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Statement by Zhou Xiaochuan
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On behalf of China
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I. The Global Economy: Outlook, Risks, and Policy Responses

The global economy continues to grow at a brisk pace. Economic growth in the United States has maintained a strong momentum; economic recovery in the euro area is on track; Japanese economic growth, freed from deflationary pressures, has become more solid; and the major emerging market economies in Asia and Latin America are on a fast growth path. Global economic growth is more broad-based and more balanced.

Meanwhile, some challenges confronting the global economy still merit our attention.

First, there is a downward risk for the world economy, and policy implementation remains a challenge. The monetary authorities of the major economies have—one after the other—adopted tight monetary policy stances. These policies are having an impact on the asset market, particularly the real estate market, and will affect economic activities through output, employment, investment and consumption. Therefore, policymakers should curb economic overheating and inflation while, at the same time, trying to avoid too much tightening by making prudent and orderly policy adjustments. By gradually removing any lurking risks in economic activities, policymakers will be contributing to an economic soft-landing and an orderly return to the path of sustainable growth.

Second, while the channels through which the price of oil and raw materials contribute to inflation and the time lag of these price effects are not entirely clear, central banks should remain vigilant to these price changes and their effect on inflation and market expectations to ensure effective adjustments are made to their monetary policies. We hope that all parties concerned will take effective measures to avoid regional tension and conflicts, ensure an essential stability in energy prices, and maintain a sound momentum for economic growth.

Third, although the major economies have made some progress in economic structural readjustment, the issue of global imbalances has yet to be effectively resolved. These so-called “global imbalances” are the consequence of a myriad of long-term factors linked to economic globalization and a new international distribution of labor as well as inappropriate economic policies pursued in certain countries. Globalization has accelerated the process of the redistribution of production factors. In this process, resources are being reallocated and market efficiency substantially improved.
We hope that the major economies will establish a policy coordination framework based on mutual respect as soon as possible. Under this framework they are expected to adopt policies flexibly and embark on gradual restructuring aimed at stabilizing market expectations, strengthening market confidence, and preventing massive financial market turbulence.

We believe that there might be some time lag in seeing the effects of many policy measures. Therefore, an overemphasis on short-term effects is perhaps counterproductive, likely to restrain economic development and stifle innovation—possibly leading to even further and more costly imbalances.

Fourth, trade protectionism of all sorts is on the rise, and trade friction has spread beyond trade in goods to trade in services and investment. This runs counter to the need for an equitable and mutually beneficial international economic environment and hinders the efforts made by some countries to improve their balance of payments.

We call upon all countries to value the good opportunities globalization has created and take full advantage of the favorable conditions for global steady economic growth. Countries should take timely measures to engage in economic restructuring, oppose trade protectionism, and create a favorable globalization environment in which all countries may participate on an equal footing and share its benefits.

**China’s Economy and Policies**

In 2006, the Chinese economy is maintaining its rapid growth momentum while inflation remains moderate. In the first six months, China’s GDP increased by 10.9 percent y-o-y; CPI rose by 1.2 percent. Policies to boost domestic consumption have been effective. In the first eight months of 2006, retail sales increased by 13.5 percent. Overall, the Chinese economy is expected to grow at a fast pace. At the same time, the Chinese government is conscious of the issues and risks it faces, such as excessive investment and credit expansion, further disequilibrium in the balance of payments, and rising inflationary pressures.

To address these issues, the Chinese government has taken a series of measures to strengthen its control of land resources and credit growth in an effort to curb overinvestment and ensure that very rapid economic growth will not lead to overheating. The People’s Bank of China has pursued its open market operations flexibly, and raised both the benchmark lending rate and the reserve requirement ratio twice to contain fast growth of credit. The Chinese government has taken further steps to improve the RMB exchange rate formation mechanism and continued to modify our foreign exchange management policy in an effort to push for a general equilibrium in our balance of payments. We are convinced that the impact of these policies will be felt over time.

The medium and long-term challenges to China’s economy include the need to address the economic structural problems, environmental concerns and job market pressures. Although significant progress has been made in financial reform, there is a long way to go in
improving the governance of financial institutions. We shall pursue our efforts to accelerate economic restructuring and modify our economic growth model, and widen economic liberalization to achieve balanced and sustainable development.

Growth of the Hong Kong SAR economy has been very robust. GDP grew by 8 percent in the first quarter. In the second quarter, however, economic growth slowed due to the impact of the slowing U.S. economy on Hong Kong’s exports, but the booming economy and trade in Mainland China partially offset this negative impact and Hong Kong SAR managed to register real growth of 5.2 percent in the second quarter. Benefiting from the consistent improvement in employment, domestic demand continues to grow. Business confidence remains strong, resulting in steadily growing investment expenditure. The CPI is still modest, although it rose to 2 percent in the second quarter. Economic growth is expected to fall back somewhat within the year and GDP is expected to be in the range of 4-5 percent for the whole year, while the CPI increase will remain at 2 percent.

Driven by the continuing strong performance of its services sector, higher fixed-asset investment and stronger private consumption, the Macao SAR economy grew by 17.7 percent in the first half of 2006. A fiscal surplus was achieved as tax revenue increased as expected. Employment has continued to improve, and the unemployment rate fell to below 4.0 percent. Foreign trade witnessed strong growth, with exports increasing by over 40 percent. The retail market is thriving, and the tourism industry shows an increasingly diversified pattern of development. It is expected that the economy will maintain its favorable growth momentum for the remainder of the year, largely supported by investment and exports of services.

II. Reform of the Fund’s Governance

Governance reform is a key element of the medium-term strategy. We support Managing Director de Rato’s suggestion that the reform should seek not only to make the distribution of quotas better reflect changes in members’ economic positions in the world economy, but also to enhance the voice of low-income countries. These two objectives are equally important and indispensable. We are pleased to note that since the Spring Meeting, progress has been achieved in reform of the Fund’s quotas, thanks to the unremitting efforts of all parties. Ad hoc quota increases for a small group of countries is a good beginning in this regard. However, reform of quotas is only one part of the governance reform. With regard to the second-stage reform plan, we support the reform package proposed by the Managing Director. We call on the Fund to strengthen its efforts to examine the second-stage reform plan, particularly on issues related to the quota formula and basic votes. We believe the new quota formula should be simpler and more transparent, that the basic votes should be increased by a significant margin, and a mechanism set up to keep the basic votes at appropriate levels. We support the Managing Director’s proposal to provide additional resources for strengthening the capacity of the offices of the African Executive Directors. We continue to call for the establishment of a more transparent procedure for the selection of the Managing Director.
The reform has entered a critical stage, requiring all members’ understanding, support, and efforts. We call on all parties to maintain the reform momentum and improve efficiency in order to achieve further progress. In particular, the developed countries should take a flexible and pragmatic attitude and work actively to enhance the voice of low-income countries.

III. Strengthening the Fund’s Surveillance

Surveillance is part of the Fund’s core mandate. Over past years, Fund surveillance has played a positive role in promoting global financial stability and economic growth. We welcome the Managing Director’s proposal to acclimatize the Fund to the globalization process by strengthening its surveillance. In this regard, I would like to make a few comments.

First, in all forms of surveillance, the Fund should always adhere to its purposes of promoting global exchange and macroeconomic stability and respect the autonomy of member countries in choosing their own exchange rate regime as stipulated in the Articles of Agreement. A country shall choose the appropriate exchange rate regime in accordance with its own economic development needs. Fund surveillance should seek to ensure that the macroeconomic policies adopted by its members are consistent with the objective of promoting economic development and financial stability at the national and global level. Surveillance over exchange rates should focus on whether the adopted exchange rate regime is appropriate and consistent with a member’s macroeconomic policies rather than on the exchange rate level. Evaluating the exchange rate level alone will not produce an objective and comprehensive analysis of the deep-seated problems. Such an approach will not be beneficial for economic and financial stability, and may even cause the Fund to deviate from its mandate.

Second, the Fund should focus its surveillance on the systemically important countries issuing major reserve currencies. The frequent outbreak of crises since the collapse of the Bretton Woods system indicates that the fundamental weakness of the international monetary system lies in its undue reliance on a single currency. The excessive fluctuation of the major currencies, the abrupt reversal of capital flows, and the lack of effective preventive mechanisms and prompt assistance are the reasons for the outbreak and evolution of crises. The Fund should enhance its surveillance over the macroeconomic policies of countries issuing the major reserve currencies, prevent their excessive fluctuation, and urge the relevant countries to strengthen hedge fund regulation so as to avoid sudden shocks to the financial markets of the emerging market economies. Of course, a fundamental solution will be to reform the international monetary system, transforming it into an equitable and fair system. We believe one of the desirable steps would be to continue strengthening the role of Special Drawing Rights.

Third, the Fund’s surveillance should fit in with the actual conditions, and be conducted within the framework, of the Executive Board and the IMFC. In order to effectively put in place any new surveillance mechanism based on the consensus of its members, we believe
the Fund must follow a scientific and pragmatic approach to adequately consider the applicability and limitation of the theoretical methodology and analytical tools of surveillance as well as the varied situations of its members. Dialogue and consultation on an equal footing are the basis of surveillance. While its governance structure remains to be improved, the Fund may lose credibility in the eyes of its members through “command-style” surveillance.

IV. Strengthening the Fund’s Role in Emerging Market Economies and Enhancing the Fund’s Support to Low-income Countries

We welcome the Fund’s efforts to explore new financing instruments for the prevention of financial crises. In recent years, thanks to favorable global economic and financial conditions, most emerging market economies have become much less vulnerable. Nevertheless, emerging market economies, as a whole, remain vulnerable. Against the backdrop of globalization, the vulnerability of these economies is not solely their own problem, but also reflects the irregularities in the world monetary and financial system. The Fund should look into this issue from a broader perspective.

We have consistently supported the efforts of the international community to reduce the heavy debt burden of low-income countries. We are satisfied with the progress achieved with respect to the Multilateral Debt Relief Initiative and hope that the international community will continue to help those eligible countries that have not met the relevant criteria to qualify for debt relief. The Fund, in a timely way, should set aside resources for debt forgiveness, and, in particular, encourage the G-8 countries to fulfill their commitment to play a larger role in the multilateral debt relief process. We support concluding the HIPC Initiative by the end of this year as scheduled, but believe that all countries that have met the end-2004 income and debt criteria and will meet the criteria under the Initiative should be granted the right to receive debt relief.

Trade liberalization is the key to the sustainable growth of developing countries as well as the global economy. We call on all parties in the Doha Round trade negotiations, particularly the developed nations, to show greater sincerity to push ahead with the Doha agenda and resume trade talks at an early date, thus contributing to the establishment of a fair and mutually beneficial new trade system.

Development and growth are crucial to low-income countries. Lack of funds has prevented many of them from achieving growth and poverty reduction targets. We call on the international community to continue to enhance the support and assistance for low-income countries, and we urge the developed nations to hasten their efforts to meet the United Nations proposed goal of increasing government development aid to 0.7 percent of gross national product. It is understandable that low-income countries seek to obtain other financing, including nonconcessional loans, when financing on concessional terms does not meet all their development needs. The ultimate objective of multilateral debt relief is to help low-income countries achieve debt sustainability and regain access to the financing markets.
The Fund and the developed countries need to examine in detail how nonconcessional loans have been used, whether they have helped promote the economic development of low-income countries, and whether they have contributed to poverty reduction and the achievement of the United Nations Millennium Development Goals. Emphasis should be placed on the monitoring of debt crisis risks to help low-income countries detect problems in a timely manner and avoid excessive borrowing that exceeds their debt service capabilities. Efforts should also be made to help low-income countries improve their own debt monitoring and crisis prevention capabilities.

As a responsible, large developing nation, China has devoted much effort to building a harmonized and prosperous international community, and has always attached importance to helping low-income countries, including the poor countries in Africa, develop their national economies. Loans provided by China to these countries are intended for the construction of public welfare and infrastructure projects, such as schools, hospitals, roads and power plants, with the aim of helping them develop their economies and reduce poverty. Meanwhile, the Chinese government has significantly reduced its bilateral claims on low-income countries to enable them to use the resources freed up in this way for economic development. So far, China has signed debt relief agreements with 46 countries in Africa, Asia, the Caribbean, and the South Pacific islands, resulting in the cancellation of 208 debts in arrears totaling RMB17 billion. China will continue to play an active role in supporting the growth and poverty reduction in low-income countries. At the Financing for Development Meeting at the United Nations Summit in 2005, Chinese President Hu Jintao announced a series of new measures aimed at supporting other developing countries, involving zero tariff treatment, debt relief, concessional loans, public health cooperation, and human resource development.