IMF staff calculations.

2. **These achievements have been accompanied by imbalances and rising vulnerabilities, and headwinds to growth have emerged.** Persistently high household saving rates have facilitated rapid capital accumulation but have also enabled an overreliance on investment as opposed to consumption. The focus on ambitious growth targets, with LGs competing to promote priority sectors, has contributed to rising capital misallocation and low returns to capital. Excessive investment in infrastructure and housing in the 2010s has resulted in elevated debt of property developers and LGs and the build-up of vulnerabilities. The ongoing housing market correction is needed to bring the sector back to a sustainable size, but it is weighing on economic activity and LGs finances, given their heavy reliance on property as a source of revenue, while also worsening asset quality of banks and increasing macrofinancial risks. The focus on industrial policies has contributed to rising resource misallocation and raised concerns from trading partners about international spillovers. Rising geo-economic fragmentation pressures, and China's already high global market shares in some exports, suggest that external demand for manufacturing goods could face constraints, further limiting growth.

Total Debt

(In percent of GDP)



Source: IMF staff calculations.
Note: For China, LGFVs are included in government debt.

3. **Recognizing the need to contain these vulnerabilities and to foster new sources of growth, the broader goal of achieving high-quality growth has been guiding economic policy.** In the past decade, the authorities have stepped up support for innovation and for green and high-tech sectors, upgraded financial sector regulations, and improved universal health care. The 2024 Government Work Report (GWR), which lays out the authorities' policy priorities and targets for the year, signals increased coordination between fiscal, monetary, financial, and other policy instruments (industrial and environmental policies) with an aim to unleash "new productive forces". It also

recognizes financial risks from the property sector and LG debt and envisages the ramping up of social and affordable housing investment and strengthening of control over LG fiscal operations.

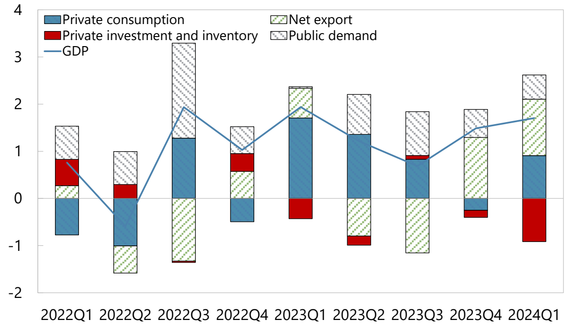
4. However, the accompanying economic policy changes have been incremental, and a more comprehensive and balanced policy approach would help in putting China on a path of high-quality and more sustainable growth. The aggregate household saving ratio remains high as upgrades to the social safety net have been modest, and leverage is still increasing in many sectors amid the authorities' continued focus on supply-side policies, including boosting investment in green and high-tech sectors. While these sectors have expanded rapidly, headwinds to growth remain, including from the ongoing property sector correction. The incremental approach to tackle property sector and LG debt overhang has kept financial stresses localized and limited their macro-financial spillovers, but not resolved underlying asset quality problems, entrenched weak confidence, and left the related risks of deflation unaddressed. In recent Article IV consultations, staff has thus advised for comprehensive efforts for a faster resolution of property market stresses and reforms to rebalance demand and strengthen market forces in key areas (see Annex IV).

RECENT DEVELOPMENTS

5. China's economy has remained resilient despite the property market correction. Real GDP grew by 5.2 percent in 2023, meeting the government's growth target, and edged up further to 5.3 percent y/y in 2024Q1. Private investment has been broadly flat, with the contraction in residential investment offset by strength in manufacturing investment. Growth was supported by public consumption and investment, which contributed significantly to domestic demand growth in 2023 and 2024Q1. Private consumption rebounded following the reopening, growing faster than GDP at 9 percent in 2023 and contributing 3.2 percentage points to GDP growth. The household savings rate has declined post reopening but remains above pre-pandemic levels amid weak consumer confidence. Net exports contributed significantly to growth in 2024Q1, reversing the modest drag in 2023. Monthly activity data suggest solid industrial production in April and May, though retail sales indicate relatively subdued domestic demand for goods and services.

GDP Contributions

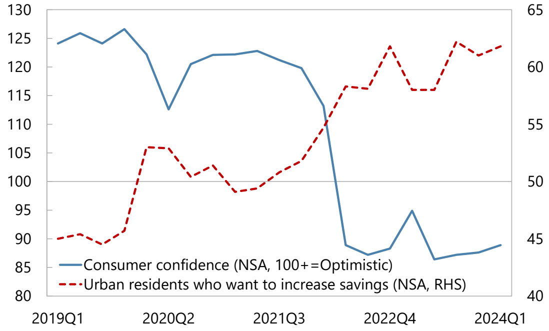
(q/q annualized)



Source: IMF staff calculations and estimates.

Consumer Confidence and Desire to Save

(LHS, index; RHS, percent of respondents)

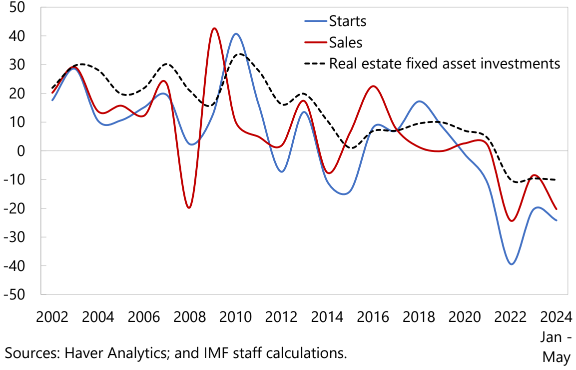


Sources: Haver Analytics; and IMF staff calculations.

6. **The property sector remains a significant drag on economic activity.** Despite recent policies to support the sector (see ¶25 for details), housing starts, sales, and residential investment have continued to decline sharply, with the latter contracting by about 10 percent y/y in the first five months of 2024, following a cumulative decline of about 25 percent in 2022-23. Completion rates for unfinished presold housing have risen moderately, in part due to policy support through the "Bao Jiao Lou" initiative, which is on track to achieve the targeted completion of 3.5 million units, with 86 percent of these units already delivered as of end-2023. Even so, the inventory pending completion remains high as of end-2023, amounting to eight times the 2023 annual completion rate, undermining homebuyer confidence. Concerns over delays in new housing delivery, coupled with limited price reductions in primary markets (urban city prices are only 5 percent below their peak on average) has shifted housing demand from the primary to the secondary market. The steep decline in primary sales has resulted in several large developers defaulting, with distress spreading to previously stable developers. About 50 percent of developers are now grappling with solvency and viability concerns, while an additional 15 percent or so are facing liquidity problems.[1]

Property Sector Indicators

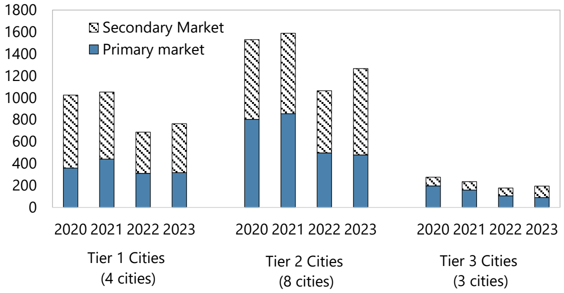
(In percent, year-on-year change)



Sources: Haver Analytics; and IMF staff calculations.

Sales by City Tiers: 2020-2023

(Thousands of units)

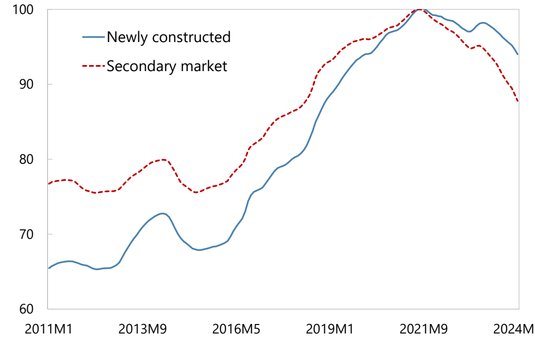


Sources: CREIS; and IMF staff calculations.

Notes: Tier 1 cities include Beijing, Shanghai, Guangzhou and Shenzhen. Tier 2 cities include Tianjin, Hangzhou, Nanjing, Chengdu, Chongqing, Suzhou, Hefei and Ningbo. Tier 3 cities include Foshan, Dongguan and Shaoxing.

70 City Average Price Index

(Index; July 2021=100)



Sources: China National Bureau of Statistics; and IMF staff calculations.

7. **Persistent disinflationary pressures have emerged amid continued economic slack and lower food and commodity prices.** After being in negative territory from October 2023 to January 2024, headline CPI inflation rose to 0.3 percent (y/y) in May. Core inflation, while consistently positive, was also low at 0.6 percent in May 2024. As of May 2024, producer prices had declined for

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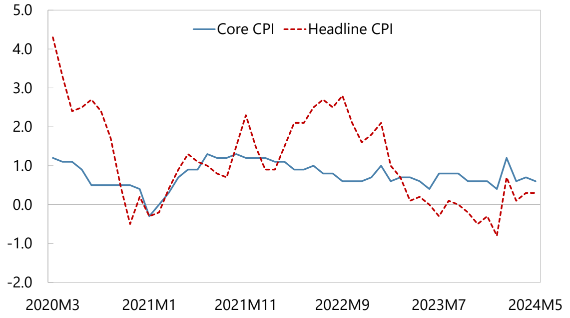
[1] The estimations are based on Capital IQ data (see SIP). Developers with solvency and viability concerns include those with negative common equity (solvency criteria), negative profitability (viability criteria), and those that have stopped publishing financial statements. Developers with liquidity problems are those with negative net short-term assets (cash, adjusted for short-term debt and net accounts payable), excluding developers identified with solvency and viability concerns.

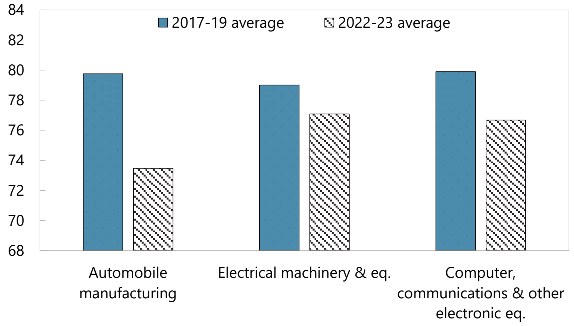
20 consecutive months, driven largely by falling global commodity prices but also slack in some sectors. The GDP deflator fell by -1.0 percent in 2024Q1, following a decline of -0.6 percent in 2023, with weakness in nominal GDP growth constraining corporate profits and debt servicing capacity.

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



Sources: Haver Analytics; and IMF staff calculations.

Sectoral Capacity Utilization
(In percent)



Sources: Haver Analytics; and IMF staff calculations.

8. While declining, economic slack remains significant. Staff estimates of the output gap suggest a narrowing from about -2.8 percent in 2022 to -1.2 percent in 2024, and industrial capacity utilization is low, at around 74 percent in 2024Q1, compared to pre-pandemic average of 76.6 percent. While the unemployment rate declined modestly from 5.6 percent in late 2022 to 5.0 percent in May 2024, other labor market indicators suggest broad-based slack, including PMI employment indices that are low by historical standards. Wage growth remains subdued and data from some private sector surveys and online recruitment platforms suggest declining salaries for new hires.

9. External position was stable despite weak capital flows.

- *The current account surplus declined* from 2.5 percent of GDP in 2022 to 1.4 percent of GDP in 2023, and 1.0 percent of GDP in 2024Q1, driven by a widening of the services deficit as China's outbound tourism recovered and a decline in the goods trade surplus as goods exports fell. The latter reflected the unwinding of the COVID-related export boom, weak global demand, and lower export prices. Imports evolved in line with domestic demand.[2] While goods trade recovered in 2024Q1, exports and imports remain below the 2023Q1 peaks. The external position in 2023 is assessed as broadly in line with the level implied by medium-term fundamentals and desirable policies (Annex I).

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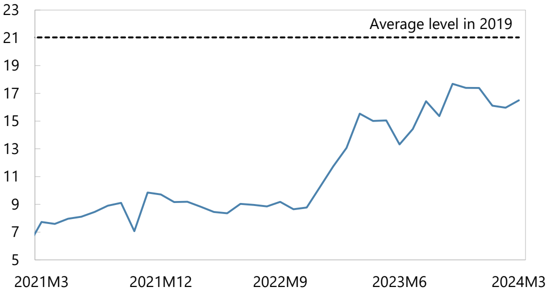
[2] In recent years, the trade surplus measured in the BoP has been smaller than the trade surplus measured using customs data. The recording of imports and exports related to global production arrangements (e.g., factoryless manufacturing) may largely explain this divergence (see Annex VII).

Tourism Imports Recovery

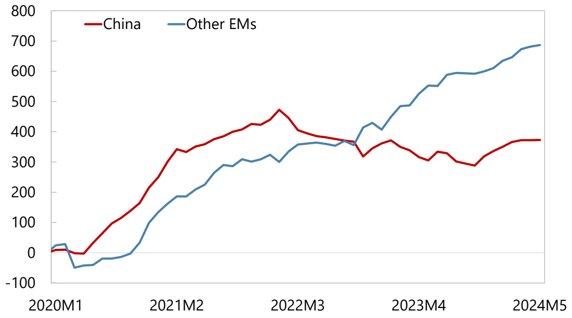
(SA, in billions of USD)



Sources: Haver Analytics; and IMF staff calculations.

Nonresident Portfolio Flows to EMs

(Cumulative since end-2019, in US$ billion)

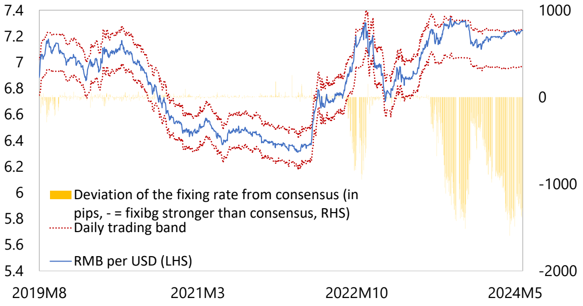


Sources: Institue of International Finance; and IMF staff calculations.

- *Capital outflow pressures have eased since 2023Q4.* Nonresident net equity and bond inflows were close to record lows in 2023, with the largest outflows seen mid-year. Despite a rebound in portfolio flows in 2023Q4, cumulative portfolio outflows in China since early 2022 are in stark contrast with developments in other EMs, likely reflecting negative perceptions about growth prospects, policy uncertainty, and geopolitical risks. Monetary policy divergence with advanced economies also contributed. Inward FDI was at the lowest on record in 2023 and remained anemic in 2024Q1 (0.2 percent of GDP in both periods), while outward FDI remained stable at 1 percent of GDP. The stability in outward FDI masks ongoing geographical diversification of Chinese FDI, with higher flows to geopolitically aligned countries, and a shift away of investment from larger economies, consistent with the emergence of "connector" countries (see SIP).

- *Notwithstanding depreciation pressures, the exchange rate has been largely stable against the US dollar since mid-2023.* Since July 2023 the authorities set the daily RMB fixing at a level significantly stronger than market consensus (with the exchange rate hovering close to the weak end of the 2 percent trading band around the fixing for prolonged periods). The authorities tightened offshore liquidity, and lowered reserve requirements on foreign currency deposits, which supported the RMB/USD rate. As of May, the REER depreciated by around 2.6 percent compared to the 2023 average, faster than the NEER (around 0.1 percent appreciation) due to low inflation in China relative to trading partners.

Bilateral RMB Fixing and Actual Exchange Rates



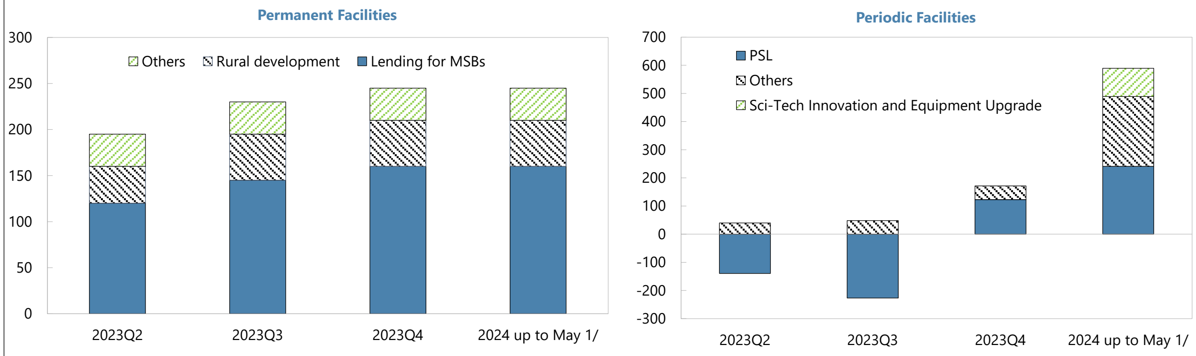
Sources: Bloomberg; and IMF staff calculations.
Note: Market consensus is a Bloomberg survey of 20 analysts' expected fixing, i.e. center of next day's trading band, mostly based on the previous days' close, multiplied by the estimated overnight change in the USD.

- *FX reserves remain adequate.* International reserves increased in 2023 by US$110 billion, largely due to favorable valuation effects. At US$3.2 trillion as of May 2024, China's FX reserves level is assessed to be adequate (Annex I).

10. The authorities further eased monetary policy amid low inflation. The PBC cut the required reserve ratio (RRR) by 50 basis points in February 2024, infusing approximately 1 trillion yuan (around 0.35 percent of M2) in long-term liquidity into the market. The cumulative reduction in reference interest rates between early 2023 and March 2024 has been modest, at 20, 20 and 35 basis points for 7-day reverse repurchase operation rate, 1-year and 5-year loan prime rates, respectively. Additional easing was implemented through quantity-based instruments, including structural credit policy tools.

Structural Credit Facilities

(Cumulative change since 2023Q2, in billions of RMB)



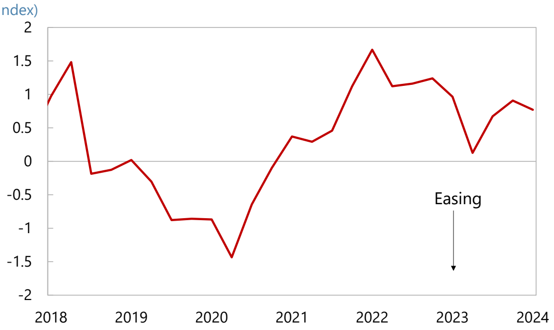
Sources: PBC, and IMF staff calculations.
1/ Changes to the periodic facilities in 2024 includes additional credit for science and innovation and for affordable housing announced in April and May.

11. Despite monetary policy easing, financial conditions have tightened modestly since 2023Q3.

- *Overall conditions:* While nominal interest rates and corporate bond yields have declined, real rates remain high, driven by declining inflation. Bond and equity financing have slowed amid the extended declines in equity prices since 2021, with the acute stress in equity markets in early 2024 triggering policy interventions, including direct purchases by state-linked financial institutions and increased scrutiny of trading and short-selling activities.[3] Property developers continue to face funding challenges across all funding sources. External financial conditions have also tightened with higher interest rates in major AEs.

Financial Conditions Index

(Index)



Sources: Bloomberg; and IMF staff calculations.
Note: Data as of March 29, 2024.

- *Credit*: Total Social Financing (TSF) growth decelarated to historic low levels, from 9.8 percent in 2023H1 to 8.4 percent in May 2024. Notwithstanding easing of monetary and macroprudential policies for the housing market, bank loan growth fell to 8.8 percent in May from an average of

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[3] On April 12, the State Council announced Guidelines for Capital Market Development 3.0. Key measures include raising the quality of listed companies, promoting minority investor interest and attracting long-term capital investment.

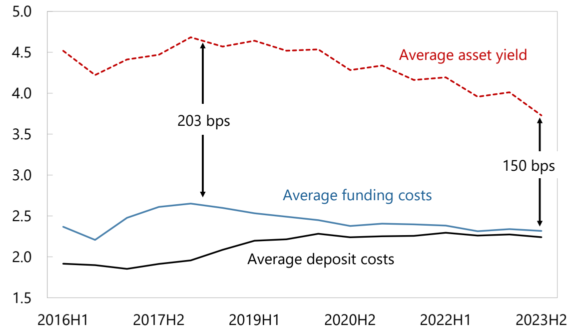
11.4 percent in 2023H1, largely on account of declining property-related loans, which was partially offset by a significant increase in inclusive loans (+21 percent y/y) and industrial credit (+24 percent y/y), including to strategic manufacturing sectors.

12. Financial sector vulnerabilities remain elevated, given credit risks and bank profitability pressures.

- *The banking system is adequately capitalized in the aggregate but is facing intensifying profitability and asset quality pressures.* Asset yields have declined by 80 bps since 2020 amid ongoing monetary policy easing, the repricing of mortgage interest rates and accelerated mortgage pre-payments. However, funding costs have only declined by 20 bps as households and corporates shifted savings from demand deposits into higher-yielding long-term deposits. While the headline NPL ratio continues to drift lower amid the extended use of forbearance measures, property sector NPLs have increased (from an estimated 5 percent in 2022 to 6 percent in 2023) and personal consumption loans are also showing early signs of worsening asset quality.

Banks' Net Interest Spreads

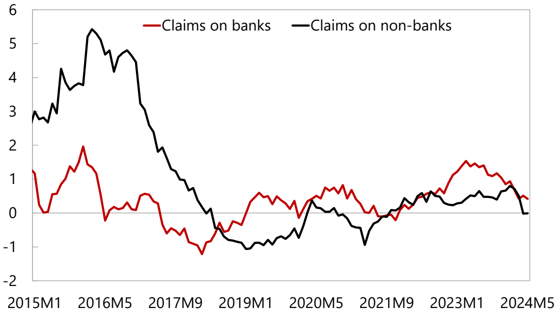
(In percent)



Sources: Bloomberg; and IMF staff calculations.

Interconnectedness: Bank Claims on Financial Institutions

(In percent, contribution to total asset growth)



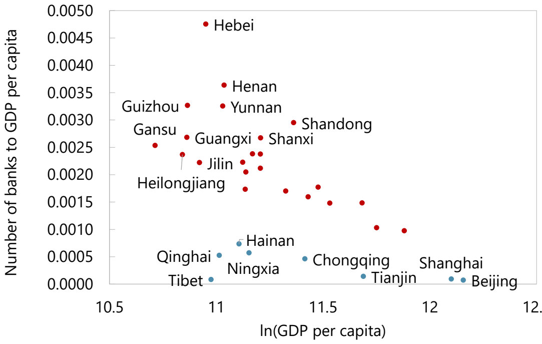
Sources: Haver Analytics; and IMF staff calculations.

- *Small and medium-sized commercial and rural banks are the weak link in the large banking system.* China has close to 4000 such banks, collectively accounting for 25 percent of total banking system assets. These banks have seen the largest decline in profitability, and they have higher NPL ratios and lower provisions and capital buffers than other banks, in part reflecting higher share of risk exposures to property developers and inclusive sectors (Figure 7, panel 4). Furthermore, the number of small and rural banks is disproportionately high relative to the size of the local economy in poorer and fiscally weaker regions, leading to fierce competition, poor governance, and challenges to proper supervisory oversight. The latest push to consolidate smaller institutions started in 2023 (building on earlier efforts to recapitalize small banks), when several mergers and acquisitions took place.

- *Risks from nonbank financial institutions (NBFIs) are concentrated in the asset management sector.* The asset management reforms in 2018 have helped reduce risky practices in this subsector. Nevertheless, the sector is subject to material credit risks, including from property-related and LGFV sectors, and liquidity risks in its asset management products. While still small in aggregate, credit from nonbank financial institutions is increasing gradually. Lending between banks and NBFIs is also rising, pointing to risks from rising interconnectedness in the financial system.

Number of Financial Institutions

(By provinces, excluding 4 G-SIBs and 16 D-SIBs)



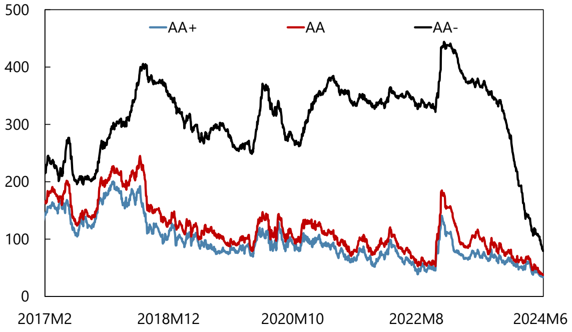
Sources: NFRA; CEIC Data Company Limited; and IMF staff calculations.

- *Corporate and household leverage remains high:* Corporate debt is relatively high in China, at about 122 percent of GDP, with vulnerabilities primarily concentrated among property developers. Corporate profitability beyond the property sector has also declined in recent years, which combined with the rapid growth of bank lending to small enterprises, could add to credit risks going forward. Household balance sheets remain largely healthy given high household savings, while household leverage has stabilized at around 60 percent of GDP since the pandemic, after a period of rapid increase in the past decade.

13. The fiscal stance in 2023 was neutral as fiscal easing by the CG offset tightening by LGs. A decline in on- and off-budget LG spending, in part due to fiscal strains from lower property-related revenue and financing, was offset by extended tax relief to support the recovery and a package of CG-funded investment in natural disaster reconstruction and resilience introduced in 2023Q4. Expectations of stronger backing of LG financing vehicles (LGFV) debt by the government have reduced LGFV spreads since mid-2023, but administrative borrowing constraints appear to have been tightened, with net bond financing turning negative in 2023Q4, forcing LGFVs to rely more on bank loans.

Credit Spreads of LGFV Bonds by Credit Rating

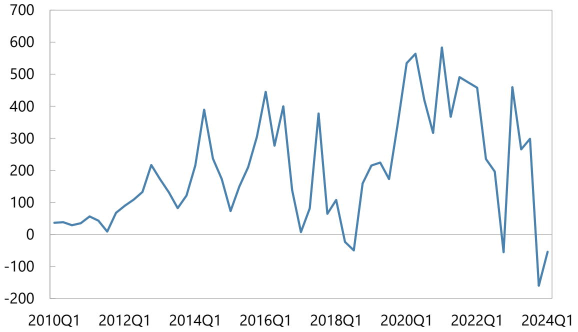
(Basis points, 3-year maturity)



Sources: Wind; and IMF staff calculations.

LGFV Net Bond Financing

(In billions of RMB)



Sources: Wind; and IMF staff calculations.

14. The 2024 budget also implies a broadly neutral fiscal stance, with a continued focus on supply-side measures. Despite additional expenditure financed with a newly announced RMB 1 trillion ultra-long CG special bond, the augmented cyclically-adjusted primary deficit is projected to increase only by 0.2 percent because of lower-than-expected general budget expenditure. The authorities provided forward guidance that such special bonds will continue to be issued in coming years. The budget continues to prioritize supply-side measures, such as financing strategic investments and tax relief for innovation and manufacturing.

15. Trade restrictions continue to proliferate globally amid heightened trade tensions between China and its trading partners. This includes restrictions by trading partners placed on China's imports of high-tech goods, higher tariffs announced on certain Chinese exports to the US, and countervailing duties on electric vehicles announced by the EU following an investigation into state-support. Ongoing WTO investigations into China's shipbuilding practices, public procurement of medical devices, and state-support which affects competition in other countries may result in further trade measures. China imposed restrictions on exports of gallium and germanium in August 2023, followed by restrictions in December 2023 on exports of graphite as well an export ban on certain processing technology for rare earths. Production and processing of these minerals are highly concentrated in China.[4]

OUTLOOK AND RISKS

16. Growth is expected at 5 percent in 2024, supported by strong public investment and a continued recovery in private consumption, before slowing in the medium-term amid long-standing headwinds. In the baseline, real estate investment is projected to contract further in 2024 amid continuing financial stress among property developers, though macro-financial spillovers are expected to remain contained.

- In 2024, growth in private consumption is projected to remain strong as the household savings rate is expected to continue normalizing towards pre-pandemic levels. Public investment is projected to remain strong, contributing significantly to growth, while private investment is expected to remain weak amid continued drag from real estate investment. Net exports are expected to result in a small positive contribution to growth in 2024, reversing the modest drag in 2023.

Text Table 1. China: Selected Economic Indicators

	2024	2025	2026	2027	2028	2029
Real GDP Growth (%)	5.0	4.5	4.1	3.6	3.4	3.3
Output Gap (%)	-1.2	-0.5	0.0	0.0	0.0	0.0
Inflation (% average)	0.7	1.9	2.0	2.0	2.0	2.0
Core Inflation (% average)	0.9	1.5	1.8	2.0	2.0	2.0
Current Account (% of GDP)	1.5	1.5	1.4	1.4	1.3	1.2
Augmented Debt (% of GDP) 1/	124.0	128.9	133.7	138.7	143.6	148.2

Sources: Authorities; Haver Analytics; CEIC Data Company Limited; and IMF staff estimates and projections.

1/ Augmented Debt includes debt of LGFVs and other off-budget government funds.

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[4] According to the IEA, China accounts for roughly 60 percent of global rare earth mining production, whereas its share of refining for rare earth elements is nearly 90 percent.

- In 2025, real GDP growth is projected to slow to 4.5 percent despite an assumed stabilization in residential investment at a lower level, reflecting weaker growth in private consumption following two years of a reopening rebound, lower contribution from net exports, and a small drag from fiscal policy.

- Economic slack will still be present. Overall, the negative output gap is closing gradually and is projected at -1.2 percent in 2024 and -0.5 percent in 2025.

- Headline inflation is projected at 0.7 percent on average for 2024, with somewhat less drag from food prices than in 2023, and a moderate increase in energy prices. Core inflation is projected to remain subdued due to continued slack, rising gradually to 0.9 percent in 2024 and to 1.5 percent in 2025.

- The current account surplus is projected to remain broadly stable at around 1.5 percent of GDP in 2024-25, as a recovery in export volumes and terms-of-trade is expected to be offset by a gradual increase of outbound travel to pre-pandemic levels.

- Over the medium term, growth is expected to gradually decelerate to 3.3 percent in 2029 due to downward pressures from the declining labor force and slower productivity growth. The current account surplus is projected to narrow further over the medium term, largely reflecting rising social spending pressures as the population ages. Additionally, the exports-to-GDP ratio is expected to decline in the baseline.

17. Risks to growth and inflation are tilted to the downside.

- **Downside domestic risks to growth and inflation.** The property market correction remains a significant risk to the outlook. The decline in residential investment could be longer- or larger-than expected, given uncertainty about the extent of inventory overhang or the underlying value of the housing stock. Prolonged weakness in the property sector could also trigger renewed LG financing strains and result in unintended fiscal tightening, while policies that delay the property sector adjustment could add to fiscal costs. Furthermore, weaker-than-expected domestic demand amid high debt levels could result in prolonged downward price pressures and increased risks of adverse macro-financial feedback loops, including through some weak small- and medium-size banks. The need to repair balance sheets could spread beyond the property sector and LGFVs, impacting households and corporates as the real burden of debt increases, thereby reinforcing aggregate demand weakness and downward price pressures. Staff estimates suggest that negative shocks that widen the output gap and lower inflation expectations could substantially increase the probability of future deflation (see Box 1) and that a period of prolonged deflation could reduce the level of GDP by 5.4 percent relative to the baseline over 5 years, with significant international spillovers (see Box 2).

- **Downside external risks:** Deepening geoeconomic fragmentation and the associated decline in external demand and capital flows are the key downside external risks, which could be exacerbated by increased political uncertainty (e.g., from elections in major economies). The impact of deepening geoeconomic fragmentation could be large, especially if accompanied with global asset repricing, triggering an economic slowdown in China and compounding the domestic risks discussed above.

- **Upside risks.** Decisive policy action to facilitate adjustment in the property sector or market-oriented structural reforms would boost consumer and business confidence and lead to a faster-than-expected rebound in private demand and a rise in core inflation, reducing risks of deflation.

Authorities' Views

18. The authorities are optimistic about the near-term growth outlook and were confident that the government's annual growth target of around 5 percent will be achieved. They noted that the recently announced macroeconomic policies will further boost domestic demand. Specifically, the consumer goods trade-in program would support private consumption, and the equipment upgrade program would improve firms' productivity and raise investment. They noted that overall housing demand has stabilized, as lower sales of new houses have been offset by higher sales in the second-hand housing market. Furthermore, the new property sector support measures are expected to restore consumer confidence and stabilize real estate investment. They acknowledged a temporary weakness in aggregate demand, due to the property market contraction but continued strong industrial production. With the anticipated strengthening of domestic demand, the authorities expect the overall price level to gradually rise.

19. The authorities noted that their projection of medium-term growth was higher at about 5-6 percent. They agreed that population aging is a major headwind to medium-term growth but argued that higher quality of human capital, as reflected in increased years of education, would compensate for the declining size of the labor force. They also emphasized scientific and technological innovation, particularly in emerging sectors, which together with deepening structural reforms and strong domestic competition, would continue to boost productivity.

20. The authorities place greater emphasis on external rather than domestic risks to the outlook. They remain concerned about the highly uncertain external environment and risks from the insufficient global economic recovery, tight global financial conditions, and elevated geopolitical risks. They were particularly concerned about the growing fragmentation pressures and the impact on the global economy. Although they agreed domestic factors, including weaker-than-expected domestic demand, could weigh on the outlook, they saw limited downside risks amid a continued recovery and supportive macroeconomic policies and the property sector measures. The authorities viewed the risk of deflation in China as low.

21. The authorities agreed with staff's external sector assessment. They viewed China's external position as broadly in line with fundamentals and saw no need for a significant adjustment in the CA surplus or the exchange rate level. They expect the current account to remain broadly stable as the continued recovery of exports, including of high value added sectors such as telecommunication and information technology, matches the recovery of imports. They viewed monetary policy tightening in developed economies as a major factor behind recent capital flow dynamics in China. They expect capital flows to normalize as the external environment improves and China's economy recovers.

SUPPORTING DOMESTIC DEMAND AMID THE PROPERTY MARKET ADJUSTMENT

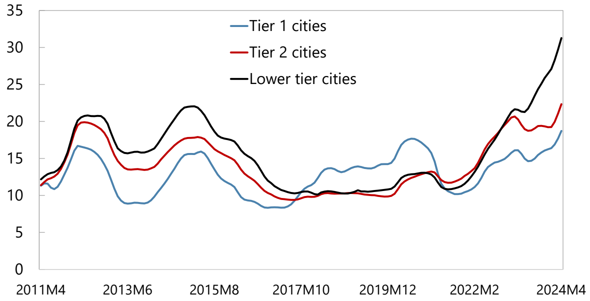
The ongoing property market adjustment, while needed, remains an important risk to the economic outlook. A two-pronged policy approach is needed to facilitate a more efficient and less costly transition for the property sector while mitigating the risk of a deeper-than-needed adjustment. First, accelerating the resolution of insolvent developers and deploying CG resources to tackle the still large stock of unfinished, presold housing would restore homebuyer confidence. Other steps to reduce the housing inventory overhang, such as greater price flexibility and the expansion of social housing, would also help. Second, macroeconomic policies should support domestic demand while the economy remains below potential, which will also mitigate the adverse feedback loop between property sector adjustment, economic activity, and debt overhang among developers and LGs, thereby mitigating risks of deflation and unintended LG fiscal tightening.

A. Policies to Facilitate the Adjustment in the Property Sector

22. The housing market correction, now in its fourth year, is necessary and should continue. The property sector experienced a significant expansion in the 2010s and was a key contributor to GDP growth. However, the rapid growth of the sector, which was accompanied by a buildup of leverage among property developers, was unsustainable. A significant correction in the housing market began in 2021, with real estate investment and sales declining sharply and some large and heavily indebted developers facing insolvency. This correction is vital for guiding the sector onto a leaner and more sustainable trajectory, with estimates indicating that fundamental demand for housing will decline by 35 to 55 percent over the next 10 years compared to the 2012-2021 average (see 2023 SIP).

Inventory of Completed Houses

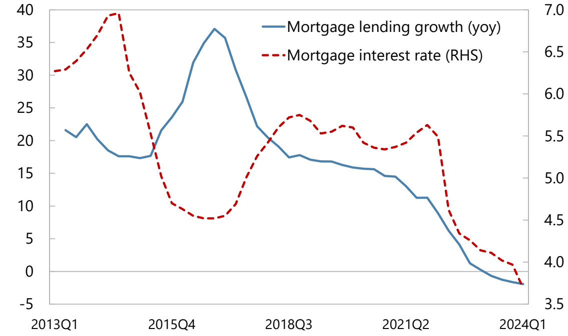
(Number of months of sales)



Sources: CRIC; and IMF staff calculations.
Note: The inventory is calculated as the ratio of total gross floor space for sale to monthly sales.

Mortgage Market

(In percent)



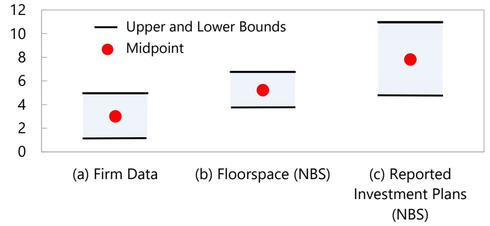
Sources: CEIC Data Company Limited; and IMF staff calculations.

23. The authorities have stepped up efforts to steer the property market transition, aiming to support homebuyer demand and developer finances. They have expanded the scope of the affordable housing and urban redevelopment programs, including by providing RMB 500 billion of funding through the PBC's Pledged Supplementary Lending (PSL), with an aim to potentially absorb part of the inventory overhang and support construction activity. To address financing constraints facing unfinished projects, the authorities have set up a cross-agency coordination mechanism to facilitate bank financing for a "whitelist" of approved projects. As of May 2024, loans worth 935 bn yuan (0.8 percent of GDP) have been approved under this mechanism. Other measures include lifting most home purchase restrictions (HPR), easing prudential requirements for home loans, lowering mortgage rates, and facilitating the refinancing of existing mortgages. In May 2024, the authorities announced a package of policies to intensify efforts to resolve property market distress. These include expanding an existing PBC facility to RMB 300 billion to support local SOEs acquiring completed housing and converting them to affordable housing, permitting local governments to reacquire land from developers, abolishing a nation-wide policy floor for mortgage interest rates, and reducing the minimum downpayment ratio for mortgage loans. Forbearance measures for distressed property developers have been extended until end-2024 and guidance to limit price adjustments continues.

24. Despite policy efforts, high uncertainty persists around the outlook for the sector, with certain government policies possibly delaying the transition and increasing future costs. Some government policies can play an important role in the sector's transition. Buying existing inventories at appropriate prices for affordable housing schemes can help reduce the inventory overhang. The 'whitelist', with safeguards to ensure robust project viability evaluation, can partially tackle the

Ranges of Estimates of Gross Completion Costs for Troubled Pre-Sold Housing Projects

(In percent of GDP, assumes no funding from additional home sales or restructuring-related recoveries)



Sources: Capital IQ; CEIC Data Company Limited; WIND; China National Bureau of Statistics; and IMF staff calculations.
Note: See Box 1 of 2022 China Article IV Staff Report for details on the methodology.

pre-sold unfinished housing stock. However, a clear strategy to address the large stock of pre-sold housing in commercially unviable projects by distressed developers is still lacking. Furthermore, measures to boost homebuyer's demand are likely to be ineffective amid low homebuyer confidence and limited price adjustment, which causes uncertainty about future prices and has discouraged households from purchasing property. In addition, forbearance has allowed non-viable developers to remain in the market, slowing progress to complete the substantial inventory of pre-sold housing, and thus further eroding homebuyers' trust in developers' ability to deliver new homes. Consequently, weakened housing demand and concerns over credit losses that have increased banks' reluctance to lend are causing cash flow challenges for developers, affecting even robust, state-supported developers, and deepening distress.

25. A comprehensive policy package, supplemented by one-off CG fiscal resources, could facilitate a more efficient and less costly transition while protecting against downside risks. A well-articulated and communicated policy package would include the following measures:

- *Utilizing CG fiscal resources to protect homebuyers of pre-sold unfinished houses*. Concerns of significant losses to homebuyers of unfinished pre-sold housing are a key constraint holding back the resolution of insolvent developers. To mitigate homebuyer losses and enable the resolution of nonviable developers, fiscal resources should be deployed. For **commercially unviable**[5] projects of developers involved in insolvency procedures, CG resources could be used to complete and deliver the pre-sold unfinished projects or offer compensation to homebuyers, whichever is less costly. The CG may also consider converting some unviable projects into social housing and integrate it into the affordable housing project. If completion of **commercially viable** projects is hindered by insufficient financing due to pervasive risk aversion, CG resources could offer risk-sharing capital or guarantees, with strict safeguards to ensure eventual repayment. While data gaps make it difficult to precisely estimate potential costs which are subject to considerable uncertainty, staff calculations suggest that implementing such a scheme could entail fiscal costs of around 5½ percent of GDP over 4 years.[6] To mitigate moral hazard and avoid the perception of a bail out of developers, CG support should be provided as a one-time measure, assets should be acquired at a sufficiently low cost, and support should be targeted to homes that are pre-sold before a certain cut-off date and that cannot be completed using market financing.

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[5] Projects that are commercially unviable are those for which completion is not economically justified based on cost-benefit analysis.

[6] The 5½ percent of GDP estimate is based on median estimates of total completion costs of both viable and nonviable projects that require government intervention. Unfinished housing should ideally be completed using market-based financing. Financing facilitated by the "whitelist" could help fund part of these projects which are commercially viable. A nation-wide plan should be developed, including total cost estimates and management procedures for incomplete projects, while coordination between the CG and LGs would be needed to develop implementation strategies reflecting regional heterogeneity. See Box 1 in the 2022 China Staff Report for further details on the estimation methodology.

- *Accelerating the resolution of insolvent developers.* The scheme to resolve unfinished pre-sold projects should be accompanied by timely resolution or liquidation of insolvent developers. This can be achieved in a market-driven manner, utilizing corporate restructuring and insolvency frameworks, and by phasing out of forbearance. This would also expedite the adjustment of the housing market and restore confidence in the ability of surviving developers to deliver housing. Meanwhile, enhancing the crisis management and resolution framework will be crucial to contain negative spillovers (¶45 and 46).

- *Expediting the recovery of housing demand including by allowing for greater price flexibility and improving financial conditions for solvent developers*. Government-backstopped completion guarantees for new housing projects and strict escrow rules can help restore confidence regarding solvent property developers' ability to deliver homes, thus invigorating demand and improving developer finances. These guarantees should be based on conservative underwriting practices and subject to strict governance standards. Greater price flexibility, for example, through the elimination of price guidance in the primary market, while monitoring and mitigating potential macrofinancial spillovers, can further stimulate demand and help restore equilibrium. The three government-led projects—affordable housing, urban village renovation, and emergency infrastructure—aiming to bolster real estate investment, affordability, and quality of housing, would also help meet demand for shelter while providing alternative revenue streams for developers. Deeper reforms to developers' pre-sale financing model, which played a significant role in the buildup of vulnerabilities, should be a key medium-term priority.

Authorities' Views

26. The authorities believe that the existing policies are sufficient to generate a positive momentum in the property market. They noted that the three projects are steadily advancing and highlighted that the recently announced policy package has strong support and is subject to high standard and has already strengthened homebuyer confidence. They consider resolving unfinished presold housing and tackling the inventory overhang as the key priorities, and viewed the coordination mechanism for real estate financing (the 'white list') as the key measure for addressing the remaining issues with housing delivery. They emphasized that projects not included in the 'white list' will also be supported by commercial banks in accordance with market principles and the rule of law. These projects may be resolved through the judicial insolvency process, and homebuyers' rights will be adequately protected. The authorities also noted that there is no centralized guidance on price adjustments in the primary market, though local governments may have used administrative measures to limit price adjustments. The authorities expect several key factors to support housing demand in the medium term, including continued urbanization and project demand for housing upgrades.

B. Macro Policies to Support Domestic Demand

27. Fiscal policy in the near-term should focus on providing one-off CG financial support for the real estate sector and avoiding a local government fiscal cliff.

- *Property sector support:* Despite high and rising debt levels, one-off CG financial support for the real estate sector is warranted. While such a targeted package would increase short-term debt levels relative to the baseline, it will mitigate the risk of a larger and more protracted contraction in real estate investment and will help to rebuild confidence and boost consumption, thereby increasing growth and fiscal revenues in the medium term. The recommended CG fiscal support package would entail a mix of above the line spending (to compensate buyers or finish pre-sold housing), as well as below-the-line liquidity support for solvent developers (in the form of risk-sharing capital and guarantees), totaling about 5½ percent of GDP spread over 4 years (given the large number of projects spread across various regions that require time to finish).[7]

Text table 2. China: Fiscal Stance

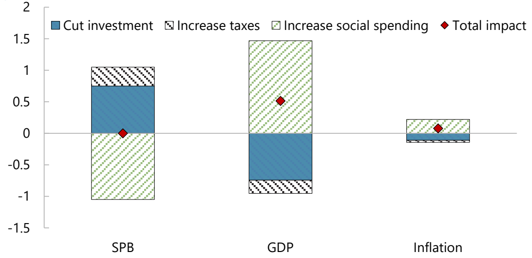
Annual change in the primary balance	2024	2025	2026-29 (average)
Baseline (cyclically adjusted)	-0.2	0.1	0.5
Recommended (cyclically adjusted)	-0.6	-0.2	1.0
Recommended (structural-excluding RE package)	0.0	0.4	0.7
Annual expenditure (above the line)			
RE package	0.6	1.3	0.5

Notes: Values in percent of GDP. Negative changes in the primary balance indicate fiscal expansion and positive values consolidation. In the baseline, the cyclically adjusted and structural balances are identical. In the recommended path, the structural balance excludes the one-off package for the real estate sector. RE=Real estate. The real estate package totals 3.8 percent of GDP in above-the-line expenditure over 4 years.

- *Fiscal policy stance:* The significant recommended property sector support would imply an expansion of the cyclically adjusted primary deficit in 2024 and 2025 (text table). Stripping out the impact of the one-off property sector package, a neutral structural fiscal stance in 2024 would balance the tradeoffs between supporting domestic demand, defusing deflation risks, and containing unfavorable debt dynamics. In addition, maintaining a neutral structural fiscal stance by the general government in 2024 will necessitate CG on-budget expansion to counteract potential LG tightening driven by financing constraints at the local level (including LGFVs), especially in provinces more affected by the real estate

Impacts of Fiscal Recomposition in 2024

(In percent)



Sources: 2023 SIP; 2022 SIP; and IMF staff calculations.
Notes: SPB=structural primary balance. Impact on GDP is based on multipliers of 1 for investment, 0.7 for taxes, and 1.4 for social spending, as estimated in IMF (2022) Selected Issues Paper. The impact on inflation assumes a Phillips Curve coefficient of 0.15.

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[7] The proposed package comprises about 3.8 percent of GDP in above-the-line spending, 1.3 percent of GDP in below-the-line support (which increases CG debt), and 0.6 percent of GDP in guarantees (which do not immediately affect debt).

contraction. The structural deficit should start declining gradually in 2025, with a pace dependent on the strength of the recovery, inflation developments, and property market outlook. Within this fiscal envelope, structural measures could support growth by reorienting expenditure away from less productive investment and towards support for households. Such fiscal re-composition could boost GDP by 0.5 percent and inflation by nearly 0.1 percentage points in the near term for an unchanged structural primary deficit (text chart). Ensuring debt sustainability in the medium term will require sustained general government (GG) fiscal consolidation beyond 2025 as well as restructuring the stock of unsustainable LGFV debt (see ¶39 and ¶41 for details).

28. **Additional monetary easing via interest rates would support domestic demand and inflation.** The monetary policy easing so far in 2024, including the cuts to the RRR and the 5-year LPR, is welcome. Given subdued inflation and economic slack, there is scope to further loosen monetary policy using interest rates, which would help support private investment and consumption, ease debt servicing burdens, and guard against risks of entrenching low inflation expectations. Phasing out deposit and lending rate guidance policies would improve transmission and create more space for monetary easing by mitigating the impact of looser policy on bank profitability.

29. **Greater exchange rate flexibility would help absorb external shocks and lower deflation risks.** The stability of the RMB/USD exchange rate since mid-2023, despite the large interest rate differential, has constrained a key transmission channel of monetary policy. Limiting exchange rate movements for extended periods of time risks rendering the exchange rate the de-facto nominal anchor and limiting the effectiveness of monetary policy. Greater exchange rate flexibility, including by letting the daily fixing move with market expectations, would help counter disinflationary pressures, facilitate adjustments to external shocks, and relieve potential pressure on capital flow measures (CFMs). Capital flow measures (CFMs) should not be used to substitute for warranted macroeconomic adjustment and greater exchange rate flexibility.

30. **In the near-term, financial sector policies should mitigate future risks to financial stability.** To contain asset quality risks, the authorities should remove forbearance and strictly enforce prudential policies, which would incentivize debt restructuring. To ensure that these measures do not unduly impede banks' lending capacity, they should be complemented by regulators preemptively engaging with financial institutions to identify vulnerabilities and prepare for any adverse impact. In equity markets, authorities should phase-out the emergency measures such as direct purchases and other trading restrictions that impede market functioning and efficient price discovery. More broadly, regulatory changes should be carefully sequenced and clearly communicated to improve transparency and policy predictability.

31. **Adopting a comprehensive strategy to strengthen weak banks is critical for maintaining economic and financial stability.** Addressing risks at small and medium banks is a key policy priority given the potential macro-financial spillovers to the local economy, and the

authorities are planning to facilitate further consolidation of rural banks. Banks facing difficulties in meeting prudential requirements should be required to submit credible restoration plans under heightened supervision and corrective actions. Recapitalization efforts should prioritize build-up of common equity and the use of public funds for recapitalization should be a last resort and only come after burden sharing by existing investors. Non-viable banks should be resolved in a timely manner, with stakeholders sharing losses in line with the established hierarchy of claims. Consolidation among viable banks should be accompanied by adequate loss recognition and recapitalization, in conjunction with other needed financial sector reforms (see section below and Box 3).

32. If significant downside risks to growth and inflation materialize, more accommodative macro policies and early financial sector intervention will be essential. Expansionary fiscal policy and more aggressive monetary easing would be warranted to cushion the impact on activity. Fiscal policy should focus on expediting funding for unfinished housing and support for households. To prevent contagion to the financial system and negative macro-financial feedback loops, systemwide liquidity support should be provided, and contingency plans should be implemented, including for handling troubled financial institutions. In such a scenario, greater exchange rate flexibility could boost net exports and counter deflationary pressures. In the event of large capital outflows that pose significant risks to macroeconomic and financial stability, including if markets turn disorderly, temporary foreign exchange intervention or tightening of outflow CFMs could be considered as a part of a broader policy package.

Authorities' Views

33. The authorities view the fiscal stance as proactive in 2024 and the stance in 2025 will be determined in a coordinated manner based on the economic situation. They emphasized the role of the new one trillion ultra-long CG special bond, which will finance strategic projects, including an equipment upgrade program for firms. They expect to continue implementing structural tax and fee reduction policies, with a focus on supporting technological innovation and manufacturing development. Public investment is still seen as a key driver of economic development. Fiscal support for the real estate sector is mainly targeted to affordable housing, and additional spending for completing pre-sold housing is not currently planned. The authorities assess the decline in LG net land sale revenue to have had a minor impact on LG expenditure, given increased CG transfers.

34. The authorities consider the monetary policy stance as broadly appropriate and noted plans for further implementing prudent monetary policy through interest rates and quantity-based tools. They attribute the currently high real interest rates to low inflation and expect these rates to gradually decline as inflation recovers. They plan to continue implementing prudent monetary policy to support economic growth, including by potentially reducing the reserve requirement ratio and interest rates, and by providing liquidity to strategic sectors.

35. The authorities reiterated their commitment to a market-determined exchange rate but emphasized the need to avoid excessive volatility and unidirectional pressures. The authorities stressed that the RMB has fluctuated in both directions in recent years, and market participants are better prepared to cope with exchange rate risks. They, however, argued that excessive fluctuations could lead to one-sided expectations, and saw the need to manage expectations through the use of macro-prudential tools such as a reduction in FX reserve requirement (RR) ratio from 9 to 4 percent as well as the re-introduction of the 20 percent reserve requirement on marginal forward transactions in September 2022. They also stressed that a stable RMB will help other emerging economies and support global financial stability.

36. The authorities viewed near-term risks in the banking sector and financial markets as largely contained. While noting continued headwinds to bank profitability, they considered asset quality risks to be contained, including those from the property sector and inclusive loans. They agreed that a broader strategy to address vulnerability in small and medium banks is essential while emphasizing that the number of high-risk institutions remains low, with concentration in a few regions. Risks in the nonbank financial sectors and financial markets are viewed as contained when being assessed in isolation. The authorities viewed the stock market plunge in early 2024 as mainly driven by investors' irrationality rather than deteriorating fundamental values.

BUILDING RESILIENCE BY UPGRADING POLICY FRAMEWORKS

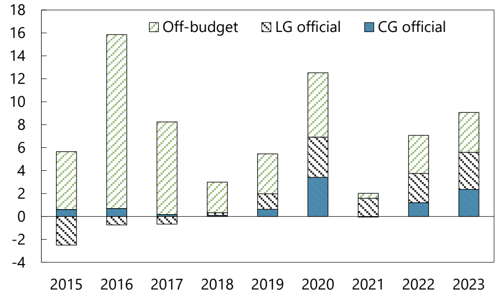
Years of high investment, driven in part by ambitious growth targets, have raised leverage, vulnerabilities, and risks, notably among property developers and LGs. Tackling these issues and preventing further build-up of risks requires a comprehensive policy effort, including reforms to institutional and policy frameworks. Fiscal consolidation to stabilize general government debt is a priority and should be accompanied by measures to reduce vertical fiscal imbalances, restructure unsustainable LGFV debt, improve fiscal monitoring, and establish subnational fiscal rules. Improving the monetary policy framework along with steps to prepare the financial system for potential spillovers from property sector and LGFV debt restructuring will also be essential.

A. Reforms to the Fiscal Framework to Ensure Debt Sustainability

37. China faces daunting fiscal challenges, especially for LGs. Large fiscal deficits since the Global Financial Crisis have led to a significant and rapid buildup of GG debt. LG debt, including both official and off-budget, accounts for most of that build up, owing to large public investment to meet ambitious growth targets, as well as underfunded social spending mandates. Reduced land sale revenues have further exacerbated pre-existing local fiscal gaps. Since the pandemic, however, the CG has stepped in and raised more financing to increase on-budget transfers to LGs.

Change in General Government Debt

(Percentage points of GDP)

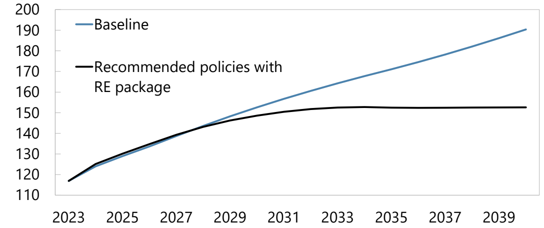


Source: IMF staff calculations.

Note: The estimate of off-budget debt in 2023 is based on preliminary data and subject to revision.

Government Debt Projections

(In percent of GDP)



Source: IMF Staff calculations.

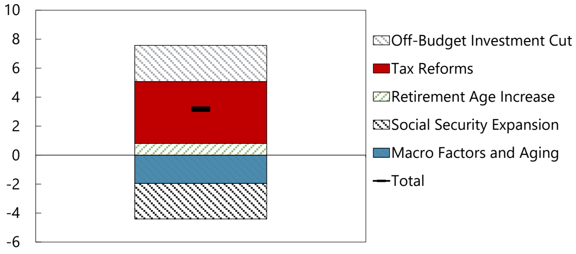
Notes: The projection under recommended policies includes the one-off financing package for the real estate sector (implemented over 2024-2027) and a structural primary balance consolidation of 0.7 percent of GDP per year over 2025-2035. Both projections include the effect of aging on pension spending. The projection under recommended policies does not include additional LGFV debt restructuring relative to the baseline.

38. The authorities' recent measures have reduced short-term LG financing pressures, but a comprehensive policy strategy is needed to ensure GG debt sustainability. LGs have been allowed to issue debt (within their debt quota) to refinance LGFV debt and clear arrears with corporates, whereas banks have also been encouraged to restructure troubled LGFV debt. Tighter controls of future LGFV borrowing and LG finances, including LG public-private partnerships, are also being enforced. The CG has imposed temporary restrictions on public investment by highly indebted provinces and established a National Financial Operation Monitoring Center to internally monitor official LG finances. While these measures have eased immediate LG financing pressures, LGFV debt remains unsustainable.

39. Significant fiscal consolidation, based on a reduction of off-budget investment and wide-ranging tax and social security reforms, will be needed to stabilize general government debt. In the baseline, the GG debt-to-GDP ratio is projected to continue increasing rapidly in the medium-term, as growing pension spending offsets reductions in off-budget investment. While China still has some fiscal space and can finance GG debt at favorable rates due to ample domestic savings, sovereign risk is assessed to be high over the medium and long term (Appendix III), as further increases in government debt ratios will be progressively more difficult to manage. This underscores the need for fiscal policy to stabilize GG debt in about 10 years, which would require an average annual reduction in the (augmented) GG cyclically adjusted primary balance of about 0.7 percentage points from 2025 to 2035. Even so, the (augmented) GG debt would stabilize only at about 150-155 percent of GDP (chart panel 2 and Appendix III). Fiscal consolidation should be based on reductions of off-budget investment, wide-ranging tax reforms (IMF 2024a), and a gradual increase in the retirement age (text table).

Change in Cyclically-adjusted Primary Balance, 2024-29

(Percentage points of potential GDP)



Sources: 2023 SIP; 2021 SIP; and IMF staff calculations.

Notes: An increase in the cyclically-adjusted primary balance reflects fiscal tightening. The impact of measures is approximate and based on international comparisons.

Text Table 3. China: Recommended Fiscal Policy

Category	Measure Details
	Expenditures
Public Investment	reduce off-budget investment
Pensions	increase Resident Pension Plan replacement rate, expand voluntary pensions saving program, set retirement age at 65 gradually
Medical Insurance	increase expense coverage, establish voluntary supplementary insurance plan
Unemployment Insurance	improve adequacy and coverage
Social Assistance	increase adequacy of Dibao program, introduce national child assistance
Other	abolish Hukou registration system, advance unification of social security system
	Tax Revenues
Personal Income Tax	lower PIT thresholds, increase PIT rates
Social Security Contributions	reduce social security contributions
Capital Income Tax	raise tax rate to 25%, reduce mortgage deductibility
Wealth Taxation	introduce nationwide property tax
Corporate Tax	streamline incentive regime, introduce minimum tax in line with Pillar 2, introduce excess profit tax
VAT	reduce number of rates and phase out exemptions and temporary measures
Excise Taxes	increase specific rates on tobacco, alcohol, and fuel
Carbon Pricing	expand ETS pricing

Note: See IMF (2021) Selected Issues Paper for more detail on expenditure measures and IMF (2023) Selected Issues Paper for revenue measures.

40. Sustained consolidation will require framework reforms to strengthen fiscal discipline and transparency, while ensuring continued provision of local services.

- *Implementing public financial management reforms:* The focus should be on increasing transparency around off-budget debt (including with a national audit and adopting international reporting principles), strengthening CG monitoring of LG debt, and phasing out provinces' growth targets, which encourage excessive debt-financed investment.

- *Reducing vertical imbalances:* The CG should reduce the share of expenditure under joint CG-LG responsibility and increase the share of revenue allocated to LGs to be commensurate with LG expenditure mandates, thus reducing existing vertical fiscal imbalances. Transfers to LGs could automatically respond to local economic conditions, further attenuating the need for LGs to resort to off-budget financing (IMF 2021).

- *Establishing and monitoring subnational fiscal rules:* Limiting the flow of new debt will require strict controls over LG spending and borrowing (including through LGFVs) going forward. Various mechanisms have been used internationally to enforce local fiscal discipline, ranging from market mechanisms to strict bans on LG borrowing. China's current system of discretionary debt quotas for LGs and insufficient monitoring of off-budget borrowing has not prevented a rapid rise in debt. This system could be replaced with fiscal rules that establish LG borrowing or debt service caps as a transparent function of fiscal sustainability indicators. Effective enforcement mechanisms, managed by the CG, would be needed to incentivize compliance and enhance the credibility of the rules (see Box 4).

41. **Restructuring the stock of unsustainable LGFV debt through greater use of insolvency frameworks is needed to improve LG balance sheets, reduce fiscal strains, and avoid risks of even larger costs down the line.** Reductions in debt via insolvency appear to be the most effective way to repair balance sheets. The use of insolvency frameworks would allow for burden sharing with the private sector and facilitate LGFV asset sales. This would increase fiscal space at the (augmented) general government level to absorb aging-related costs and implement much-needed upgrades for social safety nets. Requiring investors to absorb related losses and add new capital would also reduce moral hazard, supporting efforts to control the flow of debt in the future. By contrast, large-scale refinancing of LGFVs by LGs is likely to endanger the sustainability of official LG debt in some regions and could lead to unintended fiscal tightening, with only temporary benefits for financial stability. The extent of burden sharing by the CG could be made conditional on LGs implementing the fiscal framework reforms discussed above and adhering to fiscal consolidation plans. To avoid unintended fiscal tightening and guard against financial stability risks, LGFV insolvencies would have to be accompanied by urgent upgrades to the financial safety net and crisis management frameworks (see ¶45), as well as deployment of insolvency tools suited for timely LGFV restructuring (e.g., hybrid restructuring and out-of-court workouts, see ¶46). Deepening markets for distressed assets could also facilitate market-based restructuring of LGFVs.

Authorities' Views

42. **The authorities emphasized that their measures to contain debt risks in 2023 have successfully eased LGFV financing costs, reduced LG arrears, and supported the transformation of LGFVs.** The authorities' debt reduction plan focuses on gradually eliminating the stock of hidden debt and strictly preventing new flows, while accepting a moderate increase in official debt. They will classify the debt that LGFVs have raised illegally for LGs as LG hidden debt, and allow LGs to refinance a fraction of that debt with LG official bonds, within the LG debt quota. LGFV operating debt will instead be dealt with in consultation with financial institutions, in accordance with market-oriented and rule-of-law principles. However, the authorities reiterated that the Debt Sustainability Assessment should only cover official debt. Regarding the possibility of introducing subnational fiscal rules, they noted that LG debt quotas already take into account LG fiscal sustainability indicators and investment needs. They expect that gradual delays in the retirement age will be implemented in a stable and orderly manner, and respect existing differences across population groups.

B. Building a Resilient Financial System to Deal with Legacy Problems

43. Financial stability risks remain elevated, and at around the same level as at the time of the 2023 Consultation, amid significant debt overhang. Continued stress in the property sector and the potential need for significant house price adjustments remain key credit risks. Refinancing support from the fiscal authorities and financial institutions has helped alleviate LGFV's short-term refinancing risks, but their debt stock is large, and their lack of debt-servicing capacity remains unaddressed. In addition, corporate incomes and debt servicing capacity, especially for smaller firms, may suffer if deflation risks materialize. These factors point to high credit risks to the financial system in the future, at a time when profitability pressures limit financial institutions' ability to build buffers. Vulnerabilities are most acute among small and rural banks, especially in fiscally weaker regions. Pockets of vulnerabilities also exist among non-banks, most notably institutions with large exposures to the property and LGFV sectors. Interconnectedness between banks and non-banks raises risks of transmission of shocks across sectors.

44. The authorities have implemented significant changes to the financial regulatory and supervisory architecture to support their elevated focus on risk mitigation. The emphasis on tackling vulnerabilities around the property sector, local government debt, and smaller financial institutions is welcome. The consolidation of supervisory responsibilities and the continued upgrades to financial regulations will enhance financial oversight and financial stability in the medium term. To ensure the efficacy of the new regulatory architecture, centralized decision-making should be backed by rigorous technical analysis and adequate human resources, with prudential policies strengthened and strictly enforced.

45. However, the crisis management and bank resolution frameworks remain significantly underdeveloped. Key reforms and further upgrades are urgently needed to smoothly absorb the potential costs of dealing with legacy problems like LGFV and property developer exposures, to ensure efficacy of the new financial regulatory and supervisory architecture, and to enhance financial stability in the medium term. These include:[8]

- *Upgrading the crisis management framework:* The priority is to upgrade the authorities' crisis preparedness and response capacity, backed by the enhancement and adoption of the Financial Stability Law, a significant strengthening of the financial safety net, and work on recovery and resolution planning.

- *Strengthening the bank resolution framework:* This will require a clearly identified bank resolution authority with strong operational autonomy, standardized procedures, and adequate resources

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[8] The ongoing Financial Sector Assessment Program (FSAP), expected to be completed later this year, will explore these reform priorities in more detail. For progress with respect to recommendations from the 2017 FSAP, see Annex V.

and operational capabilities. The resolution framework should have clear objectives, well-specified resolution triggers and strong safeguards for the use of public funding.

- *Upgrading systemic risk oversight.* The key priority is to enhance surveillance in and across banks, non-bank financial intermediaries, and financial markets, by addressing data gaps, upgrading the risk monitoring toolkit, and strengthening inter-agency coordination.

46. The authorities have strengthened the insolvency regime in recent years, but additional improvements will be needed to ensure timely recovery for creditors while ensuring fair and orderly resolutions. The specialized judicial and administrative architecture for corporate bankruptcy has improved remarkably in the last decade, facilitating a rapid increase in informal restructuring and liquidations, albeit largely for private firms (and since the property downturn, largely for non-property private firms). Improved frameworks are needed to tackle increased debt repayment difficulties among smaller firms and household entrepreneurs. Key priorities in this area should include:

- Modernization of the Enterprise Bankruptcy Law, in particular to improve the effectiveness of reorganization and better facilitate hybrid restructuring techniques, which can help speed up insolvency proceedings and lead to higher recoveries for creditors. In addition, a special insolvency process for small businesses should be established.

- Introduction of a nationwide legal framework for personal insolvency, with features designed for individual entrepreneurs, to help facilitate the orderly resolution of financial stress of insolvent individuals.

47. China should continue strengthening the effectiveness of the Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT) framework. The focus on risk-based supervision of the banking sector should continue, and the authorities should step up efforts to ensure that AML/CFT supervisors are adequately involved in fit and proper decision-making to prevent criminals from owning and controlling financial institutions. Given the prominence of digital payment platforms in China, the authorities should continue efforts to ensure robust supervision of the sector and conduct inspections to verify the effective remediation of recently identified AML/CFT systems and control deficiencies. While some progress has been made to update the legal framework for beneficial ownership, concrete steps are needed to fully operationalize an effective beneficial ownership system, so that competent authorities and institutions have timely access to the needed information. Continued efforts are required to establish general legal requirements to implement targeted financial sanctions (TFS) and to prohibit legal persons and entities from making funds available to designated entities, and the amendments to the AML law should be promptly finalized. Efforts to prevent and detect illegal cross-border payment and remittance activities should continue, and while the use of crypto assets is prohibited in China, ongoing efforts to monitor and investigate its illicit cross-border use is required.

Authorities' Views

48. The authorities considered financial stability risks to have declined since the last Consultation due to reduced risks after the recent property market measures and improved local government finances. They considered the recently announced property market measures to be effective in providing strong support for the housing market and boosting homebuyer confidence. As such, they deemed the risk to the financial system from the property sector to be manageable, and the prospects of further house price declines as limited. The authorities also argued that the refinancing of high-risk LGFV debt has mitigated the credit risk arising from LGFVs as illustrated by a decline in their funding costs. Risks at the small and medium banks have reduced given the improvement in the property and LGFV sectors.

49. The authorities broadly agreed with staff about the need to contain systemic financial risk and improve the crisis management and bank resolution frameworks. They emphasized that risk prevention and control are the key priorities as highlighted in the CFWC. They noted that the introduction of the Financial Stability Law will help strengthen the legal framework and institutional arrangements to prevent and resolve systemic financial risks, including strengthening coordination mechanisms among relevant agencies and improving the market-oriented and legal resolution mechanism. Tackling illegal financial activities and emerging risks from new technology will also be a priority.

C. Improving the Monetary Policy Framework

50. The PBC has made some progress in improving the monetary policy framework. The authorities have stepped up liquidity management operations in recent years to address volatility in core interbank funding rates. Most notably, the PBC has signaled its support for allowing aggregate credit growth to slow as demand from the property and LGFV sectors wanes relative to past years.

51. However, the authorities have been employing multiple tools aimed at achieving various, sometime inconsistent, policy objectives. The PBC pursues multiple objectives including price stability, exchange rate stability, financial stability, strong growth, and industry support. Furthermore, it continues to use a combination of interest-rate and quantity-based tools to conduct monetary policy. In this context, setting and communicating the monetary policy stance can be challenging, with the interest rate and quantity-based instruments potentially being inconsistent with each other, and at times pulling in opposite directions. For example, during the current easing cycle, banks' pursuit of credit growth targets appears to have led to deposit competition at banks, resulting in an asymmetric impact of policy rate cuts on deposit and lending rates. This has further narrowed banks' net interest margins, thereby weakening lending ability and weakening financial stability.

52. Framework reforms can increase monetary policy space, improve transmission, and allow for more effective countercyclical monetary policy. The PBC should predominantly use interest rate-based tools, gradually phasing out the use of quantity and sector-specific policies. Such a framework would facilitate clear communication of the monetary policy stance. Furthermore, it would improve the efficacy of monetary policy and its ability to manage the business cycle as interest rate-based tools have stronger transmission to investment and consumption, and they avoid the pitfalls of credit misallocation that is associated with quantity-based tools (see 2022 SIP). Additionally, phasing out deposit and lending rate guidance, removing credit growth targets, further lowering the cost of mortgage refinancing, and a more flexible exchange rate regime could further strengthen the effectiveness of monetary transmission. Implementing these changes would not only simplify China's monetary policy framework but also enhance its responsiveness to economic fluctuations.

Authorities' Views

53. The authorities consider monetary policy to be generally effective, with all tools used in a coordinated and effective manner. They highlighted the merit of using both quantity- and price-based tools, enabling monetary policy to adjust flexibly to changes in economic and financial conditions. On interest rate policy, the authorities noted plans to continue to advance market-based reforms, improve the transmission of market-based interest rates, and refine the loan market quoted interest rates (LPR) mechanism. On structural credit policies, institutions are guided to meet the financing needs of the real economy, with incentive mechanisms guiding commercial banks to carry out market-oriented decisions and assume risks when issuing loans.

REIGNITING GROWTH, ENSURING SUSTAINABILITY

Structural reforms should address headwinds to growth from slowing productivity and demographic changes, and reduce underlying imbalances. A key priority is to reduce high household savings and rebalance the economy towards consumption by strengthening the social safety net. Scaling back distortive supply-side policies, including industrial policy measures to support specific manufacturing sectors, would also support rebalancing and more efficient resource allocation, while mitigating the risk of generating overcapacity amid weak domestic demand, including resulting from the property sector correction. This, together with other important reforms, would also support the transition to green and sustainable growth in line with China's climate commitments.

A. Boosting Medium-Term Growth and Rebalancing the Sources of Growth

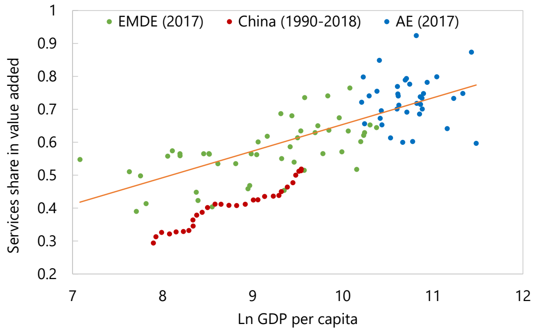
54. After decades of overperformance, growth in China is expected to slow significantly. Since the 1990s, exceptionally high investment enabled the growth of the manufacturing sector, with rising output in part absorbed by external demand as China opened up to international trade. High investment in infrastructure and residential real estate supported growth in the 2010s. However, the projected decline in fundamental demand for new housing (IMF, 2023) and declining productivity of infrastructure investment limit the role of these sectors in sustaining growth going forward. Moreover, as China has become the second largest economy in the world, it will be harder for the manufacturing sector to rely primarily on external demand, particularly in an environment of intensifying fragmentation pressures.

55. The authorities aim to counter headwinds to growth by promoting "new productive forces." The 2024 GWR appropriately highlights the need to raise productivity growth, including through pro-market reforms and improvements to the business environment. However, the focus remains on supply-side policies, notably industrial policies to support manufacturing broadly and emerging sectors such as electric vehicles (EVs), green technologies, and semiconductors. While these sectors can support growth, they are unlikely to replace the drag from the property sector (see Box 5). A more balanced policy approach, which moves away from excessive investment and puts greater focus on consumption, is needed. Undertaking comprehensive pro-market structural reforms to boost falling productivity growth and mitigate the drag from a declining labor force would promote sustainable growth.

A Services-Led Growth Model

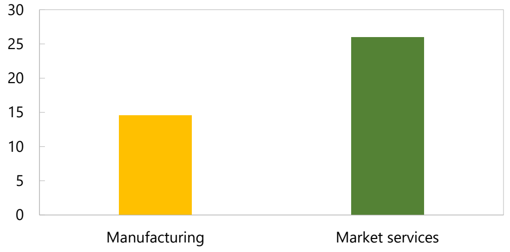
56. The service sector is an underexploited growth driver. While the share of services in China's value-added has increased significantly in recent years, at about 50 percent it is well below the advanced economy average of about 75 percent, suggesting significant scope for expansion. Firm level data indicates that allocative efficiency is, on average, lower in the service sector and has deteriorated in recent years, highlighting the scope for significant productivity gains if pro-market reforms are implemented. Furthermore, as many market-based service subsectors have productivity levels and growth rates that are comparable to manufacturing subsectors, the reallocation of resources to services has contributed positively to aggregate productivity over the last 20 years, and can continue doing so in the future.

Service Sector Share



Source: IMF staff calculations.
Note: EMDE=emerging market and developing economy; AE=advanced economy.

Allocative Efficiency Gap: China Relative to Major AEs, 2019
(In percent)



Sources: Orbis; OECD TiVA; and IMF staff calculations.
Notes: The "allocative efficiency gap" describes the percentage TFP loss in a given sector due to China's low allocative efficiency compared with major AEs (DEU, FRA, JPN, ITA, USA). Computed based on Hsieh and Klenow (2009) and Bills and others (2021).

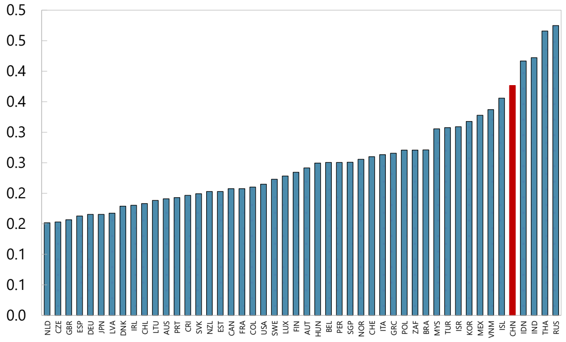
57. Reforms that promote a rebalancing of demand towards consumption and the opening-up of the service sector can promote sustainable growth and create jobs. Given its high labor intensity, expansion of the service sector can help reduce unemployment, especially youth unemployment as young workers are disproportionately employed in some service subsectors such as IT and education. Furthermore, as the service sector is less emissions-intensive, expanding services would also help China reach its climate goals. Key reform priorities include:

- *Rebalancing the economy and strengthening demand for services:* With economic development, the service sector will continue to grow. However, improving social safety nets and a more progressive tax system would reduce the need for precautionary savings, thereby strengthening domestic demand, including for services. Additional increases in the coverage and generosity of unemployment and medical benefits would further boost consumption. In this context, the increase in old age benefits by 19 percent for rural and non-working urban residents introduced this year is a welcome step, though only represents an increase in transfers of about 0.02 percent of GDP. Accelerating Hukou reforms, as indicated in the 2024 Government Work Report, and unification of the social security system, would additionally help raise consumption among lower-income groups.

- *Improving service sector productivity:* Services trade in China remains constrained compared to OECD countries, with many sectors facing restrictions on domestic and foreign entry and significant regulatory hurdles. Reforms that lighten regulatory requirements, further reduce local protectionism, and allow greater firm entry and competition in the services sector, including reduced trade and foreign entry restrictions, can boost productivity and support growth.

Service Trade Restrictiveness Index, 2022

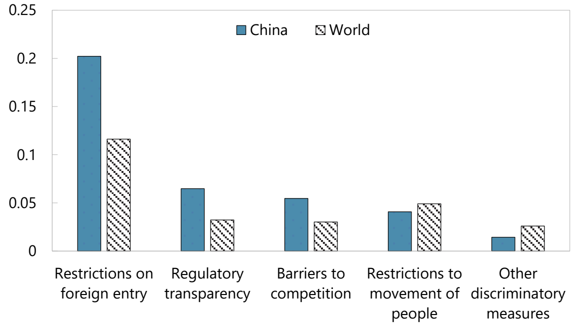
(Simple average across 22 service sectors)



Sources: OECD; and IMF staff calculations.

Service Sector Trade Restrictiveness Index, 2022

(Simple average across 22 service sectors)



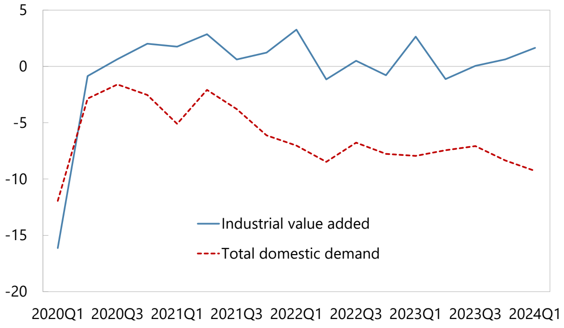
Sources: OECD; and IMF staff calculations.

Scaling Back Industrial Policies

58. Excessive use of industrial policies comes with significant economic costs and risks. China has a long history of state intervention and provides wide-ranging support to "priority" sectors, including policies such as preferential access to credit, direct subsidies, research funding, collaboration with state entities, innovation tax breaks, and incentives for strategic manufacturing, science and technology firms. Extensive use of such policies can have several undesirable side effects, notably resource misallocation, less productive investment, and increased asset quality risks in the financial sector given the reliance on debt. Recently, these policies, including via strong directed credit growth to manufacturing, have contributed to steady growth in China's industrial production and reduced capacity utilization amid weak domestic demand and the property sector correction. Externally, the combination of continued distortive supply-side support and limited policy efforts to boost domestic demand raises concerns in trading partners about international spillovers from potential overcapacity and excessive reliance on exports to drive growth (see section below).

Deviation From Prepandemic Trend

(Percent deviation from 2017-2019 linear trend)



Source: IMF staff calculations.

59. Scaling back industrial policies, combined with other complementary reforms, would benefit China through more efficient resource allocation. Industrial policies should be used only in the presence of well-defined market failures, and to be effective should be well-targeted, time-bound, cost-effective, and transparent.[9] Policies to rebalance the economy towards consumption and services can reduce potential demand-supply mismatch in manufacturing. Furthermore, fostering greater firm entry and exit by strengthening insolvency frameworks would not only improve business dynamism (Cerdeiro and Ruane, 2022, Armour and Cumming, 2008), but can also facilitate the market-based resolution of unviable firms and help curb overcapacity in some sectors.[10]

Other Reform Priorities

60. Other structural reforms can also help boost productivity growth and mitigate the negative economic effects from aging. Key priorities include:

- *Implementing SOE reforms:* Empirical estimates suggest that private firms are about 3-4 percent more productive than SOEs (see SIP, IMF, 2020). Eliminating SOE cost advantages and

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[9] IMF (2024) Industrial Policy Coverage in IMF Surveillance – Broad Considerations..

[10] China has years of experience with curbing overcapacity through an administrative approach, including in sectors such as steel, cement, and chemicals.

preferential access to credit, and improving transparency and SOE governance, would foster competitive neutrality between SOEs and privately-owned enterprises, and help close the productivity gap between them.

- *Improving regulatory certainty:* Elevated policy uncertainty and regulatory crackdowns have impinged upon private investment, including FDI (see SIP). Providing greater regulatory certainty can help improve business confidence and the investment climate.

- *Promoting R&D and innovation:* There is significant scope to enhance the effectiveness of the innovation policy toolkit (see Box 6). Model based analysis and international experience suggests scope for scaling back the degree of sectoral targeting of innovation policies, and relying more on direct tools (e.g., public spending on fundamental research, R&D tax credits) rather than indirect tools (e.g., credit allocations, subsidizing production or demand).

- *Seizing the opportunities from Artificial Intelligence (AI):* China is at the forefront of emerging economies in terms of AI preparedness, with well-developed digital infrastructure providing a head start. Establishing a robust AI regulatory framework, strengthening economic ties with other innovative countries, and upgrading the social protection system to cushion labor displacement (IMF 2024b) can help China exploit the opportunities from AI while mitigating risks.

- *Implementing pension reforms:* Gradually increasing the retirement age to 65 for both men and women (from 60 and 50-55, respectively) would help slow the decline in the labor force (IMF, 2021) and could support rebalancing towards consumption via lower savings rates.

- *Strengthening labor market policies*: Policies should increase the responsiveness of the education system to skills demand and boost human capital. Job search-and-matching assistance, retraining programs, and expanded employment services, including for recent graduates, could help tackle weakness in the labor market, especially for the youth. Accelerating Hukou reform would allow greater labor mobility and increase labor market flexibility.

Authorities' Views

61. The authorities highlighted the growing share of the service sector in the economy and the significant increase in the contribution of consumption to GDP growth in 2023. They concurred that consumption and services would continue to contribute positively to future economic growth. They emphasized the equipment upgrade and consumer goods trade-in program as measures that will effectively boost consumption of electronic equipment, new electric vehicles, and household appliances. They noted that many barriers to entry in the service sector have been lifted and that private owned companies dominate in many service subsectors. They reported rapid increase in service sector trade over the past decade, indicating substantial progress in opening the service sector to global competition.

62. The authorities emphasized their commitment to boosting productivity, with a focus on priority and future-oriented sectors. They emphasized plans to support six future-oriented sectors as a way of elevating China's innovation capacity (manufacturing, information, materials, energy, space, and health). They reported active implementation of the Anti-Monopoly Law and introduction of the Regulations on Fair Competition Review to assist with enforcement of fair market competition, removing local protectionism and accelerating the construction of a unified national market. They emphasized equal treatment of all enterprises irrespective of ownership. They highlighted ongoing improvements in SOE governance and implementation of climate policies by SOEs. They also stressed their commitment to continue pursuing policies to support upskilling, facilitate reemployment, and improve job search and matching of new graduates.

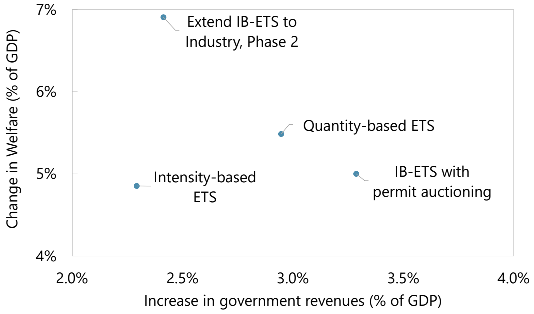
B. Fostering the Transition to a Green and Sustainable Economy

63. China has made welcome progress towards meeting its climate goals, including through concerted policy effort. China is on track to peak carbon emissions before 2030, with renewable energy developments playing a key role in containing emissions growth, and climate targets being developed at all levels of government, including SOEs. China is now the biggest deployer of renewable energy in the world, accounting for over half of all new renewable capacity worldwide (IEA 2023), and has consistently surpassed its renewable capacity targets in recent Five-year plans. Given the success in renewables deployment, the authorities have appropriately moved towards greater focus on electricity consumption targets. However, there are concerns about China's continued construction of new coal power plants, which aim to maintain grid stability, allow better integration of renewables, and also seek to ensure energy security.

64. China's emission trading system (ETS) is a key pillar of its climate policy, and further reforms can help achieve emissions goals more efficiently while limiting adverse distributional effects. China's intensity-based ETS (IB-ETS) is currently the single largest climate policy instrument in the world. However, the current ETS has important limitations that could be addressed through reforms (see SIP).

China's ETS Reform Options: Effect through 2035

How to reach China's NDCs while maximizing welfare and protecting vulnerable households?



Source: IMF staff calculations.

- *Coverage:* China's ETS only applies to the power sector, covering 44 percent of emissions. Plans to extend the IB-ETS to industrial firms, which would extend coverage to 80 percent of emissions, should be implemented as soon as possible. Such reforms would help China reach its climate goals with lower overall cost, and with smaller increases in electricity prices.

- *Raise revenues:* The current intensity-based ETS allocates all ETS allowances for free, when instead it could be used to raise fiscal revenue. Modelling results suggest that partial auctioning of permits could cumulatively raise up to 3.3 percent of GDP in revenues through 2035, which can be used to provide transfers to low-income households, reversing the regressivity of climate mitigation policy.

- *Transition to a quantity-based ETS (QB-ETS):* The current ETS prioritizes efficiency improvements of existing fossil fuel power plants, which can be more expensive than incentivizing the reduction of the overall quantity of emissions. Starting with increasing the share of auctioned permits and tightening benchmarks, China should consider eventually transitioning to a quantity-based ETS over the medium term, which would include a cap on total economy-wide emissions. Such a system would provide incentives to limit both the emissions intensity and the quantity of electricity produced by fossil fuel power plants, thereby maximizing social welfare (see SIP, Goulder and others, 2022).

- *Other energy and power sector reforms:* While ensuring energy security, China should balance new coal plant permitting—which is meant to manage the variability of electricity demand and clean power supply—by increasing retirements of older, less efficient coal power plants. Greater transparency about the costs and benefits of new coal-fired power plants, and how these align with China's climate goals, should also be provided. Further accelerating ongoing power sector reforms, including moving to a unified national power market, more market-based pricing of electricity, greater use of the ultra-high-voltage transmission grid, and expanding energy storage solutions, would all support China's green transition. China should also begin implementation of its plan to control methane emissions, and targets to reduce methane emissions should be set.

Authorities' Views

65. The authorities reported progress with the carbon market and power sector reforms. They noted progress in the functioning of the existing ETS, with an increase in trading volume and the price of carbon. They reiterated plans to extend the existing intensity-based ETS to the industrial sector in the near future. They are exploring the introduction of partial auctioning in accordance with existing regulations and acknowledged the merit of introducing a cap on total carbon emissions. They emphasized that recently built and permitted coal power plants meet the highest efficiency standards, and that old coal power plants are for emergency use only. They argued that new coal power plants are needed to ensure energy security, given the current inability to reliably meet demand through renewables alone, due to the intermittency problem. They argued that ongoing reforms and improvements in the power grid system will allow for better integration of renewables and significantly reduce reliance on coal. They noted positive progress with the construction of the China Certified Emission Reduction Trading System (CCER), a voluntary carbon market to supplement the ETS. National rules for the Administration of Voluntary Greenhouse Gas Emission Reduction Trading (Trial) were issued in October 2023, with methodologies for quantifying net emission reductions from afforestation, mangrove restoration, grid-connected offshore wind power, and grid-connected photo-thermal power. Registration and trading systems started operation in January 2024.

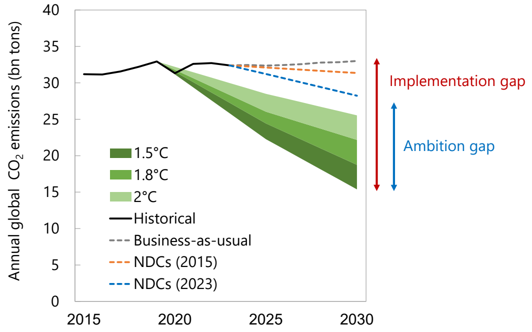
STEPPING UP MULTILATERAL COOPERATION ON TRADE, CLIMATE AND DEBT

China's constructive role and growing leadership in global debt issues and in promoting the green transition are welcome and should continue. Fragmentation pressures are on the rise, fueled by an increase in the use of industrial policies globally, and will likely impose significant economic costs. Greater international cooperation and transparency will be key to managing fragmentation challenges.

A. China's Growing Leadership in Global Climate and Debt Issues

66. Meeting the Paris Agreement objectives will require greater ambition and continued leadership from major global economies, including China. If global emissions are not cut by 25-50 percent below 2019 levels by 2030, this will likely put the goal of limiting global warming to 1.5-2^{0}C beyond reach. Given its role as the largest emitter, the pace of China's emissions reductions is both crucial in setting standards for other large emerging economies as well as pivotal in reaching the global emissions peak. The gap between current mitigation pledges and the emissions reductions needed to limit warming to 1.5-2.0^{0}C can be closed equitably, adhering to the principle of common but differentiated responsibilities, with manageable costs for China and the global economy (Black and others, 2022). China's continued leadership in supplying the renewable energy market and deploying renewable energy technologies worldwide is welcome. While China can help achieve the global climate transition at a lower cost, measures to support green technologies should minimize trade distortions and avoid measures that discriminate against foreign producers.

CO_2 Emissions, Mitigation Ambition and Implementation Gaps to 2030



Sources: Climate Policy Assessment Tool (CPAT); and IMF staff calculations.

67. As a major creditor country, China is playing an important and constructive role in supporting debt restructuring in low-income and vulnerable countries. China's critical support and partnership in recent and ongoing debt restructurings, including its leadership as co-chair of several Official Creditor Committees under the G20 Common Framework is welcome. China is also an active participant at the Global Sovereign Debt Roundtable (GSDR), helping advance the mutual understanding of key stakeholders on issues relating to the sovereign debt restructuring architecture. Continuing progress on the Common Framework and through the GSDR would help ensure effective, predictable, and timely debt resolution processes for vulnerable countries.

Authorities' Views

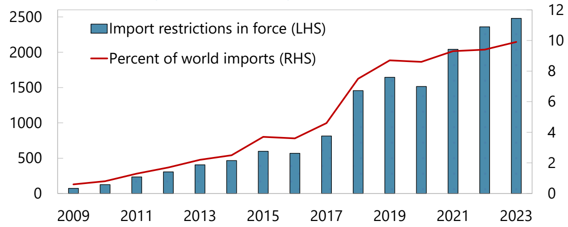
68. **The authorities acknowledged China's important role in the global joint efforts and cooperation to address climate change and in supporting debt restructuring in low-income and vulnerable countries.** The authorities emphasized that the global response to climate change should follow the principle of "common but differentiated responsibilities" and expressed determination to make continued efforts towards achieving their carbon peak goal before 2030. On supporting debt restructuring in low-income and vulnerable countries, they underscored the need for continued collaboration across key stakeholders and noted the importance of fair burden sharing.

B. Containing Geoeconomic Fragmentation Risks

69. **Geoeconomic fragmentation pressures continue to rise globally, with potentially large economic costs.** Discriminatory policy interventions, ranging from domestic industrial subsidies[11] to direct trade restrictions, are becoming more frequent among G20 economies. While some interventions may be justified based on market failures or national security concerns, their proliferation risks triggering retaliatory responses by trading partners, fragmenting supply chains, and reversing the economic gains from globalization and trade seen in the last few decades. Recent data for China, the European Union, and the United States shows that, on average, there is a 73.8 percent probability that instituting a subsidy for a given product by one major economy is met with a subsidy for the same product by another major economy within one year.[12] If fragmentation pressures continue to build, a significant de-risking scenario where countries "friend-shore" or "reshore" production can materialize, which will have significant global costs, with China particularly impacted (see APD REO).

Cumulative Trade Coverage of Import-restrictive Measures on Goods Since 2009

(In billions of USD and percent of world imports)



Source: WTO Secretariat.

Notes: The cumulative trade coverage estimated by the Secretariat is based on information available in the TMDB on import measures recorded since 2009 and considered to have a trade-restrictive effect. The estimates include import measures for which HS codes were available. The figures do not include trade remedy measures. The import values were sourced by the UN Comtrade database.

70. **China's use of industrial policies and state interventions is pervasive and lacks transparency.** China uses various tools to provide support to priority sectors (¶58), and recent high-level policy announcements suggest that these trends are set to continue, including plans to boost self-reliance in science and technology, and upgrade industrial supply chains.[13] Lack of transparency

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[11] Throughout this report, the term subsidies is used as an economic concept (IMF, OECD, World Bank and WTO, 2022), which may differ from legal interpretations based on WTO law and that can be used in the WTO dispute settlement system.

[12] Evenett, Jakubik, Martin, and Ruta (2024)

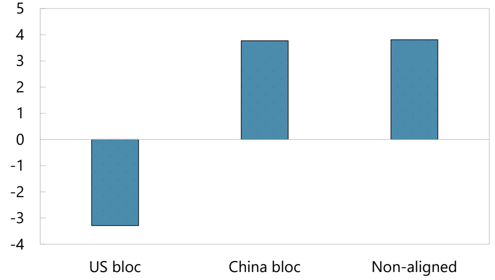
[13] Report on the Work of the Government, March 5, 2024.

of Chinese IP adds additional challenges, making it difficult to assess their size, impact, and effectiveness.[14]

71. Industrial policy actions of China, as well as other major economies, are leading to significant international spillovers, while fragmentation pressures are impacting economic decisions. Empirical evidence suggests that China's IP can have significant effects on trade flows, including through input-output linkages. Exports of sectors that directly receive support from subsidies expand over time, as do exports of downstream sectors, relative to sectors that do not receive such support. Domestic subsidies are also associated with lower imports, including for downstream sectors, suggesting import substitution effects from China's IP (see Box 7). Geoeconomic fragmentation pressures and rising geopolitical risks are also impacting trade and FDI flows in and out of China (see SIP).

Change in China's Export Market Share (2018-23)

(Percentage points)

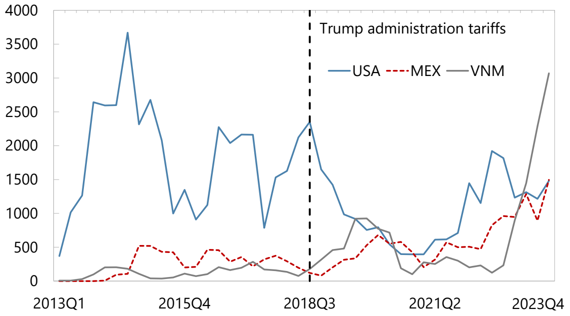


Sources: Direction of Trade Statistics; and IMF staff calculations.

Notes: The US (China) leaning blocs includes 47 (48) countries in the top quartile of their policitcal proximity to US (China). Political proximity is measured by the Ideal Point Distance (IPD), as in Bailey and others (2017).

China's Greenfield FDI in Selected Economies

(4-quarter moving average; in millions of USD)



Sources: fDi markets; and IMF staff calculations.

72. Scaling back China's IP and improving transparency with respect to government support would help potentially diffuse fragmentation pressures, while also containing domestic distortionary effects. IP should be pursued cautiously and only in cases where there are well-defined market failures, and should minimize trade and investment distortions. Extensive use risks generating negative spillovers for trading partners, in addition to domestic resource misallocation. [15] Furthermore, improving transparency around China's state support, including from LGs, is essential to better assess the costs and benefits of the policies and potential international spillovers. Export and technology restrictions on critical minerals risk disrupting key supply chains needed for a green transition.

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[14] DiPippo and others, 2022 point out that unlike other economies, China does not publish detailed budgetary expenditures, estimates of fiscal expenditures by type, and amounts allocated to subsidy programs, including those notified to the World Trade Organization.

[15] IMF (2024) Industrial Policies in IMF Surveillance – Broad Considerations.

73. In the face of these pressures, China should continue its efforts to strengthen the multilateral system, especially the WTO. China has a key leadership role at the WTO and, in this regard, its work to advance plurilateral initiatives, including the successful conclusion of the joint statement initiative on services domestic regulation at MC-13, is welcome. At the same time, China's support for the multilateral trading system could be bolstered by ensuring compliance with WTO notification obligations and demonstrating its commitment to open trade through its own domestic policies. This includes further opening up domestic markets, particularly in the areas of investment and services, and deepening state-owned enterprise reform. China also continues to take steps to increase trade integration, including through its application to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Adopting the high-standard provisions of the CPTPP can facilitate China's economic and trade integration.

Authorities' Views

74. Against the backdrop of a challenging global environment and growing risks of fragmentation, the authorities expressed their support for the WTO and the multilateral trading system. They remain concerned about rising protectionism and its impacts on global trade and stressed their commitment to globalization. They reiterated that export controls on certain critical minerals are in line with the practices of other WTO members and were imposed to safeguard national security, noting also that exports of these items have generally remained stable since the measures were introduced. On industrial policy, they disagreed with the notion that subsidies are contributing to the competitiveness of Chinese industries, and attributed their success to their innovativeness and strong manufacturing synergies. In their view, overcapacity as a concept is not applicable to a global setting that is organized according to comparative advantage and market principles of supply and demand. They see China as having developed a comparative advantage, particularly in the green sector, which will be critical for facilitating the green transition globally. The authorities emphasized the importance of WTO reform, noting that restoring an effective WTO dispute settlement system is a priority. The authorities reiterated their goal, as stated in this year's Government Work Report, of seeking to deepen multilateral, bilateral and regional economic cooperation and negotiate and sign high-standard free trade agreements with more countries and regions. They propose to do so through advancing negotiations on several ongoing FTAs and through continued efforts to accede to the CPTPP and DEPA.

IMPROVING ECONOMIC DATA

75. While broadly adequate for surveillance, data provided to the Fund has some shortcomings. Significant data gaps remain in key areas (see Annex VI). Long-standing data gaps include quarterly GDP by expenditure component (nominal, real, and seasonally adjusted); general government data with a breakdown of expenditure by economic type (current and capital expenditure); and data on off-budget entities (including LGFVs) that meet the statistical criteria for inclusion within the perimeter of the general government. China's balance of payments data does not provide the institutional sector breakdown for the financial account, or the breakdown for investment income as required by the sixth edition of the Balance of Payments Manual. China's support for the Review of Data Provision to the Fund for Surveillance Purposes that includes provision of foreign exchange intervention (FXI) data is welcome (IMF, 2024). Greater transparency on FXI would facilitate multilateral surveillance through more comprehensive monitoring of the international monetary system. Enhanced data sharing and standardization of data on critical minerals are also needed, especially to support a better understanding of the effect of trade policies on green investment.

Authorities' Views

76. **The authorities reiterated their commitment to improve data quality but raised significant concerns about the new Data Adequacy Assessment (DAA) framework.** They disagreed with the rating for national accounts, arguing that adequate data is provided for production-side GDP, which is the appropriate primary approach for measuring economic activity in China. They also indicated that the coverage of CPI and PPI is adequate. The authorities disagreed with the GFS ratings, noting that they abide by the Budget Law—debt not included in the budget is not considered government debt and the GG budget is compiled according to the functional classification of expenditure. They also argued that delays in publication of LG budget data are due to the needed approval of the local people's congress. However, they committed to continue upgrading GFS data adequacy, including through collaboration with the Fund. For external sector statistics, they will consider steps to disseminate breakdowns for investment income and institutional sectors.

STAFF APPRAISAL

77. **China's economy is projected to grow in line with the authorities' target in 2024, before slowing in the medium term.** The resilient growth in 2024 reflects strong public investment and continued recovery in private consumption, which will offset the ongoing drag from declining residential investment. Economic slack will decrease further, with inflation picking up gradually. Without structural reforms, growth is projected to decelerate materially in the medium term because of population aging and slower productivity growth. The external position in 2023 is assessed to be broadly in line with the level implied by medium-term fundamentals and desirable policies.

78. **Risks to growth and inflation are tilted to the downside.** The property market correction could be longer- or larger-than-expected and could trigger renewed LG financing strains and unintended fiscal tightening. The weaker-than-expected domestic demand amid high debt levels could also result in prolonged downward price pressures and increased risks of adverse macro-financial feedback loops. On the external front, deepening geoeconomic fragmentation remains a key risk. Upside risks include decisive policy actions to address the property sector distress and market-oriented structural reforms.

79. A comprehensive CG-coordinated policy package to facilitate a more efficient and less costly transition of the property sector is a priority. The package should accelerate the resolution of insolvent developers and deploy one-off CG financing to protect buyers of pre-sold but yet unfinished housing, which would raise consumer confidence and boost near-term economic prospects. Greater housing price flexibility, especially in the primary market, while monitoring and mitigating potential macro-financial spillovers, would also support housing demand and the clearing of the inventory overhang.

80. Near-term macroeconomic policies should support domestic demand amid economic slack and elevated downside risks. A neutral structural fiscal stance in 2024 would balance the tradeoffs between supporting domestic demand, defusing deflation risks, and containing unfavorable debt dynamics. The structural fiscal deficit should start declining gradually in 2025, with a pace dependent on the strength of the recovery, inflation developments, and the property market outlook. Additional monetary easing via interest rates would support demand and lift inflation, while greater exchange rate flexibility would help absorb external shocks and mitigate deflation risks.

81. Public debt sustainability will require significant consolidation in the medium term, supported by framework reforms and restructuring of unsustainable LGFV debt. Sustained fiscal consolidation, achieved through a reduction of off-budget investment and wide-ranging tax and social security reforms, is needed to stabilize public debt over the longer term. Fiscal consolidation should be supported by fiscal framework reforms, including improving fiscal monitoring of LG finances, reducing vertical fiscal imbalances, and establishing and enforcing LG fiscal rules to ensure fiscal discipline also at the local level. Restructuring the debt of unsustainable LGFVs through greater use of insolvency frameworks will also help reduce LG fiscal strains.

82. Financial sector policies should mitigate asset quality risks and safeguard macro-financial stability. Financial stability risks remain elevated as continued stress in the property sector and weak debt servicing capacity of LGFVs point to high credit risks, at a time when profitability pressures limit financial institutions' ability to build buffers. To contain asset quality risks, the authorities should remove forbearance and strictly enforce prudential policies, while also preemptively identifying vulnerabilities and preparing for any adverse impact that unduly impedes banks' lending capacity. A comprehensive strategy to strengthen weak small and medium banks is also needed to maintain financial stability. Strengthening the crisis management and bank resolution frameworks and upgrading and enhancing systemic risk oversight will be essential to tackle legacy vulnerabilities and prevent the build-up of new risks.

83. Broad-based structural reforms should promote economic rebalancing and high-quality growth. The service sector has the potential to drive growth and create jobs if measures that promote a rebalancing of demand towards consumption, such as boosting the social safety net and improving the progressivity of the tax system, are combined with reforms that reduce entry and regulatory barriers in service sectors. Scaling back industrial policies which favor manufacturing sectors can also help reduce domestic resource misallocation, while also mitigating asset quality risks. Other key reform priorities include implementing SOE reforms, gradually increasing the retirement age, and strengthening labor market policies.

84. Further reforms would help China meet its emissions reduction goals more efficiently. China has made welcome progress towards meeting its climate targets. Expanding the coverage of the emissions trading scheme beyond the power sector can help deliver the same reduction in emissions at a lower overall cost and smaller increases in electricity prices, while auctioning permits would raise revenue to compensate for adverse distributional effects.

85. Reducing fragmentation pressures will require a global push to strengthen the multilateral trading system as well as policy effort by major economies, including China. Industrial policies and trade restrictions by China and other major economies are leading to significant international spillovers. In addition to containing domestic distortionary effects, scaling back China's industrial policies and improving transparency with respect to government support could potentially help defuse fragmentation pressures. China should also continue its efforts to strengthen the rules-based multilateral trading system, especially through reforms of the WTO.

86. China's growing leadership in addressing global challenges is welcome. As a major creditor country, China plays an important and constructive role in supporting debt restructuring in vulnerable countries. Continued progress on the Common Framework and through the GSDR would help ensure effective, predictable, and timely debt resolution processes. Meeting the Paris Agreement objectives will require global cooperation, including to support much needed renewables and green investments. China's continued efforts in this area remains vital.

87. China should address remaining data gaps. While broadly adequate for surveillance, data provided to the Fund has some shortcomings. Addressing significant data gaps in key areas would further enhance transparency and support policy making.

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

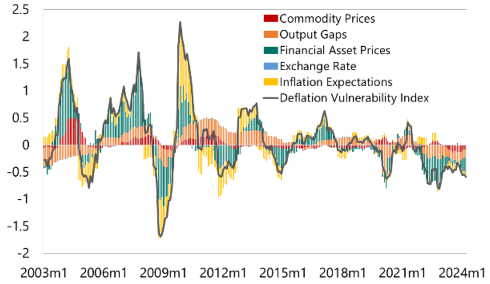
Box 1. Inflation at Risk[1]

This Box examines China's deflation risks with a novel deflation vulnerability index (DVI). Analysis suggests that risks under the baseline are limited, but negative shocks could substantially increase the tail risk of deflation.

To assess deflation risks, a deflation vulnerability index has been developed. The index is based on five categories of variables that can predict downside risks to inflation, including commodity prices, output gaps, financial asset prices, exchange rates, and inflation expectations, similar to IMF (2003). The information content of these variables is summarized into a single variable—the deflation vulnerability index—using principal component analysis. The calculated DVI, which shows persistent negative values in recent years, suggests that China is currently experiencing its longest recorded period of deflationary pressure. This was initially driven by falling asset prices at the start of the property market downturn in late 2021, and increasingly by negative output gaps in 2022 and 2023 (see text chart and SIP).

Deflation Vulnerability Index and Contributions

(In standard deviations from historical average; lower = more vulnerable to deflation risks)

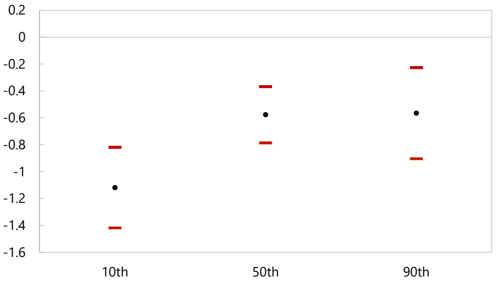


Source: IMF staff calculations.

Regression analysis implies significant downside risks to future inflation in China. A negative shock to the DVI is associated with about 1.1 percentage points lower core inflation at the 10th percentile of the inflation distribution. This is substantially larger than the -0.6 percentage point impact at the 50th percentile. A more negative estimated impact at the 10th percentile than at the median of the distribution indicates larger downside risks from negative shocks. Further analysis indicates that negative output gaps and weak inflation expectations are the key components of DVI that drive the downside risk of core inflation below zero (i.e., deflation) in China.

Impact of Deflation Vulnerability Index on Core Inflation

(In percent; 9 months after the shock)

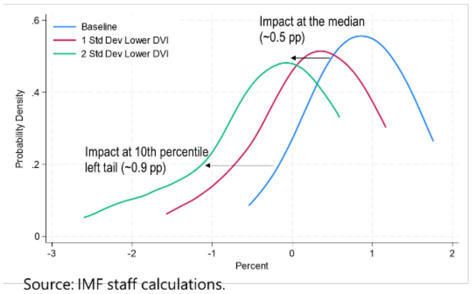


Source: IMF staff calculations.

The probability of deflation in China is estimated at around 7 percent in the baseline but could be as large as 27 (54) percent 9 months after a one (two) standard deviation negative shock to DVI. Policy makers should guard against deflation risks getting entrenched. This would require addressing stress in the property market and reviving domestic demand. PBoC should maintain accommodative monetary policy and strengthen deflation risk monitoring, focusing on downside risks and the role of inflation expectations.

Conditional Distribution of China's Core Inflation

(Probability density; 9-month ahead; year-on-year inflation)



Source: IMF staff calculations.

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[1] Prepared by Natalija Novta and Yizhi Xu.

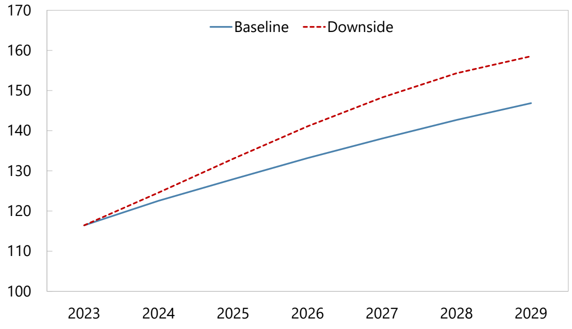
Box 2. Downside Scenario of Prolonged Deflation, Fragmentation and Spillovers[1]

A downside scenario of prolonged deflation would lower growth and worsen debt dynamics in China. This could generate significant global spillovers, adding to deflationary pressures.

A negative domestic demand shock amid high debt levels could trigger a period of sustained deflation in China, with large economic costs. Core inflation is on a downward trend with a sizeable risk of deflation if negative shocks materialize (Box 1). Following a 2 standard deviation shock to China's deflation vulnerability index, core inflation could fall as low as -0.1 percent. In a downside scenario of prolonged deflation, where -0.1 percent core inflation persists for 5 years, cumulative real GDP in 2029 is projected to be about 5.4 percent lower, and debt-to-GDP about 11.7 percentage points higher, than in the baseline.[2] In the absence of a policy response, deflation would weigh on growth through weak consumer and investor confidence, subdued inflation expectations and deleveraging. Continued focus on supply-side measures, including provision of subsidies (Ruta and Rotunno, 2024) and investment incentives in priority manufacturing sectors, amid weak domestic demand could further add to deflationary pressures.

General Government Debt-to-GDP Ratio

(In percent)



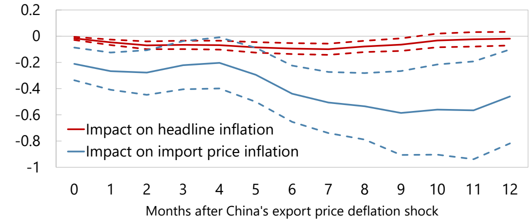
Source: IMF staff calculations.

Additional trade restrictions from some trading partners could further exacerbate domestic deflationary pressures. Fragmentation is already materializing, changing China's export markets (Gopinath, 2024). Fragmentation pressures could also be intensified if household savings further increase, including due to a longer-than-expected property contraction, resulting in higher current account surpluses in China. If geoeconomic fragmentation deepens, China's ability to export to some major trading partners would be reduced, exacerbating domestic deflationary pressures, particularly in sectors targeted by trade restrictions.

In a downside scenario of sustained deflation in China, spillovers would include lower inflation and growth in trading partners. Lower growth in China could contribute to lower growth in partner countries, especially ASEAN countries where model estimates suggest a 0.2 percentage point decline in growth for every percentage point decline in Chinese growth (IMF, 2023). Deflation in China would also reduce inflation in trading partners. At the current juncture, this would support disinflation efforts in countries fighting high inflation and would reduce the burden on monetary policy. Estimates suggest that for every percentage point decline in Chinese export price inflation, Asia's import prices fall by about 0.6 percentage points 10 months after the shock.

China's Export Price Deflation Pass-through to Asia's Deflation

(Percent; 1 percentage point export price deflation shock)



Sources: Haver Analytics; and IMF staff calculations.

Notes: The local projection impulse response is estimated with instrumented export deflation shocks in China. Negative values indicate deflation in Asia following China's export deflation shocks. Mainland China's policy uncertainty index is used as an instrumental variable. The sample of Asian economies include Hong Kong SAR, Indonesia, Japan, Korea, Malaysia, Singapore, Thailand, and Taiwan Province of China.

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[1] Prepared by Natalija Novta and Yizhi Xu.

[2] The downside scenario is calibrated using the relationship between quarterly real GDP growth rate and core inflation from Japan (1980Q1-2023Q4). Such a calibration suggests a 0.5 percentage points cumulative decline on annual real GDP growth following a 1 percentage point reduction in core inflation, which is used to project cumulative 5-year impact on real GDP in China. Lower inflation is assumed to gradually lower the nominal interest rate, while primary balances are kept fixed.

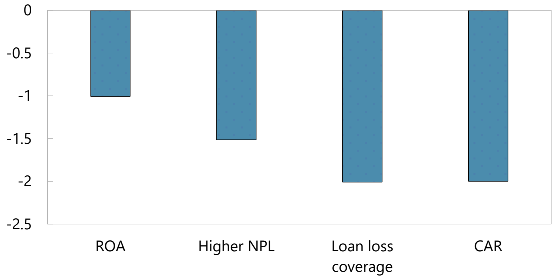
Box 3. Can Consolidation Help Address Vulnerabilities in Small and Medium-sized Banks?[1]

Well-designed and targeted consolidation that is accompanied by balance sheet cleanup and adequate recapitalization could help address vulnerabilities in small and medium-sized banks (SMBs). Indeed consolidation should take place as part of a broader strategy to address weakness in SMBs (¶31) and *accelerate financial sector reforms to improve the financial system's resilience (see section above).*

SMBs are a key pillar of the Chinese banking system, with nearly 4000 institutions holding 25 percent of total system assets. Over the last decade, the number of SMBs remained largely unchanged, in contrast to continued consolidation in other countries. Bank presence is particularly high in poorer regions (see ¶12), partly reflecting previous efforts in deepening financial inclusion. As most SMBs operate within their region, this has created fierce competition for lending and deposits from a limited clientele. SME banks also face competition from larger banks and NBFIs, further eroding their pricing power, which induces excessive risk-taking behavior and concentrated risk exposures. Risk management and governance are weak and the large number of SMBs imposes on already constrained regulatory and supervisory capacity. As a result, SMBs have significantly weaker fundamentals than larger banks, and their vulnerabilities could have significant negative macro-financial impact on the local/regional economy.

Relative Performance of SMBs to Larger Banks

(Difference in standard deviation)



Sources: NFRA; S&P Capital IQ; and IMF staff calculations.
Note: The chart shows the difference between SMBs and larger banks for each indicator, scaled by the standard deviation of quarterly data since 2015 across all banks.

After some regional bank failures in 2020, the authorities stepped up efforts to address SMBs vulnerabilities. These include recapitalization, heightened supervision and selected mergers including several cases in 2023., The authorities are considering broader consolidation for SMBs.

Well-designed and targeted, consolidation among SMBs could improve performance and reduce financial stability risks. Consolidation among smaller institutions can potentially help unlock synergies and economies of scale that supports profitability, capital accretion and system resiliency.[2] Given SMBs' low pricing power, consolidation would not give rise to local monopolies and their overall small size prevents the emergence of too-big-to-fail problems. Moreover, consolidation can improve risk management and governance by centralizing resources, in turn alleviating regulatory burden.

The authorities should prioritize balance sheet clean-up, recapitalization, and resolution of unviable banks to minimize restructuring costs. Simply merging weak banks into a larger weak bank, or relying on stronger banks to absorb the weak institution, should be avoided. Adequate bad debt disposal reduces the initial recapitalization need while minimizing the future credit costs for the merged entity. Sufficient recapitalization helps lower the funding costs for the merged entities and provides capacity for growth. The consolidation should aim to generate synergy and unviable banks should be liquidated with proper safeguards to protect depositor interest, which would lower the total restructuring costs. Encouraging market-based voluntary M&A could also help to alleviate constraint on public resources. For instance, the consolidation in the US banking system after the Global Financial Crisis was primarily driven by voluntary M&A while resolution of over 500 banks contributed a quarter of the consolidation by 2015. Lastly, installing strong governance and management structures at the merged entity would ensure sustainable resilience going forward.

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[1] Prepared by Yingyuan Chen.

[2] Consolidation does not have a significant negative impact on SME financing. (Bundesbank 2007).

Box 4. International Experience with Subnational Fiscal Rules[1]

International experience suggests that well designed and strictly enforced subnational fiscal rules can play an important role in controlling LG fiscal risks in China.

Sustained fiscal consolidation in China will require strict controls over LG finances. Much of the build-up in GG debt since the GFC has been driven by LG debt accumulation. Furthermore, fiscal deficits remain large at the LG level and better control of LG borrowing will be essential to ensure fiscal sustainability.

Various rules-based constraints for sub-national governments have been used by advanced and emerging market economies to control fiscal risks. Subnational fiscal rules are numerical constraints that apply to fiscal aggregates such as debt and budget balance. Compared to direct administrative controls, rules-based constraints have the benefit of being objective and transparent (Ter-Minassian and Craig, 1997), and easy to communicate and monitor. Rules defined ex-ante, often in primary or secondary legislation, can promote accountability by providing a benchmark for ex post performance assessment, and can also have a signaling effect on financial markets. Most OECD countries use one or more rules-based constraint (OECD 2021), though the design of rules can differ considerably across countries:

- **Borrowing constraints** are typically applied in the form of limits on the stock of debt and/or annual debt service payments, generally expressed as a share of subnational government revenues. Constraints may also be imposed on the purpose of borrowing, with many OECD countries (e.g., Canada, Denmark, France, Germany, Luxembourg, New Zealand, UK) limiting subnational borrowing for investment purposes only. Several countries do not provide CG guarantees for LG borrowing in order to foster market discipline.

Sub-national Borrowing Regulation – Selected Examples

Country	Indicator	Limit
Brazil	Debt / Net current revenue	200%
Colombia	Interest / Operating balance	40%
	Debt / Revenue	80%
India	Debt service ratio	20%
Poland	Debt / Revenue	60%
	Debt service / Revenue	15%
France	Debt / Annual operating balance	9-12 times

Source: Author's compilation.

- **Budget balance rules** often target current balance, leaving room for borrowing for capital expenditure (golden rule). Countries, such as Austria, Belgium, and Netherlands, include subnational extrabudgetary funds within the ambit of budget balance rules.
- **Expenditure limits** are relatively less common, used mostly to constrain specific items (e.g., personnel expenditure in Brazil and Türkiye), though they can also apply at the aggregate level (Spain) or on operating/current expenditure (Mexico).

To be effective, fiscal rules need to be accompanied by enforcement and oversight mechanisms, and robust public financial management systems at the subnational level. Enforcement mechanisms range from financial penalties (e.g., reduced access to central funds), to institutional and individual sanctions, and include obligations to undertake corrective measures. Compliance with rules is generally centrally monitored, typically by the ministry of finance, while some countries have independent fiscal institutions. Fiscal transparency is critical in facilitating enforcement. Ability to develop a transparent budget process (including a broad coverage of fiscal activity), and comprehensive accounting and reporting systems are critical for rules to function effectively.

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[1] Prepared by Sandeep Saxena.

Box 5. Green Manufacturing as a Potential Driver of Growth[1]

As the real estate sector contracts, the electric vehicles and renewable energy sectors have been prioritized as potential engines of growth. However, analysis suggests that these sectors alone are unlikely to fully replace the expected drag from the property sector.

The property sector has been an important driver of China's growth over the last decade and is now transitioning to a new equilibrium. The property sector was the single most important driver of China's growth over the past decade, contributing, on average, around 1.3 percentage points to GDP growth between 2010 and 2020. However, the property market has been a drag on growth in recent years as the sector transitions to a more sustainable and leaner size.

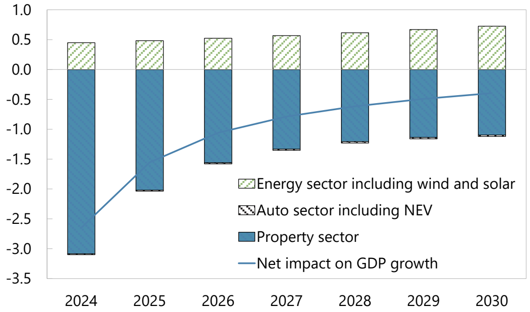
The green manufacturing sectors, such as new energy vehicles and renewable energy, are considered the priority sectors to serve as the new engines of growth. Investment in these sectors has been growing rapidly in recent years and the Box considers a scenario of continued ramp up through 2030.

- The share of new energy vehicles in total auto production has increased significantly from 6 percent in 2020 to 37 percent in 2023. We assume total vehicle production to reach 26 million units by 2030, marginally higher than 2023, with 60 percent new energy vehicles, in line with the authorities' target penetration rate.
- Installed capacity of wind and solar increased from 3.1 percent of total generating capacity in 2010 to 36 percent in 2023. The 2030 target of 1200 GW of wind and solar capacity set out in the 14th Five Year Plan is likely to be achieved by the end of 2024. It is assumed that a total of 1800 GW of wind and solar capacity will be installed by 2030, making up about 45 percent of total generation capacity.

Despite the rapid expansion in the green manufacturing sectors, the analysis in this box suggests that it is not enough to fully offset the drag from the property sector contraction in the medium term. IMF (2023) projects almost flat real estate investment between 2026 and 2030 as the sector completes its transition to a smaller size. Compared to the high growth of the sector in the 2010s, this implies a drag to growth of about -1.3 percentage points per year. The auto sector is unlikely to provide a significant boost to growth going forward, as fixed investment in new energy vehicles production has already expanded significantly, and any further expansion is likely to be offset by declines in internal combustion vehicles. On the other hand, continued rapid growth in the renewable energy sector is likely to provide a key positive offset to growth as the sector continues to experience rapid investment in transition to greener electricity generation, together with accelerated grid upgrades and energy storage facilities. However, on net, these sectors are projected to offset only about half the drag from the property sector in the medium term.

Contribution to GDP Growth Relative to 2010-2020 Average

(Percentage points)



Source: IMF staff calculations.

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[1] Prepared by Fan Zhang.

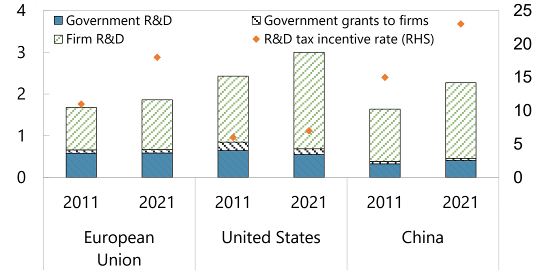
Box 6. Fiscal Policies for Innovation[1]

This Box examines the performance of innovation policies in China and provides recommendations to enhance their effectiveness based on international experience and model analysis.

Promoting innovation and high-quality growth are central goals of fiscal and industrial policies in China. Total research and development (R&D) spending has tripled over the past two decades, reaching more than 2 percent of GDP by 2021, on par with advanced economies. This surge has been fueled by a combination of direct incentives to innovation, including public R&D and increasingly generous tax deductions for firm R&D, as well as more indirect instruments such as financing support for innovative firms (e.g., via government guided funds), coordination of innovation supply chains by public-private consortia, and broader production and demand subsidies for certain sectors.

R&D Spending and Tax Incentives

(LHS percent of GDP; RHS percent)

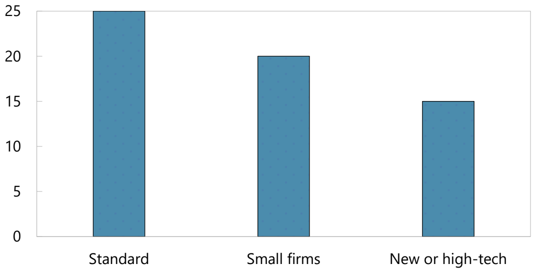


Sources: OECD; and IMF staff estimates.
Notes: Firm R&D includes R&D financed by firms (potentially supported by tax incentives but excluding government grants to firms). Government R&D is R&D financed by the government excluding grants to firms. The R&D tax incentive rate is based on implicit effective subsidies (see IMF (2024) for details).

Targeting of specific sectors is a key feature of innovation policy in China. For example, corporate income tax rates are substantially lower for high-tech sectors, particularly software and integrated circuits, which have also been favored by credit allocation (Xu 2022, World Bank 2023). Innovation inputs have also been heavily skewed towards those sectors, with electric and electronic components (which include batteries and semiconductors) at the top. Relative to the distribution in China, US innovation has been proportionally more tilted towards consumer-oriented sectors like health and entertainment.

Corporate Income Tax Rates

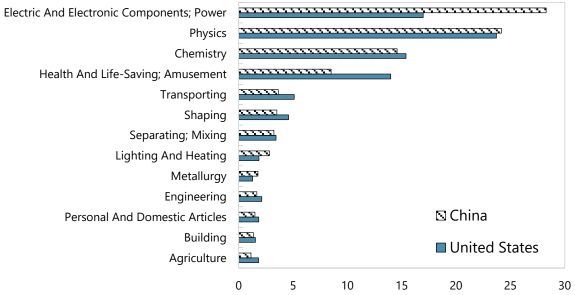
(In percent)



Sources: MOF; and IMF staff compilation.
Note: International corporate income tax reform (Pillar II) could make rates below 15 percent ineffective from 2024.

Innovation by Sector

(Share of Inventors, percent of total)



Sources: PATSTAT; and IMF staff calculations.
Notes: Sectors are based on the International Patent Classification (2-digit level). Small sectors are excluded. Inventors are identified based on authorship of patents. Normalizing sectors by their added value yields similar results. See Garcia-Macia and Sollaci (forthcoming) for details.

There is significant scope to enhance the effectiveness of the innovation policy toolkit. Despite the government's efforts to promote innovation, total factor productivity growth has significantly fallen over the last decade (SIP 2022), and citations of Chinese patents are on average lower than those of other countries—a sign of lower-quality innovation. Analysis based on the April 2024 Fiscal Monitor (IMF 2024c) suggests the following recommendations:

- *The degree of sectoral targeting should be scaled down.* Targeting can have benefits—innovation in some sectors (e.g., semiconductors) generate positive productivity and knowledge spillovers to other sectors (Liu and Ma 2023), whereas sectors like green energy or electric vehicles help to decarbonize the economy. But targeting is also prone to policy mistakes and high fiscal costs. Model analysis (Garcia-

Box 6. Fiscal Policies for Innovation (Concluded)

- Macia and Sollaci, forthcoming) suggests that the current degree of targeting in China is excessive: the optimal distribution of innovation support across sectors would only be a third as concentrated (and even less so if the potential for misallocation of support is considered).[2.]
- *Direct fiscal support is preferable to indirect instruments*. Based on international evidence, public spending on fundamental research and R&D tax credits and grants for firm R&D tend to be more cost-effective and well-targeted than credit allocation (which can encourage excess leverage), favoring SOEs (which tend to be less productive), or subsidizing production and demand (which rewards established rather than innovative firms).
- *Adequate design and implementation are critical*. In terms of design features, grants are most effective when directed at earlier stages of the innovation lifecycle, while R&D tax incentives must be made easily accessible across firms. Public R&D should focus on fundamental research that is less likely to be carried out by firms. In general, effective government support to innovation requires upgrading the public sector's technical capacity, avoiding duplication of efforts (e.g., by LGs), recalibrating programs as conditions change, promoting transparency, and acting in line with open and competitive markets.

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[1] Prepared by Daniel Garcia-Macia and Alexandre Balduino Sollaci.

[2] The model features endogenous innovation and a network of sectoral knowledge spillovers estimated with patent citations data.

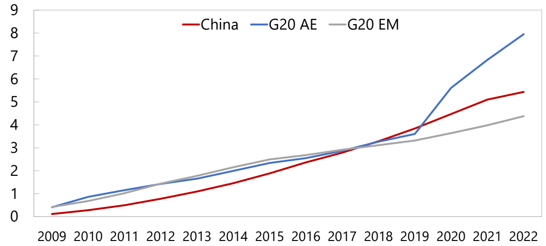
Box 7. How do China's Subsidies Affect its Trade Flows?[1]

China has used subsidy policies intensively in recent years. Evidence suggests that these policies have significant international spillovers, promoting China's exports and reducing China's imports, both directly and indirectly through input-output linkages.

As governments intensify their use of industrial policies, the deployment of subsidies increased sharply (IMF, OECD, World Bank and WTO, 2022). Data from the Global Trade Alert (GTA) show a marked increase in subsidy utilization over the past decade across multiple countries. While information on the monetary value of subsidies is missing, the database collects credible policy changes that have occurred since 2009.[2] China has implemented around 5400 subsidy policies from 2009 to 2022, two thirds of the measures adopted by all G20 advanced economies combined.

Domestic Subsidies Introduced Since 2009

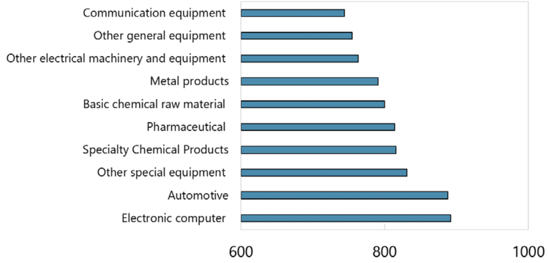
(Number of subsidies, in thousands)



Sources: Global Trade Aleart database; and IMF staff calculations.
Notes: Only includes subsidies still in force. The GTA database follows the definition of subsidies given in UNCTAD (2019). To focus on domestic subsidies, measures classified as export subsidies are excluded. Only measures classified as "distortive" (that discriminate against foreign interests) are considered. Potential cross-country differences in transparency, data availability and policy preferences should be considered when interpreting this data.

Top 10 Goods Industries Receiving Subsidies

(Number, as of 2022)



Sources: Global Trade Aleart database; 2007 China Input-Output table; and IMF staff calculations.
Notes: Industries cover 94 primary and manufacturing industries from the 2007 China Input-Output table. The product level subsidies data, recorded using the HS2012 classification, are matched with the input-output sectors using correspondences by Chor et al. (2021) and the United Nations. The upstreamness index is computed as in Antras et al. (2012) and measures the distance of an industries output to its final consumption.

China's use of subsidies varies across industries, with upstream industries receiving more support. Automotive, computing, chemicals, industrial equipment and metals are among the top receivers of subsidies. Furthermore, most of these industries are relatively upstream in the supply chain—7 out of the 10 top receivers of subsidies have an upstream index above average.[3]

Empirical evidence suggests that China's subsidies can create significant trade spillovers, including through supply chain linkages. The empirical analysis (conducted at the product and industry levels) investigates how China's subsidies affect exports and imports, both directly and through supply chain linkages.[4]

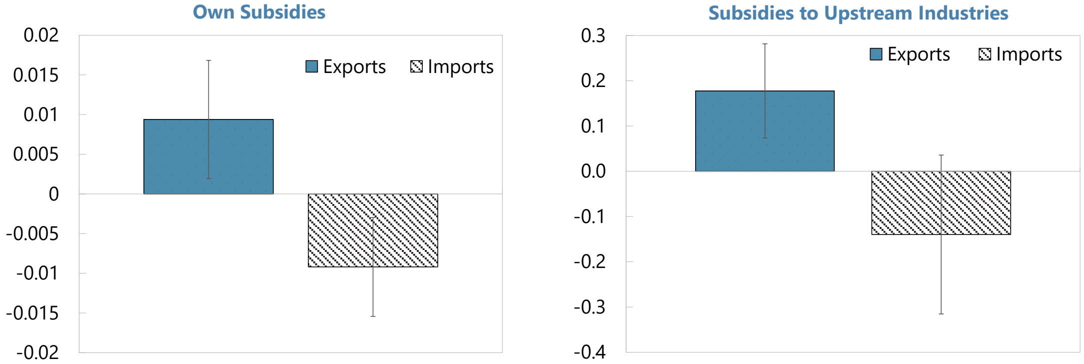
- *Direct spillovers:* The estimates indicate that after the introduction of a subsidy, China's exports of subsidized products are 1 percent higher than those of non-subsidized products. Imports of subsidized products are lower, indicating some domestic substitution.[5]
- *Spillovers through supply chains:* Supply chain linkages tend to amplify these impacts. Using aggregated data at the industry level and input-output tables to capture linkages, the results highlight a positive effect of subsidies given to upstream industries on exports of downstream industries. As an example, consider the case of subsidies provided to the steel industry, which is the main suppliers of inputs to the automotive industry (10 percent of its total costs). The empirical results imply that increasing subsidies to steel by the number observed over 2015-2022 is associated with a 3.5 percent increase in exports of autos from China. This effect is consistent with upstream industries expanding supply and lowering their prices following the deployment of subsidies, hence permitting industries downstream to become more competitive in export markets. Results from imports regressions point to a negative effect of upstream subsidies, suggesting that downstream industries also expand domestically and can substitute for

Box 7. How do China's Subsidies Affect its Trade Flows? (Concluded)

imports. Overall, these empirical results underscore the trade effects of China's subsidies, especially when provided to upstream industries.

Impact of Subsidies on Exports and Imports

(Coefficient estimates)



Sources: Global Trade Alert database; 2007 China Input-Output table; BACI CEPII database; and IMF staff calculations.

Notes: Annual data from 2009 to 2022. The empirical specifications for the "direct" effects (left-hand side panel) is at the product (HS 6-digit) level and includes 150 countries. The value of exports and imports (in logs) are the dependent variables. The chart plots the coefficient of a dummy variable for whether the product received domestic subsidies plus the interaction of the variable with a China dummy. The empirical specifications for the "indirect" effects (right-hand side panel) are at the industry level. Exports and imports (in logs) are the dependent variables, while the number of subsidies in the own industries, and measures of exposure to subsidies upstream and downstream, interacted with a China dummy, are the explanatory variables. The chart plots the sum of the coefficients on the weighted sum of subsidies given upstream and its interaction with the China dummy. 90 percent confidence intervals are shown. See Rotunno and Ruta (forthcoming) for details on the exact specification used, including fixed effects and other controls.

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[1] Prepared by Lorenzo Rotunno and Michele Ruta.

[2] The GTA retrieves information on subsidies and other policies from official documents or reports and articles with a clear link to official documents (from firms and governments). While the definition of subsidies adopted in the GTA is consistent with an economic concept of subsidies (IMF, OECD, World Bank and WTO, 2022), it may differ from legal interpretations based on WTO law and that can be used in the WTO dispute settlement system.

[3] The upstreamness index (Antras et al., 2012) measures the average position of an industry's output in the value chain. It equals the dollar amount by which output of all industries increases as a result of one extra dollar of value added in a given industry. Higher values indicate that the industry is more upstream in the value chain.

[4] The empirical analysis builds on a companion paper (Rotunno and Ruta, 2024) that examines trade effects by country groupings. Results for G20 emerging markets are further discussed in WEO (2024).

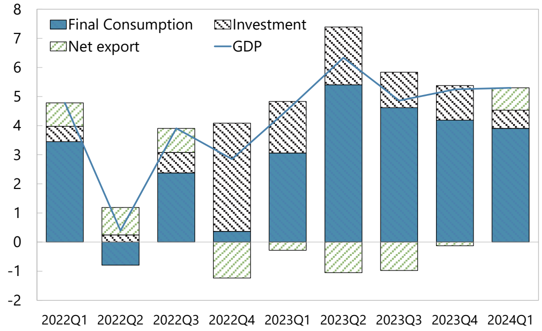
[5] These average direct effects mask important heterogeneity across industries. The positive export effect and the negative import effects are most pronounced in the machinery industry, while in other industries like metals subsidies tend to decrease both exports and imports. Additional analysis unpacking the impact on trade values into price and quantity effects suggests that China's subsidies have depressed export prices of metal, furniture and auto products, while they are associated with higher export prices and quantities in other industries including electrical equipment such as batteries. These results are discussed in an accompanying working paper (Rotunno and Ruta, forthcoming).

Figure 1. China: Recent Developments—Ongoing Recovery

Investment continued to disappoint in 2024Q1…

Components of GDP

(In percent; year-on-year)

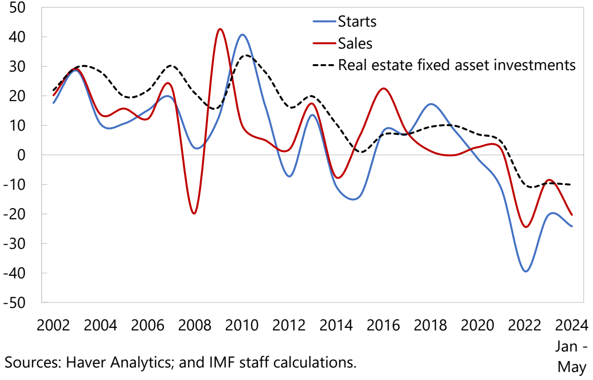


Source: China National Bureau of Statistics.

… with continued weakness in real estate weighing on aggregated demand.

Property Sector Remains Weak

(In percent, year-on-year change)

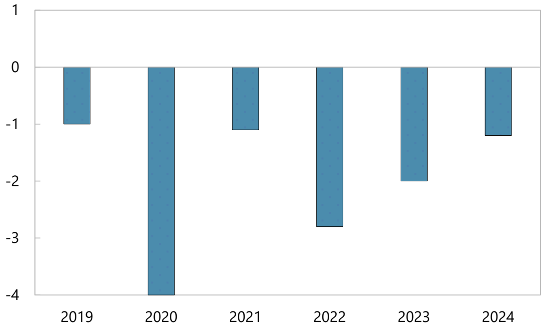


Sources: Haver Analytics; and IMF staff calculations.

Substantial slack is reflected in the negative output gap…

Output Gap

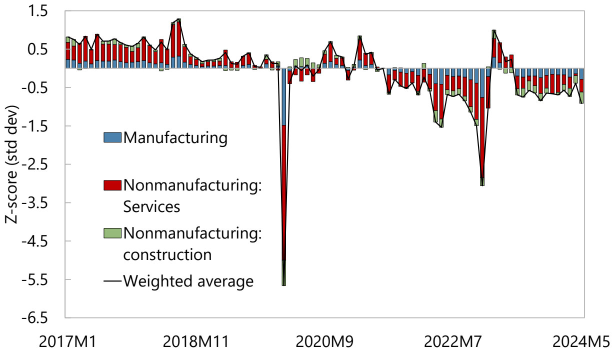
(In percent of potential output)



Source: IMF staff calculations and estimates.

… and broad-based weakness in employment.

Employment PMIs by Sector

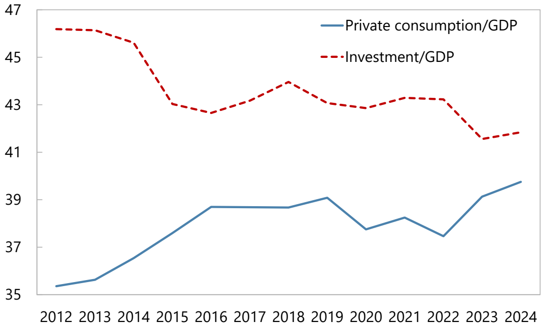


Sources: Haver Analytics; China National Bureau of Statistics; and IMF staff calculations.

Further rebalancing outlook is uncertain given the authorities' focus on supporting investment…

Rebalancing Progress

(In percent)

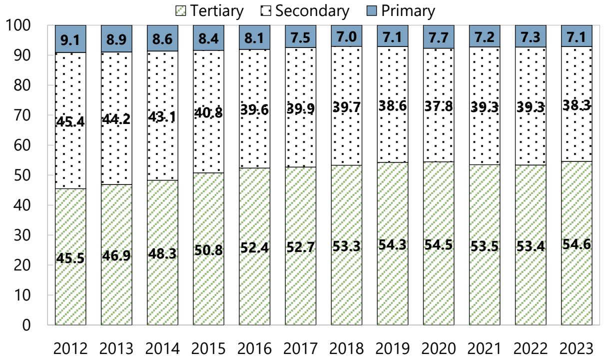


Sources: China National Bureau of Statistics; and IMF staff calculations.

… although there have been modest, but steady, gains in service sector share in GDP over the last decade.

Sector GDP Share

(In percent)



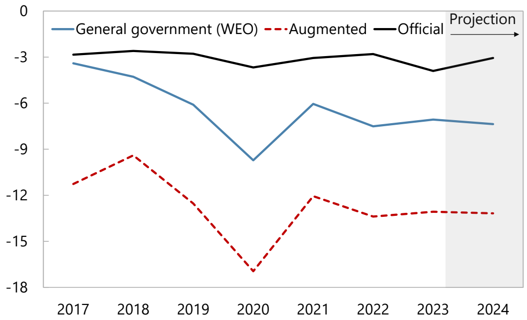
Sources: China National Bureau of Statistics; and IMF staff calculations.

Figure 2. China: Fiscal—Continued Fiscal Support Amid Rising Debt

Large fiscal deficits are set to continue into 2024…

Government Balances

(In percent of GDP)



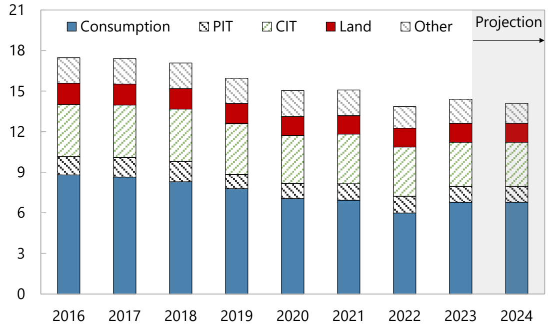
Sources: Authorities; and IMF staff calculations.

Note: See Table 2 in staff report for definitions of government balances.

…with weak expected tax revenue…

Tax Revenue

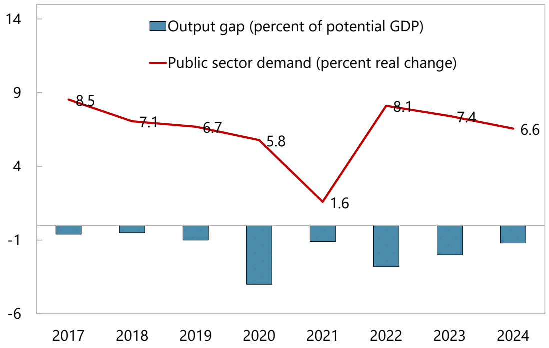
(In percent of GDP)



Sources: Authorities; CEIC Data Company Limited; and IMF staff calculations.

…and public sector demand expanding faster than GDP.

Estimated Government Demand

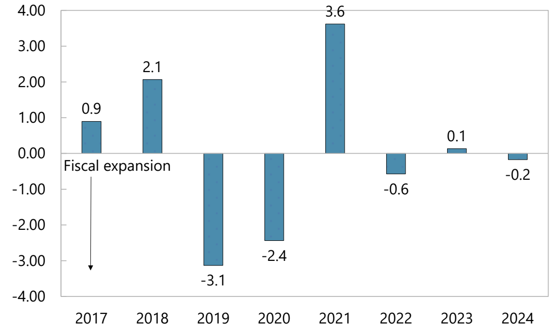


Sources: IMF World Economic Outlook; and IMF staff calculations.

The fiscal stance is projected as broadly neutral in 2024.

Fiscal Effort

(Change in cyclically-adjusted primary balance, in percent of potential GDP)

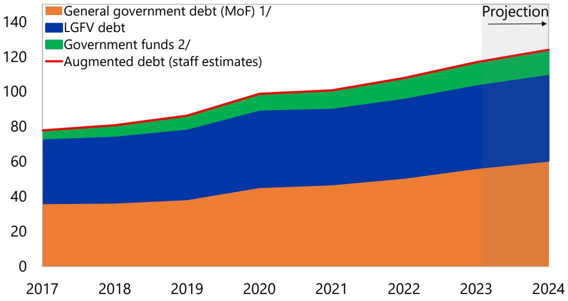


Sources: CEIC Data Company Limited; and IMF staff calculations.

Debt keeps rising at a rapid pace, with a growing share of official debt.

Augmented Debt

(In percent of GDP)



Sources: Ministry of Finance (MoF); and IMF staff calculations.

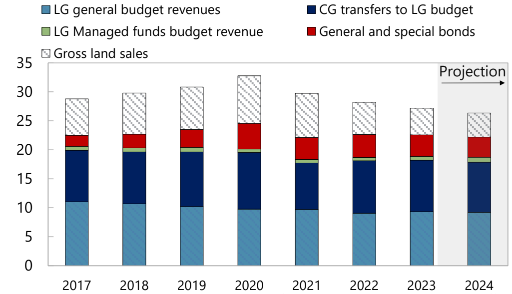
1/ Data through 2022, 2023 estimated, 2024 projection.

2/ Government guided funds and special construction funds (social capital portion only).

Local government revenues shrink further, driven by the collapse in land sale revenue.

Local Government Budget Financing 1/

(In percent of GDP)



Sources: CEIC Data Company Limited; Ministry of Finance 2022 budget; and IMF staff calculations.

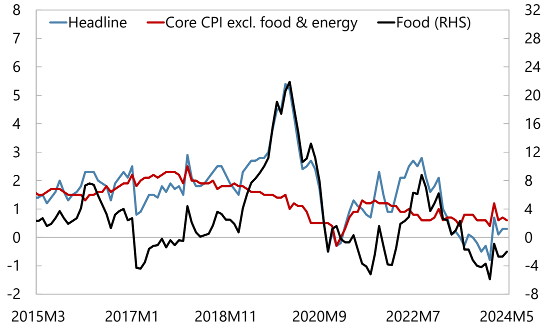
1/ Local government general budget and local government managed fund budget. Excludes off-budget financing.

Figure 3. China: Monetary—Accommodative Policy Stance Amidst Weak Inflation

Subdued headline inflation largely reflects transitory food pressures, while momentum in core inflation has also declined.

CPI Inflation

(In percent, year-on-year)

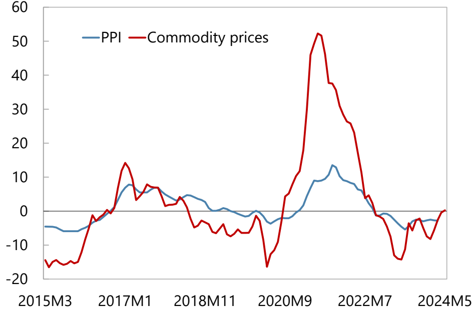


Sources: CEIC Data Company Limited; and IMF staff calculations.

Producer prices remain in deflationary territory.

Producer Price Index

(In percent, year-on-year change)

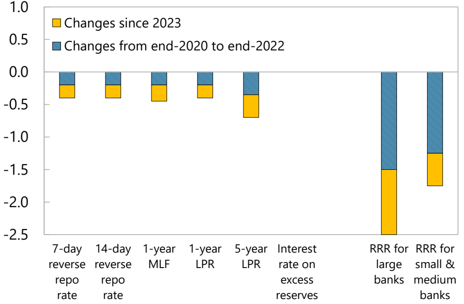


Sources: CEIC Data Company Limited; and IMF staff calculations.

The PBC has cut the RRR and the 5-year LPR, which is linked to mortgages, to support market liquidity and growth…

Policy Rate Changes Since COVID-19 Outbreak

(In percentage points)

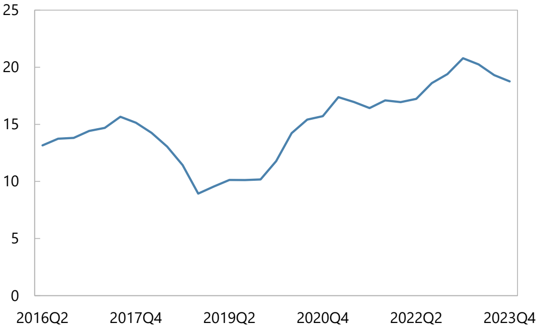


Sources: CEIC Data Company Limited; Haver Analytics; and IMF staff calculations.
Notes: MLF = medium-term lending facility; LPR = loan prime rate; RRR = reserve requirement ratio. RRR changes for small and medium banks are an average.

…and credit policies continue to be accommodative, for instance driving still-rapid MSE lending growth.

Lending to Micro- and Small-Sized Enterprises (MSEs)

(In percent, year-on-year change)

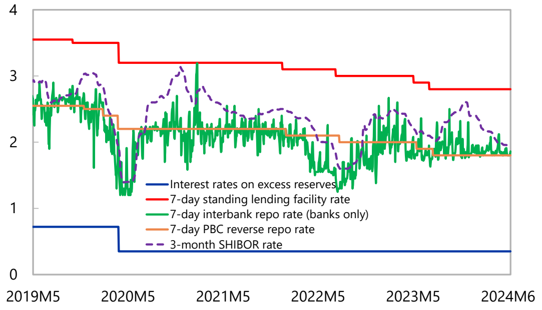


Sources: CEIC Data Company Limited; and IMF staff calculations.

Money market rates rose at the end of 2023 as banks sought to absorb heavy government bond issuance…

Interest Rate Corridor and Short-Term Market Rates

(In percent)

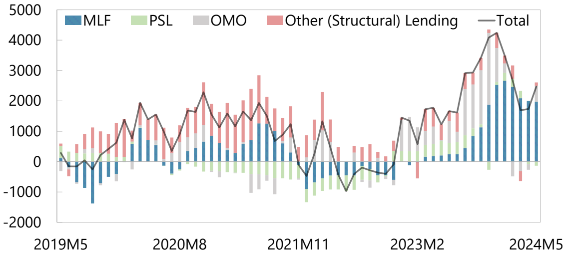


Sources: CEIC Data Company Limited; and IMF staff calculations.
Notes: SHIBOR = Shanghai Interbank Offered Rate; PBC = People's Bank of China.

…prompting the PBC to step up liquidity injections

PBC Reverse Repo and Lending Facilities: 12-month Changes

(In RMB billions)



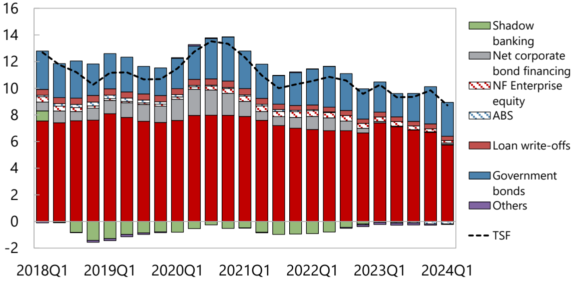
Sources: CEIC Data Company Limited; and IMF staff calculations.
Notes: MLF = Mediuterm Lending Facility. PSL = Pledged Supplementary Lending Facility. OMO = Open Market Operation.

Figure 4. China: Credit—Government and Corporate Borrowing Drives Credit Growth

Total social financing growth continued to slow down, driven by slower bank lending, while government borrowing provided support.

Contribution to TSF Stock Growth

(In percent, year-on-year)

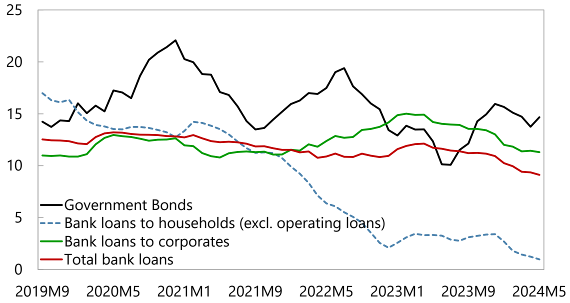


Sources: Haver Analytics; and IMF staff calculations.
Notes: Since January 2017, ABS, loan write-offs, and local government special purpose bonds are included. Since December 2019, local government special purpose bonds are expanded to government bonds (including all central and local government bonds) traced back to 2017.

Despite recent slowing, corporate lending remains the dominant driver of bank credit growth…

Growth Rates of Selected Types of Credit

(In percent)

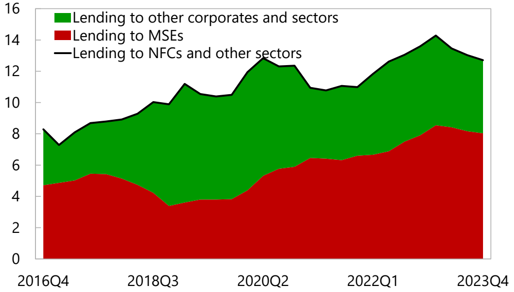


Sources: Haver Analytics; and IMF staff calculations.

…in large part due to continued rapid policy-driven growth in lending to MSEs

Contributions to Growth of Non-financial Corporate (NFC) Loans

(In percent; year-on-year)

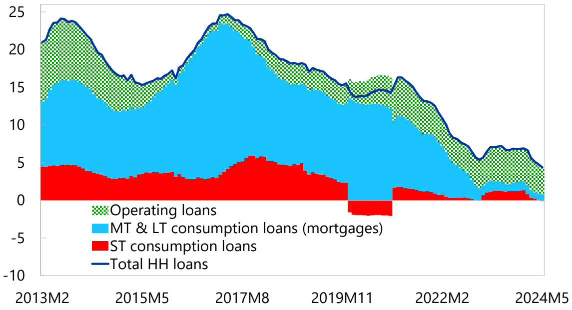


Sources: Haver Analytics; CEIC Data Company Limited; and IMF staff calculations.
Note: MSE = Micro and Small Enterprises.

Household credit continues to remain subdued amid low consumer confidence and the property sector downturn

Contribution to Growth of Household Loans

(In percent, year-on-year)

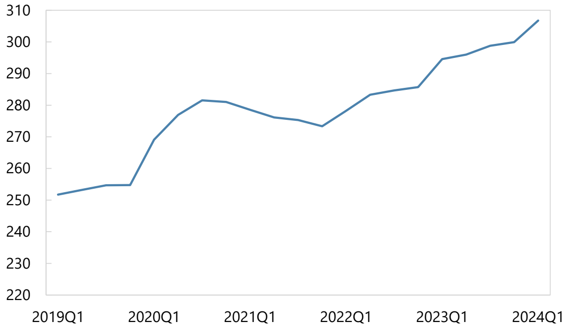


Sources: Haver Analytics; and IMF staff calculations.

The negative GDP deflator in 2023 and 2024Q1 has pushed debt to GDP well past the COVID-era peak.

TSF Stock to GDP

(In percent of GDP)

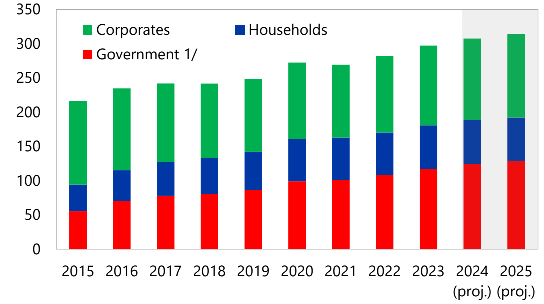


Sources: CEIC Data Company Limited; and IMF staff calculations.

The government is expected to continue to contribute the bulk of new debt growth going forward.

Domestic Non-financial Sector Debt

(In percent of GDP)



Sources: CEIC Data Company Limited; Haver Analytics; and IMF staff estimates.
1/ Government debt includes debt of central and local governments, government funds, and LGFVs.

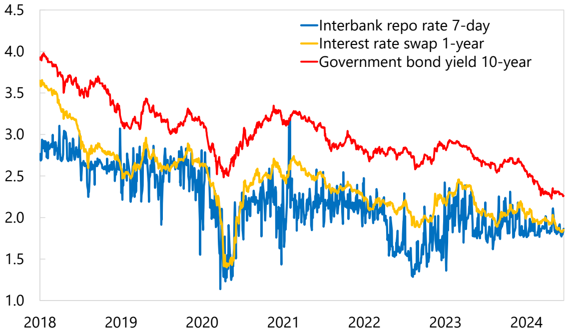
Figure 5. China: Financial Markets—Financial Conditions have been Volatile

Longer term government bond yields have declined sharply amid continuing monetary policy easing and rising concerns of deflation risks.

Both central and local government bond issuance increased strongly in Q4 amid stronger policy support

Money Market Rates and Government Bond Yield

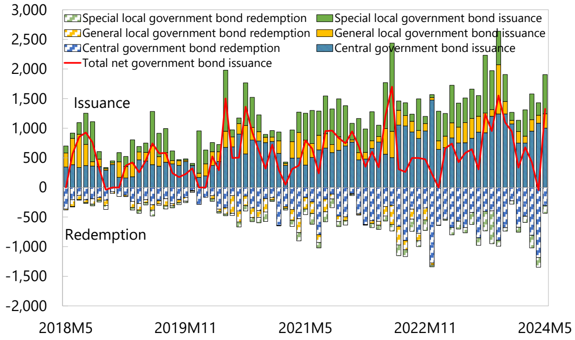
(In percent)



Sources: Bloomberg; and IMF staff calculations.

Government Bond Issuance and Redemption

(In billions of RMB)



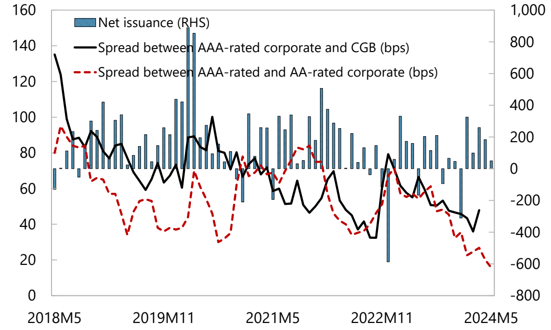
Sources: Wind; and IMF staff calculations.

Corporate net issuance recovered somewhat on lower funding costs, though issuance by private corporates remains limited.

Chinese equities stabilized after significant pressures in early 2024 that were followed by state-led interventions.

Corporate Bond Net Issuance

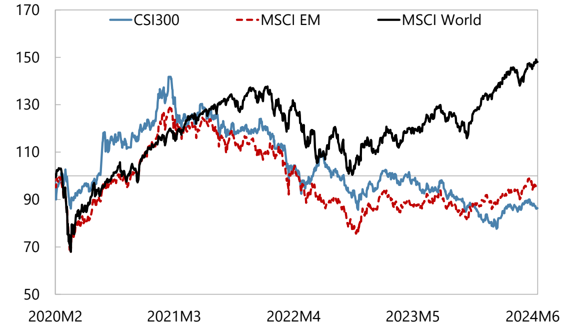
(In billions of RMB)



Sources: Bloomberg; Wind; and IMF staff calculations.

Equity Market Performance

(2020M1 = 100)



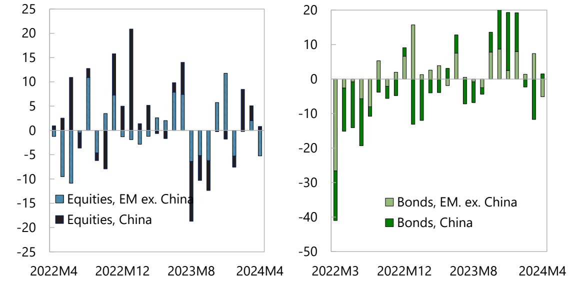
Sources: Bloomberg; and IMF staff calculations.

Local bond market attracted portfolio inflows…

… while foreign investors remain cautious on local stocks

Local Currency Bond and Equity Flow

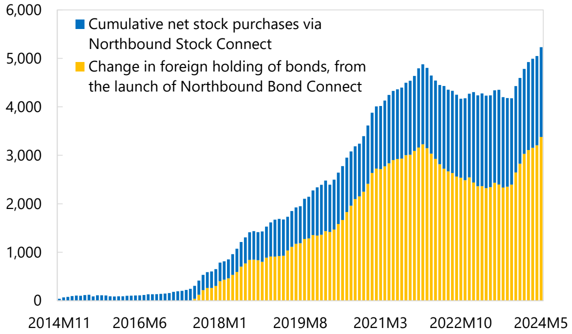
(In billions of USD)



Sources: Bloomberg; and IMF staff calculations.

Portfolio Investment Flows

(In billions of RMB)



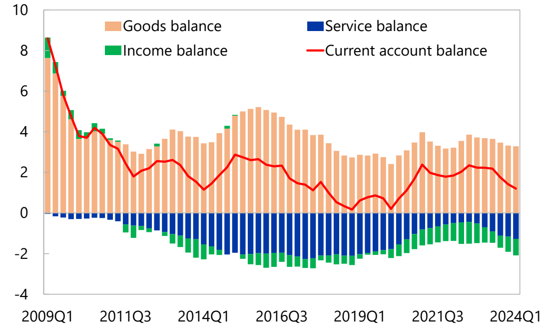
Sources: CEIC Data Company Limited; Wind; and IMF staff calculations.

Figure 6. China: External—Gradual Normalization

Current account declined in 2023 and 2024Q1, driven by a recovery in China's outbound tourism and, to a smaller extent, a reduction in trade balance.

Current Account

(In percent of GDP, 4Q moving average)

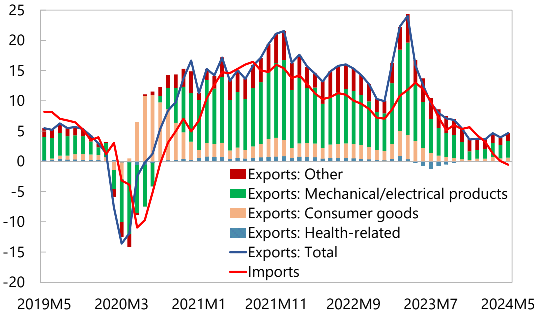


Sources: CEIC Data Company Limited; and IMF staff calculations.

Goods exports growth slowed, reflecting lower demand as well as falling prices (both price cuts and RMB depreciation)

Goods Exports and Imports

(In percent, annualized growth over previous 2-year, 3-month sum)

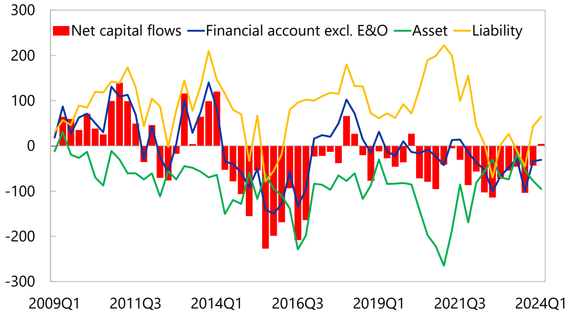


Sources: Customs Statistics China; Haver Analytics; and IMF staff calculations.

Financial account improved in 2023Q4-2024Q1 …

Financial Account

(In billions of USD)

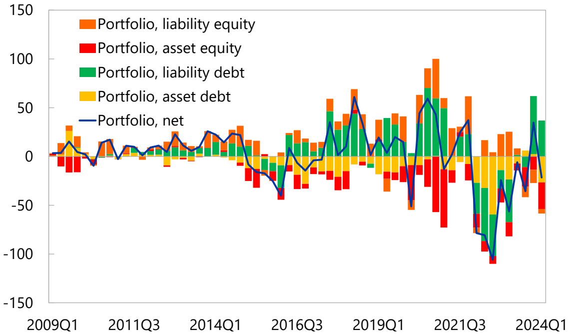


Sources: CEIC Data Company Limited; and IMF staff calculations.
Note: E&O = net errors and omissions.

…partially driven by a rebound in nonresident portfolio debt inflows in 2023Q4-2024Q1…

Financial Account: Portfolio Investment

(In billions of USD)

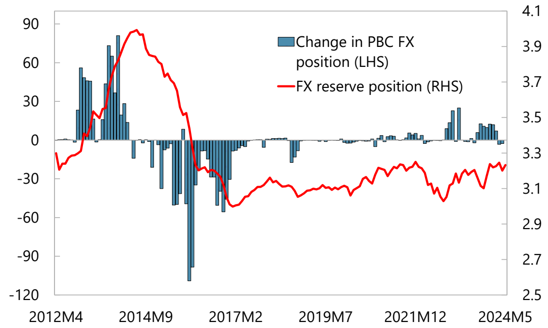


Source: CEIC Data Company Limited.

…that contributed to the reserves in 2023Q4-2024Q1, also aided by valuation effects due to USD weakness…

Foreign Exchange Reserves

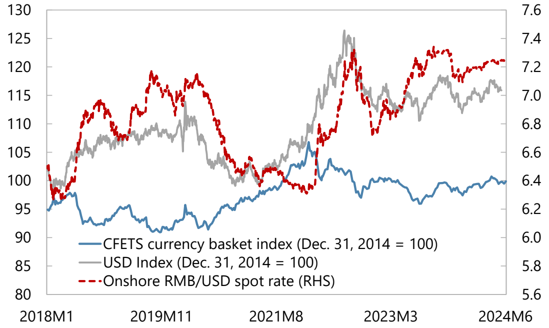
(LHS: US$ billions, RHS: US$ trillions)



Sources: Haver Analytics; and IMF staff calculations.

…as volatility of the RMB/USD exchange rate declined significantly since mid-2023.

RMB Exchange Rate vs CFETS Index



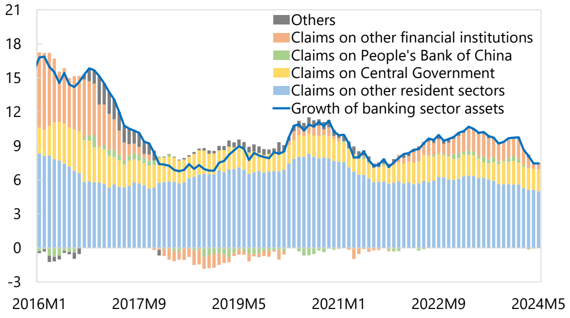
Sources: CEIC Data Company Limited; and IMF staff calculations.

Figure 7. China: Banks—Profitability Remains Under Pressure amid Asset Quality Concerns

Expansion in banking system assets are increasingly driven by non-loan assets

Growth of Banking Sector Assets

(In percent, year-on-year)

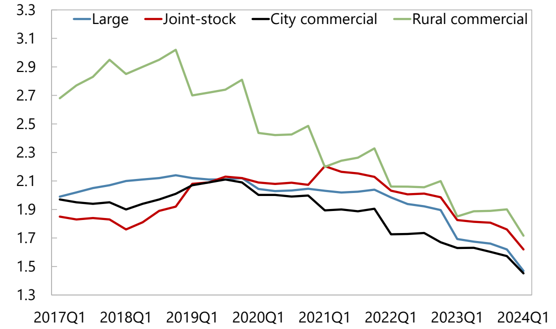


Sources: CEIC Data Company Limited; and IMF staff calculations.

Banks' net interest margin has fallen to record lows

Net Interest Margin

(In percent)

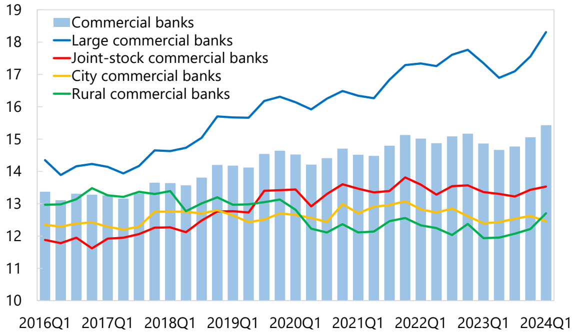


Sources: CEIC Data Company Limited; and IMF staff calculations.

Banks outside of the largest state-owned banks have struggled to build capital buffers…

Commercial Banks Total Capital

(In percent of risk-weighted assets)

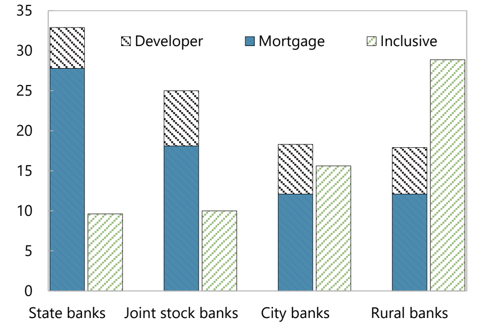


Sources: CEIC Data Company Limited; and IMF staff calculations.

…in particular smaller banks that have more concentrated and higher risk exposures

Real Estate and Inclusive MSE Loans 2022

(In percent of total loans)

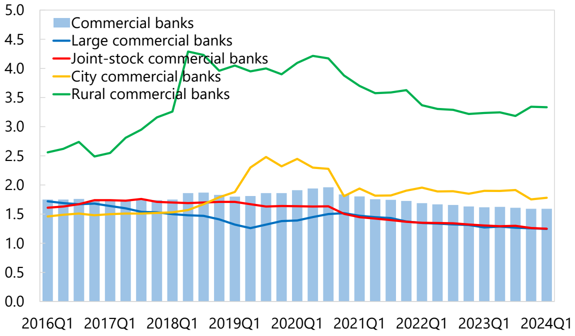


Sources: WIND; China Banking Insurance Regulatory Commission; and IMF staff calculations.

While headline NPL ratios remain largely stable in part due to extended forbearance measures…

Commercial Banks: Nonperforming Loans

(In percent of total loans)

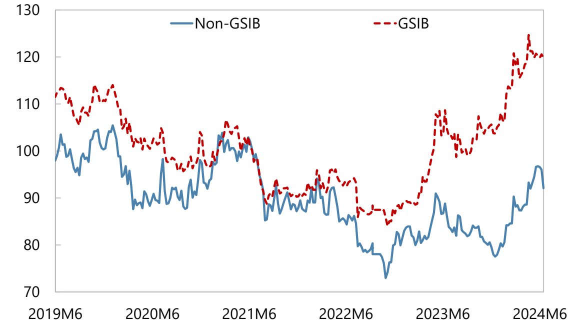


Sources: CEIC Data Company Limited; and IMF staff calculations.

… market pricing suggests increasing risk aversion towards smaller banks

Bank Equity Performance

(2021M5 = 100)



Sources: Bloomberg; and IMF staff calculations.

Table 1. China: Selected Economic Indicators

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
						Est.			Projections		
	(Annual percentage change, unless otherwise indicated)										
NATIONAL ACCOUNTS											
Real GDP (base=2015)	6.0	2.2	8.4	3.0	5.2	5.0	4.5	4.1	3.6	3.4	3.3
Total domestic demand	5.3	1.7	6.8	2.8	6.1	4.8	4.6	4.3	3.7	3.5	3.4
Consumption	6.3	-0.3	9.0	2.3	8.0	5.6	4.7	4.2	3.8	3.7	3.6
Fixed investment	5.3	3.4	3.2	3.2	4.9	5.2	4.3	4.4	3.4	3.1	3.1
Net exports (contribution)	0.7	0.6	1.8	0.3	-0.6	0.4	0.0	0.0	0.0	0.0	0.0
Total capital formation (percent of GDP)	43.1	42.9	43.3	43.2	41.6	41.8	41.7	41.8	41.7	41.7	41.6
Gross national saving (percent of GDP) 1/	43.8	44.5	45.3	45.7	43.0	43.4	43.2	43.2	43.1	42.9	42.7
Output gap estimate	-1.0	-4.0	-1.1	-2.8	-2.0	-1.2	-0.5	0.0	0.0	0.0	0.0
LABOR MARKET											
Urban unemployment rate (year-end) 2/	5.2	5.2	5.1	5.5	5.1	...	...	...	...	...	...
PRICES											
Consumer prices (average)	2.9	2.5	0.9	2.0	0.2	0.7	1.9	2.0	2.0	2.0	2.0
Consumer prices (end of period)	4.5	0.2	1.5	1.8	-0.3	1.5	2.0	2.0	2.0	2.0	2.0
GDP Deflator	2.1	1.3	3.0	2.0	-0.6	0.1	1.8	2.0	2.0	2.0	2.0
FINANCIAL											
7-day repo rate (percent)	3.0	2.7	2.2	2.3	1.9	...	...	...	...	...	...
10 year government bond rate (percent)	3.7	3.2	3.0	3.1	2.8	...	...	...	...	...	...
MACRO-FINANCIAL											
Total social financing	10.7	13.3	10.3	9.6	9.8	8.6	8.5	7.5	7.5	7.5	7.5
In percent of GDP	254	278	274	286	301	310	317	320	326	333	339
Total nonfinancial sector debt 3/	10.8	13.2	10.4	9.7	10.1	8.6	8.7	7.6	7.6	7.6	7.5
In percent of GDP	254	278	275	287	302	312	319	324	330	337	344
Domestic credit to the private sector	8.7	10.8	8.4	8.3	8.4	6.8	7.5	6.0	6.3	6.5	6.6
In percent of GDP	162	173	168	174	180	183	185	185	186	188	190
Household debt (percent of GDP)	55.8	61.6	62.1	62.3	63.7	64.0	63.0	62.7	62.6	62.5	62.4
Non-financial corporate domestic debt (percent of GDP)	106	112	106	112	116	119	122	122	123	125	127
GENERAL BUDGETARY GOVERNMENT (Percent of GDP)											
Net lending/borrowing 4/	-6.1	-9.7	-6.0	-7.5	-7.0	-7.4	-7.6	-7.8	-7.9	-8.1	-8.2
Revenue	28.1	25.7	26.6	26.0	26.6	26.3	26.4	26.6	26.8	27.0	27.0
Additional financing from land sales	2.9	2.5	2.3	1.1	0.9	0.8	0.8	0.8	0.8	0.8	0.8
Expenditure	34.2	35.4	32.7	33.5	33.7	33.7	34.0	34.4	34.7	35.0	35.3
Debt	38.5	45.4	46.9	50.7	56.3	60.5	63.7	67.1	70.9	74.9	79.1
Structural balance	-5.8	-8.6	-5.7	-6.8	-6.5	-7.1	-7.4	-7.8	-7.9	-8.1	-8.2
BALANCE OF PAYMENTS (Percent of GDP)											
Current account balance	0.7	1.7	2.0	2.5	1.4	1.5	1.5	1.4	1.4	1.3	1.2
Trade balance	2.7	3.4	3.2	3.7	3.3	3.5	3.5	3.5	3.5	3.4	3.4
Services balance	-1.8	-1.0	-0.6	-0.5	-1.2	-1.3	-1.4	-1.5	-1.5	-1.6	-1.7
Net international investment position	16.0	15.4	12.3	13.6	16.4	17.2	17.5	17.8	18.1	18.3	18.5
Gross official reserves (billions of U.S. dollars)	3,223	3,357	3,427	3,307	3,450	3,817	4,151	4,259	4,377	4,497	4,619
MEMORANDUM ITEMS											
Nominal GDP (billions of RMB) 5/	99,071	102,563	114,528	120,247	125,798	132,273	140,670	149,413	157,829	166,426	175,317
Augmented debt (percent of GDP) 6/	86.3	98.8	100.8	107.9	116.9	124.0	128.9	133.7	138.7	143.6	148.2
Augmented net lending/borrowing (percent of GDP) 6/	-12.5	-17.0	-12.1	-13.4	-13.0	-13.2	-13.1	-12.9	-12.7	-12.5	-12.2
Change in Augmented Cyclically-Adjusted Primary Balance 7/	-3.1	-2.4	3.6	-0.6	0.1	-0.2	0.1	0.2	0.5	0.6	0.5

Sources: Bloomberg; CEIC Data Company Limited; IMF International Financial Statistics database; and IMF staff estimates and projections.

1/ 2023 GDP will be revised to match official revisions, once full official data are released.

2/ Surveyed unemployment rate.

3/ Includes government funds.

4/ 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.

5/ Expenditure side nominal GDP.

6/ The augmented balance expands the perimeter of government to include government-guided funds and the activity of local government financing vehicles (LGFVs).

7/ In percent of potential GDP.

Table 2. China: General Government Fiscal Data

		2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
							Est.	Projections				
							(In RMB billions)					
Balance: General Budgetary (official)												
(1)	**Revenue (incl. adjustments) (1a)+(1b)**	21255	20905	21427	22819	23363	24489	25611	27403	29052	30699	32310
(1a)	Headline revenue	19039	18291	20255	20365	21678	22395	24017	25809	27563	29315	31031
(1b)	Adjustments 1/	2216	2613	1171	2454	1684	2094	1594	1594	1489	1384	1279
(2)	**Expenditure (incl. adjustments) (2a)+(2b)**	24013	24672	24930	26189	28243	28549	29911	31917	33812	35751	37659
(2a)	Headline expenditure	23886	24568	24567	26055	27457	28549	29861	31867	33762	35701	37609
(2b)	Adjustments 2/	127	104	363	134	785	50	50	50	50	50	50
(3)	**Fiscal balance (official) (1)-(2)**	-2758	-3767	-3504	-3370	-4880	-4060	-4301	-4514	-4760	-5053	-5349
Balance: General Budgetary (Fund definition)												
(4)	**Revenue (1a)+(4a)+(4b)**	27790	26343	30512	31233	33512	34747	37153	39762	42302	44856	47403
(1a)	General budget headline revenue	19039	18291	20255	20365	21678	22395	24017	25809	27563	29315	31031
(4a)	Social security revenue	8355	7551	9694	10250	11150	11749	12495	13272	14019	14783	15572
(4b)	SOE fund revenues 3/	396	500	563	618	683	603	642	681	720	759	800
(5)	**Expenditure (2a)+(5a)+(5b)+(5c)-(5d)**	33835	36310	37435	40260	42359	44520	47795	51346	54778	58304	61864
(5a)	Social security expenses	7535	7861	8673	9072	9928	10682	12438	13703	14970	16282	17651
(5b)	SOE fund expenditures	229	261	277	344	339	328	349	371	392	413	435
(5c)	Managed funds' expenditure financed by land sales, bond issuance or carryover 4/	5090	6144	6529	6126	5795	6062	6319	6650	6968	7293	7630
(5d)	of which: net expenditure financed by land sales	2904	2524	2612	1337	1160	1102	1172	1245	1315	1386	1461
(6)	**Net borrowing/lending (Fund definition) (4)-(5)**	-6045	-9967	-6923	-9027	-8848	-9772	-10642	-11584	-12475	-13448	-14461
Balance: Augmented (staff estimates of general government)												
(7a)	Additional infrastructure spending financed by LGFV debt	4503	5479	4722	4845	5224	5393	5510	5503	5413	5308	5091
(7b)	Additional spending of special construction (SCF) and gov't guided funds (GGF)	1874	1940	2165	2222	2324	2293	2238	2176	2098	2012	1918
(8)	**Augmented net lending/borrowing (6)-(7a)-(7b) 5/**	-12423	-17386	-13810	-16095	-16396	-17458	-18391	-19263	-19986	-20767	-21471
Debt: General government												
(9)	**General budgetary debt (official) (10)+(11)**	38114	46552	53740	60931	70770	80005	89653	100277	111930	124694	138611
(10)	Central government debt 6/	16804	20891	23270	25869	30033	34648	39428	44927	51206	58343	66371
(11)	Explicit local government debt 7/	21310	25661	30470	35062	40737	45357	50225	55350	60724	66351	72240
(12)	LGFV debt 8/	39965	45444	50165	55011	60235	65628	71138	76641	82054	87362	92453
(13)	Additional debt tied to SCF and GGFs 9/	7418	9358	11523	13745	16069	18362	20600	22776	24874	26885	28804
(14)	**Augmented debt (9)+(12)+(13)**	85496	101353	115428	129687	147074	163995	181391	199694	218858	238941	259868
Memorandum items:												
(15)	Augmented excluding "possible to be recognized" 10/	59842	71935	82273	92696	106019	118851	132175	146469	161733	178037	195350
						(In percent of GDP) 11/						
Balance: General Budgetary (official)												
(1)	**Revenue (incl. adjustments) (1a)+(1b)**	21.5	20.4	18.7	19.0	18.6	18.5	18.2	18.3	18.4	18.4	18.4
(1a)	Headline revenue	19.2	17.8	17.7	16.9	17.2	16.9	17.1	17.3	17.5	17.6	17.7
(1b)	Adjustments 1/	2.2	2.5	1.0	2.0	1.3	1.6	1.1	1.1	0.9	0.8	0.7
(2)	**Expenditure (incl. adjustments) (2a)+(2b)**	24.2	24.1	21.8	21.8	22.5	21.6	21.3	21.4	21.4	21.5	21.5
(2a)	Headline expenditure	24.1	24.0	21.5	21.7	21.8	21.6	21.2	21.3	21.4	21.5	21.5
(2b)	Adjustments 2/	0.1	0.1	0.3	0.1	0.6	0.0	0.0	0.0	0.0	0.0	0.0
(3)	**Fiscal balance (official) (1)-(2)**	-2.8	-3.7	-3.1	-2.8	-3.9	-3.1	-3.1	-3.0	-3.0	-3.0	-3.1
Balance: General Budgetary (fund definition)												
(4)	**Revenue (1a)+(4a)+(4b)**	28.1	25.7	26.6	26.0	26.6	26.3	26.4	26.6	26.8	27.0	27.0
(4a)	Social security revenue	8.4	7.4	8.5	8.5	8.9	8.9	8.9	8.9	8.9	8.9	8.9
(4b)	SOE fund revenues 3/	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
(5)	**Expenditure (2a)+(5a)+(5b)+(5c)-(5d)**	34.2	35.4	32.7	33.5	33.7	33.7	34.0	34.4	34.7	35.0	35.3
(5a)	Social security expenses	7.6	7.7	7.6	7.5	7.9	8.1	8.8	9.2	9.5	9.8	10.1
(5b)	SOE fund expenditures	0.2	0.3	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2
(5c)	Managed funds' expenditure financed by land sales, bond issuance or carryover 4/	5.1	6.0	5.7	5.1	4.6	4.6	4.5	4.5	4.4	4.4	4.4
(5d)	of which: net expenditure financed by land sales	2.9	2.5	2.3	1.1	0.9	0.8	0.8	0.8	0.8	0.8	0.8
(6)	**Net borrowing/lending (Fund definition) (4)-(5)**	-6.1	-9.7	-6.0	-7.5	-7.0	-7.4	-7.6	-7.8	-7.9	-8.1	-8.2
Balance: Augmented (staff estimates of general government)												
(7a)	Additional infrastructure spending financed by LGFV debt	4.5	5.3	4.1	4.0	4.2	4.1	3.9	3.7	3.4	3.2	2.9
(7b)	Additional spending of special construction (SCF) and gov't guided funds (GGF)	1.9	1.9	1.9	1.8	1.8	1.7	1.6	1.5	1.3	1.2	1.1
(8)	**Augmented net lending/borrowing (6)-(7a)-(7b) 5/**	-12.5	-17.0	-12.1	-13.4	-13.0	-13.2	-13.1	-12.9	-12.7	-12.5	-12.2
Debt: General government												
(9)	**General budgetary debt (official) (10)+(11)**	38.5	45.4	46.9	50.7	56.3	60.5	63.7	67.1	70.9	74.9	79.1
(10)	Central government debt 6/	17.0	20.4	20.3	21.5	23.9	26.2	28.0	30.1	32.4	35.1	37.9
(11)	Explicit local government debt 7/	21.5	25.0	26.6	29.2	32.4	34.3	35.7	37.0	38.5	39.9	41.2
(12)	LGFV debt 8/	40.3	44.3	43.8	45.7	47.9	49.6	50.6	51.3	52.0	52.5	52.7
(13)	Additional debt tied to SCF and GGFs 9/	7.5	9.1	10.1	11.4	12.8	13.9	14.6	15.2	15.8	16.2	16.4
(14)	**Augmented debt (9)+(12)+(13)**	86.3	98.8	100.8	107.9	116.9	124.0	128.9	133.7	138.7	143.6	148.2
Memorandum items:												
(15)	Augmented excluding "possible to be recognized" 10/	60.4	70.1	71.8	77.1	84.3	89.9	94.0	98.0	102.5	107.0	111.4

Sources: CEIC Data Company Limited; China Ministry of Finance; National Audit Office; and IMF staff estimates and projections.

1/ Includes central and local governments' transfers to general budget from stabilization funds, and central government transfers from government managed and SOE funds.

2/ Includes contributions to budget stabilization funds and carryover.

3/ Including operation revenue and carryover.

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/ Total interest-bearing debt of LGFVs with listed bonds.

9/ Total social capital contribution to SCF and GGFs.

10/ Includes only ~2/3 of LGFV debt, being categorized as government explicit debt according to NAO report (2013), and excludes the remaining ~1/3, being categorized as government guaranteed debt or "possible to be recognized" debt. It also excludes row (13).

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

Table 3. China: Balance of Payments

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
						Est.			Projections		
					(In percent of GDP, unless otherwise indicated)						
BALANCE OF PAYMENTS											
Current account balance	0.7	1.7	2.0	2.5	1.4	1.5	1.5	1.4	1.4	1.3	1.2
Trade balance	2.7	3.4	3.2	3.7	3.3	3.5	3.5	3.5	3.5	3.4	3.4
Exports	16.6	16.9	18.1	18.8	17.9	18.0	17.5	17.0	16.7	16.4	16.3
Imports	13.9	13.4	14.9	15.0	14.6	14.5	14.0	13.5	13.2	13.0	12.8
Services balance	-1.8	-1.0	-0.6	-0.5	-1.2	-1.3	-1.4	-1.5	-1.5	-1.6	-1.7
Income balance	-0.3	-0.8	-0.7	-0.9	-0.8	-0.7	-0.7	-0.7	-0.6	-0.6	-0.6
Current transfers	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Capital and financial account balance	0.1	-0.3	-0.2	-1.4	-1.1	0.5	0.2	-0.9	-0.8	-0.7	-0.6
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	0.1	-0.3	-0.2	-1.4	-1.1	0.5	0.2	-0.9	-0.8	-0.7	-0.6
Net foreign direct investment	0.4	0.7	0.9	-0.1	-0.8	-0.1	0.0	0.0	0.0	0.0	0.0
Foreign Direct investment	1.3	1.7	1.9	1.1	0.2	1.0	1.0	0.9	0.9	0.9	0.9
Overseas Direct Investment	-1.0	-1.0	-1.0	-1.2	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-0.9
Portfolio investment	0.4	0.6	0.3	-1.6	-0.4	0.2	0.2	0.2	0.2	0.3	0.3
Other investment	-0.7	-1.7	-1.4	0.4	0.0	0.4	0.1	-1.0	-1.0	-0.9	-0.9
Errors and omissions 1/	-0.9	-1.1	-0.8	-0.5	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.1	0.2	1.1	0.5	0.0	2.0	1.7	0.5	0.5	0.5	0.5
Reserve assets	0.1	-0.2	-1.1	-0.5	0.0	-2.0	-1.7	-0.5	-0.5	-0.5	-0.5
INTERNATIONAL INVESTMENT POSITION											
Asset	54.7	59.7	53.6	51.6	54.0	55.2	55.0	54.9	55.1	55.2	55.4
Direct investment	15.6	17.4	15.7	15.4	16.6	16.9	16.8	16.8	16.8	16.8	16.9
Securities investment	4.6	6.1	5.5	5.8	6.2	6.4	6.4	6.4	6.5	6.6	6.7
Other investment	12.0	13.6	13.0	11.8	11.7	11.3	10.8	11.5	12.2	12.8	13.4
Reserve assets	22.5	22.6	19.3	18.5	19.4	20.7	21.0	20.2	19.6	19.0	18.5
Liability	38.7	44.4	41.3	38.1	37.6	38.0	37.5	37.1	36.9	36.8	36.9
Direct investment	19.5	21.7	20.3	20.0	20.0	20.2	19.8	19.5	19.4	19.2	19.1
Securities investment	10.1	13.2	12.1	10.1	9.6	9.8	9.8	9.8	9.9	10.0	10.3
Other investment	9.0	9.4	8.9	7.8	7.9	8.0	7.9	7.8	7.7	7.6	7.5
Net international investment position	16.0	15.4	12.3	13.6	16.4	17.2	17.5	17.8	18.1	18.3	18.5
MEMORANDUM ITEMS											
Export growth (value terms, percentage change)	-1.3	5.2	28.1	4.1	-5.0	4.6	4.1	3.8	4.0	4.3	4.2
Import growth (value terms, percentage change)	-2.1	0.3	32.7	1.1	-3.6	3.7	3.1	3.3	3.7	4.1	4.0
FDI (inward, billions of U.S. dollars)	187	253	344	190	43	182	191	200	208	217	225
External debt (billions of U.S. dollars)	2,071	2,401	2,747	2,453	2,448	2,638	2,838	3,049	3,272	3,508	3,759
As a percent of GDP	14.4	16.2	15.5	13.7	13.8	14.3	14.3	14.4	14.6	14.8	15.1
Short-term external debt (remaining maturity, billions of U.S. dollar	1,205	1,316	1,446	1,318	1,305	1,411	1,523	1,641	1,766	1,899	2,039
Gross reserves (billions of U.S. dollars) 2/	3,223	3,357	3,427	3,307	3,450	3,817	4,151	4,259	4,377	4,497	4,619
As a percent of short-term debt by remaining maturity	267.4	255.0	237.0	250.8	264.4	270.5	272.5	259.5	247.8	236.8	226.5
Terms of trade (percentage change)	4.7	4.7	0.4	0.5	-0.4	-0.7	1.5	1.3	0.8	0.6	0.4
Real effective exchange rate (2010 = 100)	121.3	124.0	127.9	126.7	116.6	...	...	...	...	...	...
Nominal GDP (billions of U.S. dollars)	14,341	14,863	17,759	17,849	17,758	18,481	19,794	21,124	22,377	23,694	24,966

Sources: CEIC Data Company Limited; 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 4. China: Monetary and Credit Developments

	2019	2020	2021	2022	2023
MONETARY SURVEY					
			(Annual percentage change)		
Net foreign assets	3.5	1.9	5.0	2.2	1.3
Monetary authority (contribution)	0.5	-0.3	2.6	0.4	1.8
Depository institutions (contribution)	3.0	2.1	2.4	1.7	-0.5
Domestic credit	10.6	12.3	9.6	10.3	10.5
Claims on government, net (contribution)	2.0	2.3	1.8	2.4	2.5
Claims on nonfinanical sectors (contribution)	9.2	10.2	7.5	7.7	7.1
Claims on other financial sectors (contribution)	-0.6	-0.2	0.2	0.2	0.8
Broad money (M2)	8.7	10.1	9.0	11.8	9.7
M1 (contribution)	1.3	2.5	1.0	1.0	0.3
Quasi-money (contribution)	7.4	7.6	8.0	10.8	9.4
Reserve money	-2.0	1.9	-0.3	9.6	7.8
TOTAL SOCIAL FINANCING					
			(Annual percentage change)		
TSF	10.7	13.3	10.3	9.6	9.8
Bank loans (contribution)	7.4	8.0	7.0	6.5	6.6
Shadow banking (contribution)	-0.8	-0.5	-0.9	-0.2	0.0
Net corporate bond financing (contribution)	1.2	1.7	0.8	0.3	0.0
Non-financial enterprise equity (contribution)	0.2	0.4	0.4	0.4	0.2
Others (contribution)	0.0	0.0	0.0	0.0	0.0
Others (contribution) 1/	0.6	0.6	0.5	0.3	0.1
			(In percent of GDP)		
TSF	253.7	277.7	274.3	286.3	300.5
Bank loans	155.1	169.4	169.2	178.2	188.5
Shadow banking	22.4	20.4	15.9	14.7	14.0
Net corporate bond financing	23.7	26.9	26.1	25.8	24.7
Non-financial enterprise equity	7.4	8.0	8.3	8.8	9.1
Others 1/	6.9	8.1	8.4	8.7	8.7
MEMORANDUM ITEMS					
			(In percent)		
Non-performing loans (NPLs) ratio	1.9	1.8	1.7	1.6	1.6
Provision coverage ratio (provisions/NPLs)	186.1	184.5	196.9	205.9	205.1
Liquidity ratio (liquid assets/liquid liabilities)	58.5	58.4	60.3	62.9	67.9
Loan to deposit ratio	75.4	76.8	79.7	78.8	78.7
Return on assets	0.9	0.8	0.8	0.8	0.7
Return on equity	11.0	9.5	9.6	9.3	8.9
Capital adequacy ratio	14.6	14.7	15.1	15.2	15.1
Tier-1 capital adequacy ratio	12.0	12.0	12.4	12.3	12.1
Core tier-1 capital adequacy ratio	10.9	10.7	10.8	10.7	10.5
Net open FX position (in percent of capital)	2.7	2.1	1.6	1.3	1.4

Sources: Haver Analytics; and IMF staff estimates.

1/ Includes asset-backed securities, loan write-offs, and other components.

Table 5. China: Nonfinancial Sector Debt

	(In RMB trillions)						(In percent of GDP)						Coverage	
	2019	2020	2021	2022	2023	2024	2019	2020	2021	2022	2023	2024		
Total non-financial sector debt	252	285	315	345	380	413	254	278	275	287	302	312		
Central government	17	21	23	26	30	35	17	20	20	22	24	26	Official Government Debt	Staff Estimate of General Government Debt ("Augmented")
Local government 1/	21	26	30	35	41	45	22	25	27	29	32	34		
Local government financing vehicles (LGFV)	40	45	50	55	60	66	40	44	44	46	48	50		
Government funds 2/	7	9	12	14	16	18	7	9	10	11	13	14		
Households	55	63	71	75	80	85	56	62	62	62	64	64		Private Sector Debt
Corporates (excluding LGFV)	111	121	128	141	153	164	112	118	112	117	122	124		
Domestic 3/	105	115	122	134	147	157	106	112	106	112	116	119		
External	6	6	6	6	6	7	6	6	5	5	5	5		
Memo items:														
Total domestic non-financial sector debt	246	279	308	339	374	406	248	272	269	282	297	307		
Corporates (including LGFVs)	151	166	178	196	213	230	152	162	156	163	169	174		
	40	45	50	55	60	66	40	44	44	46	48	50		
Households	55	63	71	75	80	85	56	62	62	62	64	64		
General government (Official definition)	38	47	54	61	71	80	38	45	47	51	56	61		
Government funds 2/	7	9	12	14	16	18	7	9	10	11	13	14		
Nominal GDP	99	103	115	120	126	132								

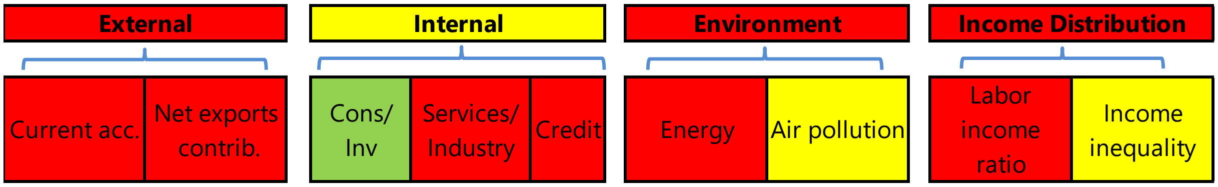
Sources: CEIC Data Company Limited; Bloomberg; Ministry of Finance; and IMF staff estimates.

1/ Including LGFV debt recognized as LG debt as of 2014 (by the 2014 audit).

2/ Government guided funds and special construction funds (social capital portion only).

3/ Domestic corporate debt (excluding LGFV) for 2018 changed relative to the 2019 Article IV Staff Report due to the new LGFV borrowing estimates and the TSF data revisions in December 2019.

Table 6. China: Rebalancing Scorecard



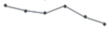
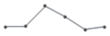
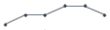
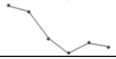
	Unit	2020	2021	2022	2023	2024
					Projection / YTD	
1. External rebalancing						
Contribution of net exports to GDP growth	%	0.6	1.8	0.3	-0.6	0.4
Current account balance	% of GDP	1.7	2.0	2.5	1.4	1.5
FX reserve coverage	months of imports	16.1	17.3	12.8	13.2	14.7
National saving rate	% of GDP	44.5	45.3	45.7	43.0	43.4
2. Internal rebalancing						
Demand side						
Growth contribution of consumption vs investment 1/	%	-0.1	2.9	0.8	2.9	6.2
Share of private consumption (Nominal)	% of GDP	37.8	38.2	37.5	39.1	39.8
Share of investment (Nominal)	% of GDP	42.9	43.3	43.2	41.6	41.8
Supply side						
Growth contribution of Tertiary vs Secondary sector 1/	%	1.1	1.4	1.6	1.8	1.3
Share of Tertiary sector (Nominal) 1/	% of GDP	54.5	53.5	53.4	54.6	59.0
Share of Tertiary sector in total employment	%	47.7	48.0	47.1	48.1	…
Credit Side						
Private domestic credit 1/	% of GDP	173	168	174	180	183.1
Credit intensity		6.6	1.7	3.7	4.1	3.3
Return on asset: SOE - private 1/	%	-3.2	-2.7	-1.7	-1.2	0.1
3. Environmental rebalancing						
Energy intensity of output 1/	per unit of output	93.2	84.0	84.6	85.8	90.5
PM 2.5 (Weighted by usual residence) 2/	mcg per cubic meter	35.7	32.0	30.6	30.2	…
4. Income distribution						
Gini	index number	0.468	0.466	0.467	…	…
Labor income 1/	% of GDP	58.1	58.5	59.1	58.9	58.6
Urban/rural income gap 1/	income ratio	2.56	2.50	2.45	2.39	2.30
Nominal disposable income growth: Median – Mean 1/	%	-0.90	-0.29	-0.34	-1.02	0.2

Note: The color coding is based on the change in each indicator relative to the previous year. 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.

1/ Reported values for 2024 are for 2024 YTD (through Q1), not full year projections.

2/ Data for 2023 is the most recent available.

Table 7. China: SOE Performance

Dimention	Indicator	2018	2019	2020	2021	2022	2023	Trend
	(In percent unless otherwise indicated)							
Profitability	Return on assets SOEs 1/	1.9	0.9					
	Return on assets industrial SOEs	4.2	3.5	3.1	4.4	4.2	3.7	
	Return on assets industrial private	7.5	6.8	6.5	7.4	6.0	5.1	
Efficiency	Cost per unit of income -SOE	97.1	97.4	97.1				
Leverage	SOE debt to GDP 1/	59.2	59.5					
	Debt to equity SOEs 1/	183	182					
	-Central	210	209					
	Debt to asset SOE 1/	64.7	63.9					
	-Central	67.7	67.0					
	-Local	62.2	61.6					
	Debt to asset - above designated size industrial	55.6	56.6	56.4	56.5	56.6	57.1	
	Debt to asset- industrial state holding enterprises	58.7	58.0	57.3	57.1	57.3	57.1	
	Debt to asset - industrial private	53.7	55.6	57.4	57.7	58.4	59.7	
	Number of zombies 2/	141	102					
	Number of default SOE bonds	20	21	84	50	11	19	
Corporate governance	Central SOEs with board of directors	94	95	95	96	96	95	
	Number of Central SOEs 3/	96	97	97	98	98	97	
	Dividend payments to budget	7.4	7.6	9.1	7.3	8.9		
SOEs share in the economy	Employment	13.2	12.7	11.8				
	Above designated size industrial sales	26.9	27.2	25.5	25.0	26.5	27.5	
	Asset (industrial state holding enterprises/total above designated size industrial)	38.1	38.7	36.5	35.3	36.2	36.3	
	Liability (industrial state holding enterprises/total above designated size industrial)	40.3	39.7	37.1	35.7	36.7	36.3	

Sources: CEIC, NBS, and Ministry of Finance.

1/ Since June 2019, the government no longer disclosed non-financial SOE assets and liabilities. The debt ratios in 2019 is calculated as of June 2019.

2/ Number of zombies refers to legal entities of central SOEs. Number of zombies in 2019 refers to data as of 2019 Q3. According to SASAC's 3-year plan, all zombie enterprises will be cleaned up by 2020.

3/ There are 97 central SOEs invested by SASAC, 4 central SOEs and 27 central financial SOEs invested by MOF and 1 central SOE invested by Ministry of Water Resources by 2023.

Table 8. China: External Vulnerability Indicators

	2020	2021	2022	2023	2024
Monetary and financial					
General government debt (in percent of GDP, narrow definition)	45.4	46.9	50.7	56.3	60.5
Broad money (M2, annual percentage change)	10.1	9.0	11.8	9.7	…
Foreign currency deposits to broad money (percent)	2.7	2.7	2.2	1.9	…
Local currency loans to the economy (annual percentage change)	12.8	11.6	11.1	10.6	…
Foreign currency loans to bank domestic credit (in percent)	2.3	2.2	1.7	1.4	…
Stock exchange index (end-of-period, December 19, 1990 = 100) 1/	3,640	3,814	3,238	3,119	…
Stock exchange capitalization (percent of GDP)	117.7	119.3	110.0	112.3	…
Number of listed companies (A-share)	3,925	4,226	4,404	4,530	4,542
Balance of payments					
Exports (annual percentage change, U.S. dollars)	5.2	28.1	4.1	-5.0	4.6
Imports (annual percentage change, U.S. dollars)	0.3	32.7	1.1	-3.6	3.7
Current account balance (percent of GDP)	1.7	2.0	2.5	1.4	1.5
Capital and financial account balance (percent of GDP)	-0.3	-0.2	-1.4	-1.1	0.5
Of which: gross foreign direct investment inflows	1.7	1.9	1.1	0.2	1.0
Foreign Exchange Reserve					
In billions of U.S. dollars 2/	3,357	3,427	3,307	3,450	3,816.8
Coverage in terms of:					
Imports (in months)	16.1	17.3	12.8	13.2	14.7
Broad money (percent)	10.6	9.3	8.4	8.4	…
Short-term external debt by remaining maturity (percent)	255	237	251	264	270
Assessing Reserve Adequacy (range, in percent of ARA metrics) 3/	88-227	84-217	75-193	68-175	64-162
External debt and balance sheet indicators					
Total external debt (percent of GDP)	16.2	15.5	13.7	13.8	14.3
Total external debt (billions of U.S. dollars)	2,401	2,747	2,453	2,448	2,638
Short-term external debt by original maturity (billions of U.S. dollars)	1,316	1,446	1,318	1,305	1,411
Net foreign assets of banking sector (billions of U.S. dollars)	801	924	914	878	…
Total debt to exports of goods & services (percent)	87.7	77.3	65.9	69.7	71.8
Total debt service to exports of goods & services (percent)	48.3	40.8	36.1	39.0	…
Of which: Interest payments to exports of goods & services (percent)	0.2	0.1	0.1	0.1	0.1
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 Data Company Limited; Bloomberg; IMF, Information Notice System; and IMF staff estimates.

1/ Shanghai Stock Exchange, A-share.

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

3/ ARA short for assessing reserve adequacy. Range for the ARA metric under different assumptions of exchange rate regime and capital controls.

Table 9. China: Core Financial Soundness Indicators for Deposit Takers

(Percent, eop)

	2018	2019	2020	2021	2022	2023	2024Q1
Capital Adequacy Ratio	14.2	14.6	14.7	15.1	15.2	15.1	15.4
Tier 1 Capital Adequacy Ratio	11.6	12.0	12.0	12.4	12.3	12.1	12.4
Core Tier 1 Capital Adequacy Ratio	11.0	10.9	10.7	10.8	10.7	10.5	10.8
Return on Assets	0.9	0.9	0.8	0.8	0.8	0.7	0.7
Return on Equity	11.7	11.0	9.5	9.6	9.3	8.9	9.6
Net Interest Margin	2.2	2.2	2.1	2.1	1.9	1.7	1.5
Nonperforming Loans Ratio	1.8	1.9	1.8	1.7	1.6	1.6	1.6
Substandard Loans Ratio	0.7	0.8	0.9	0.8	0.8	0.7	0.7
Doubtful Loans Ratio	0.8	0.8	0.7	0.7	0.6	0.6	0.6
Loss Loans Ratio	0.3	0.3	0.3	0.3	0.2	0.4	0.4
Provision Coverage Ratio	186.3	186.1	184.5	196.9	205.9	205.1	204.5
Liquidity Ratio	55.3	58.5	58.4	60.3	62.9	67.9	68.7
Loan to Deposit Ratio	74.3	75.4	76.8	79.7	78.8	78.7	78.8

Sources: Haver Analytics; National Administration of Financial Regulation.

Appendix I. External Sector Assessment

<table>
<tr><td colspan="7">**Overall Assessment:** *The external position in 2023 is assessed to be broadly in line with the level implied by medium-term fundamentals and desirable policies.* The CA surplus declined to 1.4 percent of GDP in 2023 as exports declined on the back of both weakness in global demand as well as the unwinding of the COVID-19-related export boom. Rising services imports due to a normalization of outbound tourism also contributed to the lower CA surplus. Over the medium term, the CA surplus is projected to narrow further and gradually converge to the CA norm, mostly reflecting rising social spending pressures as population ages.

Potential Policy Responses: Policies to ensure that the external position remains broadly in line with fundamentals include (1) accelerating market-based structural reforms—a further opening up of domestic markets, ensuring competitive neutrality between state-owned and private firms, scaling back wasteful and distorting industrial policies, and increasing reliance on market forces to improve resource allocation—to boost potential growth; (2) shifting fiscal policy support toward strengthening social protection to reduce high household savings and rebalance toward private consumption; and (3) gradually increasing exchange rate flexibility to help the economy better absorb external shocks.</td></tr>
<tr><td>**Foreign Asset and Liability Position and Trajectory**</td><td colspan="6">**Background.** The NIIP reached 16.5 percent of GDP in 2023, from 13.6 percent in 2022 and significantly below the peak of 30.4 percent in 2008. The increase largely reflects the CA surplus.

Assessment. The NIIP-to-GDP ratio is expected to remain positive and increase modestly over the medium term in line with the narrowing CA surplus. Increasing portfolio investment, on the back of China's gradual financial opening, is expected to diversify its foreign assets and liabilities further. The NIIP is not a major source of risk, as assets remain high—reflecting large foreign reserves ($3.4 trillion as of the end of 2023, 19.5 percent of GDP)—and liabilities are mostly related to FDI.</td></tr>
<tr><td>2023 (% GDP)</td><td>NIIP: 16.5</td><td colspan="2">Gross Assets: 54.3</td><td>Debt Assets: 15.9</td><td>Gross Liab.: 37.8</td><td>Debt Liab.: 13.0</td></tr>
<tr><td>**Current Account**</td><td colspan="6">**Background.** Following the increase since 2019, the CA surplus declined to 1.4 percent of GDP in 2023 as domestic saving declined to its pre-pandemic level. The lower CA surplus reflects lower goods and services balances. After a post-reopening increase in trade in 2023Q1, exports declined amid weak global demand and the unwinding of the COVID-19-related surge in goods exports. Imports evolved in line with domestic demand, sequentially weakening in 2023Q2–Q3 and partially rebounding in 2023Q4. Taken together, the trade balance declined to 3.3 percent of GDP (from 3.7 percent of GDP in 2022) as exports weakened more than imports. The 2023 services deficit increased to 1.2 percent of GDP (from 0.5 percent of GDP in 2022) as outbound tourism partially recovered. Over the medium term, domestic saving is expected to decline faster than investment, due to rapid population aging and the associated rising social spending pressures further reducing the CA surplus.

Assessment. Based on the adjusted results of the EBA CA model, the IMF staff CA gap ranges from –0.7 to 0.5 percent of GDP with a midpoint of –0.1 percent. As the travel balance continues to recover to pre-COVID-19 levels, an adjustor of –0.4 percent is applied to the CA. EBA-identified policy gaps are estimated at –0.6 percent of GDP, driven by relatively favorable credit conditions (–0.3 percent of GDP) and looser fiscal policy than in other countries (–0.2 percent of GDP).</td></tr>
<tr><td>2023 (% GDP)</td><td>CA: 1.4</td><td>Cycl. Adj. CA: 1.2</td><td>EBA Norm: 0.9</td><td>EBA Gap: 0.3</td><td>Staff Adj.: –0.4</td><td>Staff Gap: –0.1</td></tr>
<tr><td>**Real Exchange Rate**</td><td colspan="6">**Background.** In 2023, the REER depreciated by 8.2 percent from the 2022 average, faster than the NEER depreciation (3.4 percent) reflecting lower inflation in China. The REER depreciation more than reversed the appreciation of 5 percent in 2020–21, which followed a depreciation of 7 percent during 2015–19. As of April 2024, the REER had depreciated by 2.7 percent relative to the 2023 average.

Assessment. The IMF staff CA gap implies a REER gap of 0.7 percent. The EBA REER index regression estimates the REER gap in 2023 to be 5.1 percent, and the EBA REER level regression estimates the REER gap to be 3.4 percent. Consistent with the IMF staff CA gap, the IMF staff assesses the REER to be in the range of –3.6 to 5.0 percent with a midpoint of 0.7 percent (with an estimated elasticity of 0.14 applied).</td></tr>
<tr><td>**Capital and Financial**</td><td colspan="6">**Background.** The 2023 financial account (excluding net errors and omissions) reached –1.2 percent of GDP (–1.4 percent of GDP in 2022) as capital outflow pressures reemerged in 2023H2, while inward FDI reached a historically low level (0.2</td></tr>
</table>

Accounts: Flows and Policy Measures	percent of GDP) and portfolio investment remained subdued (0.1 percent of GDP). Net errors and omissions declined in absolute terms to –0.2 percent of GDP in 2023 (from the 2015–20 average of –1.4 percent of GDP). The authorities raised the cross-border financing macroprudential adjustment parameter for financial institutions and enterprises from 1.25 to 1.5 (relaxation of an inflow CFM measure) in July 2023. The authorities cut FX reserve requirements from 6 to 4 percent in September. As of the end of May 2024, the total Qualified Domestic Institutional Investor quota stood at $167.8 billion.[1] **Assessment.** Substantial net outflow pressures resurfaced with the divergence of China's monetary policy from that in advanced economies, expectations for weakening economic prospects as well as market-perceived geopolitical risk and economic policy uncertainty. Over the medium term, further capital account opening is likely to create substantially larger two-way gross flows. The sequencing of capital account opening consistent with exchange rate flexibility should carefully consider domestic financial stability, while addressing the faster pace of private sector accumulation of foreign assets with respect to nonresident accumulation of Chinese assets. CFMs should not be used to actively manage the capital flow cycle or substitute for warranted macroeconomic adjustment and exchange rate flexibility. Over the medium term, China should gradually phase out CFM measures in a sequence consistent with greater exchange rate flexibility and accompanying reforms.
FX Intervention and Reserves Level	**Background.** FX reserves increased (by about $110 billion) and reached $3.3 trillion as of the end of 2023. In the last quarter of 2023, a partial recovery in capital flows, including FDI, and favorable valuation effects contributed to an increase in FX reserves that more than offset losses in the first three quarters of the year. **Assessment.** The end-of-2023 reserve assets, including gold, at $3.4 trillion—69 percent of the IMF's standard composite metric at the end of 2023 (68 percent in 2022) and 112 percent of the metric adjusted for capital controls (110 percent in 2022)—are assessed to be adequate. Temporary FX intervention could be considered in the event of large capital outflows that pose significant risks to macroeconomic and financial stability, including if markets turn disorderly.

[1] See 2022 IMF CFM Taxonomy for a list of China's existing CFMs and related policy advice.

Appendix II. Risk Assessment Matrix[1]

Sources of Risk	Risk Likelihood	Expected Impact	Policy Response
		External Risks	
Intensification of regional conflict(s).	High	Medium. Escalation or spread of the conflict in Gaza and Israel, Russia's war in Ukraine, and/or other regional conflicts or terrorism disrupt trade (e.g., energy, food, tourism, supply chains), remittances, FDI and financial flows, payment systems, and increase refugee flows.	Let the exchange rate adjust to the change in the terms of trade. Protect the vulnerable from high food and energy prices through targeted transfers, without resorting to significant price controls. Allow for more accommodative macro policies, especially monetary easing through interest rate cuts, to offset headwinds from slower partner country growth.
Commodity price volatility.	High	Medium. A succession of supply disruptions (e.g., due to conflicts, export restrictions, and OPEC+ decisions) and demand fluctuations causes recurrent commodity price volatility, external and fiscal pressures in EMDEs, cross-border spillovers, and social and economic instability.	Let the exchange rate adjust to the change in the terms of trade. Protect the vulnerable from high food and energy prices through targeted transfers, without resorting to significant price controls. Increase resilience to energy price shocks by accelerating green investments in the power sector. Avoid introducing further export restrictions and seek constructive multilateral solutions.
Abrupt global slowdown or recession.	Medium	High. Global and idiosyncratic risk factors cause a synchronized sharp growth downturn, with recessions in some countries, adverse spillovers through trade and financial channels, and market fragmentation triggering sudden stops in EMDEs. • Europe: Intensifying fallout from Russia's war in Ukraine, supply disruptions, tight financial conditions and real estate market corrections exacerbate economic downturn. • U.S.: Amid tight labor markets, inflation remains elevated, prompting the Fed to keep rates higher for longer and resulting in more abrupt financial,	Allow for more accommodative macro policies, especially monetary easing through interest rate cuts. Fiscal policy should focus on redirecting expenditure towards households, which would support short-term growth and promote long-term rebalancing without unfavorably impacting debt dynamics. Let the exchange rate adjust more freely in response to interest rate differentials. Protect against financial spillovers by accelerating the reforms needed to strengthen bank resolution frameworks. Ensure the smooth functioning of credit markets, while addressing moral hazard.

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[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood 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 between 30 and 50 percent). 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. The conjunctural shocks and scenario highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Sources of Risk	Risk Likelihood	Expected Impact	Policy Response
		housing, and commercial real estate market correction.	
Monetary policy miscalibration.	Medium	Medium. Amid high economic uncertainty, major central banks loosen policy stance prematurely, hindering disinflation, or keep it tight for longer than warranted, causing abrupt adjustments in financial markets and weakening the credibility of central banks.	Let the exchange rate adjust flexibly to changing interest rate differentials. Protect against financial spillovers by accelerating the reforms needed to strengthen bank resolution frameworks. Ensure the smooth functioning of credit markets, while addressing moral hazard.
Systemic financial instability.	Medium	Medium. High interest rates and risk premia and asset repricing amid economic slowdowns and policy uncertainty (e.g., from elections) trigger market dislocations, with cross-border spillovers and an adverse macro-financial feedback loop affecting weak banks and NBFIs.	Let the exchange rate adjust flexibly to changing interest rate differentials. Protect against financial spillovers by accelerating the reforms needed to strengthen bank resolution frameworks. Ensure the smooth functioning of credit markets, while addressing moral hazard.
Deepening geoeconomic fragmentation.	High	High. Broader and deeper conflict(s) and weakened international cooperation result in a more rapid reconfiguration of trade and FDI, supply disruptions, protectionism, technological and payments systems fragmentation, rising input costs, financial instability, a fracturing of international monetary and financial systems, and lower potential growth.	Accelerate domestic structural reforms. Avoid introducing further export restrictions. Find constructive multilateral solutions together with other countries on trade, supply-chain resilience, standard setting for critical technologies, and climate change.
Cyberthreats.	Medium	High. Cyberattacks on physical or digital infrastructure (including digital currency and crypto assets ecosystems) or misuse of AI technologies trigger financial and economic instability.	Put in place adequate firewalls and security measures. Enhance crisis preparedness for cyberattacks.
Extreme climate events.	Medium	Medium. Extreme climate events driven by rising temperatures cause loss of human lives, severe damage to infrastructure, supply disruptions, lower growth, and financial instability.	Continued push for green investment, combined with well-sequenced climate change mitigation strategies, would boost the near-term recovery while promising large environmental, health, fiscal, and economic benefits over the long term. Invest in climate change adaptation to increase resilience in vulnerable communities.

Sources of Risk	Risk Likelihood	Expected Impact	Policy Response
Disorderly energy transition.	Medium	Medium. Disorderly shift to net-zero emissions (e.g., owing to shortages in critical metals) and climate policy uncertainty cause supply disruptions, stranded assets, market volatility, and subdued investment and growth.	Implement a high-quality comprehensive reform package based on market-oriented policies.
Domestic Risks			
Sharper-than-expected slowdown in the property sector.	Medium	High. Growth slowdown due to the direct impact on real estate investment, unexpected fiscal tightening due to local government financing stress and decline in investment and consumption due to low consumer and business confidence.	Facilitate the efficient and orderly restructuring of distressed property developers, ensure the completion of unfinished, pre-sold housing to protect homebuyers and boost confidence, and prepare to deal with spillovers to the financial system through stronger prudential policies. Allow for more accommodative macro policies, especially monetary easing through interest rate cuts. Fiscal policy should focus on reorienting expenditure away from investment and towards households, which would support short-term growth and promote long-term rebalancing without unfavorably impacting debt dynamics.
Protracted deflation.	Low	High. Weak consumer and investor confidence, including due to deeper and more protracted property sector contraction, could depress aggregate demand which exerts sustained downward pressure on core inflation. Focus on supply-side policies in the goods sector, amid weak demand, further intensifies the downward pressure on prices, with potential negative feedback loops.	Macroeconomic policy should be more accommodative. Monetary easing should focus on policy rate cuts, with credit policy restraint particularly in sectors with potential excess supply. Additional fiscal support may be needed, especially via transfers targeted to lower and middle-income households with higher propensity to consume. Fiscal support should be provided by the central government and on budget.
Balance Sheet Recession.	Low	High. High aggregate debt level leads to broad-based deleveraging, which could result in weak domestic demand and further disinflationary pressures, with potential negative feedback loops.	Macroeconomic policy should be more accommodative. Monetary easing should focus on policy rate cuts. In the event of a large growth slowdown due to broad-based deleveraging, additional fiscal support may be needed, but should be provided by the central government and on budget. Implement a high-quality comprehensive reform package based on market-oriented policies to reignite growth.

Sources of Risk	Risk Likelihood	Expected Impact	Policy Response
Stronger than expected recovery.	Medium (Upside risk)	High. Policy support and developer restructuring leads to stabilization in the property sector, improved consumer and business confidence, and a stronger and faster than expected recovery.	Consider frontloading fiscal consolidation to increase fiscal space for future shocks.

Appendix III. Sovereign Risk and Debt Sustainability Assessment

The Sovereign Risk and Debt Sustainability Assessment (SRDSA) assesses sovereign risk and government debt under staff's estimated general government "augmented" definition. "Augmented" debt and associated gross financing needs are high and on an upward trajectory. A gradual fiscal adjustment over 2025-2035 is needed to stabilize debt by 2035.

1. **Staff assess sovereign risk based on the "augmented" debt definition.** Augmented debt includes both official and off-budget debt:

Official debt includes central government debt and "on-budget" local government debt identified by the authorities.[1]

Off-budget debt adds other types of local government borrowing, including Staff estimates of debt from LGFVs, 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 have substantial revenues. It is also possible that some general government activity takes place outside of staff's augmented definition (e.g., public-private partnerships).

2. **Under the baseline scenario debt continues to rise over the medium and long term**. Augmented debt rises to about 165 percent of GDP in 2033 from 117 percent of GDP in 2023.[2] The main driver are large primary deficits that are projected to decline only slowly over time, as the reduction in off-budget investment is partly offset by rising pension spending due to aging.[3] Positive growth-interest differentials (owing to a financial system that channels ample domestic savings to finance GG debt at favorable rates) help contain the debt rise but are projected to slowly reverse in the long term as potential growth falls. The recommended consolidation path between 2025-2035 (an average structural primary balance tightening of 0.7 percent of GDP every year) stabilizes the debt-to-GDP ratio by 2035. Risks such as faster accumulation of general government debt or lower-than-projected potential growth would call for a more ambitious long-term consolidation path. In the baseline, gross financing needs hover around 30 percent of GDP but would slightly increase in

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[1] In 2014, 2/3 of existing LGFV debt was explicitly recognized as a government liability following a government audit.

[2] The baseline is surrounded by large uncertainty. Bolder policies to restructure the real estate sector would add to government debt in the short term (see text figure), while LGFV debt restructuring could reduce augmented debt, with the size of the reduction depending on the degree of burden sharing with the private sector and potential macro-fiscal and financial spillovers requiring further stabilization measures (see 2023 SIP).

[3] The baseline assumes continued a small amount of reductions in the LGFV debt NPV through bank maturity extensions, interest rate reductions, and refinancing with official LG debt, in line with recent years. LGFV debt refinancing with official debt does not change augmented debt. Additional pension spending due to aging is estimated using UN population projections (medium fertility scenario) and assuming unchanged policies.

the medium and long term in the absence of fiscal consolidation.[4] In addition to increased pension spending due to aging incorporated in the baseline, investment needs to reach the 2060 climate goal could substantially increase the pace of debt accumulation if they were financed with government borrowing. However, China plans to rely on additional financing instruments such as expanding the coverage of the Emissions Trading System (ETS). A prolonged period of deflation would further raise the debt-to-GDP ratio (Box 2). Increased health spending due to aging (not included in the baseline) would have minor effects.

3. **Several factors mitigate risks associated with China's high augmented debt level and large financing requirements.** Most of China's debt (about 95 percent of the total) is held by domestic residents and only a small portion is denominated in foreign currency, while the capital account is not fully open. The general government's positive net financial worth (estimated at 7 percent of GDP in 2019 by Lam and Moreno-Badia, 2023) further mitigates risks. The availability of liquid assets (government deposits in the banking system are a third of GDP), and the ability of domestic financial institutions to provide financing (the largely state-dominated commercial banking system claims on the government are only a quarter of the banking system's assets) offsets risks too. However, LGFV debt has shorter maturities (about 3 years on average compared with 7 years for official debt), is exposed to higher liquidity risks, and depends more on financing from nonbank financial institutions.

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[4] The SRDSA assumes maturing debt is rolled over and asset-based financing declines gradually.

Appendix III. Figure 1. China: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Moderate	Staff's assessment of the overall risk of sovereign stress is moderate, with downside risks. While the mechanical signal suggests medium- and long-term risks are high, fiscal consolidation to stabilize debt is feasible, and the partially closed capital account mitigates risks. Moreover, large government assets could be used to meet financing needs, with the government financial net worth estimated to be positive and include sizeable cash deposits (Lam and Moreno-Badia, 2023).
Near term 1/			
Medium term	High	High	Staff's assessment of the medium term risk of sovereign stress is high. The mechanical medium-term signals for the fan chart and GFN indicate "high" risk, largely driven by the non-stabilization of debt and annual gross financing needs that hover around 30 percent of GDP.
Fanchart	High	...	
GFN	High	...	
Stress test		...	
Long term	...	High	Long-term risks are high given the effect of aging on pension and health spending, as well as large climate mitigation investment needs, and declining potential growth prospects. Staff estimates that annual pension spending will increase by about 9 percent of GDP from 2023 to 2052.
Sustainability assessment 2/	Not required for surveillance countries	Not required for surveillance countries	
Debt stabilization in the baseline			No

DSA Summary Assessment

Commentary: China has a moderate overall risk of sovereign stress. Debt is expected to rise over the medium and long term, but it can be stabilized with a gradual fiscal adjustment over 2025-2035. Medium-term liquidity risks as analyzed by the GFN Financeability Module are high. However, China's partially closed capital account and the government's ample financial assets mitigate liquidity risks. To contain debt risks, China should seek to reduce public investment and close its structural revenue gap through comprehensive tax reform.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Appendix III. Figure 2. China: Debt Coverage and Disclosures

					Comments
1. Debt coverage in the DSA: 1/					
CG	🟩 GG	NFPS	CPS	Other	

1a. If central government, are non-central government entities insignificant? n.a.

2. Subsectors included in the chosen coverage in (1) above:

					Subsectors captured in the baseline	Inclusion	Comments
CPS	NFPS	GG: expected	CG	1	Budgetary central government	🟩 Yes	
				2	Extra budgetary funds (EBFs)	🟩 Yes	May not include all EBFs.
				3	Social security funds (SSFs)	🟩 Yes	
				4	State governments	🟩 Yes	
				5	Local governments	🟩 Yes	
				6	Public nonfinancial corporations	▨ No	
				7	Central bank	▨ No	
				8	Other public financial corporations	▨ No	

3. Instrument coverage:

🟩 Currency & deposits	🟩 Loans	🟩 Debt securities	🟥 Oth acct. payable 2/	🟥 IPSGSs 3/

4. Accounting principles:

Basis of recording		Valuation of debt stock		
Non-cash basis 4/	🟩 Cash basis	🟩 Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors:

Consolidated	🟩 Non-consolidated

Color code: 🟩 chosen coverage 🟥 Missing from recommended coverage ▨ Not applicable

Reporting on Intra-Government Debt Holdings

					Holder Issuer	Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
CPS	NFPS	GG: expected	CG	1	Budget. central govt	▨								0
				2	Extra-budget. funds		▨							0
				3	Social security funds			▨						0
				4	State govt.				▨					0
				5	Local govt.					▨				0
				6	Nonfin pub. corp.						▨			0
				7	Central bank							▨		0
				8	Oth. pub. fin. corp								▨	0
					Total	0	0	0	0	0	0	0	0	0

1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.

2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.

3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.

4/ Includes accrual recording, commitment basis, due for payment, etc.

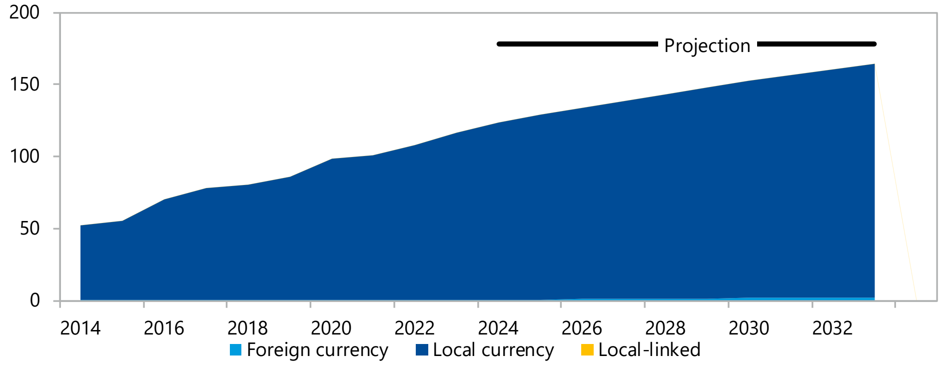
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).

6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.

7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: The general government perimeter is based on the "augmented" definition. Non-consolidation refers to cross-holdings between intra-government subsectors not being netted out.

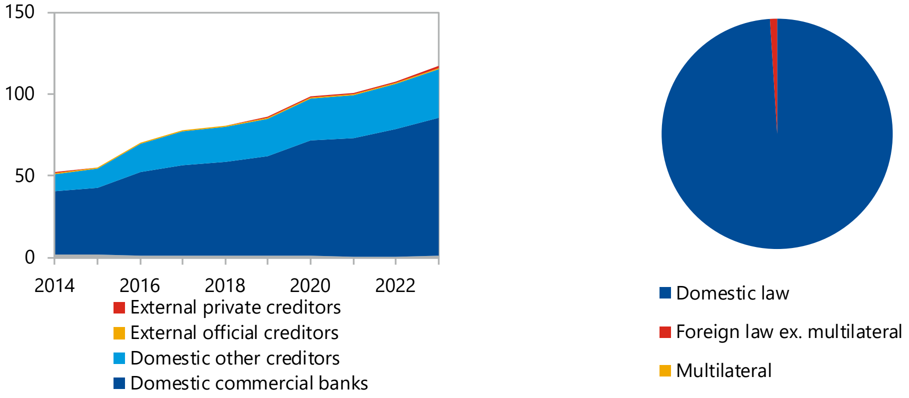
Appendix III. Figure 3. China: Public Debt Structure Indicators



Note: The perimeter shown is general government.

Public Debt by Holder (Percent of GDP)

Public Debt by Governing Law, 2023 (Percent)

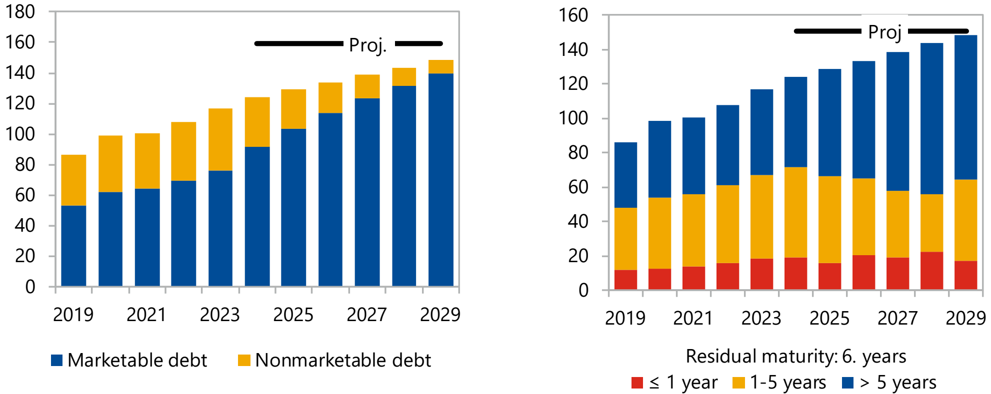


Note: The perimeter shown is general government.

Note: The perimeter shown is general government.

Debt by Instruments (Percent of GDP)

Public Debt by Maturity (Percent of GDP)



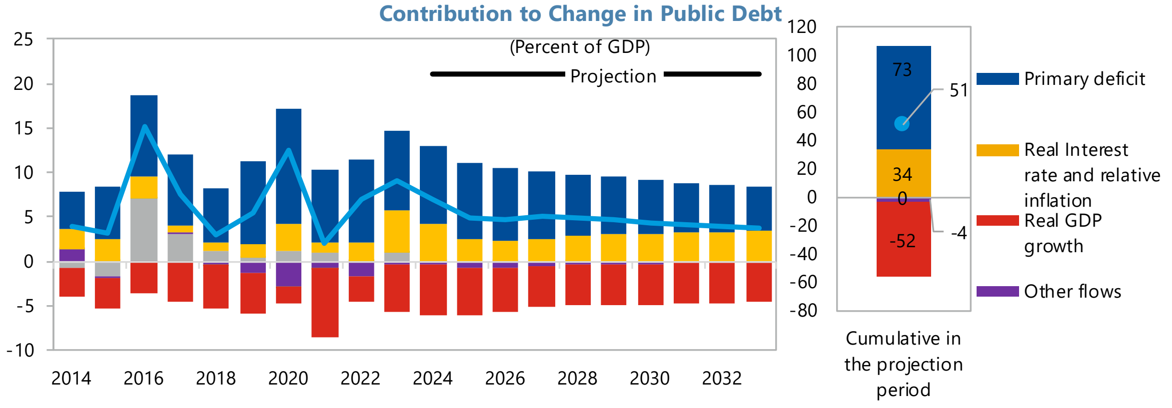
Note: The perimeter shown is general government.

Note: The perimeter shown is general government.

Commentary: Most debt is held by domestic residents and only a small portion is denominated in foreign currency, while the capital account is not fully open, both factors mitigating risks. However, LGFV debt has shorter maturities (about 3 years on average compared with 7 years for official debt), is exposed to higher liquidity risks, and depends more on financing from non-bank financial institutions.

Appendix III. Figure 4. China: Baseline Scenario

	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	116.9	124.0	128.9	133.7	138.7	143.6	148.2	152.6	156.7	160.6	164.3
Change in public debt	9.1	7.1	5.0	4.7	5.0	4.9	4.6	4.3	4.1	3.9	3.8
Contribution of identified flows	8.0	7.1	5.0	4.7	5.0	4.9	4.6	4.3	4.1	3.9	3.8
Primary deficit	9.0	8.9	8.5	8.1	7.6	7.0	6.5	6.1	5.7	5.3	4.9
Noninterest revenues	26.6	26.3	26.4	26.6	26.8	27.0	27.0	27.0	27.0	27.0	27.0
Noninterest expenditures	35.6	35.1	34.9	34.7	34.4	34.0	33.5	33.1	32.7	32.3	31.9
Automatic debt dynamics	-0.7	-1.4	-2.8	-2.7	-2.1	-1.7	-1.6	-1.5	-1.4	-1.2	-1.0
Real interest rate and relative inflation	4.7	4.2	2.5	2.4	2.5	2.8	3.0	3.1	3.2	3.3	3.5
Real interest rate	4.7	4.2	2.5	2.4	2.5	2.8	3.0	3.1	3.2	3.3	3.5
Relative inflation	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-5.4	-5.6	-5.3	-5.1	-4.6	-4.5	-4.6 .	-4.6	-4.6	-4.5	-4.5
Real exchange rate	0.0	…	…	…	…	…	… .	…	…	…	…
Other identified flows	-0.3	-0.4	-0.7	-0.6	-0.5	-0.4	-0.3	-0.3	-0.2	-0.2	-0.1
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	-0.3	-0.4	-0.7	-0.6	-0.5	-0.4	-0.3	-0.3	-0.2	-0.2	-0.1
Contribution of residual	1.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing needs	31.7	32.2	30.9	28.1	32.5	31.1	34.8	29.8	28.9	28.8	28.8
of which: debt service	22.7	23.3	22.4	20.0	24.9	24.1	28.3	23.8	23.3	23.6	23.9
Local currency	22.7	23.3	22.4	20.0	24.9	24.0	28.3	23.7	23.2	23.5	23.8
Foreign currency	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Memo:											
Real GDP growth (percent)	5.2	5.0	4.5	4.1	3.6	3.4	3.3	3.2	3.1	3.0	2.9
Inflation (GDP deflator; percent)	-0.6	0.1	1.8	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP growth (percent)	4.6	5.1	6.3	6.2	5.6	5.4	5.3	5.2	5.1	5.0	4.9
Effective interest rate (percent)	3.9	3.9	3.9	4.0	4.0	4.1	4.2	4.2	4.2	4.2	4.3



Contribution to Change in Public Debt

(Percent of GDP)

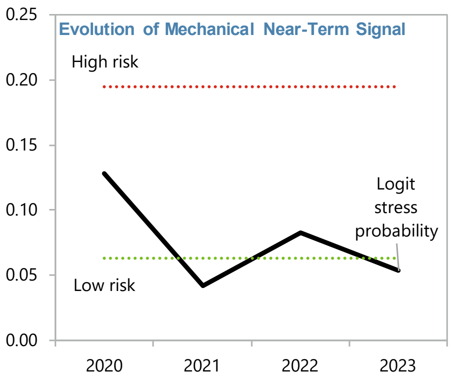
Staff commentary: Public debt rises over the projection period, as large deficits only decline slowly, with a reduction in infrastructure investment partly offset by growing pension spending.

Appendix III. Figure 5. China: Near-Term Risk Analysis

Year of data	**2020**	**2021**	**2022**	**2023**
To predict stress in [t+1, t+2]	*2021-22*	*2022-23*	*2023-24*	*2024-25*
Logit stress probability (LSP)	0.128	0.042	0.082	0.054
Change in LSP	0.081	-0.086	0.040	-0.029
due to:				
Institutional quality	-0.008	-0.001	0.000	0.000
Stress history	0.000	0.000	0.000	0.000
Cyclical position	-0.005	0.028	-0.023	-0.004
Debt burden & buffers	0.038	-0.031	0.021	0.009
Global conditions	0.053	-0.079	0.042	-0.033

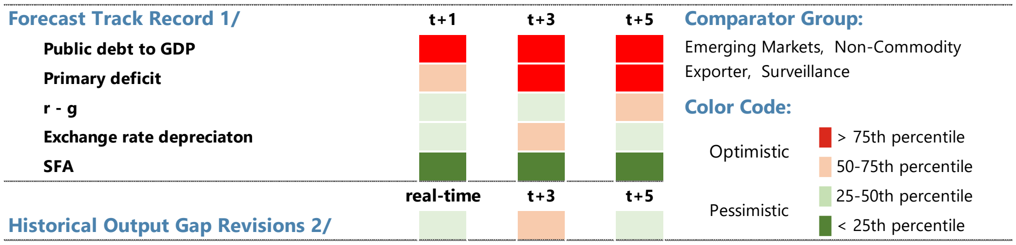
Prob. of missed crisis, 2024-2025 (if stress not predicted): 7.5 pct.

Prob. of false alarm, 2024-2025 (if stress predicted): 38.0 pct.



Commentary: Despite high domestic debt to GDP, all other factors point to low near-term risk.

Appendix III. Figure 6. China: Realism of Baseline Assumptions



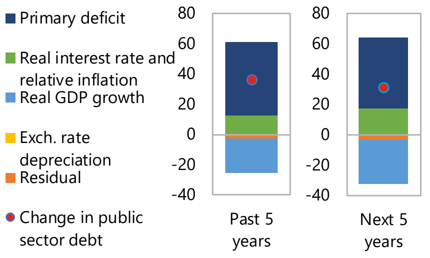
Forecast Track Record 1/	t+1	t+3	t+5
Public debt to GDP	🟥	🟥	🟥
Primary deficit	🟧	🟥	🟥
r - g	🟩	🟩	🟧
Exchange rate depreciaton	🟩	🟧	🟩
SFA	■	■	■
	real-time	**t+3**	**t+5**
Historical Output Gap Revisions 2/	🟩	🟧	🟩

Comparator Group:
Emerging Markets, Non-Commodity Exporter, Surveillance

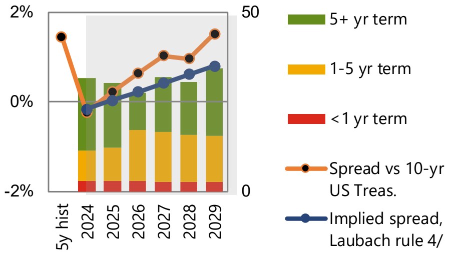
Color Code:

Optimistic	🟥	> 75th percentile
	🟧	50-75th percentile
Pessimistic	🟩	25-50th percentile
	■	< 25th percentile

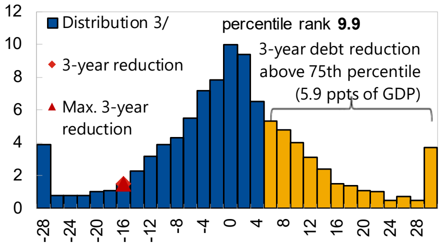
Public Debt Creating Flows
(Percent of GDP)



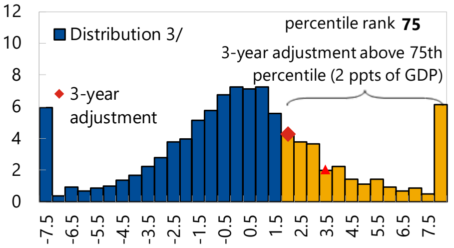
Bond Issuances (Bars, debt issuances (RHS, %GDP); lines, avg marginal interest rates (LHS, percent))



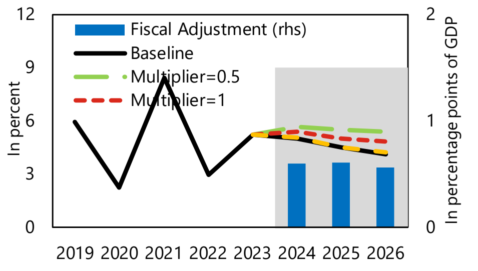
3-Year Debt Reduction
(Percent of GDP)



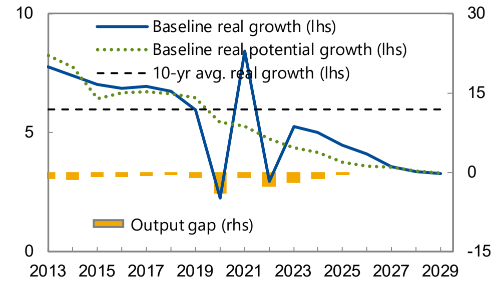
3-Year Adjustment in Cyclically-Adjusted Primary Balance (Percent of GDP)



Fiscal Adjustment and Possible Growth Paths
(Lines, real growth using multiplier (LHS); bars, fiscal adj. (RHS))



Real GDP Growth
(In percent)



Commentary: The baseline is based on a gradual fiscal consolidation over 10 years. This is feasible as public investment is currently very large and the off-budget entities carrying a significant portion of such investment are expected to face progressively tighter financing constraints.

Source : IMF Staff.

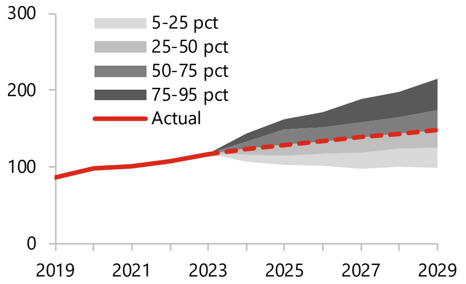
1/ Projections made in the October and April WEO vintage.

2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates

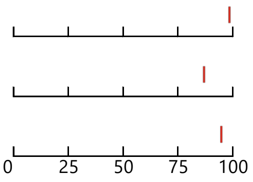
3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.
4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Appendix III. Figure 7. China: Medium-Term Risk Assessment

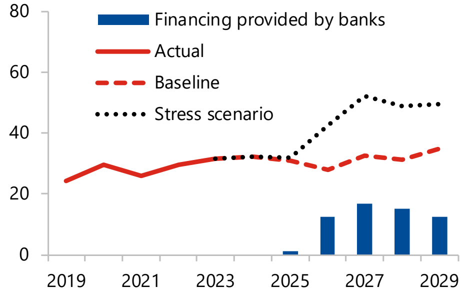
Final Fanchart (Percent of GDP)



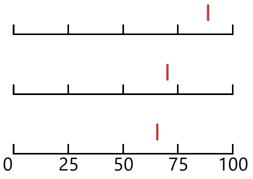
	Value	Contrib 1/	Percentile in peer group 2/
Debt fanchart module			
Fanchart width *(percent of GDP)*	115.8	1.7	
Probability of debt non-stabilizaiton *(percent)*	96.5	0.8	
Terminal debt-to-GDP x institutions index	77.9	1.7	
Debt fanchart index (DFI)		4.2	
Risk signal: 3/		**High**	



Gross Financing Needs (Percent of GDP)



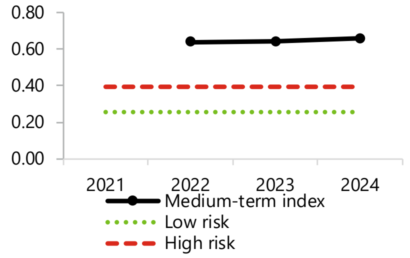
	Value	Contrib 1/
Gross financing needs (GFN) module		
Average baseline GFN *(percent of GDP)*	31.6	10.8
Initial Banks' claims on the gen. govt *(pct bank assets)*	14.0	4.5
Chg. In banks' claims in stress *(pct banks' assets)*	14.3	4.8
GFN financeability index (GFI)		20.1
Risk signal: 4/		**High**



Triggered stress tests (stress tests not activated in gray)

Banking crisis Commodity prices Exchange rate Contingent liab. Natural disaster

Medium-Term Index (Index Number)



Medium-term risk analysis

	Value	Value (normalized)	Weight	Contribution
Debt fanchart index	4.2	0.9	0.5	0.5
GFN finaceability index	20.1	0.4	0.5	0.2
Medium-term index		0.7		
Risk signal: 5/		**High**		
Final assessment:		**High**		

Prob. of missed crisis, 2024-2029, if stress not predicted: 81.8 pct.
Prob. of false alarms, 2024-2029, if stress predicted: 2.3 pct.

Commentary: The Debt Fanchart and GFN Modules are pointing to high level of risk. However, medium-term liquidity risks are mitigated by China's partially closed capital account and ample financial assets.

Source: IMF staff estimates and projections.

1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is emerging markets, non-commodity exporter, surveillance.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

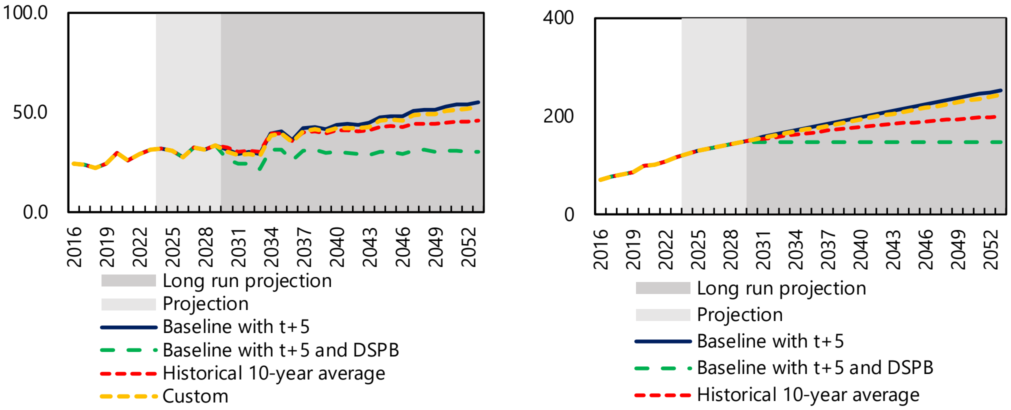
Appendix III. Figure 8. China: Triggered Modules

Large amortizations	**Pensions**	Climate change: Adaptation	Natural Resources
	Health	**Climate change: Mitigation**	

China: Long-Term Risk Assessment: Large Amortization Incl. Custom Scenario

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	🟥 🟥 🟥
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	🟥 🟥 🟥
Historical average assumptions	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	🟥 🟥 🟥
Overall Risk Indication		🟥

Variable	2029	2033 to 2037 average	Custom Scenario
Real GDP growth	3.3%	3.0%	3.1%
Primary Balance-to-GDP ratio	-6.5%	-5.3%	-5.7%
Real depreciation	-2.0%	-1.9%	-1.9%
Inflation (GDP deflator)	2.0%	2.0%	2.0%

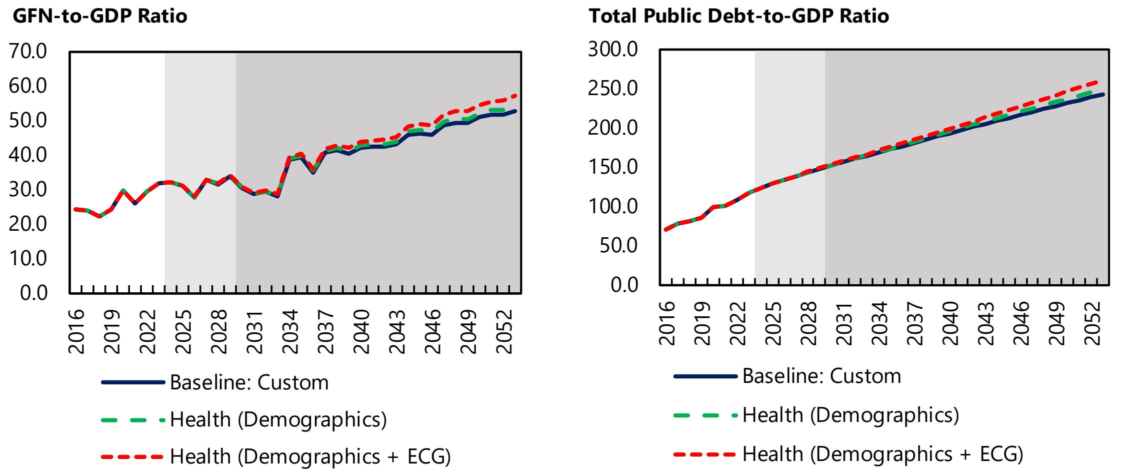


GFN-to-GDP Ratio

Total Public Debt-to-GDP Ratio

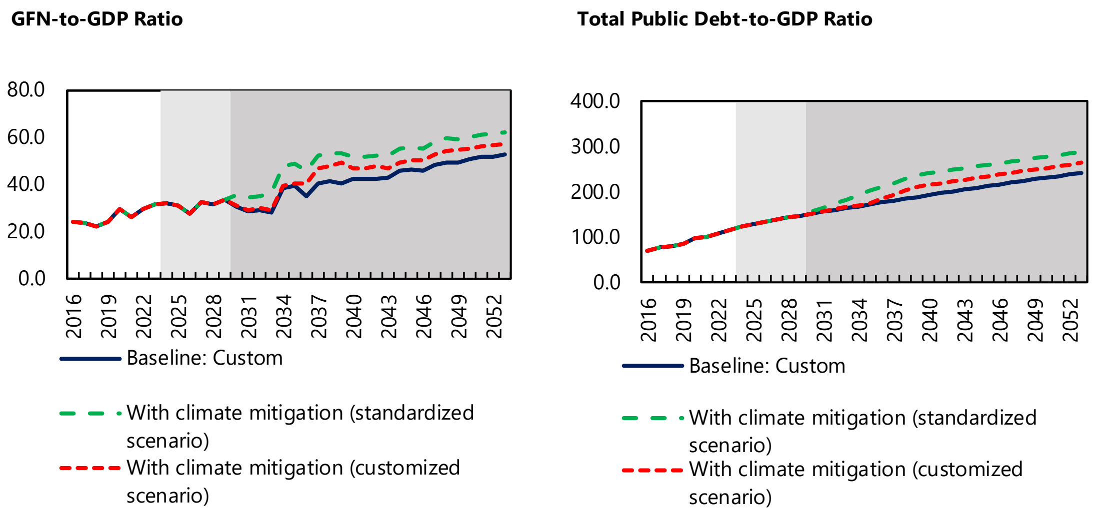
Commentary: The custom baseline assumes constant values for primary deficits, interest, and growth for the LT projection period (2030-2053), while charts in the main text are based on Staff's time-varying projections. Under the historical 10-year average scenario in which real GDP growth is at 6 percent, debt-to-GDP grows significantly less than in the baseline, as the baseline incorporates declining growth in the absence of comprehensive structural reforms (IMF, 2022).

Appendix III. Figure 9. China: Demographics: Health



Commentary: The demographics health module shows a slightly steeper trajectory of public debt-to-GDP ratio when taking into account the effect of China's aging population on health expenditures over the long term. The increase in debt-to-GDP ratio is largest under the scenario with both demographics and excess cost of health (ECG), though the differences across the different scenarios are overall very small.

Appendix III. Figure 10. China: Climate Change: Mitigation



Commentary: China's investment needs to meet its net neutrality target in 2060 are sizeable, estimated at around 5 percent of GDP (Chateau, Chen, Jaumotte, Zhunussova, 2022). If these climate investments were funded with the same instruments that are used to finance the general govenment deficit, then debt could reach close to 250 percent of GDP by 2050. This indicates that other options, such as ETS reforms (to move closer to an optimal carbon pricing tool), as well as improved standards and regulations, and private sector investment would be preferable from the perspective of public debt-to-GDP.

Appendix IV. Implementation of Past Fund Advice

1. **The take up of past Fund advice has been mixed.** The fiscal and monetary policy stance since the last Article IV has been directionally consistent with staff advice. Some progress has also been made in property sector and structural policies, though significant challenges remain.

2. **The authorities have implemented various measures to steer the property market transition, with varied results.** Policies aimed to stimulate housing demand and increase financing available to real estate developers have had limited success. More recently, the authorities have scaled up financing for social and affordable housing, including allowing local SOEs to acquire completed housing for conversion to affordable housing, and set up a cross-agency coordination mechanism to facilitate bank financing (whitelist). Key staff recommendations regarding accelerating the exit of insolvent developers, providing CG funding to complete pre-sold unfinished housing, and removing impediments to price adjustments have seen limited progress.

3. **The staff-assessed neutral fiscal stance in 2023 and in the 2024 budget are appropriate, though tackling underlying fiscal challenges will require further policy effort.** While the near-term fiscal stance has been in line with staff advice, little progress has been made in reorienting expenditures away from investment and towards households. The government's intention to tackle LG debt vulnerabilities is also in line with staff advice, though a comprehensive plan to implement the needed medium-term consolidation and resolve the large stock of LG debt remains missing.

4. **The PBC has loosened monetary policy, consistent with staff advice.** However, there remains scope to rely more on interest-rate based policy tools rather than quantity-based tools. Allowing for more exchange rate flexibility and continuing to deepen the market-oriented reform of interest rates can also help enhance transmission and increase monetary policy space.

5. **Tackling financial sector vulnerabilities is appropriately a key focus of the authorities.** The latest round of consolidation of small banks is consistent with staff advice and should continue, though faster progress is needed to strengthen and strictly apply prudential rules. Significant changes to the financial regulatory architecture, if well implemented, can support the elevated focus on financial vulnerabilities. Bridging gaps in risk resolution frameworks and financial safety nets remain key areas where reform momentum is needed.

6. **Some progress has been made on structural policies, notably on climate mitigation, though the deep reforms needed to boost productivity remain elusive.** The authorities have extended Hukou reforms, marginally improved social safety nets, and have plans to expand the scope of the ETS, all consistent with staff advice. However, progress remains limited in other key areas, including on implementing SOE reforms, scaling back industrial policies, and advancing pension reforms.

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

(as of June 2023)

Recommendation	Time Frame	Measures Taken
Macroeconomic recommendations		
Reduce the relatively high GDP growth forecasts in national plans, which encourage local governments to set high growth targets.	NT High priority	No new developments.
Systemic risk, macroprudential policies, and strengthening supervision		
Newly establish a financial stability sub-committee and entrust it with the sole function of maintaining financial stability	NT High priority	No new developments.
Establish vigorous mechanisms for cooperation, coordination, and information sharing with participants in domestic and foreign financial security networks, including the sharing of detailed financial data.	NT High priority	Since March 2023, under the leadership of the Central Financial Commission (CFC), financial regulators have established a number of joint working mechanisms to address major cross-sectoral and cross-regional issues; they have also improved policy coordination and information sharing. **Mechanisms for information sharing among members of the domestic financial safety net. Measures by the People's Bank of China (PBC): (1)** The PBC is using information sharing mechanisms to enable better access to banks' offsite regulatory data, including key indicators for banking operations and financial operations; data on the quality of credit loans and assets; and key regulatory indicators. **(2)** The PBC regularly shares its central bank ratings with the National Administration of Financial Regulation (NFRA). **(3)** Any issues with deposit insurance discovered during onsite inspections or risk testing are quickly reported to the NFRA. The NAFR has improved its coordination and information sharing with other institutions. It regularly shares data from the banking and insurance industries with the PBC, National Bureau of Statistics (NBS), China Security Regulatory Commission (CSRC), Ministry of Commerce (MoC) and other authorities, to support shared efforts to maintain the security and stability of the financial system. It continues to develop and improve national and local coordination on monitoring and warning systems for illegal financing, and sharing of leads on the risk of illegal financing. Measures by the CSRC: (1) Signed memoranda of cooperation on data sharing with the PBC and the State Administration of Foreign Exchange (SAFE); and improved information sharing among financial regulators. It is obtaining relevant data on bank and insurance company balance sheets, P&Ls, OTC stock pledges, and asset management products. (2) In compliance with the *Rules for the Accounting of Assets and Liabilities for Securities Industry Financial Institutions* and its sub-regulations, the CSRC shares balance sheet data for securities companies, providing it to relevant regulators on an annual and quarterly basis. (3) The CSRC is exploring all possibilities for joint action on the monitoring of cross-exchange, cross-market and

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

Recommendation	Time Frame	Measures Taken
		cross border transactions and risks. The CSRC coordinates with the PBC and departments/institutions within the CSRC system to encourage the pooling of data on investor assets and transactions, which was previously distributed across various CSRC functions, into a unified big data pool. This includes data on cross-border transactions, asset management products, derivatives, etc. **The PBC has worked to improve information sharing with international members of the Global Financial Safety Net (GFSN).** The PBC continues to support the collection of financial stability data by the IMF. We submit key indicators to the IMF on a quarterly basis and agree to data disclosures on the IMF website. The PBC actively supports the NFRA's reporting of data since 2022Q4 using the new template required by the IMF. Data has been provided up to Q3, 2023. **The NFRA** is engaging and working with overseas financial regulators, building systems for collaboration that are multi-level, multi-channel, and span multiple fields. **(1)** The NFRA regularly chairs joint conferences with key regulators of G-SIBs as part of the PBC-led working group on managing cross-border financial crises. It engages as a regulator with the regulatory institutions of many other countries, and maintains open channels of communication. **(2)** Expanding the current geographical reach of regulatory MoUs, and expanding the scope of regulatory collaboration. As of the end of April 2024, the NFRA has signed 126 agreements on regulatory cooperation with financial regulators in 87 countries and regions, including 55 Belt and Road participating countries. For example, the NFRA has signed new regulatory MoUs with the monetary authorities of Saudi Arabia and Azerbaijan; it has updated its MoU with the UK's Prudential Regulation Authority, adding insurance regulation into the scope of the MoU; signed an MoU on cooperation on the insurance industry with the Swiss Financial Market Supervisory Authority (FINMA); and renewed our MoU with the central bank of Hungary. These MoUs specify how the parties will handle information exchange, onsite inspections, crisis management, data protection, regulator meetings, etc. **(3)** Regular bilateral regulator conferences. The NFRA has established arrangements for conferences with regulators in Japan, South Korea, Singapore, UK, Luxembourg, USA, and the EU. It holds regular meetings with these regulators on the status of branch offices in each others' territories; areas of regulatory concern; new regulatory decisions; and to share experience. Going forward, as the need arises, we will explore appropriate formats for bilateral discussions on regulatory strategy with key national regulators, and reaffirming the ongoing, regular exchanges we have with the US banking and insurance regulators. We will be expanding our relationship with regulators in key nations and in neighboring countries and regions, and exploring formal arrangements for regulatory communications with more overseas regulators. **(4)** Organizing and participating in joint conferences. The NFRA organizes an annual joint conference on the regulation of China's largest four G-SIBs, to which we invite representatives of relevant global regulators. These conferences touch on the current status of these Chinese banks, new regulations in various countries (regions), and specific issues in the regulation of individual banks. The NFRA, in its capacity as the home regulator of Chinese banks and insurance companies, also attends joint conferences organized by overseas financial regulators on the regulation of foreign entities. It also keeps up to date with the business of foreign banks and insurance companies with branches in China. And it discusses recovery and resolution plans for banks and insurers within the framework of a crisis management group (CMG) when necessary. **(5)** Day-to-day communication with overseas regulators. The NFRA communicates with overseas regulators on issues such as the qualification checks

Recommendation	Time Frame	Measures Taken
		for senior managers, information requests, and sharing regulatory experience. Channels include phone conferences, emails, and video conference. **CSRC and international organizations:** improved exchanges of information and sharing of financial data. **(1)** The CSRC has responded to the Financial Stability Board (FSB) climate change survey questionnaires, providing data on the size of funds under management to the non-bank sector expert group. It engaged in a mutual exchange of data with the Hong Kong Securities and Futures Commission (HKSFC); and it regularly exchanged information on the MSCI China A 50 Connect Index Futures, and OTC derivatives of stocks on the A-share market. **(2)** Better regulatory collaboration. The CSRC is actively expanding cross-border regulation and enforcement cooperation with securities and futures regulators in other countries, and is an active participant in international financial regulation. As of the end of April 2024, it has signed MoUs on bilateral regulatory cooperation and established mechanisms for regulatory collaboration with securities/futures regulators in 67 countries and regions. The agreement with the HKSFC includes regular high-level meetings for consultation over policy on market regulation and major areas of cooperation. These meetings expand and extend the depth and breadth of the regulatory collaboration between the two regions, and make our regulatory and law enforcement collaboration more effective. As a full member of the International Organization of Securities Commissions (IOSCO), the CSRC also faithfully fulfills its duty to cooperate in cross-border law enforcement under the multilateral MoU, working with its partners to crack down on cross-border securities crime.
Trigger the countercyclical capital buffer, assess bank capital requirements, and implement targeted capital replenishment	NT High priority	No new developments.
Amend major laws to strengthen the operational and budgeting autonomy of the PBC and regulatory agencies and increase their resources	MT High priority	**(1) The Chinese government's departmental budget management systems effectively support and safeguard the work of financial regulators.** The PBC, NFRA, and CSRC operate the departmental budget management system, ensuring that public expenditures are properly budgeted and disbursed. The drafting, review, approval, and oversight of budgets, as well as their administration and amendment, are carried out in compliance with *the Law of the People's Republic of China on Budgets*. Budget records show that regulator budgets have maintained positive growth over the past few years. For example, the NFRA's budget for 2024, as approved by the Ministry of Finance at the start of the year, was CNY 967 million higher than in 2017, reflecting an average growth of 2.12% per year. Monetary policy operations are not included in the budget, and are financed on an as-needed basis, so budget restrictions will not affect monetary policy operations. **(2) A new round of institutional reforms is improving the structure of financial regulatory bodies and their relative weights.** Following *the Reform Plan for Party and State Institutions* and institutional reform plans approved by the State Council, the NFRA was created out of the previous China Banking and Insurance Regulatory Commission (CBIRC); the CBIRC and CSRC changed from operational units of the State Council to institutions of the State Council. The NFRA was given enhanced regulatory powers over financial operations beyond securities; and the CSRC given more powers over capital markets. Budget calculations were updated, and more fiscal resources were provided to ensure that duties could be properly executed. **(3) Actively increases the resources and capacity for front-line regulators, improving the allocation of regulatory resources.** As part of the institutional

Recommendation	Time Frame	Measures Taken
		reforms, **the NFRA** has increased regulatory capacity at the front line, improving the allocation of regulatory resources, improving the efficiency of resource use, and reinforcing the foundations of regulatory operations. Personnel are required to have more practical experience, with programmed transfers of officers to front line operations to gain experience, including risk resolution operations and onsite inspections. Training programs have been enhanced. From 2018 to 2024, the NFRA carried out 597 training programs. 220 were in-person training, whereas 277 were online. **The CSRC** continues to refine its allocation of regulatory resources, and to update the duties of regulators, to ensure practical implementation of regulatory operations. For example, the number of personnel employed by the CSRC grew from 2,903 in 2017 to 3,749 in 2023, an increase of 29%. Moving forward, the CSRC will continue to improve its allocation of resources and regulatory capacity, based on the needs of regulating the Chinese capital markets, to ensure that it achieves the objectives of improving regulation, preventing risk, and supporting high-quality growth in the capital markets.
Resolve data gaps that place constraints on systemic risk monitoring and effective financial regulation and supervision	MT High priority	No new developments.
Evaluate and simplify the objectives and structure of the PBC's macroprudential assessments, and only use them as a means of monitoring by the financial stability sub-committee and its subordinate agencies.	Medium priority	No new developments.
Bank regulation and supervision		
Strengthen risk supervision of financial holding groups, and upgrade supervision capabilities with respect to banks and their related financial groups and their ownership structure, including identification of ultimate beneficiary owners.	MT High priority	No new developments.
Stop considering the effects of collateral in loan classifications, restrict loan rollover to non-small and medium enterprise (SME) borrowers, and	MT High priority	No new developments.

Recommendation	**Time Frame**	**Measures Taken**
categorize all loans that are 90 days or more past due as non-performing loans.		
Strengthen implementation of the "look-through" principle.	Medium priority	No new developments.
Tighten liquidity coverage ratio requirements for interbank products and off-balance-sheet financial products.	Medium priority	No new developments.
Increase supervision reporting requirements, and collect more detailed supervision data, including bank investment information and corresponding provisions.	Medium priority	**The NFRA continues to increase the granularity in its reporting requirements, and to raise the required levels of data quality. (1)** For off-site surveillance, reporting requirements have been increased on commercial banks for online lending, derivatives services, real estate financing, resolution of non-performing loans, credit cards, and local government debt and wealth management products at commercial banks. Improvements have also been made in the accounting of on-balance sheet and off-balance sheet investments and provisions. **(2)** Using the off-site surveillance system, the newly-developed regulatory platform, and other tools, the NFRA is collecting all regulatory data and improving data collation, with a focus on the quality of bank loan and investment assets, provisions, and capitalization. **(3)** The NFRA has created a regulator data system for corporate governance, which collects regulatory information on banks, including their shareholders and holdings, related-party transactions, and corporate governance practices. This system is making regulation smarter and more data-based. Using the system, the NFRA can conduct governance assessments, understand the operations of banks' shareholders, directors, supervisory boards, and management; the actions and fulfillment of duties by directors, supervisors and senior management; their management of shareholders and related-party transactions; etc. When problems have been discovered, it can follow up and monitor the remedies. **(4)** The NFRA has developed reporting requirements for special credit risks, such as creditors' committees, and requires banks to provide regular reports on them. It has increased the reporting frequency for some data, requiring banks to make some quarterly reports on a monthly basis. **(5)** The NFRA has developed a dedicated reporting form for on-balance sheet and off-balance sheet investments by local commercial banks, with increased granularity in the reporting, and monitoring carried out on a regular basis, collecting data on and monitoring asset quality and provisioning for investment projects. **(6)** The NFRA regularly carries out risk identification exercises for trust companies, including two-way "look-through" analyses of their trust services, to determine the real level of risk. Off-site surveillance of trust companies focuses on the compliance of trust products, "look-through," and risk monitoring. In trust services, It requires that parties, sources of funds, and uses of funds are legible and properly understood. **(7)** The NFRA encourages financial infrastructure companies to use the National Bank Wealth Management Product Registration System, to develop a big data database on wealth management. It makes constant use of data on wealth management products for dynamic risk monitoring, with a regulatory analysis of wealth management services carried out every month. In early 2023, the then CBIRC created monthly/quarterly monitoring systems for insurance asset management products. The NFRA continues to closely monitor the

Recommendation	Time Frame	Measures Taken
		development and changing risks in asset management products for insurance, and is committed to early identification, early warning, early exposure, early resolution. (8) The NFRA researches and sets additional data reporting templates for small rural banks to collect data on credit loans, interbank operations, investments, etc., outside the bank's region of registration, both on-balance sheet and off-balance sheet, to enhance regulatory analyses.
The CBIRC should strengthen its forward-looking comprehensive risk analysis to identify vulnerabilities, question banks, and encourage intervention before the fact.	Medium priority	**The NFRA continues to make its regulation more forward-looking and effective, and has put in place risk warning systems. (1) Bank ratings are forward-looking.** Applying the updated *Measures for Regulatory Ratings of Commercial Banks*, regulators engage in an ongoing, comprehensive, in-depth data collection process on internal and public information related to bank ratings. Data collected include (but are not limited to): off-site regulatory information, on-site inspection reports and data, operational and management documentation for banks, auditor's reports, complaints and reports of illegal conduct, and other significant internal and external information. This data fully reflects the status of corporate governance, risk management, and operations at banks. Having collated and analyzed all of this information, regulators consider bank risk, growth, areas of concentration, etc., and develop a rating and form a judgment of the bank's future condition. **(2) Stress testing.** Stress tests are an important forward-looking regulatory instrument. Regulators require that commercial banks conduct regular stress tests, and make full use of stress tests in their internal risk management and capital planning, in compliance with *Guidance on Stress Tests for Commercial Banks* (Yin Jian Fa [2014] No. 49). Regulators also see stress tests as a highly important part of commercial banks' capital planning, and require banks to make stress tests a key part of their internal capital adequacy assessment processes. Banks should reference the outcomes of stress tests when determining their internal capital adequacy targets. The coverage of stress tests should include all of the main risks in a bank's major areas of business, and tests should fully consider the implications of economic cycles for capital adequacy. The then CBIRC issued *Interim Measures on the Supervisory Rating of Insurance Asset Management Companies* in January 2021, and conducted yearly ratings of insurance asset management companies. The rating process requires insurance asset management companies to establish risk indicator systems that satisfy their trustors' risk appetites and risk tolerance. The ratings assess the development and use of said systems and apply stress tests to predict levels of risk in these companies' asset management. **(3) Developing early warning systems for banking risks.** *The Regulation on Early Warning Systems for Bank Risk (Trial)* was issued, establishing mechanisms for risk alarms and responses. Regulator personnel are encouraged to accept and respond to early warnings. In the light of the overall assessed risk, regulators should take targeted, differentiated measures for early intervention. The NFRA updated the REASS risk alert system for banks, putting the risk alert process completely online. The risk indicators were updated, with broader sources of information, enabling alerts with range of levels and types. **(4) Updating bank risk analyses and controls.** In December 2023, the NFRA amended *Measures for Operational Risk Controls at Banks and Insurers*, updating the regulatory rules for the operational risk controls by banks and insurers. It made specific requirements for improvements in operational risk control. The amended Measures will go into effect on July 1, 2024. **(5) Updated bank early warning systems.** The NFRA, working with the PBC, is developing a guidance to regulate early interventions of bank risk. This work will continue as scheduled in the legislative plan. **(6) Specific measures for different classes of institution.** (i)

Recommendation	Time Frame	Measures Taken
		Annual bank ratings for commercial banks. If a bank's governance deteriorates, or it has multiple risk issues, then its rating will be reduced. The consequences of bank ratings have been expanded, with banks informed of negative ratings more quickly, and reminders to rectify problems. Improved use of risk early warning systems, with timely analysis of warning signals and appropriate responses. (ii) Improved risk monitoring and early warning systems for urban commercial banks and private banks. Five new aspects were added to expand the scope of typical risks monitored: expansion risk, concentration risk, cost of debt, asset deterioration, interest rate risk. This has enabled better overall assessments and warnings, and made our risk management more forward-looking, better targeted, and more effective. Improved analysis and monitoring of liquidity risk at municipal commercial bank and private banks improving day-to-day analysis and response to warnings. (iii) The NFRA constantly tracks the operations and risk levels in small and medium-sized rural banks, running monthly data analyses. Where necessary, it issues risk alerts at meetings, in published reports, risk warnings, or through window guidance. It may also carry out targeted risk elimination, focusing on large loans, remote transactions, and credit risk; it may require the development of risk-specific risk response plans. For small rural banks it has a system of risk warning indicators, and monitors for risk warnings in these institutions on an ongoing basis, including liquidity and liability stability, growth of on-balance sheet and off-balance sheet operations, loan mix, credit risk, and key operations. (iv) We carry out risk surveys on trust companies on a quarterly basis, track risk trends in the trust industry, and send risk notices and risk alerts as necessary. (v) Issued *Notice on the System for the Rectification of Problems Discovered by Regulators in Early Intervention in Non-bank Risks*, as part of our efforts on early intervention in non-bank risks, to promote compliance and stable growth in non-bank institutions. Issued *Measures on Capital Management for Financial Asset Management Companies*, creating capital adequacy indicators for improved regulation of financial asset management companies. Improved off-site regulatory reporting system for non-bank institutions, and required financial asset management companies to report all of their business activities. Amended and updated special regulatory reporting requirements for financial leasing companies, improving the data monitoring of the special operations of the financial leasing industry. Amended and updated regulatory reporting for groups with treasury companies, improving the data monitoring of the operations of groups with treasury companies. Amended and updated special regulatory reporting requirements for consumer finance companies, vehicle financing companies, and currency brokerage companies, improving the offsite monitoring of these special business operations. Differentiated risk analyses and alert models are applied to different classes of non-bank institution. Key features for analysis include capital and leveraging, credit risk, liquidity risk, and market risk.
Stress testing		
Enhance stress testing and systemic risk assessment, data and information sharing among the PBC, CBIRC and CSRC must be substantially increased and systematized. Use	MT High priority	No new developments.

Recommendation	Time Frame	Measures Taken
more detailed supervision data in stress testing.		
In systemic risk assessments, substantially expands the scope of coverage for non-banking institutions and their relationship with other financial institutions and develop and integrate stress testing for collective investment plans.	Medium priority	No new developments.
Strengthen inter-agency coordination and the analytical capabilities of the stress testing teams.	Medium priority	No new developments.
Shadow banking and implicit guarantees		
Amend laws or supervisory regulations, to ensure the bankruptcy remoteness of collective investment plans (including wealth management products) when a manager or custodian goes bankrupt.	MT High priority	**The NFRA** is actively pursuing a judicial interpretation of *the Trust Law of the People's Republic of China* from the Supreme People's Court. It recommends that in judicial practice, the principle of the separation of entrusted assets and owned assets should be further clarified, to avoid situations in which debts owed by a trust company cause the freezing of entrusted assets; or the trust company's handling of entrusted assets causes its owned assets to be frozen.
Conditioned on the elimination of implicit guarantees, gradually eliminate credit restrictions on certain industries.	Medium priority	**The NFRA** advises banks to apply differentiated credit policies to different industries, on the principle that "if there are guarantees, there must be restrictions." Banks consider their own risk appetite, risk control capacity, and business strategy to meet the reasonable funding needs of companies with advanced technologies, competitive products, and strong market demand. In May 2024, the NFRA issued *Guiding Opinions on the Implementation of Five Major Policy Directions in the Banking and Insurance Industries*. It requires differentiated regulation and dynamic assessment of the market and social and governance risks, which should be incorporated into operational processes and into comprehensive risk management systems, with differentiated regulatory approaches. This will effectively satisfy the demand for finance during the low-carbon transition of high energy and high emissions industries. It includes fair treatment for companies of all sectors, with improved financial support for private companies, small companies, and individual traders.
Intervention measures in capital markets (including real estate and stock markets) should be limited to those in response to systemic risks.	Medium priority	The PBC updates the macroprudential regulation of real estate finance on an ongoing basis. It carefully calibrates strength and pace of the regulation of concentration in real estate loans. When significant changes hit real estate markets, it may allow an extended period for compliance with sectoral concentration limits. **The NFRA** sees the control of real estate-related risk as a major priority. It encourages banks to improve compliance and risk controls; organizes onsite

Recommendation	Time Frame	Measures Taken
		inspections as necessary; and is improving systems of regulatory alerts and risk resolution. It is committed to preventing the emergence of systemic risk. **The CSRC** is continuously developing its regulatory, risk prevention, and quality systems. Under normal circumstances, it does not intervene in the operations of the market, but it will take action when necessary: if a market deviates severely from its fundamentals; in case of severe irrational volatility; when liquidity is tightly constrained; or during market panics. In such situations, the CSRC will hedge the risks, and correct the market failure.
Regulation and supervision of securities markets		
Improve information disclosure for collective investment plans and prohibit the stating of anticipated rate of return in the prospectuses of wealth management products.	NT High priority	No new developments.
Introduce functional supervision, to ensure that similar products issued by different financial institutions are subject to similar supervision.	MT High priority	No new developments.
Strictly control repo collateral qualifications and improve the discount rate calculation methodology.	Medium priority	**In April 2024, the PBC instructed Shanghai Clearing House (SCH) and the China Foreign Exchange Trade System (CFETS) to launch general repo clearing services for the interbank bond market; it charged SCH with developing and updating regulatory arrangements and discounting formulas for collateral repos.** Qualification of collateral bonds: The SCH developed strict controls for the approval of collateral bonds. Initially, qualification was restricted to financial bonds and interbank deposits issued by development banks, policy banks, and selected commercial banks; and debt financing instruments issued by high quality non-financial corporations. Discounting formulas: The SCH applies the prudential principle to the calculation and setting of discount rates. It also reflects macroeconomic policy in settings such as collateral discount rates, participant discount rates, and countercyclical adjustment factors. Collateral discount rates and participant discount rates are discount factors applied to collateral assets and clearing house members, respectively. They are calculated by SCH based on the risk control policies of the central counterparty clearing house, and reflect factors such as price volatility in collateral bonds, and the credit ratings and likelihood of default of repo transaction participants. These discount rates reflect the macroeconomic policies of the PBC Headquarter, based on current policy and its comprehensive view of the markets, and offer a lever for preventing and resolving leveraging risk, and mitigating pro-cyclical effects in the money markets.
Strengthen systemic risk monitoring mechanisms, to ensure that the connectedness among securities markets and	Medium priority	

Recommendation	Time Frame	Measures Taken
between securities markets and other financial sectors is examined from a holistic perspective.		
Regulation and supervision of insurance		
Formulate a risk-based supervision plan that incorporates all issues and conduct of each insurance company (including market conduct).	Medium priority	**In March 2024, the NFRA issued** ***Measures for Regulatory Ratings of Personal Insurance Companies***. This instrument creates a comprehensive risk evaluation system with six dimensions: corporate governance, business operations, use of capital, management of assets and liabilities, solvency, and other. Different regulatory regimes apply to insurers depending on their rating. This has improved the ability of the NFRA to identify risks among personal insurance companies and to issue alerts, supporting the regulatory objectives of differentiated regulation for personal insurance companies; and early identification, early warning, early exposure, early resolution. The Measures also improve differentiated regulation, and encourage personal insurance companies to develop specialized offerings and compete through differentiation, to promote high-quality growth in the personal insurance industry.
Formulate a plan to gradually use more market-oriented means of valuation.	Medium priority	No new developments.
Supervision of financial market infrastructure		
China Securities Depository and Clearing Corporation Ltd. should make full use of delivery-versus-payment (DVP)	NT High priority	In October 2023, the CSRC instructed the CSDC to reduce the minimum settlement reserve payment ratio for stock trading from 16% to an average close to 13%, releasing close to CNY 40 billion of reserve capital.
Fully implement the principles of the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Regulators (IOSCO) and strengthen the legal framework to increase the resilience of the financial market infrastructure.	MT High priority	In December 2023, the PBC issued *Guiding Opinions of the PBC General Administration on Improving the Regulation of Payment and Settlement Services by Settlement Institutions and Improving the Quality and Standards of Payment and Settlement Services*. The Opinions propose 12 measures, in two areas: long term mechanisms for the healthy growth of payment service providers; and comprehensive regulatory systems. The Opinions improve the regulation of payment and settlement service providers, improve the quality and efficiency of payment and settlement infrastructure, and will boost the building of payment and settlement infrastructure. In December 2023, the CSRC officially approved CSDC as a qualified central counterparty (QCCP).
Extend the services of the central bank to all systemically-important central counterparties.	Medium priority	In July 2023, the PBC issued *Regulatory Measures for Central Bank Deposit Accounts* (Yin Fa [2023] No. 127), specifying the conditions for opening a central bank deposit account, the application and approval processes, account services and requirements on account users. The Measures stipulate that financial market infrastructure companies such as systemically-important central counterparties may open central bank deposit accounts, and make use of central bank settlement services.
Anti-money laundering and combating the financing of terrorism		
Adopt stronger customer due diligence measures	Medium priority	China is currently amending *the Anti-Money Laundering Law* and its supporting regulations to require financial institutions to consider risk levels in their customers

Recommendation	**Time Frame**	**Measures Taken**
with respect to domestic political and public figures based on risk.		and undertake prompt KYC diligence and risk control measures against money laundering. *The Anti-Money Laundering Law (Amendment Draft)* was discussed and passed by the State Council Standing Committee in January 2024; the first reading by NPC Standing Committee was in April 2024; the amendment was open for public consultation from late April to late May. In practice, China applies risk-based KYC measures to domestic political and public figures.
Ensure more effective investigations for acts of self-laundering, and prosecute them as independent convictions.	Medium priority	No new developments.
Crisis management		
The conditions that trigger government-led crisis responses should be more clearly defined and limited to systemic events that require the use of public resources.	NT High priority	Since March 2021, the PBC has continued with the development of legislation for financial stability, in partnership with other relevant government departments. In December 2022, the 38th meeting of the Standing Committee of the 13th NPC carried out its first review of the draft *Financial Stability Law*. It was also published for public consultation. The Law on Financial Stability is scheduled on the legislative agenda of the 14th NPC Standing Committee for 2024. The second review has been conducted in June 2024. Relevant departments will update their institutional arrangements based on the recommendations from the second review.
Formulate special resolution mechanisms for banks and systemically important insurance companies.	MT High priority	Financial regulators have now published the list of D-SIBs three times, in October 2021, September 2022, and September 2023. The 19 SIBs have all submitted their recovery and resolution plans three times to date. In October 2023, the PBC and NFRA jointly issued *Measures for the Assessment of Systemically Important Insurance Companies*, which went into effect on January 1, 2024.
The PBC should formulate a formal emergency liquidity bail-out framework.	MT High priority	No new developments.
Upgrade the institutional design of various types of protection funds to limit moral hazard.	Medium priority	No new developments.
Inclusive Finance		
Upgrade the legal, regulatory, and supervision framework for financial technology.	Medium priority	No new developments.

Appendix VI. Data Issues

Annex VI. Table 1. China: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/

B

Questionnaire Results 2/

Assessment	National Accounts 4/	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	C	B	C	B	B	B	B

Detailed Questionnaire Results

Data Quality Characteristics						
Coverage	B	B	C	A	B	
Granularity 3/	C		C	C	B	
			B		B	
Consistency			C	B		B
Frequency and Timeliness	A	A	C	A	B	

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.
4/ The overall sectoral assessment for national accounts gives a higher weight to granularity given the significant data gaps in expenditure side GDP, resulting in a "C" rating versus the "mechanical" "B" rating assigning the same weight to each sub-category.

A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. The data provided to the Fund has some shortcomings but is broadly adequate for surveillance. Efforts at strengthening the statistical system and enhancing data transparency led to China's subscription to the Special Data Dissemination Standard (SDDS) in October 2015. Nevertheless, China's statistics continue to have significant gaps. The main areas of concern relate to national accounts data and government finance statistics. For national accounts, lack of quarterly GDP by expenditure component (nominal, real, and seasonally adjusted) is a key shortcoming, as reflected in the choice of the team to lower sectoral rating for national accounts to "C". China does not publish CPI weights and PPI weights, either on the website of the statistical office nor on the IMF CPI database. This makes it difficult to analyze the source of consumer price inflation by products, by regions etc. For fiscal data, long-standing data gaps include general government data with a breakdown of expenditure by economic type (current and capital expenditure) and data on off-budget entities (including LGFVs) that meet the statistical criteria for inclusion within the perimeter of the general government. While external sector data is broadly adequate, lack of institutional sector breakdown for the financial account and the type of investment income (e.g., FDI income, portfolio investment income, and other investment income) for the primary income account hampers analysis of financial and income flows.

Changes since the last Article IV consultation. The National Bureau of Statistics had suspended the publication of survey unemployment by age group in July 2023 as they worked on updating the methodology. Publication of a revised series was resumed in December 2023, with enrolled students excluded from the labor force when computing unemployment rate by age groups.

Corrective actions and capacity development priorities. The authorities reiterated their commitment to improve data quality, including through collaboration with the Fund.

Use of data and/or estimates different from official statistics in the Article IV consultation. The fiscal data used in the Article IV consultation supplements the official GFS statistics with Staff estimates for deficits and debt for a broader definition of general government which includes data on off-budget entities (including LGFVs). Staff's augmented defintion of the general government better reflects the fiscal stance and the government's role in the economy.

Other data gaps. Data on aggregate economically active population is published, but only at an annual frequency and with long lags.

Annex VI. Table 2. China: Data Standards Initiatives

China subscribes to the Special Data Dissemination Standard (SDDS) since October 2015 and publishes the data on its National Summary Data Page. The latest SDDS Annual Observance Report is available on the Dissemination Standards Bulletin Board (https://dsbb.imf.org/).

Annex VI. Table 3. China: Table of Common Indicators Required for Surveillance

As of June, 2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	China[8]	Expected Timeliness[6,7]	China[8]
Exchange Rates	June 2024	June 2024	D	D	D	D	...	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	May 2024	June 2024	M	M	M	M	1W	1W
Reserve/Base Money	May 2024	June 2024	M	M	M	M	2W	2W
Broad Money	May 2024	June 2024	M	M	M	M	1M	4W
Central Bank Balance Sheet	May 2024	June 2024	M	M	M	M	2W	2W
Consolidated Balance Sheet of the Banking System	May 2024	June 2024	M	M	M	M	1M	4W
Interest Rates[2]	June 2024	June 2024	D	D	D	D	...	D
Consumer Price Index	May 2024	June 2024	M	M	M	M	1M	13D
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	2022	Aug 2023	A	A	A	A	2Q	NLT 7M
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	May 2024	June 2024	M	M	M	M	1M	25D
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2024Q1	June 2024	Q	Q	Q	Q	1Q	1Q
External Current Account Balance	2024Q1	May 2024	Q	A, Q	Q	Q	1Q	1Q
Exports and Imports of Goods and Services	May 2024	June 2024	M	M	M	M	8W	13D
GDP/GNP	2024Q1	April 2024	A, Q	A, Q	Q	Q	1Q	15D
Gross External Debt	2024Q1	June 2024	A, Q	A, Q	Q	Q	1Q	1Q
International Investment Position	2024Q1	June 2024	A, Q	A, Q	Q	Q	1Q	1Q

[1] Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than;.

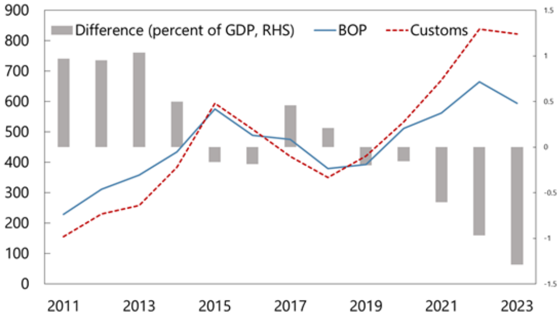
[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

Appendix VII. Difference in Goods Trade Balance Between BOP and Customs Data

In recent years, China has recorded smaller trade surpluses in the balance of payments (BOP) statistics than those in based on Customs data. The divergence seems to be mainly caused by the different methodologies used to record exports and imports of goods in BOP and Customs. The former records imports and exports when ownership of the goods is transferred between residents and nonresidents while the latter records them when the goods physically cross the border. This Appendix discusses potential underlying reasons for the BOP-Customs gap and clarifies that the recording of imports and exports related to global production arrangements (e.g., factoryless manufacturing) may largely explain the widening divergence between the two indicators based on the information provided by the authorities.

1. **China's BOP goods trade surpluses in recent years show a widening divergence from those recorded by Customs—with the gap over one percent of GDP in 2023**. Since 2019, the Customs-based trade surpluses have been persistently above the BOP-based surpluses, with the gap widening significantly over time. In 2023, China's BOP goods trade surplus was USD 594 billion while Customs recorded a surplus of USD 823 billion, a difference of USD 229 billion or 1.3 percent of GDP.[1]



Goods Trade Balance, Customs vs. BOP
(In billions of US$)

Sources: China General Administration Customs; SAFE; Haver Analytics; and IMF staff calculations.

2. **The divergence seems to be mainly caused by the difference in methodologies to record imports and exports of goods in BOP and Customs.** In BOP, imports and exports of goods are recorded when ownership of the goods is transferred between residents and nonresidents regardless of the location of the goods. Customs records imports and exports of goods when the goods physically cross the border of China regardless of ownership of the goods.[2] The methodological difference is particularly relevant in the recording of imports and exports related to global production arrangements (e.g., factoryless manufacturing) where nonresident enterprises (e.g., multinational enterprises) outsource part of production to contractors in China.

3. **Exports and imports arising from factoryless manufacturing seem to have been reducing China's overall goods trade surplus in BOP**. When a Chinese contractor sells produced goods to the nonresident enterprise that outsourced the production, exports of goods are recorded in BOP even if the goods remain in China (e.g., in warehouses). If the nonresident enterprise

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[1] The difference slightly increased to 1.4 percent of GDP in the first quarter of 2024.

[2] See paragraphs 10.16 and 10.26-27 of the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)*.

subsequently sells the goods in China, imports of goods are recorded in BOP. Given that the Chinese contractors' ex-factory price for the nonresident enterprise (China's exports) is normally lower than the nonresident enterprises' wholesale price for Chinese distributors (China's imports),[3] these transactions result in a deficit in the goods trade balance in BOP. Customs does not record exports or imports for these transactions because the goods never cross the border. So, these transactions do not reduce the trade surplus recorded by Customs while they do in BOP (see text Table 1, 'Sold in China').

Appendix VII. Text Table 1. Illustrative Examples of Recording of Factoryless Manufacturing in BOP and Customs

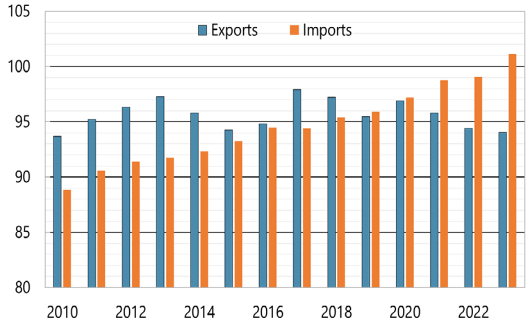
Ex-factory Price=60 Wholesale Price=100		Export	Import	**Balance**
Sold in China	**BOP**	60	-100	**-40**
	Customs	0	0	**0**
Sold abroad	**BOP**	60	0	**60**
	Customs[1]	100	0	**100**

[1]Customs' declaration price, which in most cases would be the wholesale price

4. BOP imports kept increasing relative to Customs imports in recent years and surpassed them for the first time in 2023 (chart). The upward trend in this ratio is supported by China's growing domestic market and rising goods produced by factoryless manufacturing. In the past, Customs has recorded higher imports than BOP because Customs' imports include costs for transport and insurance while BOP imports of goods do not (they are recorded in services account).[4]

Ratio of BOP Data to Customs Data

(In percent)



Sources: General Administration Customs China; SAFE; and IMF staff calculations.

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[3] The price difference comes from margins for and costs incurred by the nonresident enterprise (e.g., planning, management, patent, and marketing). The Chinese BOP compilers' pilot survey to several contractors producing electronics found that the difference could be around 30 to 50 percent. The difference varies significantly depending on types of goods and types of outsourcing arrangements.

[4] Manufacturing services by Chinese contractors on goods owned by nonresidents (e.g., assembly of airplanes, electronic products, and clothing owned by nonresidents) also cause the divergence. Fees for manufacturing services that do not involve a change of ownership of the goods owned by nonresidents are recorded as services trade (not goods trade) in BOP while the full values of the goods are recorded as imports and exports of goods by Customs. There are also other cases where BOP and Customs record goods trade data differently (e.g., warehousing and logistics services, merchanting, and different timing of recording).

For example, in China, imports recorded in BOP were lower by more than 10 percent, compared with imports recorded by Customs in 2010.

5. Exports of goods produced by factoryless manufacturing also result in a lower trade surplus recorded in BOP than in Customs. For example, in cases where the nonresident enterprise sells the goods produced by factoryless manufacturing to a third country, the ex-factory/wholesale price difference make exports recorded in BOP lower than those recorded by Customs as the former is recorded at ex-factory price while the latter is recorded at declaration price, which in most cases would be the wholesale price (see Table 1, 'Sold abroad'). Indeed, the BOP-Customs exports ratio has been persistently below 100 percent since 2010. The recent decline in the BOP-Customs exports ratio is also in line with an increase in exports from bonded zones where many manufacturers operate under tax-advantaged arrangements (USD 196 billion in 2020 to USD 313 billion in 2023—60 percent increase while the overall exports increased by 27 percent during the same period).

6. The ratio of BOP imports to Customs imports has increased by 12 percent points since 2010,[5] while no clear long-term trend is observable in the ratio of BOP exports to Customs exports data. The ratios on the export side have been volatile, and the ratio in 2023 remained higher than that in 2010. Chinese BOP compilers who have access to data sources (data on individual transactions) are also of the view that the increasing imports of goods produced by factoryless manufacturing have been the main driver for the divergence in goods trade data between BOP and Customs data.

7. In order to capture exports and imports of goods that do not physically cross the border comprehensively, the Chinese BOP compilers switched the data sources from Customs data to direct reporting of financial records by large enterprises in 2022. According to the Chinese BOP compilers, more than 13,000 large enterprises directly report goods trade data, which account for about 70 percent of the total goods trade. The compilers use cross-border receipts and payments on goods trade obtained from the International Transactions Reporting System (reports from banks on international payments and receipts) for the rest of the enterprises. The new data sources help Chinese BOP compilers produce BOP trade data in line with the *BPM6* (based on the change of ownership principle rather than physical movements of goods, as well as based on actual transaction prices rather than declared prices at Customs). The compilers are of the view that the switch of the data sources also contributed to narrowing net errors and omissions by correctly recording goods trade based on the transaction price in BOP.

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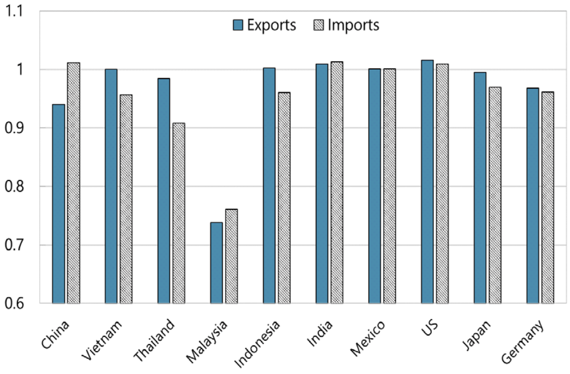
[5] Twelve percent of imports in 2023 is USD 310 billion—1.7 percent of GDP. Without the increase in BOP imports relative to Customs imports, BOP would have recorded a higher trade surplus than Customs in 2023.

Ratio of Exports and Imports: BOP to Customs



Sources: Haver Analytics; and IMF staff calculations.

8. The divergence in BOP and customs goods trade data are common across countries while China's divergence seems to be boosted by (i) the high level of implementation of the change of ownership principle, (ii) its status as a major outsourcing destination, and (iii) its growing domestic market to import goods produced from outsourcing. Generally, countries rely on customs data with adjustments for specific transactions (e.g., goods for processing) to compile trade data for BOP according to the change of ownership principle. However, the adjustments are often challenging given compilers need to identify additional information which may not be available from customs.[6] So, some countries are not fully implementing the change of ownership principle in BOP,[7] while China started using new data sources to enhance the alignment with the change of ownership principle. Further, expanding and deepening global manufacturing arrangements have been making the application of the principle more challenging as they involve many layers of imports and exports (e.g., materials and parts) with various resident and nonresident enterprises.

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[6] For example, even if the data for the adjustments can be collected from surveys to enterprises, the data have to be linked to corresponding customs data to make the adjustments, which is often challenging.

[7] For example, the United States records goods sent or received from abroad for processing without change of ownership as trade in goods in BOP.

INTERNATIONAL MONETARY FUND

PEOPLE'S REPUBLIC OF CHINA

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 1, 2024

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

CONTENTS

FUND RELATIONS

(As of May 31, 2024)

Membership Status: Joined December 27, 1945; Article VIII (December 1, 1996)

General Resources Account:

	SDR Million	% Quota
Quota	30,482.90	100.00
Fund holdings of currency	23,070.19	75.68
Reserve position in Fund	7,412.76	24.32
Lending to the Fund		

SDR Department:

	SDR Million	% Allocation
Net cumulative allocation	36,206.16	100.00
Holdings	40,401.62	111.59

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				
	2023	2024	2025	2026	2027
Principal		0.00	0.00	0.00	0.00
Charges/interest		0.28	0.28	0.28	0.28
Total		0.28	0.28	0.28	0.28

Exchange Rate Arrangement:

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 percent 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 percent around the midrate released that day by China’s Foreign Exchange Trading System (CFETS). China’s de facto exchange rate regime is classified as a “crawl-like” arrangement as the CNY CFETS index remained within a sloping band of ±1 percent since July 2023 with one realignment in November 2023. 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(a), 3, and 4 of the IMF’s Articles of Agreement and 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 No. 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. On 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

CAPACITY DEVELOPMENT

Table 1. China: Summary of Capacity Development Activities, 2011–24

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
FAD	Workshop on Microsimulation on Income Tax	November 2020
FAD	Workshop on Value-added Tax	July 2021
FAD	Workshop on Capital and Labor Income Taxation	October-November 2021
FAD	Revenue Forecasting and Analysis	February 2023
FAD	Income Tax Cross Border Issues	November, 2023
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	January 2018
FAD	Tax administration—performance measurement	March 2018
FAD	Tax administration--PIT	November 2018
FAD	Workshop and report on tax modeling and analysis	April 2019
FAD	Improving International and Domestic Taxpayer Compliance through Strengthened Services and Supervision	October 2020
FAD	Administering the Value-added Tax on Cross-border Transactions	November-December 2020
FAD	Improving Taxpayer Compliance through Strengthened Services and Supervision	October 2021
FAD	International Practices in Compliance Risk Management and Data Management	November 2021
FAD	Administering the Individual Income Tax on Offshore Transactions	December 2021

Table 1. China: Summary of Capacity Development Activities, 2011–24 (continued)

FAD	Administration of Human Resources	July-August, 2022
FAD	New Tax Administration Technologies	November, 2022
FAD	Strategy and Practice of Digitalization	July, 2023
FAD	Strengthening Administration of Social Security Contributions	May-June, 2023
FAD	Consumption (excise) tax on oil producers	September, 2023
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
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	China-Revenue Administration	May-June 2023
FAD	China-Revenue Administration	July 2023
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

Table 1. China: Summary of Capacity Development Activities, 2011–24 (continued)

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	January 2019
MCM	Financial Sector Technical Assistance	January 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
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

Table 1. China: Summary of Capacity Development Activities, 2011–24 (continued)

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	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
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	January 2019
SPR	Debt Sustainability Framework in Low-Income Countries and Fund	February-March 2019
MCM	Policies	March 2019
ICD/MCM	Stress Testing and Systemic Risk II	April 2019
ICD	Financial Markets and Instruments	April 2019
ICD	Financial Sector Policies	May 2019
MCM/ICD/LE	Macroeconomic Diagnostics	May 2019
ICD	Managing Capital Flows	June 2019
STA	Financial Sector Surveillance	June 2019
	Debt Securities Statistics	
ICD	Monetary & Fiscal Policy Analysis with DSGE Models-Advanced Workshop	September 2019
ICD	Fiscal Sustainability	September 2019
LEG	Current International Issues in Tax Law Design	September 2019
MCM	Bank Restructuring and Resolution	September 2019

Table 1. China: Summary of Capacity Development Activities, 2011–24 (continued)

ICD	Macroeconomic Diagnostics	October-November 2019
STA	Cross-Border Position Training	November 2019
ICD	Financial Programming and Policies	December 2019
SPR	Virtual Workshop on Debt Sustainability Analysis and IMF Policies	July 2020
MCM	Virtual Course on Stress Testing and Systemic Risk	September 2020
ICD	Virtual Course on Macroeconomic Diagnostics	October 2020
ICD	Economic Issues in Regional Integration (ERIv)	November 2020
ICD	(Selected Issues in) Financial Sector Policies (FSSv)	November-December 2020
SPR/ICD/LEG	Debt Sustainability Analysis and IMF Policies	December 2020
ICD/MCM/LEG	Managing Capital Flows (MCFv)	December 2020
ICD	Fiscal Policy Analysis (FPA)	December 2020
LEG	Corporate and Household Insolvency (CHI)	January 2021
ICD	Financial Markets and Instruments (FMI)	January 2021
LEG	International Issues in Tax Law Design (TLWD)	March 2021
MCM	Workshop on Regulation and Supervision of Issuers (RS)	April 2021
ICD	Fiscal Frameworks (FF)	July 2021
LEG	Implementing the International AML/CFT Standards (AMLS)	July 2021
ICD	Monetary and Fiscal Policy Analysis with DSGE Models(DSGE)	August 2021
SPR	Webinar on Implications of RCEP and CPTPP for China	September 2021
SPR/LEG	DSA AND IMF POLICIES WORKSHOP	September 2021
MCM	Course on Bank Restructuring and Resolution	November 2021
FAD	Financial Development and Financial Inclusion (FDFI)	November 2021
STA	Statistics on International Trade in Goods and Services	November-December 2021
MCM	Systemic Macro-financial Risk Analysis (MFRA)	November-December 2021
FAD	Applying the Tax Administration Diagnostic and Assessment Tool (TADAT)	December 2021
ICD	Managing Capital Flows	December 2021
ICD	Financial Sector Policies (FSP)	January 2022
ICD	Macroeconomic Diagnostics (MDS)	February 2022
ICD	Financial Development and Financial Inclusion (FDFI)	March 2022
ICD	Fiscal Sustainability (FS)	March 2022
ICD	Debt Dynamics and Fiscal Adjustment Paths (Part 2) (DDFAP)	March 2022
MCM	Selected Issues in the Regulation of Fintech (SIFR)	March 2022
ICD	Macroeconometric Forecasting & Analysis (MFA)	April 2022
ICD	Financial Markets and Instruments (FMI)	June 2022
LEG	Implementing the International AML/CFT Standards (AMLS)	June 2022
ICD	Nowcasting (NWC)	June-July 2022
ICD	Macroeconomic Diagnostics (MDS)	August-September 2022
SPR	Debt Sustainability Analysis and IMF Policies (DSA)	August-September 2022
STA	Statistics in International Trade in Goods and Services (ITGS)	September 2022
MCM	Current Issues in Banking Supervision and Regulation (BRS)	October 2022
FAD	Tax Policy and Administration: Theory and Practice (TPAT)	October 2022
ICD	Managing Capital Flows (MCF)	October-November 2022
STA	Balance Sheet Approach (BSA)	November 2022
STA	External Sector Statistics - Intermediate Level (ESS-M)	November 2022
LEG	International Issues in Tax Law Design (TLWD)	November-December 2022
ICD	Vulnerability Diagnostics (VDS)	December 2022
ICD	Fiscal Sustainability (FS)	December 2022
FIN	IMF Financial Account Operations	December 2022
ICD	Financial Sector Surveillances (FSS)	March 2023
MCM	"Green Finance" Webinar	April 2023
STA	Financial Soundness Indicators (FSI)	June 2023
LEG	Implementing the International AML/CFT Standards (AMLS)	July 2023

Table 1. China: Summary of Capacity Development Activities, 2011–24 (concluded)

MCM	Core Elements of Banking Supervision (CBS)	July 2023
ICD	Monetary & Fiscal Policy Analysis with DSGE Models (DSGE)	August-September 2023
STA	Monetary and Financial Statistics-Introductory (MFS-I)	September 2023
ICD	Fintech Market Development and Policy Implications (FINTECH)	September 2023
ICD	Macroeconomic Diagnostics (MDS)	September 2023
FAD	Tax Policy and Administration: Theory and Practice (TPAT)	October 2023
APD/FAD/STA	Managing Fiscal Risks of Local Governments	October 2023
LEG	International Issues in Tax Law Design (TLWD)	November 2023
SPR	Debt Sustainability Analysis and IMF Policies (DSA)	November 2023
MCM	Selected Issues in the Regulation of Fintech	November 2023
ICD	Macroeconometric Forecasting and Analysis	December 2023
ICD	Inclusive Growth	December 2023
MCM	Bank Restructuring and Resolution	December 2023
MCM	Macroeconomic Stress Testing	January 2024
ICD	Central Bank Digital Currencies: Principles and Policy Considerations	February 2024
ICD	Financial Sector Policies	March 2024
ICD	Macroeconometric Forecasting and Analysis	April 2024

INTERNATIONAL MONETARY FUND

PEOPLE'S REPUBLIC OF CHINA

July 16, 2024

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

Prepared By	Asia and Pacific Department

This statement provides an update on developments that have taken place since the staff report was issued to the Executive Board. The thrust of the staff appraisal remains unchanged.

1. Data. Real GDP growth slowed from 5.3 percent y/y in Q1 to 4.7 percent in Q2, primarily reflecting weaker consumption. While a decline in economic momentum was expected in Q2, the slowdown was somewhat sharper than expected. Inflation also remained low, with headline inflation declining from 0.3 percent (y/y) in May to 0.2 percent in June amid continued weakness in food prices. Core inflation remained unchanged in June at 0.6 percent (y/y). Growth of total social financing (TSF) slowed from 8.4 percent in May to 8.1 percent in June, while real estate investment and house prices continued to decline.

2. Monetary policy operations. The People's Bank of China (PBC) has announced additional tools for its monetary operations toolkit. To better manage interbank liquidity, the PBC announced temporary overnight repo and reverse-repo operations at 20 basis points below and 50 basis points above the 7-day reverse repo rate, respectively. While operational details remain limited, the PBC also announced plans to borrow government bonds from selected primary dealers. Their stated aim is to maintain stable operations in the bond market. As discussed in the staff report (¶52), the PBC should transition towards a predominantly interest rate-based monetary policy framework, with a clear, effective, and transparent operational framework that aligns market conditions with its announced policy stance.

Statement by Zhengxin Zhang, Executive Director for the People’s Republic of China

July 19, 2024

Our authorities would like to thank the IMF staff and management for their constructive policy dialogue during the China 2024 Article IV Consultation. We appreciate the staff for their professionalism and hard work, and value their comprehensive and well-focused analyses. In this year, Chinese production has grown steadily; demand has continued to recover; employment and prices have overall been stable; the international balance of payments is balanced; transformation and upgrading continue; and the economy continues to recover with positive signs. Going forward, China will continue to promote high-quality development, accelerate the development of new quality productive forces, foster and strengthen the new momentum of economic development, consolidate and strengthen the momentum of economic recovery, and continue to promote effective qualitative improvement and reasonable quantitative growth of the economy.

I. Recent developments and medium-term forecast of China’s economy

We welcome staff’s assessment that China’s economy has remained resilient and the upward revisions to China’s economic growth forecasts for 2024 and 2025. China’s economic performance is broadly stable, with recovery across major economic indicators. There was a positive start to the year, and the economy grew by 5.0 percent in the first half of 2024. Domestic demand contributed 86.1 percent of the growth, of which 60.5 percent was from consumption. Consumption continues to serve as both a booster and a stabilizer for economic growth.

In the first half of this year, total retail sales of consumer goods grew by 3.7 percent year-on-year; total value added of industrial enterprises grew by 6.0 percent year-on-year; and fixed asset investment grew by 3.9 percent year-on-year, particularly manufacturing investment maintained high-speed growth at 9.5 percent year-on-year. Prices remained generally stable. The consumer price index (CPI) increased by 0.1 percent year-on-year, with core CPI rising by 0.7 percent year-on-year. Going forward, the CPI is expected to continue its mildly recovering trend. The month-on-month producer price index (PPI) growth recovered to positive territory, while on a year-on-year basis, the contraction is narrowing, which reflects an improvement in supply and demand balance of industrial products domestically. In RMB terms, total imports and exports of goods grew by 6.1 percent year-on-year, with 6.9 percent growth in exports and 5.2 percent growth in imports. The trade of goods for half a year exceeded RMB 21 trillion for the first time. On foreign investment, during the first five months of the year, 21,764 new foreign-invested companies were established, an increase of 17.4 percent year-on-year. Actual utilization of foreign capital in the high-tech manufacturing sector increased by 2.7 percentage points year-on-year. Overall, China's economy remains stable with a positive outlook, and upside factors outweigh downside factors. We are confident in our ability to achieve our growth forecast of about 5 percent for the whole year. **Therefore, compared to the statement in the Staff Report that "while declining, economic slack remains significant", our authorities' assessment of the recent Chinese economic developments is more positive.**

On China's economic growth outlook. Currently, the complexity and severity of the external environment are on the rise, effective domestic demand is still insufficient, and there is still a need to bolster our internal momentum for economic development. **But overall, the positive fundamentals of China's economy have not changed and our structural reforms have already produced many positive developments. First,** consumption has become an important driver of the economic recovery and there is still potential for further growth. The advantages of China's ultra-large market scale continue to accumulate and take effect. **Second,** the low-carbon transition is advancing quickly and China's green economy is growing stronger by the day. China is a leader in every link in the chain of renewable electricity generation, transmission, and storage. **Third,** the manufacturing sector has achieved significant advances. Corporates' R&D capability continues to grow and new quality productive forces are being quickly fostered. In new energy vehicles, high-speed rail, shipbuilding, aerospace, consumer electronics, and other areas, China is currently among the top globally in terms of value-added and competitiveness. And many of the industry leaders are privately-owned companies. The rapid rise of China's new industries reflects global trends in technology revolution and green growth. They are providing added momentum to China's economic growth and creating a broader space for cooperation with corporates all around the world. These strengths have made China the most comprehensive, stable, and reliable link in many global supply chains. Looking to the future, China's economy will retain great resilience and potential, and its high-quality talent dividend will continue to deliver value. The long-term upside factors and drivers will have a sustained impact, and China's capacity to implement macroeconomic policy will steadily increase.

Considering these factors, our projections for China's growth in 2025 and in the medium term are more positive than staff's view. China still has ample macroeconomic policy space and has the capacity to support sustainable economic growth. For the foreseeable future, China will remain an important engine of global economic growth. While expanding domestic demand, China will continue to promote a high level of openness internationally. We will maintain stable and smoothly-flowing supply chains, and increase liberalization and facilitation for trade and investment. We will lead and promote healthy globalization and inject positive momentum into global economic growth. To this end, we recommend that staff conduct a full analysis of the upside factors in China's economic growth to make a reasonable judgment of the medium-term growth path for China's economy. This will also help to reinforce confidence in global economic growth.

II. Policy Issues

1. Monetary policy. We are glad to see staff's assessment that China's monetary policy in 2024 "is welcome." In recent years, the Loan Prime Rate (LPR) reforms have made significant impact and the market-based adjustment mechanism for deposit interest rates has been effective. As a result, monetary policy transmission has become more efficient and the average financing cost has made a sustained decline. There is now a generally smooth transmission from the central bank's policy rate to market benchmark rates and finally to specific market rates. Supply and demand for foreign exchange are generally balanced, the current account surplus is stable, foreign exchange reserves are sufficient, the RMB exchange rates fluctuate in both directions, and expectations are stabilizing, with the RMB exchange rate remaining basically stable at an adaptive and equilibrium level. **In its monetary policy practices, China has already implemented the recommendations made in the Staff Report for "additional monetary easing via interest rates, better monetary policy transmission, and greater exchange rate flexibility." It is consistent with the policy orientation recommended in the report.**

Since the start of 2024, China's macroeconomic policy has been focused on stability while attempting to make progress, and the sound monetary policy will be flexible, appropriate, targeted, and effective. First, liquidity is kept at a reasonable and adequate level. We have reduced the reserve requirement ratio (RRR) by 0.5 percentage point, which released over RMB 1 trillion in medium- to long-term liquidity. Financial institutions have been guided on providing credit loans in a more balanced manner and supporting the economy with stable and sustainable financing. **Second, effort was made to steadily reduce the overall financing costs.** The interest rates for central bank lending and rediscounts for agriculture and small business loans were cut by 0.25 percentage point. The LPR for loans of 5 years or longer was guided downwards by 0.25 percentage point. We also continued to promote liberalization of deposit interest rates. **Third, the credit structure has improved.** We established a central bank lending facility of RMB 500 billion to support technology innovations and upgrades, expanded the eligibility for small- and micro-loans for financial inclusion, and expanded the access to the carbon emission reduction facility (CERF). **Fourth, a series of supportive policies to ensure delivery of housing units was introduced.** These include the establishment of a central bank lending facility of RMB 300 billion for affordable housing projects, a reduction in the minimum downpayment ratio for residential mortgages at national level, the elimination of the minimum policy rate for residential mortgage rates at national level, and a 0.25 percentage point reduction in the rates of housing provident fund loans of all maturities.

Looking to the future, China will strengthen the implementation of existing monetary policies. First, we will maintain liquidity at a reasonable and adequate level, guide towards a reasonable credit expansion and balanced supply of credit, and ensure that aggregate financing to the real economy (AFRE) and money supply are commensurate with expectations of future economic growth and price levels. **Second,** we will promote a mild recovery of inflation and maintain prices at a reasonable level. **Third,** we will improve the market-oriented interest rate formation and transmission mechanism, expand the monetary policy toolbox, and let the central bank's policy rate play the guiding role. We will also unleash the potential of LPR reforms and the market-based adjustment mechanism for deposit interest rates. These changes will help steadily reduce corporates' and households' financing costs. At the same time, as the economy recovers, we shall also monitor any changes in long-term yield. **Fourth,** we will ensure a smooth transmission mechanism for monetary policy and increase the efficiency of fund usage. **Fifth,** we will maintain the RMB exchange rate stable at an adaptive and equilibrium level, by adopting comprehensive measures, correcting deviations, and stabilizing expectations. We are committed to correcting procyclical behaviors, preventing one-sided market expectation and its self-reinforcement, and resolutely avoiding the risk of overshooting.

2. Fiscal policy. We thank staff for their recommendations on fiscal policy. However, we hold a different view on issues such as the "augmented" fiscal concept, the fiscal stance, and local government debt.

On the fiscal stance, based on the "augmented" fiscal concept, the Staff Report noted that "the fiscal stance in 2023 was neutral" and "the 2024 budget also implies a broadly neutral fiscal stance." **But in reality, China has implemented a proactive fiscal policy during 2024, with policy measures reasonably strengthened and their efficiency improved. First,** we have strengthened the fiscal policy adjustment. The 2024 budget deficit is set at 3 percent of GDP, i.e., RMB 4.06 trillion, which is RMB 180 billion higher than the 2023 budget. We plan to issue a total of RMB 3.9 trillion of new local government special bonds (RMB 100 billion higher than last year) and RMB 1 trillion of ultra-long special treasury bonds. Most of the proceeds from the RMB 1 trillion additional government bonds issued in 2023 Q4 will be used this year. And we continue to implement our policy of reducing taxes and administrative fees in a more targeted and effective way. In January-May 2024, general budgetary revenue reached RMB 9.7 trillion, down 2.8 percent year-on-year. Last year, the collection of postponed tax payments from micro-, small- and medium-sized enterprises (MSME) inflated fiscal revenue, and tax cuts announced last year took effect this year; when these special factors are discounted, comparable tax revenues have increased by 2 percent year-on-year. General budgetary expenditure for January-May stood at RMB 10.8 trillion, up 3.4 percent year-on-year. **Second,** we have been strengthening fiscal support for major national strategies and basic livelihood. The implementation of our structural policy to reduce taxes and administrative fees continues. We are providing key support to the development of the high-tech and manufacturing sectors, stimulating large-scale updating of equipment and trade-in of consumer products, and expanding consumption in key sectors. **Third,** we are improving the coordination of fiscal policy with monetary policy, employment policy, etc., enhancing the consistency in macroeconomic policies, and improving the synergy of the policy mix. **In 2025, our initial consideration is that China's fiscal policy will maintain its positive stance.** We will keep stability, continuity, and sustainability in our fiscal policy, and continue to send clear signals about stable and high-quality growth to stimulate vitality in the whole economy and boost momentum for economic growth.

On local government debt, as of end-2023, the outstanding amount of official local government debt is RMB 40.74 trillion, which is within the limit of RMB 42.17 trillion approved by the National People's Congress (NPC). Together with the RMB 30.03 trillion central government debt, the total outstanding government debt is RMB 70.77 trillion, equivalent to 56.1 percent of the 2023 GDP. This level of debt is lower than other major market economies and emerging market economies.

There are two important features in China's local government debt. First, it is generally used for investment in infrastructure, so the debt is mostly backed by physical assets and has positive externalities for the local economy. This feature fundamentally differs from other countries where government debt is used to finance current expenditures. **Second,** most local government debt is concentrated in provinces with strong fundamentals and growth momentum, which have the capacity to absorb the debt. **For these reasons, the risk from local government debt in China is generally under control.** In 2023, China launched a new policy of "effectively preventing and mitigating risks from local government debt, through the development and implementation of a package to resolve debt issues." Within the approved debt limit, a certain amount of government bonds would be refinanced, helping local governments, particularly those in high-risk regions, to resolve implicit debt and clear overdue payments to enterprises. This will help ease the pressure from concentrated debt repayment and reduce the interest burden. The guiding principle for local government debt is that "provincial governments assume overall responsibility, whereas municipal and county governments shall make every effort to resolve debt issues." Every locality should contribute its own efforts and use all available resources to develop plans to address their debt issues and to gradually decide the specific action items. State-owned enterprises, including local government financing vehicles (LGFV), are market entities with responsibility for their own operations, risks, and balance sheets. On the question of resolving risks from LGFVs, China maintains the principle of separation between the government and enterprises. A process of categorization and differentiated resolution must be taken - if an LGFV has illegally raised financing on behalf of a local government, the debt is treated for resolution purposes as an implicit government debt, while if an LGFV has raised debt for operational purposes, we guide financial institutions to negotiate with the LGFV following market-based, rule-of-law principles, to resolve the debt risks by offering loan extensions, replacement, or refinancing. Through these differentiated paths, the risks from the stock of debt can be resolved.

Revenue from land sales. The Staff Report comments on the impact of land sale revenue on local governments finances, saying, "reduced land sale revenues have further exacerbated pre-existing local fiscal gaps." We recognize that the fall in land revenue may create stress for local government finances given it has been a major component of local government fund budgets. However, it must be stressed that land sale revenue is a gross revenue - as this revenue is reduced, there will also be a reduction in fiscal outlays on the associated costs, such as relocation compensation. **For this reason, the fall in net revenue from land sales will only have a very minor impact on local government budgets.** In 2023, the decline in national land sale revenue narrowed for 10 percentage points compared with 2022. In Q1 this year, national land sale revenue is RMB 814.7 billion, down 6.7 percent year-on-year. This fall was 20.3 percentage points smaller than last year's huge drop.

We expect land sale revenue to further recover and stabilize in the upcoming future. On local government fiscal operations, in recent years, transfers from central government have reasonably increased. In 2024, transfers will total RMB 10.2 trillion, representing a 4.1 percent increase in comparable payments when excluding one-off factors. This increase would cover the fiscal gap experienced by local governments from the fall in land sale revenue and can lend powerful support for local socio-economic development. The Chinese government is currently implementing three major housing projects: construction of affordable housing, redevelopment of "urban village," and the development of dual-use infrastructure for regular use and for contingency. It is also speeding up the formation of a new development model for the real estate sector. These will make an important contribution to the high-quality economic development. At the same time, China is encouraging local governments to foster and develop new quality productive forces, making use of local resources, existing industrial base, and R&D capacity. Local governments are encouraged to actively foster new drivers for economic growth and to gradually reduce their reliance on land sale revenue.

<u>3. Preventing and Mitigating Financial Risks.</u> Since the last consultation, there has been a reduction in China's financial stability risks, which can be attributed to a number of actions targeting at the real estate market over the past few years and an improvement in the fiscal situation of local governments. The People's Bank of China (PBC) and other financial regulators continue to prevent and resolve financial risks in key sectors such as real estate and local government debt. Reform and risk reduction in small and medium financial institutions is also gathering pace, and high-risk institutions are being effectively resolved. At the same time, the supply-side structural reforms of the financial sector are deepening, with a comprehensive enhancement of financial regulation, which takes concrete measures to enhance its effectiveness. At present, China's overall financial risk is under control. Financial institutions are broadly running on a sound basis, financial markets are generally operating smoothly, frameworks safeguarding financial stability are working effectively, and the legal systems for the financial sector are being improved.

We thank the Fund for its focus and recommendations on China's real estate market, and for its acknowledgement of the authorities' policies on supporting housing demand and financing for developers, as well as guiding the transformation of the real estate markets. Many of the recommendations of staff are consistent with the policies already adopted. In recent years, the Chinese government has taken many actions to respond to the adjustment in the real estate sector. These include ensuring the delivery of housing units, so that pre-sold units will be completed and delivered, thus protecting the rights of home buyers, and creating a "whitelist" of in-construction projects eligible for government-supported financing to support real estate developers. **Beginning in mid-May this year, China has further updated its real estate policies, and positive changes have already emerged in the real estate market. We expect that going forward, the real estate sector's drag on the economy will continue to dissipate. In terms of demand,** in January-May, the year-on-year fall in building starts for private residential housing was smaller than last year. Since June, there has been an upturn in activity in new housing and second-hand housing in some key metropolitan markets. **In terms of supply,** the credit crunch for developers has been eased. The year-on-year downward trend in the total floor area of both new starts and project completions have been flattening out for the past several months. Inventory reduction measures are starting to take effect, and the total unsold floor area has been falling for the past three months. It should be noted that any policy response takes time to have an effect. The real estate market is still undergoing an adjustment. China is actively implementing the policies already announced and will continue to study into new policies for reducing inventory and stabilizing the market. The execution of these policies will promote the stable and healthy growth of the real estate market.

The Staff Report suggests that the "continued stress in the property sector" is a source of credit risk. However, in reality, the spillover from the adjustment in the Chinese real estate market to the financial system remains generally under control. Real estate loans make up 23 percent of outstanding bank loans, of which 80 percent are personal mortgages. China has always imposed highly prudent personal mortgage policies. On one hand, the downpayment for self-occupied residential mortgages, which averaged at around 35 percent, could provide a thick buffer. On the other hand, the regulators have imposed on banks a limit on the ratio of loans to the real estate sector and personal mortgages. For most banks, real estate loans make up less than 20 percent of their assets, which effectively controls the concentration risk. The credit quality of personal mortgage loans is closely connected to borrowers' employment and income, and it is relatively unaffected by the volatility in housing prices. The non-performing loan ratio has long been kept at a low level of 0.5 percent. Real estate development loans are backed by pledged assets in the form of the land and the project under construction; there are also strict risk management requirements. Only a small number of developers or projects have encountered financial difficulties, and the overall impact remains under control.

The Chinese real estate market has experienced a 20-year boom and is now undergoing a major transition as it seeks a new equilibrium. Currently, the overall housing demand has already stabilized, medium-term demand is well-supported, and there remains a strong foundation for long-term growth. After more than 20 years of high-speed growth, the demand for housing from Chinese residents has basically been satisfied in aggregated terms; however, there is still considerable space for improvements in the housing mix. As of 2023, China's urbanization rate stands at 66.16 percent. This is still some distance from a mature level of urbanization of about 75 percent. There is a large population of new urban residents, meaning demand will be powerfully buoyed by the need for affordable housing, redevelopment of "urban village," and infrastructure development. The desire of existing residents to upgrade their living conditions will also create a significant demand for redevelopment. As the decline in new home sales has been effectively set off by an increase in second-hand home sales, the overall demand for residential housing has been stabilized. As the macroeconomy and residents' outlook improve, real estate developers' ability to obtain financing will improve, and the stabilization of the real estate market will be further reinforced. **Given the above, we recommend that staff fully consider these factors when making projections for housing demand in China to arrive at a reasonable judgment.**

On ensuring the delivery of pre-sold housing units, China continues to address the issues on a city-by-city basis through assigning responsibilities to

local governments, real estate developers, and financial institutions, so as to ensure that units are delivered and the legitimate interests of the home buyers are guaranteed. First, we are determined to ensure the delivery of pre-sold residential housing units and to prevent and mitigate risks of unfinished projects. Applying market-based and rule-of-law principles, we are categorizing and dealing with each instance of housing projects that have been sold but not yet delivered to their buyers. We are pushing for the completion and delivery of these units to fully ensure the rights and interests of the home buyers. **Second,** we are making full use of coordination mechanisms for urban real estate financing, helping project developers meet their reasonable financing needs. Municipal governments are encouraging projects that have been whitelisted to complete construction wherever possible, and commercial banks have been encouraged to provide financing to whitelisted projects wherever possible. **Third,** we are promoting the reduction of housing inventory. Municipal governments may organize local state-owned enterprises to purchase some inventory at reasonable prices as affordable housing in a demand-driven way. **Fourth,** we are ensuring the proper disposal or revitalization of existing land inventory. Land inventory that has not yet been developed, or on which construction remains unfinished, can be repurchased by local governments and resold on the market, or the developer may continue to develop it. These will help the developers reduce their own distress and debt, helping to ensure that land resources are used efficiently. **Staff recommend that the authorities "deploy one-off CG (Central Government) financing" to the real estate sector. We believe that we should continue to apply market-based and rule-of-law principles in completing and delivering these units, and at the same time safeguard the proper rights and interests of the home buyers. It would be inappropriate for the central government to directly provide fiscal support, as it could lead to expectation of future government bail-out and therefore moral hazards.**

4. Opening up the economy, international cooperation, and industrial policy. In recent years, China has actively promoted opening-up. We have established the new system for an economy with a higher level of openness, and continued to develop a business environment that is market-based, law-governed, and international. Additionally, China is comprehensively and deeply involved in the reform of the World Trade Organization (WTO). It also firmly supports the stability of global supply chains, expands our partnerships with the Belt and Road countries, and resolutely opposes unilateralism and protectionism. Since 2023, China and the USA have established two working groups: the Economic Working Group and the Financial Working Group. China and the EU have also established a financial working group. These working groups are already operational and are advancing policy dialogues between China and the USA and the EU on issues of macroeconomics, monetary policy, and financial stability. China will continue to actively work through bilateral, regional, and multilateral channels, including the Fund, to cooperate with all partners.

China is actively benchmarking against international trade rules, deepening domestic reforms in relevant sectors, and progressively increasing institutional openness in terms of regulations, administration, and standards. On external cooperations, we are proactively implementing high international standards and expanding our free trade zones. China currently has entered into 22 free trade agreements with 29 countries and regions, covering one-third of our international trade. We are actively advancing negotiations on the ASEAN-China Free Trade Agreement (ACFTA) 3.0, our entry into the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), and the Digital Economy Partnership Agreement (DEPA). **Domestically,** China is actively benchmarking international trade regulations and carrying out pilot projects for reforms in relevant fields. China is actively benchmarking against strict international standards such as the CPTPP and DEPA rules, and advancing corresponding reforms domestically, achieving positive results.

The Staff Report suggested that "geoeconomic fragmentation pressures and rising geopolitical risks are also impacting trade and FDI flows in and out of China." In 2023, actual utilization of foreign capital in China totaled USD 163.25 billion. Despite some volatility, the figure is still high for the recent years. Many factors have contributed to the volatility: global cross-border investment has been low for several years, and increasing international competition has meant that flows of investment have become more scattered. Geopolitical factors as mentioned in the Staff Report are also interfering with normal decisions on cross-border investment. It must be noted that investment by foreign companies is a market decision, and short-term volatility is a normal phenomenon, both in global aggregate terms and in terms of individual economies. Fundamentally, the trend of economic recovery and long-term growth in China has not changed. **As new quality productive forces develop and a series of policies to stabilize the economy, promote growth, and attract foreign investment take effect, the environment for foreign investment in China will become only better.**

In August last year, the State Council issued *Opinions on Further Optimizing the Environment for Foreign Investment and Increasing Efforts to Attract Foreign Investment*, detailing 24 measures in six areas such as national treatment for foreign enterprises, protection of intellectual property rights, facilitation for business operations, and supportive tax policies. These measures will further improve the investment environment for foreign businesses and boost our efforts to attract foreign investment. China is now working to quickly implement all of these policy measures. In this Q1, we carried out a review on the implementation of the new policies through a questionnaire survey and roundtable to understand the feedback from foreign enterprises. For more than 60 percent of policy measures, implementation is complete or significant progress has been made. Over 90 percent of the responding foreign enterprises gave a positive assessment. In terms of movement of people, since 2023, China has introduced more than 20 new policies, facilitating foreign nationals to come to China to visit, work, and live.

On industrial policy, China fully respects the decisive role of markets in resource allocation and has minimized direct government intervention in microeconomic activities. Subsidy policies are an example. Since its entry into the WTO, China has strictly complied with the WTO rules on subsidies. We are constantly improving our laws and regulations about the market economy and actively fulfilling our duty to report information on subsidy policies and to be transparent. China strictly complies with all commitments made to the WTO by ensuring that the level and form of subsidies implemented complies with WTO rules.

China's new emerging sectors are quickly growing, both because of our unique comparative advantages and the global trend of high-tech and green development. China is taking active actions to mitigate climate change, and we are committed to our “dual carbon” targets. We are actively fostering green industries, including green energy, to help drive the green transformation of the economy. China has a vast market of more than 1.4 billion in population, comprehensive industrial systems, and rich reserves of human resources. Our consumers are happy to accept new technologies, giving corporates the perfect stage to innovate and iterate new products. Against this backdrop, the economies of scale enabling corporates to spread out the cost of innovation and the capacity to support different technologies and business models competing against each other are two of the major competitive advantages that China’s new emerging industries possess.

The rise of new emerging industries illustrates the major and decisive role of companies in the innovation process. Companies are on the cutting edge of the market economy and are the most sensitive to changes in customer demand. As such, their impetus to innovate is the most pressing. **To take new energy vehicles as an example:** China’s new energy vehicle manufacturers recognized the opportunity for electric vehicles and invested heavily. China also proactively built out the infrastructure needed for electric vehicles, and in this way fostered the market and nurtured economies of scale, and through a market process developed competitive electric car manufacturers. Multinational companies also compete and collaborate with local companies on a level playing field and have been an important force in the development of the industry. Tesla came to China precisely because China has the supply chain and infrastructure, and a market environment that allows for fair competition. **The growth and competitiveness of China’s new energy vehicle industry is a result of market competition, not subsidies; and there is no overcapacity.** Exports represent a much smaller proportion of China’s new energy vehicle production than some other major car manufacturing nations. In 2023, just 12.5 percent of Chinese electric vehicles were exported.

To take the semiconductor sector as another example: the semiconductor sector is a highly globalized industry, and for decades, China’s companies maintained a mutually beneficial relationship with partners in the semiconductor sector in other countries. A dense interlinkage between the upstream and downstream, from which all parties benefited, formed over the years. This was the natural result of the resource allocation and market processes. But for some years, the USA has stretched the concept of national security and abused its export control systems to impose a cordon around China, restricting China from the global semiconductor market. It has artificially fragmented global semiconductor supply chains, forcing China to develop its own semiconductor industry. With the benefit of China's huge market, the Chinese semiconductor industry has achieved significant growth already, and is contributing to China's trade surplus. The exploration of cutting-edge technologies should not be a zero-sum game, but a process of shared growth. Attempts to decouple or taking a "small yard, high fence" approach will only increase the cost of operations, create geoeconomic fragmentation, and stir up greater opposition. **China is committed to eliminating unreasonable regulations that limit market access and fair competition. We hope that the Fund, after thorough consultations with the WTO, will objectively analyze the different backgrounds that inform the industrial policy of each country, and will continue to be an active supporter of multilateralism and a facilitator of multilateral cooperation.**

5. Climate change. China has made a serious commitment to achieve carbon neutrality and has created a policy system around the peak carbon emission and carbon neutrality targets, as well as developed a strategy for controlling greenhouse gas emissions over the medium- to long-term. The national emissions trading system (ETS) was launched in July 2021, and is now operating smoothly. Two compliance periods (2019-2020 and 2021-2022) have successfully concluded, in alignment with expectations. Currently, the ETS represents 5.1 billion tons of annual CO2 emissions and includes 2,257 key emitters. It is the largest carbon trading system in the world by amount of greenhouse gas emissions. In 2024, the allowance price in the ETS has been steadily trending upwards. China also continued to develop our systems for combating climate change with the release in 2023 of *Action Plan for the Control of Methane Emissions* and its supporting regulations. We also issued *Administrative Measures for the Trading of Voluntary Reductions in Greenhouse Gas Emissions (Trial)*, which provides a framework for trading and other activities around voluntary emissions cuts. In January 2024, we launched the national registration and trading systems for voluntary emissions cuts.

China is also making major efforts to develop non-fossil and renewable energy technologies, and our green/low-carbon energy transition is picking up pace. China is the world leader in wind, solar, hydro, and nuclear generation capacity, and renewable energy now represents more than 50 percent of China's total installed capacity. Between 2013 and 2023, the ratio of non-fossil fuel energy consumption, including wind power, solar, hydroelectricity, nuclear, and biomass power, rose from 10.2 percent to 17.9 percent. Electric vehicles, lithium-ion batteries, and photovoltaics manufactured by Chinese companies have satisfied China's domestic demand, and are expanding the supply on the international market, making a contribution to the global response to climate change.

China continues to enhance the financial sector's support for green/low-carbon development, making substantial progress in developing green finance. China already has a multi-layered green finance market focused on green loans and green bonds. We are also actively working towards compatibility between Chinese and international standards, so that domestic and global instruments and services in green finance are compatible and interoperable. This will facilitate cross-border investment by both domestic and international investors. As of the end of Q1 2024, China has the world's highest total green loans, at about RMB 33.8 trillion, up 35.1 percent from the previous year. China's outstanding green bonds have surpassed RMB 1.98 trillion, putting China in second position globally. In 2021, the PBC launched the carbon emission reduction facility (CERF), a structured policy instrument offering financial incentives to financial institutions for extending loans to the sectors that are more aggressive in reducing emissions. As of the end of March 2024, CERFs are backing over RMB 770 billion in emission reduction loans, making it a highly successful initiative. The Chinese authorities are expanding the list of financial institutions that have access to the CERF scheme, and now 13 foreign financial institutions are included in the CERF. This represents an expansion and internationalization of the scheme and ensures that financial institutions are equally receiving national treatment.

Staff recognized the progress made by China in the implementation of our climate goals and China's role as a global leader in the supply of renewable energy and deployment of renewable energy technologies. We welcome this

understanding. We welcome the incisive analysis by staff on climate issues and encourage staff to continue to offer policy recommendations within the multilateral consensus of the *UN Framework Convention on Climate Change*, the *Paris Agreement*, and WTO rules. China is willing to accept the principle of common but differentiated responsibilities, and to continue to play an active and constructive role in multilateral and bilateral climate discussions and cooperative actions. We will contribute our wisdom and our strength to the construction of a global system of climate governance that is fair, rational, and cooperative.

Additionally, China has always fully complied with our agreements and commitments to the Fund on data disclosure and provision. Even so, China will continue to expand our data collection, and improve data quality and transparency, to better support the needs of policymaking. During the First Deputy Managing Director Gopinath's visit to China in November 2023, an MoU on statistical cooperation was signed between the Fund and China's National Bureau of Statistics (NBS). This agreement is now in steady operation. This July, a seminar was co-organized by the Fund and the Ministry of Finance of China to exchange views on the "augmented" fiscal concept, laying the ground for building common understanding between the two sides. On January 10 of this year, the Executive Board discussed the Staff Report for the 2023 Article IV Consultation with China, in which the youth employment data was one of the concerns. In our written statement, we pointed out at the time that the volatility in these data has always been too great, and data quality low. The NBS had therefore suspended the publication of these data and took action to improve the statistical methodology, and we were expecting the resumption in due course. Shortly after the Executive Board discussion, publication of the data resumed on January 17. These examples demonstrate that China is determined to improve on data issues.

Finally, we would like to thank once again Ms. Gopinath, First Deputy Managing Director; Mr. Srinivasan, Director of the Asia and Pacific Department (APD); Mr. Helbling, Deputy Director of APD; Ms. Jain-Chandra, Mission Chief; Mr. Klein, Deputy Mission Chief; and all of the China team for their diligent work and professionalism during the 2024 Article IV Consultation. We also thank the

Managing Director Kristalina Georgieva for her consistent support for the cooperation between the IMF and the Chinese authorities.