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**Statement by Mr. Hilbers and Mr. Milutinovic on People's Republic of China
(Preliminary)
Executive Board Meeting
January 14, 2022**

We thank staff for the insightful Report and the interesting Selected Issues Paper. We also thank Messrs. Jin, Zhang and Bai for their informative Buff statement. We broadly agree with the thrust of the staff appraisal and would like to make the following remarks.

We agree with staff's assessment of the economic outlook and associated risks. China showed an early and strong economic recovery by the end of 2020, which continued into 2021. The investment-driven recovery reversed to some extent an earlier shift towards consumption, and hence policies to rebalance the economy continue to be warranted. The ongoing financial stress in the property sector remains the most prominent short-term risk and close monitoring of financial risks is needed, with rebalancing interventions focussed on financial stability.

Fiscal policy requires a delicate balance between tackling fiscal risks and supporting rebalancing. Although targeted support to the most vulnerable groups and SMEs is still needed, we commend the authorities' policy shift to fiscal sustainability. Rebuilding fiscal buffers is a priority due to the fiscal risks stemming from rising SOE and local government debt and the potential impact of the distressed property sector on LGFVs. At the same time, strengthening social protection through reprioritization of spending and labor market reforms would support rebalancing toward consumption. We welcome further relaxed *hukou* restrictions and recent regional increases of minimum wages in this context. *Staff's comments on labor market reforms that promote rebalancing are welcome.*

We support the authorities' accommodative monetary policy and encourage further modernization of the monetary policy framework. Interest rate cuts and structural credit policies to MSMEs are adequate, given subdued inflation and the risk of liquidity constraints for MSMEs. Looking forward, phasing out interest rate guidance for deposits and inclusive lending would enhance financial intermediation.

Containing financial risks from the distressed property sector and local SOEs should be a priority. We agree with staff that facilitating the market exit of unviable companies while restraining

systemic contagion is the right approach. Limiting negative spillovers from distressed property developers and local SOEs to relatively exposed smaller banks is crucial to prevent a credit crunch for already struggling SMEs. In that context, further strengthening of prudential policies together with a stronger bank resolution framework would mitigate financial stability risks. *How does staff assess interlinkages between financially distressed property developers and struggling small banks in some regions?*

A structural reform agenda focusing on SOEs and private sector development would revitalize productivity growth. The still large ratio of SOEs in the economy, their lower productivity and profitability compared to the private sector and high debt call for a continuation of SOE reforms. The latter should improve corporate governance, market-based insolvency and resolution framework and phase out preferential access to credit, ensuring competitive neutrality. Furthermore, enhancing competition policies, addressing credit misallocation, and facilitating market entry would invigorate business dynamism. In addition, to strengthen policymaking we encourage authorities to pursue transparent and well-communicated regulation while addressing statistical gaps.

China's ambitious climate goals call for a structural shift of the economy and enhanced climate policies. We very much welcome China's ambitious commitments to achieve climate neutrality as we understand the difficult tradeoffs between growth, climate goals, and energy security. We agree with staff that rebalancing towards consumption is a structural solution to the economy's energy intensity. Furthermore, we encourage improving carbon pricing mechanisms and leveraging green finance to utilize the private capital markets to meet the substantial financing needs for green investment.

China has an important international role as well. In this context, we welcome the authorities' contributions to debt relief for low-income countries. At the same time, we would welcome efforts by the authorities to enhance debt transparency and strengthen external lending frameworks by enhancing debt sustainability monitoring. We also look forward to China's continued participation in the Common Framework to provide necessary debt relief to low-income countries in debt distress. And finally, we agree with staff that China has an important role in building a more open, stable, and rules-based international trade system.