IMF Executive Board Concludes 2016 Article IV Consultation with the People's Republic of China

August 12, 2016

On July 27, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation [1] with China.

China continues its transition to sustainable growth, with progress on many fronts yet also many challenges. Growth slowed to 6.9 percent in 2015 and is projected to moderate to 6.6 percent this year owing to slower private investment and weak external demand. The economy is advancing on many dimensions of rebalancing, particularly switching from industry to services and from investment to consumption. But other aspects are lagging, such as strengthening SOE and financial governance and containing rapid credit growth.

Inflation dipped below 1.5 percent in 2015 and is expected to pick up to around 2 percent this year, reflecting the rebound in commodity prices and the exchange rate depreciation since mid-2015.

Infrastructure spending picked up and credit growth accelerated in the second half of 2015. Accommodative macro policies are projected to continue supporting activity over the remainder of 2016.

The current account surplus is projected to decline to 2.5 percent of GDP this year (from 3 percent of GDP in 2015) as imports increase and the services deficit widens with continued outbound tourism. The balance of payments came under pressure in 2015 due to large capital outflows, mainly related to repayment of external debt. The volume of outflows is expected to moderate this year. After appreciating 10 percent in real effective terms through mid-2015, the renminbi has depreciated some 4.5 percent since then and remains broadly in line with fundamentals.

Executive Board Assessment [2]

Executive Directors commended the Chinese authorities for their strong determination to achieve more balanced, sustainable growth. They noted that economic growth continues to moderate and is driven increasingly by services and consumption. Directors welcomed the impressive progress on structural reforms in many areas, notably interest rate liberalization, internationalization of the renminbi, and urbanization. They also welcomed the 13th Five-Year Plan, with its ambitious goals centered on economic rebalancing.

Directors noted that China's economic transition will continue to be complex, challenging, and potentially bumpy, against the backdrop of heightened downside risks and eroding buffers. They stressed the need for decisive action to tackle rising vulnerabilities; reduce the reliance on credit-financed, state-led investment; and improve governance, risk pricing, and resource allocation in the state-owned enterprise (SOE) and financial sectors. Directors emphasized that consistent, well-coordinated, and clearly-communicated policies are key to a smooth, successful transition, which will eventually benefit the global economy.

Directors highlighted the urgency of addressing the corporate debt problem through a comprehensive approach. They encouraged the authorities to harden budget constraints on SOEs; triage and restructure or liquidate over-indebted firms; and recognize losses and share them among relevant parties, including the government if necessary. Piloting a few SOEs would make a strong start to the process. Directors recommended that the authorities complement these measures with targeted social assistance for displaced workers, and initiatives to facilitate entry of new, dynamic private firms.

Directors concurred that macroeconomic policies should be geared at lowering vulnerabilities, which would likely entail somewhat slower growth in the short term. They welcomed the authorities' intention to rely on fiscal support if growth falls sharply in the near term. To this end, they saw merit in using on-budget, pro-consumption measures, which would help promote internal and external rebalancing. Measures could include raising pensions; increasing social, education and health spending; providing restructuring funds; and cutting minimum social security contributions. Continued efforts are also needed to ensure full implementation of the new budget law, improve fiscal transparency, and modernize the tax system.

Directors underscored the importance of further enhancing financial stability. Priorities include encouraging banks to proactively recognize loan losses and strengthen capital ratios; enhancing supervisory focus on liquidity risk management and funding stability risks; and addressing vulnerabilities in shadow products. Directors also recommended a major upgrade of the supervisory framework to foster cross-agency information sharing and policy coordination, reduce the scope for regulatory arbitrage, and enhance crisis management capabilities. They looked forward to the forthcoming Financial Sector Assessment Program Update.

Directors noted the staff's assessment that the renminbi is broadly in line with fundamentals, although the external position in 2015 was moderately stronger than consistent with fundamentals. They welcomed steps toward an effectively floating exchange rate regime and encouraged the authorities to build on this progress while carefully managing the transition, and with the support of a more market-based monetary framework. Directors supported a cautious approach to capital account liberalization that is carefully sequenced with the progress on exchange rate flexibility and financial sector reforms.

Directors encouraged the authorities to continue to improve data quality and policy communications, which would help reduce uncertainty, align expectations, and guard against market turbulence.

China: Selected Economic Indicators

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
						Projections					
NATIONAL ACCOUNTS											
Real GDP	9.5	7.9	7.8	7.3	6.9	6.6	6.2	6.0	6.0	5.9	5.8
Total domestic demand	10.7	7.9	8.1	7.2	7.2	7.2	6.5	6.2	6.1	6.0	5.9
Consumption	12.2	8.7	7.2	7.2	8.3	7.8	7.7	7.1	6.8	6.6	6.4
Investment	9.2	7.1	9.1	7.1	6.1	6.4	5.2	5.2	5.3	5.3	5.3
Fixed	8.8	9.0	9.3	6.8	6.8	6.6	5.3	5.3	5.4	5.4	5.4
Inventories (contribution)	0.4	-0.7	0.1	0.3	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Net exports (contribution)	-0.8	0.2	-0.1	0.3	-0.1	-0.5	-0.2	-0.1	0.0	0.0	0.0
Total capital formation (percent of GDP)	48.0	47.2	47.3	46.7	45.0	43.9	43.3	42.8	42.2	41.6	41.0
Gross national saving (percent of GDP)	49.8	49.7	48.8	49.3	47.9	46.3	44.9	44.1	43.2	42.4	41.6
LABOR MARKET											
Unemployment rate (annual average) 1/	…	…	5.0	5.1	5.1	5.1	5.1	5.0	5.0	5.0	5.0
Wages	16.7	14.0	12.9	10.0	9.9	9.0	8.7	8.5	8.5	8.3	8.1
PRICES											
Consumer prices (average)	5.4	2.6	2.6	2.0	1.4	2.1	2.3	2.4	2.6	3.0	3.0
GDP Deflator	8.1	3.2	2.4	1.2	0.4	0.7	0.9	1.4	1.6	2.0	2.1
FINANCIAL											
7-day repo rate (percent)	6.4	4.6	5.4	5.1	2.5	…	…	…	…	…	…
10-year government bond rate (percent)	3.4	3.6	4.6	3.7	2.9	…	…	…	…	…	…
Real effective exchange rate (average)	2.8	5.6	6.3	3.1	10.1	…	…	…	…	…	…
Nominal effective exchange rate (average)	0.1	5.0	5.3	3.1	9.5	…	…	…	…	…	…
MACRO-FINANCIAL											
Total social financing 2/	18.1	19.1	17.5	14.3	12.4	12.7	11.9	11.4	11.0	10.3	10.1
In percent of GDP	157.9	169.0	180.0	189.5	198.4	208.3	217.4	225.1	232.0	236.9	241.6
Domestic credit to the private sector	16.2	19.8	16.6	13.5	14.7	14.7	13.4	12.1	10.9	9.9	9.7
In percent of GDP	124.8	134.3	141.9	148.2	158.3	169.2	179.0	186.5	192.1	195.5	198.7
House price 3/	5.7	8.7	7.7	1.4	9.1	8.9	7.3	7.0	7.3	6.9	6.8
Household disposable income (percent of GDP)	58.3	59.4	60.0	60.7	62.2	63.2	63.6	63.9	64.2	64.2	64.2
Household savings (percent of disposable income)	41.0	40.8	38.5	37.9	37.4	36.9	35.8	34.7	33.7	32.7	31.7
Household debt (percent of GDP)	27.8	29.6	33.0	35.3	38.4	41.8	45.5	49.1	52.4	55.3	57.5
Nonfinancial corporate domestic debt (percent of GDP)	97.0	104.7	108.9	112.8	120.0	127.4	133.5	137.5	139.7	140.2	141.2
GENERAL GOVERNMENT (Percent of GDP)											
Net lending/borrowing 4/	-0.1	-0.7	-0.8	-0.9	-2.7	-3.0	-3.1	-2.9	-2.9	-2.8	-2.7

China: Selected Economic Indicators

	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
						Projections					
Revenue	26.9	27.8	27.7	28.0	28.6	27.8	28.1	28.0	27.8	27.7	27.5
Expenditure	27.0	28.4	28.5	28.9	31.3	30.8	31.2	30.9	30.7	30.4	30.2
Debt 5/	15.2	15.2	15.9	38.5	38.3	38.6	39.1	39.3	39.3	39.2	39.0
Structural balance	-0.1	-0.5	-0.5	-0.5	-2.4	-2.9	-3.1	-2.9	-2.9	-2.8	-2.7
BALANCE OF PAYMENTS (Percent of GDP)											
Current account balance	1.8	2.5	1.5	2.6	3.0	2.4	1.6	1.3	1.0	0.8	0.6
Trade balance	3.0	3.6	3.7	4.1	5.1	5.1	4.5	4.3	4.0	3.8	3.7
Services balance	-0.6	-0.9	-1.3	-1.6	-1.6	-2.0	-2.3	-2.6	-2.7	-2.9	-2.9
Net international investment position	22.4	21.8	20.7	15.2	14.3	16.5	16.9	16.7	16.3	15.5	14.8
Gross official reserves (bn US$)	3,256	3,388	3,880	3,899	3,406	3,181	3,064	2,993	2,890	2,813	2,740
MEMORANDUM											
Nominal GDP (bn RMB) 6/	48,604	54,099	59,696	64,849	69,630	74,715	80,118	86,159	92,834	100,244	108,246
Augmented debt (percent of GDP) 7/	45.8	47.1	51.0	51.8	55.8	60.4	64.5	67.8	70.4	72.2	73.5
Augmented net lending/borrowing (percent of GDP) 7/	-6.0	-5.1	-7.6	-7.2	-7.8	-8.4	-8.2	-7.8	-7.4	-7.0	-6.6
Augmented fiscal balance (percent of GDP) 8/	-8.2	-7.8	-10.3	-9.8	-9.5	-10.1	-9.8	-9.3	-8.8	-8.4	-8.0

Sources: CEIC Data Co., Ltd.; IMF, Information Notice System; and IMF staff estimates and projections.

1/ Surveyed unemployment rate.

2/ After adjusting local government debt swap, staff estimate that TSF stood at 203 percent of GDP in 2015.

3/ Average selling prices estimated by IMF staff based on housing price data (Commodity Building Residential Price) of 70 large and mid-sized cities published by National Bureau of Statistics (NBS).

4/ Adjustments are made to the authorities' fiscal budgetary balances to reflect consolidated general government balance, including government-managed funds, state-administered SOE funds, adjustment to the stabilization fund, and social security fund.

5/ Estimates of debt levels before 2015 include central government debt and explicit local government debt (identified by MoF and NPC in Sep 2015). The large increase in general government debt in 2014 reflects the authorities' recognition of the off-budget local government debt borrowed previously. The estimation of debt levels after 2015 assumes zero off-budget borrowing from 2015 to 2021.

6/ Expenditure side nominal GDP.

7/ Augmented fiscal data expand the perimeter of government to include local government financing vehicles and other off-budget activity.

8/ "Augmented fiscal balance" = "augmented net lending/borrowing" - "net land sales proceeds" (in percent of GDP) as we treat net land sales proceeds as financing.

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.