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**Statement by Mr. Weber and Mr. Djokovic on People's Republic of China
(Preliminary)
Executive Board Meeting
July 20, 2012**

The positive overall performance of the Chinese economy in the current difficult economic environment—striking a balance between unwinding from crisis-induced stimulus and supporting growth—is welcome. The staff’s emphasis on the desirability to rebalance the economy towards private consumption-driven growth is appropriate. With many structural reforms on course, a gradual growth slowdown represents a sound trajectory towards longer-term economic sustainability. As helpfully spelled out in the risk assessment matrix, external risks and domestic vulnerabilities nevertheless remain significant. We generally concur with the assessment and the policy advice provided by staff and limit our comments to following specific points.

While the immediate vulnerability from a property market downturn has eased, the underlying causes of excessive price developments in the property market, such as a lack of alternative saving vehicles and low capital costs, remain. The authorities should address these factors expeditiously in order to avoid renewed over-investment in the property market once currently applied restrictions are relaxed.

We note that stimulus-driven bank lending led to an increase in indebtedness of local government financing vehicles, giving rise to concerns about the financial health of some local entities as well as bank asset quality. This situation highlights the need for more transparency and broad reforms of local government finances, including their revenues, expenditures, and financing mechanisms. We welcome that this reform is high on the authorities’ agenda.

The rebalancing away from investment towards private consumption should remain a priority policy objective. As staff contends in the Pilot External Sector Report (ESR), adjustments in social protection schemes appear appropriate in some major surplus countries. Indeed, the limited coverage of pension schemes and health services seems to be a key driver of

households' high precautionary savings in China. We encourage the authorities to support internal demand by strengthening the social safety net and direct public resources to education and healthcare.

On monetary policy, we welcome the recent increase in flexibility in setting both the deposit and the lending rates. However, the complexity of China's monetary framework calls for more transparency, with a greater emphasis on price-based tools of monetary policy.

We take note of several statistical issues, specifically related to the national accounts and government finance statistics (i.e., data shortcomings, technical difficulties, long delays for public dissemination). The relatively limited range of data and a number of breaks in historical data series seriously hamper economic analysis. While the authorities intend to improve collecting and compiling data, no target dates have been set yet. *Staff comments on progress in this area are welcome.*

We encourage the Chinese authorities to consent to the publication of the staff report.