



International Monetary and Financial Committee

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Statement by Zhou Xiaochuan
Governor of People's Bank of China
On behalf of China

**STATEMENT BY ZHOU XIAOCHUAN
GOVERNOR, PEOPLE'S BANK OF CHINA
AT THE
TWELFTH MEETING OF THE INTERNATIONAL
MONETARY AND FINANCIAL COMMITTEE
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WASHINGTON, D.C.**

I. THE GLOBAL ECONOMY AND FINANCIAL MARKETS: OUTLOOK, RISKS, AND POLICY RESPONSES

The global economy continues to maintain sound growth momentum. Although the risks of an economic slowdown have been increasing moderately since the spring of 2005, the growth trend has shown no clear sign of diminishing. Economic growth in the United States is still robust, the pace of the Japanese economic recovery has accelerated, and the euro area economy continues to face many difficulties. Economic growth in emerging markets and developing countries has been further solidified, and the Chinese economy continues to contribute significantly to global economic expansion. The overall outlook for global economic growth continues to improve, and financial markets are performing well.

However, several issues increasingly threaten the stability of the global economy and financial markets, and merit our attention. First, oil prices continue to rise and have already begun to damage market confidence. Second, low long-term interest rates may rise and affect economies and financial markets. In particular, if inflationary pressures rise rapidly, driven by the persistent upsurge in oil prices, interest-rate hikes could trigger fluctuations in real estate prices. This type of risk lurks in many industrialized and emerging market countries. Third, because of concerns over the competitive pressures arising from emerging markets, protectionist sentiments are mounting in some industrialized countries, some of which have even inappropriately politicized economic issues. Such behavior not only harms the global economy, of which these countries are members, but also undermines the principle of fair competition and the spirit of amicable cooperation that the international community has been working so hard to promote. The major industrialized countries should abandon the outdated mentality and behavior of protectionism, strengthen cooperation and dialogue, and seek mutual benefits and win-win scenarios.

In the medium term, the global economy faces other challenges, such as a mounting global imbalance, gloomy medium-term fiscal situations in many countries, the slow pace of structural reform, and sluggish international cooperation and coordination.

Therefore, we are cautiously optimistic about the global economic outlook. All the major economies need to take practical initiatives to overcome problems stifling healthy economic growth in the world and in their own countries, and they also need to enhance coordination and dialogue. At this time, it is particularly vital to maintain stability in oil markets, increase investment in petroleum extraction, promote the efficient use of energy, strengthen energy

conservation, develop reusable and substitute energy, and expedite the transfer of energy conservation technology. At the same time, we must speed up the Doha Round of trade negotiations and work together to maintain the momentum of global economic growth.

THE CHINESE ECONOMY

Over the past few years, the Chinese economy has consistently maintained a relatively fast and steady growth momentum. Particularly within the overall trend of the global economic recovery of the past two years, the Chinese government has been able to keep excessive investment in certain sectors in check as well as inflationary pressures while maintaining rapid economic growth by implementing effective macroeconomic policies. China has had an important effect on the process of global economic recovery.

Since 2004, as excessive investment and inflationary pressures have intensified in some sectors, the Chinese government has adopted a variety of coordinated measures to manage economic aggregates and structures so that the economy maintains the momentum of a steady and relatively fast track. The trend of excessively fast investment growth and rising inflationary pressures has been kept in check, domestic consumption and external sector growth have intensified, fiscal revenue has grown, the government spending structure has become more reasonable, and the fiscal deficit has fallen somewhat. Business conditions in the corporate and financial sectors have improved further, and profits have increased. Overall, the projected macroeconomic management goals have been achieved.

During the first half of this year, the growth of domestic consumption escalated steadily, investment growth also remained steady—albeit dropping only slightly—net exports continued to grow at a relatively brisk rate, and GDP grew by 9.5 percent. Final consumption prices fell steadily, and the CPI for the first eight months of the year rose 2.1 percent y-o-y. Monetary and domestic credit growth has tended to stabilize.

Of course, the Chinese economy still faces many challenges. There are relatively high employment pressures and income disparities; bottlenecks in the supply of energy and some raw materials have not been completely resolved; and the fixed asset investment structure has yet to be rationalized.

The Chinese government maintains a scientific development philosophy and will continue to devote its efforts to raising the quality of economic growth and building a harmonious society. We will pay close attention to aggregate and structural changes in economic operations and utilize various policy tools to make timely and appropriate adjustments to the imbalances in economic development, increase domestic demand, and encourage consumption. We will speed up tax reform, strengthen payment transfers, strive to reduce income disparities, continue to push forward financial sector reform, and further improve market economy mechanisms.

On July 21, 2005, adhering to the principle of proceeding in a proactive, controllable and gradual way, the Chinese government autonomously instituted a reform of the renminbi exchange-rate regime by moving into a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. This reform meets the practical needs of Chinese economic and social development and has profound significance for maintaining macroeconomic and financial market stability.

The Hong Kong SAR economy continues to grow quickly. During the first six months of 2005, real GDP growth reached 6.5 percent due to robust export growth, increased demand for investment, and the continuing rise in private spending. In May 2005, the local authorities made three adjustments in the linked exchange rate system to further stabilize market expectations over the Hong Kong dollar. Although the economy still faces some uncertainties, such as rising oil prices, the overall outlook is good.

The Macao SAR economy recorded a 28 percent growth in 2004, its highest historical level. The economy continued to grow by 8.4 percent in the first half of 2005, and employment increased steadily. The CPI in July 2005 inflated by 4.8 percent over the same period y-o-y, pointing to the rising of inflationary pressure with the booming economy. We expect the economy to grow at a comfortable pace this year.

We believe that, boosted by the strengthening global economy and particularly by the stable economic growth of mainland China, the economies of Hong Kong SAR and Macao SAR will perform even more admirably in the years to come.

II. IMF OBJECTIVES AND MEDIUM-TERM STRATEGY

Since discussion of this topic at the last Spring meeting, Fund management and staff have gained a clearer understanding of the organization's objectives and medium-term strategy. The Managing Director's report rightly establishes globalization as the organizing principle guiding all aspects of the IMF's work, and provides a framework for strengthening surveillance. I would like to take this opportunity to express my views on the following issues.

- 1. Maintain the stability of the international monetary system.** This year marks the 60th anniversary of the founding of the Bretton Woods system. The IMF should take additional steps to clarify its core tasks and to safeguard the stability of the international monetary system. Currently, it is particularly necessary to strengthen surveillance over countries issuing major reserve currencies and to maintain the stability of exchange rates between the major reserve currencies.
- 2. Strengthen surveillance.** The framework for strengthening surveillance proposed by the report is appropriate. In particular, I would like to stress the IMF's significant role in facilitating multilateral dialogue. As an international financial organization with 184 member countries, the IMF should, on the one hand, take advantage of its special skills and knowledge of international economic and financial affairs to construct a complete framework

suitable for multilateral surveillance and analysis. Within this framework, it should propose rational recommendations for promoting global economic balance, sustaining development, guaranteeing a rational sharing of the benefits of globalization among all economies, and promoting broad cooperation in international economics and finance. On the other hand, the IMF should also explore mechanisms for further strengthening and improving multilateral dialogue so that all economies can engage in dialogue and cooperation within a guiding framework of mutual understanding. I notice that the report advocates the adoption of different forms of communication for different countries. I very much appreciate this idea. One must acknowledge that any framework can play no more than a guiding role and that there is no one method of communication that is appropriate for all member countries. Therefore, when communicating with its various member countries, the IMF must make the achievement of its objectives and the attainment of substantial results its priority and, in the interests of successful dialogue, should be flexible in its means of communication.

3. Further increase the effectiveness of surveillance. I also note that the report proposes a series of recommendations and working points specifically intended to raise the effectiveness of surveillance based on different countries' unique characteristics. In particular, it proposes specific ways of fully utilizing the channel of the Article IV consultation. I believe that these proposals ought to be affirmed. All countries attach great significance to the Article IV consultation, but they also hope that the staff's policy recommendations should be even more specific and that each country's conditions could be reflected in a more objective, accurate, and focused manner in the consultation report. In order for the IMF's policy proposals to be better integrated into a nation's policy initiatives, I encourage the IMF staff to look into this area. The report also identifies a separate work focus for developed countries, emerging market countries, and low-income countries. Overall, this plan is appropriate; however, I must point out that the IMF's effectiveness in monitoring developed countries, especially the key industrialized countries which have a systematic influence, is a major cause of concern. I hope effective measures will be taken to improve the situation. Policy recommendations for developing countries should be specific and also suitable for the particular country's conditions. A simplistic, one-size-fits-all model should be avoided.

On the question of opening up capital markets, I applaud the viewpoint held by the IMF and by many governments. It is necessary to proceed step by step, and we must not relinquish patience in favor of rapid results. I think that the IMF should first improve its study of capital market fluctuations and their impacts, and then propose appropriate recommendations in order to minimize disorderly capital flows, maximize the benefits of the free circulation of various key production factors, and keep potentially destructive influences at bay.

4. Institution and capacity building. We welcome the IMF's efforts to strengthen its member countries' institutions and capacity building. It is similarly important to emphasize the notion that different countries have different institution and capacity-building needs. I was happy to see in the latest issue of the *World Economic Outlook* the IMF's focus on the importance of preconditions in institution building. We encourage the IMF to remain guided by this philosophy, to analyze carefully each member country's institutional and

historical background, to identify the best institutions and the best ways to build these institutions for each of these countries, and to bring about a genuine expansion of their capacities to meet the challenges of globalization.

5. Improve the IMF's internal governance structure. We welcome discussion of the issues of IMF governance and reform within the medium-term strategy framework. At the same time, we call on all sides not to miss the opportunity of the 13th quota review to speed up reform of the IMF's governance structure. I believe that the key to reforming the IMF's governance structure is to augment developing countries' voting rights. The IMF's quota distribution has to take into consideration different member countries' economic strengths, and it should also accommodate the demands of the democratization of international economic relations. We wholeheartedly welcome the IMF's move to make quota and voting rights a major issue. At the same time, it should be noted that some developed countries have already expressed their sincerity to resolve the issue of quota and voting rights. The staff's recommendations to resolve the issue through an ad hoc quota increase, voluntary adjustments among member countries, or augmenting basic voting rights are all positive. A program containing all three plans would likely meet member countries' varying needs. Even if member countries find it difficult to reach a consensus on the new quota formula, the IMF can still first consider increasing the quotas of those countries whose quotas are significantly underestimated, measured by all current and proposed formulas.

III. INCREASE SUPPORT FOR LOW-INCOME COUNTRIES (LICs)

We affirm the IMF's role in assisting LICs to realize sustained economic development and poverty reduction. Although the international community has done a great deal of work in this area and has made much progress, the economic and social conditions of LICs still face many challenges. There is a long way to go before we can reach the MDGs. Therefore, I call on the international community to increase and improve its support and aid to LICs so that the MDGs can be met.

We have always maintained that the IMF must remain centered around its core areas and specialties in fulfilling its important role in promoting poverty reduction.

We welcome the assessment of poverty reduction and growth strategies and stress that the strategies should be better utilized to facilitate the policy formulation autonomy of LICs and to maximize the value of financial aid. We encourage full consideration of the countries' actual conditions in the design and execution of poverty reduction and growth strategies and encourage increased specificity of policy recommendations for LICs.

We also encourage the IMF to continue to bolster LICs' capacity building with the aid of technical assistance, and we encourage IMF staff to improve their exchanges with the governments of LICs to help them strengthen their capacity to develop, manage, and monitor their macroeconomic policies.

We welcome the positive developments in the HIPC Debt Initiative. We stress that the IMF's initiatives to relieve the debt of LICs should adhere to the spirit of equal treatment of member countries, as stipulated in the IMF's Articles of Agreement, and should not impair the IMF's fiscal foundation. We encourage the developed countries to make an even larger contribution to the debt relief of LICs.

We call on developed countries to hasten their efforts to meet the United Nations proposed goal of increasing government development aid to 0.7 percent of GNI. Additionally, development through trade is a key means for LICs to overcome poverty. We advocate the establishment of a multilateral system that is comprehensive, open, fair and nondiscriminatory, and hope that industrialized countries will devote efforts in the next Doha Round of trade negotiations to fully opening their markets to developing countries, lowering their trade barriers—especially for LICs—and reducing agricultural subsidies.

Although China is still a medium-to-low-income developing country, we will do our best to support and assist other developing countries in accelerating their development. The Chinese government will further strengthen its support by means of tariff reduction, debt relief, preferential loans, and other assistance to these nations, especially those in Africa, and help them develop their human resources through education and training. At the recent UN High-level Meeting on Financing for Development, the Chinese leader announced five important measures to support these countries.