International Monetary and Financial Committee

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On behalf of People's Republic of China

STATEMENT BY DR. ZHOU XIAOCHUAN
GOVERNOR OF THE PEOPLE'S BANK OF CHINA
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INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE
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With unprecedented turbulence in global financial markets and uncertain global economic prospects posing challenges for both policy makers and the Fund, it has become all the more imperative for the Fund to fulfill its mandate—safeguarding global economic and financial stability—by putting its comparative advantages to best use and drawing lessons from the present crisis. The Fund must also address its own weaknesses by carrying out reforms with determination and adapting to the ever-changing world, so as to be better able to serve its members' needs for stability and development.

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

The global economic and financial outlook is of grave concern. Global growth faces substantial downside risks in 2008. The increasing risk of the U.S. economy sliding into recession is expected to affect Europe, Japan, and the major emerging market economies to varying degrees. Those emerging market economies with weak financial systems or heavy reliance on foreign capital are likely to suffer a severe shock. The sub-prime mortgage crisis has worsened and the turbulence in global financial markets is still unfolding. Financial institutions are reporting increasing losses, market confidence is severely dampened, and the whole financing environment is showing a marked deterioration. The recovery of financial stability and market confidence will not be easy. In the face of these uncertainties and the high price of oil and other commodities giving rise to inflationary pressures in some countries, the global economic outlook for 2008 cannot but be somewhat pessimistic. If the relevant countries' policy responses fail to address the problems and uncertainties that constrain their macroeconomic stability, the risk of recession in certain advanced economies, a hard landing in some emerging market economies, and a further slowing in global growth cannot be ruled out.

The biggest risk to the global economy remains the financial crisis emanating from the U.S. sub-prime mortgage sector. Addressing its macroeconomic impact is the major challenge for policymakers and the immediate priority is crisis resolution. In the early stages of the crisis, the Fund did not pay adequate attention to—nor did it make timely analysis of—the impact of the U.S. sub-prime meltdown on external stability. It underestimated the severity of the crisis and failed to present effective policy advice to deal with the negative impact on international financial markets and the global economy. Instead, the Fund was too preoccupied with exchange rates, whose orderly adjustment is already well on the way.

We call on the Fund to improve its analysis of the linkages between financial sector development and the real economy, including the implications of the financial crisis for members' macroeconomic and financial stability.

Being at the centre of the financial crisis, **the major advanced economies** need to take the primary responsibility for stabilizing global financial markets. They need to adjust their monetary, fiscal, and financial policies in a timely manner without sabotaging medium- and long-term economic and financial stability while improving supervision and transparency. Drawing on recent experience, these economies should evaluate their financial innovation practices, improve risk assessment strategies, and strengthen supervision of speculative activities. We welcome their recent initiatives to improve financial regulation.

Many emerging market and developing countries confront the risks of economic overheating and heightened inflationary pressures as well as a global slowdown. They need to monitor closely changes in trade and capital flows, speed up domestic reforms, improve resilience to external shocks, and effectively adjust macroeconomic policies in a timely and flexible manner.

Heightened trade protectionism in the context of a global slowdown has made inroads into the financial and investment sectors. We call on all parties to take firm actions against protectionism and continue to promote the multilateral trade liberalization process.

Progress has been made in addressing global imbalances. It has to be emphasized that these corrections should proceed in a gradual and orderly manner, through the joint efforts of the relevant countries. As exchange rates play only a limited role in their unwinding, unrealistic expectations of the effect of exchange rate adjustments are likely to result in inappropriate policy responses and exacerbate the imbalances.

THE CHINESE ECONOMY

Since the inception of the reform and opening policy, China has taken determined steps toward the creation of a prosperous society. Economic policies are being geared toward more sustainable and balanced growth through structural improvement, efficiency gains, and environmental protection. The long-term growth target is to quadruple per capita GDP from 2000 to 2020. In 2008, GDP growth is projected to moderate to 8 percent, CPI to increase by around 4.8 percent and the balance of payments is expected to improve.

Good economic performance continued through the first two months of 2008. The growth of fixed asset investments and exports slowed somewhat. The trade surplus is on a downward trend. While the overall economic outlook remains favorable, some acute imbalances and deep-rooted problems will continue to be addressed, including the fast credit and investment growth, the large trade surplus, heightened inflationary pressures, and increasing external uncertainties.

In dealing with these imbalances and problems, policy adjustments need to be made in a more forward-looking and timely manner. Fiscal and monetary measures have been taken to promote aggregate balances. Industrial and land policies have been improved to foster economic restructuring. Adapting to evolving developments, China has gradually tightened its monetary policy. Since the beginning of 2007, interest rates have been raised six times and the required reserve ratios hiked on 12 occasions. The RMB appreciated 6.9 percent against the U.S. dollar in 2007. In addition, China has eliminated—or reduced—the export rebates of energy-intensive and environmentally-unfriendly products. These measures have achieved significant results.

We will continue to push forward structural adjustment and transform the growth model. Sound fiscal policy and tight monetary policy will be maintained to prevent overheating and generalized inflation. Policies will be fine-tuned as warranted by changes in the domestic and external environment to maintain fast and steady growth.

HONG KONG SAR AND MACAO SAR

Hong Kong SAR's economy remained strong in 2007 with GDP growing by 6.3 percent. The labor market saw substantial improvement and the unemployment rate declined to 3.4 percent. However, inflationary pressures increased and the CPI for the whole year rose by 2.8 percent. Hong Kong SAR is expected to maintain strong economic growth in 2008, with GDP growth in the order of 4-5 percent and a CPI increase of 4.5 percent.

Macao SAR's economy grew by 29.5 percent in the first three quarters of 2007. The increase in government tax revenues was much larger than expected. While the labor market remains strong, the unemployment rate declined further to 2.9 percent in the fourth quarter of 2007 and the CPI rose by 5.6 percent. With further diversification of its tourism industry, Macao SAR is expected to maintain steady and sustained economic growth in 2008.

II. IMF REFORM

QUOTA AND VOICE

As a key step in improving the Fund's governance and enhancing its legitimacy, we welcome broad consensus on the quota and voice reform reached through the joint efforts of all parties. While the proposed package is a step forward, it falls far short of the objective of the Singapore Resolution. However, we are willing to take a pragmatic approach to promote further progress on this reform. We stress that the quotas of under-represented members should be further adjusted in the next general quota review and a regular mechanism for quota adjustment established. This will allow quota shares to better capture members' changing positions in the world economy and the Fund's governance structure to reflect globalization trends and the role of emerging market economies, thereby enhancing the legitimacy and relevance of the Fund.

INCOME MODEL

It has been over a year since the Committee of Eminent Persons (CEP) put forward its proposals to reform the Fund's income model. Delay in activating a new self-sustainable income model will adversely affect the Fund's reputation and hinder the reform process on other fronts. As the Fund's income/expenditure gap continues to widen, addressing the income shortfall has become no less urgent than cutting expenditure.

The Board has come up with specific and feasible proposals based on the CEP recommendations. We call for prompt implementation of the important elements which have gained consensus. At the same time, we expect further work on other CEP recommendations, including investment of part of the quota resources.

STRATEGIC DIRECTION IN THE MEDIUM-TERM BUDGET

To better fulfill its mandate, the Fund must adapt to the changing global environment. We welcome the Managing Director's proposals on the Fund's future strategic direction, broadly reflecting the needs for global economic development and for the appropriate development of the Fund. The budget helps fulfill the Fund's mandate and any reduction in the medium-term budget should not undermine its ability to carry out its functions.

It is more important that the Fund upgrade its operating model and makes best use of its comparative advantages. The Fund needs to focus on strengthening surveillance over the systemically important countries, particularly those issuing major reserve currencies; financial market risks in the advanced economies and their spillover effects; and the linkages between developments in the financial sector and the real economy. We are in favor of improving the efficiency of bilateral surveillance from a broader global perspective, and by drawing on cross-country experiences. As regards multilateral and regional surveillance, it should further improve its surveillance tools that have already gained broad support—the *World Economic Outlook* and the *Global Financial Stability Report*. Multilateral consultations should be based on the voluntary principle, conducted according to actual needs, and should not become a regular form of Fund surveillance.

The Fund's role in LICs should focus on strengthening their capacities and safeguarding their macroeconomic and financial stability. The Fund and LICs could benefit from engaging more TA experts from the emerging markets who are well-acquainted with the specific needs of the recipient members.