International Monetary Fund

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IMF Staff Completes the 2015 Article IV Consultation Mission to China

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Webcast of the press briefing

End-of-Mission press releases include statements of IMF staff teams that convey preliminary findings after a visit to a country. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF's Executive Board for discussion and decision.

A mission from the International Monetary Fund (IMF), led by Mr. Markus Rodlauer, Deputy Director of the Asia and Pacific Department, visited Beijing, Shanghai and Taiyuan from May 14 to 27 to conduct discussions on the annual Article IV review of the Chinese economy. The mission held highly constructive and candid discussions with senior officials from the government, the People's Bank of China, private sector representatives, and academics to exchange views on prospects for the economy, reforms and challenges ahead.

The IMF's First Deputy Managing Director, Mr. David Lipton, joined the final policy discussions and met with Vice Premier Ma Kai, People's Bank of China Governor Zhou Xiaochuan, and China Securities Regulatory Commission Chairman Xiao Gang, among other senior officials.

At the end of the visit, the mission made the following remarks:

"China is transitioning to a new normal, aimed at safer and higher-quality—even if a bit slower—growth. A transition that is both challenging and necessary. Our discussions focused on the policies needed successfully to meet those challenges. As one of the world's largest economies, China's success is of vital importance for its own future and that of the global economy.

"Growth in China is moderating, a slowdown that is not a goal onto itself but a by-product of moving the economy away from the unsustainable growth pattern of the past decade. We project China to grow at 6.8 percent this year, consistent with the authorities' growth target of around 7 percent, and well within the 6½–7 percent range we consider appropriate for this year. The labor market has remained resilient despite slower growth, which, in turn, has supported household consumption. Inflation is expected to end the year at around 1½ percent.

"Since the global financial crisis, growth has relied on an unsustainable mix of credit and investment that has resulted in rising vulnerabilities. The authorities have moved on several fronts to address these vulnerabilities, as we have seen the decline in total social financing (TSF) growth, tighter oversight of shadow banking, moderating investment growth, and slowdown in real estate construction. Nevertheless, vulnerabilities in these areas remain large and continued, determined efforts are needed to address them.

"At this juncture, our assessment is that the macro-policy stance is broadly appropriate and consistent with the annual growth and inflation outlook. The impact of recent developments—such as appreciation of the real exchange rate, lower oil prices, adjustments in reserve requirements and interest rates, and implementation of the new budget law—are still reverberating through the economy. If incoming data suggest that growth is likely to exceed 7 percent, the authorities should take advantage of the opportunity to reduce vulnerabilities faster. If instead growth looks set to dip below 6½ percent, then fiscal policy should be eased. Fiscal stimulus, if needed, should be on-budget and rely on measures that protect the vulnerable, support rebalancing, and are consistent with the reform agenda. All goals that can be best achieved through fiscal policy.

"Next year, policies should continue to address vulnerabilities, even if that requires allowing growth to slow into the range of 6–6½ percent. Our forecast of 6¼ percent growth in 2016 assumes such progress.

"Slower growth, of course, is not a goal unto itself, but a by-product of efforts to move the economy to a safer and higher-quality growth path. China has a comprehensive plan, the ambitious 'Third Plenum Blueprint', to achieve this transformation. Now, the key is to press ahead with timely implementation, including financial, fiscal, state-owned enterprise, and external sector reforms. Successful implementation will reduce excess savings, lower investment while making it more productive, boost consumption, and allow China to continue its convergence towards high-income status.

"Moving to a market-based financial system is essential for boosting productivity growth. With deposit insurance now in place, the time has come to complete the liberalization of deposit rates. Doing so will facilitate the move toward using interest rates as the primary tool of monetary policy. This, in turn, involves establishing a policy interest rate and using it as the main tool to adjust monetary conditions and signal changes in policy. Another priority is to break the web of implicit guarantees, which are still prevalent throughout the financial system. This cannot be done overnight, but the process must start and will involve greater acceptance of defaults and bankruptcies.

"Leveling the playing field between private and public sectors is a key goal of the Blueprint, and rightly so. Progress with SOE reform, however, has been too slow. Important reforms will include increasing the dividends to the budget, eliminating direct or indirect subsidies of factor costs, strengthening governance, and greater tolerance of SOE bankruptcy and exit. Successful SOE reforms have the potential significantly to boost productivity growth and create millions of new jobs.

"Implementation of the new budget law will create a much-needed new framework for local government borrowing, improve transparency, and strengthen medium-term fiscal planning. While implementation is complex and may take some time, it is important for the authorities to announce a clear and comprehensive transition plan for local government financing as soon as possible. Finding a long-term solution to the imbalance between local government spending responsibilities and revenue assignments remains a priority.

"On the external side, China has made good progress in recent years in reducing the very large current account surplus and accumulation of foreign exchange reserves. Nevertheless, staff projections for 2015 suggest that China's external position is still moderately stronger than consistent with medium-term fundamentals and desirable policies. There are several factors influencing a country's external position, with the exchange rate being one of them. While undervaluation of the Renminbi was a major factor causing the large imbalances in the past, our assessment now is that the substantial real effective appreciation over the past year has brought the exchange rate to a level that is no longer undervalued. However, the still-too-strong external position highlights the need for other policy reforms—which are indeed part of the authorities' agenda—to reduce excess savings and achieve sustained external balance. This will also require that, going forward, the exchange rate adjusts with changes in fundamentals and, for example, appreciates in line with faster productivity growth in China (relative to its trading partners). On the exchange rate system, we urge the authorities to make rapid progress toward greater exchange rate flexibility, a key requirement for a large economy like China's that strives for market-based pricing and is integrating rapidly in global financial markets. Greater flexibility, with intervention limited to avoiding disorderly market conditions or excessive volatility, will also be key to prevent the exchange rate from moving away from equilibrium in the future. We believe that China should aim to achieve an effectively floating exchange rate within 2–3 years.

"In recent years, China has played an increasingly important role in driving global growth, contributing to global economic and financial stability, and helping to improve the international monetary system. As part of the ongoing review of the Special Drawing Rights (SDR) basket at the IMF, the Chinese authorities have stated publicly their interest in including the Renminbi in the SDR basket. We welcome and share this objective and will work closely with the Chinese authorities in this regard. As the Managing Director of the IMF has said, RMB inclusion is not a matter of 'if' but 'when'.

"The mission would like to express its appreciation to the Chinese authorities for their excellent cooperation and hospitality extended to our team over the last two weeks."

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