Statement by Mr. Jin on People's Republic of China Executive Board Meeting
November 10, 2017

On behalf of the Chinese authorities, I thank the FSAP team for their hard work, candid assessment and valuable recommendations. We take this FSAP update as a good opportunity to comprehensively examine the health and soundness of our financial system, while at the same time for the outside world to better understand the progress of the financial reform and developments China has made since the last FSAP. The outcome of the stress tests under extreme scenarios has shown strong resilience of China’s financial system. We generally concur with staff’s assessment, and we are pleased to see that many recommendations are in line with the authorities’ ongoing efforts and planned reform agenda. The 19th CCP congress has further underscored the high priority of the financial opening-up and reform.

When China and the Fund started to discuss how to conduct this FSAP, our authorities approved and supported a comprehensive assessment covering all possible areas instead of a selective assessment. That showed the authorities’ confidence in both China itself and the professionalism of the Fund. In the past year, the Fund staff has made a very careful scrutiny of China's financial sector, with more than 500 meetings and the stress test using confidential regulatory data. The result I think is better than many people's original imagination. The stress test shows that the four largest commercial banks are sufficiently capitalized even under extreme scenarios. The medium sized commercial banks may face some liquidity stress and a significant erosion in capital, but they will all remain solvent. The central bank will not allow any liquidity stress to trigger systemic financial risks, and the newly established deposit insurance system will take care of any insolvency problem effectively.

I thank Ratna Sahay, Simon Gray, and the entire FSAP team for their diligent and excellent work in this FSAP mission. My authorities have been very supportive during the mission. We respect staff’s independent assessment and policy recommendations. We also pay serious attention to the diagnosed challenges that we need to address with decisive actions.

Having read all the grays before the meeting and listened carefully to the EDs’ remarks during today’s meeting, I would like to thank all the EDs for their insightful observations and valuable comments. I will faithfully convey your views and comments to my authorities.
While agreeing in general on the FSAP's assessment, I would make a few more comments for emphasis and supplements.

**The macro financial context for assessing financial risks in China**

Since the last FSAP in 2011, the financial sector has witnessed fast development along with further reform and opening up, supporting China’s economic growth and transformation against the backdrop of highly volatile and uncertain global financial conditions and capital flows. Significant progress has been made in the last 5 years in developing the financial markets, enhancing oversight and macroprudential regulation, and promoting financial inclusion. Full recognition of such positive developments can help better understand the associated risks against the dynamics and resilience of the financial system. We are pleased to see such progress being largely captured by the main text of the FSSA report.

**We have some news from China. The authorities have just announced that it will relax the foreign ownership limit on banks while allowing overseas firms to take majority stakes in local security ventures, fund managers and insurers.** Specifically, foreign firms will be allowed to raise their shares in securities ventures and fund managers to 51 percent, and foreign ownership limits will be removed three years after the new rule takes effect. The cap on life insurers will be lifted to 51 percent after three years and will be removed after five years. Non-discriminatory ownership limit rules will be applied on equity investment in Chinese banks (private banks excluded) and financial asset management companies I believe these new measures of openness will greatly increase the competition in China's financial sector and improve efficiency in the medium and long term.

**China has already shifted its focus to the quality and efficiency of growth, rather than solely emphasizing the growth itself.** The 19th CCP Congress stressed that our main policy target would be meeting the Chinese people's increasing demand for a better life, without mentioning any specific quantitative growth targets as before. China now sets its GDP growth as a forecast based on estimated potential growth, just like what the Fund does for its members. While decisively advancing with the transition, counter cyclical measures are warranted to avoid sharp slowdown and large volatilities. Such counter cyclical policy should not be regarded as a purely GDP motivated stance. China's inflation rate is now lower than 2 percent under current GDP growth. Attributing the financial risks to a GDP target may have oversimplified the complexity of the challenge. Cyclical factors, structural factors, and international factors all played their roles in affecting the financial system. A growth rate lower than its potential will generate its own risk.

Although the “credit gap” (deviation of credit growth from its long-term trend) deserves appropriate attention, it is to some extent counter cyclical and has been narrowed
recently. As growth picked up since late 2016 and monetary policy shifted to a more neutral stance, the growth of the overall leverage of the economy in 2016 has seen a slower pace. In particular, the leverage of the corporate sector has dropped since the third quarter of 2016. In fact, the overall loose international monetary environment has also been one of the important factors behind China’s rising debt issue. Thanks to China’s flexible macroeconomic policy and structural adjustment, the risk of an ever-increasing credit gap has been alleviated.

The rapid increase of corporate debt in China during a period of time needs to be properly analyzed. Recently, there are discussions in China regarding the nature of the corporate sector's debt. Some believe that some part of the corporate debt actually is debt issued by the local government established entities. The purpose of raising these debt is to fulfill their responsibility to implement urbanization and infrastructure development. In China, the local governments take a lot of responsibilities, but their ability to mobilize resources through taxation or bond issuance is limited. In that case, part of the corporate debt is actually local government debt. As a result, we may need to revise the corporate debt ratio down, but increase the local government leverage ratio accordingly. Now the official public sector’s debt over GDP is quite low, only 40 percent. If you add the hidden local government contingent debt, that may increase the total public debt over GDP ratio, and the corporate sector debt will decrease by the same amount. In the end, what really matters is the total leverage ratio in China, which includes the government debt, corporate debt, and the household debt. And the total leverage ratio in China is 260 percent of GDP, which is still lower than most of the advanced countries, and is comparable with many emerging market economies.

The perception of the government’s implicit guarantee for SOEs does not have legal basis. In fact, there are some famous cases in China in recent decades that shows the government will not provide this guarantee, such as the case of the Guangdong International Trust & Investment Corp about 20 years ago. The government allowed the bankruptcy of that state-owned company without bailing out its debt, and that was well known to international investors ever since. This is a very important precedent, which shows that, actually, any perceived implicit government guarantee is not reliable if there is no legal basis.

We would appreciate the Fund’s consistent support to exchange rate flexibility while reminding us of the importance of risk management. China has been moving determinedly toward the market-based exchange rate and greater exchange rate flexibility, aimed at achieving external and domestic balance and preventing financial risks. The capital outflow pressure largely arose from the changes in the global economic and financial developments, particularly the adjustments of monetary policies in major economies. In response, China has taken a few market based counter-cyclical macroprudential policies to mitigate potential financial risks and safeguard financial stability.

The regulatory framework
The authorities are fully aware of the need to fill the regulatory gaps in an increasingly complex and interconnected financial system. The Financial Work Conference in July 2017 has made a series of decisions to enhance financial oversight, including establishing the Financial Stability and Development Committee (FSDC), reinforcing the central bank’s mandate on macroprudential regulation/supervision and prevention of systemic risks, enhancing accountability of the regulatory authorities, and strengthening regulation on a consolidated basis through functional and behavioral regulation. The policy recommendations raised in the report are largely consistent with these decisions and follow-up actions.

The macroprudential assessment framework works well in monitoring and preventing systemic risks. The People’s Bank of China (PBC), the central bank, introduced the Macroprudential Assessment (MPA) framework to assess banks’ key macroprudential indicators in a rule-based manner. The process is transparent for both the central bank and banks assessed, and the banks concerned are informed of the assessment outcome. The policy on the eligibility for accessing the PBC’s facilities has provided needed incentives to encourage prudent operations of banks, and the policy on remuneration of reserves has never been enforced in practice.

Uniform regulatory requirements on Asset Management Products (AMPs) are in progress. We agree that similar products should be regulated in the same way with a function based rather than institution based approach. The booming AMPs have supplemented the traditional financing and supported the growth, while their risks have also accumulated during the fast expansion. The PBC and relevant regulatory authorities are formulating the regulatory policy for AMPs, aimed at eliminating discrepancies in regulating similar products by different regulators. Specifically, AMPs will be subject to uniformed regulatory standard to minimize regulatory arbitrage, and defined as off-balance sheet products with clear requirements of investor suitability and explicit removal of implicit guarantees. More importantly, the targeted macroprudential and functional regulation will be reinforced based on the “look-through” principle, with enhanced regulatory and statistical coordination.

The statistics of NPL ratio has generally reflected the asset quality appropriately. Some people expressed their concern that the low NPL ratio may be underestimated, and have covered some hidden risks. My authorities have worked together with staff to see any potential underestimation of the NPLs. Currently, loan classification system in China is generally in line with international standards on prudential regulation and accounting. Moreover, the regulatory authorities have paid great attention to the accuracy of loan classification, with reinforced monitoring of NPLs, tightened regulatory requirements on the investment book and the off-balance sheet exposure, and intensified on-site examination and punishment to contain illicit risk transfer that could blur the NPL picture. Banks have also reinforced provisioning and write-offs of NPLs in the past 5 years. The deposit insurance scheme was put in place in 2015,
in compliance with international core principles on deposit insurance and disposal of financial
institutions, providing a solid basis for market based resolution. There is one thing that is
commonly understood: the profitability of the corporate sector has improved significantly this year, as
compared to that of last year. In most cases, local government borrowings have been backed
by long-term, cash-generating assets. The room for any underestimation of NPL ratio is very
limited and is shrinking.

**Supervision of Financial Market Infrastructures (FMIs) should be well tailored to
country specifics.** China has made progress towards the full implementation of internationally
accepted principles and practices of FMI supervision, while exploring best practices that are
more feasible and operational in China’s context. For instance, the China Securities Depository
and Clearing Corporation Limited (CSDC) has established adequate risk and liquidity
management framework in securing the payment one day after the delivery of securities,
including a contingent plan to directly compensate unsettled payment with debtors’ securities
holdings, a 100 percent margin requirement and comprehensive regulations for risk control.
Current practices are well functional in China and broadly in line with the FMI principles.
Under extreme scenarios of liquidity shortage, the CSDC can have access to liquidity through
collateral management. The central bank will provide ad hoc liquidity support to avoid
liquidity shocks to clearing banks in case of extreme circumstances, while being cautious of
potential risks, including moral hazard that could arise in directly using central bank clearing
and liquidity facilities for securities transactions.

Lastly, I am pleased to inform the Board that my authorities have agreed to publish the FSSA
report and the DAR report.