International Monetary and Financial Committee

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October 4, 2009

Statement by Dr. Yi Gang
Deputy Governor of the People's Bank of China

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I. The Global Economy and Financial Markets—Prospects and Policy Response

The outlook of the global economy and financial market has improved, thanks to the stimulus policies and financial sector support measures. However, the recovery remains to be established as the effect of the manufacturing sector rebounds and inventory adjustment may be short-lived. The lingering deleveraging, credit crunch, and financial market instability, as well as weak private demand, all point to a slow recovery.

The global economy is confronted with the risks of rising trade and investment protectionism, delayed restoration of the normal functioning of the financial system, and uncoordinated macroeconomic policies. The pressing task is to join efforts to fight protectionism, stabilize the financial markets, and restore growth. It is essential for the major markets to accelerate financial reforms, strengthen supervision, remove toxic assets, and enhance capital adequacy. Coordination of macroeconomic and financial sector policies is also crucial.

At the critical stage of global recovery, the IMF has an important role to play in policy coordination. It needs to monitor more closely risks and policy implementation, particularly the progress of financial sector restructuring and supportive fiscal and monetary policy implementation in developed countries, as well as capital flows, to promote relative stability of the exchange rates of major reserve currencies.

Our attention must focus appropriately on the areas where policy action and coordination are most critical and urgently needed. Global cooperation is needed to secure a more open trade system, accelerate comprehensive structural reforms and improve allocation of resources. It is of particular importance to remove impediments to productivity growth, particularly in the labor, product, and service markets. Such actions are fundamental to strong and sustainable global growth. We also call on the IMF and the World Bank to explore ways to reallocate more resources to developing countries, raise their potential growth, and accelerate their income convergence with the developed world.

II. Chinese Economic Developments and Policies

The Chinese economy outperformed the expectations in the first half of 2009. With acceleration of investment growth, the real GDP grew 7.1 percent. In the first eight

months, fixed asset investment grew by 33 percent in urban areas, retail sales by 15.4 percent, and industrial output by 12.3 percent. Although the monthly average CPI declined by 1.2 percent in the same period year-on-year, the August CPI registered a 0.5 percent increase from the previous month. Money growth accelerated in the first eight months, with M2 and M1 up 28.5 percent and 27.7 percent respectively, resulting in a credit growth of 34.1 percent. The renminbi exchange rate remained stable.

The domestic demand has become the dominant source of growth. The package of macroeconomic measures in response to the global financial crisis--suited to the Chinese circumstances--has proven to be timely, forceful, and effective, and has helped reverse the sharp decline in growth. The projected growth target for this year is within reach.

Efforts are also being made to contain fiscal and financial risks. The government intends to limit the fiscal deficit and public debt to around 3 percent and 20 percent of GDP, respectively. The banking system has improved its asset quality and resilience to shocks. The nonperforming loan ratio of the banking sector declined by 0.64 percentage points in the first six month to 1.8 percent at end-June. And their capital adequacy stood at 11.1 percent.

The Chinese government is faced with an uncertain global environment. In the first eight months, exports dropped by 22.2 percent while imports, by 22.7 percent. The task for structural adjustment remains formidable. While the effect of the supportive policies is expected to phase out, the measures aimed at addressing longer-term issues will take time to yield results. The government is committed to maintain stable and consistent macroeconomic policies while accelerating structural adjustment. Promotion of domestic demand, particularly consumption, will remain a top priority. In this regard, the government is committed to maintain a reasonable investment growth, improve investment structure, and enhance efficiency by eliminating inefficient capacity and encouraging merger and restructuring.

It will continue to restructure and revitalize key industries, encourage innovation, and improve the people’s livelihood. It will monitor closely the developments in the domestic as well as the global economy and stand ready to take contingent actions, as necessary. China will also remain vigilant against various potential risks, including the risk of inflation, and sustain strong economic growth.

Against the economic rebound in mainland China and easing of the downside risks in the global economy, the Hong Kong SAR economy in the second quarter recorded a 3.3 percent rebound over the previous quarter, and the decline in exports moderated. Total employment stabilized and the unemployment rate was 5.4 percent. The underlying consumer price inflation eased to 1.2 percent in the second quarter over a year ago. For 2009 as a whole, real GDP is projected to contract by 3.5-4.5 percent and CPI inflation is projected at 0.5 percent.

Hit by the global recession, the economy of Macao SAR contracted 12.8 percent in the first half of 2009, with pronounced declines in both exports and investment. However, labor market performance remained stable, with the latest unemployment rate remaining at 3.7 percent. Inflationary pressures were quickly alleviated. As the tourism industry income stabilizes, economic activity is gradually improving, and the decline in GDP is expected to moderate gradually in the second half of the year.

III. Reform and Future Mandate of the Fund

The current financial crisis, which originated in developed countries, has resulted in substantial losses for the countries of the world. The failure of major international financial institutions to issue timely early warnings highlights the consequences of its misfocused surveillance. Only through the acceleration of fundamental reforms will the major international financial institutions be able to discharge the mandate assigned to it by its member countries.

The persistently misaligned quota shares and underrepresentation of emerging market and developing countries hamper Fund governance and even-handed surveillance. It undermines Fund legitimacy and effectiveness. The traditional unreasonable quota allocation and adjustment method have intensified the misalignment. It is critical that the Fund complete in a timely manner the reform objective announced by the G-20 leaders, namely a shift of at least five percentage points of the quota shares in favor of the emerging market and developing country members.

We support increasing Fund resources through a variety of means. However, the Fund is a quota-based institution and quotas should be its primary resource. From the long-term perspective, the Fund should introduce a reasonable automatic quota adjustment process in order to reflect changes in the relative economic positions of its members and avoid serious quota share misalignment. We join in the call for prompt approval of the 2008 quota reforms.

Building on the quota reform, we support the broader reform of Fund governance, which will result in a strengthened role of the Executive Board, better oversight over the management, and a transparent, competitive, and merit-based process of management selection. Emerging market and developing countries should also have greater participation in management and staff.

Even-handed surveillance is an important condition for Fund legitimacy and effectiveness. The Fund needs to strengthen surveillance over major financial markets. Its policy analysis needs to be balanced, giving full regard to members' circumstances. The 2007 Decision distracted the attention of the Fund and the international community from real systemic risks, and delayed policy responses. The revision of the operational guidance in May was a small step in the right direction. We call for a timely thorough review of the 2007 Decision in order to avoid a recurrence of past mistakes.

We welcome the progress achieved with the Early Warning Exercise (EWE), and support the continued cooperation with the FSB to improve EWE methodology and enhance EWE capabilities. With regard to EWE communication issues, the Fund needs to ensure both communication effectiveness and confidentiality of sensitive information. The analytical results of the EWE should be integrated with multilateral and bilateral surveillance. It is particularly important to ensure that the developed countries with significant vulnerability and potential spillover risks implement appropriate measures to address such risks and that policies are implemented in the areas that require joint efforts.

We welcome the package of reform measures adopted by the Fund with respect to lending facilities and financing mechanisms for low-income countries. The international community should pay close attention to and minimize the damage to low-income countries caused by the current financial crisis. We call on the international community to provide greater support to help low-income countries weather the crisis. We welcome the Fund's increased flexibility with nonconcessional financing to low-income countries. Given the large gap for development financing, we call on the Fund to work with other international financial institutions to explore new financing mechanisms for more effective reallocation of productive resources to low-income countries.

The current crisis has caused severe damages to the current international financial system. Restoration of international monetary and financial order is the shared responsibility of the Fund and the whole membership. The result of our efforts will be critical to the future of the Fund and the world economy. And the capacity of the Fund to deliver depends on the outcome of the reforms currently under way. A significant quota realignment along with other governance reforms could help it go a long way toward enhancing its legitimacy and its effectiveness in promoting global financial stability and sustainable growth through independent, even-handed, and effective surveillance.