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On behalf of China

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

After five years of solid growth, the global economy began to moderate last September, increasing the likelihood of a soft landing. Expansion in the United States has slowed; growth in the euro zone is expected to ease toward its potential growth; the current expansion in Japan is likely to continue at about the same pace; and emerging market and other developing countries will continue to grow briskly.

But the global economy faces challenges. First, if U.S. housing prices continue to fall, investment and consumption might be affected further and other countries feel the spillover effects. So far, the falling housing market has had only a limited impact on U.S. household consumption and economic growth, but the combined effects on the U.S. economy of the decline in housing prices and the rising default rate of sub-prime mortgage loans have yet to unfold. With its influence on the global economy, U.S. economic developments must be closely monitored and prompt, appropriate measures taken when warranted.

Second, global inflationary pressures remain strong. After a prolonged economic boom, the major economies have seen inflation rates rise. Due to geopolitical developments, oil prices remain uncertain and might produce new inflationary pressures. With the likely slowing of economic growth and narrowing room for policy maneuver, domestic policy readjustments must proceed in a prudent, orderly, and better coordinated manner.

Third, financial market risks are on the rise. In the current economic environment—ample global liquidity, increasingly integrated international financial markets, active hedge fund and carry trades transactions, under-priced risks and overextended financial markets—large capital flows to emerging markets have exacerbated asset price and inflation pressures. The recent equity market turbulence should serve as a warning. We call on the countries concerned to better monitor speculative flows, strengthen supervision of hedge funds, and maintain the stability of the major reserve currencies' exchange rates.

Fourth, with trade protectionism pressures growing, measures taken by certain countries—under the pretext of righting global imbalances—will hinder the trade liberalization process. We call on all countries to harness the opportunities created by globalization, pursue timely structural readjustments, resolutely oppose protectionism, promote progress in the Doha Round, and create a favorable globalization environment in which all countries may participate on an equal and beneficial footing.

CHINESE ECONOMY AND POLICIES

As a result of macroeconomic measures to address the rapid expansion of investment and the money and credit supply since last fall, the Chinese economy has continued on path of steady and fast growth, and prices have generally remained stable.

China's economic growth model has undergone welcome changes. Investment growth continues to fall while consumption shows signs of acceleration. In 2006, fixed-asset investment increased by 24 percent, decelerating by 2 percentage points over 2005; and retail sales expanded by 13.7 percent, accelerating by a 0.8 percentage point y-o-y. In January and February 2007, fixed-asset investment in urban areas grew 23.4 percent, 3.2 percentage points lower y-o-y; retail sales, however, rose 14.7 percent, 5.7 percentage points faster. Foreign trade continues to grow rapidly. The trade surplus, while showing a substantial increase in January and February due to the slower growth of oil imports and the faster growth of ordinary trade, declined markedly in March.

The Chinese economy is projected to remain on a fast growth track—exceeding 8 percent in real terms—in 2007. Policy measures will focus on structural improvements, efficiency gains, energy conservation and savings, and pollution control. More emphasis is being given to the quality and sustainability of economic growth. While keeping the growth of fixed-asset investment at an appropriate level, policies will aim at promoting household consumption by raising urban and rural household income, creating a better environment for consumption, and providing more support to education, medical care, employment, and social security. One of the major objectives of the government's economic and social development for 2007 will be to reduce the external imbalance. Comprehensive measures will be taken to expand imports, and neutralize export and investment incentives, so as to achieve external balance over time.

China is making steady progress with financial system reform. In developing the shareholding structure of state-owned commercial banks, the successful IPOs of the Bank of China and the Industrial and Commercial Bank of China—in both Hong Kong SAR and the Mainland in 2006—have strengthened their balance sheets, internal controls, and profitability. The reform of non-tradable shares in listed companies—almost complete—has led to a substantial rise in stock market capitalization as a percentage of GDP. The reform of the foreign exchange regulatory framework has steadily deepened. The RMB exchange rate formation mechanism is being improved and flexibility of the RMB exchange rate has increased significantly.

ECONOMIES OF HONG KONG SAR AND MACAO SAR

Driven by strong domestic demand and export growth, the **Hong Kong SAR** economy grew by 6.8 percent in 2006 while the CPI rose 2.0 percent and the unemployment rate declined to 4.4 percent—the lowest in six years. The fiscal position continues to improve rapidly. The Linked Exchange Rate System functions well and the Hong Kong dollar remains stable. In 2007, Hong Kong SAR is expected to achieve above potential economic growth for the fourth consecutive year—in the range of 4.5-5.5 percent while the CPI will rise 1.5 percent.

Macao SAR has maintained its strong economic momentum, spurred by overall growth in consumption, investment, and service exports as well as a booming market. GDP grew by 16.6 percent in 2006 and a considerable fiscal surplus was recorded. The unemployment rate fell to 3.5 percent, but the inflation rate rose to 5.2 percent. These favorable conditions, coupled with a consistently positive economic outlook in the Mainland, point to continued strong expansion in 2007.

II. THE FUND'S SURVEILLANCE FRAMEWORK

We support the Fund's efforts to strengthen surveillance in safeguarding global financial stability and promoting the economic prosperity of its members. We have noted the efforts to strengthen Fund surveillance since the Singapore Meetings, including through possible revision of the 1977 Decision on Surveillance over Exchange Rate Policies.

In this regard, we wish to emphasize that, first, revision of the Decision should not proceed too hastily. In making adequate and careful analysis, the Fund must take the opinions of all concerned parties into account and build broad consensus among all member countries to ensure that it would benefit them all.

Second, in strengthening surveillance, the Fund should be realistic—and not overestimate—the role of exchange rate. Biased advice would damage the Fund's role in safeguarding global economic and financial stability. Given the limitations of various exchange rate analytical tools, it is well known that the concept of exchange rate misalignment is subject to theoretical weaknesses, their estimates highly unreliable, and therefore could not serve as criteria or premises for surveillance.

Third, the focus of surveillance should be consistent with the purposes laid out in the Fund's Articles of Agreement. Due respect should be paid to the fundamental role of sustaining growth in promoting external stability. External stability can only contribute to overall sustained stability when anchored by domestic stability.

In response to economic globalization, the Fund has initiated a multilateral consultation process which has given the participants a better understanding of global imbalances and relevant policy measures. The causes of global imbalances are complicated. Addressing the imbalances which have emerged over many years requires all concerned countries to maintain economic growth while taking steps to rebalance consumption and saving. We commend the Fund's considerable efforts in facilitating the exchange of views between the relevant economies in exploring policy measures to alleviate the situation.

With discussions of a Surveillance Remit underway in the Fund, we believe that this should be addressed within the Fund's existing framework and institutional arrangements to avoid possible overlaps or conflicts. Given that member countries are at differing stages of financial development, surveillance should focus on both the stability of financial sectors and the development of financial markets. For developing countries, surveillance should also encompass the role of the financial sector in promoting economic growth. In regional surveillance, the views of regional group participants should be respected.

III. Other issues related to the Fund's Medium-term Strategy

1. Sustainable Financing of the Fund

We welcome the proposals put forward by the Committee of Eminent Persons led by Mr. Andrew Crockett on sustainable income for the Fund. We support the proposals to appropriately relax the restrictions on the Fund's investment account, invest a portion of quota resources, and sell part of the Fund's gold holding which should be properly arranged to avoid market shocks. We emphasize that the Fund should enhance the management of its investment activities to ensure the safety, profitability, and liquidity of its resources. There is need for caution against charging for technical assistance, which would affect the demand and use of the service. Guided by the Committee's report, we encourage staff to expedite specific proposals for sustaining the Fund's income sources.

2. Reform of Quotas and Voice

As a key element of the Fund's Medium-Term Strategy, we call on all parties to strengthen consultations to complete the second-stage of the reform within the agreed timeframe.

We support the two main—and equally important—objectives of the reform set forth in the resolution adopted in Singapore, i.e. better aligning members' quota shares with their economic weight in the world economy; and enhancing the participation of LICs in the governance of the IMF. The new quota formula should be simple, transparent and include four variables—GDP, openness, variability, and reserves, with the largest weight given to GDP. We are open to further consideration of the concepts and weights of the variables as well as use of the PPP-based measure of GDP. We call for a significant increase in basic votes, and support measures to increase the staffing resources and capacities of the African Executive Directors' Offices. Quota reform should lead to greater recognition of the growing relative positions and role of the developing countries.

3. The Fund's role in emerging market economies

We welcome the initiative of a new liquidity instrument. In its design, the Fund should take full account of the opinions of emerging market economies to ensure it is well tailored to the needs of potential borrowers. Due consideration should be given to the financing terms, maintaining sufficient flexibility, so that the new instrument will indeed play a role in preventing crisis and strengthening market confidence.

4. The Fund's role in low-income countries

We support the fund in actively promoting economic growth and development in LICs. We encourage the Fund to use its expertise to assist these countries formulate practicable macroeconomic frameworks, strengthen capacity building, and gain expertise in economic development and poverty reduction to enable them gradually to establish economic development patterns suited to their own needs. We are satisfied with the progress made so far in the Multilateral Debt Relief Initiative, and encourage G-8 countries to play a larger role in this process according to their commitments. We note the Fund's efforts to address its members' arrears, and hope that this issue will be resolved in an even-handed way. The recipient countries should make good use of the resources freed up by debt relief. We call on the developed countries to enhance their assistance to LICs and meet the U.N.'s ODA goal of 0.7 percent of GNI as soon as possible.

5. Collaboration between the Fund and the World Bank

We maintain that Fund/World Bank collaboration should be based on their respective mandates and expertise. Each institution should focus on its own mission, and complement the other in performing its operations. They should strengthen joint efforts while maintaining their respective areas of focus. In principle, the Fund should center its work around macroeconomic stability by carrying out macroeconomic analysis and surveillance, while the World Bank should play a leading role in the development of specific sectors at the micro level to promote the sustained development and long-term growth of its members. While we commend the two institutions on strengthening cooperation, we encourage them to enhance their interaction and dialogue in various areas and at various levels. The priority should be to establish collaborative mechanisms at the working level. Once again, we urge the Fund to continue to meet the needs of LICs, particularly in policy advice, technical assistance, capacity building, and balance of payments adjustments. While the PRGF has played a positive role, a complementary new instrument could be developed.