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Statement by Mr. Li Ruogu
Deputy Governor of the People's Bank of China
On behalf of the People's Republic of China

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DEPUTY GOVERNOR OF THE PEOPLE'S BANK OF CHINA
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I. World Economic Outlook: Vulnerability, Risks, and Policy Responses

Since last Fall, global economic growth has remained strong. Due to the measured tightening of macroeconomic policies by the major economies, the global economy has strengthened the momentum of a sustainable growth. To a certain extent, growing productivity and the implementation of macroeconomic management measures have alleviated inflationary pressures and partially offset the detrimental effects of rising oil prices. Although economic recoveries in Europe and Japan suffered reversals, emerging markets and developing countries have begun to play an important role in global economic growth.

The overall condition of financial markets is good. Real interest rates in the majority of countries remain quite low. The interest rate spread in emerging market economies has shrunk, and foreign borrowing has increased markedly. Asset markets are growing. The overall outlook for the global economy remains favorable.

Nevertheless, there are various risks that might affect stable global economic growth. In the near term, we need to pay close attention to three risks: disorderly adjustments to the U.S. dollar exchange rate, sudden rises in long-term interest rates, and further increases in oil prices.

Since last September, U.S. dollar exchange rates have been declining. Not only does this place great pressure on the export growth of some economies, but it also threatens the stability of U.S. domestic financial markets. If the U.S. fiscal and current account deficits continue to expand, the U.S. dollar will depreciate further, which may in turn lead to upheavals in financial markets and the real economy.

Another consequence of the expanding U.S. fiscal deficits is the possibility of large increases in long-term interest rates, now at a historical low. If fiscal deficits continue to grow as the United States gradually tightens its monetary policy, investor confidence may suffer, driving up long-term interest rates and subjecting consumption, investment, and international markets to a series of shocks.

Neither can the risk of further increases in oil prices be ignored. The fact that they continue to surpass predicted levels constitutes a major threat to industrial nations which have not yet laid a foundation for recovery. Rising oil prices pose a major threat to emerging market countries dependent on imported oil or with high levels of foreign debt as well as to poor developing countries. The oil supply capacity is nearing its current limits and there is still no obvious improvement in peace and stability in the Middle East. Therefore, the risk remains that oil prices will continue to climb. I call for technology transfers and aid to the developing countries to help them become more energy efficient and allow them to develop new energy resources.

In the medium term, the world economy continues to face challenges—poor fiscal conditions, slow progress on structural reforms for many countries, and unbalanced economic growth across regions. These factors not only affect macroeconomic stability in the medium term but also create tremendous pressure for short-term economic trends.

I call on all countries to strengthen their capacities for cooperation and dialogue and to join in striving to bring about global economic stability and prosperity. In particular, the major industrial countries should assume the responsibility for global economic adjustment commensurate with their economic positions. They should avoid resorting to trade protections and sanctions, which will subvert, and possibly even ruin, the global production and trade system just now taking shape after many difficulties. To improve the sustainability of their domestic economies and the soundness of their economic policies, the main industrial countries should begin with fiscal consolidation, increase domestic savings, and speed up structural reforms. Macroeconomic policy adjustments should take account of their possible global and long-term effects. In the short term, we need to avoid large fluctuations between the major currencies and prevent sudden increases in long-term interest rates. We should track interest rates closely, find ways to alleviate their associated risks and thereby reduce economic vulnerability.

Emerging markets and developing economies should seize the opportunity afforded by the current economic recovery to accelerate structural reforms, strengthen the stability and soundness of macroeconomic policies, and improve public sector governance capabilities. In developing domestic financial markets and restructuring debt, they should pay special attention to preventing the negative effects resulting from a possible widening of interest rate spreads and to reducing vulnerability to external impacts. These economies should promote sustainable economic growth.

THE CHINESE ECONOMY

In 2004, the Chinese economy maintained its rapid growth momentum. The excessive and rapid growth of domestic credit has been effectively checked since the implementation of macroeconomic controls; investment growth in some overheated sectors and industries has slowed down; aggregate investment growth has contracted somewhat; and the consumer price index has appeared to fall. Consumption markets are steadily becoming more active, and foreign trade is growing rapidly. Personal income, enterprise profits, fiscal revenues, and foreign exchange reserves have increased considerably. Economic growth is returning to a more sustainable level.

However, China's economic adjustments are still in a critical period and some deep-rooted economic contradictions and problems remain unresolved. The tasks of promoting economic development, deepening systemic reforms, and maintaining financial stability are enormously difficult. First, investment rebound pressures remain and investment and consumption growth are unbalanced. Second, there has been no fundamental alleviation of upward price pressure. Third, adjustments to monetary and credit aggregates and structures are difficult to accomplish. Fourth, the financial system lacks a sufficiently solid foundation for stable functioning.

In 2005, China will continue to implement sound fiscal and monetary policies to uphold the scientific development concept, support steady economic growth to prevent inflation, and guard against systemic financial risks. We will continue to strengthen and improve macroeconomic management, and improve indirect control mechanisms in accordance with our market orientation. We will increase the effectiveness of monetary policy transmission mechanisms, intensify adjustments to credit structures, promote the conversion to new modes of economic growth, and optimize economic structures.

We will further deepen reforms on the foreign exchange management system and promote the balance of payments. Our foreign exchange policies mainly take account of China's external economy and its overall balance of payments. We will push forward the reform of the renminbi's exchange rate mechanisms in a proactive, prudent, and sequenced approach. Given China's current balance of payments situation, the future primary task will be to improve the renminbi exchange rate formation mechanisms, not simply adjust its exchange rate levels. China will give responsible consideration to the effects of this reform on the regional and global economies.

The economy of the Hong Kong Special Administrative Region continues to improve, with a growth rate of 8.1 percent in 2004. Trade remains robust, private consumption has increased markedly; and business investment has also begun to grow. During the second half of 2004, the comprehensive consumer price index stopped declining and registered a small increase of 0.5 percent, ending nearly six years of deflation. As the recovery spreads, the economy this year is expected to continue growing steadily at a rate above 4.5 percent. Inflation should remain moderate.

The economy of the Macao Special Administrative Region (SAR) grew by 28 percent in 2004, recording a historical high. Employment continued to improve, with the unemployment rate falling at year end to 4.1 percent. Employment will further strengthen with the recovery in the service and construction sectors. We expect the Macao SAR economy to maintain robust growth in 2005, driven by brisk activities in the tourism and services sectors.

II. STRATEGIC DIRECTION OF THE FUND

Upon the 60th anniversary of this institution, I have been pleased to observe the careful reflection on the part of management and staff on to the purpose, functions, and primary operations of the Fund, and the ways in which they interrelate. The framework for the Fund's strategic development over the next three years is a step forward. I take this opportunity to discuss the following issues.

1. Clearly defining the core operations of the Fund

Under its Articles of Agreement, the Fund's mission is to maintain the stability of the international monetary and financial systems, and promote balanced growth of the global economy. Over the past 60 years, the international political and economic situation has changed dramatically, calling for the Fund to adjust its functions and methods of supervision accordingly. The Fund's first priority is to respond to the changing international economic situation, seriously review its functions, define its core operations, identify the direction of reforms, and improve the quality of its work.

2. Enhancing the effectiveness of surveillance

I believe that everyone agrees on the need to improve the effectiveness of surveillance, yet differences remain about the specific methods to be employed, the measures to be adopted, and where its focus should lie. The imbalance between Fund surveillance of the industrial and developing countries can be seen in the absence of an effective mechanism for the major industrial economies that have a systemic impact. As global economic integration intensifies, the influence of these countries' economic polices on the global economy has become even more pronounced. Therefore, the Fund must establish an effective surveillance mechanism for the policies of these economies in the medium term. For developing countries, the Fund should make policy recommendations consistent with each member's conditions and make necessary adjustments to the recommendations in accordance with each country's economic development. In sum, the Fund's policy recommendations and programs should not hinder the growth of developing countries.

3. Improving the Fund's internal governance structure

We welcome discussion on reform of the Fund's governance structure, request that it be given higher priority and greater importance, and call for greater political determination and concrete actions on this issue. The 13th General Review of Quotas provides an important opportunity to reform the Fund's governance structure. A key element of this reform is to increase developing countries' voting rights, which requires members to achieve political consensus before resolution of the technical issues. We urge all parties, particularly the developed countries, to demonstrate their foresight, flexibility, and pragmatism in dealing with this issue.

4. Promoting regional economic and financial cooperation to better serve the process of globalization.

In recent years, regional organizations have developed rather fast, and the level of cooperation has continued to rise. I believe that regional cooperation is an effective way for countries to participate in the globalization process, share its fruits, and avoid its risks. Regional cooperation does not undermine globalization and multilateral cooperation; in fact, they are mutually reinforcing. Strengthened coordination and cooperation among the various regional cooperation mechanisms will help promote the orderly development of globalization and the progress of multilateral global cooperation. The Fund should adopt a more positive attitude in studying the relationship between regional and global cooperation. It should vigorously promote the development of regional cooperation as a way of laying the foundation for a higher level of globalization.

III. Help Low-Income Countries Reduce Poverty and Achieve Sustainable Growth

Within the medium-term strategic framework, we welcome discussion of the Fund's role in low-income countries (LICs), which face many economic and social challenges. The international community should continue to provide LICs with support and aid. We support the Fund's continued active role in LICs.

First, we recommend that Fund policy focus on its core fields—macroeconomic and financial stability. It should emphasize research on how macroeconomic stability brings about high economic growth in LICs and how it affects growth and poverty reduction. The Fund should help LICs ensure poverty-reducing budgetary expenditures. We recommend that the Fund's policies in LICs more closely conform to their economic development environment. The rigid application of a single model for all countries should be avoided. In addition, the Fund should conduct further research on ways to improve the relevant policy tools and thus accelerate the process by which LICs escape poverty.

Second, we encourage the Fund to carry on with its effective technical assistance to strengthen capacity building in LICs. We also encourage dialogue between Fund staff and the local authorities on how to improve the ability of LICs to develop, manage, and oversee their macroeconomic policies.

We are in favor of the Fund's continued efforts to reduce the debt of LICs, but we emphasize that any such proposals should be discussed within the broader framework of the Fund's borrowing capacity, financing sources, and future direction. We support the use of donations to finance debt reduction. We welcome development of a joint IMF-World Bank LIC debt sustainability analysis framework, but we emphasize the need to consider each country's actual conditions when analyzing its ability to sustain debt. Dynamic trends, in particular, preclude the exclusive use of standardized models.

The role played by official aid cannot be ignored. We call upon developed countries to reach the official development aid goal put forward by the United Nations of 0.7 percent of GNP. The development of trade is another important means by which LICs can defeat poverty. We encourage the industrial nations to work hard in the new round of Doha talks by opening their markets completely to developing countries, lowering trade barriers to them, especially to LICs, and reducing agricultural subsidies.