



International Monetary Fund
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China

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Introduction

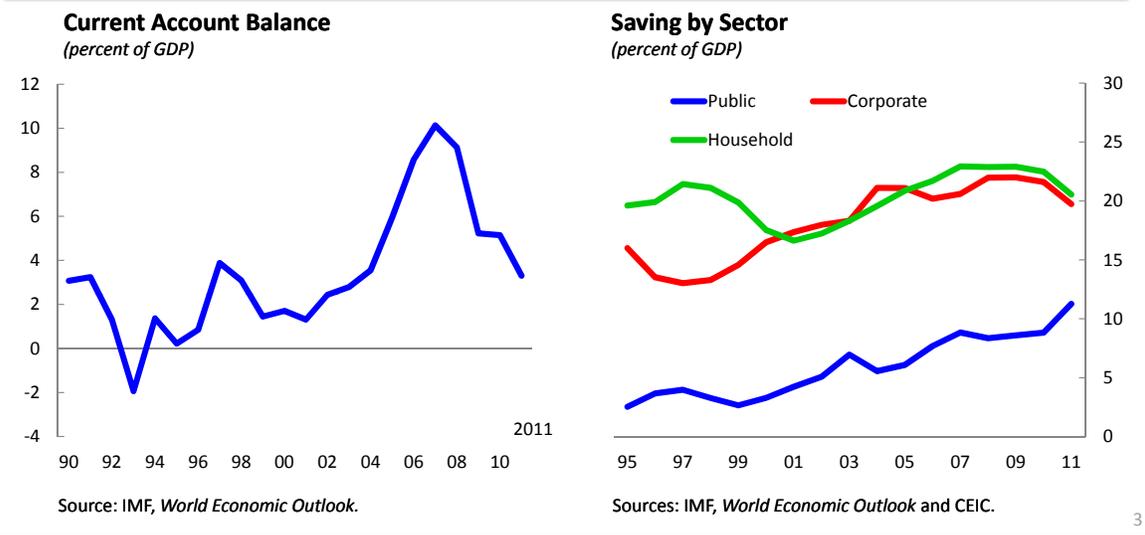
G-20 indicative guidelines identifies China as experiencing significant imbalances in private saving and the current account.

The roots of China's imbalances lie deep in the economy's structure, including distortions that sustain high saving by households, corporates, and the government.

Removing these distortions would benefit China—in particular, by raising household incomes and welfare—and also benefit the rest of the world.

Background

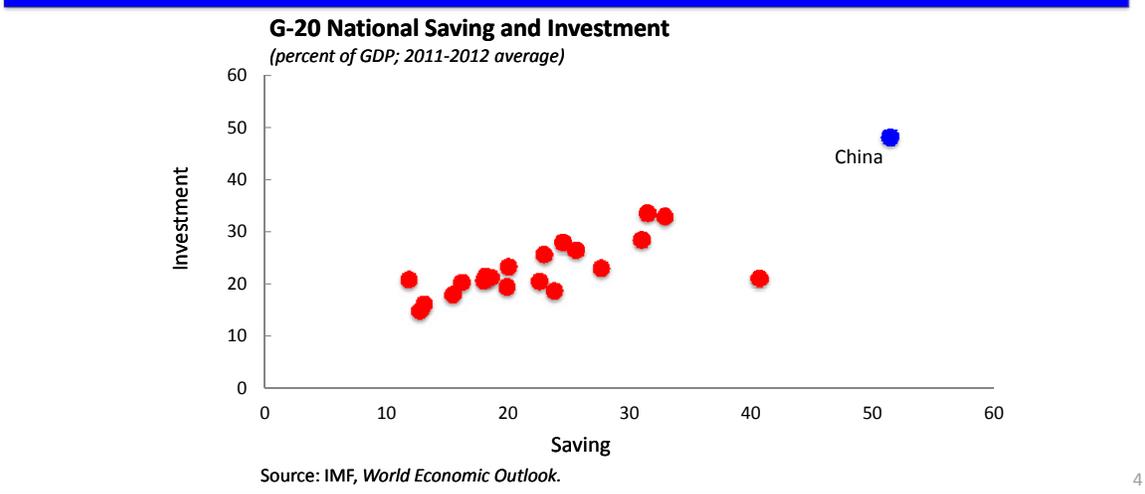
China has followed an unusual development path, combining exceptionally rapid growth with large external surpluses, driven by high saving.



Is China Rebalancing?

Was the 2005-08 current account surge temporary or permanent? Not clear...

...but a lower surplus should not be confused with a true rebalancing of the economy.



Root Causes

China's imbalances are rooted deep in the economy's structure.

They can be traced back to the signature measure of the 1990s, the reform of state-owned enterprises (SOEs).

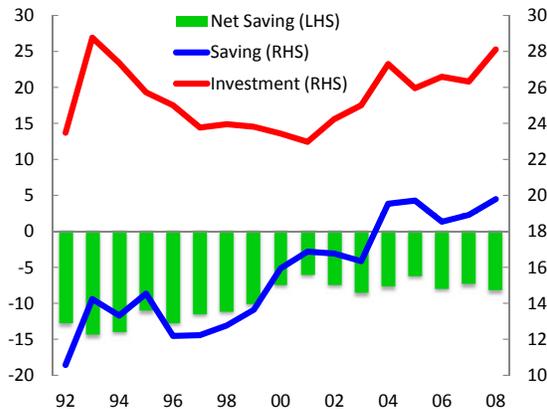
Subsequent policies, together with accumulating distortions, have sustained high saving and exacerbated external imbalances.

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Corporate Saving

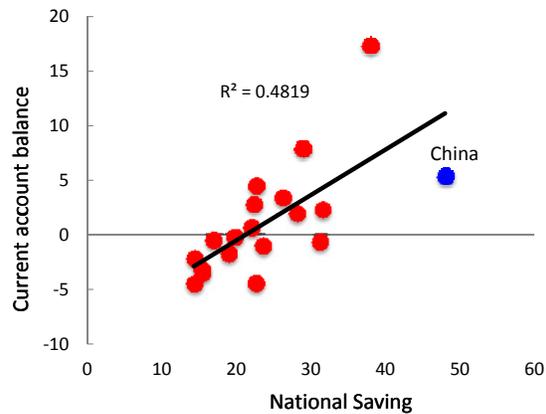
SOE reforms initially boosted gross corporate saving. Other policies and distortions have further increased saving.

Corporate Saving and Investment
(percent of GDP)



Source: National Bureau of Statistics.

G-20: Saving and Current Accounts
(percent of GDP, average 2001-2010)



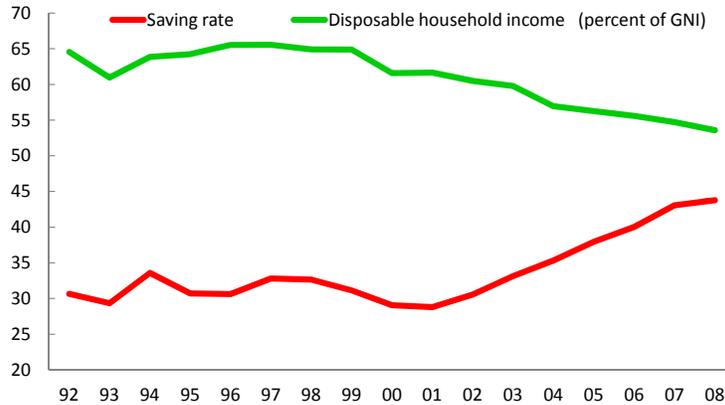
Source: IMF, World Economic Outlook.

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Household Saving

Household saving is high, in part due to lack of social safety nets and financial sector restrictions and controls.

Household Income and Saving Rate
(percent)



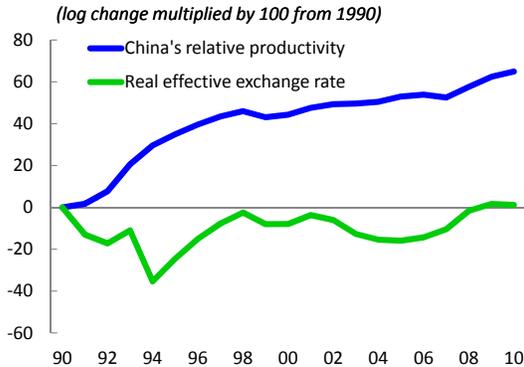
Source: National Bureau of Statistics.

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Policy Response: Exchange Rate Intervention

With high domestic saving, rapid growth has been supported by strong external demand. Achieved, in part, by keeping the exchange rate at a low level.

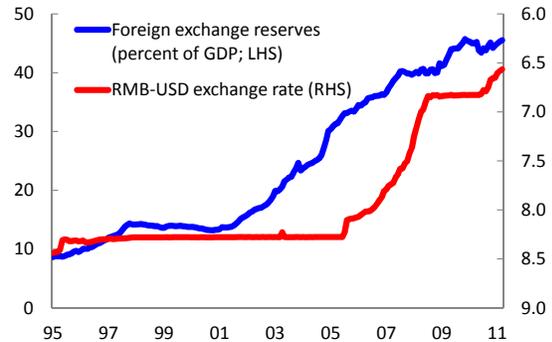
Relative Productivity and the Real Exchange Rate 1/
(log change multiplied by 100 from 1990)



Source: IMF staff estimates.

1/ Relative productivity of tradables-nontradables in China (relative to trading partners).

Reserves and the Exchange Rate

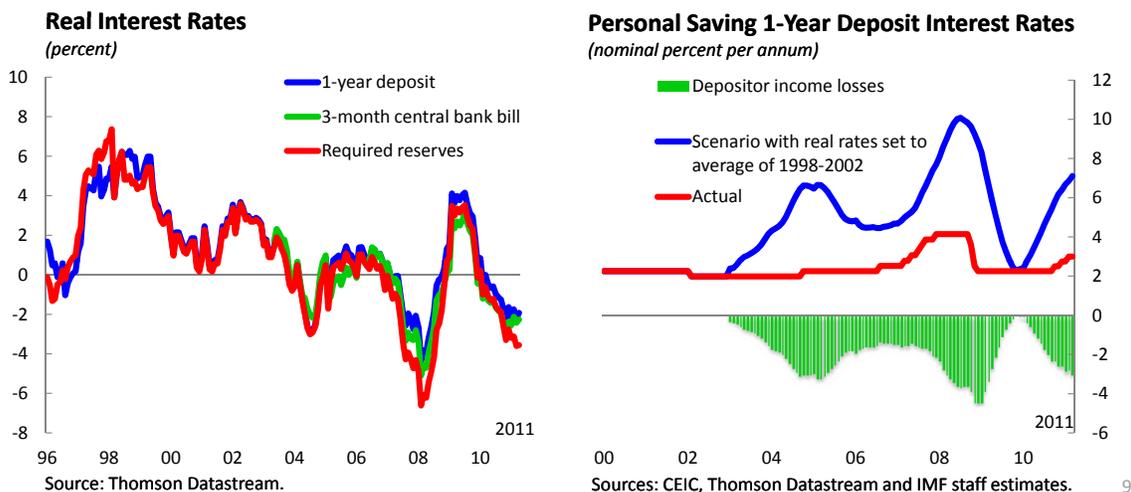


Source: Thomson Datastream.

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Policy Response: Sterilization and Higher Saving

Massive sterilization has accompanied FX intervention. Achieved at below-market cost, resulting in transfers from households (depositors) to the government (borrowers) and higher national saving.



How Should China Reduce Imbalances?

Strengthen social safety nets. Much progress made, more needs to be done.

Increase exchange rate flexibility, to prevent overheating as domestic demand rises (saving falls), change firms incentives (from tradables to nontradables), reduce need for sterilization and pave way for financial liberalization.

Liberalize and develop the financial system.

Raise distributions from SOE profits.

Remove factor cost distortions and allow greater competition in domestic markets.