International Monetary and Financial Committee

Eighteenth Meeting
October 11, 2008

Statement by YI GANG
Deputy Governor, People's Bank of China, China

On behalf of People's Republic of China

STATEMENT BY DR. YI GANG
DEPUTY GOVERNOR OF THE PEOPLE'S BANK OF CHINA
AT THE EIGHTEENTH MEETING OF THE
INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE
WASHINGTON, D.C.
OCTOBER 11, 2008

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

The deepening and widening of the U.S. financial crisis has triggered a major global slowdown and escalating uncertainty. While the advanced economies have slowed significantly since the U.S. sub-prime crisis, the emerging market economies have maintained robust growth but the deteriorating external environment is putting the resilience of their macroeconomic policies to the test. Our current priority is to enhance international cooperation to prevent further deterioration and spillover of the crisis and restore global economic and financial stability.

The crisis has underscored shortcomings in the financial markets and we hope the stabilizing measures of the advanced economies—in particular, the U.S. *Emergency Economic Stabilization Act of 2008*—will have the positive effect of calming the markets and restoring confidence. China is willing to strengthen its cooperation with other countries and, through such joint efforts, we hope global financial stability can be safeguarded. In line with their status, the major reserve currency issuing countries should shoulder the responsibility for preventing further spillovers and minimizing shocks to other economies—especially to the emerging markets. To promote balanced and steady global growth over the longer term, efforts should be made to advance structural reforms and increase savings.

The Fund—at the core of the international monetary system—should carry out its mandate to safeguard global economic and financial stability. The Fund should monitor the crisis, assess its progress and implications, and play a proactive role in helping member countries design crisis resolution measures. The IMFC is expected to provide guidance in this regard.

As the impact of the crisis on the real economy is much worse than expected and the recovery more protracted and difficult, the risks of deflation in some countries as a result of the credit crunch have increased significantly. It is imperative that the major advanced economies coordinate rapid implementation of bailout packages to avoid deflation and facilitate the global recovery. However, we should be aware that the injection of liquidity from these emergency measures could be a potential source of inflation in the medium and long term.

II. CHINA'S ECONOMY AND POLICIES

In 2008, despite severe natural disasters and the adverse external environment, China's growth has remained strong. In the first half of the year, GDP growth moderated by 1.8 percentage points to 10.4 percent.

Improved Economic Structure

Domestic demand, particularly the contribution of household consumption to growth has increased. In the first half of the year, the contribution of consumption and investment to growth increased by 10.5 and 6.1 percentage points to 50.2 percent and 44.9 percent, respectively. Net exports contributed 4.9 percent, down 16.6 percentage points from 2007. The external imbalance has moderated. In the first eight months, import growth outpaced exports by 7.6 percentage points and the trade surplus decreased by 6.2 percent. The growth of foreign exchange reserves slowed by 11.5 percentage points. The industrial structure has improved and efforts have been intensified in conserving energy and reducing pollution. In the first half of the year, unit GDP consumption of energy decreased by 2.88 percent.

With the slowing of international and domestic growth and the consequences of macroeconomic structural adjustments, inflationary pressures have moderated. CPI started its fast hike in the second half of 2007 but has receded in recent months, moderating from 8.7 percent in February to 4.9 percent in August. However, at 10.1 percent in August, PPI has remained elevated and the cost of labor and other production factors have increased, with the possible transmission to CPI. On the other hand, with the weakening of aggregate demand, corporate profits may be eroded and competitiveness weakened, in effect, moderating imbalances on the external account.

Substantial progress has been seen in reform of the RMB exchange rate regime, with increased exchange rate flexibility and the currency moving closer to equilibrium. From the reform in July 2005 to September 2008, the RMB REER appreciated by 21.8 percent, more than the U.S. dollar, the euro, the Japanese yen, and other emerging Asian currencies. From January 1994 to June 2008, the RMB REER appreciated by 54.47 percent, the NEER by 31.9 percent and 27.15 percent against the U.S. dollar. The annual average appreciation of the REER, the NEER, and the bilateral exchange rate against the U.S. dollar were 3.04 percent, 1.7 percent, and 1.5 percent, respectively, much higher than the major currencies. The RMB has recently appreciated against the euro. From July 15 to September 16, the RMB appreciated by 11.84 percent against the euro. The external imbalance has been on the decline this year.

The fundamentals of China's economy have not changed and, as envisaged, macroeconomic adjustments are beginning to work. Despite the negative shocks of the financial crisis, China will accelerate transformation of the growth model, promote domestic demand—especially household consumption—and maintain fast and stable growth. Through reforms, financial institutions have enhanced their profitability and resilience. The market remains liquid and the financial system is broadly sound. It is of the utmost importance—particularly for the capital market—that China maintains economic and financial stability. We have every confidence in China's ability to do so. For a country with a population of 1.3 billion, its greatest global contribution is to sustain fast and stable economic development.

Hong Kong SAR and Macao SAR

Hong Kong SAR's economy grew moderately by 4.2 percent in the second quarter of 2008, largely in line with the average annual pace of growth over the past decade. Export growth of goods and services also moderated amidst the increasingly challenging external environment. Nonetheless, labor market conditions remained firm, with the unemployment rate remaining at 3.3 percent, the lowest in the past decade. Inflationary pressure has continued to trend upward and the CPI rose to 5.7 percent. On the whole, Hong Kong SAR is expected to expand at a similar rate for the rest of 2008, with GDP at 4-5 percent and CPI inflation at 4.2 percent.

Macao SAR's economy grew by 26.1 percent in the first half of 2008. The increase in government tax revenues was much larger than expected and the fiscal surplus increased. While the labor market remained strong, the July-August unemployment rate was 3 percent. The CPI rose by 9 percent in the first eight months of 2008. Despite the impact of the crisis, with further diversification of economy, Macao SAR is expected to maintain double-digit growth in 2008.

III. STRENGTHENING THE FUND'S SURVEILLANCE

To improve the effectiveness of its surveillance, the Fund must adapt to the changing environment, and focus on the key factors affecting global economic and financial stability, in particular on the major reserve currency issuing countries and their financial sectors. The ongoing financial crisis underscores the need for the Fund to maintain a sharp focus on risks in the major developed countries and their potential spillover effects. Misfocused surveillance hampers the discharge of the Fund's mandate in promoting global economic and financial stability, and damages its credibility.

While we broadly agree with the Fund's medium-term surveillance priorities adopted in the Statement of Surveillance Priorities, we believe the immediate priority is to address the deepening financial crisis. As the Guidance on Operational Aspects of the 2007 Surveillance Decision issued in August authorizes the Managing Director to initiate *ad-hoc* consultations on issues of important economic or financial development, the Fund should closely monitor the current crisis and its impact on the global economy and the financial market, and, as necessary, consider an *ad hoc* consultation with the United States.

In the longer term, the Fund should study the inherent deficiencies in the current international monetary system and propose fundamental improvements according to current global economic and financial circumstances. Under the current international monetary system, the lack of effective surveillance of reserve currency issuing countries and their weak financial policy discipline has resulted in excess global liquidity and disorderly capital flows, increasing the difficulties for other countries in preserving macroeconomic stability and boosting growth while posing serious risks for global economic and financial stability. The current financial crisis has shown that this is harmful for reserve currency issuing countries too. The Fund must draw lessons from the crisis and take corrective measures to enhance its surveillance over the developed countries—especially the reserve currency issuing countries—strengthen financial sector surveillance and macro-financial analysis; strengthen the monitoring of international private capital flows; and deepen analysis of the spillover effects of financial crisis. In the long term, the Fund should strive to establish a fair and reasonable international monetary system.

The Fund should review and amend the 2007 Decision as soon as possible by drawing lessons from the current financial crisis and taking advice from member countries to guide its surveillance work in keeping up with changes in the global economic and financial environment, focusing on the most serious risks, and responding to the needs of member countries for a stable and orderly global economic and financial system.

IV. REVIEW OF THE FUND'S LENDING ROLE

We welcome the Fund's holistic review on the adequacy of resources, the configuration of lending instruments, conditionality, and cost structure so as to have a coherent and streamlined financing framework which can be adapted to the changing global financial environment.

Recent modification to the Exogenous Shocks Facility will help LICs deal with balance-of-payments problems arising from food and fuel prices shocks. The shock to emerging market economies from the most recent financial crisis has underlined the need for a new financing instrument aimed at helping such economies with sound fundamentals counter capital account shocks. As soon as possible, the Fund should introduce a crisis prevention instrument suited to the needs of its membership while allowing for greater flexibility in the speed and size of access.

While safeguarding the Fund's resources, lending conditionality should be streamlined and tailored to the specific circumstances of member countries. In conducting the review of access limits, the rate of charge and maturities of lending instruments, consideration should be given as to how attractive these instruments are in satisfying the potential needs of member countries.

In addition, we encourage the Fund to consider a greater role for the SDR.

V. IMPROVING THE FUND'S GOVERNANCE

We welcome progress on the Fund's quota and voice reform—central to the Fund's governance structure and key to improving its governance. We call for further progress with the reform, hoping that the Fund can establish an effective mechanism for a timely quota adjustment, appropriately reflecting members' changing positions in the world economy.

We note the Managing Director's recommendations on the future direction of the Fund's governance reform and the IEO's assessment report and advice. We look forward to the steps to be taken by the Executive Board, Management, and the Committee of Eminent Persons, and welcome the recommendation of all relevant parties. Despite the difficulties ahead, we encourage all member countries to adopt a pragmatic and cooperative approach in bringing about a better governance structure. We hope that a consensus on the preliminary framework for reform of the Fund's governance can be reached by the next Spring Meeting.