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On behalf of China

Statement by Deputy Governor Yi to the 26th IMFC Ministerial Meeting

I. Global economy and financial markets

The global recovery is facing renewed headwinds. The slowing global recovery suggests that fundamental constraints to economic growth and financial stability remain unresolved. The need for bold, swift, and decisive action to arrest the global slowdown and preserve financial stability is more urgent than ever.

Looking forward, the global economy continues to face elevated downside risks, a large part of which is related to the Euro area crisis. Steps taken at the EU, Euro area, and individual countries in the last few months are in the right direction. But it is imperative and equally important to fully and resolutely implement the announced policies in order to restore and rebuild confidence. A durable solution to the Euro area crisis would provide a much-needed boost to global recovery.

The continued absence of a credible medium-term fiscal consolidation plan in some of the major advanced economies such as the United States and Japan is an important reason for the slow pace of recovery in these economies, as the uncertainties related to fiscal sustainability weighs on sentiment and confidence, negatively affecting consumption, investment, and hiring decisions. The slow recovery in these major advanced economies poses costly spillover effects to the rest of the world.

While the announcements of further unconventional monetary policy measures by major advanced economies seemed to have lifted market sentiment somewhat, it remains to be seen whether these measures could support growth and employment as they intended to. The earlier rounds of unconventional operations appear to have had diminishing returns and we remain concerned about the collateral consequences such actions may cause, such as volatile capital flows, erratic exchange rate and asset price movements, commodity price surges, and the associated complications for macroeconomic management in other countries. In any case, monetary policy should not become a substitute for other needed policy adjustments, particularly responsible fiscal consolidation and structural reforms.

Emerging market and developing economies are experiencing a mild slowdown, as earlier efforts to address overheating risks coincided with worse-than-expected spillovers from advanced economies. The global slowdown, together with excessive global liquidity and volatile capital flows, are making macroeconomic management very difficult in emerging market and developing countries. While some emerging market economies retain policy space to conduct countercyclical policies, a more supportive external environment would be helpful to ensure sustainable growth.

II. The Chinese economy and policies

Recent economic data on the Chinese economy point to a slower but still robust pace of growth, reflecting weaker external demand as a result of the soft global recovery, as well as proactive macroeconomic management undertaken by the Chinese government.

Since the beginning of this year, the weakening global recovery, the continued uncertainty surrounding the Euro Area crisis, as well as volatile commodity prices have posed challenges to the Chinese economy. The Chinese government has adopted a proactive fiscal policy and prudent monetary policy, made preemptive policy adjustments based on changing conditions, and put greater emphasis on maintaining growth stability. Since the beginning of this year, the two rounds of reduction of the reserve requirement ratios and interest rates, increased flexibility for the banks to set interest rates, the intensification of open market operations as well as structural tax reduction, and improved public expenditure composition in favor of social sectors have helped to sustain stable growth.

Real GDP grew 7.8 percent in the first half of 2012, higher than the 7.5 percent projected at the beginning of the year. In the first eight months of 2012, real industrial value-added grew 8.9 percent year-on-year, nominal retail sales increased 14.1 percent, while nominal fixed asset investment grew 20.2 percent year-on-year.

Inflation continued on its downward trajectory. In the first half of 2012, CPI inflation was 3.3 percent year-on-year, or 2.1 percentage points lower than the same period of 2011, and it further declined to 1.8 percent and 2.0 percent in July and August, respectively. But challenges to maintaining price stability remain, stemming from high and volatile import commodity prices, rising domestic factor costs, and frequent shortage of a few categories of agricultural products.

In line with the implementation of the Twelfth Five-Year Plan, the rebalancing of the economy toward domestic demand has seen further progress, resulting in the narrowing of external balance. During the first half of 2012, final consumption expenditure contributed 57.7 percent to GDP growth, while total capital formation contributed 49.4 percent, and net exports, a negative 7.1 percent. The current account surplus has declined from 10.1 percent of GDP in 2007 and 2.8 percent in 2011 to 2.1 percent in the first half of 2012. This has been primarily driven by structural factors, including the substantial appreciation of the real exchange rate, significant expansion of the social safety net, reforms with regard to factor prices, and more stringent environmental standards.

In the face of the uncertain global environment, the Chinese government will continue to take effective measures to maintain growth stability and accelerate the restructuring of the economy. The Chinese economy is expected to expand steadily in the second half of the year and to sustain its relatively strong momentum in the medium and long term.

The Hong Kong SAR economy grew at a tepid pace in the first half of 2012, with real economy expanding by 0.9 percent over a year earlier. While merchandise exports decelerated amidst the difficult external environment, the resilient domestic sector provided support to overall economic performance. The labor market remained in a state of full employment, with the unemployment rate at 3.2 percent in the second quarter. Inflation eased further with the underlying consumer price inflation receding to 5.1 percent in the second quarter of 2012. Looking ahead, the Hong Kong SAR economy is forecast to grow by 1-2 percent, with an inflation of 4.3 percent in 2012.

Macao SAR's economic growth tapered off to 12.6 percent in the first half of 2012. Merchandise exports rebounded while private consumption and investment continued to expand. The growth of tourism-led services exports, however, decelerated significantly. Meanwhile, the unemployment rate stayed at the historically low level of 2.0 percent, while the inflation rate remained high at about 6.0 percent. Although the pace of economic expansion is expected to further slow down during the rest of the year, the real gross domestic product is anticipated to achieve a high single-digit growth rate for the whole year of 2012.

III. The Role of the IMF

We welcome the adoption of the Integrated Surveillance Decision by the IMF as a step in the positive direction to enhance the effectiveness of Fund surveillance through better integration of bilateral and multilateral surveillance, together with the broadened focus on macroeconomic policies. The IMF needs continued efforts to safeguard global economic and financial stability and to enhance and improve its surveillance for that purpose. Surveillance of macroeconomic, financial sector policies, and capital flow volatilities originating from major reserve currency-issuing economies should be accorded with greater priority. We note that an External Sector Report (ESR) and its related work on External Balance Assessment (EBA) have been conducted on a pilot basis by the IMF. However, the underlying conceptual framework and methodology in ESR and EBA are subject to a great deal of uncertainty. We would welcome further efforts by the IMF to engage with its members and the public in the efforts to enhance its surveillance of the external sector.

To safeguard the IMF's legitimacy and effectiveness, we call on member countries to conclude the 2010 quota and governance reforms by completing the domestic approval process by the agreed deadline. We also call on all parties to complete the review of the quota formula by January 2013 in the spirit of cooperation. The new quota formula should be simple, transparent, well accepted by IMFC members, and protect the voice and representation of the poorest members. It should also lead to a shift in voting shares toward dynamic emerging market and developing countries. In our view, the variable "GDP" best serves the above-indicated purposes and should receive central attention in the quota formula review.

The Fund has been playing an important role in supporting macroeconomic stability in Low Income Countries (LICs). During the global financial crisis, Fund engagement in LICs through programs financed by the Poverty Reduction and Growth Trust (PRGT) has been instrumental in providing liquidity and policy support to LICs. The strong demand for Fund arrangements and the increasing use of a broader range of facilities by LICs suggest that the Fund is rising to meet the challenge faced by LICs in their unique economic circumstances. LICs, like other economies, will continue to face global risks and vulnerabilities. Therefore, the prospective sharp drop in the PRGT's lending capacity after 2014 should be avoided. We support measures to ensure that the PRGT is financed on a sustainable basis in the medium to long term, including through the reallocation of excess profits from gold sales.