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On behalf of the People’s Republic of China
I. THE GLOBAL ECONOMY AND FINANCIAL MARKETS; OUTLOOK, RISKS AND POLICY RESPONSES

Since our meeting last Fall, global economic growth has been robust and broad based. The United States continues its strong growth momentum; the euro area is seeing positive signs of economic recovery; the Japanese economy is undergoing further consolidation; and the main emerging market economies in Asia and Latin America continue to grow vigorously. International financial markets remain healthy and stable.

And yet the global economy still faces some challenges that deserve close attention.

First, protectionism is on the rise. Against the backdrop of economic globalization in recent years, global outsourcing and reorganization of the supply chain are developing with increasing speed. As comparative advantages are being readjusted, trade imbalances are expanding, arousing protectionism sentiment. Moreover, trade frictions are no longer restricted to commodities but are widening to include services and investments, posing challenges for global trade, economic growth, and resource allocation.

With this background, we call on all countries to take advantage of the current favorable circumstances afforded by strong global economic growth and address structural problems in a timely manner. In particular, the developed countries, while enjoying low-cost imported goods and services, have to restructure their industrial sectors quickly to create job opportunities and export advantages to improve their competitiveness and dampen protectionism. Further efforts are needed to carry the Doha Round forward and help create a truly globalized environment in which all countries participate equally and share the benefits.

Second, oil prices remain high and volatile. Notwithstanding the efforts of the net oil-exporting countries over the past year to increase supply and of the net oil-importing countries to develop substitutes and contain consumption, oil prices continue to surge in the face of geopolitical uncertainties and haphazard events. The impact of soaring oil prices on the growth outlook—particularly on activities in the net oil-importing countries—might increase further.

We hope that all concerned parties will refrain from destabilizing the oil supply. Net oil-exporting countries are encouraged to improve their investment climates and gradually increase their production and processing capacities while the net oil-importing countries are
urged to conserve energy, develop cleaner substitutes, and reduce their oil consumption. Along these lines, China’s recent Eleventh Five-Year Plan targets a 20 percent reduction in the unit GDP-to-energy consumption ratio by 2010.

Third, favorable conditions in the financial markets do not rule out the possibility of a sudden reversal in sentiment. Major liabilities include the weakened risk assessment of investors while searching for high returns in the easy liquidity environment of the past few years; the notably lower resilience of the housing market to rising interest rates; and the absence of effective hedge fund supervision. The lack of policy coordination in the major economies as their monetary conditions tighten could result in large and volatile movements of financial markets. Thus, we cannot ignore the risk of disorderly adjustments in financial markets.

In this context, coordinated policy frameworks and smooth adjustments will be welcome to anchor market expectation and boost confidence. Strengthened surveillance over hedge funds will also help prevent disruptive adjustments in financial markets and asset prices.

Global imbalances have become an increasing concern. The causes are manifold and the rebalancing process will require all parties, particularly the major developed countries, to take joint responsibility and adopt a set of complementary economic policies and structural reforms. Any over-simplistic and drastic unilateral movements might subject the global economy and financial markets to new destabilizing factors. I believe most countries have reached a consensus on this point.

To fulfill its responsibility and improve its balance of payments, the Chinese government is adopting further measures to expand domestic demand, encourage consumption, open its markets, improve the exchange rate regime, and restructure trade.

We believe that an orderly adjustment of these imbalances is in the interests of all countries. We also believe that global economic imbalances can be adjusted gradually through vigorous actions on the one hand and patience on the other.

**The Chinese Economy**

Since our last meeting in September, China has been implementing sound macroeconomic policies. The Chinese economy grew steadily in 2005; inflation was subdued, and investment grew at a relatively high level. Retail sales grew by 12 percent and consumption demand made an increasingly important contribution to growth. Since last August, imports have accelerated. In the first quarter this year, imports grew by 24.8 percent and are catching up with export growth.

Since the renminbi exchange rate regime reform on July 21, 2005, the Chinese government has taken measures to cultivate and develop foreign exchange markets. Forward, swap, and other hedging instruments have been developed. A market-making system and OTC in the interbank foreign exchange market have been introduced. Incentives have been given to enterprises to retain more foreign exchange and the capital account restrictions have been
further relaxed. Since the implementation of these exchange reforms, the RMB exchange rate has been moving in both directions against the U.S. dollar, displaying a larger flexibility based on market supply and demand. By March 31, 2006, the RMB had appreciated against the U.S. dollar by 3.20 percent. In 2005, the real effective exchange rate of the renminbi rose 8.1 percent. After the introduction of the market-making system on January 4, 2006, the RMB exchange rates became even more flexible. Between July 21, and end-2005, the scope of the average daily appreciation rose from 3.5 basis points to 8.6 basis points, and the average daily fluctuation rose from 17 basis points to 20 basis points over the same period.

At the same time, financial sector reforms have been moving forward. The China Construction Bank was successfully listed in Hong Kong SAR; the Industrial and Commercial Bank of China was restructured as a joint-stock limited liability company; and the Bank of China will be listed overseas during the first half of this year.

The economy of Hong Kong SAR continued its robust growth in 2005. Real GDP rose by 7.3 percent, representing a broad-based expansion supported by strong export performance and sustained growth in domestic demand. Consumer price inflation remained benign throughout the year. The Hong Kong SAR government restored fiscal equilibrium in FY 2005-06, three years ahead of schedule. GDP is forecast to maintain a 4-5 percent growth rate in 2006 despite the effects of weakening external demand; and inflation will continue to moderate.

The Macao SAR economy maintained steady growth. Real GDP growth in 2005 was 6.7 percent; job market conditions continued to improve; the unemployment rate was at 4.0 percent; and inflation pressure remained with the CPI at 4.4 percent. The Macao SAR economy is expected to maintain strong growth momentum in 2006 with investment and trade in services remaining the primary driving forces.

II. THE FUND’S MEDIUM-TERM STRATEGY

Enhancing the Effectiveness of Surveillance

Against the backdrop of globalization and structural changes in the world economy, we are pleased that the Managing Director’s Report on Implementing the Fund’s Medium-Term Strategy proposes that the Fund should perform its surveillance function in a more effective manner.

First, while it remains the primary framework for policy discussions with member countries, the Fund should further improve and increase the effectiveness of its Article IV consultations. However, the introduction of multilateral consultations is a useful attempt to adapt to the needs of globalization and the development of regional economic cooperation, enabling the Fund to hear all viewpoints before making objective and realistic policy proposals, helping to ensure that such proposals are well received and correspond to the interests of the member countries. However, the multilateral consultation procedure must be
designed properly and be widely accepted by member countries. Since regional cooperation organizations are important for discussions on global issues, the Fund should enhance communication with these organizations through dialogue or by participating in discussions at their invitation. Any developments in multilateral consultations should be reported to the Executive Board and the IMFC.

Second, Fund surveillance should comply with the objective of promoting exchange and financial stability and respect the autonomy as to exchange rate systems that is granted to all member countries in the Articles of Agreement. The focus of Fund surveillance should be on reviewing whether a member country’s macroeconomic policies are consistent with the objective of maintaining the stability of the country and the international economy. Exchange rate policy is only one component of macroeconomic policy. Each country is entitled to choose an exchange rate system consistent with its own economic development. If surveillance is wrongly focused on an evaluation of the exchange rate level or an isolated judgment as to whether the exchange rate system is appropriate, it will hardly be objective and certainly miss more fundamental issues. This would be contrary to the maintenance of economic and financial stability and might even deviate from the Fund’s mandate.

Third, there is a fundamental need for the Fund to enhance the effectiveness of its surveillance since global trade, settlements, and reserve assets are heavily reliant on a single currency. On the one hand, the Fund should give priority to establishing a surveillance and check-balance mechanism of the major reserve currency countries while on the other hand giving thought to reforming the international monetary system. To this end, the continuous enhancement of the role of the SDR in the international monetary system remains an important issue.

Fourth, the Consultative Group on Exchange Rates should deal carefully with its evaluation of the exchange rates of the major emerging market economies. Since their financial markets are less efficient and their financial institutions less sophisticated than those in the advanced economies, it is hard to obtain a dependable estimate of their equilibrium exchange rate levels.

Finally, to avoid misleading the market, triggering unnecessary speculation, and damaging the Fund’s credibility, the Fund should be extremely cautious in publishing the results of member countries’ exchange rate evaluations.

**Governance**

Since improved governance will fundamentally enhance Fund supervision, it should become a primary focus. Quota is an important issue in the reform of governance structure. The two-step approach proposed by the Managing Director shows that a comprehensive resolution of the issue is essential, while reflecting management’s pragmatic approach to resolving this issue in light of current realities.
We believe that the Fund’s quota structure should reflect the changed world economic structure. The serious under representation of the quotas of certain countries should be corrected and the degree of under representation reduced on the basis of consensus and actions. Moreover, the Fund’s governance structure should be enhanced through an appropriate increase in basic voting rights to boost the voice and representation of small and medium-sized developing countries, particularly African countries. I hope that with the efforts of all members, substantive progress can be made on the quota issue before the Singapore Annual Meetings in September.

III. ENHANCED FUND SUPPORT FOR LOW-INCOME COUNTRIES—STATUS OF THE MULTILATERAL DEBT RELIEF INITIATIVE (MDRI) AND DEBT SUSTAINABILITY

We welcome the Fund efforts to reduce the heavy debt burdens of low-income countries (LICs) and are pleased that progress has been made in implementing the MDRI.

We hope that the Fund will continue to help countries eligible for debt relief to come to the completion point as quickly as possible and we encourage the G-8 to play a larger role in debt relief in line with their commitments. We support the Fund’s analysis of debt sustainability in LICs and its encouragement to beneficiaries in putting the resources released through debt relief to good use. Despite this, LICs still face many challenges in their economic and social circumstances and the international community should continue to provide them with support and assistance. While we agree that the Fund should continue to play a proactive role in LICs, we call on the developed countries to meet the U.N. target for ODA of 0.7 percent of GNP as soon as possible.

The Chinese government will continue to play a hands-on role in supporting growth and poverty reduction in LICs. In 2005, President Hu Jintao announced that China would accord zero tariff treatment to certain products from those least developed countries (LDCs) with which it has diplomatic relations. Within the next two years, China will work through bilateral channels to write off or forgive, in other ways, all the overdue parts of the interest-free government loans as of end-2004 owed by heavily indebted poor countries having diplomatic relations with China. Over the next three years, the Chinese government will provide US$10 billion in concessional loans to developing countries, increase its related assistance to them, particularly to African countries, and help them to train 30,000 professional personnel.

At the beginning of this month, Premier Wen Jiabao announced that within the next three years, China will provide the Pacific Island countries with RMB 3 billion in concessional loans; accord zero tariff treatment to the majority of exports to China from LDCs in the region that have diplomatic ties with China, cancel their debts that matured at end-2005, and extend the debt payments contracted by other island countries that matured at end-2005 by 10 years. Over the next three years, China will also provide training to 2,000 government officials and technical staff from the island countries.